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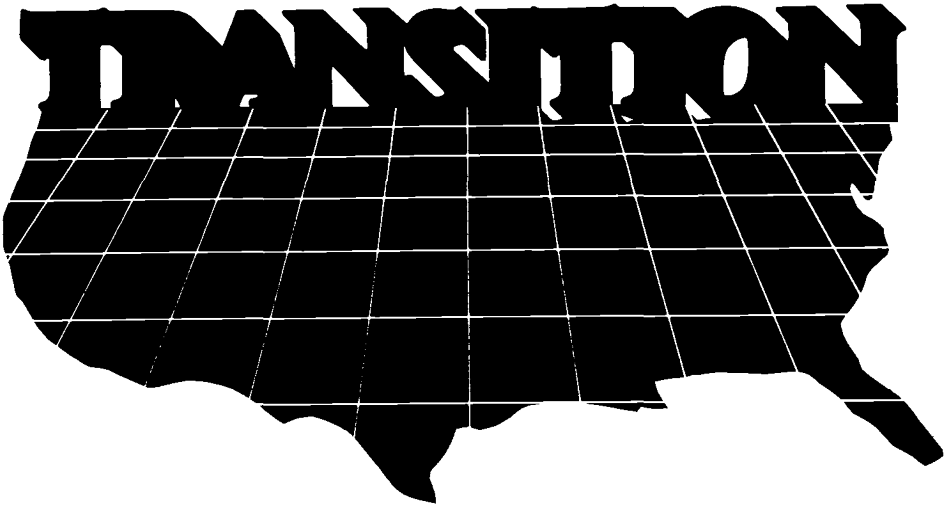

BENEFITS FOR THE FUTURE

AN EBRI-ERF POLICY FORUM

EMPLOYEE BENEFIT RESEARCH INSTITUTE

Employee Benefit Research Institute

The Employee Benefit Research Institute (EBRI) is a Washington-based, nonprofit, nonpartisan public policy research institution. EBRI's overall goal is to promote the development of soundly conceived private and public employee benefit plans.

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America in Transition:

Benefits for the Future

AN EBRI-ERF POLICY FORUM

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Foreword

Most of us are so absorbed in our daily tasks and challenges that we rarely have an opportunity to contemplate and plan for what the future has in store. This book is designed to examine what the future holds, so that all parties involved in the planning, delivery, and receipt of employee benefits will have an opportunity to make any adjustments they deem necessary.

In 1981, the Employee Benefit Research Institute sponsored a policy forum on "The Effect of Changing Family Relationships on Employee Benefit Programs." Many of the demographic trends noted at that time continue today: labor force participation among women and especially among mothers continues to grow, the number of single-parent households is growing, and life expectancy is increasing. U.S. employment is continuing its shift away from manufacturing and into the service sectors. The U.S. Department of Labor estimates that the largest gain in jobs between 1984 and 1995 will be in the business services, followed by retail trade, and eating and drinking establishments. The majority of work in the service sectors, moreover, is with small employers.

Not only are demographic changes taking place, but the public's values and attitudes are changing; American businesses are experiencing intense foreign and domestic competition; and government policy is now, more than ever, assuming an increasing role in the work place.

These trends have major implications for employee benefits. Almost all Americans are affected by the public or private programs that provide for society's retirement, health, and economic security. Businesses, with an average of more than 35 percent of payroll going toward all types of employee benefits—voluntary and government mandated, taxable and tax-favored—are keenly aware of factors that might influence this cost.

EBRI's October 15, 1986, policy forum, "America in Transition: Benefits for the Future," brought together corporate executives, staffs from the congressional and executive branches of government, and representatives from academia, labor, and the press to reexamine how a changing America might affect employee benefits in the years to come. Specifically, the policy forum identified demographic and economic changes in America, examined employer and employee attitudes toward employee benefits, discussed the government's role in retirement and economic security, and reviewed how businesses integrate all these issues when designing benefits packages.

This book takes the papers and proceedings of EBRI's policy forum and integrates them into a single work, organized into four parts reflecting the order of the day's proceedings. We have supplemented the actual policy forum material with a chapter by EBRI education and communications director, Frank B. McArdle, on "Congress and the Work Place" to give readers a more specific idea of how the U.S. Congress has become involved in work place issues, particularly through tax reform.

On behalf of EBRI, I wish to thank the policy forum speakers and participants for their substantial contributions to this book. We are certain it will aid policymakers, benefits experts, and the public in better understanding the complex interrelationships between the business environment, society as a whole, and the concerns of the federal government in shaping our nation's employee benefits structure. Special thanks are due to Margaret Newton, EBRI's assistant director of education and communications, who helped plan and organize the policy forum and compiled, edited, and produced this book. Thanks are also extended to Christie Dolan who created the index.

DALLAS L. SALISBURY
President

May 1987

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Part One
Demographic and Economic Trends in America

Striking demographic and economic changes are occurring in the United States. After increasing birth rates after the second World War gave rise to the "baby boom," a sharp decline in the birth rate began in 1965. Fertility rates have been below the level needed to replace the population every year since 1972. Death rates have declined at every age, and in recent years there has been a pronounced increase in the number of the oldest elderly (age 85 and older). Finally, household composition is changing. Marriages are being delayed, divorce and separation rates have dramatically increased, the number of single-parent families headed by women is up sharply, and the proportion of children under age 18 living with one parent has risen.

U.S. employment is shifting away from manufacturing and into the service sectors, particularly business services—where the largest gain in jobs is expected (2.6 million between 1984 and 1995)—retail trade (1.7 million), and eating and drinking establishments (1.2 million). The majority of work in the service sectors, moreover, is with small employers.

Part One of *America in Transition: Benefits for the Future,* "Demographic and Economic Changes in America," examines how these changes have affected the work place and individuals themselves. Reflecting the slowdown in growth of the population of labor force age, the U.S. labor force is expected to grow by only one percent each year between 1990 and 1995, compared with almost 3 percent per year in the 1970s. By 1995, three quarters of the labor force will be between 25 and 54. In chapter I, authors Thomas Espenshade and Tracy Ann Goodis predict that businesses will face a large supply of mid-career workers but only a limited number of advancement opportunities, which will force them to make labor market adjustments, such as new rewards and job structures, to ensure employee satisfaction.

Businesses will also need to deal with the benefits implications of the movement of women into the paid labor market. Between 1965 and 1980, labor force participation rates of married women increased from 35 to 50 percent. Participation rates of older men (age 55–64) during this period actually declined. In the future, even more women are likely to be in the work force. The Bureau of Labor Statistics predicts that 47 percent of the work force will be female by the year 2000 and 60 percent of women will be working. Mothers with young children are in the vanguard of this trend. By 1984, 52 percent of married women with children under age six were in the labor force, compared with 12 percent in 1950. Despite lower birth rates and postponed childbearing, mothers are entering the labor force in record numbers.

Espenshade and Goodis predict that to be successful in attracting and retaining the workers they want, employers will have to raise the overall level of compensation in an increasingly tight and competitive job market. Higher wages are one option, but tomorrow's workers may also respond to an enhanced benefit package. Given the demographic trends predicted, benefits that workers are likely to find the most attractive, say Espenshade and Goodis, are: (1) greater access to working at home; (2) flextime; (3) day care at the place of work; (4) expanded parental leaves; (5) planned break in the workday to accommodate the increasing amounts of informal care that takes place over the phone; and (6) greater health care benefits for workers' elderly parents.

A phenomenon with as much significance to society as mothers in the work force or birth rate declines is the aging of the population. This occurrence places increasing pressure on employers and policymakers to tackle the issue of assuring economic security of the elderly. In chapter II, Deborah Chollet looks at financing retirement and its implications for today's and tomorrow's workers. The economic status of today's elderly, notes Chollet, has improved over the last decade to the extent that they are no longer disproportionately the nation's poor. Microsimulation projections of income among future elderly indicate that the elderly's retirement income will continue to rise, largely as a result of improved pension participation and vesting among current workers. The elderly remain, however, economically vulnerable. Catastrophic health care expenses, particularly those associated with long-term chronic health problems are virtually uninsured. Almost no health insurance plan other than Medicaid adequately insures these costs, and most retirees remain largely at risk for the expense of long-term care.

Continued health coverage by employers provides an important income supplement for retirees, but growth in the proportion of future retirees with continued health coverage from employers is projected to be modest. This coverage, nevertheless, provides the elderly with an important real income supplement in retirement. In most cases, the employer pays all or part of the cost of these plans. As a result, the real income benefit received from continued health coverage represents, in effect, a fully indexed retirement benefit. For many retirees, the value of continued health coverage may approach or even exceed the value of a pension benefit over time.

Financing the elderly's long-term care, Chollet concludes, may become the most important part of assuring economic security for the majority of the elderly, both today and tomorrow.

I. Demographic Trends Shaping the American Family and Work Force

PAPER BY THOMAS J. ESPENSHADE AND TRACY ANN GOODIS*

Introduction

The period since the Second World War has been marked by turbulent population changes in the United States. Birth rates rose sharply at the close of the war, and the annual number of births exceeded 4 million in each year from 1954 to 1964. A sharp collapse in fertility began in 1965, and fertility rates have been below the level needed to replace the population in every year since 1972. Death rates have declined at every age, especially the youngest and the oldest, and recent years have witnessed a pronounced increase in the number of extreme elderly. Immigration to the United States—both legal and illegal—has also accelerated. Largely as a result of new legislation in 1965, legal immigration shifted away from Europe toward Asia and Latin America as the major sending countries. According to the 1980 population census, the U.S. population included some 14 million foreign-born persons.

Hardly any aspect of the population has been left untouched by these demographic trends. As fertility rates have fallen and life expectancy among the retired population continues to improve, the U.S. population is gradually getting older. The racial and ethnic composition of the population is also changing with rising proportions of both minority and foreign-born populations. The spatial distribution of the population has continued to be reoriented away from the northeast and northcentral states toward the West and South. For example, the center of U.S. population has marched steadily westward since the first census was taken in 1790 and crossed the Mississippi River for the first time in the 1980 census.

The way that individuals group themselves into families and households has also undergone a radical shift over the past 40 years. Marriages are being delayed, divorce and separation rates have shot up, the number of single-parent families headed by women is up sharply,

*The authors thank Terri Murray for capable technical assistance.

and the proportion of children under age 18 living with just one parent has risen.

It is impossible in a paper of this length to review all the important demographic trends in the United States. Instead, we have elected to focus on three developments that seem to have the greatest relevance to the topic of this policy forum—the adequacy of the current system of employee benefits. The three trends include: (1) changes in the overall size and composition of the U.S. population, especially the population of labor force age; (2) the rapid rise in female labor force participation rates and the corresponding growth in the number of working mothers; and (3) increasing longevity among the elderly in the United States.

This paper assumes that employee benefit packages are something that employers use to attract and retain the kinds of employees they want. Between now and the end of this century, employers will confront an increasingly tight labor market. Growth in the population of labor force age will slow down, and women will find it increasingly difficult to balance their desires for a job or a career on the one hand with caregiving responsibilities for both young and old on the other. Because labor force growth will slow, employers will find that they are increasingly locked in a zero-sum game competing with each other for valued employees. In this highly competitive environment, employee benefits will assume a more important role in influencing individuals' choices not only about whether to work but also about where to work.

The remainder of this paper is divided into three sections. First, we discuss macrodemographic changes in relation to the work force, concentrating on the most recent projections of the size and composition of the U.S. population. Second, microdemographic changes relating to changing family economics—especially the rise in the number of working mothers—and the increasing number of elderly dependents are reviewed in relation to their implications for families and the work force. A third and concluding section summarizes the policy implications of these key demographic changes for the future of employee benefits.

Macrodemographic Trends Affecting the Labor Force

Total U.S. population grew continuously in the postwar period, from 152 million in 1950 to 232 million in 1982. This addition of 80 million Americans meant an increase of more than 50 percent in total population. Population growth is expected to continue through the year 2030. According to the middle series in the most recent projections released by the U.S. Bureau of the Census (1984), projected U.S. population totals will reach 250 million by 1990, 268 million by the year 2000, and 305 million by 2030.

Though total population size rises over this entire 80-year period, the rate of growth is not steady. Growth rates were highest in the 1950s with the cresting of the postwar baby boom: average annual rates of population growth exceeded 1.7 percent in this period. By the 1970s, when the baby bust was well underway, population growth rates had fallen to just over one percent per year. Continuous slowing of population growth is expected in the future. Throughout the 1980s, growth rates are projected to average about 0.9 percent per year. A further slowing to roughly 0.37 percent per annum is projected for the period 2010–2030 (U.S. Bureau of the Census, 1984).

A gradual slowing in the rate of overall population growth is attributable mainly to declining fertility. The average number of lifetime births per woman in the United States is now about 1.9, and this figure is not expected to increase appreciably over the projection period—certainly not above the level of 2.1 needed to replace the population in the long run (Ryder, 1986).

Because of low fertility, the population will undergo a progressive aging. In 1950 the median age of the U.S. population was 30.2 years. It fell to 27.9 years by 1970, reflecting the large number of young people born during the 1950s and early 1960s. But with the subsequent decline in fertility, the aging of the baby boom cohorts, and the growth in the number of elderly due in part to increased longevity at older ages, the median age is on its way up again. By 1982 it had rebounded to 30.6, just slightly more than its 1950 value. Continued increases are projected: 33.0 in 1990, 36.3 in 2000, and 40.8 in the year 2030 (U.S. Bureau of the Census, 1984). The United States is not the only industrial democracy to be undergoing rapid population aging, but the fact that it is happening elsewhere does not mean that we are any better prepared to deal with its consequences here.

Population aging is also reflected in changes in the relative numerical importance of the young and old in the population. Though the absolute number of children under age five will not change much from its current value of about 18 million, as a proportion of total population size this age group is projected to decline from about 7.7 percent today to about 5.8 percent by 2030. More palpable changes are anticipated for persons over age 65. From about 12 percent of total population in 1985, this group is expected to increase to more than 21 percent by 2030. The United States has never known a time when more than one out of every five residents is past the age of 65. The proportion of the elderly population (65 and over) that is among the oldest old (85 and over) is also growing. In 1950 this proportion was less than 5 percent. It stands close to 10 percent today and is expected to reach 25 percent within the next 100 years (U.S. Bureau of the Census, 1984).

Of greater concern from the standpoint of this paper than the numbers of young and old are the trends in the number of persons of labor force age, defined here as persons between 18 and 64 years of age. The population age 18 to 24 years, so important to colleges, the military, and employers of new labor force entrants, is now at an all-time high of 30.4 million. This age group is expected to decline by more than 7 million during the next 15 years because of the aging of the last baby boom generation out of it. In the Census Bureau's middle series projection, this group would rebound to 24.6 million people in 2000 and 27.7 million in 2010. Thereafter it would fluctuate between these limits and never again be as large as it is now. College and universities are already competing vigorously against each other for new students; it is now a seller's market. In short order, employers will find themselves in a similar situation.

The age groups from 25 to 34 years old up through those from 45 to 64 years old all show similar patterns in the future. Each group first increases as the baby boom generation swells its ranks and then declines sharply with the subsequent replacement of this group by the smaller birth cohorts of the 1970s. None eventually returns to the size it is when it contains the birth cohorts of 1955 to 1964. For example, members of the baby boom began to reach age 25 in the early 1970s, and the 25–34 year old age group has been growing ever since. This group will not peak in size until 1990 when it reaches a total of 43.5 million. Within a few years, however, it will fall back to its present size (39.5 million), and during the remainder of the twenty-first century the number of people in this age group is not expected to exceed today's total. A similar pattern will be followed by the older age groups. Only the date of their peak size differs. Those age 35 to 44 will peak in the year 2000, those age 45 to 54 in the year 2010, and so on (U.S. Bureau of the Census, 1984). From this example, one can easily see why Norman Ryder compared the aging of the baby boom generation to the appearance of a boa constrictor swallowing a pig (Ryder, 1986).

Employers may be more interested in the prospective growth of the total population of labor force age than in the behavior of particular age groups. Total population in the 18–64 year old age range rose from 92.6 million in 1950 to 138.3 million in 1980, but growth was not steady. The fastest rates of growth occurred during the 1960s and 1970s when the baby boom generation was being absorbed into the labor force. The average annual growth rate of population in the labor force ages rose from 0.72 percent in the 1950s to 1.47 percent in the 1960s and peaked at 1.83 percent in the 1970s (U.S. Bureau of the Census, 1984). Because the last of the baby boom generations is just about to graduate from college and have entered the labor force years, the total population of labor force age will grow much more slowly in the future, as the baby bust generation—those children born since 1965—are now entering the labor force.

According to the middle series Census Bureau projections, the population 18–64 years old is expected to grow by 1.05 percent during the 1980s and then fall to about 0.8 percent between 1990 and 2010. After the year 2010 and continuing to about the year 2030, the number of persons between 18 and 64 is projected to decline by about 0.3 percent per year, from 179.2 million to roughly 174.4 million. Coping with slower labor force growth portends one set of problems. But dealing with actual declines presents an entirely new set of concerns.

Population trends will also mean changes in the racial and ethnic makeup of the labor force. Between 1950 and 1982, for example, the proportion of the total U.S. population that is black or other nonwhite races increased from 10.7 to 14.5 percent. With a continuing influx of immigrants from Asia and Latin America and with higher birth rates among blacks and other nonwhites than among whites, this proportion is projected to keep on rising. According to Census Bureau figures, for example, the percent black or other nonwhite will reach 20.7 percent by the year 2030 and 25.5 percent by 2080. The Population Reference Bureau has estimated that if immigration to the United States continues at about 500,000 per year, then the U.S. population of Hispanic origin will rise from 6.5 percent of the total in 1980 to 8.9 percent in the year 2000 and ultimately to 16.1 percent by 2080 (Bouvier and Davis, 1982).

Population trends have already been and will continue to be reflected in the size and composition of the labor force. Based on data from the U.S. Bureau of Labor Statistics, the total U.S. labor force—defined as the sum of the number of employed persons and the number unemployed, yet willing and able to work—rose from 63.4 million persons in 1950 to 116.5 million by June of 1985. The largest gain for a single decade was between 1970 and 1980 when the labor force jumped by 23.7 million, or by 28 percent. This was a period when large numbers of baby boom children were being absorbed into the labor market. Only a small amount of the overall increase in the number of workers was due to an increased propensity of individuals to participate in market work. For example, between 1965 and 1980, the number of employed persons rose by 28 million, but the proportion of persons of working age with jobs increased just slightly—from 56 to 59 percent. One-fifth of total employment growth represented an increased likelihood of working, and more than four-fifths was due to a greater number of people of working age (Norwood, 1986).

Much of the increase in labor force participation rates can be explained by the rapid movement of women into the paid labor market. Between 1965 and 1980, for example, the labor force participation of married women increased from 35 to 50 percent. Participation rates of older men actually declined. In 1950, 46 percent of all men 65 and over were in the labor force; now only 16 percent are working or looking for work. For men age 55–64, nine out of ten were in the labor force in 1950; today that figure has dropped to fewer than seven out of ten (Norwood, 1986).

In the future the labor force is projected to grow much more slowly than it has in the recent past. Reflecting the slowdown in growth of the population of labor force age, the U.S. labor force is expected to grow by only one percent per year between 1990 and 1995, compared with almost 3 percent per year in the 1970s. There will be a bunching of labor force members between the ages of 25 and 54. By 1995 three-quarters of the labor force will be in this age group, compared with two-thirds in 1985 (Norwood, 1986). This impending mismatch between a large supply of midcareer workers on the one hand and a limited number of advancement opportunities on the other will require additional labor market adjustments in the coming decade to maintain employee morale and productivity. Businesses may have to experiment with additional training for workers and to look for new rewards, reporting structures, and job structures as ways of altering job environments that have traditionally depended upon higher pay and promotions to ensure employee satisfaction (Kolberg, 1986).

The future is likely to witness even more women in the labor force. The Bureau of Labor Statistics predicts that 47 percent of the work force will be female by the year 2000 (versus 42 percent in 1980 and 29 percent in 1950) and that 60 percent of women will be at work (compared with 51.5 percent in 1980 and 37.7 percent in 1960). The number of young workers is expected to decline both relatively and absolutely, but the proportion of the youth labor force made up by minorities will increase. By 1990 one out of five new entrants will be a minority youth (Norwood, 1986). Finally, because U.S. fertility rates are low and immigration to the United States is accelerating, immigrants will contribute the largest share to overall population growth and to labor force growth since the First World War. Together, minorities, women and immigrants will account for more than 80 percent of net additions to the labor force between now and the year 2000 (Semerad, 1986).

Because tight labor markets for entry level workers are anticipated through the year 2000, the next 15 years represent a "window of opportunity" for workers without exceptional job skills (Semerad, 1986). Over the past 15 years, 5 percent of new jobs created were in manufacturing, and 90 percent were in the services and information sector. This trend will continue. Jobs will continue to shift from the goods-producing industries into the service sector, which will account for 90 percent of new jobs through 1995. These new jobs will in general require a higher level of analytic skill; three out of four are likely to require education or training beyond the high-school level (Semerad, 1986). At the same time, however, relatively tight labor markets should result in higher relative wages for and more hiring and training of less well-prepared entrants to the labor market. Employers are increasingly likely to turn to young, minority, handicapped, female, and immigrant workers during the next 15 years. One potential consequence of these anticipated hiring patterns is the opportunity to narrow occupational and earnings gaps between majority and minority workers (Semerad, 1986).

As the population of working age gets older, so the average age of the work force will also rise. By the year 2000 the median age of the U.S. population is expected to reach 36 years–six years older than any previous time in U.S. history. The average age of the work force will also rise—from 35 years in 1986 to 39 years by 2000. These changes in the age distribution of the labor force have both good and bad effects. On the positive side, a more experienced and stable work force should improve productivity. With fewer children to care for, wives will have added incentives to enter the job market, thereby reducing the economic dependency ratio (if dependents are thought of simply in terms of children under age 18). With a larger fraction of the total labor force over the age of 40, the national savings rate should improve, leading to lower interest rates and higher levels of investment in both human and physical capital. On the negative side, as long as job advancement is based on age, there will be increasing pressure on seniority systems. Older workers who become dislocated may be more difficult to train or retrain, and they may, therefore, have a harder time matching their previous salaries. Lastly, a more mature work force may also be less flexible and, therefore, less likely to move to new job locations or to new occupations in response to changing economic conditions (Semerad, 1986).

Before leaving this section, it is important to consider an issue about which one hears more and more these days—the prospect of labor shortages in the U.S. economy between now and the end of the century. We have already noted the anticipated slowing in labor force growth rates and the fact that the number of persons between 18 and 24 will drop sharply. But does this presage a labor shortage? We think the answer is no. A labor shortage is likely to materialize only if employers insist on offering the same levels of total compensation that they have in the past. Under those conditions there will be excess demand for labor or a labor shortage. But in a market economy the usual response to excess demand is for the price of that commodity to rise to the point where the shortage is eliminated. So as we have noted, relative wages for workers—especially entry-level workers—may be expected to increase in the near future. Furthermore, other sources of labor exist. There is continued pressure for migration to the United States from Third World countries; increased labor force participation rates are possible; and the trend toward earlier retirement might be reversed. Moreover, if wages rise too much, employers will increasingly find that it is in their best interests to adopt new labor-saving technology and to substitute capital for labor in their production processes. This development could have the salutary effect of accelerating productivity growth in this country.

Microdemographic Trends Affecting the Labor Force

Though our notions of what a traditional American family should be may not have changed, the actual statistical picture is quite at variance with these ideals. In 1955, 60 percent of American households consisted of a working father, a mother who was at home, and two or more children in the family. By 1980 only 11 percent of all households conformed to this pattern, and by 1986 the figure has fallen further to just 4 percent (Quinones, 1986). Everywhere we look families seem to be in disarray. Amitai Etzioni, a sociologist at George Washington University, projected that if we continue to dismantle the American family at the accelerating pace evident since 1965, "there will not be a single American family left by the year 2008" (Etzioni, 1983).

American family structures are changing so rapidly that it appears they will soon be structureless. In recent testimony to the Joint Economic Committee, Peter Morrison observed: "Fewer and fewer American families conform to traditional stereotypes. They are more diverse and less stable now than ever before. More children are born to unmarried mothers, and more childhood years are spent in fatherless families. Couples marry later and are quicker to divorce. Over half of mothers with preschool-age children are now in the work force (only 12 percent were in 1950). Some couples who are nearing retirement age are finding themselves caring for both an elderly parent and a divorced daughter with her children" (Morrison, 1986). The public is slow to catch on to the fact that family demography is changing so fast. Says Morrison, "People think they are seeing departures from the norm, but departures now are 75 percent of the norm" (Otten, 1986).

Our purpose in this section of the paper is to focus on two changes in family demography that have the greatest significance for the labor force and for the willingness of individuals to participate in work outside the home. These trends are the rapidly growing number of working mothers and the increasing longevity of the elderly.

The Rising Number of Working Mothers—Economic growth, technological change, changes in the status of women, and the rise in female wage rates have all combined during the past 40 years to alter the roles of men and women at home and at work and to undermine the implicit contract that has existed between husbands and wives for centuries. Traditionally husbands were the only spouses that worked outside the home for pay. Wives concentrated in providing domestic services, including childbearing and childrearing. But there are now fundamental economic and social changes underway that are destroying this sexual division of labor and the comparative advantage that men and women were historically believed to have in market activities and home activities, respectively.

Not too many years ago, working mothers were a relatively uncommon phenomenon. The typical pattern was for a woman to work after she completed her formal education until she married. Thereafter children and the responsibilities of domesticity became her full-time occupation. If mothers subsequently returned to market work, it was often not until their children were grown and substantially independent. But after the Second World War the educational attainment of women increased rapidly, and the gap between the educational attainment of men and women narrowed. Female wage rates increased so that the time women spent out of the labor market having children and caring for them became increasingly costly when measured in terms of foregone income. Many women have responded to these changes by having fewer children and by attempting to juggle the dual responsibilities of holding down a job and raising children simultaneously.

The statistics are striking. The number of working mothers with children under age 18 is conservatively estimated at 6.6 million in 1960. That number had come close to doubling by 1970 when 11.8 million mothers were at work. By 1985 the number stood at 18.6 million and nearly triple the number 25 years earlier (U.S. Bureau of the Census, 1985). Growth has been most rapid for working mothers with children under six. In 1960 there were 2.5 million such mothers, but by 1985 their ranks had swelled to at least 7.4 million. These trends are also reflected in the number of children under 18 with working mothers. Between 1970 and 1980, the number of children with working mothers rose from 27.2 to 30.7 million (U.S. Bureau of Labor Statistics, 1981). This growth may not seem all that significant until it is realized that the total number of children under 18 fell over this decade from 69.8 million in 1970 to 57.9 million in 1980. At the outset of 1980, 53 percent of children had mothers in the labor force compared with 39 percent 10 years earlier. Forty-three percent of children below age six had mothers in the labor force in March 1980 compared with 29 percent in March 1970 (U.S. Bureau of Labor Statistics, 1981).

Many of these working mothers are single parents, and many children with mothers in the labor force are living with their mothers only. Between 1970 and 1982, for example, there was a doubling in the number of female-headed households with dependent children under age 18—from 2.9 to 5.9 million—causing this family type to increase its share of all households from 4.7 percent to 7.0 percent, and its share of all families from 5.7 to 9.6 percent. Similarly, the proportion of all children under age 18 living with two parents fell between 1970 and 1982 from 84.7 to 75.0 percent, while the proportion living with one parent (principally their mother) rose from 12.0 to 22.0 percent (Espenshade, 1985).

So much has been heard in recent years about the decline in the American birth rate and about the baby bust period following the baby boom years of the 1950s and early 1960s that it might seem that the number of working mothers should be decreasing. One widely used measure of the rate of childbearing is the general fertility rate—the annual number of births per 1,000 women between the ages of 15 and 44. This rate hovered below 80 during the Depression decade of the 1930s. But it shot up during the postwar baby boom, and by the late 1950s it had reached more than 120. In the 1960s, however, a steep slide began in fertility and since the early 1970s the general fertility rate has fluctuated between 65 and 70 (National Center for Health Statistics, 1985).

Time trends in the annual number of births also reflect this general pattern. Between 1946 and 1953, the first phase of the postwar baby boom, the total annual number of births in the United States averaged 3.7 million. In the second phase of the boom, which lasted from 1954 through 1964, there were more than 4 million U.S. births per year. Then the baby bust set in, and between 1965 and 1976, births averaged 3.4 million each year. Since 1977, a period that might be termed the baby boomlet, births have been rising slowly and have averaged 3.6 million on an annual basis (National Center for Health Statistics, 1985).

On the basis of fertility patterns that existed during the 1950s and early 1960s, one would have expected births to start turning up sometime in the late 1960s or early 1970s as the large number of females born following 1946 entered their childbearing ages. But, in fact, births did not start to trend up until the last half of the 1970s. Much of the demographic explanation is due to the phenomenon of delayed childbearing. Since the early 1970s, first birth rates for U.S. women between 25 and 39 years old have increased steadily, whereas the rates for younger women have declined. The most dramatic increase has been for women aged 30 to 34, with a doubling from 7.3 first births per 1,000 women this age in 1970 to 14.6 in 1982 (Baldwin and Nord, 1984).

In addition, in 1982 first births to women 25 and older accounted for 36 percent of all first births in the United States; in 1970, the proportion was only 19 percent. Between 1970 and 1981, the proportion of women still childless at ages 25 to 34 rose by more than one-half—from 18 to 28 percent. Finally, some researchers predict that as many as 28 percent of American women born in the 1950s will never bear children. Only about 9 percent of women born in the 1930s—the mothers of the baby boom generation—were childless at age 40 (Baldwin and Nord, 1984).

Despite these trends toward lower birth rates and postponed childbearing, the number of working American mothers increased because of a massive movement of mothers with especially young children into the paid labor market. The movement of women into the world of work outside the home has been referred to as "the subtle revolution," and social historians may some day conclude that this revolution is one of the most significant of the twentieth century (Smith, 1979). In 1890, for example, the proportion of U.S. white women 14 years of age and older that were in the labor force was just 15.8 percent. This proportion then grew gradually so that it stood at 28.4 percent by 1950. By 1980 it had reached 51.3 percent (Waite, 1981). It is clear that most of the gain in female labor force participation during the last century has occurred in just the last 30 years.

Mothers with children, especially mothers with children under age six, are in the vanguard of these changes. Between 1950 and 1984, there was a complete reversal in the relative rates of labor force participation between married women with children under 18 and those without. In 1950, among married women, those with no children under 18 had the highest rates of labor force participation—30 percent, compared with about 28 percent for married women with children 6 to 17 and about 12 percent for married women with children under 6. By 1984, however, 65 percent of married women with children 6 to 17 were in the labor force compared with 52 percent of married women with children under 6. Married women with no children under 18 had the lowest tendency to be engaged in market work—47 percent (Baldwin and Nord, 1984).

With so many mothers of young children now participating in the paid labor force, an obvious question is who is rearing America's children? Who is providing the care these children need while their mothers are at work? Some information on the child care arrangements of working mothers is available from the U.S. Bureau of the Census. In 1982 the child care arrangements for the youngest child under age five of married mothers working full time were as follows: One-quarter of the children (25.5 percent) had care provided for them in their own home (12.8 percent by the father, 8.5 percent by another relative, and 4.2 percent by a nonrelative). For slightly less than one out of two children (45.0 percent) care was provided in another home (19.5 percent by a relative and 25.5 percent by a nonrelative). For another one-sixth of the children (17.3 percent) care was provided in a group care center, and the remaining one-eighth of all children (12.3 percent) were either cared for by their mothers while the mother was working or had some other arrangement (Baldwin and Nord, 1984).

There is plenty of anecdotal evidence to suggest that finding appropriate day care for their children is one of the biggest problems confronting working mothers. Other data suggest that the absence of such care is one of the reasons some women are not in the labor force or that they are working fewer hours than they would like to.

Commenting on the rapid increases in the labor force participation rates of married women with young children, Wendy Baldwin and

Christine Nord say, "These dramatic increases have escalated the problems of combining motherhood with the worker role. Businesses of all types, from law firms to manufacturers, are having to accommodate to the needs of the mothers among their employees. For working parents, a prime concern is the provision of child care for their preschool children and some before or after school supervision for their school-age children. Flexibility in work schedules through flex-time, part-time employment, or job-sharing is one way to meet some of the child care needs. Flex-place, the option to work at home, is another. Companies and government agencies that only recently regarded these options as risky are now beginning to experiment with them in order to attract and keep valued employees" (Baldwin and Nord, 1984).

Demographic trends that are transforming the roles of women at home and at work make it plain that, in the future, the availability of appropriate and high-quality day care at the place of work will assume an increasingly prominent role in the total package of benefits offered to employees.

Increasing Longevity among the Elderly—It is one of the ironies of a modern technological society that as couples gain better control over their fertility, they are increasingly less able to control the number and corresponding needs of their surviving elderly parents and other elderly dependents. And while the child dependency ratio has been dropping, the elderly dependency ratio is projected to undergo a major increase. This section of the paper focuses on improved life expectancy among America's elderly and what this means not only for the future number of elderly but also for those with the responsibility of caring for them.

One of the most impressive achievements of mankind is the control of mortality and the extension of human life through improved public health measures and advances in modern medicine. Between 1900 and 1984, life expectancy at birth in the United States increased a full 28 years, from 47 to 75 years (Keane, 1986). Death rates in the United States declined steadily through 1954. Then from 1954 until the late 1960s, there was a period of stability during which death rates leveled off. Beginning in the late 1960s, however, the decline in death rates resumed once again, and the gain in life expectancy has been especially impressive at older ages. Since the late 1960s, death rates for persons 65 and over have been reduced by 20 percent (Rosenberg, 1986). A full year was added to U.S. life expectancy at birth between 1980 and 1984, equalling the gain that it took a decade to achieve between 1960 and 1970. And in 1984 a typical 65-year-old could expect to live an additional 16.8 years, up from 13.9 extra years in 1950 (Morrison, 1986).

There is little reason to think that mortality conditions will not continue to improve. There certainly is room for improvement. Compared to other industrialized nations in 1980, for example, U.S. life expectancy ranked 15th for males and 8th for females (Rosenberg, 1986). At the same time, longer life spans may also be associated with lengthening durations of illness and periods of infirmity; if so, future increases in life expectancy at the older ages could have major implications for health and social services. To see what the future might look like, the U.S. National Center for Health Statistics has prepared some illustrative mortality projections. Their conservative forecast assumes that death rates will be unchanged from current levels. Their optimistic scenario, which is based on a continuation of mortality trends from 1966 to 1976, yields by the year 2003 life expectancies at birth of 84.2 years for females and 74.2 years for males. These figures represent increases over their 1985 levels of 78.2 and 71.2 years, respectively (Rosenberg, 1986).

The aging of the baby boom generation coupled with expected continued improvements in mortality among the elderly foreshadow a significant future increase in the number of older persons in the United States. Based on the middle series of the U.S. Bureau of the Census' latest projections of U.S. population, for the next 25 years the elderly population will increase steadily but not dramatically. But soon after the year 2010, both the absolute number of elderly and the ratio of the number of elderly to persons under age 20 will rise sharply. Between 2010 and 2030, the number of persons 65 and over is projected to grow from 39 million to 65 million—at least two and one-half times as many elderly as in 1980. Today there are 5.9 million persons who are 80 years old or older. This number is projected to increase to 17 million by 2030 and again to 26 million by the middle of the twenty-first century. At present, every 40th American is 80 or older. By 2050, however, at least every 12th person will be in this age bracket (Keane, 1986).

These changes in age distribution portend drastic changes in the U.S. dependency burden, defined as the number of dependents (both young and old) per 100 persons aged 18 to 64. While the youthful dependency burden is declining, the elderly dependency burden is going up. Between 1950 and 1982, that portion of the overall dependency burden attributable to children under 18 fell from 51.0 to 44.1. Under the Census Bureau's middle series population forecasts, it is projected to decline still further to 36.2 by the year 2080. However, the trend in that portion of the total dependency burden due to elderly dependents (those 65 years of age and over) rose from 13.3 in 1950 to 18.8 by 1982. It is projected to hit 21.9 by 2010 and then rise sharply to 41.9 by 2080 (U.S. Bureau of the Census, 1984). The total dependency burden, the sum of the two series, fluctuates over time. It started off at 64.4 in 1950 and then rose during the 1960s to a peak of 83.1, reflecting the birth of baby boom children. By 1982 it had receded to a level of 62.9 as the baby bust generation came along. Following 1985 the total dependency ratio falls gradually to a low point of 58.1 in 2010, but then it accelerates quickly to 78.1 by 2080.

Who will care for tomorrow's elderly, and where will the financial resources come from? As a group the elderly are better off today than in the recent past. Between 1969 and 1984, the proportion of elderly living below the poverty line declined from 25.3 percent to 12.4 percent. The proportion of elderly receiving Social Security benefits (or a spouse's) rose from 84 to 93 percent between 1969 and 1984, and during this same period the proportion of elderly receiving private pensions (or a spouse's) rose from 23 to 39 percent (Penner, 1986). In addition, the elderly have had expanded access to health care through Medicare and Medicaid. Partly for these reasons workers have been retiring earlier, and the elderly have shown both an increased willingness and ability to live independently from their children in retirement. Between 1960 and 1984, for example, the proportion of elderly living with their children dropped from 40 percent to 22 percent. And these trends are expected to continue. In 1984 one-half of all women 75 and over lived alone. By 1995 this figure is expected to reach more than 60 percent (Keane, 1986).

The growth of the elderly population has impacts on the federal budget. Between 1965 and 1985, total spending for the elderly under major federal transfer programs grew from $63 billion to $260 billion (in constant 1985 dollars). These expenditures were equivalent to $3,400 per elderly person in 1965 and to $9,000 per person in 1985 (Penner, 1986). This rise was also reflected in an increase from one-third to one-half in the fraction of all outlays on domestic programs going to the elderly. The elderly also receive major tax benefits. Most Social Security payments are exempt from federal taxes, and only about one-half of the elderly pay federal taxes compared with about 90 percent of all other adults.

It is not clear how long this relatively generous financial treatment of the elderly can persist. Some scholars have argued that payments to the elderly have escalated at the expense of the well-being of children, thus triggering in some quarters a kind of elderly backlash.

Moreover, health care costs are mounting rapidly, and strenuous efforts to brake the process are underway. There exists a persistently large differential between the general rate of inflation and inflation in the health sector. Between 1970 and 1982, for example, 60 percent of the average annual rate of increase in hospital expenses was due to inflation, and the U.S. Bureau of Labor Statistics projects that health care inflation will be more than 10 times greater than the general inflation rate in 1986 (Rother, 1986). Finally, as the U.S. Congress becomes more cost conscious in the wake of the Gramm-Rudman-Hollings deficit reduction law, budget cutters are looking carefully at practically all budget items for evidence of potential savings.

The problems seem especially serious in the area of long-term care for the elderly who are chronically ill. In 1986, $27 billion, or 0.6 percent of Gross National Product, was spent on long-term care, and the demand for these services is certain to increase. Less than 2 percent of persons 65 to 74 are in nursing homes; for persons 75 to 84 the figure rises to 7 percent; and for those 85 and over the proportion reaches 20 percent (Penner, 1986). Therefore, the expected doubling between now and 2050 in the number of persons 75 to 84, and the anticipated six-fold increase in the number of people over 85 will increase the demand for nursing homes. Projections indicate that the nursing home population will jump from 1.2 million in 1980 to 2.2 million in 2000 and to 3 million by the year 2020 (Rother, 1986).

If, as seems likely, the elderly can expect to count on diminished support from federal sources in the future, then the elderly themselves, their families, and other support groups will be called upon to shoulder more of the responsibility. It is unlikely that the elderly will be able to make it on their own. Elderly persons now spend 15 percent of their income on medical care, and this figure is likely to increase to 20 percent by the year 2000 (Rother, 1986). What seems increasingly probable is that the working-age children of the elderly will have to provide larger and larger shares not only of the financial resources the elderly require to meet their needs but also of the actual time spent caring for elderly parents and other relatives. As matters stand now, in fact, the needs of the impaired elderly are satisfied primarily by family members who provide 80 percent of such care and average 26 hours per week in caregiving (Soldo, 1986). Moreover, Medicare covers physician-provided or authorized services mainly in acute care hospitals, and Medicaid requires depletion of financial resources before the elderly can qualify. The prevailing gap is now filled by informal networks of family and friends.

As some advocates for retired persons have argued, the long-term care system in the United States is in need of drastic overhaul. Older persons are better helped by maintaining their independence at home rather than by institutionalization. Moreover, chronic care patients also need personal care services that are not strictly medical. If a consensus develops around this viewpoint, then the demands and expectations on the elderly's children are likely to grow. Just as the rapid growth in the number of working mothers is creating a demand for day-care services, the United States could very soon see an accelerating number of working daughters who are also in need of some kind of assistance to help them balance their simultaneous obligations of working outside the home and caregiving at home. As the trend toward delayed childbearing becomes more pervasive and the years separating successive generations widen, it is increasingly likely that the future will witness a pronounced rise in the number of individuals who are at once working mothers (fathers) and working daughters (sons) and who find themselves in both a time squeeze and a financial squeeze trying to provide at the same time for their young and old dependents.

The financial and emotional pressures on working adults as they attempt to cope with dependent elderly parents are likely to be enormous. Trends in birth rates that today point to fewer children per family and to increasing rates of childlessness mean that tomorrow's elderly will have fewer children on whom to depend. Declining fertility reduces the "caregiver ratio," the potential number of caregivers for the dependent elderly population. For example, the ratio of younger female family members to the number of oldest-old (those 85 and over) declines to the turn of the century and then levels off at more than four females 50 to 64 for each person 85 and over (Meyers, 1986). But this ratio will turn down once more after 2010 as the baby boom generation with their attendant low fertility begins to retire. These problems due to twists in the age distribution are compounded by rising rates of separation and divorce that reduce the availability of family members for caregiving. Finally, the postponement of disability until the extremes of old age will mean that adult children will confront parental care problems as they themselves retire and attempt to live off fixed incomes.

Policy Implications of Changing Demographics

Demographic changes that have their antecedents in the past and that will extend well into the future are undermining the current system of employee benefits. Employers who are successful in attracting and retaining the workers they want will have to raise the overall level of worker compensation in an increasingly tight and competitive (from the employer's standpoint) job market. Because growth in the population of working age is projected to slow and the number of new entrants to the labor force will shrink as the baby bust generation enters the labor market for the first time, employers will have to count on higher rates of labor force participation to ensure a steady flow of workers. Paying higher wages is one way to induce greater labor force participation. But the needs of tomorrow's workers may be such that they are more likely to respond to an enhanced package of benefits.

Given the demographic trends we have enumerated, benefits that workers are likely to find especially attractive include (1) greater access to working at home; (2) flextime in greater amounts; (3) day care at the place of work; (4) expanded maternity leaves for wives and their husbands; (5) greater recognition that a nonnegligible amount of informal day care takes place over the work phone in the afternoon when the children get home from school, and that a planned break in the workday might be needed to sanction this activity; and (6) greater health care benefits for the elderly parents of workers included in workers' family health plans.

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II. Financing Retirement Today and Tomorrow: The Prospect for America's Workers

PAPER BY DEBORAH J. CHOLLET

Introduction

The improved economic status of the elderly is an important public policy achievement. On average, the elderly are no longer worse off than the younger population. Indeed, the proportion of elderly in poverty is now less than the proportion of nonelderly in poverty and substantially less than the proportion of our nation's children in poverty. Social Security recipiency among the elderly is nearly universal. Federal regulation of private pensions and tax-fostered growth in pension plan participation among workers have produced a growing rate of pension recipiency among retirees. Medicare pays a large and growing bill for the elderly's health care, representing an important real income supplement.

Despite these achievements, a substantial proportion of the elderly remain poor, and the rate of near-poverty among the elderly (the percent with income within 125 percent of the poverty line) exceeds that among the nonelderly. Furthermore, the elderly as a group remain at much higher risk than the nonelderly of having financially devastating health care expenses, including the expense of long-term institutional or home care. For today's elderly, their continuing vulnerability to catastrophic health-related expenses is a foremost, critical problem demanding the attention of Congress and the administration.

The accelerating cost of public programs for the elderly, serving ever-larger numbers of people with longer life expectancies, is an overriding concern of public policymakers. The rising cost of current public programs—not considering additional programs to meet the elderly's continuing problems, however worthy—poses an immense problem, even over the next two decades:

> Between 1984 and the year 2000 the total number of aged is expected to increase 25 percent. And the ratio of the aged to the potential work force, . . . [by] 12 percent. These aggregate numbers . . . mask the aging of the aged cohort themselves and . . . underestimate the potential size of future federal benefits (Torrey, 1985).

Anticipated growth in the fiscal burden of public programs that assist the elderly has generated increasing interest in improving their cost effectiveness. The prospect of the baby boom retiring, to be supported in large part by the younger and considerably smaller baby-bust cohort, is forcing a reappraisal of the elderly's current and future needs for income assistance.

This paper reviews the current economic status of the elderly, identifies economically vulnerable segments of the elderly population, and presents preliminary microsimulation results of income among future retirees. The first section examines the economic status of current elderly relative to the nonelderly. The money income of the elderly, as well as their after-tax income and the value of real income from public programs is discussed. The second part reviews the elderly's sources of income and compares the sources of income reported among the poor, near-poor, and nonpoor. The health insurance status of elderly in these groups—a critical source of income security—is also compared. Finally, the paper summarizes the projected income of future retirees and the relative importance of different income sources among future retirees. The last section also provides a summary profile of the future poor among successive cohorts of elderly retired workers and their spouses.

The Economic Status of the Elderly

Improvements in the average economic situation of the elderly over the last 15 years, and even more recently, are well-documented. In real terms (after accounting for inflation), the average cash income of families with one or more elderly members increased by nearly 18 percent between 1969 and 1984; the average real income of elderly unrelated individuals (those not living with immediate family) rose by 34 percent (Congressional Budget Office, 1986). Economic gains among the elderly accelerated between 1980 and 1984. Over those years, the average real disposable incomes of families headed by someone 65 or older rose by 9.5 percent (Moon and Sawhill, 1984).

Real median income among the elderly—both married couples and single elderly—rose about 75 percent between 1962 and 1984 (Ycas and Grad, 1986). Among single elderly women, real median income rose 88 percent. These increases in median income produced successively lower percentages of elderly living in poverty. In 1984, about 3.3 million elderly, 12 percent of the elderly population, lived in poverty. This compares to nearly 19 percent in 1972 and nearly 16 percent in 1980.

On average, the economic status of the elderly compares increasingly well with that of the nonelderly. The average per capita income of elderly-headed households now exceeds that among younger-headed households. In 1984 mean per capita income of households with a householder age 65 or older was 101 percent of mean per capita income among younger-headed households before taxes (table II.1).

After taxes, the elderly show a substantial per capita income margin above that of younger-headed households, reflecting tax preferences that have been available to elderly taxpayers but not to younger taxpayers. Most Social Security income—representing about one-third of the elderly's total income—is tax-exempt. The elderly also have an additional federal income tax exemption[1] and receive tax preferences under many state and local property tax laws.

After taxes, the ratio of mean per capita income among elderly-headed households to mean per capita income among younger-headed households in 1984 was 112.8; that is, the mean per capita income of households headed by someone age 65 or more was nearly 13

TABLE II.1

Before- and After-Tax Income among U.S. Households by Householder Age, 1984

	Average Before-Tax Household Income		Average After-Tax Household Income	
	Total	Per Capita	Total	Per Capita
All households	$27,464	$10,207	$21,564	$8,015
Householder under age 65	29,892	10,189	23,102	7,875
Householder age 65 or older	18,279	10,316	15,745	8,886
Ratio: Elderly/nonelderly average household income	61.1%	101.2%	68.2%	112.8%

Source: U.S., Department of Commerce, Bureau of the Census, *After-Tax Money Income Estimates of Households: 1984*, Current Population Reports, Special Studies, series P-23, no. 147 (July 1986).

[1] The Tax Reform Act of 1986 replaces the separate exemption for the elderly with a deduction of $600 for married elderly and surviving spouses who are not heads of household and $750 for other unmarried elderly (including elderly surviving spouses if they are heads of household). The elimination of the exemption and inclusion of these deductions are effective beginning in 1987 and adjusted for inflation beginning in 1989.

percent higher after taxes than the mean per capita income of younger households. This compares to a 10 percent after-tax advantage in 1983 (Andrews, 1985). More conservative estimates offered by the Congressional Budget Office (1986) indicate marked improvement in the elderly's after-tax status relative to the nonelderly since 1969, but show 1984 after-tax per capita income among families with one or more elder members at 108 percent of other families and after-tax income of elderly unrelated individuals at 70 percent of after-tax income among younger unrelated individuals.

The elderly's categorical eligibility for public program benefits also improves their average economic status relative to the nonelderly. Adding the market value of public in-kind transfers to the elderly's after-tax income, Smeeding (1986) estimates that the ratio of the elderly's per capita income to that of the nonelderly rose from 103.6 percent to 118.6 percent in 1979. Including insurance benefits (Medicare, Medicaid and the value of employer-provided benefits for workers), the elderly were, on average, still better off than the nonelderly by 10.7 percent.

Improvement in the elderly's average economic situation relative to the nonelderly is also reflected in relative poverty rates (table II.2). While the proportion of the elderly living in poverty has steadily declined since 1980, the proportion of the population as a whole in poverty has risen. In 1984, 12.4 percent of the elderly lived in poverty, compared to 14.4 percent of the population as a whole and more than 20 percent of all children (Congressional Budget Office, 1985). The elderly are now less than 10 percent of the poor, compared to more than 15 percent in 1972 and more than 13 percent in 1980. The average income advantage of the elderly relative to the nonelderly and the declining percentage of the poor who are elderly are beginning to redefine the way we think about the elderly and the way we formulate federal policy toward poverty in the United States.

The average income of the elderly, however, even adjusted for their preferred tax status and real income from public programs, inadequately describes the complexity of their economic situation.[2] Although relatively few elderly lived below the poverty line in 1984, more than one in five—21.2 percent of the elderly—were near-poor—reporting incomes above poverty but within 125 percent of poverty (chart II.1). Nearly half the elderly—42.6 percent—reported incomes

[2] Slater (1984) has argued for a revision of the poverty standard to reflect better the income position of the poor relative to the rest of the population. In 1964 poverty income was defined at 42.3 percent of median family income; in 1983 the poverty

TABLE II.2
Poverty Rates among the Total Population and the Elderly Population of the United States, 1972–1984

	All Persons		Persons 65 or over		
Year	Number below Poverty (000's)	Poverty Rate (%)	Number below Poverty (000's)	Poverty Rate (%)	Elderly As a Percent of All Poor (%)
1972	24,460	11.9	3,738	18.6	15.3
1973	22,973	11.1	3,354	16.3	14.6
1974	23,370	11.2	3,085	14.6	13.2
1975	25,877	12.3	3,317	15.3	12.8
1976	24,975	11.8	3,313	15.0	13.3
1977	24,720	11.6	3,177	14.1	12.9
1978	24,497	11.4	3,233	14.0	13.2
1979	26,072	11.7	3,682	15.2	14.1
1980	29,272	13.0	3,871	15.7	13.2
1981	31,822	14.0	3,853	15.3	12.1
1982	34,398	15.0	3,751	14.6	10.9
1983	35,515	15.3	3,730	14.2	10.5
1984	33,700	14.4	3,330	12.4	9.9

Source: U.S., Department of Commerce, Bureau of the Census, *Characteristics of the Population Below the Poverty Level: 1983*, Current Population Reports, series P-60, no. 147, p. 5 (Washington, DC: U.S. Government Printing Office, 1984); and U.S., Department of Commerce, Bureau of the Census, *Estimates of Poverty Including the Value of Noncash Benefits: 1984*, Technical Paper 55 (Washington, DC: U.S. Government Printing Office, 1985), p. 5.

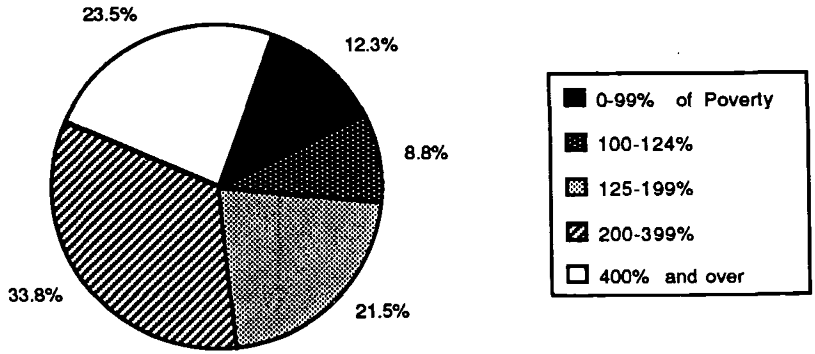
within 200 percent of poverty. (Annual income cutoffs by poverty status for the elderly are presented in table II.3.) Possibly the most important characteristic distinguishing the elderly's economic situation from that of the nonelderly is the large proportion of the elderly living in near-poverty and the volatility of their living costs associated with health care expenses.

Economic Security among the Elderly: Income and Health Insurance

The Poor and Near-Poor Elderly—Nearly 3.3 million elderly lived in poverty in 1984, and another 2.3 million lived in near-poverty. The

level was 34.9 percent of median income. Relative to median income, near-poverty (125 percent of the poverty standard) in 1983 was approximately equivalent to the poverty standard in 1964. "In other words, today's near-poor are in about the same relative position in the national income distribution as were the poor of a quarter-century ago."

CHART II.1
Distribution of the Elderly by Poverty Status, 1984



Source: EBRI tabulations of the March 1985 Current Population Survey, U.S. Department of Commerce, Bureau of the Census.
Note: Data exclude elderly who reported negative net income from any source.

TABLE II.3
Annual Family Income Levels Defining the Elderly's Poverty Status, 1984

	Elderly Couples		Single Elderly	
Income As a Percent of Poverty Income	Family Income in 1984 Dollars[a]	Percent of Median Family Income[b]	Family Income in 1984 Dollars[c]	Percent of Median Family Income[b]
100%	$ 6,282	23.8%	$ 4,979	18.8%
125	7,852	29.7	6,186	23.4
200	12,564	47.5	9,898	37.4
300	18,846	71.3	14,847	56.2
400	25,128	95.1	19,796	74.9

Source: Calculated from: U.S., Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States, 1986* (Washington, DC: U.S. Government Printing Office, 1986), pp. 430 and 450.

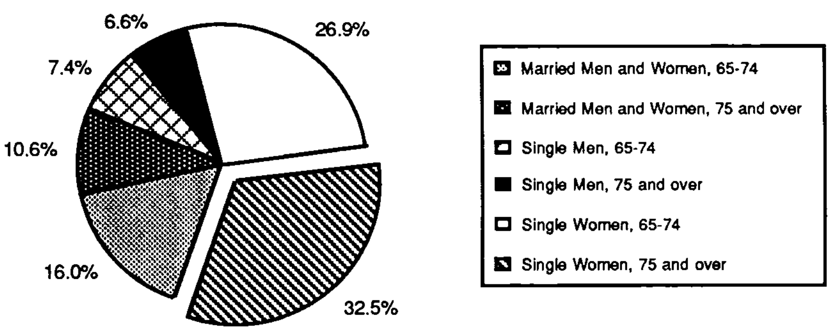
[a]Poverty income for a two-person family, householder age 65 or older.
[b]Median income of all U.S. families in 1984, unadjusted for family size.
[c]Poverty income for unrelated individual over age 65.

elderly who are poor or near-poor are disproportionately those over age 75 and disproportionately single women. Of all elderly over age 75 in 1984, nearly 28 percent were poor or near-poor. This compares to 17 percent among elderly age 65–74. About half (49.7 percent) of all poor and near-poor elderly in the United States were age 75 or older. Nearly two-thirds (61 percent) of poor elderly and more than half (57 percent) of the near-poor were single women—unmarried women or married women not living with their spouse. In all, more than half (59 percent) of all poor and near-poor elderly in 1984 were unmarried women, and about one-third (32.5 percent) were single women age 75 or older. These distributions of the poor and near-poor elderly are summarized in chart II.2.

Sources of Income—The relative importance of different sources of income among the elderly varies dramatically by income level. Principal sources of income among all elderly include Social Security (33 percent of all income), earnings (26 percent), asset income (25 percent), and private and public pensions and veterans' payments (14 percent). Poor or near-poor elderly are distinguished from higher-income elderly (those with family income at or above 400 percent of poverty) by their significantly greater reliance on Social Security and their low reliance on earnings, assets, or pensions as income sources.

In 1984 Social Security payments provided about three-quarters of the personal income of all elderly with family incomes within 200 percent of poverty and nearly half of all personal income among elderly between 200 and 399 percent of poverty (table II.4). By comparison, among elderly in higher-income families (400 percent of pov-

CHART II.2
Proportion of Poor and Near Poor Elderly by Marital Status, Sex, and Age, 1984



Source: EBRI tabulations of the March 1985 Current Population Survey, U.S. Department of Commerce, Bureau of the Census.
Note: Data exclude elderly who reported negative net income from any source.

TABLE II.4

Percent of Elderly with Personal Income from Various Sources and Average Amount Received by Poverty Status, 1984

		Family Income As a Percent of Poverty Income				
Sources of Income	**Total**	**0–99%**	**100–124%**	**125–199%**	**200–399%**	**400%+**
			Percent with Income			
Social Security	92.2%	86.5%	95.6%	95.5%	94.0%	88.3%
Earnings	14.4	3.5	5.7	10.2	16.0	24.9
Interest or dividends	68.8	28.5	44.6	60.1	80.7	89.9
Pensions or veterans' payments	33.8	10.8	19.4	28.7	42.6	43.1
Public assistance	7.1	31.2	14.4	5.3	1.8	0.9
All other	2.6	2.0	2.1	2.7	2.6	3.0
			Average Amount per Recipient			
All sources	$11,112	$3,607	$ 2,011	$6,367	$10,214	$22,859
Social Security	4,869	3,108	4,165	4,785	5,242	5,576
Earnings	9,907	1,155	1,993	2,374	5,415	18,229
Interest or dividends	4,532	469	602	1,120	2,828	10,236
Pensions or veterans' payments	5,293	1,337	1,735	2,455	4,702	8,985
Public assistance	1,784	1,547	1,893	2,084	2,269	2,360
All other	4,254	893	13,354	1,644	2,549	10,520

Source: EBRI tabulations of the March 1985 Current Population Survey, U.S. Department of Commerce, Bureau of the Census.
Note: Data exclude elderly who reported negative net income from any source.

erty or more), Social Security provided only 22 percent of personal income and 17 percent of family income.

Poor and near-poor elderly are also distinguished from higher-income elderly in that they are less likely to work or to receive any personal income from pensions or assets. In 1984, elderly with family income at or above 400 percent of poverty were more than seven times more likely to work than were poor elderly and more than four times more likely to work than near-poor elderly (table II.4). Similarly, nearly 90 percent of higher-income elderly reported personal income from assets, compared to 28.5 percent of poor elderly and 45 percent of the near-poor.

Among poor and near-poor elderly who do report earnings, asset income, or pension recipiency, the average amount received from each source is small relative to the average amount reported among nonpoor elderly. As a result, while higher-income elderly derived more than three-fourths of their personal income from earnings (20 percent), assets (40 percent), and employer-provided pensions (17 percent), poor and near-poor elderly derived 9 to 14 percent of their personal income from these sources.

The differences between personal income sources and family income sources presented in table II.5 suggest that many elderly in nonpoor families receive important support from other workers in the family. Among elderly with family incomes at or above 400 percent of poverty, fully one-third of family income is derived from earnings, compared to 20 percent of the elderly's personal income. Similarly, among elderly in families between 200 and 399 percent of poverty, 22 percent of family income is derived from earnings, compared to only 9 percent of personal income.

The lower average Social Security income reported among poor and near-poor elderly mirrors their lower average career earnings. Likewise, average pension income is lower among poor and near-poor elderly, and they have (apparently) accumulated less in income-producing assets over their lifetimes. In 1984 Social Security income among poor and near-poor elderly averaged 56 percent of Social Security income among higher-income elderly, despite Social Security's higher rate of wage replacement among retirees with lower preretirement earnings. Pension income among poor and near-poor recipients averaged 15 percent of pension income among higher-income recipients. Similarly, asset income among poor and near-poor elderly with income-producing assets averaged less than 5 percent of that reported among higher-income elderly. In general, the elderly's personal income patterns strongly suggest that today's low-income elderly are largely yesterday's low-earnings workers.

Health Insurance Coverage—Living close to poverty, but not in poverty, is particularly problematic for the elderly because of their relatively high risk of incurring large health care expenses. In 1984 the elderly's total spending for health care averaged more than three

TABLE II.5
Percent of Personal and Family Income from Selected Sources, Persons Age 65 or Older by Poverty Status

Sources of Income	Total	0–99%	100–124%	125–199%	200–399%	400%+
	Family Income As a Percent of Poverty Income					
			Percent of Personal Income			
Social Security	40.6%	76.6%	79.6%	72.0%	48.4%	21.5%
Earnings	12.9	1.2	2.3	3.8	8.5	19.8
Interest and dividends	28.0	3.8	5.4	10.6	22.4	40.2
Pensions and veterans' payments	16.2	4.1	6.7	11.1	19.7	17.0
Public assistance	1.2	13.8	5.5	1.8	0.4	0.1
All other	1.0	0.5	0.6	0.7	0.7	1.4
			Percent of Family Income			
Social Security	33.1%	71.6%	74.3%	66.9%	41.4%	17.2%
Earnings	26.1	4.8	7.2	10.8	22.4	33.5
Interest and dividends	24.7	3.8	5.0	9.0	18.6	33.6
Pensions and veterans' payments	14.0	4.3	6.1	10.3	16.5	14.3
Public assistance	1.0	14.8	6.8	2.1	0.4	0.1
All other	1.0	0.5	0.7	0.9	0.7	1.3

Source: EBRI tabulations of the March 1985 Current Population Survey, U.S. Department of Commerce, Bureau of the Census.
Note: Data exclude elderly who reported negative net income from any source.

times the per-capita health care spending among the entire population. Per capita, the elderly's out-of-pocket spending for health care averaged 272 percent that of the population as a whole (Waldo and Lazenby, 1984; Levit et al., 1985). The elderly's largest uninsured health care expense is nursing-home care (42 percent of average out-of-pocket spending in 1984), followed by noninstitutional expenses—largely prescription drugs (31 percent) and physician fees (21 percent).

A recent effort to quantify the economically-vulnerable elderly in the United States (Smeeding, 1986) identified them as elderly in two or more of the following circumstances: (1) reliance on Medicare as their only source of subsidized insurance; (2) home renters with no receipt of housing income-in-kind; and (3) reliance on Social Security as the primary source of money income. Using these criteria, Smeeding estimated that nearly 42 percent of elderly households were economically vulnerable in 1979.

The economic vulnerability of many low- and middle-income elderly to high health care expenses is apparent from their reported sources of insurance coverage. In 1984, more than one-third of all elderly below 200 percent of poverty reported Medicare as their only source of insurance coverage (table II.6). Even among poor elderly,

TABLE II.6

Number and Percent of the Elderly with Health Insurance from Selected Sources by Poverty Status, 1984

Source of Health Insurance Coverage	Family Income As a Percent of Poverty Income					
	Total	0–99%	100–124%	125–199%	200–399%	400%+
	Persons in Thousands					
Medicare only	8,044	1,196	926	2,136	2,503	1,284
Medicare and supplementary coverage[a]	15,244	912	1,021	3,013	5,890	4,408
Medicaid[b]	3,071	1,263	456	634	497	222
	Percent within Poverty Group					
All persons	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Medicare only	30.5	36.7	39.7	37.6	28.0	20.8
Medicare and supplementary coverage[a]	57.8	28.0	44.7	53.0	66.0	71.2
Medicaid[b]	11.6	38.8	19.6	11.2	5.6	3.6

Source: EBRI tabulations of the March 1985 Current Population Survey, U.S. Department of Commerce, Bureau of the Census.

Note: Data exclude elderly who reported negative net income from any source.

[a]Supplementary coverage includes employer-provided coverage to active workers and retirees, individual coverage, and coverage from CHAMPUS.

[b]Includes less than one percent of elderly who report coverage from Medicaid but not Medicare.

only 37 percent reported qualifying for Medicaid—in part, reflecting the erosion of Medicaid qualifying income levels relative to the federal poverty standard. Whereas more than half of all elderly report private supplemental insurance coverage or CHAMPUS [Civilian Health and Medical Plan of the Uniformed Services] in addition to Medicare, only 28 percent of poor elderly and 45 percent of near-poor elderly report supplemental coverage.[3]

The vulnerability of even higher-income elderly to catastrophic health care expenses is suggested by the Medicaid eligibility they reported in 1984. The elderly are categorically eligible for Medicaid, but must meet income and asset tests to qualify for benefits. In 31 states the elderly whose incomes exceed the qualifying income level set by Medicaid may still receive Medicaid benefits based on their incomes net of health care costs. In these states, Medicaid insures the elderly's catastrophic health care costs above the level that literally impoverishes them. In 1984, nearly 4 percent of elderly with family incomes at or above 400 percent of poverty qualified for Medicaid, presumably based on "spend-down." In total, more than 7 percent of all nonpoor elderly qualified for Medicaid benefits. However, many states do not recognize spending down to determine Medicaid eligibility. Consequently, the rate of Medicaid eligibility among nonpoor elderly probably underestimates significantly the percent of elderly who actually incur catastrophic health care costs. The proportion of nonpoor elderly with catastrophic health care costs would be yet higher if catastrophic health care costs were defined less stringently—less than impoverishing.

Retirement Income among Future Elderly

This section presents results of a microsimulation of income among future cohorts of retirees. The model used to produce these estimates is the Pension and Retirement Income Simulation Model (PRISM), first developed for the 1979 President's Commission on Pension Policy. A full description of the model appears elsewhere (Kennell and Sheils, 1986), including its assumptions and enhancements for the purpose of producing the estimates presented below. Briefly review-

[3]About 11 percent of elderly reporting coverage from a private insurance plan in addition to Medicare received coverage from an employer, either as an active worker or as the dependent of an active worker. Data from the 1977 National Medical Care Expenditures Survey indicate that about 23 percent of the elderly have employer-sponsored coverage as a retiree.

ing PRISM's key assumptions, however, facilitates interpretation of the model's results.

The version of PRISM used here assumes that rates of pension coverage by industry group are static throughout the 40 year simulation period. As workers enter the model by 1979 age cohort, their participation in a pension plan and the type and provisions of their plan are in part determined by their industry of employment. Despite static within-industry rates of pension coverage, aggregate rates of pension coverage change over the simulation period reflecting employment shifts among industries and firm sizes. Rates at which workers roll over defined contribution plan assets upon job termination are consistent with the rates reported in the EBRI/Department of Health and Human Services pension supplement to the May 1983 Current Population Survey. Estimated employment among the elderly—producing earnings as a source of income—is based on the macroeconomic employment forecasts of the U.S. Department of Labor.

For the first time, PRISM also includes a microsimulation of saving in individual retirement accounts (IRAs). The model assumes that tax-favored IRA contribution limits are indexed at 80 percent of the Consumer Price Index (CPI) throughout the simulation period. This assumption, together with the radically changed tax treatment of IRAs likely to occur in tax reform, probably produces very generous estimates of the number of retirees with IRA assets at retirement and the amount of their IRA asset accumulation.

Finally, the version of PRISM used here simulates the continuation of employer-sponsored health insurance into retirement. The receipt of continued health coverage assumes that (1) the retiree's former employer offered retiree health insurance benefits; (2) the retiree vested in a defined benefit pension plan on that job; and (3) the retiree left that job eligible for immediate pension benefits.

Sources of Income—Despite the assumption of static pension coverage rates within industry groups, future elderly are more likely to have employer-provided pension assets at retirement than today's new retirees. In part, this trend can be explained by the longer tenure of young workers in a post-ERISA work force, compared to workers now retiring. Most of this growth, however, results from the greater opportunity of young workers to vest in several defined contribution pension plans. These plans typically have short vesting periods relative to defined benefit plans.

Among workers now retiring (retirees age 55–64 in 1979), PRISM estimates that 48 percent have pension income, either from a defined benefit plan or from assets accumulated in a defined contribution plan, assuming that those assets were annuitized (table II.7). Among younger cohorts, this rate is expected to rise, reaching 63 percent among PRISM's youngest cohort, workers age 25–34 in 1979.

In 1985 dollars, average pension income among married-couple retirees with pensions is expected to rise more than 83 percent, to $13,000 compared with $7,100 among couples retiring today (table II.8). Among single retirees, average pension income is projected to rise somewhat slower, from $5,300 among single workers now retiring, to $9,000 among PRISM's youngest cohort of single retirees.

The elderly's reliance on public income sources—Social Security and Supplemental Security Income—is projected to decline relative to their reliance on pension income and private saving. Excluding income from assets other than pensions and IRA accumulations, today's new retirees receive an estimated 48 percent of their total income from public sources, compared to 41 percent projected among PRISM's youngest cohort (table II.9). Most of this shift is the result of growing pension income, rather than substantial growth in the annuity value of IRA asset accumulations. Under current laws (before tax reform), 41 percent of PRISM's youngest cohort is projected to retire with any IRA asset accumulation; among those with IRA assets, the annuitized value of IRA assets would provide about $3,000 per year. In total, IRA assets are projected to provide about 5 percent of aggregate retirement income among PRISM's youngest cohort.

Retiree Health Insurance—Continued health insurance from an employer plan is an important source of economic security for many

TABLE II.7

Percent of Future New Retiree Families with Retirement Income from Various Sources

Income Source	1979 Age Cohort			
	25–34	35–44	45–54	55–64
Social Security	96	93	90	86
Pensions	63	61	57	48
Earnings	29	37	35	35
Individual retirement account savings	41	37	24	3
Supplemental Security Income	3	6	8	11

Source: Employee Benefit Research Institute. Preliminary results from the Pension and Retirement Income Simulation Model (EBRI, 1986).

TABLE II.8

Average Income from Selected Sources among Recipient Families at Age 67: 1979 Age Cohort and Projected Marital Status (in thousands of 1985 dollars)

Income Source	1979 Age Cohort			
	25–34	35–44	45–54	55–64
	Married Couples			
Social Security	$12.8	$10.6	$9.8	$9.5
Defined benefit pension	9.0	7.9	7.1	6.5
Defined contribution pension	9.9	7.9	6.1	4.4
Summary: defined benefit or defined contribution pension	13.0	10.4	8.8	7.1
Individual retirement account annuity	3.0	2.3	1.2	0.5
	Single Individuals			
Social Security	$6.8	$6.0	$5.4	$4.8
Defined benefit pension	7.2	6.0	5.6	5.1
Defined contribution pension	6.9	5.1	4.8	3.3
Summary: defined benefit or defined contribution pension	9.0	6.8	6.9	5.3
Individual retirement account annuity	2.0	1.6	0.8	0.4

Source: Employee Benefit Research Institute. Preliminary results from the Pension and Retirement Income Simulation Model (EBRI, 1986).

retirees. Based on the assumed eligibility conditions for continued benefits described earlier, PRISM estimates that 22 percent of workers now retiring (age 55–64 in 1979) have continued health insurance coverage from an employer plan (table II.10). This coverage rate is projected to rise only slightly over the 40-year simulation period, reflecting the assumption that rates of defined benefit pension coverage among workers (a precondition for retiree health insurance benefits in PRISM) are static within industry group. Among PRISM's youngest cohort, 24.5 percent—31 million retirees and their spouses—

TABLE II.9
Percent of Total Retirement Income from Various Sources among Future New Retiree Families

Income Source	1979 Age Cohort			
	25–34	35–44	45–54	55–64
Social Security	41	38	40	46
Pensions	32	26	27	23
Earnings	23	32	30	29
Individual retirement account savings	5	4	1	[a]
Supplemental Security Income	[a]	1	2	2

Source: Employee Benefit Research Institute. Preliminary results from the Pension and Retirement Income Simulation Model (EBRI, 1986).

[a]Amount not statistically significant.

are projected to have continued health insurance coverage from an employer plan. About 29 percent of retirees with continued coverage in the youngest cohort are projected to receive employer-based health insurance benefits as the dependent or survivor of a covered spouse. This is a slightly lower rate of dependents' coverage than among today's retirees.

The Future Poor Elderly—Despite the fact that PRISM does not simulate all sources of income among future cohorts of retirees, it

TABLE II.10
Retirees at Age 67 with Health Insurance Benefits Continued from an Employer Plan: Microsimulation Results by 1979 Age Cohort

Income Source	1979 Age Cohort			
	25–34	35–44	45–54	55–64
Number of retirees (in millions)	31.2	22.4	21.3	22.1
Retirees with coverage, total percent	24.5%	25.1%	26.4%	23.7%
benefits from own plan	17.5	17.7	19.0	17.1
benefits as dependent only	7.0	7.4	7.5	6.7
Retirees without coverage, percent	75.5	74.9	73.6	76.3

Source: Employee Benefit Research Institute. Preliminary results from the Pension and Retirement Income Simulation Model (EBRI, 1986).

offers an approximate picture of the future poor. In particular, PRISM's income projections exclude personal income from any asset accumulation other than defined benefit pension distributions and IRAs. In 1984 about one-third of poor and near-poor elderly reported asset income; average personal income from assets among those reporting asset income was about $1,500. Since it is unknown how much of this income resulted from lump-sum pension distributions, it is impossible to estimate how much of this income is omitted from PRISM's results. Regardless, this potential omission is unlikely to change PRISM's general results describing the poor among future retirees.

Among PRISM's oldest cohort—workers now retiring—30 percent of worker families are estimated to have incomes within 125 percent of the poverty line based on the personal income of retirees and their spouses (table II.11). This standard is somewhat stricter than the family income standard used earlier (in that it ignores the income of other family members) and probably approximates a family income standard of about 150 percent of poverty.

Assuming that the poverty rate is fully indexed at the CPI, the poverty rate among retiree families is projected to fall substantially over the simulation period. Among the youngest cohort, about 18 percent of elderly families are projected to be poor or near-poor. However, the percent of single women who are poor or near-poor (within approximately 150 percent of poverty) is estimated at 64 percent among PRISM's cohort now retiring. Although this rate is projected to fall, it remains at 43 percent among PRISM's youngest cohort of single women.

TABLE II.11

Percent of New Retiree Families in Poverty or Near-Poverty, by Sex and Projected Marital Status at Age 67

	1979 Age Cohort			
	25–34	35–44	45–54	55–64
All families	18%	20%	24%	30%
Married couples	2	4	6	9
Single men	6	8	12	25
Single women	43	52	63	64

Source: Employee Benefit Research Institute. Preliminary results from the Pension and Retirement Income Microsimulation Model (EBRI, 1986).

[a]Rates approximate individuals living within 150 percent of poverty.

The distribution of the poor by sex and marital status projected by PRISM reflects the persistent higher rate of poverty and near-poverty projected among single women. Among PRISM's oldest cohort of poor and near-poor retiree families, 74 percent are single women (table II.12). Although both the number and percent of single women in poverty or near-poverty are projected to decline over the simulation period, single women are projected to be an increasing majority of this group. Among PRISM's youngest cohort of retiree families, 90 percent of the poor and near-poor are projected to be single women.

Summary and Concluding Remarks

The improvement of the elderly's economic status over the last decade, both absolutely and relative to the nonelderly population, are notable. As a group, the elderly are no longer our nation's poor. This realization is beginning to redefine our national poverty agenda, and it's beginning to redefine the way we think about the elderly's ongoing need for income assistance.

Despite this achievement, however, a large proportion of the elderly remain economically vulnerable—in 1979, as many as 42 percent (Smeeding, 1986). Most of this vulnerability is the result of under-insurance for catastrophic health care expenses—particularly expenses associated with long-term, chronic health problems.

Microsimulation projections of income among future elderly indicate that the elderly's retirement income will continue to rise, largely as a result of improved pension participation and vesting among

TABLE II.12

Composition of Poor and Near-Poor[a] Elderly among Future Retiree Families, by Sex and Projected Marital Status at Age 67

	1979 Age Cohort			
	25–34	35–44	45–54	55–64
Married couples	5%	12%	13%	17%
Single men	5	5	7	10
Single women	90	83	79	74

Source: Employee Benefit Research Institute. Preliminary results from the Pension and Retirement Income Microsimulation Model (EBRI, 1986).

[a]Rates approximate individuals living within 150 percent of poverty.

current workers. In particular, access to defined contribution pension plans with short vesting periods is likely to substantially improve pension income among future retirees. Even without growth in within-industry pension coverage rates, however, the likelihood of receiving income from defined benefit pension plans rises slightly among future cohorts of retirees. Since the real income derived from pension plans is also projected to rise, these trends imply a declining reliance on Social Security and Supplemental Security Income among future cohorts of retirees.

Reflecting the assumption of no intraindustry growth in the defined benefit pension coverage that generates continued health benefits among retirees, growth in the proportion of future retirees with continued health coverage is projected to be modest. Among the future generation of retirees as a group, about 23 percent of retirees and their spouses are projected to have continued health coverage from an employer plan.

This continued coverage provides the elderly with an important real income supplement in retirement. In most cases (perhaps 85 percent), the employer pays all or part of the cost of these plans. As a result, the real income benefit received from continued health coverage represents a fully-indexed retirement benefit. For many retirees, the value of continued health coverage benefit may approach or even exceed the value of a pension benefit over time.

Despite the important income supplement provided by these plans, most retirees remain largely or fully at risk for the expense of long-term care. Although Medicare and many private plans cover a limited period of skilled nursing care, virtually no health insurance plan other than Medicaid adequately insures the cost of long-term care at the intermediate-skill level. Financing intermediate care in the United States has become a national dilemma. Resolving the problem of financing long-term care among the elderly may be the most important part of assuring economic security for the majority of the elderly, both today and tomorrow.

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III. Part One Discussion

Employers and Day Care

MR. MIKKELSEN: Earlier in your address, Mr. Espenshade, you seem to underscore the importance of employers providing high quality day care at the work place. I'd like to expand on that.

I anticipate that most New York City employers would strenuously resist the establishment of work situs day care, favoring instead other approaches.

MR. ESPENSHADE: Let me elaborate on this a little bit. At the present time families have a variety of day care provisions from which to choose. Earlier I mentioned the various arrangements that are currently being made for children. But parents sometimes find these alternatives unsatisfactory or inconvenient. In deciding whether to work in the first place, how much to work, and where to work, parents are making cost-benefit calculations, either implicitly or explicitly.

So the more advantageous particular day care provisions appear to be to parents, the more likely they are to choose that particular alternative. If day care is provided at the place of work, and if that means that mothers or fathers don't have to spend extra time dropping children off at the day care place before they go to work in the morning and don't have to stop again in the afternoon on the way home, from the employee's perspective it makes working for that particular employer a more attractive option.

Day care at the place of work would have other implications as well, I think. There has been a lot of talk about the gender gap in wage rates. Work by some economists suggests that it's not entirely labor market discrimination that is causing this pay gap between men and women, but that in some instances women are deliberately choosing jobs that may pay less because they happen to be closer to home, and they can, therefore, more easily manage their work responsibilities and their child care responsibilities. Therefore, an extension of employer-based child care might have some beneficial side effects in terms of closing this wage gap between men and women.

Labor Force Shortages

MS. RAPPAPORT: What do you think this means for retirement ages?

MR. ESPENSHADE: Let me elaborate on what I said earlier about the reasons why I don't think that we will have a labor shortage in this country.

I pointed to the fact that there is slower growth in the labor force and, in fact, an actual decline in terms of people coming into the labor force. But there are other sources of labor apart from young people coming into the labor force for the first time.

We've seen sharp increases in labor force participation, at least on the part of women; and these increases are probably going to continue, although not at the same pace.

Another source of labor is on the part of elderly persons, and I can anticipate a situation where the decline in the retirement age could slow down and possibly even reverse itself as a result of the increasingly tight labor market. Immigration is a third source of labor supply. I think that demographic pressures on the labor market will have some impact on the retirement age, and that they will work in the direction of slowing the decrease and possibly even toward reversing the trend to earlier retirement.

MR. DOBSON: A comment and a question. The comment concerns future labor shortages. Wouldn't there be a tendency as the price of labor increases to procure more capital and change the capital/labor ratio, and wouldn't that influence benefits? On the one hand, the presumed shortage; on the other hand, maybe there'll be a substitution of capital for labor, and that will take some of the pressure off employers to increase their employee benefit packages.

MR. ESPENSHADE: I agree. That's the natural consequence of an increase in the relative price of labor; you would expect to find some substitution away from labor toward capital. And that may have a secondary benefit in terms of spurring productivity growth in the United States once again.

I believe that one of the reasons the United States has had low rates of productivity growth in recent years is the tendency to rely heavily on relatively inexpensive sources of labor, as the baby boom generation was being incorporated into the labor market. We may see this change back in the other direction as the baby bust cohorts become absorbed into the labor market.

Taking Care of the Elderly

MR. DOBSON: And as the people that have come into the labor market acquire more skills, that should lead to higher productivity.

In addition, as we look ahead to predict future overall dependency ratios with fewer children, yet more elderly, how do you think the burden on the working cohort will change? Will the overall dependency ratio be a lot greater? A little greater? Or about the same? And what will that mean in terms of economic burden on the labor force?

MR. ESPENSHADE: The overall dependency ratio is now about 62 persons either under age 18 or 65 and over for every 100 persons 18–64. That ratio is not expected to change much between now and the year 2010, after which it will rise sharply. But over the next 25 years the youthful component of that ratio will decline slowly, offset by a slow rise in the elderly component. An answer to your question must recognize that expenditures can be broken down into private components and public components because youthful dependents as well as elderly dependents are supported partially out of private resources and partly out of public resources.

In the demographic literature it has usually been assumed that the cost of providing for youthful dependents is more or less the same on a per capita basis as the cost of providing for elderly dependents. But I think that some of the economic research shows that that is not necessarily the case—that we are spending more for the elderly on a per capita basis than we are for young people.

So even if the overall dependency burden doesn't change in the short run, the burden on the working population is likely to increase because of the differences in the per capita cost of maintaining elderly dependents and youthful dependents.

MR. DOBSON: If we take dollars away from the working class, how are they going to support themselves after they've supported their parents? You hear that this is going to be a real issue. If we pull out of Social Security and out of Medicare, where is the wherewithal for the baby boomers who are taking care of their parents now?

MR. ESPENSHADE: We're in for a substantial squeeze as a result of the demographic shifts. To a certain extent, the health of the Social Security system depends on a chain-letter mechanism. As long as there is an age distribution that is tilted toward the young, the number of elderly people that each person in the labor force is trying to support is relatively low. But declining U.S. birth rates give a torque to the age distribution that changes these ratios.

In the absence of high rates of real economic growth the choices are rather limited. The pie can only be cut so many ways, and the choices are basically among smaller benefits for the elderly, higher taxes on the working population, or a redefinition of the retirement age.

MS. YOUNG: There are a couple of things that disturb me. In the systems before Medicare, many women went from taking care of what were then larger families—so that they had a longer time period of having dependent children at home—to taking care of elderly relatives. These may be the same women now who are not in the job market, who are all the women who have not had any children under 18, etc.

There seems to be an increase in the elderly, but there doesn't seem to be any evidence at this point that people are remaining healthy longer, only that our medical miracles have kept them alive beyond the point where the illness would have killed them 30 years ago. If there are all these broken families, all these women heads of households who were forced to or chose to, for whatever reasons, keep on working even when their children were under six, who cares for these elderly over 80 if you can't make a logical presumption that even some people in their sixties will retire? If they're not looking at a longer period of greater health, they are going to say, if we don't retire now we will never get our opportunity to play golf in Florida.

In this case, there may be a situation in which there are not going to be women who can even *choose* to stay home. Who is going to take care of these people, and where are these resources going to come from, if the young-old choose to stay in the work force and do not choose to take care of the old-old?

MR. ESPENSHADE: This is admittedly a problem. I alluded to this growing tension that confronts persons of labor force age, not just women but men as well, of having elderly dependents to care for at the same time that they are having young dependents to care for. And it may even be worse than that, because with the rise in separation and divorce rates, you can easily imagine a working couple in their fifties trying to provide for two sets of elderly parents and at the same time having a married daughter who has moved back home following a divorce with several children of her own. So you can imagine multigenerational households with three or four generations in them.

In terms of providing for the extreme old, there are basically three choices. The care can be provided out of public resources, out of family and community resources, or by the individual alone.

As a society, we have in the past tended to rely largely on the public option. The proportion of domestic spending going to the elderly has been rising in this country. But this philosophy that we should provide for elderly dependents out of public funds has been challenged under the Reagan administration, and it raises once again the question of whose responsibility it is to provide for elderly dependents. Is it the public's? Is it the responsibility of individuals by themselves, or is it the responsibility of the individual's family network?

Demographic trends are bringing these choices into sharper focus, resulting in increasing financial pressures on members of the work force.

MR. YOUNG: I don't want to be a Pollyanna or to brush aside what I think are real problems. In particular, in talking about the elderly, there are a lot of problems that go beyond merely finding the finances. I think the structure in delivering whatever it is that we think is necessary is a very real issue. I think we get real gloom and doom when we focus only on the head count.

As I recall, even if you look at the pessimistic assumptions that are used to project the Social Security system—the "Alternative III" assumptions—in the second quarter of the twenty-first century, the per capita gross national product in this country is projected to be something like three times what it is today. That is not just for the working population; that includes the elderly and everybody else. So it seems to me that we should balance the focus on numbers of people with the economic capacity to provide whatever it is we want to do in our society.

MR. ROTHER: I am interested in exploring the implication of the growth in new jobs being concentrated almost exclusively in the service sector. My guess is that the growth would be very largely in the *small business* end of the service sector. And, isn't that precisely the end of the spectrum today that is failing to provide employee benefits to its workers, and that explains why more people have no health insurance coverage or pension coverage compared to five years ago? I wonder what you see in the future for this part of the labor market?

MR. ESPENSHADE: I can only speak to one-half of your question, and that has to do with where the new jobs are coming from. I think the projections are that about 90 percent of new jobs are going to be created in the service sector as opposed to the manufacturing sector. That continues a trend that we've seen in the last 10 or 15 years with the decline in the manufacturing base. It is a striking proportion of new jobs being created in the service sector. But I don't really have any basis for commenting on which part of the employment market that's failing to provide employee benefits.

MS. MYDER: My comment has to do with the caregiving responsibilities that younger workers are assuming. I think it is a mistake to say that there's growing tension between the responsibilities that workers have for young dependents and older dependents; and this is especially true when we're speaking about women.

I think we need to look at women as caregivers as another one of the dwindling resources. You spoke of federal funding as a dwindling resource. I think we need to look at human resources as well. Then, if we're going to do something about the problems we have today and also those in the future, we may come up with some answers. I think that the support that women are providing as caregivers is a resource that is dwindling, because in large part, women are returning to the work force. I think we should look at it in this context rather than as a growing tension.

I am sure there has always been tension between a woman's role toward her children and her aging parents or relatives. Recent changes in the work force, in the economy, and in demographics, however, are increasing this tension.

Continued Health Coverage of the Elderly

MR. MIKKELSON: Deborah [Chollet], with respect to your projection that about 23 percent of retirees and their spouses would have continued health care coverage from an employer plan, to what extent does your modeling take explicit or implicit account of the following negative developments: First, the unfunded nature of most of these health care promises, the associated substantial and growing unfunded liabilities, and the recent spate of adverse court cases that severely restrict employers' flexibility in altering plan design? With these, there is the anticipated FASB [Financial Accounting Standards Board] accounting statement, which will probably be issued by, say, 1988. These developments will have a very chilling impact on the willingness of employers to maintain these plans, at least for prospective generations of pensioners.*

MS. CHOLLET: I agree with you that these probably represent tremendous increased costs to employers. This cost of continuing health insurance plans for retirees in the form that they currently exist—that is, as a service benefit that is automatically indexed—is ex-

* Editor's Note: The Financial Accounting Standards Board is an independent, private authority, which sets general accounting accounting principles.

tremely difficult, if not impossible, to project over a long period of time, whether 20 years or 5 years. Most projections indicate that it may be prohibitively expensive to continue the benefit.

I think on the other side of that constraint, however, is the apparent need for some kind of health insurance assistance to retirees. There are several ways that employers might meet that need. The court cases, the projected cost, and the potential FASB ruling should alert employers to scrutinize their retiree benefits, to come up with possibly more creative ways of assisting retirees to finance health insurance to supplement Medicare and potentially, to pay for long-term care.

These might be a cash benefit to retirees, access to a group health insurance plan, a health insurance plan for acute care, and a health insurance plan for long-term care. Those products have yet to be developed.

It appears that about 15 percent of workers who currently participate in a health insurance plan that continues benefits in retirement would continue those benefits exclusively on a self-pay basis; that is, the employer contribution to insurance terminates at age 65. Those models are out there. We haven't looked at them carefully. We don't have sufficiently detailed data to rely on what industry groups or what establishment sizes they're found in, and we have no idea at this point whether they adequately serve the retirees themselves. It's something we need to look at more carefully.

MR. ROTHER: Deborah, I want to second a part of your conclusion in your paper because I think it is likely to be even more significant in the future than it is today: " . . . For many retirees, the value of continued health coverage benefit may approach or even exceed the value of a pension benefit over time."

Clearly, if health costs continue to escalate at rates greater than costs of living in general, and if we fail to find ways to spread the risk of catastrophic health care costs, I think we may indeed find employees who are more knowledgeable and more interested in maintaining a health benefit after retirement than they are in their pension benefit. I think that has very significant implications, not only for employers but also politically.

MS. CHOLLET: I would like to make one point in response. The kind of benefits that workers demand, I think, will largely rely on the kind of retirement advice that employers give their workers. Retirement planning is something that is given short shrift in many corporations. Many, possibly most, workers are not led to think about retirement income needs, including potentially vast increases in their health care costs, in sufficient time to plan for meeting those needs.

I agree with you that the demand for these kinds of benefits on a rational level probably should be high and growing. I think, in part, it is not as high as it might be, it is not growing as fast as it might be, because workers are not being led to think about retirement early in their working careers. That probably will change.

MR. PAULY: Deborah, I wonder how the health benefits for retirees might be paid for. It is hard to believe that in the long run, they will come out of firm profits. There has been some talk about flexible benefits plans for retirees where, in a sense, retirees pay for themselves by giving up their annuity or their pension or some such thing. If that is the way benefits for retirees are going to be paid for, then to some extent maintenance of health care benefits means less cash income for retirees, and there would need to be an offset. Where are the resources going to be extracted to continue the benefits at this level, or for that matter, where are they extracted now?

MS. CHOLLET: I guess it depends on whether the retirees are themselves paying for it or the workers are paying for it in advance. I think there's every reason to believe that there is pressure for a lot of these payments to come out of current wages and salaries, basically in the form of forced saving that is more or less invisible to the worker. Given the other pressures that are equally important to employers—trade pressures, etc.—this may be possibly the only avenue of funding.

MR. SALISBURY: There are a number of very large, unionized companies that are beginning to advance fund their retiree health benefits, even though there is no tax advantage to do so. They're focusing on the dollar value of those liabilities and what they see as the very unlikely scenario that would allow them to cut back on those benefits through the collective bargaining process.

We have two pieces of work underway that, hopefully, will give a little better view of what that is. One is the piece that Deborah has been doing on the projections of actual cash income retirees will have. Another project, which Milliman & Robertson is doing for us, will be available this year. Their's is more heavily actuarial work, estimating the aggregate liability, and using sensitivity analysis, looking at different work-force structures, ages, and balances of active workers to retirees. They also look at the approaches that can be taken potentially to advance fund those liabilities, including cash-account type approaches, which the Treasury Department in its study mandated by the tax act is going to pay particular attention to. The Treasury staff has not at this point been able to determine how to do this with concepts of vesting involved in a defined benefit type of vehicle, which is the typical way that that protection is now provided.

Income of the Elderly

MR. ATKINS: There are two problems that bother me when we compare the elderly to the nonelderly and draw the conclusion that the elderly are much better off than the nonelderly. I don't disagree that the incomes of the elderly have increased substantially in real terms relative to the rest of the population in recent years. But when we compare the elderly to the nonelderly, particularly looking at poverty rates, what we're really doing is comparing the elderly to children.

There is no question that children have gotten much worse off economically in recent years, as the elderly have gotten somewhat better off. But the elderly in comparison to nonelderly adults are still generally worse off, particularly those cohorts of adults who are the nearest them in age. Anyone from 35 up to 55 or 60 is better off economically than the elderly are, and substantially so.

I think it helps if we compare the elderly first to nonelderly adults and then to children. You get very different results. For instance, the poverty rate among the elderly is 12.4 percent and among nonelderly adults is 11.7 percent. So it still is a lower poverty rate.

The other problem is, a lot of times we're using per capita income measures to compare the elderly to the nonelderly. The nonelderly are in larger households than the elderly are. While it is wrong to compare the incomes of different-sized families without adjusting for family size; for the same reason, it is wrong to compare individuals to individuals independent of the fact that they may live in families, because there are some efficiencies in living with families.

A lot of recent work has taken into account a middle measure, which is essentially a poverty-type adjustment. It adjusts relative to family size but doesn't count each additional individual family as an equal individual in terms of cost of living. I think it is important to consider these kinds of measurements, because we get very, very different results. Looking down the road to see whether or not the elderly are really going to be much better off than the rest of the population, and whether pension income and other sources of income are really going to help out a lot, there are a couple of things that concern me.

One is this. Although pension income is a growing share of the total income that the elderly are going to receive down the road, one of the things you've shown is that even for the best cohort—the cohort retiring in the most distant future—only 63 percent of that group are going to be receiving pension income. So there's still 37 percent of the elderly who are going to be largely dependent upon Social Security and nothing else.

Although your projections show Social Security benefits are going to increase substantially down the road, I am puzzled by that finding for a couple of reasons. One is that the 1983 Social Security Amendments raised the retirement age two years for this cohort and, therefore, presumably lowered benefits paid at any particular age. It is that generation—born after 1935—that will have the most substantial benefit decreases in Social Security relative to the current generation.

The other thing is that the current retired generation has the highest replacement rates we will ever see in Social Security under current law and the best earnings record relative to the rest of society. If you look into the future, you see retiring generations that have had for the last several years real declines in their incomes, and that's part of their earnings records. Over the long term I do not think they will have the kinds of growth in their earnings records that powered increasing benefits for the generation that's just now retiring. So I am a little concerned that we're projecting substantial increases in Social Security down the road as well.

I want to bring this comment to a close by asking two questions. First, given that there are now substantial portions of the elderly population getting only Social Security benefits, and there is a tremendous concentration of elderly in the near-poor category just above the poverty level, how is that distribution of income going to change over the long run? Will we see a growth in pension benefits going to a small percentage of the population with high pension benefits helping to raise the income for the well-off, but leaving this concentration of the elderly just above the poverty level, or even possibly making it worse?

Secondly, what is the effect of the increasing percentage of the oldest old in the elderly population? Given the things that we have seen in the past with the oldest old—that increasing percentages of the oldest old, for instance, are single individuals, mostly single women, surviving into old age without a spouse, and the substantial reductions in income that go along with that—are these going to make a big difference in terms of the well-being of the elderly down the road?

Ms. Chollet: You have given me a lot to respond to. Let me start by talking about your comment on measures of poverty.

I agree that virtually all the summary measures we use are inadequate to describe the elderly. Recently, one author said that the least meaningful statistic applied to the elderly is an average. I would agree that different measures of poverty adjusted for family size, etc. do produce different results. I would not say they're dramatically different results. I would say they're different results at the margin—one or two percentage points, even 10 percentage points. That is a lot of people, but still different results at the margin.

I think the real problem is not in where the poverty line lies, but in the fact that income does not equate to economic security for the elderly, and near poverty is an important problem for the elderly. Their uninsured status with respect to enormous health care costs is something that the nonelderly population does not confront.

The kinds of income projections that we derived from our microsimulation model include all of the legislative changes, the Social Security amendments, all of the demographic projections and the labor force projections of the Department of Labor. The results hinge on those assumptions. They include those assumptions. They also include conservative estimates of real income growth. We used the Social Security alternative III assumptions as opposed to the more optimistic II-B assumptions. So they are, in fact, conservative estimates of what we can expect among future elderly.

My response to your comment is that we did take economic and demographic trends into consideration. We also added assumptions that reflected the Retirement Equity Act. That makes some difference, too. There are relatively few survivors among the elderly at the age at which we are projecting, which is age 67. But, nonetheless, their probability of receiving benefits as a survivor of a pension-covered worker rose substantially.

The old-old are relatively difficult to draw out of our results. The product of the microsimulation model is an individual at age 67. If one wants a snapshot of the oldest-old in the year 2010, the best one could do is look at the cohort of people in the model who were age 55–64 in 1979. Survivors in that group will be among the oldest-old. But what they look like is unknown. We do not know if the survivors will be the pension recipients. Single women at age 67 are some fraction of the women who will be age 85 and single. So it's very difficult to talk about what the oldest-old look like.

One thing I tried to do in the paper is to take a look at the poor in outlying years and what they look like. As a proportion of the elderly, there are fewer poor, but there are more elderly. Therefore, in numbers there are likely to be more poor elderly, although a smaller fraction of the total elderly. I think what is distinct about the elderly—and especially the poor elderly in outlying years—is that they will be more predominantly single women. It appears that women who are single at age 67 will be a larger proportion of the poor elderly in out-years than they are now. I think the numbers range from 74 percent of poor new retirees being single women among the cohort now retiring to 90 percent of poor retirees being single women in the most distant cohort, those beginning retirement in 2010.

Our projections do show a change in composition of the poor. What this portends about the very old, is something we cannot determine.

MS. RAPPAPORT: I have several comments that pick up on some of the things that were said about postretirement medical benefits. Mr. Mikkelsen pointed to employers' dropping plans.

I think we're really at a watershed where we have a choice, probably over the next two to five years, in terms of public policy and accounting policy. And I see that choice as trying to stabilize and turn policy around and make it desirable for employers to keep plans, because I think employers really want to provide financial security for their employees. But if we do not do that, then as was said, I see employers really being driven out of the plans.

So in terms of something that within a very short period of time we can really influence, how much security is going to come from this source over a long period of time, I think we are at a place for action today.

A second point. Deborah talked about retirees paying for these benefits. I caution people to make sure that they've looked closely at the numbers, because I have seen a lot of situations where we said the retiree is paying for it. But what they are paying for is the average cost of health care over the active and retiree population. Many times we think retirees are paying for the coverage but they might really be paying for half of 40 percent. So an employer may be subsidizing and not really recognizing it. There are few retirees today, so it is not a big issue. But there will be more retirees tomorrow. It *will be* a big issue.

The third point I will make relates to cash accounts. I know there's been a lot of discussion about cash accounts. The risks that are inherent in a medical program are very different if you have a program that offers medical reimbursement or an HMO [Health Maintenance Organization] or PPO [Preferred Provided Organization] or a cash account. I think we need to pay a lot of attention to how the risk is split between the employer and the retiree in each of these types of plans, and be careful not to do something that is protective of the retirees' interests in terms of vesting, for example, but at the same time drives people into cash accounts and gives up a lot of the protection that goes with it. There is a lot of concern that we might throw out the baby with the bath water here.

I also encourage people in that regard to think about the possibility of plans that offer not cash accounts only, but medical reimbursement for people who stay to retirement. Maybe if we are going to vest a benefit, a cash account for the early leavers. But, I see a lot of problems with cash accounts from the retiree's point of view and hope that they will not be ignored, because otherwise we may have an increase in the pension benefits that leaves the retiree unable to satisfactorily handle the problem.

MS. CHOLLET: I agree with your concluding comment. We do not know whether cash plans would serve retirees well. The risk in giving retirees access to a service plan and a fixed contribution is that there is no assurance that contribution will be adequate relative to the growing cost of the service plan.

MS. YOUNG: I'm concerned, because it seems to me that in the real world the union worker is beginning to see that benefits that are not protected by law, unvested benefits, can disappear overnight. You can probably talk about this much better than I can.

So even in industries where unions are still strong and not embattled, it would seem very unlikely that this would be a priority now. So you have unions not willing to fight for any form of unvested benefit, which if the world turns around in 10 to 15 years is gone anyway. Employers faced with FASB and no tax benefits will be less likely to think in terms of incurring this type of expense far out, particularly if they are concerned that the more that is developed, the more likelihood that they could be slapped with a law that would require them suddenly to fund that which they really weren't encouraged and, in fact, were largely discouraged to fund. And you add to that the changing demographics, the number of divorced women, so that in the future you may have fewer old women trapped into pensions because these are the same women who are working in service-industry jobs close to home because of their child care problems and are not working in situations where they are likely to be developing their own pensions. Some of them are working part-time. So your numbers seem optimistic.

MS. CHOLLET: Only in the sense that the numbers reflect workers—women who were in the work force in 1979. Yes, they probably do not give a good picture of women who are at the fringe of the work force, who are dropping in and out, who were in fact out in 1979. Although the microsimulation model does allow women to leave the work force and brings them back in with probabilities that we have measured from past data. The numbers include some women who are marginal workers, but not all of them.

MS. YOUNG: Do your probabilities take into consideration the fact that 95 percent of the new jobs are going to be in service industries, which is the least likely to provide benefits?

MS. CHOLLET: Yes, they do.

MR. SALISBURY: But the numbers are also conservative in that we have purposely, in order to try to stay on the conservative end of the equation, used assumptions of no pension coverage growth. In addition, because of the timing of this modeling process, the model uses assumptions on consumption of lump-sum distributions prior to retirement that do not reflect the changes in the Tax Reform Act [of 1986], which are likely to decrease that consumption level prior to retirement by some factor.

The model does not factor in five-year vesting, which should increase the number of individuals that will get something. I underline *something*. But if you combine that something with the greater incentives not to consume what little you are getting as a lump-sum distribution, then we think that there is reason to feel that this ends up being, vis-a-vis the past, a conservative projection.

I underline *the past*. The piece that we have not been able to factor in, and based on the time frames of effective dates of this tax bill, it is going to be some time before we see the true picture, is simply the issue of the degree to which the provisions of this tax bill could cause some number of employers that now do promise pensions to get out of the business of promising pensions. Should that occur to any marked degree, then you end up with that type of a timeline. I add as a footnote that it is not our intent that this study be a be-all or an end-all, or that our view of pension coverage is static. We used the most recent survey we had done, which is the 1983 Current Population Survey, as one of the feed-ins on pension coverage; and we currently are building a reserve to have the Census Bureau redo that data collection for us in late 1988 and, hopefully, on a four-to-five-year cycle thereafter.

So I simply note, we view this as a moving target, but we are trying simply to provide some data for evaluation that is more complete than what otherwise might be there.

MR. CULLINAN: Deborah, it seems a little strange to me that you see as much of an increase in Social Security benefits between the cohorts you examine, particularly because, while you have programmed in the changes in the 1983 Social Security Act, only one phase of the increase in the retirement age will have an effect on the individuals in the simulation. That is, the normal retirement age of these people will be 66, not 67.

First, how that will relate to similar statistics, let's say, for the next cohorts who would be fully affected by the retirement age increase and who are really the bulk of the baby boom? Second, is the growth a reflection of the maturing of the increase in female labor-force participation and married couples getting more in Social Security benefits because fewer of the wives are dependent spouses?

MS. CHOLLET: Yes, that is part of it. With respect to the delay of retirement age and Social Security, it is assumed in this model that real wages rise, albeit slowly. Secondly, with the delay in the retirement age, individuals are one year longer in the work force at peak earnings. That has an impact on the amount they receive from Social Security.

MR. CULLINAN: That is a rather strong assumption.

MS. CHOLLET: Well, in fact, I am not assuming it. It tumbles out of the model. People are or they are not; but on average they are, and that seems to have some impact. I think those two aspects produce the higher rate.

MR. JACKSON: I am impressed with Deborah's figures, because it seems to me that they confirm something I have observed. Never before in my own personal experience have so many old people had so much. Certainly measured in terms of dollars, they have a great deal. They have perhaps less in terms of family support, but at the same time there have never been more people complaining about the deficiencies of the system.

I think one of the problems is we use income as a basic measure, from the point when an individual enters the labor force until that individual's death. If you look each year at the income and the expenditures that are necessary in the course of the individual's lifetime, it seems to me that there have to be some years preceding the individual's old age when the individual is saving, and the saving leads to assets. The elderly are dissavers, and it seems to me this is an element of conservatism that is built into these figures when you're focusing on income, that people have other resources and that the new Tax Reform Act encourages some individuals not to defer income under less tax-favored bases than they had in the past. They will take it as current income, and then the question is, do they spend it immediately? The analysis appears to be based on the assumption that income will obviously be spent, and the individual reaching old age will need an income at least as great as what he had the year before, because his expenses are just as great. I am not discouraged by the process at all. I think we are in better shape than we have ever been.

MS. JONES: At another meeting yesterday on postretirement health benefits, I was struck by the degree to which labor is concerned and wants to make sure that the benefits of their members are protected. They are worried about immediate vesting of health care benefits and do not want to see too many people signing up for jobs in state governments and so on simply to get the benefits that accrue with the job. If they continue to pursue changes in vesting policy, the numbers eligible for benefits in the future, I think, are likely to be less than the numbers you cited today would indicate. There are trade-offs involved in covering large numbers inadequately and limiting the access to benefits but making sure they are adequately prefunded.

MS. CHOLLET: I think it depends a lot on how we decide to finance those benefits in the next several years. We not only have accruing liability, but we have substantial fixed liability for current retirees, and ratios in at least one major corporation of seven retirees to each active worker. Obviously, with generous, unfunded retiree benefits, that firm is in bankruptcy reorganization. In other large corporations, particularly in manufacturing, we are pushing ratios of one-to-one, retirees to current workers. That is an enormous burden for corporations, and they are becoming increasingly aware of it.

In part, the pressure exerted by the ratio of retirees to workers is going to force substantial rethinking and possibly restructuring of the health insurance benefit for retirees. But I think there is also a lot of pressure to retain that benefit in some form. I think the form is likely to change.

MR. SMITH [Harry]: I want to comment on the real world as I see it. I think it is far more stable than we might think. There are many more opportunities out there than we might suspect to handle our problems.

It is true that corporations will respond to their balance sheet. However, I do not think this means that industry is just waiting for a chance to eliminate the burden of retiree medical programs. I don't believe this at all. I think rather they are looking for better methods—better public policy, Larry [Atkins]—to make this easier to handle.

I see other things happening. I see better studies on medical care for the aged, long term care, and so forth. We are also faced with the problems of care for the terminally ill. But business is generally not talking about insuring this at the moment. I find it difficult to think that industry should be asked to provide insurance policies for the lady down the street who admits she is 98 and needs a couple of years in a nursing home.

I see a great stability in what we have. We should keep the good and make it stronger. I hope Congress does something with public policy with respect to taxation. I agree with John Rother that you can have a discussion with the labor union or hourly people on pensions, but you cannot on medical. You have arguments. It is the most emotional subject going.

Industry is not about to drop those plans, but we need better policy efforts to continue them. We need better understanding of what we are doing, and I want to leave on a note of encouragement. We will come out of this very well, and I think we will handle it properly in due course.

PART TWO
EMPLOYEE BENEFITS: WHAT DO EMPLOYEES AND EMPLOYERS EXPECT?

Employee benefits have become an important share of total compensation. Benefits (including those required by federal and state law) represented 35.2 percent of wages and salary in 1985. While average benefit costs have been stabilizing nationally, they still represent a significant slice of the cost of doing business. In Part Two of this book, "Employee Benefits: What Do Employees and Employers Expect?" we examine the extent to which workers understand their benefits and how satisfied they are with them. We also review the attitudes of employers toward providing employee benefits and the reasons they do so.

Because Social Security remains the cornerstone of America's retirement income system, Part Two leads off with an examination of public attitudes and expectations toward the Social Security system. In chapter IV, Florence Skelly first reviews, as a framework, some key elements of social values among the public, then highlights findings from a survey assessing attitudes toward the Social Security system and profiles how today's workers will respond to becoming tomorrow's retirees.

Today's society, says Skelly, reflects a set of values that have contributed to public opinion on any number of issues, including Social Security. There is an increasing commitment to meritocracy—where advancement is based on ability or achievement—an increasing focus on work as the measure of people, and support for a lessened role of government. Although Social Security is assessed favorably by a substantial majority of the public—the most favorably being current retirees—young Americans (those under age 35) do not rely on it as being the major expected source of retirement income. Young workers are counting more and more on employer pensions—possibly because they perceive Social Security benefits as being inadequate. These workers, however, and the majority (9 out of 10) of all workers want the social security system to continue. Finally, Skelly reports that there is a growing widespread attention to, and concern about, retirement income, reflecting a new concern among the public about longer-term issues and the future.

That more workers have health insurance than any other benefit is strongly connected to the fact that they prefer it the most, suggests Matthew Greenwald in chapter V. Group health insurance is perceived to be critical, and employees know more about their health insurance than other benefits. Employers, too, clearly sense the importance employees place on health insurance—those with larger companies consider it the most important benefit they offer. Although employees are increasingly asked to assume a greater share of the cost of these benefits, this has not diminished the strongly positive feelings toward the benefit itself. But, employees are generally reluctant to accept changes in their health care plan even to help contain health care costs. They understand and are concerned about the rising cost of health care, but they would prefer to pay more rather than accept lower benefits, says Greenwald. Cost is a problem employees want solved but they are not in a rush to solve it themselves.

A concern for those advocating the popularity of cafeteria plans is Greenwald's finding that some studies report employees are not eager for choices. This could be because they are generally not well informed about their benefits, the benefits package is often complex, and the costs difficult to understand, says Greenwald. "Thus, for some employees the provision of choices raises some difficult issues that they would almost rather not address."

Health insurance in the future is likely to focus on postretirement health benefits, predicts Greenwald. The public generally misunderstands what is needed in health care expenses at older ages. The current working generation has an optimism about their financial futures that "may not fit well with what awaits them." Public and private benefits policy will need to address health care for retirees with these attitudes in mind. A number of surveys have indicated that employees may be willing to contribute to a health plan that would cover long-term care expenses after retirement if the employer matched the contributions. But, there is a higher level of interest in the health care individual retirement account (IRA) concept. It would be desirable, says Greenwald, for individuals to prefund a good portion of their health and long-term care costs in retirement. In this regard, employer plans offer a number of advantages. Employees like their health benefits and have indicated a willingness to pay more to maintain or add benefits, which is crucial because more cost sharing for long-term and retiree health care seem necessary. Also, the cost of communicating and marketing to people at the work place is easier than on an individual basis.

In chapter VI, John Parkington responds to the often asked question: Do employees understand their benefits? Are employees satisfied with their benefits? What kinds of changes do employees want? Why do employers provide benefits? In general, Parkington finds employees cannot effectively articulate descriptions of benefits they have. Employees expect, however, a reliable company source to explain their benefits. Employee satisfaction with benefit programs as a whole has declined—17 percentage points over the last decade and a half, based on a data base of 300,000 employees. The benefits that have experienced the greatest downturns are those that cost the most—health and pension benefits. Why? Employees say that now more employee contributions are required, benefit coverage is sometimes limited, the process of using benefits has become more complex, and benefits are not fitting demographic needs. Employees generally do not want to change their benefit programs, but some are open to choice. IRAs, Keogh and 401(k) plans, and wellness programs have all contributed to the independence of workers, to the mindset that they must take care of themselves.

A 1986 study by Buck Consultants found that 70 percent of workers would pay more out of pocket if their benefits could be restructured to fit their personal needs, a finding similar to Greenwald's observation that people will pay more for their health care than accept reduced coverage.

Parkington finds that employers provide benefits to attract and retain valued employees, provide for the economic security of employees, and facilitate employee relations. In a survey of corporate executives, very few believed that benefits improve productivity. Even fewer claim their company sponsors employee benefits because of the tax deductibility of benefit costs or because of the tax effectiveness of benefits relative to direct compensation.

Although pension and health benefits are those that employees have become the least satisfied with, larger employers rank them the most important benefits they offer. Although some employers would decrease company contributions to retirement plans if tax preferences were reduced, the majority would maintain their current plan.

Company size is directly correlated to a number of considerations in maintaining a benefit plan: the level of sophistication and staffing in the benefits division; the ability to fund different levels of coverage; the extent to which employers shop for coverage and consulting services; the role employee benefits are perceived to play in attracting and retaining employees; and the degree of flexibility in benefits that can be offered to employees.

A recent series of group interviews with small business owners on retirement plans found that they were financially unsophisticated, unaware of the different types of plans, and wary of the paperwork involved.

IV. A Report Card on Social Security: How Employees Feel about the System

REMARKS OF FLORENCE R. SKELLY

I have divided my remarks into three parts. First, I will give you a very brief encapsulated overview of some key elements in the current social climate, the social values among the public. Then I will briefly highlight the findings that were developed from a survey among the population assessing the Social Security system some 50 years after its birth. Third, I will say some things about the future.

Overview

If you can consider the 1950s as a period when national economic growth was our focus under an umbrella of supreme confidence, and if you look at the sixties and seventies as decades when the country pursued a social agenda, a fix-society agenda, our environment, our workplace, our minorities, our poor, our rigid lifestyles, etc.—all under a psychology of affluence—then now, the eighties, can possibly be characterized as the era of the strategic, competitive, pragmatic individual under a sense of limits.

People are more competitive, focused on getting what is theirs, or what they think is theirs, more disinterested in the overall problems of society. They are not ideological in a sense of worrying about what is right, but more pragmatic in thinking about what works for them.

Some subthemes that are relevant: First, there is a more restrictive tolerance for pluralism, although we are still struggling toward a workable pluralism. Second, there is a strong commitment to meritocracy, which is, of course, leading to a two-tiered society. Third, there is an increasingly "beat the system" orientation. This is true in every aspect of American life. Fourth, there is a rise in concern about the future, which is relevant to our discussion today. Fifth, there is an increasing focus on work as the measure of people, not leisure. We do not give our astrological signs and hobbies at cocktail parties, but instead tell what we do for a living. The focus on work has led to a sense of widespread stress and time constraints which, in turn, has in a sense led to openness to all sorts of low-cost shots in the arm, which is fueling lots of markets and deflecting people from paying attention to some of the issues that confront them.

Important to our discussion today is the sixth subtheme, which is a blurring of age groups. We have all commented on the aging of the population. What is more fascinating from an attitude point of view is: Marketers have a very hard time now marketing to either a youth market—there are not enough of them—or to a middle age versus an elderly market, because even people who are 60 do not know why they should use a different kind of shampoo from people under 40. So there is much more blurring of age groups that we find now. The seventh subtheme is support for a lessened role for government.

So that is the context. Those are some of the themes and values that seem to be permeating our culture and are on the rise. In such a framework, what have we learned about how Americans view the Social Security System?

Assessing the Social Security System

First, not surprisingly, Social Security is assessed favorably by a substantial majority. A large majority would elect to stay with it if they had options. Most people cannot imagine being without it.

The most favorably disposed are the currently retired. I think it's important to remember *when* the currently retired were acculturated, the period during which they grew up. These are people who felt the impact of the Depression during their formative years. Their ideas about what an adequate standard of living is, about what is necessity versus luxury, have been shaped by that experience.

Among a majority of this group of retired, Social Security is a primary source of income. Only 16 percent claim to be in hardship. I guess that is sort of similar to your 12 percent poverty figure. Eighty percent say they are okay, about half of those saying they are just getting by. Among those retireds who are better off, having higher income, living well in retirement, Social Security is not the main source of income. Company pensions are. That is important, not so much for what it says about the current retireds and about Social Security, but because of what it tells working Americans about how retireds live.

Eight of 10 Americans know people on Social Security and know retired people. What about the working Americans, those who are not retired yet? How do they feel about Social Security?

First of all, even with the flaws, and there are flaws, about 9 out of 10 Americans want the Social Security system to continue. Why do young Americans, those under 35, who resent every moment that an elderly person draws a Social Security check—want the system to go on, even though they themselves have doubts about what they will get when they retire, and at best feel that the lifestyle it will give them is less than adequate? I call the reason the "dreaded mother-in-law" syndrome. Putting it as humanistically as I can, they do not want the system necessarily to go on only for themselves in their old age, but they would like anything to go on that would offset the possible incursion into their lives of the dreaded mother-in-law. I have described it humorously, but I think that they see it as a way of absolving themselves, to some extent, of responsibilities that they might otherwise face, perhaps in a sense more rigorously than if there were no Social Security.

Older working Americans, those in the 45-to-64 age cohort, are counting on Social Security to a substantial degree for their retirement, although here, too, it is by no means the major expected source, as it is for so many currently retired.

I said the word flaws, and the major flaws that people see in the system is the inadequacy of current payments. It's not the inadequacy of payments anticipated when the population gets lopsided, but the inadequacy of payments now. I think this concern about adequacy reflects two phenomena.

First, ideas about what an adequate lifestyle for older people means. I mentioned that the current retireds were acculturated during the Depression, that their ideas about adequacy were colored by that experience, and that they have a high level of satisfaction with Social Security payments. Current working Americans, among whom the boomers are a major cohort, were acculturated during times of economic vitality during the psychology of affluence. Their perceptions about adequacy are more demanding. They know people on Social Security, and they do not like what they see. That is one element in the flaw that is seen in the Social Security payments.

The second element deals with ideas about what Social Security should do. Social Security, according to Franklin Roosevelt himself, was initially envisioned as a barebones economic floor for the retired. Over the past 50 years it has come to be seen not as a floor but as the whole house in terms of providing for retirement. Seventy-one percent feel that Social Security should provide an adequate or better standard of living for retireds. The flaw emerges because only 38 percent see Social Security as providing such an adequate living.

What are Americans doing about this? First, there is widespread reported attention and concern about retirement income, even among those under 35. This is a relatively new phenomenon. I think Matt Greenwald can attest to that. And it reflects the sense of limits that is permeating our country now. So we see more concern about the future, as I mentioned, and more concern about longer-term issues.

Social Security is seen as a piece of a package. Exceeding Social Security as an expected source of retirement income are company pension plans. Six out of 10 workers report being in such plans. Investments, savings, IRAs, and Keoghs are also part of the mix. More than Social Security, workers are looking to pension plans in a major way for a secure future, although they certainly want Social Security to continue to help with their own retirement income and to avoid the dread mother-in-law syndrome.

Future Retirement Planning

What about the future? A few elements in the current climate are troublesome when one thinks about how Americans will fare some 25 to 30 years from now when they are retired. Let us look at their current retirement thinking in the light of these elements.

One third of them are planning to use savings, investments, etc., as a major source of retirement income. Yet their ideas about what an adequate lifestyle is, reflecting the affluence during which they were acculturated, apply to the here-and-now as well as to retirement. By their own admission, they are having a very hard time putting money aside. Consumer debt continues to rise. Real income is level. The wife has already been leveraged in over 50 percent of households, and the effects of tax reform are still not clear.

So I think that we need to look at what they are saying against some realities. About 28 percent are planning to use company pensions as a major source. You have to speculate about this one as well, and I am not talking about what managements would like to do, but some cold, hard realities.

The pragmatic, competitive, strategic, difficult climate I mentioned earlier applies to business as well. Eighty-four percent of chief executive officers (CEOs) in a cross-section of Fortune 1,000 companies feel that they are operating in flat, no-growth industries, still committed to increasing margins and profits. Their focus continues to be on cost cutting, although, of course, that is not their major focus. But cost cutting is now a way of life. Medical benefits are being cut. Pension fund contributions are being looked at. Mergers and acquisitions not only provide a rationale for getting lean and mean in personnel terms; they also enable rethinking of every cost item.

So when you think about it, there are some compelling pressures on the pension plan system, certainly nothing to suggest that there will be increasing contributions made over the ensuing future.

Social Security is looked to as a major source of retirement income by 23 percent, and there is reason to believe that these payments may be less adequate in the future than now, based on the future lopsidedness of the labor force vis-a-vis the retired.

I guess these issues, put together, would make one worry a little about how—as everybody says—how real human beings will be living about 25 to 35 years from now.

I cannot end on a pessimistic note, however, because there are these elements: There is this blurring of age differences, which I mentioned earlier, and it is reflected, in part, in the vigor and vitality of older people. I think you can count on the fact that they will want to be active longer. There is a large proportion of older people opposed to mandatory retirement. They fear *being* the dreaded mother-in-law as much as young people fear the dreaded mother-in-law arrival. In a recent study among Harvard/Stamford alumni that we conducted—and, granted, they are the intellectually elite of our country—close to 70 percent said that they would never consider retiring at the age of 65. They do not know when. I guess they die in their boots.

The groups that want to retire are in the production sector. That is where you get the high interest in retirement. Most people fear retirement. With exposure to retireds, there has been a lot of evidence that people who are retired have fights with their spouses, and very often get sicker than when they were working. So I think that you can expect that there will be a gradual interest in people working longer, not because they are being compelled to by the government, but because they will find their lives are better. They will make certain kinds of adaptations, but study after study shows there is an interest in continuing to be active, to blur age differences for longer periods of time. This may in fact reduce some of the economic strain on the society of a very large cohort of retireds against a relatively small cohort of workers.

As far as company benefits are concerned in this pragmatic era, with the widespread recognition of the retirement issue, what may happen is not that employers will reduce their contributions, but rather cap them. And in turn, there may be a far greater receptivity of the working labor force to forced savings programs, products yet uninvented. Employees want a stake in the future. They are concerned about the future. They are having a very hard time doing it on their own, and there may be ways of utilizing this new individualism, this new strategic pragmatic, "I'll-do-it-my-own-way," through products in which the employer benefit or contribution is not necessarily increased, but where the employee's contribution takes the form of forced saving.

These are factors that reflect the social values of this period more than they are informed modeling of the future. But they certainly would tap into some of the social climate issues that are permeating the culture today.

V. Health Insurance: The "Crucial" Employee Benefit

PAPER BY MATTHEW H. GREENWALD

This paper examines two sets of attitudes relating to group health insurance benefits—attitudes about benefits that people get while working and attitudes about postretirement health benefits. With these attitudes as background the final part of the paper addresses how benefits are likely to change in the future.

Employee Attitudes about Health Insurance

It is fairly easy to describe employee attitudes about health insurance. There is a simple reason why more employees have health insurance than any other benefit. It is the one they prefer most. Health benefit plans have two attributes that separate them, in the minds of employees, from all other benefit plans—they are perceived as essential far more than other benefits and they are thought to be difficult, if not impossible, for people to buy individually, while other types of benefits are seen as easy to buy. I do not mean to imply that pensions, group life insurance, and vacations are not thought to be important. They are. But group health insurance is thought to be more than important, it is perceived to be crucial.

Let me offer some empirical support for my conclusions. When I was director of Social Research for the American Council of Life Insurance, we asked The Roper Organization to conduct a survey of attitudes toward employee benefits. The study was conducted in 1984. We found that 93 percent of those with health insurance considered it very important. A lower proportion of those with pensions or group life insurance said they considered those benefits to be very important. Seventy-nine percent of those with employer-sponsored health insurance said it added "a lot" to their feeling of security, again considerably more than felt that way about the other benefits tested. Finally, and perhaps most importantly, 61 percent of those with health insurance believed it would be very difficult for them to afford to buy health insurance on their own, and another 27 percent felt it would be somewhat difficult. A 1984 Yankelovich, Skelly and White survey found that only 6 percent of the public disagreed with the statement, "The price of health insurance is getting too high for the average family to afford." These feelings of the essential nature of health insurance and the extremely strong dependence on the employer to provide it colors all attitudes toward this benefit.

Recently, The Roper Organization asked employees which two benefits they would like to add to the benefits they already receive. Obviously most employees could not say they would like to add health insurance because they already have it. Automatic cost-of-living adjustments were selected most often, an indication, at least, that the public does not think that inflation is totally dead. But dental insurance was selected second most frequently. This was the most preferred noncash benefit that people wished to add. Dental insurance is, of course, a close extension of health insurance and therefore its popularity is a testament to the favorability toward health insurance.

Employee knowledge of their health benefits is another key aspect of the configuration of attitudes. Employees may not know as much as they should about their benefits, but they know more about their health insurance than about any other benefit. There is, of course, a simple reason for this. People "use" their health insurance while they are working in ways they do not use, if they are lucky, their pension, their life insurance, or their disability insurance.

Employers clearly sense the importance their employees place on health insurance. I conducted a survey of small business owners and found that many did not believe that their employees strongly valued a pension plan. Perhaps these employees had a short time perspective or did not think they would be with the company long enough to vest. But that short time perspective did not prevent them, according to their employers, from very strongly valuing their health benefit.

In larger companies employers also consider health insurance to be the most important benefit they offer. The Roper Organization conducted a survey of CEOs for the American Council of Life Insurance in 1984. The smallest company surveyed had 100 employees and some of the largest companies in the country were included in the study. When asked to name the three most important benefits they offered, in terms of attracting and keeping employees, 97 percent mentioned health insurance. The next most frequently mentioned benefit was pensions, listed by just over half of the proportion who mentioned health insurance.

As you know, employees have been asked to take a greater share of the financial cost of these benefits. This has had a perceptible impact on attitudes. But it has not diminished the strongly positive feelings toward the benefit itself. A good deal of the blame for the rising costs have fallen not on the employer but on health insurance companies. Surveys conducted by Yankelovich, Skelly and White and The Roper Organization found that the proportion of the public who feel that health insurance companies give people their money's worth declined from 37 percent in 1981 to 22 percent in 1985.

Although the public in general and employees specifically are concerned about the rising cost of health care their favored solution is to pay more rather than accept lower benefits. They are lukewarm at best about any changes in their benefit plans that would help hold down the cost of health care. Only a little more than half of the public agrees with the following statement, "If there are different ways of treating someone who is sick, all of which provide reasonable care, then health insurance programs should provide incentives to encourage people to choose the least expensive program." On the face of it that seems to be a reasonable statement, one that is hard to quibble with. It suggests providing incentives rather than forcing people into a specific mode of treatment. It specifies that reasonable care would be provided no matter what. Yet only 54 percent agree with it—a sign of resistance to change. Similarly, only half of the public say they are willing to participate in a PPO arrangement to reduce health care costs. HMOs have won increased enrollment. Yet, again, strong majorities prefer their current health insurance arrangements, despite the lower costs commonly available in HMOs.

Thus, in another way the public, and employees in particular, are saying that they like their health insurance the way it is. Cost is a problem that people would like solved. But, as in many other areas, they are not in a rush to solve it themselves.

There has been a good deal of discussion about cafeteria plans and the issue of choice in employee benefits. It is easy to assume that employees would almost by reflex be "prochoice," to borrow a phrase from another context. After all, choice seems to be a social good. But I have seen some studies that show employees are not eager for choices. Employees generally are not well informed about their benefits. The elements in the package are often complex, their costs difficult to understand. Thus, for some employees the provision of choices raises some difficult issues that they would almost rather not address. I am not suggesting that people are against flexibility in benefits. Families and lifestyles have changed faster than benefits, and some adjustment is inevitable. But it seems to me the positive disposition of employees toward their health benefits makes them *open* to change rather than *seekers* of change. And for a significant minority, resistance to change and flexibility will be high.

Attitudes toward Postretirement Health Benefits

Let me now shift to the subject of attitudes toward postretirement health benefits. This is an easy area to cover because, basically, there are no employee attitudes toward this subject, and employer attitudes can be described in six words—"they want to keep costs down."

Employees have not thought much about postretirement health benefits for three basic reasons. First, there is a vast overestimate of what Medicare covers. Many people believe that Medicare insures against just about everything, including nursing home expenses. Second, there has been a rapid movement toward the sense that individuals should be responsible for their financial obligations, including expenses in old age. The individual retirement account, it seems to me, played an important role in reinforcing that point of view. This value on self-reliance points away from employer-provided as well as government-provided benefits. Third, people greatly overestimate their financial situation in retirement.

This last overestimate is the product of a combination of misunderstandings, wishful thinking, and lack of knowledge. National Research, Inc. conducted a survey of people ages 50–64 for the American Council of Life Insurance in 1984. This group, reasonably close to or at the age at which many Americans retire, should be better informed than younger people about what to expect in the older years. However, this group underestimates what their life expectancy will be and, based on historic retirement patterns, seriously overestimates the degree to which they will work after age 65. Hence, their estimate of the length of the retirement period they will have to fund is far too short. These preretirees are, by and large, not concerned about their ability to meet their basic expenses in retirement, but they are concerned about the financial impact of unexpected events, such as a major illness or other catastrophe.

These views make postretirement health care benefits less salient than a number of other issues. Of course, the cost of these benefits could be immense, which makes them somewhat unpopular among employers, especially if employees will not appreciate them now.

The current working generation's optimism about their financial futures may not fit well with what awaits them. Life expectancy is increasing significantly, especially at the older ages. As people live longer the health profile of the elderly actually worsens. That is because increased life expectancy puts more and more people into the sickness years, especially after age 85, when the incidence of chronic disease rises rapidly.

New medical technologies are likely to raise the cost of medical care at the older ages and to raise life expectancy still further, but it is less likely to reduce the incidence of chronic illness at old-old age. As this occurs the average age of retirement continues to come down. Many people expected the extremely high inflation we experienced recently to reverse the movement to early retirement. It was reasoned that people would postpone retirement out of the fear that inflation would seriously erode the value of their savings for retirement. However, that factor was not forceful enough to push the retirement age back up. With retirement before age 65 continuing to be prevalent and life expectancy going up, the time spent in retirement is going up significantly.

With older Americans facing longer retirements, worse health, and higher health care costs in retirement, some of the main supports of the unhealthy old are withering. Families used to be an extremely important provider of support for the elderly. But a variety of factors are reducing that. The increasing tendency of women, the main caregivers, to work makes it more difficult for them to care for elderly parents. Also attitudes about caring and supporting older parents have changed considerably. I have done a good deal of research on the issue of familial responsibility across the generations. To an extent, the issue can be summarized by the remark of a 50-year-old man I interviewed in Atlanta who said, "To my Dad, leaving money behind to his children was extremely important to his feeling of self-esteem. He felt better about himself because he could leave an estate. I don't feel that need at all. Just putting my kids through college was quite a burden. Now, I would prefer to spend my last dollar on my last day on this earth." Increasingly, the elderly wish to make it on their own with no financial help and are not disturbed about spending all their money to maintain this independence.

Medicare is another principal financial support for the unhealthy old. But its financial difficulties are apparent. Medicare beneficiaries are already paying a greater proportion of their health care costs than they were a few years ago. A combination of the aging of society and the development of new and expensive medical techniques and technologies makes future economic difficulties inevitable. Indeed, the system is projected to become "bankrupt" in the 1990s.

Overall then, we have a working population that considers health insurance for current health problems to be very important, but is not very concerned about buying private health insurance now for their retirement years.

A number of insurance companies have tested consumer interest in long-term care insurance. The results to date have not been very encouraging. Slow sales are an indication of some reluctance to prepare for an future insurable health-related event with a fairly high likelihood of occurring.

Future Changes in Benefits

Considering the current configuration of attitudes toward health benefits and the growing problems of paying for the health care needs of the elderly, how are benefits likely to change? Some survey work has been conducted on interest in various methods of accumulating funds for long-term care expenses, and the results are instructive. In a number of surveys employees have indicated reasonably high levels of willingness to contribute to a health insurance plan that would cover long-term care expenses after retirement, if the employer matched the contribution. But there is a higher level of interest in the health IRA concept, in which tax-deductible contributions could be made into a fund that would cover health care and long-term care services in retirement.

This preference is of interest for a few reasons. From a strictly financial perspective, an employee-employer match is preferable to a tax-deductible contribution for every employee paying a marginal tax rate of less than 50 percent. That now includes most people and will soon include everybody. Second, the matching plan would cover health care and disability costs through a sharing of the risk. To my mind that is the most efficient and lowest cost way of covering a group. The IRA proposal would use an accumulation approach, with the accumulated funds not spent on health care or long-term care going to heirs.

Thus, considering tax implications, employees have a preference for an approach to prefunding health care costs in retirement that would cost more in actual after-tax dollars and would require a higher level of accumulation than a program that allowed for a sharing of the risk. These results are a testament, it seems to me, to the desire to control finances, a preference for self-reliance, rather than reliance on the employer and a continued feeling that one should "save for retirement" rather than use an insurance and annuity approach that would provide financial security in retirement at lower cost through the sharing of risk.

Clearly, more funds are going to have to be set aside for the health care of older Americans. The question is, how? Given the set of attitudes described in this paper, employer health benefits are very promising. When it comes to insurance for current health care expenses, employees like things just as they are. If costs go up, they will pay more, as long as their current set of benefits is maintained. There is not a strong demand, as I see it, for greater choice in benefits. But there is enough openness to it for the movement toward cafeteria benefits to continue.

When it comes to health care costs in the future, the picture becomes more difficult. The public likes the concept of a health IRA best. But a fairly small minority of those eligible have contributed to regular IRAs. With the further complication that many people believe that Medicare pays for almost all health care costs in old age, contributions to health IRAs would not be universal, even if the Treasury could afford the cost of the tax deductions. Requiring employers to extend the health insurance of their employees into retirement would not be too popular. Only a small number of employers now provide that type of coverage, and their unfunded liability is staggering. Some of those employers are attempting to retract their coverage. So, movement in the other direction will not be taken without a struggle.

Medicare could be expanded and, indeed, is under pressure to. But considering that it will not be easy for the system to meet its current set of commitments in an aging and technologically advancing society, greater dependence on Medicare alone is not a good long-term strategy. Of course, the old are paying more for their health care and could continue to take on an increasing burden. But with increasing longevity and growing risks of expensive chronic illnesses, such as Alzheimers, many will not be up to the challenge.

It will, of course, be desirable for people to prefund a good part of the health care and long-term care costs for their later years. In this regard, the employer group mechanism offers a number of advantages. Employees like their benefits. It is easier to attach elements to a package people like than to start afresh. Employees have indicated a willingness to pay more to maintain or add benefits. (This is crucial because more cost sharing by employees for benefits in the retirement period seems necessary.) The cost of communicating and marketing to people at the work site is easier than to sell to people on an individual basis. As the movement toward greater choice and cafeteria benefits continues, benefits that cover insurance for health care and long-term care costs could easily be put on the list.

These benefits would have to be designed carefully. Incentives for use of less expensive care, such as home health care rather than nursing home care would help. Various methods of allowing employees the privilege of buying extensions to group health insurance coverages could be developed. Tax advantages to employer and employee also would be extremely important.

Obviously, much needs to be done to correct misperceptions about Medicare and to inform people about the health care and long-term care cost risks they face in their later years. But using the employer group mechanism to prefund or insure for these risks appears, based on the current configuration of attitudes, very promising and perhaps the most appealing of the choices available.

VI. Employee and Employer Expectations for Benefits: Changes in the Years Ahead

PAPER BY JOHN J. PARKINGTON

There is no doubt that we have all worked hard at our jobs as employee benefits executives, insurers, consultants, legislators, and providers. But what are employees' and employers' (i.e., the taxpayers') views on benefits? Are these groups ready for the changes that are in the wind for benefits, and what are some likely demands that they may place on us over the next several years?

When I was asked to summarize the results of my research experience and a multitude of other survey research on this subject, I thought it a unique opportunity to develop a picture from what otherwise resembled a connect-a-dot profile without the lines drawn in. Interestingly, the research from various sources is reasonably consistent on a number of points.

The Employee Perspective

When considering the employee perspective several questions come to mind.

1. Do employees understand their benefits?
2. Are employees satisfied with their benefits?
3. Do employees understand the ramifications of the new tax legislation? Are they capable of understanding the new law?
4. What kind of change do employees want in their programs?

First, from the Opinion Research Corporation (ORC) data base, we know that when you ask employees of any job level to rank a variety of work values, the ones that consistently head the list are pay and benefits. It is *not* that everything else about work is not valued, merely that everything else is valued *less*.

When you ask employees whether they understand their benefits, however, we find mixed signals. The answer is generally, "No, but that's not necessarily a problem if, . . ." A good way to illustrate this issue is with a case study. The CEO of a large privately-held company with a very rich benefit package asked us to evaluate what he perceived to be a problem—employees' lack of understanding of their benefits. Indeed, we found that employees could not effectively articulate descriptions of the benefits that they have and how they work, particularly for their pension benefits. They had difficulty even naming all of them. For these employees, however, being able to recite their benefits chapter and verse was not only *not possible*, but also *undesirable* from their viewpoint.

What these employees expected, however, was a reliable company source, in particular a person who could guide them through the steps and paperwork with a high degree of confidentiality as the need to use benefits arose. This is a consistent finding across my studies, and I suspect that it fits with your experiences.

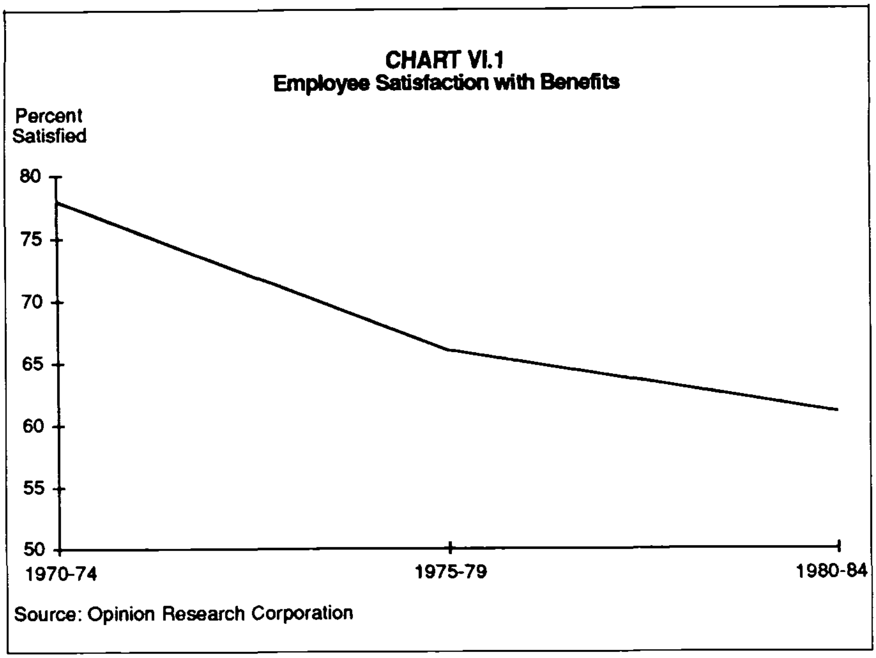
The issue of understanding is, in my view, a bit more critical as we migrate employees into flexible programs. There is a real need to insure that employees understand what they are selecting when handed a menu. However, I find that their understanding levels will generally peak at enrollment time and drop thereafter until they need to use their plans.

In terms of satisfaction with benefits, the ORC data base indicates that satisfaction with employee benefit programs as a whole has actually *declined 17 percentage points* over the last decade and a half (chart VI.1).

Turning to specific benefits, the latest ORC data base shows figures for employees' satisfaction ratings of benefits as well as the percentage point change since the early 1970s. The benefits that have incurred the largest downturns in satisfaction ratings are those that cost the most, in particular, health and pension benefits. When employees are queried about trends such as these, they offer a number of explanations for the changes.

1. Employee contribution levels for benefits have been initiated in many instances and increased in others.
2. Benefit coverages in some instances have been limited, and the process for using benefits has become more complex (e.g., the requirement for precertification).
3. Many traditional plans simply do not fit the demographic configuration of many employees' households (e.g., single persons vs. married individuals).
4. Employee confusion surrounding asset reversions in some companies, concerns over the solvency of the Social Security system, and the perennial complaint about Social Security offsets to pension benefits.

These last comments about pensions are supported to some extent from other survey efforts. The 1985 Yankelovich survey on the public's



attitudes toward Social Security showed that, while 96 percent of the public feel that Social Security is an important government program and 78 percent believe that most people's financial position would be worse off without Social Security, 66 percent of nonretired Americans think that Social Security payments are not likely to be available once they retire.

Two other 1985 surveys found that few Americans expect Social Security to be the major source of their retirement income: Hamilton & Staff (15 percent of the sample) and Harris (25 percent of the sample). In fact, 24 percent of the Harris sample predicted that Social Security will play *no* role at all.

A 1986 ECFC [Employers Council on Flexible Compensation] survey on retirement benefits with a national probability sample of the American public found that a significantly greater percentage of respondents felt today that *they* must carry more of the responsibility to provide for their retirement than they felt they did five years ago. In their minds, the shift in the burden has been from government to self. This was more often the case for those persons who were 35 years old or less.

Most of the public (73 percent) in the 1985 Yankelovich survey said that they would remain in the Social Security system even if they could opt out; but from my research this is probably because most of the public are not sufficiently astute from a financial point of view to initiate their own retirement savings and investment programs.

Despite the fact that we have succeeded in convincing the public that IRAs are "good deals," as evidenced by reports of the growing volume of investments and number of people participating, and that more and more workers are participating in 401(k) plans—roughly 20 million U.S. workers according to ECFC—we have taken legislative measures to restrict the use of these "easy-to-understand-and-participate-in" and publicly "appealing" capital accumulation vehicles.

I submit to you that someone is facing a substantial "sales job" with employees to modify their present mindset. For those who will be adversely affected by the legislative changes in tax-deferred savings plans, the "sale" will involve convincing, motivating, and educating these persons to the value of continued savings and to the alternatives that are available to them.

Once employees are made aware of the tax-favored status of employee benefits, most research shows that employees do not wish to see them taxed. The following table presents results from various surveys to the question of taxing benefits.

Survey	Favor Tax on Benefits	Oppose Tax on Benefits	
Roper, 1984	15%	77%	
NBC, 1985	33%	57%	
Harris, 1985	30%	62%	(to reduce deficit)
	53%	40%	(to reduce tax rates)
Hamilton & Staff, 1985	33%	56%	

In terms of the new tax legislation, it is unlikely that employees as a whole have any idea what the ramifications of the legislation will be for them personally. In the Hamilton & Staff survey, 56 percent of American workers did not even know that employee benefits are tax-exempt—not a surprising finding in my experience. It is likely that employees will not have an informed position on the legislation until they file their next few tax returns. And then their position is likely to be based on a global assessment of the amount of taxes they paid for 1985 vs. 1986 vs. 1987.

When asked, employees generally want change in their employee benefit programs. But the kind of change they most often talk about is not more benefits; rather, employees want choice. Through programs like IRAs, Keoghs, 401(k)s, wellness programs and an emphasis on pay for performance, government and private industry have created a mindset among American workers that the time has come for *them* to take care of *themselves*.

Although this has not always been directly articulated in employee benefit research, this concept becomes manifest in the stated desire of employees to have a voice in shaping their employer-sponsored benefits. A 1986 study by Buck Consultants found that 70 percent of Americans would pay more out-of-pocket for choice in configuring benefits to fit their personal needs.

The Employer Perspective

Perhaps the initial point that should be addressed is the basic reasons that employers offer benefits in the first place and what role employers see benefits playing in the work place.

In a 1985 Wyatt survey conducted with a nationally projectable sample of corporate benefit executives, we found that the primary reasons that employers sponsor employee benefit plans are:

1. to attract and to retain valued human resources;
2. to provide for the economic security of employees; and
3. to facilitate employee relations.

These results parallel those in 1984 studies of CEOs by Roper and Mercer-Meidinger. Very few corporate executives believe that benefits improve productivity. Even fewer claim their company sponsors employee benefits because of the tax deductibility of benefit costs or because of the tax effectiveness of benefits relative to direct compensation for employees.

There are a number of salient issues among employers. At best, I can only touch on a few. The points that I will cover concern findings from my work and that of others regarding:

1. the posture of employers of different sizes on benefits;
2. opinions among the smallest of employers on retirement benefits;
3. whether and how employers use employee input;
4. the changing nature of the relationship between employers and health care providers; and
5. views among employers on the tax-favored status of benefits and the consequences of eliminating that status.

Since most of the research on these issues has been proprietary, I can, in some instances, address only general conclusions from a compilation of studies, as opposed to individual projects, that will not violate client relationships.

From my research, the employer market for benefits is divided into six strata: under 100 lives, 100–250 lives, 250–500 lives, 500–1,000 lives, 1,000–5,000 lives, and those employers with more than 5,000 employees. This stratification is based on the positive correlation between company size and the following criteria:

1. employers' level of sophistication and staffing in the employee benefit area;
2. employers' ability to fund different levels of coverage;
3. the importance of the role that employee benefits is perceived to play in attracting and retaining human resources;
4. the extent to which employers shop for coverage and consulting services; and
5. the degree of flexibility in benefits that can be offered to employees.

It is important to be mindful of these differences from legislative, marketing, and service delivery vantage points.

AARP [American Association of Retired Persons] and EBRI sponsored a study earlier this year on retirement benefits for the small employer—those with fewer than 50 lives. A majority of U.S. employers have fewer than 50 employees, although they do not collectively employ a majority of the work force. Our task was to conduct a series of group interviews with small business owners and managers around the country who do and do not offer retirement benefits to their work forces. My expectations were that affordability and availability of retirement plans would be principal discriminators between those who did and did not provide plans.

To my surprise, these did not regularly surface as salient issues, although it was clear that affordability is a concern. Many of the small business owners that we interviewed claimed to have been frightened away from retirement plans by insurance agents promoting expensive annuity and life insurance programs. What did emerge from the interviews was a strong sense that small business owners and managers, like most of the public, are financially unsophisticated, wary of paperwork and government red tape associated with retirement plans, and unaware of simplified employee pensions [SEPs], although positively intrigued by the SEP concept.

In terms of employee input, there appears to have been a shift in the way management uses information garnered from a variety of upward communication vehicles. In a 1986 Wyatt survey of more than 1,200 corporate executives, we found a pronounced increase in the *actual* use that executives' say they make of employee input as compared with their posture five years ago.

How Employee Input Is Used	Percent Today	Percent 5 Years Ago
As input before making major policy decisions	19%	6%
As input for implementing major policy decisions	27	13
Simply to keep in touch with employees' opinions	47	69

Not only did these executives report listening *and* using employee input, but large numbers of them reported providing input on pay and benefits to employees through structured vehicles in addition to SPDs [summary plan descriptions]: 76 percent reported they give employees a personnel handbook; 62 percent said they publish annual benefit statements; and 15 percent told us that they provide reference materials on their pay systems to employees. Although employees are generally not too worried about their lack of understanding of benefits, employers certainly are. I am not, by the way, advocating that we put a halt to our communications efforts.

Employee involvement in benefits is generally on the rise. By involvement, I mean the extent to which companies are surveying employee views and preferences toward benefits, the degree to which employers are providing health and benefit usage education, and the growth in wellness programs. On this last note, Johnson & Johnson has begun marketing their "Live for Life" wellness program to other employers. Unfortunately, this greater focus on listening and using employee input and encouragement of employee involvement has come *after* the decline in employee attitudes toward benefits.

In their relationships with health care providers, many employers, particularly larger ones and employer coalitions, are taking a tougher line with health care providers on several fronts. These include:

1. employers' requests for greater customization of plans offered by HMOs for their particular work force—a move that is being resisted by some of the larger HMOs;

2. more frequent employer requests for experience rating by HMOs on their own work force rather than on some larger population—another point of resistence among some HMOs; and
3. employers' concerns over the quality of care that their employees receive, from an employee welfare as well as a liability perspective, when entering arrangements with HMOs and PPOs. However, this concern also extends to requirements for precertification. While concerns over quality of care have risen, many employers are stymied in their quest to satisfy their concerns.

Not only are employees indisposed to the idea of taxing benefits, but so also are employers, who are quite a bit more vehement on the subject. In the 1984 Mercer-Meidinger study noted earlier, 87 percent of the CEO respondents indicated that the current policy of providing tax preferences for employer-sponsored benefit programs should remain intact. In the event that tax preferences were eliminated, less than half (47 percent) of the CEOs reported they would continue to provide the benefits they do now. Twenty-one percent said they would shift some of the benefit dollars into direct compensation. Another 28 percent noted they would simply reduce benefits.

In the previously noted 1984 Roper survey, CEO respondents were even more extreme in their proposed reactions to taxing benefits. Sixty-nine percent reported they would cut benefits in some way if the tax-deductible status were removed. Furthermore, 87 percent indicated that such governmental action would have a ricochet effect in ultimately increasing the pressure on governmental welfare systems including Social Security.

In my research, I have found that employees more often prefer maintaining the level of benefit coverage rather than receiving more direct compensation. So, if benefits were taxed, the idea that about one-half or more employers would shift benefit dollars to compensation or reduce benefits altogether would not be palatable to employees.

If the federal government were to tax benefits, the last benefit employers wish to see taxed are retirement plans. While the Mercer study showed that most CEOs (76 percent) would increase or maintain pension plans as they are now if tax preferences were reduced or eliminated, roughly a third indicated they would decrease company contributions to employee savings, profit-sharing and 401(k) plans. All of this, despite the fact that 100 percent of these employers support employer-sponsored plans to enable employees to save for retirement in light of the perceived inadequacy of Social Security as a source of retirement income.

The CEOs in the Roper survey ranked pensions as the second most important benefit they offer employees behind health benefits. In fact, 6 of 10 said they would *not* reduce their contributions to pension plans for low-income employees even if restrictions on pension plan contributions for high-income employees were mandated.

Conclusion

The decline in employee satisfaction with benefits and the complex changes in benefit programs from the 1986 Tax Reform Act will place heavy demands on employers, insurers, and legislators. These groups must deal with the uncertainty and confusion surrounding the effects of a new law and try to respond to workers' expectations of employee benefits. This can be accomplished as long as employers *actively*

1. explain the reasons for changes in benefits clearly to employees;
2. make plans available to employees that fit their needs; and
3. facilitate employee involvement in benefits;

and as long as insurers, consultants, and providers *actively*

1. recognize and accommodate the diversity among companies of different sizes; and
2. adapt to, rather than challenge or ignore, employer demands for customization to which, admittedly, there is a cost;

and as long as legislators *actively*

1. understand and integrate into legislative strategy the views of employees and employers on the tax-favored status of benefits and the likely consequences of reducing or eliminating that status;
2. insure that legislative actions regarding retirement and capital accumulation plans do not force additional reliance on Social Security that would exacerbate everyone's growing concerns about the system; and
3. create a legislative and regulatory climate that is consistent and that promotes the general welfare.

The operative word is proaction, not reaction.

VII. Part Two Discussion

"Baby Boom" Values: Self-Reliance and Independence

MR. DOBSON: I am wondering if the picture we are painting of the "greedy baby boomers" might have some political implications. If we baby boomers decide that saving is pretty hard business, could we go at it through the political process. This kind of action could change notions of self-reliance. It will be easier to extract from the baby bust generation, maybe, than to provide for ourselves. Do you have a sense of how the politics of this is going to play out? It seems like we have hard times coming for people with high expectations, and this will lead to some interesting politics.

MS. SKELLY: I mentioned briefly the phenomena of a two tiered society.

I think that, if you look at the fifties, there was a thrust towards developing the largest middle class in the history of the world, something like a 73 percent growth. I think what you are seeing now is a group—and I would estimate from my data that it is about 40 percent—who think that they are going to win. I would not characterize them as greedy. I would characterize them as wanting what was their birthright—and what their parents wanted. It is not greed; it is what they were brought up to believe was theirs under a psychology of affluence. So you have about 40 percent who think they are winning. They have the two-earner household. They have the 1.8 child, or whatever. I mean, some fraction of a baby. Their per capita income is not bad, but they are possibly feeling very distressed with themselves for not saving. Hence, some of these comments about forced savings being attractive to them.

You also have a group of about 40 percent, equal in size, who do not think they are going to win. They are pursuing a lot of "beat the system" tactics. I am not saying beat the system is illegal, but beat the system is working several jobs. It is not declaring everything. I did work for the IRS [Internal Revenue Service], and you know there is a tremendous gap in declarations.

Now on the politics of it: we are still continuing toward a conservative alignment in the country, and people still profess to be sort of socially Darwinistic.

MR. GREENWALD: I have a slightly different view. There is an ad campaign that is quintessential baby boom. The theme line is "you can have it all." That is what the baby boomers believed when they were young—that they could have it all. They grew up in a time of tremendous economic expansion, which lasted until approximately 1973. After 1973 the economy basically stagnated, until the past few years. As a result of the economic slowdown in the 1970s, many baby boomers entered a tight labor market and did not meet their economic expectations. In 1949 the average 30-year-old man buying a median priced house spent 14 percent of his salary on carrying charges for the house. His salary, in the next 10 years went up 65 percent in real terms, further reducing the cost of the house.

By 1973 that same median priced home cost the average 30-year-old man 21 percent of his salary in carrying charges, and his real income did not go up at all over the next decade. By 1984, carrying charges were 44 percent of the salary of the average 30-year-old man buying a medium priced house.

Baby boomers are doing relatively less better financially when compared to older people than previous generations. They are coming to the age of the mid-life crisis, a time when people look at what they have accomplished and compare it to what they wanted. For many baby boomers that is going to be a very distressing time, especially for baby boom women who had dreams of combining family and work in ways that were hard to achieve.

Thus, there are going to be some rough times for boomers. But I do not think they are going to look to a government solution, because I think they are too individualistic.

MR. DOBSON: They are not saving, and they are looking ahead and seeing grim times. That is inconsistent with self-reliance, because in reality they are not being self-reliant at all. I have seen many of the statistics you have, and they do not suggest a large pool of retirement funds or any other funds being generated based on self-reliance. What is going to happen when they wake up and figure out it has been a mistake?

MS. JONES: I think it is interesting to see the tugging of different dynamics. It may be a gap between observation and reality. For example, the interest of aging workers in staying productive and staying in the work force, I think, is true. On the other hand, aren't there indications that people are retiring early and being forced to retire early as a labor/management tool? So the issue may be how we keep people in the work force when many of the dynamics are pushing the other way.

Another thing, Matt [Greenwald], your observation that people want to take more responsibility in, for example, the financing their long-term care. I think that is true. On the other hand, there is a growing number of people who say that as long as there is a Medicaid program that will pay for my long-term care, I am foolish to struggle to invest my savings and take individual responsibility.

So I think it will be interesting to see how these dynamics play out, and how we can encourage people to move in the right direction rather than in the wrong direction.

MS. SKELLY: There is no question that the early retirement phenomenon has got to be recognized. I think what you are going to see 25 to 30 years from now is a two-career life. People leave the labor force, sometimes forced, especially now with the new mergers and acquisitions, which really are obsolescing duplicative staffs. They do not retire, necessarily. What they do is beat the system.

I will give you an analogy. We did a lot of research after some of the real troubles in the automotive industry in Detroit because everybody was wondering why this city was not being burned down. We found, one, they had working wives. So right away they were collecting the paycheck Friday night from the wife.

The other thing that they were doing was moving into what could be called the service sector. They were painting homes. They were repairing things. They were getting paid under the table, and that helped to keep down some of the distress that was being felt. And I call that "beat the system," which I realize is a euphemism that covers a lot of things. Certainly, IRS studies indicated that they are not reporting that as income. But I think very few of us do not know of people who were forced out, let us say, in the course of major acquisitions, mergers, etc., and who are working as consultants, still in the labor force, and do not see themselves as retired.

I think that there is one other point I would like to make in that regard. One of my associates, Arthur White, recently attended the 35th anniversary of his Harvard Business School graduating class, among whom we conducted a survey. Interestingly, while many of these graduates rose to high stature in giant corporations, 78 percent would say to a man start your own business and stay with it. This by-pass of corporate America that is going on is, again in the 35 to 40 years ahead, going to offset some of these early retirements.

So I think that there are a couple of pressures that still make my prediction that people will be working past the current retirement age.

Is Individualism a Temporary Phenomenon?

MR. FISHER: Several references were made this morning to the mindset of the Reagan administration as it relates to these issues. As one of those who helped win World War II and who is a bleeding heart liberal Democrat, I suggest to you that there may be a dramatic change in that mindset in the next less-than-two-year period.

Even some of my most conservative Republican friends are distraught with the havoc that has been wreaked within the last six years by the Reagan administration, and there is going to be, I believe, with the help of some of the people around me here, a rather revolutionary expression of opinion about the continuation of these things that I have worked all of my life to accumulate and have had absolute disaster occur in the last three or four or five years.

I believe there is an undercurrent, and it is not so far under, either, that is going to express itself very shortly with respect to specific identification and preservation of the things we built and paid for over the last 25 years. I hope you schedule another one of these policy forums in about 18 months to see how people out there feel about these things.

MR. PARKINGTON: One of the things I would point out is that, while there is a definite attitude toward self-reliance and independence, I think one of the reasons that there are some gaps between that attitudinal position and reality is that, in many instances, people are not aware of options and alternatives available to them. We have sold the concept of IRAs and other kinds of financial vehicles; and to the extent that these vehicles are going to be limited or constrained in some fashion, people will likely ask, what am I going to replace them with? Somebody is facing a tall sales job to convince and motivate and explain options and alternatives to these people who are now saying, what do I do, where do I go from here.

MR. SALISBURY: The financial planners are telling them all to defer.*

MR. SEIDMAN: I hope Larry [Fisher] is right, that we are going to see this swing in the political pendulum. It seems to me to assume

*Editor's note: EBRI commissioned a survey in 1986 by Mathew Greenwald and Associates on how professional financial planners would advise their clients about retirement saving in the wake of tax reform. The results are presented in Employee Benefit Research Institute, "EBRI Survey of Financial Planners on Tax Reform and Retirement Savings," *EBRI Issue Brief* 61 (December 1986).

that because we have a certain political climate today, that it will exist forevermore is not consistent with the history of this country or any other democratic country that I know of.

The specifics are the important thing. And the specifics that I heard are that what people do not like about Social Security are two things: One, that the benefits are not high enough; and two, that they are not sure that they are ever going to get the benefits when they retire. What they do not like about health insurance is that they are having to pay high deductibles and coinsurance. Not that they do not like to have health insurance, not that they want to go out and buy their own health insurance, but that the health insurance they are getting on the job is not as good as it used to be. The same thing is true about the long-term care insurance. Nobody said that we have the problem that while everybody's talking about providing incentives for the family and so on, the traditional family does not exist anymore. We are talking about women who are working and are not able to give this kind of care. We are talking about old people taking care of old, old people.

So I think the answer to Allen Dobson's question may be that people will begin to look at the direct ways of dealing with these problems instead of these terribly indirect ways that, thus far, are not convincing people that they are doing anything for them, and they have not developed any enthusiasm about.

MR. GRASSO: It seems to me that one of the real problems we have in the kinds of analyses we have been discussing is that we are looking at long-term demographic trends and comparing them to short-term political trends, and we are saying, look, in the short run we have got these political attitudes, which are relatively recent and do not go back very far and which are undergoing changes.

So we are talking about the kinds of pressures that are short term and comparing them to long-term demographic trends about 25, 30, 35 years from now, and saying, well, these short-term trends from the eighties foreshadow these problems for 2010. I do not think that is a very convincing way of looking at it. I think, if we went back to the 1960s and made the same kinds of projections based on the attitudes of 1965 to 1985 and the nineties, you would never have predicted the situation we're in right at the moment.

MS. SKELLY: I think the focus on the individual has roots that will let it survive longer than people realize. The entire thrust of what has been called the "new values" revolution, led by the boomers in the late sixties and seventies, was an almost incessant focus on the self. It has been called narcissism. But it meant that, rather than group affiliation, we became as a culture very involved with who we were, and how we were expressing ourselves, did everybody understand us, and were we really happy and all of that stuff.

I am obviously not a boomer, so I can talk about them that way. But when that gets translated into real life, it does bespeak a certain kind of individualism, perhaps misguided. But that is not going to go away overnight, because the boomers were brought up that way. Just as Depression people and World War II people remember those years, which are a shaping, formative experience, so was the focus on self-revolution a shaping experience.

So some of the rugged individualism is not a temporary phenomenon that is reflective of a political administration. Rather, it sets the precondition for the fact that even so many liberal Democrats are now very much in the individualism, fiscal conservative mold. So it is very hard to tell without a scorecard.

MR. GRASSO: Could it be true that those boomers who are so individualistic were really in fact going to school largely on government money? I was in school and I am one year ahead of the boomers, and I assure you that without the federal government I would not be sitting here. I would be back in a Teflon factory spreading Teflon [without federal help], which is what I was doing before I got into school. I was entirely supported by federal support, and so were most of my colleagues. When I was teaching, virtually all of my students had federal government support.

MS. SKELLY: Because they were entitled to it, because they were wonderful individuals.

MR. GRASSO: Exactly. My question then is, is that attitude of "me first" going to get translated into "the government owes me health care," the government owes me an adequate retirement income," the government owes me housing? At what point does that individualism—which is not individuals in the production but rather individuals in the consumption—get changed into somebody owes me the wherewithal to consume what I think I deserve? I think that puts pressure on government.

MR. GREENWALD: Let me make three comments about that. I am not going to predict what is going to happen over the next 35 years. But, number one, I think there is little question that entitlement programs will stay basically in place. There is strong support for them. Social Security is not going to go away, even if "X" percent do not think they are going to get paid. They will get paid. But there is an epidemic of aging coming forward, and it is not the kind of thing you begin preparing for in 2010. You have to do it before.

So we are talking about a 25-year wait before demographic pressures are felt. With pressures of an aging society congruent with other fiscal problems and global economic problems that we have right now, it will be hard to *expand* entitlement programs. People will have to meet the increased cost of living longer, to a great extent, through private and personal initiative.

I think there is an inclination right now for people to take more control of their finances. I was involved in a research program that tracked attitudes since 1968, with the help of Yankelovich. We saw, starting in 1968, a tremendous decline in people's feelings of control over their lives. We seem to be seeing a reaction to that now by people seeking to gain more control. That is one of the elements leading to a hope for more self-reliance.

So it is not a question that people want to do it all by themselves. It is a question that there is more to be done because of the various pressures we have talked about. I think it is doubtful that the entitlement programs will be able to or be asked to make up the whole burden. So individuals will have to and, to some extent, will want to do more.

Individualism and the Changing Work Force

MR. ROTHER: I am interested in how this discussion on attitudes meshes with the first panel's discussion on changes in the work force. What strikes me about this particular rugged individualism attitude is, number one, it is very young. It is very male, and it is very white. And what we know about the coming work force is, it is going to be more female, certainly older, and much more minority. I wonder if you could give us some data on attitudes on those subgroups that might have implications for future changes as the work force becomes a different one than we have today.

MS. SKELLY: I am not going to take on the job today of dealing with other sex differences. But we have not seen any basic sex differences in the attitudes about reliance on the self, focus on the self, concern with the self, or wanting control.

Our studies among the Hispanic community also indicate the same level. I am not talking about black Americans, because they are different; but the Hispanic community also is showing this surprising interest in seizing more control, in taking advantage of the system, you might say, which is operating to pit one's wits against the system rather than to be nurtured by it.

MR. ROTHER: What about age differences between a 30-year-old and a 50-year-old?

MS. SKELLY: Well, there is no question that what I am describing is significantly more applicable among the 76 million who were born between 1946 and 1964. The 55–64 group are really quite different, as everybody around the table who is 55–64 would probably attest.

MR. GREENWALD: There are a couple of dots on the radar screen in terms of the reaction to "Live Aid" and "Band Aid" and other indications that we may be open for more communal action. These incidents may be signs of a shift in attitudes, but it is too soon to tell how extensive the shift will be.

MS. SKELLY: Only 19 million showed up.

MR. GREENWALD: Only 19 million showed up. But that is more than showed up the year before. It seems to me that in a sense one of the key stories of the rest of this century is going to be the midlife crises of the baby boomer. When people look back at what they have achieved compared to what they thought they would achieve and look ahead to what they face, we will have a somewhat unstable situation. It is a situation that could shift very rapidly, and it is very hard to predict just which way they will move. But I think part of it will be to move to try to retain a fair degree of personal self-control over their futures.

MS. YOUNG: I want to throw something else into this mix. In the generation following the baby boomers—a small generation—a lot have parents like me who are not going to get to retire until they are 66. They are not in that 50–55 generation. Some of us did have babies in our twenties. These people are going to be a very strange people that nobody is considering. They are going to be a small group among those who are educated and white and privileged, not impoverished. They are a second generation born in privilege. If you think the baby boomers were born in privilege, what do you think the kids were who are my kids? They grew up totally and completely in privilege. They have been raised in privilege, and yet the reason why they did not show up for "Hands Across America" and everything else is because most of those kids were working, and *are* working. And they are already feeling very pushed by a system, which raised them with a silver spoon in their mouth and somewhere along the line from age 15 on said, now you go pay for the silver.

Twenty years down the road they are going to be pressuring along with the baby boomers—sometimes against them but also in some cases with them—"Please retire, I want the job." Are we going to wind up with a rugged individualism that says, for those of us who are middle class, we will demand the things that we want, the kind of health insurance we want, the kind of housing that we feel that we should have when we get close to retirement, the kind of programs to make sure that Mama is taken care of because I do not want to take care of her?

MS. SKELLY: I am a messenger, not a message. So I do not want anybody to get upset. But I have said that you see in study after study is, in a sense, not revulsion at the growing two-tiered society, because another phenomenon is this meritocracy. You can almost rationalize anything in the rugged individualism mode. If you say people get what they deserve—I mean, you could do it on the "deserves." And when you do it on the deserves, somehow it does not strike quite at the same kind of horror that it may in people who do not have that orientation.

The group behind the boomers is an interesting group. We find them to be particularly materialistic and very competitive. They are the ones our research shows spill on each other's exam papers. They are a rough crowd. I call them the baby killers.

MR. GREENWALD: The baby bust generation is now ages 11–22. They had pretty high rates of poverty as kids. They had a lot less parental supervision than previous generations. They have lived to a greater extent than boomers in broken homes.

There are indications that the schools "busters" attend are not as good as the schools their parents went to. Busters seem less social. It seems that more of them are not behaving themselves in school. They like movies like "Rambo." They could become a more individualistic, even selfish, generation overall.

MR. JACKSON: I am one of the people who helped win World War II. I didn't want everybody to think that Larry Fisher spoke for the entire generation. Our generation, when we were young, was disapproved of by our elders to exactly the same extent that I hear the baby boomers and the baby killers being disapproved of. People in their twenties have attitudes, we analyze them, and then we characterize a cohort. And as they go through the various age groups like a pig through a python, they have this tag on them. The tag is based on some analysis, but you ought to put a date stamp on the tag and say, well, this conclusion was drawn in 1965 or 1970. Those attitudes change.

I personally see a resurgence of religion and permanent values in this country. I see a resurgence of families. I do not see many simple linear relationships. If you take a sine curve, and you start getting to the top and you use the simple projection technique that most economists use, you will project yourself off into the sky somewhere. The one point in time when you are the most wrong is at the turning points, when things change.

Larry Fisher spoke of a hope that government would change, and that then we will have more simply by having the government give it to us. That does not add anything to the total supply of goods and services that are available. They are a constant, and if you give them to one, you take them away from another. If you start penalizing the people who work by taking from them and rewarding the people who do not work by giving to them, you are going to end up with some people who just stop working and decide that the alternative of just sitting there and taking something is better.

There is another problem that Larry Fisher and Bert Seidman are going to have to contend with. They want to change the government's course. It has changed in the last five years. They want to change it back and hope that then we will be able to really count on something 20 or 30 years hence that the government says it will do. When you inject change in the government and when the government injects change in the laws, you reduce confidence in the stability of the system and the confidence that an individual can place on the government's promise.

When I was a small boy, there used to be an expression that can now be viewed as absolutely silly, "sound as a dollar." It meant something then. Also, "Made in Japan" was another funny one that referred to little paper things with bamboo and so on. But nobody is going to start saving, nobody is going to start deferring value if you are going to have a system that changes all the time and that you cannot count on. That is why our savings rate is low. We encourage people to put in private pension plans, and we tax people who put their money in savings accounts. The average American is possibly not totally educated, but he is not dumb. He has been saving through building up equity in a home. He has not paid a tax on that, and he is going to look around at other tax effective ways of saving also.

A government should not say that broad groups of people cannot do it on their own, and so we must help them. I want to help the people who tried to help themselves and could not make it, but I have no desire to help the guy who just wants to sit back and say, the world owes me a living.

MS. SKELLY: The material that Matt Greenwald and I were talking about reflects annual tracking research done every year, rather than a one-shot snapshot.

MR. SMITH [JESSE]: There is another social/cultural phenomenon that I have been personally concerned about in an organization I have just come from that I term the "success criterion." I am one of the baby boomers—or right at the very front of them—and we and the baby bust generation have both been raised with a concept that if one works hard, keeps his or her nose to the grindstone, one will succeed.

Regrettably, success in our society has often been equated with upward mobility. We have a very severe compression crisis coming with the combination of the baby boom impacting midmanagement and upper midmanagement ranks, at the same time companies are downsizing. The major trend now is to downsize. Business has about an 8-to-1 ratio of qualified individuals for every opening. By 1990 it could easily become a 33-to-1 ratio. I think as that happens, people's connotation of success is being challenged very severely. They are going to become very frustrated. As that frustration level increases, they are going to look at alternatives, and the alternatives are to either change job, change career, or start their own business, all of which are very risky. I think these people are going to try to secure that risk fear in order to be able to pursue success, and how they pursue that risk fear is very, very detrimental to a lot of questions that have been raised here.

Tax Reform and Saving

COMMENT FROM THE AUDIENCE: At the risk of taking the discussion from the sublime to the ridiculous, I want to ask Mr. Parkington about taxes. One of the things that the recent tax reform has done, which to a bonehead economist seems important, is reduce marginal tax rates, at least for lots of the population.

Now the simple-minded approach would be that that can change the relative attractiveness of tax-shielded fringe benefits compared to taxable income to make them less attractive. Do you think that is going to happen? And before you say no—if that is what you are going to say—remember that that needs to be squared with the statements that you reported of employers who, unless they can tax shield benefits, will not be able to provide them, at least not in as large a magnitude as they have. Do you think it will matter?

MR. PARKINGTON: I think that I was trying to reflect the fact that we have sold certain concepts—certain savings vehicles—to people, namely, IRAs and 401(k)s. They have been publicized, and people have probably, I would suggest to you, understood them a little bit better than some of their other investment options. To the extent that we are now limiting some people's use of those vehicles, I suspect that a lot of them will be looking around for other alternatives. To the extent that they either do not have the time, the intelligence, or the informational resources or cannot seek those sources out, I suspect that there will be either a lag in their savings rate or possibly a decline.

It is difficult for me to make economic forecasts. I am just suggesting that there is confusion among some people about what they are going to do in securing their nest egg for the future.

COMMENT FROM THE AUDIENCE: Do you think the tax advantage of doing whatever you are doing is now smaller than it used to be because of the marginal tax rate, at least for those people for whom it is now smaller than it used to be? Will that reduce the attractiveness of those kinds of strategies?

MR. PARKINGTON: People do understand that there is a tax savings associated with an IRA. The fact that the marginal advantage of the tax deferral has been eroded slightly will probably not dissuade those persons who can still fully utilize that particular vehicle.

MR. SALISBURY: On the IRA numbers, for example, of all those now with IRAs, only 15 percent will not be able to have them [under the new tax law]. Another 12 percent will be phased out. So, close to 75 percent of those with IRAs can still have a fully deductible IRA under the 1986 tax reform bill. And for that 75 percent, their marginal tax rate under this bill is not very different from their marginal tax rate under prior law.

The data that has always been intriguing but also surprising to me about IRAs is that, if you look at the average contribution, or average deduction on tax returns, even those individuals at low tax rates and relatively low income levels have put in almost as much money as people who were riding at the 50 percent marginal tax bracket.

I will add a second comment, though, vis-a-vis what John Parkington was saying about the selling of IRAs, which is particularly telling in light of debate over the tax bill and some of the arguments for maintenance of IRAs. A much-used figure is that 40 million people have IRAs, and there has been continued fantastic growth in the number of people with IRAs. The IRS, shortly after this tax bill was completed, came out with the *Statistics of Income*, which included the first tabulations for tax year 1985. And between tax year 1984 and tax year 1985, the number of tax returns claiming an IRA deduction increased by less than one-half of one percent. This was true across the income spectrum. So contrary to the implications in that debate, that we were seeing continued dramatic growth in the number of people with IRAs, the 1985 versus 1984 tax returns would indicate that the advertising had hit its saturation in the short term.

MR. LINDEMAN: Being part of that older generation called the baby boom, let me rise to its defense ever so slightly. I do not know that their savings rates are in fact lower than previous cohorts. If you have got evidence on that, I would very much like to hear it, because it is a question many people ask.

I think perhaps the more serious problem is that at the federal level, we did save whatever private funds there are. And for those concerned about investment and capital growth, it seems to me that that may be the more important issue. But in terms of business and individual savings rates, my sense was that they had been, in fact, pretty good. They are roughly what they have been in the past. And if you have any specific information, I would enjoy hearing it.

The baby boomer, in my judgment, is about entering into its peak savings years. So I think it may be too early to make a judgment.

MR. GREENWALD: My source is an Urban Institute study conducted by Frank Levy and a colleague, which basically demonstrated that the baby boom generation is not doing very well financially.

MR. LINDEMAN: I agree with that.

MR. GREENWALD: That study indicated that young families headed by someone under age 35 were saving one percent of disposable income.

MR. LINDEMAN: The key question is, it seems to me, is that different from previous cohorts in the same age group?

MR. GREENWALD: That compares to 4 percent in earlier years.

MR. GARBER: Part of the question also is that home ownership is not counted as savings in the usual statistics. Mortgage is not counted as savings under most of the statistical bases that are kept.

MR. GREENWALD: That is right. And, of course, not only did the cost of housing go up, but the interest rates to cover that proved to be a fairly enormous burden.

MR. LINDEMAN: I agree with your observation—which I think is probably important when you are thinking about the future—that current generations of retirees and people who are about to retire got some fairly considerable rates of return, windfall rates of return, not only in Social Security but from start-up windfalls in private pensions as well.

Your point about the appreciation in housing values is well taken as well. So I do not think you can necessarily assume that you are going to get the same rate of return on whatever savings now that previous cohorts had. And I think that makes the future somewhat more pessimistic.

PART THREE
WHAT ARE THE APPROPRIATE ROLES OF GOVERNMENT IN SECURING RETIREMENT AND ECONOMIC SECURITY FOR THE AMERICAN WORKER?

In parts one and two of this book, we examine how changing demographics, values, and expectations about employee benefits may help shape benefit programs of the future. In an ideal world these factors influence benefits to the extent that government benefits and tax policy are consistent and rational, and continue to encourage employee benefits. Clearly, the federal government has increasingly intervened to shape and monitor employer-provided benefits policy. Over the last decade, there have been more than 10 major laws that have affected the provision of employee benefits. But in the face of this steady stream of benefits-related legislation, some employers and policymakers question whether the federal government has done a good job in legislating benefits policy and argue that the government has not developed a coordinated and consistent national benefits policy.

In part three of this book, the authors respond to the question, "What are the appropriate roles of government in securing retirement and economic security for the American worker?"

We lead off with a chapter by EBRI education and communications director, Frank B. McArdle, that introduces key political and policy issues that have led Congress to become more involved in work place and employee benefit issues, particularly through tax reform. We believe the discussion will assist readers in better understanding how the remainder of the papers in part three relate to the topic. McArdle's paper is drawn from a presentation before the Tax Foundation's 38th National Conference on Fiscal Policy—Post Tax Reform, on December 3, 1986. The views expressed are solely those of the author and should not be attributed to EBRI, its officers, trustees, sponsors, or other staff.

In chapter IX, Ronald Pearlman submits that the federal government's role in encouraging and monitoring employee benefit programs is two-pronged. The first is the perceived need to assure that employers in fact provide benefits that are promised to employees.

The second is an explicit encouragement through tax incentives for the provision of benefits by the private sector. Calling these two policies, "regulation" policy and "tax incentive" policy, Pearlman notes that they frequently overlap, are inconsistent, and often result in a piecemeal approach to retirement income and benefits policy.

Furtherance of the government's legitimate role in retirement and benefits policy must recognize and accommodate these competing policy considerations, Pearlman argues.

Pearlman suggests that recent changes in rules governing employee benefits do not reflect changes in the two basic policies but rather reflect an increased focus on these policies. In the retirement income area, regulation policy, in the decade since the Employee Retirement Income Act, has focused on prohibited transactions, investment policies, and, most recently, pension plan funding requirements and plan terminations. Increasing federal regulation in a voluntary system, however, often produces tension. Appropriate policy must always consider what effect increased regulation will have on the willingness of employers' to provide retirement benefits—and any foreseeable side effects that might work to the long-term detriment of benefits provided through the work place. For example, says Pearlman, a balanced asset reversion policy should take into consideration the tension between the knowledge that any absolute prohibition on asset reversions likely will discourage employers from establishing defined benefit plans and the realization that the unlimited right to withdraw plan assets from an ongoing plan increases the risk the plan could be underfunded in the future.

Tax incentive policy in recent years has been driven by the need to raise additional federal revenues. Because of this budget-driven policy, employee benefits are being evaluated on their tax effectiveness and tax efficiency, notwithstanding their social desirability. The federal government does this through estimates called "tax expenditures," which are benefits perceived to accrue to certain taxpayers as a result of the statutory treatment of certain sources or uses of income and thus result in federal revenue losses. They are difficult to measure and a source of considerable controversy. Nonetheless, the Joint Tax Committee estimates the projected revenue losses for all benefits—public and private sector—at $146 billion for 1988, with $49.3 billion for employer-sponsored pensions and $24.2 billion for contributions to health coverage. These large numbers will keep benefits at the forefront of budgetary considerations.

To what extent qualified employer pension plans increase retirement income and the effects of the 1986 Tax Reform Act are questions

David Lindeman addresses in chapter X. Because of the tax advantages given qualified plans, Lindeman estimates that the income of retired couples will be 21 percent higher than if the tax incentives for qualified plans did not exist. The results vary depending on the length of time an individual remains in the plan and on the individual's income. Lindeman states that future retirement incomes projected under his simulations will not be altered much by tax reform. Because of lower marginal tax rates at the top of the income distribution, the value of these tax incentives will diminish somewhat, but only a fraction of those in the top income quartile will be affected. Although the new vesting, coverage, and integration rules could alter the relative distributions of retirement income gains, the effects of the rules in the aggregate are not likely to be very large.*

The real issue facing policymakers in determining the appropriate role of government in retirement income is how the benefits of the current federal and private system will be distributed across income levels, argues Patricia Dilley in chapter XI. Dilley suggests that the goal of benefits policy should be to "promote both stability and security in retirement income for workers across income lines, while preserving and encouraging the flexibility of the private system for employers of all sizes and employees who prize job mobility as much as future security."

In her paper, Dilley focuses on two general issues often debated in retirement income policy: the outlook of the "baby boom" generation and "intergenerational equity," and the prospects for a true national retirement income policy structure.

Securing an adequate retirement income for today's workers and especially for the "baby boomers" is often framed in the context of "intergenerational equity," says Dilley. "Intergenerational equity" presents a picture of generational warfare between the current elderly and America's children. As the costs of programs to support the elderly have taken a major share of the federal budget, children have become the nation's most impoverished age group, the argument goes, and young workers have a harder time making ends meet and pay higher taxes than their parents did. Under this analysis, Social Security is now redistributing income from impoverished young workers to wealthy retirees and will not be able to support tomor-

*Editor's note: For a comprehensive analysis of the long-term effects of tax reform, see Employee Benefit Research Institute, "Long-Term Effects of Tax Reform on Retirement Income: Many Unanswered Questions," *EBRI Issue Brief* 64 (March 1987).

row's retirees because of a projected reduction in future workers paying into the system.

Dilley disagrees with the entire notion of intergenerational equity. The Social Security financing crisis of the 1970s, which precipitated the idea that the system was running out of money, is over, says Dilley, and changing work force demographics do not necessarily mean the system cannot be maintained.

That the elderly are disproportionately wealthy, Dilley also disputes. She argues that estimates showing that fewer elderly live below the poverty level than the population as a whole can be misleading. Poverty "can mean one dollar or one thousand dollars above an extremely low level of income. Of all those households with at least one person over age 65 in 1984, less than half (46 percent) had total incomes of three times the poverty level or more ($18,600 or more)."

In addition, the poverty statistics are so low for the elderly precisely because Social Security is in place performing the function it was designed for—to prevent poverty in old age.

In summary, Dilley says that the argument over whether we as a nation can "afford" retirement income security for the baby boom as currently funded should be laid to rest. "It is not a question of whether these programs will exist, but rather what they will look like and how we can best distribute the benefits and burden of assuring income for the nonworking." A new, more interesting debate will be the focus of congressional activity over the next decade, as policies for Social Security, private pensions, and savings incentives are increasingly examined as part of one overall area of inquiry.

VIII. Congress and the Work Place

PAPER BY FRANK B. MCARDLE

The second session of the 99th Congress adjourned October 18, 1986. In many ways, it was a remarkable Congress—in particular as it relates to Congress and the work place.

Tax reform was, of course, this Congress' crowning achievement. But other pieces of legislation passed or considered were equally important in their significance to the work place. This paper will first discuss tax reform, then examine other legislation.

Analyzing the impact of tax reform involves solving an apparent riddle: how is it that Congress, in passing tax reform, sought to lighten the load of government and of tax considerations on private-sector decisions, and instead ended up involving itself more deeply in the work place, particularly with respect to retirement income, health insurance, and other voluntary employee benefit matters?

How Does Tax Reform Affect Employee Benefits?

The effects on benefits come from two directions: from the numerous provisions directly aimed at employee benefits and from the changes in the tax rates. Employers not only must move quickly to comply with the new rules, but may also to reappraise their current employee benefit packages.

Direct Benefit Provisions in Tax Reform—The direct provisions, which comprise 114 pages of the act itself and 179 pages of the Conference Report, are intended to produce more comparable employee benefit coverage of rank and file employees and of highly compensated employees. The pension changes would increase the number of workers with a vested interest in their pensions by some 2 million workers in the first year alone. It would increase pension amounts for rank and file employees by limiting the coordination with Social Security benefits. And it would mandate broader and more comparable coverage of rank and file employees under pension, health, life insurance, and other plans. Education assistance and group legal services will lose their tax exclusion in 1988; employer-provided transportation benefits were allowed to expire.

If rank and file workers are in the intended beneficiaries, higher-paid employees are the intended losers from the benefits provisions.

Certainly the higher paid will enjoy lower tax rates. But they suffer potential losses in benefits. Some examples: restrictions on 401(k) salary reduction contributions; a new limit effective in 1989 of $200,000 on the amount of compensation that can be taken into account under all qualified plans; a new excess benefit tax of 15 percent on most annual distributions over $112,500; and sharply reduced maximum benefits paid directly to early retirees under defined benefit plans.

Changes in welfare benefit areas, such as health and life insurance, also aim for the same effects: an intended broadening of benefits because of tighter nondiscrimination rules, which also reduce tax-favored benefits payable to the higher paid. Government staff have argued that reduced tax-favored benefits for the highly paid constitutes more comparable coverage of rank and file and highly paid, when you view the benefits in terms of dollars rather than as a percent of their compensation.

Effect of Tax Rates—Despite good intentions, some unintended consequences of the new legislation may actually slow the future growth of benefit coverage and even result in less coverage in the sector of the economy—the small employer sector—where benefit coverage is the least available today. A top rate of 28 percent for the owners of a small business and 15 percent rate for 80 percent of taxpayers may make cash more attractive than benefits, which are also more difficult and more costly to administer under the new rules. The desirability of deferring compensation for nonretirement purposes under qualified plans is also called into question because of new penalties on early withdrawals and the expectation that future tax rates may be higher than the new rates. Finally, because of the new restrictions on the higher paid, many employers will face the option of removing the higher paid from their general qualified benefit plans, which could result in a deterioration in benefits for rank and file employees. As more of their compensation is provided through nonqualified plans, the higher compensated may "lose their stake" in the general benefit plan. Obviously, whether nondiscrimination rules cause expanded and more comparable coverage of rank and file employees or reduce tax benefits for the highly paid will differ from employer to employer.

Employee benefits will remain an important piece of total compensation, but the changes in their tax effectiveness may prompt a reevaluation of overall benefits and a return to the basic purposes employee benefits were intended to fulfill: the nontax purposes of promoting economic security and satisfying human resource needs.

The Politics of Tax Reform

President Reagan was the essential ingredient in tax reform. Early on, he made it a priority, and his administration put forward the first two comprehensive proposals before the tax committees began their own work. The tax reform effort also had the critical support of the chairman of the House Ways and Means Committee, Dan Rostenkowski (D-IL), and the then chairman of the Senate Finance Committee, Robert Packwood (R-OR). The support of the congressional leadership was key in that it helped overcome the reluctance of individual members of Congress who had slammed the door on previous efforts at comprehensive tax reform.

The support of the president and the congressional leadership made it clear that the bill would receive very careful consideration. Once the House passed its version, it was a foregone conclusion that Senate members who had any sort of tax agenda should strive to attach it to this bill. This was a bill destined to move.

This is important in solving the riddle. The legislative intent of a bill rarely speaks to us with a single voice. The legislative process itself forces compromise, forces accommodation, and requires the melding together of different bills. Tax reform not only involved accommodation and compromise and merging of two very different House and Senate bills; it was also a massive bill. And the larger the bill, the more likely it will embody various intentions.

Rationale for Tax Reform

The first intention was to broaden the tax base as a path to lower tax rates. Fairness was also the ostensible aim, namely to treat people with comparable incomes more uniformally. Simplicity was a goal subsumed along the way.

Broadening the base was the key to everything else. The tax code was strewn with incentives that had accumulated over the years, most of which were passed for "good" reasons—either good intentions or good politics.

The argument behind tax reform was that the government should intervene less in the economic decisions of individuals and firms. As chairman Rostenkowski phrased it: "We are turning away from the idea of making social policy in the tax code."

For employee benefits, tax code considerations did not always play such a key role. In the late nineteenth and early twentieth centuries, employers provided benefits without specific legislated tax incentives. They did it for nontax reasons: to attract, reward, and retain employees and to provide an equitable way of retiring employees.

Legislated tax incentives followed only decades later. In the 1920s, led by the Revenue Act of 1921, the current tax treatment of pensions had its beginning; later, in late 1930s and early 50s, legislation creating the favorable treatment of health and other employee benefits was passed.

These incentives, or "breaks," primarily accrued to *employees*, not to the firm. They are deductible business expenses to firms, regardless of the form in which they are paid: in cash or in benefits. But the incentives did aim to encourage a social policy goal.

Tax incentives undoubtedly stimulated further growth of employee benefit plans, especially post World War II, as labor unions used them in collective bargaining. Later, in the 1970s, rising inflation caused workers to move into higher tax brackets. The value of tax preferences thereby increased, and the demand for them grew. And as the size of tax preferences grew, the approach taken by policymakers also changed.

Sen. Jacob Javits (R-NY) the father of the Employee Retirement Income Security Act [ERISA], believed that social policy, not tax policy, was the appropriate motivation for pension policy. He and his colleagues on the Senate Labor Committee appproached the issue from the angle of labor law and labor policy. Their goal was to fill a social need: the need for pension and welfare benefit plans to promote economic security and protection of workers. With that social and labor policy in mind, tax preferences were seen as the instrument to encourage business to assume its share of the national responsibility of providng retirement income. That was the goal; tax preferences were the means of achieving that end. It was that kind of approach that led Sen. Javits in 1967 to begin the push for legislation that resulted in ERISA in 1974.

By ERISA's tenth anniversary in 1984, the tables had turned. By then, the "tax expenditure concept" was well-established. Each dollar in revenue that could have been collected absent a tax preference began to be viewed as a cost to the government, as a government expenditure. In fact, the budget committees of Congress have viewed tax expenditures as entitlements like any other direct spending. Despite serious flaws in the "tax expenditure" concept, particularly in the calculation and measurement of tax expenditures, the tax expenditure concept influenced congressional thinking. And not without reason: although there are wild fluctuations in estimates, the size of employee benefit tax expenditures is very large—nearly $50 billion in annual revenue losses from pension plans plus $24 billion for employer-sponsored health benefits.

Gradually, the tax committees and the tax agencies of the federal government had the most influence on the direction of retirement income policy. For some, like Sen. Javits, "This is the wrong end of the stick." But like it or not, that is what happened.

And so, years before the Tax Reform Act of 1986, tax committees had seized the initiative, often with bruised egos and hard feelings among Labor Committee members who were losing the initiative.

TEFRA Marks the Turning Point

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) in many ways marks the turning point. Base broadening really began with this law. It began because federal budget deficits were huge, and the Congressional Budget Office and others were predicting sharply rising interest rates unless additional revenues were raised. President Reagan was adamantly opposed, as he is today, to any tax increases. So base broadening was the only real alternative. And Congress took it.

For pensions and employee benefits, TEFRA also marks the turning point in these ways.

1) Important legislative changes were thrust upon employers and the work place with no chance to influence the process.
2) Substantial cuts were made in tax benefits for qualified plans.
3) Roughly half a century of expansion of social programs and of employee benefits came to a close and retrenchment began.

Employee benefits became viewed by some leading senators and representives as "excessive," i.e., they were tax benefits enjoyed primarily by the higher paid, and therefore were an inadequate supplement to Social Security because too few individuals qualified for benefits. A similar theme inspired the Social Security Amendments of 1983, the Deficit Reduction Act of 1984 [DEFRA], and the Retirement Equity Act of 1984 [REA]. It also spawned legislation to cap health insurance benefits and to reform pension vesting integration, portability and coverage rules. Tax reform was not far behind.

The private sector looked upon this metamorphosis in public policy with a mixture of bewilderment, alarm and betrayal. One private-sector speaker said at a conference on ERISA held by the Senate Aging Committee:

> There was a time when the federal government was clearly on the side of providing tax incentives for the development of private retirement programs in ways that advantaged workers in every part of our economy. It's no longer clear that that is the goal of the federal government. We are hearing more and more about tax expenditures, we are hearing more and more about how this is an unjust way of providing retirement programs, while at the same time, the replacement rates of Social Security have dropped for the average worker. . . .

So the provision of private-sector benefits, which was once viewed as a social partnership between government and the private sector, had begun to take on more of an adversarial relationship. Certainly there are important exceptions. Certain congressional staff have reached out. But generally there is an atmosphere of mistrust, suspicion and disrespect. And Congress, which was critical of the status quo, was viewed by the private sector as being hostile rather than supportive of benefits in the work place.

Why Did Tax Reform Contain Rules Governing Provision of Benefits Through the Work Place?

The Department of Treasury has made the strongest statement here. Treasury's original tax reform proposal would have abolished many tax incentives for benefits on grounds that, "It is unfair that one taxpayer is excused from paying income tax on the value of a fringe benefit, while another who wants to enjoy the same good or service, but does not receive it as a fringe benefit, must purchase it with after-tax dollars." Benefits were viewed by Treasury as one example of an overall tax system that is "complex, inequitable, and interferes with economic choices of households and businesses." However, the critics of inconsistency were themselves not fully consistent. The Treasury proposal made a major exception for retirement programs that are tax-favored, saying, in effect, "This is a social purpose usefully and properly fulfilled through the Tax Code."

Echoes of the Treasury statement influenced the general tax reform justification—less intervention. Chairman Rostenkowski opposed using tax incentives to shape retirement policy. And he was by no means alone.

Yet the final provisions of tax reform include very little in the employee benefits provisions that is noninterventionist. On the contrary, it imposes the most elaborate and complex specifications that each qualified retirement, health, and welfare benefit must comply with since ERISA. These specifications are so detailed, so complex, and so difficult to understand that for many plan sponsors, even for experienced practitioners, full compliance will be difficult and in some cases impossible.

Again, the question is, "Why these contradictions?" Why did Congress embark on a course of less tax code intervention in social policy and yet disembark at the detailed specification we have discussed? In a sense, it might be helpful to recall another authority. The Roman mythical god, Janus, had, like Congress, a difficult task. His duty was to safeguard the gateways to heaven, and to do his job carefully he was depicted as having two heads facing in opposite directions. One could argue that Congress accommodated change coming from two opposing directions and had to look at two different aspects of the situation.

First, one could argue that employee benefits were spared to some extent in the tax reform. The changes overall are certainly less draconian than Treasury originally proposed. Tax preferences for most employee benefits, with the exception of three, were maintained. True, education assistance and group legal services expire at the end of 1987. But history shows the sun has a way of rising again for these programs, and there may be pressure again in 1987 to keep them.

Preservation of tax preferences for benefits was by no means automatic. Influential members of Congress early on were disposed to taxation of some benefits. There was a hard campaign waged, a political struggle in which labor unions were especially involved and influential. That is why some important employee benefits, such as the tax exemption for health insurance contributions, remain untaxed.

But what could not be done on the House or Senate floor did in fact take place behind the closed doors of the conference committee, where an agreement emerged that cut employee benefits by $44 billion over 5 years—*more* in *cuts* than either the House or the Senate approved independently.

In this case, the tax reform compromise did not split the difference. Rather, it tended to take the more restrictive of the Senate or House provisions.

Forty-four billion dollars in revenue gains sounds large, and if you measure the revenue effects of the same provisions by using current-law tax rates instead of future, lower rates, the revenue gain would be much larger.

Yet these same decisions about employee benefits reflect the thinking that benefits provided through the work place are a more effective means of helping individuals than individual efforts by themselves.

For example, over half of the benefit cuts come from individual retirement account (IRA) eligibility changes. That decision was revenue motivated—$24 billion will be saved—but it was also a policy decision, that employer plans are less discriminatory from a tax benefit standpoint than IRAs, which were far more heavily used by higher-income taxpayers.

Because work place provided benefits keep their tax preferences, it is natural to expect more regulation of them. After all, nonintervention in economic decisions was chiefly the argument for *repeal* of tax breaks. Where tax preferences were *retained*, it is logical to expect continuous, even further regulation. The result was *regulation* with a *vengeance*, a culmination of reforms discussed for years, many for a decade or more. This was a different agenda coming into play, a longstanding agenda of pension and benefit reforms, intersecting or merging with the tax reform agenda.

A reasonable argument for pension reform in the tax bill can be made despite the fact that industry begged the Congress to disassociate the two issues of tax reform and pension reform. Interested congressional staff made employee benefits an issue of tax equity, an issue of where the tax benefits flow. For example, the way in which private pension benefits are coordinated with Social Security is called integration. Tax reform made major changes prospectively in integration rules as part of the benefits provisions.

For years, staff have looked at integration from the standpoint of equity, i.e., the distribution of benefits from tax-qualified pension and profit sharing plans that are awarded preferred tax treatment by the federal government. They reasoned that the purpose of special tax treatment is to encourage establishment of *adequate retirement income*, not merely to the level of Social Security but beyond that and perhaps to permit continuation of the preretirement standard of living.

Because current integration rules test discrimination by looking at the combined benefit from Social Security and the employer plan, they allow substantial replacement for higher-paid individuals who get no Social Security beyond the maximum wage base—and sometimes zero supplementation of low or moderate paid. In Congress' opinion, changing integration in that argument provides greater tax equity and fits within the legitimate purview of tax reform.

Practically and realistically, tax reform was the only vehicle likely to carry pension reform. Congress has followed a tendency in recent years to pass megabills dealing with budget and tax issues. Sponsors of the Retirement Income Policy Act, from which many of the final pension provisions were drawn, saw tax reform as the only chance to move their bill in 1986. (They attached it to the Senate Finance Committee version of tax reform.)

The policy objectives also focused on the tax expenditure analysis.

1) Tax benefits should not disproportionately go to higher paid (hence tighter nondiscrimination rules were legislated).

2) Programs that contain tax incentives should supplement Social Security. Tax incentives are not for short-term savings plans that are squandered before retirement. The benefit provisions in tax reform could increase benefit payments at retirement by discouraging lump-sum payments, increasing coverage and benefit receipt. decreasing vesting to five years, and changing the vesting integration rules.

3) Tax incentives for benefits should be limited, not unlimited. Within this concept of limits, the goal is to discourage *over*accumulating as well as *under*accumulating. Provisions reflecting this goal are the 401(k) $7,000 cap; the excess benefit cap; and the limit on includible compensation.

At the bottom line, Congress way saying to the work place: "If you want to retain tax preferences for these programs, this is the price you have to pay." For the private sector, the price is administratively cumbersome; compliance is difficult and costly.

But in the process, the other face of government policy said, "We're also going to make you less willing to pay that price." How? Through lower tax rates of 15 percent and 28 percent.

Because of lower rates, an option for noncompliance with the tough welfare benefit nondiscrimination rules is to remove the higher paid from the plan and have the higher paid pay the tax on the discriminatory benefits.

Tax effectiveness can no longer be the chief selling point of a benefit plan. And, looking ahead, if you foresee higher tax rates, as many of us do, the wisdom of deferring compensation is called into question.

With tax effectiveness no longer the *chief selling* point, the decision to offer employee benefits will turn on different considerations. We will return to the original purposes of benefits: providing economic security and human resource needs.

But, future growth of employee benefits will be far less than previously projected. The Social Security Administration has been projecting that tax-favored benefits would more than double as a percentage of pay between now and the middle of the next century. Actually benefit growth has already slowed down, and the new rates are like pulling up the emergency brake.

So in this sense, the federal government through the lower tax rates *is* intervening *less* in the *decision* to offer benefits. But once the decision to offer them is *made*, then federal intervention is direct and detailed to make sure the social policy purposes are being achieved. This latter type of federal intervention in the work place is likely to grow, rather than diminish, in the future.

Other Mandates in the Work Place

Recent examples of congressional involvement in the work place include:

1) abolishing mandatory retirement;
2) mandating that employers continue providing pension accruals and contributions for workers beyond age 65;
3) proposing that employers contribute to state-wide risk pools to provide health coverage to the uninsured; and
4) proposing a mandate to provide unpaid parental leave.

The message is that government wants to pay less for tax expenditures and wants to buy more for its money. Buying more for its money means thrusting greater social responsibility on employers. As Sen. Javits would have said, "Business is going to be asked to shoulder its share of the social responsibility."

In the case of employer-provided retiree health benefits, Congress has intervened to pass two different pieces of legislation directly aimed at a single company—LTV Corporation—and any others that may want to follow in the tracks of LTV.

During the 99th Congress, at least 4 bills passed that will affect employer-provided health care benefits; another 7 were approved by congressional committees; and another 20 did not make it out of committee—a total of about 30 bills in the 99th Congress.

The 100th Congress Will Continue This Direction. By every indication the 100th Congress, again limited by huge federal deficits, will seek to fulfill social purposes in ways that don't carry a direct federal price tag.

Sen. Edward M. Kennedy (D-MA) stated in his decision to assume the chairmanship of the Senate Labor and Human Resources Committee that he welcomed the opportunity to participate in "creating a new agenda for social progress in America." He continued that he was, "Convinced that new approaches can work without increased spending. In a sense, the challenge on social issues in the next Congress, will be the same far-reaching challenge met and mastered by the past Congress on *tax reform*—to develop *revenue-neutral* approaches that advance the great economic and social goals of our nation."

One way of providing his goal of greater health coverage without more federal spending is to mandate that employers provide more through the work place. It therefore comes as no surprise to learn that Sen. Kennedy intends to reintroduce the Access to Health Care Act that would have required employers to extend health insurance coverage to laid-off workers for four months and forced states to set up payment systems for uncompensated health care and insurance pools for individuals at high risk. Kennedy's staff have reportedly been saying that the new legislation may require all U.S. employers to provide at least a minimum level of health insurance coverage to all workers. That could be done making health benefits part of the minimum wage.

Kennedy is by no means alone in his view that mandating is a way of getting more out of the work place. Mandating benefits through the work place is also not unique to the federal government. More than half of U.S. states, for example, mandate some form of specific health provision by employers, although the reach of these state mandates does not extend to the growing number of large employers who self-fund their health insurance plans.

Not only is there precedent for federal mandates coming from the states, but when Health and Human Services Secretary Otis Bowen released on November 20, 1986 recommendations to improve catastrophic protection for the general population, one of his recommendations was that states mandate the offer of catastrophic protection in employee-related health insurance. In effect, the federal government would be urging and relying on state mandates.

Tension between Congress and the Private Sector

In the long run the adversarial attitude between Congress and the private sector cannot endure, because it is antithetical to a representative political system such as ours.

It happens in the short run, in part, because these benefit issues are so technical and so complex that individual members of Congress do not understand them and do not, in fact, decide them. More than any other issue, benefit decisions are delegated to staff. That delegation is unwittingly facilitated by the private sector, because often the business leaders do not escalate these issues to the level that *demands* a member of Congress' attention. For example, during tax reform, business had so many other overriding tax issues that most had "bigger fish to fry." Few wanted to expend all their political capital on an issue that does not directly affect the corporate bottom line.

The trend of greater congressional intervention and mandating of social responsibility is going to affect a firm's bottom line, its profitability. For example, if a tax were levied upon firms to finance risk pools for the uninsured, business, in effect, would be taxed to provide benefits to nonemployees. This may cause corporate leadership to escalate the priority of some of the benefit issues, particularly if the tax code remains stable for awhile and competing tax issues do not come to the fore. But if business does not make benefits a priority, Congress will make the decisions for them.

Finally, the private sector can influence Congress through its own good example. Often, Congress will take a practice developed in the private sector but practiced by a minority of firms and make that the norm. For example, in the employee benefits area, one could argue that congressional mandating of faster vesting and revised integration rules did not come completely out of nowhere. By increasingly shifting to defined contribution plans, the American work place implicitly recognized the need for faster vesting. If the private sector cannot stop congressional intervention, it can nonetheless do much more to shape its long-term course.

IX. The Federal Role in Encouraging Benefit Programs: Accommodating Competing Policy Considerations

PAPER BY RONALD A. PEARLMAN*

Introduction: Basic Policy Objectives

The federal government's role in encouraging and monitoring employee benefit programs is based primarily on two broad policies. The first is the perceived need to assure that employers, in fact, provide benefits that are promised to employees. The second is an explicit encouragement through tax incentives for the provision of benefits by the private sector. (Abbreviated references to these two policies hereafter will be to the "regulation" policy and the "tax incentive" policy, respectively.) The principal focus of this paper is on the tax-incentive policy. However, in the policymaking process, the regulation and tax-incentive policies frequently overlap and, unfortunately, frequently are inconsistent. Thus, the discussion will on occasion refer to both.

We begin by accepting the notion that private-sector provided retirement benefits not only are desirable but, indeed, are an essential component of the country's retirement income security infrastructure. Thus, as was reflected in both the Treasury Department Report to the President on Fundamental Tax Reform, November 1984 (Treasury I) and the President's Tax Proposals to the Congress, May 1985, the substantial tax incentives currently contained in the Internal Revenue Code to provide retirement benefits for employees[1] were in most part retained.

Consistent with our policy to use the tax system to encourage the provision of private-sector employee benefits should be the policy to encourage their provision on the most economically efficient basis possible. Thus, for every dollar of tax incentive it is appropriate for the federal government to insist on as close to a dollar inuring to the benefit of employees as is reasonably possible. Economic efficiency

[1] Estimated in the administration's fiscal year (FY) 1986 tax expenditure budget at approximately $70 billion for FY 1986 for pension contributions and the exclusion of earnings on pension funds.

* The author acknowledges the valuable comments of his partners, Juan D. Keller and Douglas D. Ritterskamp.

also means that tax incentives should be designed to maximize employer and employee choice and minimize governmental dictates; in other words, the private sector should have primary control over employee benefit design. Finally, it is appropriate to take into consideration other government programs and costs that are affected by tax-motivated private-sector employee benefits.

We must not lose sight, however, of the need to assure that benefits promised employees are, in fact, provided. Thus, continuing and perhaps increased federal concern with the funding of promised benefits (i.e., the regulation policy) is appropriate.

In What Ways Is Federal Policy toward Retirement Benefits Changing?

Recent changes in the federal rules governing the provision and administration of employee benefits do not reflect changes in the two basic policies discussed above but do reflect an increased focus on these policies and, in turn, an increased level of sophistication in analyzing and articulating these policies. Let us look at some of the changes we have seen since the enactment of ERISA [Employee Retirement Income Security Act] in 1974.

With respect to regulation policy, we have seen the emergence of the Pension Benefit Guaranty Corporation [PBGC], much more attention to funding requirements, more attention to the regulation of prohibited transactions which might jeopardize the assets of employee benefit plans, and a greater sensitivity on the part of plan trustees to investment policies in light of public disclosure of plan assets.

Increased focus on the regulation policy has resulted in increased legislative and administrative attention to funding and related issues. It is appropriate to ask to what extent have the increased standards in this area produced a decrease in employers' willingness to provide retirement benefits—to the long-term detriment of the work force.

Clearly, the retirement benefits of many employees are more secure today than they were prior to the enactment of ERISA. It also is fair to say, however, that the funding requirements of ERISA and the potential termination or withdrawal liability of employers have reduced their willingness to provide retirement benefits to many other employees and have encouraged many employers to terminate their defined benefit plans. Certainly, the shift from defined benefit to defined contribution plans has been motivated in large part by the ERISA funding requirements.

Since it probably is fair to assume the federal government's concern with the adequacy of the funding of promised benefits will continue, we must strike a reasonable balance between the future obligations an employer reasonably can be expected to assume and the risk these obligations pose to the long-term financial security of the employer's business. If the employer perceives this risk to be unacceptable, he is likely to limit or eliminate the provision of retirement benefits.

An example of the tension produced by increased focus on the regulation policy is the dilemma resulting from asset reversions from defined benefit plans. Most would agree that an employer should not be prohibited from withdrawing from a defined benefit plan assets that *clearly* are unnecessary to the provision of future employee benefits, subject only to the condition that an appropriate level of tax be paid on any withdrawn assets to offset the tax deduction taken by the employer for the prior contribution of those assets.

Conversely, most would agree that an employer should not be entitled to withdraw plan assets without regard to the plan's future funding requirements. The problem, of course, is in the determination of what is or is not clearly needed to provide future benefits. Not only is this a subjective determination but under current practice is based on an actuarial snapshot of the plan's future financial requirements and, thus, is bound to be in error. To the extent that the current snapshot errs in accurately predicting the future rate of return on plan assets, the snapshot either will understate or overstate the extent to which existing plan assets are sufficient to provide for future benefits.

Thus, a balanced asset reversion policy must take into consideration the tension between the knowledge that any absolute prohibition on asset reversions likely will discourage employers from establishing defined benefit plans and the realization that the unlimited right to withdraw plan assets, even when prudently determined, increases the risk the plan will be underfunded in the future. Efforts undertaken by the administration over the past several years and reflected in the Treasury Department Guidelines for Termination of Defined Benefit Pension Plans (May 24, 1984) were intended to reflect a recognition of these competing considerations and an effort to accomodate them. This effort appears to be a part of a trend toward a more realistic application of the regulation policy although certainly not an abandonment of the policy.

If we shift our focus to the tax incentive policy, we also see the results of significant changes in the articulation of this policy. In a few short years, we have seen changes in the defined benefit and defined contribution limits, changes in the participation rules and proposed changes in the coverage and discrimination rules applicable to qualified retirement plans. These changes are attributable in significant part to two closely related phenomena: first, the effect of the budget deficit on tax policy generally and, second, the increased focus in recent years on the economic efficiency of tax incentives.

We have seen particularly since 1981, a legislative tax policy that is budget driven. The Tax Equity and Fiscal Responsibility Act of 1982 [TEFRA], the Social Security Amendments of 1983 and the Deficit Reduction Act of 1984 [DEFRA] all resulted from the need to raise additional federal revenues. Indeed, one can even characterize the current tax reform effort as budget driven; the revenue neutrality constraint which was so central to the development of Treasury's and the president's tax reform proposals and has been the focal point in the congressional debate on tax reform probably would have been considered expendable if it were not for annual $200 billion budget deficits.

Many believe the pressure of the budget on the formulation of tax legislative policy is constructive. Notwithstanding the social desirability of a myriad of tax incentives, each should be measured in the context of overall economic policy, including the current condition of the budget. Whether there is consensus on this point, it is clear that the current political environment is such that the budget will continue to drive federal tax policy at least for the foreseeable future and, therefore, employer-provided retirement benefits as well as other tax incentive programs can be expected to continue to be scrutinized.

Closely related to the influence of the budget process on the formation of tax policy are the increased efforts undertaken within the government and the private sector to measure the economic efficiency and effectiveness of tax incentives designed to encourage the provision of employee benefits and to explore ways to maximize the tax "bang for the buck."

Two recent examples involving particular employee benefits illustrate the potential impact on the tax legislative process of more careful economic analysis. The first relates to DEFRA as it dealt with flexible spending accounts, or so-called "cafeteria plans." This legislation was undertaken in an environment where little was known about the nature and growth of cafeteria plans. In the private sector's efforts to preserve flexible spending accounts, the desire to reduce health insurance costs was consistently offered as the reason for encouraging the adoption of cafeteria plans.

In the absence of any satisfactory data to the contrary, it was difficult for those within government to quarrel with the assertion that given the proper tax incentive, an employee could be encouraged to forgo Cadillac or first-dollar health insurance coverage in favor of somewhat more modest coverage. In fact, at the time flexible spending accounts were being debated, Treasury had no empirically developed model (that is, based on actual behavioral data) that would permit more accurate analysis of total health spending or total tax revenues. Moreover, we had not satisfactorily analyzed whether this cost-containment objective might contribute to the expansion of other employee benefits such as educational assistance, dependent care and group legal services, all of which at one time or another during the legislative debate were urged for inclusion in cafeteria plans.

Those of us in government were willing to take for granted the assertion that employees will enthusiastically embrace properly designed flexible spending accounts. In fact, the broader the menu of benefits from which the employee can select, the more advantageous the plan is likely to be to the employee from a tax standpoint and the more enthusiastic will be his or her response. What we did not know in 1984 was how employees would respond, the extent to which they would respond, and whether flexible spending accounts would, in fact, contribute to health care cost containment.

In an effort to analyze more carefully these questions, the Congress directed the Department of Health and Human Services [HHS] to evaluate the effects of cafeteria plans on the containment of health care costs. This study, which was undertaken with the cooperation of the Treasury Department but more importantly with heavy reliance on data on actual behavior, was released in July 1985. It concluded that prior estimates regarding the growth of cafeteria plans had been greatly understated; the data revealed dramatic annual increases in the number of cafeteria plans since 1981 and every indication that the growth would continue in geometric proportions. The study also concluded that flexible spending accounts do not appear to contribute to economy or efficiency in the provision of health care.

Without regard to whether one concurs in the conclusions reached in the HHS study, there appears to be general consensus that it contributes to our collective data base on cafeteria plans and advances our tools for undertaking further analysis of these plans in the future. Although it is unlikely that the report would have altered the DEFRA legislation, had it been available it certainly would have contributed to the quality of the debate.

The second illustration of the effect of careful analysis of the economic efficiency of tax-favored retirement programs hits very close to home, namely, EBRI's recent analysis of individual retirement account participation. By undertaking this analysis and by going public with it, EBRI confirmed the increasing importance of looking more carefully at the economic efficiency of tax-favored benefits.*

Where Do We Go from Here?

This paper asserts that our two basic federal government policies regarding retirement benefits, namely, the regulation policy and the tax incentive policy, have not changed but that policymakers both within government and in the private sector are being forced, primarily because of the impact of the budget on tax policy, to focus on these policies with much greater precision than in the past. In charting a course for the future, there are two major objectives that appear to be in order, one conceptual and one operational.

On the conceptual front, it is extremely important as we debate retirement benefit policy that we recognize when we are seeking to foster the regulation policy and when we are seeking to foster the tax incentive policy and, most importantly, when these two policies overlap. Previous reference to the administration's asset reversion implementation guidelines was intended to serve as an illustration of an effort to accomodate competing policy considerations. As future retirement policy is developed and implemented, it is important to articulate the regulation and tax incentive policy considerations and to seek to base decisions on a coherent accomodation of both.

The second objective is operational and relates to the increasing importance of coordinating policymaking among the administrative agencies charged with the regulation and administration of employee benefit plans and among congressional committees charged with various aspects of employee benefit policymaking.

Because federal retirement policy is at least two-pronged, involving regulation and the provision of tax incentives, it may be appropriate to continue to tolerate multiple and frequently overlapping jurisdiction. The involvement in the policy formulation process of more than one agency or department on the administrative side of government

*Editor's note: EBRI has examined use of IRAs by income level, sex, age, and other variables. Results have been published in several EBRI publications, the most recent being, Employee Benefit Research Institute, "Individual Retirement Accounts and Retirement Income," *EBRI Issue Brief* 52 (March 1986).

and more than one congressional committee on the legislative side, may well produce a more satisfactory resolution of competing policy issues. Nevertheless, the efficiency of the policy resolution process is impeded by a multiple delegation of policymaking authority and, in addition, in the administrative process creates impediments to employers who are required to deal with more than one agency on a single matter.

Within the administration, efforts have been made to coordinate major policy initiatives through the use of the former Cabinet Council on Economic Affairs and the current Economic Policy Council. More recently, in January 1986 the president created a cabinet level working group, the ERISA Coordinating Committee, chaired by the Secretary of Labor and comprised of the Secretaries of Commerce, Health and Human Services and Treasury, the Attorney General, the Director of the Office of Management and Budget, and the chairman of the Council of Economic Advisers. Several meetings of the committee apparently have been held at the subcabinet level, focusing particularly on pension funding issues.

Efforts within the administration over the past several years to coordinate retirement policy generally have been constructive. However, a careful further review of the administrative policymaking process, including a evaluation of the current authority and responsibilities of the various departments and agencies, may be appropriate to determine whether the responsibilities of any particular department or agency could be better undertaken by another agency and whether the coordination of policy otherwise might be further improved. Likewise, although admittedly more difficult, it is extremely important as we see the Congress revisit employee benefit issues with increasing frequency to encourage congressional leadership to improve the coordination of employee benefit policymaking. This will require more meaningful coordination among the tax-writing committees and other committees within each house of Congress and more meaningful coordination between the two houses. Hopefully, if the ERISA Coordinating Committee meets with success within the administration, a similar effort at coordination (perhaps resulting in the establishment of a Joint Committee) could be undertaken by the Congress.

Conclusion: Continued Legislative Change

Legislative change in the employee benefit area since 1974 can only be described as overwhelming. Frankly, although we might hope that the pace of legislation will abate, it is likely that there will be continued legislative change and most certainly a continued stream of administrative pronouncements.

There are any number of major employee benefit policy issues requiring careful consideration; for example, postretirement health care, the leveraged ESOP [employee stock ownership plan]—which is rapidly gaining prominence as a corporate financing device—and the role and obligations of pension fund managers in corporate takeovers.*

There is clearly going to be legislation dealing with asset reversions. In fact, Senator John Heinz* has said that he views asset reversions as an important item for the 1987 legislative agenda.

Postretirement health benefits will also be the subject of future legislation. And, I view nonstatutory fringe benefits as prime candidates for future legislation, particularly if further base-broadening efforts are undertaken, as I suspect they will be if Congress determines additional revenues are needed.

Nonqualified deferred compensation will probably be a candidate for legislative reaction, both because there is a perception that it is the ultimate nondiscriminatory compensation and also because of the perception that the existence of nonqualified deferred compensation plans have an adverse effect on an employer's willingness to establish or embellish broader-based qualified plans.

Finally and somewhat unrelated, there will probably be legislation in the ESOP area. I see this resulting from several things: first, Senator Long's* retirement; second, the pressure being placed on the administrative process to treat ESOPs differently; and finally, the realization of the risks to participants in stock ownership plans, particularly to the extent the plans are being used in shaky leveraged buy-outs.

Furtherance of the federal government's legitimate roles in fostering private-sector employee benefit plans and in protecting covered employees through the responsible regulation of such plans can best be effected by proper recognition of the need to accommodate com-

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*Editor's note: Senator William S. Cohen (R-ME), writing in the *New York Times*, stated that "All the ingredients are present for a major scandal in the handling of pension funds" because managers are using the funds in "the Pac-Man mania of takeovers and mergers."

*Editor's note: John Heinz (R-PA) was chairman of the Senate Special Committee on Aging—one commitee that monitors pension issues—from 1980–1986.

*Editor's note: Russell Long (D-LA), former chairman of the Senate Finance Committee, played a major role in passing legislation to create ESOPs.

peting policy considerations and in the increased analysis within government and in the private sector of the most effective ways to implement these policies.

X. How Do the Tax Advantages Given Qualified Plans Increase Retirement Income?

PAPER BY DAVID C. LINDEMAN

Introduction

The potential scope of our assigned topics—what are the appropriate roles of government in securing retirement and economic security for the American worker and how are those roles changing—is daunting. I have chosen to concentrate on the federal role in retirement income policy and, because they are so important to federal revenues and spending, I will focus particularly on the tax advantages given qualified plans and on Social Security. My paper has three sections. First, I outline the dimensions of the federal government's current role in retirement income provision. Second, because it looms so large in any consideration of future trends, I examine how the Tax Reform Act of 1986 may affect that role. Third, I examine the current federal role and some future choices in terms of the competing political cultures of our society.

Dimensions of the Current Federal Role

Because of industrial organization, job mobility, and greatly improved life expectancies, modern societies inevitably have had to develop structured (and relatively impersonal) means to enable their citizens to transfer potential consumption and leisure from their prime working years to their later years. Starting early in this century and beginning earnest in the 1930s and 1940s, the federal government has assumed paramount responsibility for this nation's organized systems of retirement income provision—primarily through Social Security, the tax code's support of qualified plans, and the broad regulatory framework of ERISA.[1]

How central retirement policy is to the federal government is demonstrated by how much of its resources is devoted to Social Security

[1] The federal government also fosters other types of retirement assets, such as housing, through tax subsidies and government guarantees. It also has a substantial and growing commitment to the health care of the aged through the Medicare and Medicaid programs.

and, indirectly, to qualified plans. Social Security cash benefits are the largest social spending program maintained by the federal government. For the foreseeable future, Social Security will command between roughly 4.75 percent and 6.3 percent of the gross national product [GNP].[2] Social Security is also the federal government's single largest program of income redistribution. Among its other features, Social Security redistributes the costs of retirement income from higher-wage to lower-wage workers.

In terms of annual revenue losses (albeit an imperfect measure on several grounds), the tax advantages[3] given qualified plans and IRAs are the largest departure from the income tax base—about $77 billion in 1987 or an amount approximately equal to 1.7 percent of the GNP.

Another way of looking at these tax advantages is to ask how much they increase retirement incomes. Table X.1 displays results from a simulation of retirement incomes in the year 2019 based on policy before the Tax Reform Act of 1986.[4] (As I conclude later, these simulated results probably are still valid even after tax reform.) Because of the tax advantages given qualified plans, the simulation estimates that the incomes of couples, both of whom are retired, will be 21 percent higher than if the tax advantages did not exist. Stated somewhat differently, the retirement income gain from the tax advantages will equal about 17 percent of the average retired couple's income. In contrast, for such a couple, Social Security probably will constitute around 35 percent to 40 percent of their retirement income.

Because qualified plans enjoy such considerable tax advantages, it has long been held that conditions should be imposed on them in

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[2] See Appendix F of the 1986 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, alternative II-B assumptions.

[3] By the tax advantages of qualified plans, I mean that extra amount of retirement income that a qualified plan beneficiary receives because his savings in that plan were given preferential treatment during the accumulation phase. These preferences are essentially twofold. First, foregone wages devoted to savings in a qualified plan (usually in the form of employer contributions to the plan) effectively are taxed at the worker's tax rate during retirement. For many workers (more so before the Tax Reform Act of 1986), tax rates in retirement are lower than the tax rates they encounter while working. Second, those foregone wages (or contributions) are allowed to earn interest or other investment income at a full market rate of return, rather than at an after-tax rate of return.

[4] Tables X.1–X.4 are based on a simulation of the Pension and Retirement Income Simulation Model by ICF Incorporated, prepared for the Congressional Budget Office [CBO]. These tables have been taken from a forthcoming CBO paper on the tax advantages of qualified plans. A detailed description of the simulation and its results will be contained in that paper. The simulations may be separately obtained from the author at any time.

TABLE X.1
Distribution of Income Gains from the Tax Advantages of Qualified Plans in Year 2019

Quartiles of Income without Gains	Average Income without Gain	Average Income Gain	Percent Increase	Percentage Share of Total Increase
		Single People in 2019		
All	$12,228	$ 1,760	14%	100.0%
Q1	4,426	116	3	0.3
Q2	8,210	394	3	5.8
Q3	12,484	1,405	11	20.8
Q4	23,683	4,908	21	72.9
		Couples Retired in 2019		
All	$26,085	$ 5,410	21%	100.0%
Q1	14,276	1,965	14	9.1
Q2	21,345	3,630	17	16.7
Q3	27,426	6,133	22	28.3
Q4	41,240	9,883	24	45.8
		Couples Working in 2019		
All	$51,173	$ 6,282	12%	100.0%
Q1	30,659	2,677	9	10.6
Q2	43,166	4,706	11	18.6
Q3	55,415	6,058	11	24.0
Q4	75,128	11,611	15	46.6

Source: Congressional Budget Office. Simulations from the Pension and Retirement Income Simulation Model, 1986.
Note: All incomes are after-tax incomes.

exchange for the foregone revenues that could have been used to finance lower tax rates or increased public expenditures. Hence, the tax code contains nondiscrimination requirements that limit discretion about which employees are covered and the extent to which contributions and benefits may vary according to income or other criteria. As a consequence of the nondiscrimination rules, higher-income workers probably bear some of the costs of retirement income accruing in qualified plans for the benefit of lower-income workers.

Table X.1 gives some sense of the success of the nondiscrimination rules, as well as the breadth of basic demand among workers for qualified plans. As a percent of retirement income, the increases from the tax advantages are relatively uniform among couples—ranging, for example, between 14 percent for those in the lower quartile to 24 percent in the highest. Some of this bias in favor of the upper-income population is inevitable in a progressive tax system; the tax advantages are necessarily more valuable the higher a worker's marginal tax rate. In addition, some of this upward disparity will be offset by net losses in Social Security for those in the higher quartile and net gains in that program for those lower in the income distribution.

When we examine results by the length of time under a qualified plan, a different picture emerges. Tables X.2, X.3 and X.4 indicate that within any income class, the gains from the tax advantages are disproportionately enjoyed by those who are simulated as enrolled in one pension plan for at least 20 years. For example, among retired couples, the tax advantages of qualified plans are, on average, about two or two and one-half times more valuable for long-service workers. In the bottom quartile, the comparable ratio is somewhat more skewed; here the tax advantages are over three times more valuable for long-service workers than for short-service workers.

The importance of plan tenure is even more important among retired singles. Among singles in the upper half of the income distribution, the gains in retirement income from the tax advantages are three to four times more valuable for the long-service worker, and in the bottom half of the income distribution virtually all the gains are

TABLE X.2

Distribution of Gain in After-Tax Income by Plan Tenure in Year 2019 for Singles (1984 dollars)

Quartiles of Income Without Gains	Years of Longest Plan Tenure	Average Income without Gains	Average Income Gain	Percent Increase
All	Under 20	$10,176	$ 596	6%
	20+	17,610	4,755	27
Q1	Under 20	4,370	44	1
	20+	5,472	1,416	26
Q2	Under 20	8,144	98	1
	20+	8,467	1,552	18
Q3	Under 20	12,361	722	6
	20+	12,760	2,927	23
Q4	Under 20	22,179	2,105	9
	20+	24,976	7,323	29

Source: Congressional Budget Office. Simulations from the Pension and Retirement Income Simulation Model, 1986.

Note: All incomes are after-tax incomes.

TABLE X.3
Distribution of Gain in After-Tax Income by Plan Tenure in Year 2019 for Retired Couples (1984 dollars)

Quartiles of Income without Gains	Years of Longest Plan Tenure	Average Income without Gains	Average Income Gain	Percent Increase
All	Under 20	$23,088	$ 2,540	11%
	20+	29,006	8,205	28
Q1	Under 20	13,936	1,104	8
	20+	14,975	3,829	26
Q2	Under 20	21,081	2,150	10
	20+	21,649	5,331	25
Q3	Under 20	27,452	3,700	13
	20+	27,406	8,019	29
Q4	Under 20	39,764	4,638	12
	20+	41,943	12,379	30

Source: Congressional Budget Office. Simulations from the Pension and Retirement Income Simulation Model, 1986.
Note: All incomes are after-tax incomes.

TABLE X.4
Distribution of Gain in After-Tax Income by Plan Tenure in Year 2019 for Working Couples (1984 dollars)

Quartiles of Income without Gains	Years of Longest Plan Tenure	Average Income without Gains	Average Income Gain	Percent Increase
All	Under 20	$48,609	$ 3,778	8%
	20+	53,713	8,761	16
Q1	Under 20	30,293	1,490	5
	20+	31,152	4,276	14
Q2	Under 20	43,188	3,138	7
	20+	43,136	6,767	16
Q3	Under 20	55,164	4,281	8
	20+	55,614	7,478	13
Q4	Under 20	74,578	7,312	10
	20+	75,504	14,547	19

Source: Congressional Budget Office. Simulations from the Pension and Retirement Income Simulation Model, 1986.
Note: All incomes are after-tax incomes.

concentrated among long-service workers. These horizontal differences among singles help explain the vertical disparity among single people shown on Table X.1. Because there is a strong correlation between single status and lack of coverage or short job tenure, few singles in the bottom half of the income distribution receive gains from the tax advantages. But the few that do receive such gains have increases in the retirement income comparable to those of couples. I should note, however, that some of the vertical disparity among singles is the result of divorced wives not receiving very much from their former husbands' pensions. Unfortunately, this simulation does not reflect the possible effects of the Retirement Equity Act on such outcomes.

In part, these horizontal dispartities can be explained by coverage and vesting rules. If a worker is never covered by a plan or if he never vests, by definition he cannot obtain any of the tax advantages associated with qualified plans. In addition, these horizontal disparities are the result of the interaction of inflation and the value of deferred annuities under final pay defined benefit plans. When a vested employee leaves such a plan, he is entitled to a deferred annuity, starting at the plan's annuity starting date, based on his *nominal salary at the time he leaves the firm* that is sponsoring the plan. Even with a relatively modest rate of inflation, the present value of that deferred annuity entitlement erodes very quickly if the employee leaves the firm any time in younger or even middle years.

The extensive regulatory duties of the Department of Labor [DOL] under ERISA are another measure of the importance of retirement policy to the federal government. In the main, the role of DOL under ERISA can be characterized as consumer protection. The various aspects of ERISA—the reporting and disclosure rules; the definition of and duties imposed on fiduciaries; rules that give a uniform meaning to key pension variables such as "years of service;" and even, it may be argued, the funding requirements—are designed to help the worker better negotiate his pension plan and to more accurately assess his outcomes under any plan. The other ERISA requirements—the participation and vesting rules—apparently exist to force any broad retirement plan into the regulatory nexus of the tax code.[5]

[5] Both ERISA and the tax code prescribe that any broad-based retirement plan must be funded and that participation and vesting must occur well before retirement. The tax code also makes it inevitable that employees in any broad-based nonqualified plan have to pay taxes on contributions and investment income accruals after vesting. Thus, employees and employers alike are motivated to be sure that any broad-based retirement plan also qualifies under the tax code.

The Tax Reform Act of 1986

By itself, the new income tax rate structure legislated by the Tax Reform Act of 1986 will not alter the basic demand among employees for qualified plans or other employee benefits. CBO tabulations show that marginal tax rates will be affected only slightly by the new rate structure (tables X.5 and X.6).[6] In 1988 marginal tax rates will be reduced by only 6 percentage points or less for most taxpayers (about 97 percent of taxpayers), compared to previous law. Among the 3 percent of taxpayers whose earnings exceed $75,000, reductions in marginal rates will be about 9 to 17 percentage points compared to previous law. Though for these upper-income individuals, retirement savings through qualified plans will still be a better alternative than any other, the lower tax rate structure will mean a smaller wedge between tax-favored rates of return in qualified plans and taxable rates of return. Hence, the pool from which any redistribution within qualified plans can be financed will be smaller. In addition, the ability of the well-to-do to escape the redistribution requirements imposed

TABLE X.5

Average Marginal Tax Rates in 1987 under Current Law and Conference Agreement for Wage Earners, Weighted by Unit and by Wages and Salaries

Wages and Salaries (W&S)	Current Law		Conference Agreement			
	By Unit	By W&S	By Unit	By W&S	# Units	Total W&S
Less than $10,000	9.1	12.3	7.3	10.2	28627.	135777.
$ 10,000–$ 19,999	17.7	17.9	16.2	16.1	21866.	322189.
$ 20,000–$ 29,999	21.8	21.9	19.4	19.5	14622.	361079.
$ 30,000–$ 39,999	25.3	25.4	21.3	21.4	10903.	377402.
$ 40,000–$ 49,999	28.4	28.5	26.3	26.4	6947.	309871.
$ 50,000–$ 74,999	32.7	32.9	30.2	30.5	6576.	389476.
$ 75,000–$ 99,000	37.3	37.3	33.7	33.7	1364.	115420.
$100,000–$199,000	40.3	40.5	34.8	34.9	802.	104494.
$200,000 or more	43.8	44.1	35.1	35.1	192.	64963.
All incomes	19.0	26.6	16.8	23.6	91899.	2180671.

Source: Congressional Budget Office. CBO Individual Tax Model, 1986.

[6] Tables X.5 and X.6 display simulations of marginal tax rates before and after the Tax Reform Act of 1986, as generated by the Congressional Budget Office Individual Tax Model using data from the IRS *Statistics of Income*.

TABLE X.6

Average Marginal Tax Rates in 1988 under Current Law and Conference Agreement for Wage Earners, Weighted by Unit and by Wages & Salaries

Wages and Salaries	Current Law		Conference Agreement			
	By Unit	By W&S	By Unit	By W&S	# Units	Total W&S
Less than $10,000	9.1	12.2	6.5	8.9	27757.	131511.
$ 10,000–$ 19,999	17.6	17.8	16.8	16.9	21767.	321314.
$ 20,000–$ 29,999	21.7	21.8	18.5	18.6	14793.	364859.
$ 30,000–$ 39,999	25.3	25.3	20.0	20.0	11197.	388613.
$ 40,000–$ 49,999	28.3	28.3	24.2	24.3	7493.	334828.
$ 50,000–$ 74,999	32.5	32.7	27.3	27.4	7775.	462961.
$ 75,000–$ 99,999	37.4	37.4	28.8	28.8	1679.	142249.
$100,000–$199,999	40.2	40.4	30.6	30.6	959.	124291.
$200,000 or more	43.8	44.1	27.7	27.2	222.	75358.
All incomes	19.4	27.0	16.2	22.1	93642.	2345984.

Source: Congressional Budget Office. CBO Individual Tax Model, 1986.

on these arrangements is narrowed by the tax bill; by how much is unclear.

The effect of these changes—less being available for redistribution and tighter nondiscrimination rules—will partly depend on the employment context. Large plans mainly exist in response to a consensus demand among the rank-and-file (often expressed through their unions) and, quite possibly, because of the production requirements of employers. These plans generally are not very discriminatory under current law and probably contain relatively little shifting of costs from upper- to lower-income workers. On balance, tax reform should not affect the formation and continuation of these plans to any great extent.[7]

[7] The new section 415 defined benefit limit on early retirement benefits, however, could throw increasingly large numbers of the middle-management and even highly skilled hourly workers into unfunded "excess benefit" plans. Although this may be appropriate from a revenue and tax equity perspective, it does conflict with the objective of ERISA to assure retirement plans are funded. To compromise these conflicting policies, it may be necessary to develop a new creature in the Code and ERISA—funded excess benefits plans that do not raise constructive receipt problems once the employee vests but in which the investment income of the funds are taxed at, say, the 28 percent rate. The recent provisions in DEFRA [Deficit Reduction Act of 1984] governing the funding of postretirement medical benefits provides a model for such an arrangement.

Among medium- and smaller-sized employers, tax reform may have different effects. If, as generally thought to be the case, the rank-and-file's *a priori* collective demand for qualified plans is weaker in these settings, the typical employee is less willing to absorb any reductions in current income to finance these plans. Because of the nondiscrimination rules, owners and upper-income management must share some of the gains from the tax advantages of qualified plans otherwise accruing to them in order to finance benefits and bribes to reluctant savers among the rank-and-file. But by shrinking the wedge available to finance any vertical redistribution and by making such redistribution harder to avoid, the tax reform bill alters whatever are the existing balances in such plans. One likely response is that fewer traditional pension plans—with their fixed employer commitments—will be established in settings when the consensus demand among the rank-and-file for retirement savings is weak. In addition, some existing pensions in such settings may be closed down.

Because 401(k) and similar plans allow rank-and-file workers to sort themselves according to their savings preferences, tax-favored savings plans may become increasing attractive in settings where the demand among the rank-and-file for retirement income is not very uniform. In fact, the new provisions for elective deferrals in SEPs [Simplified Employee Pensions] may help spread these arrangements. Even here, however, the Tax Reform Act's tighter constraints—more stringent average deferral percentage rules, the $7,000 limit on elective deferrals, the narrow strictures on the use of elective deferrals in SEPs, and the narrower definition of the highly compensated—make formation of such savings plans less attractive to owners and management. When faced with a great many reluctant savers among his rank-and-file, the small employer might simply resort to more private savings on his own—for example, private deferred annuity contracts—and abandon qualified plans of any sort.

In general, I conclude that the simulation results presented in tables X.1 through X.4 have not been much altered by tax reform. Because of lower marginal tax rates at the very top of the income distribution, the value of the tax advantages by definition will fall somewhat; however, only a fraction of those in the top quartile will be so affected. Conceivably, the new vesting, coverage, and integration rules could have some effect on the income and plan tenure distributions shown on those tables. The new vesting rules, however, have been estimated to increase plan costs by only about 2 to 7 percent (about .03 percent of annual compensation on average).[8] This relatively small cost suggests that the new vesting rules will have little effect on the typical employee's lifetime pension benefits and, therefore, his gains in retirement income from the associated tax advantages. Relatively small gains are especially likely in defined benefit plans where preretirement inflation will continue to render most of the newly vested benefits among short-service workers a nullity. Though no comparable estimates of the new coverage and integration rules yet exist, their effects in the aggregate are not likely to be very large.[9]

Three Competing Political Cultures

In some recent work Aaron Wildavsky[10] has put forward an interesting and, I believe, helpful way of thinking about political change in America. He suggests that America has three political cultures: one that places primary emphasis on liberty and equal opportunity; one that places primary emphasis on equality of condition; and one that places primary emphasis on social order within a framework of structured hierarchies. To some extent these political cultures compete one with another, although clearly our nation's political and economic institutions contain elements of all three. Similarly, each citizen fashions his own political and economic world view in ways that commingles these three cultural perspectives. Indeed, Wildavsky asserts that the United States is special because of the widespread belief among its citizens that liberty and equality are compatible with each other and with fundamental social order.

I believe that these three categories can help illuminate trends and compromises in federal retirement income policy. For example, the Social Security system contains traditional notions of social order and egalitarianism. Its central "earned right" premise legitimizes the program in terms of work—a basic value central to any social order—and the program's distribution of benefits is structured in no small degree around the basic social unit of the family, rather than simple

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[8] See Employee Benefit Research Institute, "Pension Vesting Standards: ERISA and Beyond," *EBRI Issue Brief* 51 (February 1986).

[9] With the exception of the new minimum coverage rule, the new coverage standards continue to allow employers considerable discretion in what types of employees they choose to cover, and few major plans now exceed the integration maximums that the act apparently is trying to codify.

[10] The categories have been taken from Dennis Coyle and Aaron Wildavsky, "Requisites of Radical Change: Income Maintenance Versus Tax Reform," paper prepared for a September 1986 conference sponsored by the Federal Reserve Bank of Boston and the Brookings Institution on "The Income Maintenance Experiments: Lessons for Welfare Reform."

market measures of equity. Its distribution of benefit outcomes toward lower-wage workers clearly achieves a greater equality of results.

Of the three cultures, individualism is represented least in Social Security, although arguably its inherent portability enhances competitive individualism in the job market. Individualists always have been uncomfortable with Social Security and frustrated with its widespread support among both generally conservative hierarchs and more liberal egalitarians. As long as the program's start-up windfall seemed to make everyone winners, the individualists' complaints had little effect. But, as that windfall has wound down, criticisms from the individualist camp about Social Security have become more insistent and seriously regarded. The debate in the late seventies about "earnings sharing" for Social Security is one such manifestation, and the more recent surge of "rate of return" analyses and critiques from various quarters is another. Even the 1979 Advisory Council felt it necessary to recommend that all workers receive an equal average and marginal rate of return in Social Security as measured by the very visible employee payroll tax (though not as measured by the less visible employer payroll tax).

Public policy toward employer-sponsored pensions also contains elements of all three political cultures. The record is clouded, but I suspect that at the start tax policy toward occupational pensions was motivated more by a general feeling that the tax code should accommodate a set of preexisting and highly regarded institutions rather than by an explicit desire to encourage a specific activity—retirement savings—among workers. As institutions, defined benefit pensions are attractive to the hierarch element in our society. They promote stable employer and worker relationships and, hence, settled communities; they emphasize long-term commitments and evidence social responsibility by employers for loyal employees. Though economists can and have rationalized the defined benefit promise in terms of employer and worker bargaining about lifetime wages and the maximization of production in enterprises demanding firm specific capital and training, the defined benefit pension has qualities of a social institution that are not easily explained by standard economic analysis.

The egalitarian and individualist cultures, of course, also have had their influence on public policy toward pensions. The extension of the income tax in the 1940s to the whole population increased by several orders of magnitude the gains from the tax advantages previously given to pensions as institutions, and as a result the principle of nondiscrimination in qualified plans was first legislated. Though arguably both policy objectives always have been present, the avowed justification for the nondiscrimination rules seems to have been shifting since then from one of preventing too much tax avoidance among a select few—owners and management—to one of redistributing the gains arising from the tax advantages from upper- to middle- and lower-income earners.

Egalitarians and, to some degree, individualists (at least those who acknowledge that unequal bargaining power can exist) can concur about the first rationale—limiting tax avoidance. For individualists, however, the logical remedy for preventing owners and management in company-based qualified plans from monopolizing the tax advantages is to assure that those advantages are open to all would-be savers. Taken to logical conclusion, this position eventually leads to a consumption tax or, at the least, very large IRAs. Egalitarians, on the other hand, need the structure of company-based plans in order to achieve redistributional results. Thus, an implicit alliance has developed between egalitarians and those who favor pensions for reasons of social order. Hierarchs can reconcile themselves to limiting tax avoidance and to some redistribution of costs and benefits, provided that neither objective is taken to the point where they undermine pensions as viable institutions.

ERISA, as would be expected from a major piece of legislation, represented a blending of the three cultures. The provisions for reporting and disclosure, the specification of uniform terms, and even the requirement of funding can be seen as correcting market failures and enhancing the ability of workers and employers to negotiate rational pension outcomes. All but the most extreme individualists could be comfortable with these market-oriented remedies. Egalitarians received greater prescription of outcomes in the form of rules about participation, vesting, joint-and-survivor annuity requirements, and such. Hierarchs were assured that the status quo would not be too greatly disrupted, and the provision of PBGC insurance extended a mantle of protection around defined benefit plans as institutions that the market probably would never provide.

Since ERISA, Congress seems to have vacillated between individualism and egalitarianism in its legislation about qualified plans, while continuing to shore up PBGC protection for defined benefit plans. On the one hand, Congress has fostered so-called tax-favored savings—IRAs and salary reduction agreements through 401(k), 403(b) and similar arrangements. Both IRAs and, to a lesser extent, salary reduction arrangements provide access to the tax advantages of qualified plans on a more flexible, individually determined basis than can happen within the structure of traditional pension plans. Because each worker must decide how much to exploit these advantages, the emphasis is on individualism rather than on collective decision-making.

On the other hand, repeated cutbacks in section 415 limits, the top-heavy rules in the 1982 Tax Equity and Fiscal Responsibility Act, the Retirement Equity Act, the extensive provisions in the Tax Reform Act of 1986, and other recent legislation about qualified plans evidence very egalitarian objectives. It is true that without the imperative of the budget deficit, some of these actions—for example, the cutbacks in the section 415 limits and the recently enacted limits on deductible IRAs and salary reductions—probably would not have taken place. As an indicator of what may happen in the future, however, this pattern may be significant. Faced with the need to raise revenues in the area of qualified plans, Congress first limits the tax advantages for those at the upper end of the income distribution.

In general, however, there has been a shift in viewpoint from perceiving the tax advantages of qualified plans as attributes of certain institutions—company based pensions—to regarding them as attributes of, and incentives for, an activity—retirement income saving—that can be abstracted from those institutions. Partly this is attributable to the triumph of economists in public policy analysis. Partly it reflects a changing economy with global markets, less permanence in industries and large corporate employers, and declining union influence. In this changed economic environment, final pay defined benefit plans, as they are now constituted, do not easily accommodate the retirement income aspirations of a work force that is more mobile and less certain about the duration of their jobs.

The more that the activity of tax-favored retirement savings is abstracted from the institutions of company-based plans, the greater the potential emphasis on the values of individualism. For those policymakers with strong egalitarian objectives, this shift poses a dilemma. In the past, egalitarians have made common cause with the hierarchs because company-based plans can be manipulated to achieve more vertical redistribution (high- to middle- and low-income workers) that cannot be achieved otherwise—except through direct spending programs like Social Security.

On the other hand, the egalitarian and individualist imperatives have combined to force changes in qualified plans to make them behave more like individual savings—for example, the just-enacted limits on vesting periods—in order to achieve more equal results between short- and long-service workers. Though the distribution of benefits between long- and short-service workers does have its effects on the size and distribution of incomes in retirement, it is just as important for determining how equally the gains of qualified plans are distributed within any given income class. The growing question for egalitarians is to what extent can the demands of horizontal equity—more equal distribution of the gains from qualified plans within given income classes—be reconciled with the desire for vertical redistribution.

Conclusion

As I indicated earlier, although the many changes in the 1986 Tax Reform Act related to qualified plans address what many perceive as abuses, they probably will not much change outcomes from what they would have been otherwise. If anything, the tax system has been changed in ways that probably will make it more difficult to achieve voluntary redistribution through qualified plans. The continuing pressures of the budget deficit may well bring further restrictions on qualified plans and, thereby, the ability of society to achieve redistributional goals through their operation. In this situation it is appropriate for Congress and others to step back and examine retirement objectives more deliberately. In fact the [House] Ways and Means Committee has just begun that kind of reexamination. In that vein let me pose some concluding questions.

How much more vertical redistribution of retirement income is desirable to achieve what ends? Do we have the appropriate measures to evaluate that question? Our current standards of replacement rates for either Social Security or qualified plans are not very well grounded in empirical examination of consumption either before or after retirement. Much more normative and empirical analysis needs to be done before we can even grapple intelligently with alternative objectives and policies. Given some objective of vertical redistribution of retirement income, what are the tradeoffs between using Social Security and tax policy? Would it be better to use Social Security more for these ends and loosen somewhat the strictures on qualified plans?

Potentially more urgent for resolution are questions about the horizontal distribution of the gains in retirement income attributable to the tax advantages of qualified plans. As long as coverage remains at its present levels and final pay defined benefit plans provide little in lasting value to younger and short-service workers, large disparities in the distribution of these gains by coverage and job tenure will continue. Should Congress try to alter these outcomes by even greater prescription of defined benefit plan rules than it already has done? Alternatively, should greater access to retirement savings of the defined contribution type be created for all workers, thus allowing the otherwise uncovered worker or the short-service worker in a defined benefit plan a way to compensate? Can such access be created without increasing disparities in the vertical distribution of the tax advantages from qualified plans and at an acceptable cost in terms of revenues? What are the consequences of either approach—more prescription of defined benefit rules or more access to defined contribution savings—on the viability of defined benefit plans, and what are the economic and social costs, if any, of undermining their viability?

These are not easy questions to answer, nor do they exhaust the full range of the important issues Congress may have to address in retirement policy over the next several years. (Another key question is to what extent do Social Security and qualified plans reserve sufficient income for the long-lived widow?) They do, however, point out the interdependency of our competing value systems and our existing mechanisms. For example, the more emphasis that is placed on egalitarian objectives in Social Security, potentially the more emphasis can be placed on individualist objectives in qualified plans. Conversely, if Social Security is made less redistributional, as many are now advocating, the more likely that greater social controls will be placed on qualified plans and even other less tax-favored forms of retirement savings.

With many others, I worry about Congress using up scarce political capital by constantly changing the rules of qualified plans. Thus, I hope—albeit with little optimism—that in the next round of major policy deliberations about retirement income provision we ask these systemic questions about the nation's largest social spending program and our biggest exception to the tax base, rather than being driven solely by perceptions of abuse in qualified plans and similarly partial analyses of Social Security objectives.

XI. The Federal Role in Retirement Income Security: Income Policy in a Tax Policy World

PAPER BY PATRICIA E. DILLEY

The question, "what are the appropriate roles of government in retirement and economic security," seems to suggest that in some alternative vision of the next 50 years, there might not be much of a federal role. My purpose today is to explode that notion.

The phrase "privately funded retirement income security" is a contradiction in terms for all but the privileged few in this society. Without the federal role, whether through the direct benefit payments of the Social Security program, or indirect tax expenditures for qualified pension, profit sharing, and retirement savings plans, there would be no such thing as retirement income security.

Indeed, I would suggest that the federal role today is barely adequate to meet the requirements of the baby boom as it reaches retirement age. The real issue facing us is not whether there will be a federal system of assuring retirement income, but how the benefits of that system will be distributed across income levels. While much can be and needs to be said about the concrete achievements and gaps in the current system and possibilities for the future, my discussion will focus on two general issues concerning the structure of the current debate: first, the overall outlook for the retirement of the baby boom generation and the issue of "intergenerational equity;" and second, the prospects for a true national retirement income policy structure.

In considering these issues and how Congress should approach the task of planning for problems arising well into the next century, it is critical to resist oversimplification both of problems and solutions. There is no reason to assume today's answers to retirement security questions will also be tomorrow's. The issues we face in retirement income security are important and recurring, but they do not constitute a crisis that must be resolved with heroic (and politically sexy) actions today. Rather we must be prepared to take on the more difficult task of addressing issues arising out of changing needs of the work force and the economy as they develop—before crises emerge.

It thus seems most productive to work toward establishing a policy-making *structure* flexible enough to respond as problems become apparent, as well as a benefit and tax *policy* that provides the primary long-term security workers need without locking in inefficient and ultimately socially destructive subsidies. Our goal must be to promote both stability and security in retirement income for workers across income lines, while preserving and encouraging the flexibility of the private system for employers of all sizes and employees who prize job mobility as much as future security.

Baby Boom Retirement and Intergenerational Equity

Much of the debate throughout the last decade over the long-term prospects for secure retirement income for American workers at all income levels has been sparked by recurrent financial crises in the Social Security system. Discussions of ways to strengthen the private pension system and to promote savings for retirement inevitably assume that one major reason for doing so is to "take the pressure off of Social Security." The other major reason cited for encouraging private measures to ensure retirement income is to encourage overall savings and capital formation, which the Social Security system is widely assumed to discourage, based on Martin Feldstein's* persistent theories (and advocacy of those theories.)

Even analysts who generally support the notion of federal income support for retirement can disagree about the appropriate levels of benefits and the relative role of public and private retirement security measures. However, the current debate has taken on a more fervent air, as proponents of the notion of "intergenerational equity" have begun to dominate media and political discussions of the future of Social Security and private pensions.

These discussions generally present a stark picture of emerging generational warfare. As the costs of programs to support the elderly have taken a major share of the federal budget, children have become the nation's most impoverished age group, and young workers have a harder time making ends meet and pay higher taxes than their parents did. Under this analysis, Social Security is presented as the paramount success of federal domestic policy that has, ironically, outlived its usefulness, redistributing income from impoverished young workers to wealthy retirees.

The widespread popularity of the Social Security system cannot be denied, even among young workers who do not believe it will be

* Editor's note: Martin Feldstein, a Harvard economics professor since 1969, was chairman of the Council of Economic Advisers' from 1982 to 1984.

available to them in their retirement, as a way of providing for their parents and grandparents. However, it is argued that the program must be adjusted to fit the new economic landscape despite its political untouchability, particularly in light of the expansion of the private pension system and tax deferral incentives for retirement savings through IRAs, Keogh plans, and 401(k) plans.

Traditional retirement policy analysis has long seen the private and public systems of retirement security as complementary, two aspects of what should be a single structure. This perspective has been radically twisted in the intergenerational equity debate of recent years, which poses the two realms as opposing alternatives rather than parts of a whole. In my view, this is a polarizing and counterproductive trend of political analysis. Framing the issue as a choice between private and public retirement systems can ultimately only distract policymakers from the substantive issues of how the public and private systems should be coordinated.

My thesis is a rather simple one: retirement income security programs, public and private alike, serve a variety of public policy goals, the principal one being social stability in the face of economic uncertainty. The private pension system is guided just as much by public policy decisions, expressed through the tax code, as the Social Security system is through an explicitly redistributive benefit structure. While individual choice about savings vehicles may be given more scope in the private sector, the tax subsidy encouraging those savings represents a distributive incomes policy choice just as much as decisions about the Social Security benefits structure.

The financing changes made to the Social Security system in 1977 and 1983 represent a continuation of, rather than any basic change in, the fundamental premise that social insurance is the basic and necessary mechanism in modern industrial society for regulating the flow of production from the working to the nonworking. The key issue is what the nature of that regulation should be. Social insurance provides a coherent structure within which choices may be made about how income is to be distributed, between generations and among individuals at different income levels within those generations, through the political system rather than through the vagaries of the market economy. The tax incentives for private pensions and savings form an integral part of the overall income security structure based on social insurance, as a means of allowing choices by individuals in saving for retirement and by employers in offering different incentives to employees in varying circumstances.

The current debate over expansion of the private tax-favored system to replace or allow diminution of the public social insurance system has tended to focus on two areas: the insecurity of the Social Security system, and the negative impact of public funding on savings rates and capital formation. The concentration on the economic impact of Social Security is misplaced, primarily because this analysis tends to overlook the broad policy goals of the retirement income system as a whole. As for the widespread predictions of the future collapse of Social Security as the baby boom retires, a brief examination of the current and future funding picture reveals that there is much less than meets the eye to the pop demographics of intergenerational scare stories.

Current and Future Funding Issues in Social Security

Social security systems, including private annuities and savings incentives, generally represent an attempt by industrialized society to promote social stability across income lines and between employer and employee, who otherwise would be engaged in a personal battle over at what age work should end and what level of income is available for the retiree. By preventing lifelong wage earners, particularly those at low- and average-income levels, from falling into poverty in old age, without substantially improving their lifetime income position, Social Security plainly has become the principal economic mechanism in American society for social cohesion. Private pensions can be seen as the second tier providing no redistribution to lower-income workers, but insuring through qualification requirements, that low- and high-wage workers share in the tax benefits of income deferral and funded benefits in the future.

The choice was made in 1935 to create a system with fairly moderate income redistribution, in order to mitigate the impact of economic cycles on the elderly, as well as on their children who in the absence of the program would have to bear the burden of their parents' support on an individual rather than shared basis. The political consensus has generally been that direct income redistribution is unacceptable in the United States without severe means tests which limit aid to only the desperately poor. The Social Security benefit structure, in contrast, is based only indirectly on income variations, so that benefits flow across the entire income spectrum, and the funding scheme gives all workers a material stake in the program through the very visible payroll tax.

A clear and important distinction has always been drawn between old age insurance—and by extension, private pension and savings incentive programs—and old age assistance. The means-tested assistance system is designed for those who are already or have declined into poverty in old age, while the retirement income security system is designed to allow those still working to *avoid* poverty in old age through participation in a system that will guarantee benefits when they stop working. Despite strong pressure from some economic theorists to refine the public income maintenance system toward more targeting of public subsidies according to need, the social insurance model with indirect, although strong, redistributive elements has remained dominant. It is this structure that allows moderate public subsidies to be paid to low- and average-wage workers who would otherwise never be eligible for public assistance without declining into poverty. The mirror image of this structure, of course, is the tax incentives that flow primarily to upper-income workers through the private system.

The contributory principle is thus deeply imbedded in the structure of Social Security, as it allows benefits to be based on the imputed needs of the retiree based on his or her lifetime earnings patterns. The ideology of the system depends on the personal link between the worker, the taxes he has paid and the benefits he has "earned" as a result. There is no doubt that a powerful political and economic message is sent to workers who contribute a visible tax in each paycheck and connect it directly to benefits being earned for retirement.

A pure insurance view of Social Security would imply an advance funded system along the lines of fully funded private pension plans. However, payroll tax rates have generally been held to the level necessary to pay current costs and establish a comfortable safety reserve. This compromise of the insurance model of Social Security reflects the general analytical view that Social Security is a mechanism for regulating the flow of consumption from working to nonworking, and that decisions about the precise magnitude of that stream of income are never permanent and immutable. At the same time, however, the very fact of payroll tax financing is a sign of the political commitment of workers and politicians alike to the permanence of the Social Security system itself.

Current cost financing, however, raises criticisms that the system is insecure because there is no guarantee that benefits will be paid in the future, and at the same time that it exacts too harsh a toll from current workers because high payroll taxes now are funding a build-up of the funds to pay benefits after 2020. These critics most often contrast this "insecurity" with the assumed security of funded pension plans or, more usually, of individually controlled tax-favored savings and investments. Such criticisms overlook the fact that every working generation supports the nonworking population of all generations, older and younger, no matter what the mechanism for distributing the burden and the benefits may be. The savings of one generation, whether through public or private mechanisms, can provide cash income in retirement only if the next generation is sufficiently productive to back up the commitment those savings represent. The savings of the generation that reached old age in the 1930s were little or no guarantee of retirement income in the face of a massively contracting economy and widespread bank failures.

Much of the concern over the financing of Social Security for the next two generations of retirees grew out of the decade of uncertainty following the 1972–74 benefit structure changes. It is thus important to look briefly at how the financing crises of the late 1970s to early 1980s developed, and whether they in fact have much to do with possible future problems of the system.

The Financing Crisis of the 1970s—The value of Social Security benefit payments increased dramatically throughout the postwar period prior to the major financing crisis of 1977, through a series of ad hoc benefit increases from the mid-1950s to the largest single increase of 20 percent in 1972, coupled with automatic indexing of benefit levels to the rate of increase in the Consumer Price Index beginning in 1974. Two points are important about the more than 300 percent increase in benefit levels since January 1959. First, ad hoc increases between 1965 and 1974 account for about one-third of that increase, indicating that positive policy decisions were made to increase the real level of benefit income to the increasing numbers of beneficiaries. In 1959, 22.4 percent of the general population had income below the poverty line, whereas 35.2 percent of those 65 and older were in poverty; in 1970 the comparable figures were 12.6 percent for the general population, but 24.5 percent for the elderly—just about double for the elderly as opposed to the rate for the population as a whole. Thus these benefit increases were completely consistent both with the 1930s predictions that the program would eventually be the primary, if not only, antipoverty program among the elderly, replacing means-tested old-age assistance, as well as with the Great Society agenda to eliminate poverty in general.

The second point is that the decision in 1972 to index benefits to the cost of living in addition to increasing the base level by 20 percent was essentially a decision to commit a fixed portion of the nation's economic output to the elderly. The introduction of indexing into the system may well have been the watershed change that led eventually to many of the current attacks on the system. The ramifications both of indexing per se, and of the particular miscalculation made when indexing was enacted in 1972, are important for understanding the current debate over the commitment to a permanent social insurance program, which may in turn allow greater understanding of the nature of current "generational warfare" rhetoric against that very commitment.

The Social Security cost-of-living increase provision was enacted in 1972 after several years of pressure, as much from conservative as from liberal advocates. The assumption underlying enactment of price-indexing of benefits was that economic growth would continue to keep wage increases well ahead of price increases, so that workers could well afford to protect those with fixed incomes against inflation that would otherwise seriously erode their standard of living. This problem was, and still is, seen as especially acute for the very old, since the longer one lives into retirement, the more likely one is to have exhausted other sources of income such as savings. In addition, fixed annuity pensions, even for the relatively few who had them at that time, were and are not generally adjusted for inflation, so that their purchasing power gradually eroded.

If the 1972 legislation had done no more than raise benefits by 20 percent overall and then fixed that benefit gain permanently through indexing, it is possible that the system could have gone through the oil price shocks of the 1970s relatively unscathed. Unfortunately, the way in which automatic increases were applied to both existing and future benefits had an unintended and catastrophic effect on benefit levels, which began to increase much more rapidly than had been previously forecast. The extreme instability and the enormous growth potential that had been introduced into the system resulted in repeated forecasts of an adverse financial situation for the program both in the near term (late 1970s and early 1980s) and over the next 75 years. The short-term forecast of the 1977 Trustees' Report showed a long-term deficit for the combined Old Age, Survivors and Disability Insurance (OASDI) programs of 8.2 percent of taxable payroll over the 75-year forecasting period, which represented an average shortfall in revenues of more than 40 percent of the costs of the program.

Indexing thus solidified the working population's commitment to maintaining the income of the nonworking elderly at a fixed level high enough to bring most of them out of poverty even without substantial private pension income. This commitment alone would probably have led to questions about the size of program expenditures during times of economic contraction such as the late 1970s and early 1980s. In addition, however, indexing led to forecasts of major financing problems beginning in 1975 that for the first time raised fears among the public at large that "Social Security won't be there" when they or their children retire. The new benefit formula, which produced unpredictably high benefits, was only fully in effect for four years, 1975–1978. But the combination of rapidly rising new benefit levels applied to the greatly increased base from the ad hoc increases of 1972–73 resulted in a huge bulge in the size of benefits being paid to those who became entitled during those years, which had a lingering effect up through the financial crisis leading to the 1983 Social Security Amendments.

The 1977 Social Security Amendments, while reducing overall benefit levels for those retiring in the future to correct for the overinflation of the earlier period, nonetheless reinforced the social and political commitment represented by indexation of benefits. The basic benefit formula now insures that workers receive a benefit accurately reflecting average lifetime earnings calculated in real dollar terms at the age of retirement. The principles of wage-indexing the benefit formula and the earnings to which it is appled for initial benefit amounts, and of giving yearly automatic increases according to increases in the cost of living after retirement, mean that any increases in overall productivity will be shared by beneficiaries, and will not be allowed to disappear through the erosion of inflation during the years of benefit receipt. No formula could better express the enduring principle of preserving workers in their comparative income positions during retirement. The overall impact of the 1983 Social Security Amendments was to reinforce this basic structure by expanding coverage of the current program to most of those workers not yet covered (nonprofit and federal employees) and introducing taxation of benefits for upper-income beneficiaries.

Any assessment of the current financial status of the system following these financing changes of course depends on the economic and demographic assumptions used. Under the standard assumptions used for the annual Social Security trust fund reports and the president's budget, the combined OASDI trust funds will build up very large surpluses over the next 15 years, primarily because the baby boom generation will be earning at its peak while the beneficiary population will largely consist of the Depression-era generation, which is relatively small. The very large yearly surpluses of revenues in excess of the amount needed to pay benefits are carried over every year and held as U.S. government debt (special bonds issued solely to the trust funds).

The excess of payroll tax revenues is in essence being used now to reduce overall government deficits. In the next century when reserves will have to be "drawn down" to pay for benefits beginning around 2015, income taxes will have to be raised or larger general revenue deficits will have to be run in order to cover the cost of benefits under the current tax schedule. The payroll tax rate necessary to fund the program on a strict current cost basis would be much lower than currently scheduled during the 1990s, but would have to be increased beginning around 2015 to cover the increasing costs of the large retiring generation. The amount of increase, of course, would depend completely on the size of taxable payroll,which is determined by both demographic (birth rate, immigration) and economic (productivity, percentage of compensation taxable, etc.) factors.

The most interesting facet of the financing debates over the last two decades, and the public controversy surrounding them, is the almost total acceptance by the public of the social insurance ideology, and the resulting possibility that "funding" for future benefits might not be adequate. Such a prospect would, of course, seem incongruous if applied to other types of government expenditures, such as defense or education, which are assumed to be ongoing expenses for which monies will be supplied according to the level of spending deemed appropriate.

In contrast, the debate over the financing of Social Security revolves around actuarial assumptions concerning long-term economic growth, the percentage of payroll needed to fully finance benefits in the aggregate over a 75-year period, and the relationship between the benefit structure and growth in the economy. The whole public discussion has been framed as a debate over funding of benefits that the public as taxpayers have already contracted to pay almost as if Social Security were a qualified funded pension plan whose benefits and contribution from the "employer" were fixed. The system's future is frequently described in almost naturalistic terms, as if tax and benefit provisions were phenomena of nature rather than public policy choices.

The fact that young workers today most often speak of Social Security as "not being there" when they retire speaks not only to their lack of faith in government as an instrument of popular will, but also to their view of the program as a kind of rare species that may be extinct in 50 years, simply because it is beyond each worker's personal control. Inescapably, however, social insurance rests on the notion of openly acknowledged and socially shared intergenerational responsibility, which requires each individual to rely on the political whole to keep the implicit bargain of joint responsibility for the non-working levied on each generation of workers. Social Security has been transformed in the rhetoric of the intergenerational debate from a political mechanism for regulating production and consumption into an institution seemingly outside the control of ordinary voters, in part because of the social insurance ideology. It is ironic that while the institutional view of Social Security as an intergenerational compact serves to protect the system from political attack as part of the budget constraint battles and to underwrite its longer-term political stability, that same view of the program exposes it to attack as a "sacred cow," vulnerable to criticism precisely because it appears invulnerable to change. The fact that major benefit and financing changes could be made as needed in 1977 and 1983 seems to belie this impression and should give some comfort, but apparently has not done so, to participants and policymakers that the system can respond to perceived problems.

The Debate over Financing—Nonetheless, the financial crisis precipitated by the indexing error of the 1972 amendments generated what has proved to be a long-lasting debate about the long-term failure of the program as currently financed. A major element of criticism, at least among economists, has been concern over the economic impact of Social Security, specifically on overall savings rates and labor supply. Current "intergenerational warfare" critics have based their alternatives to Social Security, if not their entire critique, squarely on Martin Feldstein's theories concerning the impact of Social Security on depressing overall savings rates. Arguments over Social Security and private savings form the subtext for all proposals to encourage "private" alternatives such as IRAs, 401(k)s, and other sorts of individual savings incentive programs.

In 1974 Feldstein published an analysis of Social Security that argued that Social Security depresses national rates of savings, on the assumption that workers behave as if Social Security benefits are substituted for personal savings. His empirical analysis of this thesis revealed that Social Security had reduced personal savings by about 50 percent. Feldstein originally advocated a substantial increase in the then-scheduled payroll tax rate in order to accumulate large Social Security reserve funds which would increase aggregate capital formation. However, in his most recent papers, Feldstein has suggested that benefits under Social Security should be provided for those who do not have the foresight to save for retirement, but should be very low to minimize the impact on private savings and should be means-tested.

Despite the continued influence of this analysis, there appears to be little or no compelling evidence for the assertion that Social Security depresses private savings rates. The credibility of Feldstein's 1974 study was substantially weakened by Leimer and Lesnoy's analysis of his data in a series of papers in the early 1980s, which demonstrated that the conclusion was an incidental result of a programming error, combined with Feldstein's particular assumptions about how the present value of future Social Security benefits should be measured, and with the particular period chosen over which data were used for estimates. Correction of the programming error or choice of any one of several plausible alternative ways of measuring the present value of Social Security benefits or measuring periods for the data resulted in estimates that Social Security had either had no effect on private savings or had actually increased savings. A review of this analysis, plus the great volume of other studies on the subject, led Henry Aaron, in 1982, to conclude that there is no conclusive evidence or consensus among analysts about the effect of Social Security on savings, and that the empirical work up to that point had mainly served to produce "...a series of studies that can be selectively cited by the true believers of conflicting hunches...."

The weakening of Feldstein's specific analysis of the impact of Social Security on the savings rate has done little to dampen either his or his intellectual heirs' enthusiasm for the notion. Indeed, while Feldstein himself has not advocated phasing out Social Security, favoring instead a drastic scaling back of benefits, the entire intergenerational equity attack on Social Security depends heavily on the theory that Social Security depresses savings rates to justify elimination of the program as a way of encouraging personal savings. There are two main themes in this argument: the impending collapse of public retirement programs and the need for private substitutes that will encourage rather than depress overall savings rates; and the relative wealth of the current generation of elderly as compared with an impoverished baby boom working generation. It should be noted that even if these arguments are accepted, the end result must be not to diminish the burden of support for the baby boom's retirement, but simply to "desocialize" the responsibility, allowing upper-income workers to improve their retirement incomes at the expense of lower-income workers who will have to fend for themselves and ultimately rely on welfare in old age.

Under this analysis, most popularly disseminated by Peter Ferrara through Heritage Foundation and Cato Institute publications, the following basic points are usually made: First, the 1983 rescue package was a fraud because by 2026, when today's young workers retire, the program's combined trust funds will be completely exhausted requiring an almost doubling of the total Social Security payroll tax rate. Second, the long-term financial catastrophe is a direct consequence of demographic trends as the baby boom generation starts to retire, at a time when the work force will be relatively small, resulting in the collapse of system's basic financial structure. And finally, permanent payroll tax cuts in the 1990s could be achieved by allowing workers to substitute expanded "super IRAs" for part of their Social Security coverage.

Under the super-IRA proposal, workers would receive a full tax credit for super-IRA contributions instead of the present law deduction, with a concomitant reduction in their Social Security retirement benefits. Over the long run, Social Security benefit expenditures and payroll taxes would decline as super-IRAs increased and presumably replaced the benefit system entirely.

Upon examination, the equity critics' discussions of Social Security are incomplete, to say the least. First, these discussions frequently lump Medicare trust fund experience in with the Social Security cash benefit trust fund operations. While it is true that all three trust funds are part of the larger Social Security program and are financed through payroll taxes, most analysts agree that the problems of financing health care in general are substantially different from the problems of financing retirement income and should be analyzed separately. The role of health care providers in determining health care costs make the future cost patterns even more difficult to predict than in the cash benefit programs, where the benefit formula is set.

If the cash benefit programs are examined separately, the numbers are quite different, and considerably less catastrophic. According to the 1985 Trustees' Report, the cost rate of the combined OASDI system over the period 2010 to 2034, the "catastrophic" period, is 13.79 percent of taxable payroll, while the current tax rate for that period (unchanged since 1990) is 13.01 percent. This means an increase in the tax rate of .39 percent on employers and employees each would erase the deficit for that 25-year period, ignoring the surpluses built up in the previous period. For the final 25-year period, the deficit between income and cost rate is larger—2.46 percent—again, ignoring any surpluses built up in previous periods.

Even for that period, however, an increase in taxes to support an aging population need not be catastrophic or problematic. The problem with most discussions of financing is that they focus on how much the decline in the ratio of workers to retirees increases payroll taxes, when the real point ought to be the effect of a reduced work force in increasing overall income on which the payroll taxes will be paid. An analysis of the impact of increasing payroll taxes on workers' real earnings, assuming the worker fully bears the cost of the employer share of the tax, indicates that ". . .under current cost financing, real income from Social Security taxable earnings would fall by 4.0 percent because of the tax increase" (unpublished paper by Henry Aaron and Larry Thompson). This reduction, under the current tax rate schedule, would actually be 1.0 percent or less, since the program is overfinanced over the next 15 years and underfinanced after 2020. Aaron and Thompson point out that the future reductions in benefits from increasing the age of entitlement for full benefits also reduce benefit income to recipients by about 4.5 percent, meaning that the retirement age changes essentially divided the cost of demographic shift about equally between future workers and future beneficiaries.

Thus while the costs of the system will clearly increase, one step to reduce them has already been taken—to lower early retirement benefits in the next century. And a second—to increase tax rates to cover the deficit sometime after 2010—certainly seems feasible. While a 4 percent reduction in income is not insignificant, neither does it seem catastrophic, particularly in view of what we already know about the overall dependency ratio for the coming period. The National Commission for Employment Policy, in a recent report on older workers, points out that according to the Bureau of Labor Statistics, the number of nonworkers per 100 workers reached its highest point ever in 1965, at 154 nonworkers for every 100 workers.

The ratio has declined steadily as birth rates have fallen since 1965 and is expected to continue over the next 20 years, when there will be more labor force participants than nonparticipants in the population. After that the ratio is projected to rise to around 115 by 2050 but will still be substantially below the levels of 140 and higher, which were prevalent during the decades before 1979.

The trade-off between decreased support for children and increased support for the elderly in the next century will not be exact for each individual, because in general, expenditures for children are more likely to be private or supported through state and local government tax and benefit structures (e.g., education), while expenditures for the elderly tend to be socialized at the federal level. These differences may simply strengthen the case, however, for continued socialization of the costs of support for the elderly, to prevent the large disparities in income security in old age that were part of the impetus for setting up Social Security originally.

Thus, the predictions of demographic catastrophe that will bring the retirement income system down once the large baby boom retires must be viewed with considerable skepticism. The fact that the baby boom generation will be supported in retirement by a much smaller generation does not in itself mean that the burden on the younger generation will be too great or even much heavier than the burden on today's working generation.

Moreover, the size of the taxable payroll will depend as much on several important economic factors as on the sheer number of workers. A comparison between the cost of the cash benefit programs as a percent of GNP [Gross National Product] and their cost as a percent of taxable payroll is instructive. Program costs increase from 4.94 percent of GNP in 1985 to 5.67 in 2050, dropping during that period to 4.12 percent around 2005 and peaking at 6.11 percent in 2030, for an increase of about 15 percent. In comparison, the costs of the program as a percent of taxable payroll increase from 11.29 percent currently to 15.51 percent, peaking at 15.89 percent in 2035, for an increase of 27 percent.

The difference between 15 percent of GNP and 27 percent of payroll is at least partly due to the increasing percent of total compensation projected to be paid as nontaxable benefits over the next 75 years. Clearly, policy changes such as lowering of overall tax brackets or outright taxation of employee benefits that are not now taxable, either for solely FICA purposes (as the 1983 Social Security Amendments imposed for some deferred compensation savings plans such as 401(k)s, etc.) or for all tax purposes, could greatly reduce this kind of "leakage" from total taxable payroll. Similarly, the impact of greater competition for fewer workers in the next century on increases in wages and productivity is likely to raise the total size of payroll to be taxed, which will both increase trust fund income under current tax schedules and make tax increases in the future less onerous.

"Super IRAs": Are They a Substitute for Social Insurance?

Putting aside the problematic financing analysis, then, the central concerns of intergenerational equity critics about social insurance are most clearly revealed by the solution they propose for the retirement of the baby boom: super-IRAs. (These analysts seem to ignore qualified employer-provided pension plans entirely in favor of total reliance on IRAs.) The popular demographic analysis they rely on would seem to leave no way out of poverty in old age for the baby boom but an early grave, since clearly the ratio of elderly nonworkers to young workers in 2015 cannot be much affected at this point. An alternative solution to the financial burden might be simply to advocate generally reduced Social Security and pension benefits in the next century, if skepticism about the future performance of the economy is too strong to allow for tax increases when they become needed. The super-IRA is the one alternative that eliminates redistribution from rich to poor and puts the maximum risk of poverty in old age on the individual, since income available in retirement would depend on the investment performance of the individual worker's IRA, as well as how much income he was able to defer into the IRA while working.

The government role of providing subsidies for retirement income security would be preserved, but only through the tax preferences accorded super-IRAs, as well as through general government revenues to continue funding current Social Security benefit payments as the new plan siphoned off payments that would have gone into the payroll tax contribution. The major objective of super IRAs purports to be to increase saving by converting the retirement income system from one based in part on an unfunded public program to one based entirely on private savings. The actual objective, however, seems to be to appeal to those high-income workers under 45 who will receive the lowest dollar return on FICA taxes paid in single-worker retirement benefits. For this group, the eventualities of early death or disability of one or both wage earners, for which Social Security provides the only widespread protection through survivors' and disability benefits, are much more remote or impossible to imagine than are steady, long-term and secure 8 to 10 percent real rates of return on an IRA. Moreover, the social objectives of redistribution and social stability, which are major benefits of the social insurance system, cannot be quantified and are difficult to factor into individual calculations of cost-benefit ratios.

This solution ignores the past 50 years of development of the classic three-legged stool of retirement, i.e., Social Security, qualified pension plans and private savings, by putting the entire burden of saving for retirement once again on individuals. In addition, the direction of federal subsidies would be shifted from the redistribution down from rich to poor provided by public benefit programs to the inevitable upward distribution resulting from tax incentives more valuable to the upper-income workers.

Just as in the 1930s, however, the uncertainties of work, wages, and risk-laden investments (even in such apparently safe places as savings and loans institutions) make it extremely difficult for an individual to plan for retirement. A system relying solely on individuals providing for themselves would require extremely sophisticated planning and accurate predictions for the future in order to provide any real security. Each worker's individual lifetime earnings pattern, prospects for marrying and having children, future health, length of working career and length of life, etc., would greatly affect savings and investment decisions. Moreover, any mistakes an individual might make in planning for retirement would not be apparent until it was too late to repair the damage. It was in recognition of these problems that the Social Security system was established to begin with, and the tax code was structured to encourage provision of pension benefits to low-income workers who would suffer disproportionately from misfortune in investment and employment.

Clearly, there would be no real reason to turn to super-IRAs as a substitute for the current system if the issue was simply the size of benefits promised in the next century or, alternatively, the inevitable demographic changes in that period. A continuing adherence to Feldstein's views about Social Security's negative impact on personal savings is used to justify rejection of Social Security's redistribution of part of the burden of providing for retirement from the individual to the social whole, and of income from the wealthy to the working poor. Regardless of one's thoughts on the importance of increasing the private savings rate, it is critical to recognize this debate over "privatizing" Social Security as a political, not an economic one.

Wealth of the Elderly versus the Baby Boomers

The other major theme of the intergenerational equity debate is the focus on the current wealth of the elderly as contrasted with the impoverished working baby boom. According to this thesis, the elderly are *too* well-off, and Social Security now constitutes welfare for the rich—truly, enriching the old at the expense of the young. One recent piece in the *Atlantic Monthly* by Philip Longman states that, "Old age is no longer synonymous with need . . . as recently as 1959 nearly a third of the population over 65 was living below the poverty line. According to the latest census figures, the number is now 12.6 percent—almost two percentage points less than for the population as a whole. By some measures, the elderly as a group actually have a higher standard of living than the working-age population does.

. . .To demand across-the-board benefits merely on the basis of age is, in effect, to advocate welfare for the rich."

There are several major problems with this analysis of the welfare of the elderly. First, the reason the poverty statistics are so low for the elderly is precisely because Social Security is in place performing the function it was designed for, i.e., to prevent poverty in old age rather than waiting to alleviate it after the fact. Second, the poverty statistics themselves are somewhat misleading, as above poverty can mean one dollar or one thousand dollars above an extremely low level of income. Of all those households with at least one person over age 65 in 1984, less than half (46 percent) had total incomes of three times the poverty level or more (i.e., $18,600 or more). For that group, Social Security benefits comprised less than 20 percent of income, with earnings providing 42 percent. Thus, the most affluent major group of elderly people is, not surprisingly, the group that is still working. It is certainly questionable to aggregate that group in with nonworking beneficiaries for whom Social Security was primarily intended.

In contrast, for those below three and above twice the poverty level, still not an "affluent" level of $12,400 for a couple, earnings comprised 28.2 percent of income, while Social Security provided over 44 percent. For the elderly below twice the poverty level, Social Security provides well over half of total income, and earnings drop well below 15 percent of income. Even though only about 50 percent of Social Security payments went to persons who were poor before they received them (the pretransfer poor), Social Security had more impact on reducing poverty than any factor besides earnings. Social Security reduced the aggregate poverty gap by nearly 90 percent for persons age 65 and over, lifted nearly 9.4 million older persons out of poverty altogether and reduced the poverty rate among the aged by 73.9 percent.

Clearly, Social Security benefits are paid to some affluent elderly people—about 10 percent of current beneficiaries are required to pay income taxes on half their total Social Security benefits as a result of the 1983 Social Security Amendments that require taxation of benefits for those with total incomes (including tax-exempt sources) of over $25,000 ($32,000 for a couple). Since revenues from this provision flow into the Social Security trust funds, and since the numbers of beneficiaries affected will gradually increase because the income thresholds are fixed dollar amounts not indexed to inflation, it would appear that some redistribution from wealthy elderly to young taxpayers, whose payroll tax burden is reduced because of income from taxation of benefits, has already been put in place.

The fact that some well-off elderly receive nonmeans-tested benefits does not logically mean that all elderly would be better off relying on savings for the well-off and means-tested benefits for the poor. The problems with relying on means-tested benefits far outweigh the loss of economic efficiency accompanying payments of a small portion of Social Security benefits to the well-off, who, in any event, will recycle at least a portion of the benefit back through the income tax system in order to reduce the payroll tax burden on baby boomers.

Conclusion

In summary, then, the argument over whether we as a nation can "afford" retirement income security for the baby boom as currently funded through public social insurance should be laid to rest. It is not a question of whether these programs will exist, but rather what they will look like and how we can best distribute the benefits and burden of assuring income for the nonworking. A new, more interesting debate will be the focus of congressional activity over the next decade, as policies for Social Security, private pensions, and savings incentives are increasingly examined as part of one overall area of inquiry.

In fact, in contradiction of the recent popularity of individual savings arrangements, deferred compensation plans, and defined contribution plans of all sorts, the needs of the baby boom generation in retirement will probably be best served through more, not less, sharing of the risks of employment and investment experience. If the principal reason for all of our retirement policy is to assure that most people do not suffer disproportionately from economic and personal misfortunes that are the natural by-product of industrial civilization, the sheer size of the baby boom generation suggests that we should strengthen our social mechanisms in this area, not weaken them.

In light of the preceding discussion, it should be clear to those in the pension field that there is little to gain for qualified plans or even for employer-sponsored savings vehicles from the kind of warfare between public and private income supports suggested by the intergenerational debate. The whole qualified plan structure as established under the Internal Revenue Code and ERISA is designed to serve essentially the same principal purpose as social insurance: to allow workers at all income levels to provide for retirement on a risk-sharing basis, either through funded plans that guarantee a certain benefit level in retirement or through pooled savings funds that spread the risk of investment loss across all participants.

The law explicitly attempts to bind together the interests of workers at various income levels by requiring participation across wage-levels. Similarly, the interests of the employer in maximizing both his personal income deferral and the tax reductions from contributions to plans are tied to the interests of his employees in assuring adequate retirement income, through the whole range of qualification requirements. The policy at work here is essentially the same as the fundamental reason for a first-tier federal social incurance plan, i.e., social stability as a result of an assured source of income in the face of inability to work.

There are a couple of major differences, however, between the public benefit and private pension systems that are crucial to understanding what the future course of retirement income policy may be, as the system is increasingly examined as a unified whole. First, we must carefully weigh the distributional effect of a choice to rely more in the future on private pensions than on Social Security. Any system based on tax incentives of necessity will provide the largest public "subsidy" to those at higher-income levels, to whom the tax breaks are most valuable. The most far-reaching effect of the 1986 Tax Reform Act on private pensions and savings of all descriptions may well be the reduced incentive for employers to lower taxes by establishing such plans, given the flattened rate structure.

Second, the voluntary nature of private plans means that there is less room for structuring the income guarantees they provide than in the mandatory public benefit program. The current structure, particularly as revised in the new tax bill, represents an attempt to insure some "trickle down" of tax benefits against the natural flow of tax incentives upward to the highly compensated. The difficulty in constructing qualification requirements that eliminate egregious opportunities for tax avoidance or deferral by highly compensated employees and employers is that the incentive to establish any plan at all may be reduced as well.

These two factors mean that while the flexibility of the private pension system is a necessary complement to mandatory social insurance, we purchase that flexibility at the price of considerable inefficiency in subsidies. The whole thrust of the 1986 Tax Reform Act was to reduce that inefficiency as much as possible within the basic framework of a voluntary system. The bill clarifies the rules for insuring that benefits must be similarly provided to workers at all wage levels in order to limit the disparity in retirement income provided to workers at different levels under tax-advantaged arrangements.

Similarly, by reducing the overall limits for income and tax deferral by high-wage employees through changes in the 415 limits, the bill attempts to limit the tax advantages of funding for large early retirement benefits. This change is consistent with the policy established in 1983 to encourage later retirement in Social Security and in current plans to eliminate mandatory retirement altogether under the Age Discrimination in Employment Act. Finally, by tightening withdrawal restrictions before age 59½, *except* in the context of an early retirement annuity, the bill reduces the ability of workers to take advantage of tax incentives intended for retirement income savings for short-term objectives.

These are only a few of the changes contained in the tax bill for qualified plans and retirement savings, but they exemplify the retirement policy goals that underlie the provisions in general. The provision that most clearly demonstrates the sort of unified approach possible in this area, however, is the new Social Security integration formula, which has received little public attention to date, apart from the guarantee carried over from the Senate bill to limit the reduction from integration to no more than 50 percent of the nonintegrated benefit.

Closer examination of the new structure, however, reveals that the formula now is much more consistent with the current Social Security benefit structure and replacement rates provided under it than prior law. The new structure is based on limiting the extent to which employers may "take credit" for their own payment of Social Security taxes for employees through a more accurate calculation of what the employer-provided share of a Social Security benefit is. The basic disparity between accrual rates for benefits above the integration level and below can't exceed .75 percent per year of service with that employer. This results in a maximum possible disparity of slightly over 26 percent—or about one-half (the employer-provided share) of a mostly nonweighted Social Security benefit with a 53 percent replacement rate (for a worker at somewhat below average career earnings).

This paper is not the place for an exhaustive examination of the new integration structure; I mention it simply to point out that the nature of issues in the retirement area requires more careful coordination of Social Security and pension policy. There is obviously much room for improvement in this regard, and the 1986 Tax Reform Act by no means represents either perfection or the end of the line.

Clearly, however, the policies best suited to assure retirement income security for the baby boom generation must be developed through a consistent policy approach to Social Security, private pensions, and tax-favored savings.

This sentiment is, of course, neither new nor revolutionary and has been widely expressed by those in the pension field, academics, and even a few congressional staff. The problem is, of course, that great structural difficulties stand in the way of such unified approach. The retirement income policy field is split at the federal level between three cabinet departments and many more subcabinet level agencies, and between four committees of jurisdiction in Congress. Mere coherence is a tall order in such a setting.

Nonetheless, the House Committee on Ways and Means, as one major player in the field, is attempting to come to grips with the challenge of developing retirement policy that reflects coordinated goals in the private and public retirement systems. For the last two years, the two Subcommittees on Social Security and Oversight have conducted a series of joint hearings on major issues in retirement income security, with view toward laying the foundation for future committee consideration of legislation in the whole area. The Congressional Research Service [CRS] is now putting together a major, and I think very exciting, study for Ways and Means on the issue of retirement income security for the current working generation. This study will both review the current thinking about most of the issues discussed in this paper, and I think will break new ground in looking at the role of work and earnings for older people as the baby boom ages.

While I do not expect this study to result in immediate introduction of a new minimum universal pension system* or another Retirement Income Policy Act,* I hope that as a result of CRS and other efforts, the issues of private pensions and Social Security will never be looked

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*Editor's note: In 1981, the President's Commission on Pension Policy recommended the creation of a plan called "minimum universal pension system" (MUPS) covering all employees over age 25 with one year of service and 1,000 hours of employment with their employers. The recommended minimum benefit standard would be a 3 percent of payroll contribution. Current pension plans not meeting the MUPS standards would be amended to provide equivalent benefits. See President's Commission on Pension Policy, *Coming of Age: Toward a National Retirement Income Policy* (Washington, DC: U.S. Government Printing Office, 1981).

*Editor's note: The Retirement Income Policy Act, introduced by Sen. John Heinz (R-PA) and Rep. William Clay (D-MO) in 1985, proposed a number of changes in private pension plans, such as five-year vesting, a minimum guaranteed benefit above Social at in isolation again. The policymaking structure approach to the issues of income distribution and guarantees of income in retirement must reflect our ultimate policy goals: to pay for the improvidence and bad luck of ourselves and our neighbors through social mechanisms that minimize the risk while retaining each individual's incentive to work and provide for his old age.

Security in integrated plans, restrictions on preretirement benefit distributions, and distinctions between "retirement" and "capital accumulation" plans. Significant portions of the bill, including five-year vesting and changes in integration provisions were included in the 1986 Tax Reform Act.

XII. Part Three Discussion

Taxing Withdrawals from Pension Plans

MR. JACKSON: I have two questions for Ron Pearlman. In your paper you wrote that most would agree that the employer should not be prohibited from withdrawing pension assets. I am probably in the minority if that is the case; because I think the employer should be prohibited. You go on to say, ". . . subject only to the condition that an appropriate level of tax be paid on any withdrawn assets to offset the tax deduction taken by the employer for the prior contribution to those assets." I presume you mean the tax free build-up.

MR. PEARLMAN: Indeed, I think one can argue that there should be, in addition, a tax on the tax free build-up, but the point I was making in the paper was simply that at a bare minimum, there should be a recapture of the tax benefit obtained at the time the original deduction was taken.

MR. JACKSON: My question was about the 10 percent excise tax and the 15 percent tax on excess benefits. Primarily, an appropriate level of tax would be proportional to the level of interest rates. With very high interest rates, the advantage is much greater than with very low interest rates. And, what about the period of time the money has been in the fund and the level of the corporate tax rate? If you compare the tax advantage with the private sector alternative of buying and holding stocks, for example, which a corporation would certainly have, the tax advantage is really rather small for most periods, and the 10 percent excise tax does not seem to be an appropriate level of tax but sort of a punitive one, and the 15 percent tax as well.

MR. PEARLMAN: Well, I can't quarrel with that. Let me first make a point of clarification. There are really two taxes on a withdrawal. First, the reversion itself is taxable income, and that really is the recoupment of the tax benefit. Then, in addition, under the [1986 Tax Reform] Act there is an excise tax, which is intended as a surrogate for the deferral, or the build-up.

I think it is unfortunate that the excise tax is viewed as a penalty, because it was really not intended as a penalty. It also is unfortunate that in certain instances it in fact operates as a penalty, as it clearly can depending, as you point out, on the length of the deferral and the rate of return during that period of time.

At the time we began the process of developing rules regarding excise taxes, both on premature preretirement withdrawals subject to excise tax to the employee and an excise tax on reversions, our objective was to make the rules simple. However, the point you make is a legitimate one, and, indeed, in a world that makes any sense, one should have the opportunity to more accurately calculate the tax. Maybe employers, now knowing what the law is, would be much more willing to support a rule crafted to permit a more accurate calculation of the benefit of deferral.

MR. JACKSON: The second question I had was on a very general aspect. When you lower tax rates, you lower the advantages of these programs for highly compensated people. With less advantage, there is bound to be less abuse, even with the old rules; and yet over an extended period of time we've gone from a point where tax rates were 92 percent with no regulations at all and no limits on these plans. Now we've got the tax rates down to [a maximumm of] 28 to 33 percent. While you would not expect anyone to step back from all the rules in ERISA and elsewhere, this tax law now injects a whole host of more complex rules. It is puzzling as to why, when we need them least, we have the most of them.

MR. PEARLMAN: I think your point is well taken, and, indeed, if you look at the revenue tables for the pension changes—particularly if you go back and look at the detailed revenue tables—you will find that many of the changes don't have a huge revenue impact, which really proves the point you're making.

I'll simply go back to the point that I tried to make earlier and say that I think that tax policy makers, rightly or wrongly, have taken it upon themselves to make decisions that are really retirement policy decisions in a federal income tax context. I don't think there's anything wrong with that, but I think it does emphasize the importance of trying to get other people who are more expert in the nontax aspects of retirement rules involved in the process.

Medicare

MR. DOBSON: Mr. Lindeman, you mentioned the Medicare trust fund. You didn't mention the Social Security trust fund. Some commenters, thinking ahead, say that the Social Security trust funds will show a large surplus by the mid 1990s or thereabouts, and that surplus may make us as a nation feel relatively affluent. If so, we may find support for large social programs again.

MR. LINDEMAN: The Social Security trust funds are a way, in effect, of smoothing out the payroll tax over a long period of time. Pat

[Dilley] discusses in her paper some alternative ways of addressing the issue by letting the payroll tax actually track expenditures, the so-called cost rate.

If you want to smooth out the payroll tax over time—and there are good reasons to do that, some of which are programmatic, some of which I think are philosophical—you, in effect, overtax the nation using the payroll tax and undertax the nation using other tax sources for some period of time. Then you flip that around through trust fund calculations. Our relatively optimistic projections on the budget deficit assume all of that, I might add. We assume that the payroll tax is in place as it is now legislated and that there are trust fund surpluses. Thus, if you were to decide as a nation to use those surpluses for benefit liberalizations, as some have suggested, for the purposes of earnings sharing or lowering the payroll tax, then all those projections about the deficit go away, and the deficit reemerges rather significantly.

A lot of people suppose that the so-called surpluses in the trust fund will be used to get Medicare through whatever time necessary. I am not sure. I think the magnitude of the Medicare problem in the 1990s is considerable. I think it dwarfs the problem that we had in 1983. Then, you could say, we will cut back on benefits or we will increase the payroll tax, which we never did. We only accelerated scheduled dates of increase. It was a balancing package. The magnitude of the problem in Medicare is so much greater that it is hard to see how the political process is going to grapple with it. Indeed, it must. I have not even mentioned SMI [Supplementary Medical Insurance],* which is open to hemorrhage in the general revenues.

So, it seems to me this is a world of strong constraints, and I do not see much wiggle room for new initiatives.

MR. DOBSON: In summary, you are saying that if you do the accounting properly, what appears to be a surplus, if you look at all the pluses and minuses, sort of goes away. We really won't have what people think is there.

MR. LINDEMAN: You can make the surpluses translate into national savings if you want, but you must run a surplus in the budget as a whole or federal transactions as a whole. Social Security is no longer

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*Editor's note: SMI, or Part B of Medicare, is a separate federal trust fund financed from general revenues and from premiums paid by recipients. Medicare Part B pays for physician services as opposed to hospital charges, which are covered by Medicare Part A.

technically part of the budget, so I cannot say that. But in effect, if you want the trust fund reserves to translate into national savings in the sense that you are rolling over less national debt every year, you have to be running, in the aggregate, a total surplus.

MR. SALISBURY: David, let me put it in the context of Gramm-Rudman. In the year we are supposed to have a balanced budget under Gramm-Rudman, 1991 I believe, something like $65 billion will be attributable to a positive cash flow in Social Security.

MS. DILLEY: It is between $65 billion and $70 billion.

MR. SALISBURY: So, by eliminating the Social Security consideration, you end up in 1991 on the general tax revenue side with a $65 billion deficit.

MR. LINDEMAN: Exactly right. And one of the things that Gramm-Rudman does is make more apparent these cross-transactions between the Social Security system and the rest of the budget.

Using Excess Plan Assets to Fund Retiree Health Benefits

MR. TURCO: I have a comment on the funding of long-term care and postretirement health benefits. It appears to me that we may have an emerging Catch 22 situation very in line with the thoughts from this morning—that we are on the threshhold of making public policy in this area.

There is some suggestion that we need something like a health care IRA or some tax-favored impetus for individual financing of postretirement benefits for long-term care.

Realistically, the climate is not particularly attractive for a federal policy in this area, but I think we are likely to have to seriously look at sources of funds for long term care and postretirement health care.

One source of funds that we could consider are pension funds, *excess* pension funds. But under the 1986 Tax Reform Act, there are constraints on the application of [excess] pension assets. And this may defer employers from setting up [defined benefit] pension plans. Therein, I see the Catch 22.

If we are not going to have created the incentives for, if you will, tax-favored savings, at the same time we are going to have the kinds of restrictions that impede looking to other sources of capital wherein then will the funds flow in order to address long-term care and postretirement health.

MR. LINDEMAN: I think you add another dimension to the issue. I guess that one of the policies behind the excise tax on reversions is that the government ought to at least get back the lost revenues. But presumably, having made the employer more indifferent to raising money through normal market mechanisms versus the termination and reestablishment procedure, there will be fewer terminations [of overfunded plans].

Excess plan assets may be desirable, some contend. One reason is that the future of the financial market is unclear. Just as the stock market went up and therefore pension fund assets went up, the stock market could come down. The more reserve funding, the better. The second reason excess assets may be desirable is for liberalizing benefits, although there are constraints on liberalizing health care benefits.

MR. TURCO: The constraints go beyond the use of excess assets, to the elections available to participants themselves. It seems to me that there are fewer opportunities for individuals to elect more imaginative forms of health benefits.

MR. LINDEMAN: These tables point out the rather substantial torquing of the tax advantages now for people who are long service workers in one plan. To the extent that you give tax advantages for retiree medical benefits because they are very much tied to defined benefit plans, you are going to get the same pattern. It is a question of public policy as to whether you want that kind of distribution of those tax advantages. After all, everybody pays for those tax advantages. Not everybody gets their benefit. So, that is a further complication in trying to determine the appropriate remedies.

MR. SEIDMAN: We tend to look at these things in terms of the funds and the plans that are involved. But from the viewpoint of the individual, I am not so sure that there are many workers who think their retirement income now is so excessive that they are going to take from their retirement income to put money aside for long-term care, even though they are becoming increasingly sensitive to their needs for it.

I do not know what the solution is. But, surely, the robbing Peter to pay Paul approach is not going to sit very well with the people who will be affected. They do not believe that there is an excess of funds in their pension plans to begin with. So, I think this idea of being able to take the money from the cash side in order to put it into the health care side is not going to work.

MR. YOUNG: I want to expand on the last point that David Lindeman made, which is that you not only get a disparate effect by income groups of a tax incentive to set up postretirement medical plans, but it is hard to see how you would get any substantial portion of the population covered by it.

After all the effort that has been made, we still fall short in cash benefit retirement plans. I think Deborah Chollet's figures talked about 60 percent getting pensions in the 2020s, and postretirement medical care, as we all know, involves a lot more inhibitions in setting up the programs than cash benefit plans.

So that not only do we have the problem of distribution, but any sort of tax-incentive system would seem to leave us still with an enormous part of the problem left untouched.

MS. YOUNG: In an environment where an employer is permitted to take out excess funds from the pension plan, where is there an incentive for an employer to divert it to another program, instead? It seems to me, in an environment where the employer can put it in his pocket, you are not really giving him an incentive, are you?

MR. LINDEMAN: I think the economic argument for the excise tax is that, in its absence, employers are able to tap a reserve of funds that build up on a tax-favored basis. That is better than having to save those monies on a regular after-tax basis, except for their depreciation allowance. That essentially is what you have to do for reinvestment, or you have to borrow it. I think the logic behind the excise tax is to make the employer indifferent, to no longer impel him to use this tax-favored source of funds.

Now, he may very well terminate the plan under certain circumstances. We had a colloquy earlier as to whether the 10 percent penalty is too much or too little. In some instances, it will be a penalty. In other instances, it is not enough to render the employer indifferent, and we will still have reversions in those circumstances.

MS. YOUNG: There is also a question as to whether or not the employer might have other agenda. I think the textile workers—maybe Bert Seidman knows better than I do—have filed a suit in California claiming that the pension plan was invested in things that the owner wanted to get his hands on. The owner got his greenmail* then shut down the plan and took out the excess funds. The workers claim that

*Editor's note: "Greenmail" refers to a payment by a takeover target to a potential acquirer, usually to buy back acquired shares at a premium. In exchange, the acquirer agrees not to pursue the takeover bid further.

this was a nonfiduciary use of the plan. This is now going through the courts. But, obviously, there can be another agenda on the part of the employer.

MR. LINDEMAN: That is right. All of these reversion issues raise fiduciary issues as well as tax policy issues, and I can only speak to what the theory is on the taxes and whether or not we should have prohibitions on reversions because we think the employee really paid for those benefits and they ought to get them or have them reserved or whether they violate fiduciary obligations or not.

MR. GARBER: We are a large employer and have a significantly overfunded pension plan. It is not practical, because of certain provisions in the plan, to undertake a reversion of assets. On the other hand, there are increasing obligations to current and prospective retired employees for health benefits, which are unfunded and which cannot be funded on a reasonable basis.

In the one case we have more money than we need, and in the other case we have obligations that are not funded. While we can mentally balance the two, it is awkward and will balance only by chance.

If changes in tax law were enacted that would permit us to move money from one pot where it is not needed to another pot where it is needed, it would certainly be desirable.

MS. CHOLLET: Partly in response to Bert Seidman's comment. The problem with financing long term care for workers today versus later are very different kinds of problems. Also the accrued liability looks very different from accruing liability. Accrued liability represents an enormous problem. The financing of long-term care for those who are already eligible represents an enormous problem. The kind of asset accumulation necessary to rationally finance long-term care were an appropriate insurance vehicles available upon retirement is not such a problem. It is a matter of assembling the appropriate vehicle and making plans early enough down the road.

New Demands on Social Security

QUESTION FROM THE AUDIENCE: You have a statement in your text, Pat, on taxation of benefits and what it means for Social Security. But if you take it one step further and relate it to other things in your paper—the extent to which tax reform may reduce incentives for fringe benefits—would that not reduce the amount of compensation that would go to nontax sources? That raises the burden of Social Security in future years by raising future benefits.

MS. DILLEY: Recent surpluses in the short term, yes.

QUESTION FROM THE AUDIENCE: And, to some extent, the discussion of this in your paper was contrary to your claim that we should concentrate on the burden rather than the financing mechanism, that is, what we are going to have to pay and how we distribute it. In fact, we affected the financing mechanisms by having more compensation in the wage base, but we have raised the benefits that we pay out under current law so that the GNP measure in fact goes up while the trust funds look better off.

MS. DILLEY: Right. To the extent that people are looking to Social Security rather than to other forms of compensation, it is going to put a lot more pressure on what benefits—especially in the health area—we are going to provide in the next century. However, on the cash benefits side, it is not going to be that critical. Expanding the revenue here raises our revenue throughout the period, essentially, and of course raises benefits as used for those not already over the wage base. But I think the kinds of nonstatutory fringe benefits that are available out there now are not the kinds of things that people are going to ask Social Security to provide them in the future.

So, on the health side, I agree that new benefit demands might be made, and I think that that is far more important. And, I stayed away from the health side in my paper because I think the issues in health are really far more complex, far more difficult, than the issues in cash benefits.

We have talked a lot here about financing long-term care through various mechanisms, but most of the discussion on Capital Hill is how to restrict increases in health care costs. We have to get at the root cause of why people feel an increasing need for some sort of insurance against long-term health care costs, which comes down to inflation in the health field. I see that as more of a problem in the health area than in the cash benefits area.

QUESTION FROM THE AUDIENCE: I want to talk about one of the three legs of the retirement stool. There is coverage on the Social Security side. We are trying to increase coverage on the private side. If this fails, as many people think, then what do you think the response would be? You sound as if you do not want the private system to mirror Social Security. What other alternatives are there?

MS. DILLEY: Well, I suppose you can look at the new coverage rules as a grand experiment, and we will see what happens as a result of those changes.

When I say that I do not want the private pension system to mirror Social Security, I mean that we cannot expect all of the guarantees provided through a mandatory public system also to be guaranteed through a private system. That does not mean that I do not want to see coverage expanded. And I really do not know what the private sector response will be to the new rules, or what the congressional response would be if the new law fails to expand coverage. Quite frankly, I do not know what the data is going to look like. It takes years to determine the effect of new laws. I would image that by the next time we look at this, there will be a whole new way to look at the problem.

I think we will want to try and leave the coverage rules in place for a while. That would be my hope. I really do not want to come back and redo the whole thing again next year. I also know that everyone said that exact same thing in 1981, 1982 and 1984; so I do not expect anyone to believe that. But [I think we need] to give employers time to get used to the new law, to see if it works. It is a very complex structure, and to me, the complexity in the structure is in great measure a result of the voluntary nature of the system. Since we cannot impose a benefit structure, nor do I think we should do so directly, we simply have to try and hedge in the way people can funnel the tax benefits of the system as best we can.

MR. GARBER: Pat, a couple of things. First, with respect to Social Security, itself, one of the things we were told this morning was that many people do not have confidence that their social security benefits will be paid when they retire, but you speak of them in terms of guarantees. I think one of the significant elements is the funding method. Social Security is funded by a direct tax on working people to pay for people who are retired. As the federal government has shown itself over the last decade or so to be willing to reduce what appeared to be promised benefits as the various budget contingencies occurred, this perception has gained strength.

Is this not a problem because of the distinction that has been created by the strict funding requirements on employer-sponsored plans in contrast to Social Security, the PBGC, and other areas where there are no advanced funding requirements? Does this not create a problem in the minds of the public in terms of whether they really can plan on a benefit that is dependent entirely on forces that are not in their control?

MS. DILLEY: I agree, and I think I address some of the issue in the paper in discussing the social insurance model. The payroll tax is a critical element of the system. The whole contributory principle, I think, underlies the political popularity of the system so far. People do fundamentally feel the payroll tax represents something concrete to them. The income tax goes off into the void. They do not connect income tax payments with particular kinds of services. Everyone knows abstractly what income tax revenue pays for, but it is not real. On the other hand, the payroll tax being tied to a specific program contributes to the strength of the program politically, but at the same time creates doubts in people's minds as to why it is not more like a private pension. Or why it is not funded. And that is where the social part of it comes in. David Lindeman's discussion of the trust funds, I think, addresses this issue. When we talk about any sort of advance funding, what we are really talking about is a commitment, a draw on the future economy.

Personally, I think that applies just as much to privately funded plans as to publicly funded plans. Consider an economy such as we had in the thirties—where money is worthless, where savings institutions go out of business, and where paper commitments between financing institutions suddenly become worthless. Advance funding of a pension system does not mean a lot more in that context than advance funding of a public system. Fundamentally, both rest on a continuing productive economy from one generation to the next. The difference or the similarity of funding private pensions or Social Security is that advance funding of Social Security, which is what we're doing now, is a very stark example of a draw on a future economy. That is what the trust funds represent, a commitment by the next generation of workers to pay benefits or to fund the system in some way or other. I think it is a massive and very dear example of what any sort of advance funding is. The difference is that it is public, not private. I agree with you that ideologically it does create problems for the system, that people have "bought" the pension model in Social Security. They feel they have bought their pension and they are entitled to it.

MR. GARBER: Then some of the individualism that we are seeing today . . .

MS. DILLEY: . . . is a reaction.

MR. GARBER: . . . is in fact saying, "I am going to save my own money, and I am going to make sure I have got something for the future. I cannot depend on the other."

MS. DILLEY: That is right. But talk to someone who saved their own money in Old Court Savings and Loan.* How good is their money to them now? I think that you cannot go too far with individual self-reliance without running into as many losers as winners over the long run. I think there are instructive analogies between the public and private situations: ultimately all of these systems depend on a productive economy and on people honoring commitments, whether it is a private investment commitment or a federal government commitment.

MR. GARBER: I guess the question is what are the federal government's commitments, because some of them do not seem to be very longstanding.

Pension Policy: What Is Congress Doing?

I'd like to ask one more question on another subject, which is essentially on the question of pension policy. My view of pension policy at this point is that it is in a free fall, and it has been for some time. I'm interested in your view. If policy decisions are being made, they're very obscure to some of us outside the federal government.

MS. DILLEY: A small group in a dark room.

MR. GARBER: The front page of RIPA had a statement of policy on it, but the back pages did not do much about that policy. But at least the front page had a policy statement. If there were a policy statement of that sort one could sit down and say, see, this is what we have done and it is in accord with these policies, and so on. I think some of us would feel much more comfortable with this type of approach.
What we see appears to be a lot of revenue-driven, ad hoc decision making, which some might say has a policy backing to it. But, for those of us on the outside, it is very hard to discern what the policy elements are in all of this. If you think there is good overall policy, it would certainly be helpful to set it down on a piece of paper and communicate it to the pension community.

MS. DILLEY: As I tried to lay out briefly in my paper, there are elements of the tax bill that I think clearly came out of policy con-

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* Editor's note: Old Court Savings and Loan Association is a Maryland thrift institution that was chartered and insured by the state. When reports of mismanagement and fraud circulated in the spring of 1985, there was a run on deposits and the beginning of a state thrift crisis.

cerns. The coverage rules are a perfect example. There is no revenue involved in any of that. The new integration formula was clearly designed to coordinate better with the current Social Security system as a matter of policy, not revenue.

I will agree with you that the process can be disjointed. I am not going to pretend to you that there was some sort of grand meeting of the chairmen where they decided what the policy would be, and then all of the decisions flowed from that. Frankly, no piece of legislation is ever put together that way, and certainly, no tax bill is ever put together that way. One thing I would like to see happen more in the future is more communication and cooperation—at least on the House side—between the Ways and Means Committee and the Education and Labor Committee. That has been a major problem over the past few years, quite frankly, because the interests are seen as competing because of the revenue issue. As you well know, it is a very difficult thing to balance jurisdictional interests. We have tried to work together on several issues, and I think, frankly, that the policy objectives of the two committees are not that different. But, clearly, in the tax bill we had an enormous number of small issues that were decided—some on policy grounds; some on other grounds. That is the way issues are always worked out, and that is the way any bill like that works out.

I think the pension community should work toward trying to get more explicit recognition that there are policy issues that need to be looked at in a broader context. And I cannot emphasize too strongly that when that is done it simply cannot be done in the context of "don't include me in your tax bill; leave me alone because you ought to look at my problems later." That is really how the message came across the last two years, and I think it was unfortunate, because I think many people meant what they said about the policy issues that needed to be decided. But the message got garbled along the way, and I think that that is something we all can work on.

MR. SEIDMAN: I was pleasantly surprised to find in the survey that was done for AARP [American Association of Retired Persons] that people now generally understand the Social Security system, and they understand that their money is not being put aside for them for their retirement, but that it is a system of intergenerational redistribution. I do not think you would have found that result 10 or 15 years ago or maybe even more recently. I think that is very encouraging, because it means that people now understand the system under which they are operating.

I want to repeat the point I made before—that people feel that they are not going to get their retirement payment when their time comes due. This question is put to me over and over again when I go out and talk to union groups and other groups where people express that kind of skepticism. I tell these people that when the baby boom generation retires, they are going to be very much larger than the current retiree generation, and they are going to have the political strength to make sure that they're not ignored when their time comes.

My question, Pat, gets back to a point that has been made before. I understand when people say various proposals are being made that would make Social Security more like the private pension system. But I do not know of any proposals, other than the proposal for portability, which has not really been spelled out very much, that would make the private pension system more like Social Security, and I would be interested in knowing specifically what you have in mind.

MS. DILLEY: I think portability is the key issue.

MR. SEIDMAN: You would be opposed to introducing that?

MS. DILLEY: I am personally not opposed to looking at any of that, but I am trying to point out that in the context of a voluntary system, which depends on the willingness and the incentives that we give to employers to set it up, there is a limit to how many and what kind of restrictions you can place on what they must offer employees. I think portability is a very, very difficult issue.

MR. SEIDMAN: The closest I know to such a proposal is MUPS, and that got nowhere at all. Nobody gave it any consideration whatsoever.

MS. DILLEY: Right. What I'm trying to say is that, as we're looking at other types of benefits that could be offered—and I think the long-term care issue is a perfect example—the impulse appears to be to create a tax incentive so that people will fund a program to take care of this problem. Twenty years ago, I think the public policy response would have been what kind of a Medicare program can we set up to meet this problem. The only point I am trying to make is that you cannot expect the tax system to do everything, and you are not going to get the kind of distributional effects that you want by doing everything through the tax system. Inevitably you are not as long as we have a progressive tax system.

MR. SEIDMAN: I agree with you, but there are no proposals that would give it that responsibility to any greater extent than it has now.

MS. DILLEY: I would say that the changes in the nondiscrimination requirements, while not making private pensions look exactly like Social Security, were an attempt to achieve some of the same goals as Social Security, which is to ensure that workers at all income levels get an equal hit from those benefits. That is the fundamental policy behind nondiscrimination requirements. I am not, by any means, quarreling with that. I am in full support of that. All I am trying to say is that I think there are limits on how far you can push the voluntary private pension system. In the mandatory system, it is easier to say we must primarily take care of the needs of low and average income workers. Upper income workers are going to be better able to take care of themselves, although long term care is going to be a need across all income levels.

Perhaps what I am saying is out of synch with the times, but I think over the next decade we are going to see a return to consideration of how government can directly solve these problems, how government can directly create programs to solve these problems; instead of expecting the tax code to create incentives for individuals to solve these problems themselves. That is really my fundamental point.

MR. BIGGINS: I would like to return to the comment that Ron Pearlman made expressing a concern for legislation in the area of nonqualified deferred compensation. What are the particular concerns, and what is likely to happen to nonqualified deferred compensation arrangements in the next year or two?

MR. PEARLMAN: I cannot predict what might happen in the next year or two, if anything. But I think the concern, which is not a new concern, incidentally, is that by using particularly tailored nonqualified deferred compensation plans, frequently for select key executives of a company, you can effectively provide additional retirement benefits and avoid the qualified plan rules. More importantly perhaps—and I do not know that this is accurate—this will put less pressure on employers to utilize the qualified plan vehicle.

Whether any of this will produce legislation or not, I do not know. I think only time will tell. My guess is that, when the system begins appreciating the tremendous growth in nonqualified deferred compensation, including incidentally, the phenomenon that we are seeing today with tremendous amounts of short-term deferral as a result of the reduction in tax rates in 1987 and 1988, there is going to be a reaction. I think it is going to have to be a legislative reaction, because I think the law is as it is, and it is going to require Congress to react if it chooses to. Whether Congress will or not, I do not know. My guess is that that is the next area of congressional reaction. We will have to wait to see.

As long as you asked me a question, I want to make one comment. I think it is really quite unfair to suggest that there were not policy reasons for virtually everything that was contained in the pension package in the final conference bill. Indeed, they were rather extensively discussed, both in the public process at the committee hearings and in the executive and legislative work on the package.

The problem, I think, is the one that Pat Dilley mentioned, and that is the disjointed nature of that policy process. This is really what prompts me to argue again that there's got to be a much broader range of debate within the legislature and within the administration in order to sort out these very broad policy issues that perhaps will permit future retirement benefit legislation to seem to have a whole to it, rather than just pieces of a part.

MS. DILLEY: I agree completely, and I think one of the motivations behind the committee's retirement income study,* is that it is terribly difficult to get most people interested in narrowly-drawn benefit issues. It is called the "glaze factor" among staff, and it is very tough to keep very busy members focused on what are very important but very complicated and technical issues. I think one of the motivations behind trying to pull all of these issues together is to raise congressional awareness of what the significant issues are, how these things can be looked at together, why they ought to be looked at together, and why member attention specifically ought to be focused on this area. I think that all of us who are involved in the study are hopeful that it will raise the awareness, at least of the members of the tax-writing committees and probably of all the other committees involved as well, as to what is at stake in these issues. Otherwise, it is going to remain an ad hoc process that is very difficult to get a handle on.

MR. GARBER: When I describe policy, I describe policy with a big "P," which says we are trying to do something, and these are the ways in which we are going to do it. I would agree that there has

*Editor's note: In 1986, House Ways and Means Committee chairman Dan Rostenkowski (D-IL) asked the Social Security and Oversight Subcommittees to report broadly on the nation's retirement income system. The effort continues in 1987, and further congressional reports and hearings are expected.

been policy established, but it is a lot of policies with small "p's," which achieve very subobjectives to the whole question of the overall issue of how to get more pension coverage to more people, which I think is the fundamental overriding issue. And this has not been addressed at all in a fundamental way. That is the question I was concerned about, not that there were not policy objectives, that we were not trying to do this or were not trying to do that.

MS. HAGEN: AT&T [American Telephone and Telegraph] was very active in lobbying on the benefits provisions of tax reform, and we were especially interested in the section 415 limits. A lot of what you have said ties in with our concern about retirement income security and the changes that are going on that are oriented to broadening coverage for lower- and middle-income people but creating some problems for those who aren't in those categories. One of the things that we were hoping would be recognized is the importance of retirement income security regardless of the tax incentives that are operating within the pension plan. I notice that David Lindeman mentioned this in a footnote in his paper.

Mr. Lindeman references a new feature possibly being created to deal with the conflicting policies of retirement income security and tax equity. He suggests that there be "funded excess benefit plans that do not raise constructive receipt problems once the employee vests but in which the investment income of the funds are taxed at, say, the 28 percent rate." This is one way of approaching the matter, and I imagine there are a lot of others, too. I would be interested in your reaction to the opportunity to have secured plans that are not necessarily tax-favored plans but that do operate to provide the retirement income security across-the-board to all employees.

MS. DILLEY: Well David's proposal is interesting. I think, as was said earlier, when we look at the whole area of nonqualified deferred compensation, all of these issues are going to arise. The more restrictions we put on a voluntary system, and the limits are a good example, the less incentive we're going to give high-income employees, small business owners, etc., either to set those plans up or to participate in them. I think that that is one of the underlying policy issues, and I think Harry Garber is right. We have not paid enough specific attention to what the results are going to be. I think that all the things we did in the tax bill were done with a view toward better securing people's retirement income, making the system fairer for low- and average-income workers.

But of course there is an open issue, which is if the tax bill has a big impact on the incentive for high-wage people to participate in these plans, is there going to be much interest in setting up new plans in the future? Are we going to see a move toward defined contribution plans and 401(k)s, and forget about the rest of this?

I think the basic thrust of policy discussions is always going to be how to best secure retirement income for people in the low/average/middle range, because the assumption is people in the high end are going to be better able to take care of themselves one way or the other. I think the issue that's going to be addressed is how do we keep them a part of the whole system instead of having different systems for different classes of people. I think that's a tremendously important social issue.

MR. LINDEMAN: It seems to me that the more you pull down the 415 limits, particularly now with the early retirement reduction, the greater the effect. But I do not think we are going to know for a while because the people that really have generous early retirement programs tend to be in the public sector, and they are exempt from the early retirement provision. I am not sure exactly what the effect will be, but I think generally the more you pull down the 415 limits, the more you have a fundamental conflict in policy objectives.

One of the purposes of ERISA was to try to get retirement commitments funded. ERISA's rules are the same as Internal Revenue Code rules, so that after somebody vests he's thrown into constructive receipt, whether or not the plan is tax-qualified. You can escape this through so-called nonqualified deferred compensation, but the burden there is that whatever funding is set aside for those things is subject to the employer's general credit.

From a tax revenue point of view, from a tax equity point of view, the main advantage that qualified plans have is that their investment build up is tax-exempt, and it is essentially a consumption tax island within the income tax. If you want to do something that would diminish the tax losses but still pursue some of the funding objective in ERISA, the first thing to think about is taxing the investment build up. It's another question as to when the employer can take the contribution.

I think I can prove to people analytically that the present value of the contribution is the same to the employer whether he takes it now or he takes it when the payment is actually made. Therefore, the present value of the tax to the government is the same as well. But we are in a cash flow problem right now. And even though I could show that if an immediate deduction was allowed, an employee would get back in equivalent present value terms the same amount 10 or 20 years from now, I do not think that would capture much attention.

That is another issue. It seems to me, there are three issues. One is the taxation of investment income. Another is constructive receipt. And finally there is the time of the employer deduction.

Let me just reinforce Pat's earlier comment and also comment on the nonqualified plan incentives as well. People in the upper part of the income distribution will have their tax rates lowered significantly, from rates of 40 and 50 percent to 28 to 33 percent. The incentives for nonqualified plans are thereby diminished. I agree with you that there is a lot of incentive for the next year or two to try to defer as much compensation as possible, but I think most people in that part of the income distribution would just as soon take it as a wage and stick it off into a deferred annuity contract, a life insurance contract, stocks, or anything else that is tax-deferred. Why? There is probably more investment flexibility. That's one of the reasons I think the nondeductible IRA will be much more popular than people are now predicting.

So I think nonqualified plans will probably dry up, because the only other advantage is that you can move from one tax rate when you are working to another tax rate when you are retired. But if your tax rate is going to be 28 percent regardless of which part of your life you are in, presumably there is no advantage. By the same token, you shrunk the amount of rate-of-return advantage in qualified plans for those people. To the extent that that has been the source of whatever redistribution is occurring in qualified plans, you have shrunk the source. Therefore, there is going to be less redistribution, or it's going to be much more difficult to achieve. I do not think this will affect large plans, but I do think it will affect small and medium plans. So you've got a real conflict in tax policy there. I agree with Pat that the only way out of that is either something like MUPS or direct federal spending. I am not sure there is any other way.

The Concern over Long-Term Health Care

MS. YOUNG: I want to go back to something you said before, indicating that the reason why people want long-term health insurance is the inflation in medical care. I think the perception of the public on what the word inflation means—and I am not quite sure what you meant to say—would not be the same as yours. I think the reason why people want insurance for long-term health care is because they recognize that the technology is exploding in medicine, and that there are a lot of expensive treatments out there and alot of people who are going to wind up living long periods of time, needing care in nursing homes who would not have survived the stroke 15 or even 10 years ago. So I am not quite sure that it is not an economist's cover-up to call that inflation.

MS. DILLEY: Let me stop you right there. Inflation is, obviously, a careless word to use. The concern of people about the cost of health care is exactly what you are talking about, which is that we have an increasingly expensive system because we are finding new ways to keep people alive, none of which is free.

MS. YOUNG: When people talk about inflation, you immediately get into the spectre of discussing whether or not we can put more controls on the system. Congress would have to have the courage to say "let's play God" and decide who shall live and who shall die, which I would not recommend and can hardly see ever coming about. Inflation really brings up the wrong idea. It brings up the idea that something is out of control that need to be controlled when that's not really what the public is seeing.

MS. DILLEY: You do not have to call it inflation, though, to say that we have a system of increasingly expensive health care.

MS. YOUNG: The public may see this as positive, not negative, in the terms of long-term health care.

MS. DILLEY: Positive in that everyone wants to stay alive as long as they possibly can, and everyone wants every doctor to do whatever they can when it is their life at stake. They just do not want the doctor to do everything possible when it's somebody else's life at stake, when they have to pay for it. That's the issue. I think that really reinforces my point, which is that financing a system like that is a tremendous burden on tax incentives. There are public policy decisions about the kinds of health care we are willing to pay for, which are very critical issues. But inflation, it is not.

MS. YOUNG: Where would Ways and Means put it, if they did not put it on tax policy?

MS. DILLEY: We have a Medicare program. We are a spending committee.

MS. YOUNG: That is what I am saying.

MS. DILLEY: We are a spending committee *as well as* a tax committee. That is my point. When you have a direct benefit program, you have to make those decisions about what you are going to pay for and how you are going to pay for it, and that is what controls the way the costs are contained. That has nothing to do with inflation. It has to do with making those life-or-death decisions. I agree, it may be unlikely; but I think Congress is going to face that.

Congress and Pension Policy Revisited

MR. JACKSON: Pat, you mentioned that the private sector left you with the impression of "leave us alone" in the tax reform discussions.

MS. DILLEY: Not just me, but it left that impression with many people.

MR. JACKSON: When I started in the benefit business, we had in this country a voluntary private pension system, voluntary in the sense of nobody had to have one, and private in the sense that if an employer put in a plan for a nonunion group or if he wanted to negotiate with a union over pensions, they decided the details of the benefits within the framework of some very, very broad and probably inefficiently enforced regulations.

ERISA, coupled with a welter of legislation since then, has changed this to the point that the employer who takes on such a plan has a long-term liability that may show up on his balance sheet or affect his credit rating. And he further faces the fact that every year or two there's another set of laws changing this detail or that. Frank McArdle [EBRI Director of Education and Communications] sent out, for example, a list of the legislation pending in the current Congress. Obviously, it is not all going to be passed, but, heavens, there must be 50 bills focusing on this little topic. Should you retire people at 70, or should you continue coverage for the children of divorced marriages?

Probably the eyes of the House members glaze over when you approach them with these technical details. But every two years they run for election, and every two years there must be a 25 or 30 percent turnover in the group. So each one of these members has something that he wants to accomplish, to take back to his constituents.

Now it seems to me that in planning, you focus on what you think is a very attractive tax incentive to put in a private pension plan. But I would submit at the moment, with the impermanence in the rules and regulations relating to them and the prospective impermanence, that people are putting in plans not *because* of the tax incentive but *despite* the impermanence. They are putting them in because they want the benefits. They feel the benefits are good for their work force. Is there any hope of every getting to the point where you will leave us alone?

MS. DILLEY: I certainly hope so. As I said before, I hope that we leave the coverage rules in place long enough to see whether they work or not. That is what I would hope we would do. The problem is, as you suggest, there are members of Congress whose job it is to pass laws, and there are staff of those members who will not have anything to do if they do not develop legislation for their members to push. So there is constantly going to be some kind of pressure, I think, to reexamine all these issues.

The only thing I could say is that the 1977 and 1983 Social Security Amendments did not contradict each other—they were complementary—and we have not reversed anything we did in those bills in any major way. In 1983, in particular, we did some very unpopular things with Social Security. Taxation of Social Security benefits is not one of our all-time winners in terms of public relations. The windfall benefit formula and coverage of federal workers was another very, very tough issue. We have not gone back one inch on those, primarily because the members of the Ways and Means Committee, from chairman Rostenkowski down, refused to reopen that package. The analogy to this is that the pension package in the tax bill was enormous. It was a lot larger than what we started out with in the House bill. It kept growing.

I hope that there will be some of the same pressures as have worked in the case of Social Security after 1983 to not tinker with it again, to not reopen all the issues. But I will submit to you that the tax field has a different sort of culture than the Social Security field, and there are people out there who want to eliminate or repeal the coverage test, the nondiscrimination test, and the new integration formula before they ever take effect. If that move gains momentum, I think it will cut against the argument we hear all the time, which is leave these things in place long enough to see them work. My hope is that we will not have further legislation for awhile, but I think that some in the private sector are going to be pushing for exactly the opposite, and that is going to create tension over the next couple of years.

PART FOUR
BENEFITS FOR THE FUTURE: INTEGRATING DEMOGRAPHIC TRENDS, EMPLOYEE AND EMPLOYER EXPECTATIONS, AND GOVERNMENT POLICY

In designing and planning benefit packages, employers and human resource managers must grapple with all the issues examined thus far in this book: they must integrate demographic and economic trends, employer and employee attitudes, and governmental policies to develop a coordinated employee benefits plan suited to their particular work force. Part Four concludes our examination of *America in Transition: Benefits for the Future* with observations of three benefits professionals, who predict how businesses will manage, design, and cope with the changes influencing their benefit programs.

Because many industries are experiencing increasing foreign and domestic competition, most companies agree on the need to manage total labor costs tightly. One aspect of cost control has been accomplished by reducing, or "downsizing," the labor force and limiting gains in total compensation, both cash pay and employee benefits. In chapter XIII, Margaret Gagliardi forecasts that after years of historic upward trends in benefits, the corporate community will be managing their work forces with limited resources for compensation and benefits for at least the next several years.

Pension plans will probably continue at the current level, but potentially with increasing attention given to capital accumulation plans, where employees share in the contributions to the plans. Disability and death benefits, which also are now providing adequate protection for employees, will be maintained at their present level. Group health plans will probably experience the most change, with increasing focus on cost-managing resources such as front-end deductibles and premium sharing, but also on health promotion and wellness programs. (A comprehensive examination of the changes occurring in health care financing and delivery and how employers have been redesigning their programs to better manage their costs is presented in Frank B. McArdle, ed., *The Changing Health Care Market*, Washington, DC: Employee Benefit Research Institute, 1987.)

In the coming years, companies will also be addressing benefit plan changes required as a result of tax reform and other new laws. Will the new laws change the direction of employee benefits? Gagliardi generally thinks not. Some marginal employers might discontinue certain plans. Other companies will adjust to the new rules, continue their plans, and "bear up with the [governmental] interference while acting out the central function of benefits in protecting employees against the economics of work life."

Benefit design in the long term will be driven by demographic and economic trends, employee desires and corporate policy. In the short term, however, the most important issue benefit mangers will deal with is changing federal policy. Richard Velloney, in chapter XIV, discusses how one company (The Travelers) is attempting to cope with the short-term issues that changing governmental policy necessitates, as well as how the company plans to meet work force changes and business needs that are driving long-term policy.

"Clearly we will be moving toward a plan that provides options," says Velloney. Like other companies that have a large and varied work force with different job goals, work mediums, and work schedules, Travelers must coordinate company policies on several interrelated issues in developing an overall benefits program: corporate philosophy, expense, plan design, and employee communication. Corporate philosophy and program expense drive plan design. Travelers' self-described "paternalistic" corporate philosophy will not dramatically change, but the company's benefits structure will concentrate on providing the minimum *prudent* level of protection for major life events. The expense pressures will dictate that the company's benefits package will be smaller, expenses more tightly controlled, and more costs absorbed by the employee. The overall plan design will include an emphasis on wellness, death benefits, pensions, health care, and retiree long-term care. And since the changes will require more complete understanding, there will be a special emphasis on employee communication.

A decision-making process that enables employers to respond to changes in an integated fashion is the focus of Anna Rappaport's paper in chapter XV. An integrated planning process is driven, explains Rapaport, by the internal and external business environments which together form the company's decision-making environment. It involves development of benefit policy and setting of objectives that form the basis for the plan. The decision-making environment defined by these factors is unique to each organization. For example, if a plan is out of compliance with the law, the laws may be the most important issue. In another case, the financial constraints may be most important. In other situations, the labor relations environment may be of greatest significance. Of course, change is ever-ocurring, and coping with changes at different stages of benefits planning challenges all involved.

The changes in federal government policy, work place-values, and financial needs already occurring may be helpful in understanding future trends, suggests Rappaport. For example, individuals are beginning to assume a greater role for retirement income and medical care, sometimes encouraged through tax inventives such as individual retirement accounts and 401(k) plans, or sometimes forced through employer health care cost managing measures. Other emerging financial needs, those that are less traditional, should also be recognized by employers. They include job security, skills maintenance, financing of education, child care, home buying, and care of aging parents.

Certainly, the 1986 Tax Reform Act will require many employers to make numerous employee benefit plan changes or, at least, reevaluate the direction of their current benefits package. In most ways, government policy is no longer encouraging the expansion of benefits. In fact, in the past several years, there has been a growing restriction on employer-provided benefits and on direct federal retirement savings programs as well. Further changes should be expected. Employers, as always, will have to balance employee needs with the firm's resources and the changing economic and regulatory environment.

In conclusion, Rappaport discusses potential areas of change and/or emphasis in employee benefits of the future, including (1) an increased priority on postretirement medical benefits; (2) further reduction of tax preferences for benefit plans; (3) increased use of nonqualified executive plans, (4) increased recognition of child care needs; and (5) development of alternative work arrangements.

XIII. Benefits for the Future: Managing with Limited Resources

REMARKS OF MARGARET M. GAGLIARDI

As those of us in the corporate community look ahead, one theme is expected to be dominant for compensation and benefits, and it has been discussed many times today: we are going to be managing with limited new resources for additions to total compensation. This has been with us in 1986, and most certainly is going to be with us for several more years to come.

Managing Labor Costs

Most companies agree on the need to manage total labor costs tightly. Even with business experiencing good times today, there is a sober realization of the need to keep costs in line. The pace is set by industry's experiencing intense competition, both foreign and domestic. Cost control is required by the needs of the business. Happily, the modest level of inflation in the country today permits lower cost increases.

The first line of attack on this problem in most businesses is to institute tough head count controls that go beyond temporary fixes like hiring freezes. Companies are approaching the issue systematically, finding ways to operate permanently with fewer employees per unit of output. Usually, this takes two forms—a decrease in the number of staff jobs compared to line and a decrease in the number of line managers per production worker.

This is a discouraging time for salaried professionals, especially staff specialists. Jobs are few and far between, and the number of very good people in the market grows every month.

Hardest hit may actually be the human resource specialists who are faced with simultaneous pressures for head count control, reduction of staff jobs, the centralization of decision making to line managers in each business unit, and widespread mergers where one staff can do the work of two. After head count control, the next step in controlling labor costs is limiting gains in compensation, both cash pay and employee benefits.

A brief word about compensation. The outlook for compensation can be summed up in three statements. First, limited resources will be available for total compensation gains. That is the imperative arising from the need to control total costs. Second, at the same time there is a strong impetus to make more cash available to reinforce the need for higher productivity. And the third, inevitably, follows the first two. Major efforts will be devoted to holding down the growth in expenditures for employee benefits.

A key question is, will the new legislation change the direction of the benefits? Not for large companies, because virtually all these plans today cover everybody and allocate company contributions fairly. However, new legislation does mean more complexity and overhead costs for required revisions. I believe some marginal employers might discontinue certain plans. Other companies will adjust to the new rules and keep their plans going.

The thing to remember is that tax evasion is not the soul of employee benefits. So companies will generally bear up with the interference while acting out the central function of benefits in protecting employees against the economics of work life.

Trends in Employee Benefits

Today, I'd like to talk about the trends in employee benefits given the push to control costs, government legislation and changing demographics. I will also discuss some strategies being used to deal with this area of limited resources and address questions such as, what lies ahead for employee benefits? What will organizations do to squeeze down on expenditures for noncash forms of pay?

Companies are trying to reverse an upward trend in benefit expenditures that have lasted a generation. During the sixties, benefit costs rose from 25 percent to 32 percent of direct pay expenditures. In the seventies there was an even faster increase to 41 percent of wage and salary payments. Is it realistic to expect that this enormous movement can be stopped? Well, the pace of benefit growth is slowing. While the value of benefits is 20 percent higher than a decade ago, most of the growth occurred prior to 1980. The values have been only inching up since. The value of pensions rose rapidly after the passage of the Employee Retirement Income Security Act [ERISA], but virtually no improvements have occurred recently. Medical benefit values kept rising until 1982, after which they actually declined as cost containment efforts became prevalent. The only expanding form of benefit recently have been capital accumulation plans.

What is in store for benefits? Let's look at each major area concentrating on salaried groups where management intention is more easily translated into action.

Outlook for Pension Plans—The outlook for pensions is flat; no growth is expected. But no major wave towards retrenchment is likely either, even in the face of legislation further restricting tax effectiveness. There are instances of plan terminations, but most are a result of financial motivation to recover excess assets rather than a deliberate policy to abandon pension coverage.

There are important reasons for keeping the defined benefit retirement plan. It provides a predictable benefit that the employee can count on. It guarantees lifetime income that a retiree cannot outlive. It encourages planned retirement to help both the individual and the organization, and the risks of variations in investment yield and pay growth from what were assumed are borne by the employer rather than the individual.

Continuation of pensions is enhanced by recent experience. Pension funds have been getting good investment returns, and many are paying off past service liabilities. As a result, contributions to pensions have been dropping at many companies. The costs are being lowered without cutting benefits. So the prognosis for pensions is that they will continue at the same level at lower company cost.

The trend in capital accumulation plans will continue to be up despite legislative capping of benefits. That is because companies want to maximize the role of the defined contribution program. This type of plan easily accommodates employee contributions, helping to build the third leg of the security stool.

Tax law will continue to permit pretax employee savings in an employer-sponsored plan, and the employer's contribution can vary with profitability, easing the financial impact. In fact, the capital accumulator has grown so popular among companies that many have more than one type in addition to the pension plan. The most typical pattern has been a matching savings plan plus a modest stock ownership plan. This, however, may change as a result of legislation.

About 80 percent of major companies have savings plans, about 25 percent have profit sharing plans, and almost half have some form of a stock ownership plan. I think the capital accumulator is alive and well.

Outlook for Disability and Death Benefits—The trend in disability and death benefits is simple. They really are not going anywhere. Their basic characteristics are high risk for an individual but low incidence of occurrence. Consequently, the cost is moderate to provide reasonable levels of benefits. We have already obtained adequate protection. There is little to be gained financially by cutting benefits. Consequently, no action is the rule of the day.

Outlook for Medical Benefits—Three major trends in medical benefits are helping to control rising medical plan costs. One is an accelerating pace of change in plan content. Incentives for proper use of medical services are prevalent, like second surgical opinions and preadmission checks.

There is also the growing use of front-end deductibles for hospital benefits. While only 14 percent of major employers' salaried plans required hospital deductibles in 1980, 52 percent do so today. One result is cost shifting from the company to the employee. But more important is the reduction in hospital utilization that deductibles are bringing. By reducing unnecessary use, the total cost of the plan is going to rise more slowly.

The second major trend is toward more medical premium sharing by employees. Today, the proportion of major employers that pay full premiums for salaried employees and their dependents is down to 36 percent. Another 16 percent pay fully for employees but require employee contributions to cover dependents. More than 40 percent now require employee payments toward both employee and dependent premiums. The remaining 8 percent are mostly those with choice plans requiring employee contributions towards the highest value of coverage.

The third major trend is an increasing focus on health promotion or wellness programs in the belief that healthier employees not only save a company money by spending less on health care coverage, but the healthier employees are more productive and help give a company a competitive edge. It is becoming clear that programs aimed at smoking, alcohol abuse, and high blood pressure are most effective, but programs at the work site that offer guidance, support, and continuity have the biggest chance of success to change what may be lifelong habits.

Trends in medical costs should be mentioned. Without question, cost containment efforts have borne fruit in the last year or two. The rate of increase has slowed considerably, but the good news is not likely to last. Medical costs are starting to rise again. The fat of unnecessary utilization has been squeezed out of the system, but the underlying factors that cause costs to increase, like technological advances and an aging population, are still there and will continue.

It seems probable that even well-designed medical plans will undergo premium increases that are greater than compensation gains, meaning that medical plans will gradually eat up more of total compensation dollars available.

Viewed from a total compensation perspective, will we succeed in leveling off the portion allocated for benefits? Probably not. Costs for private benefits will be nearly level as a percentage of pay, except for some creep in medical premiums. Paid time off will probably see little change. Although the pace of increase will surely slow, there will be some net upward allocation of a higher portion of total compensation for benefits. The squeeze may be to hold down their growth, but stopping it is not entirely in the cards in the future.

Managing within Tight Constraints

The picture I have been painting of future benefit trends is not one that human resource professionals are likely to eagerly look forward to. Managing within tight constraints is very frustrating. If this were a one-year belt tightening exercise, we would manage by such tactics as deferring some expenditures and stretching out effective dates for plan change. But it is not a one-year problem. For at least several years, we will be managing with limited resources available for total compensation gains, and in this environment we have to choose our strategies carefully.

No single formula is going to work for all businesses, but here are a few suggestions that are being tried by some organizations today. Some are emphasizing a defined contribution approach to retirement and medical programs. If the objective is to limit commitments to benefits to a specified portion of total compensation, this goal is easier to accomplish by determining the company's commitment rather than agreeing to pay whatever is necessary to fund a stated level of benefits. This strategy also requires employee contributions which change from time to time to make up the difference between the required premium and the company's defined contribution commitment.

Another strategy is to employ flexibility to permit alternative uses of the same total dollars. If the costs of a medical plan, for example, are rising faster than the employer is willing to pay, usual alternatives are to reduce benefits or to require employee contributions. But if there are alternative plans to choose from, the employee decides whether to contribute toward an extensive coverage or accept smaller benefits paid for entirely by the company or, to a lesser extent, by himself or herself. The presence of individual choice makes cost containment much more palatable.

These are only a few examples of strategies that may help to stretch the limited amount of new money available, but there are undoubtedly others. However, we have to recognize that without change in compensation management, we are likely to be harmed. We may find there is not enough new money available to reinforce pay for performance, that fixed labor costs are too high for the health of the business, and that benefits keep eating an increasing portion of the total pie. Managing down is certainly harder than managing up. Strategies *can* be developed by following a logical process, but it is not easy.

First, assess the environment inside and outside the organization. What circumstances are you in? What factors will impact compensation? Second, management has to agree on goals and directions. What happens has to fit within the business plan. Besides, in the end, the line managers have to be able to live with the program. Third, develop long-term strategies. There are traps in looking at this issue as a short-term, belt tightening exercise, for next year may bring the need for another dose of the same medicine. Altogether, this is not a very comforting picture for compensation and benefits in the future, nor is it a prescription for easy management.

Perhaps challenging is the best epithet for what lies ahead.

XIV. Designing Benefit Plans for the Future: Flexibility in a Climate of Growing Governmental Restrictions

PAPER BY RICHARD A. VELLONEY

Introduction: The Forces Driving Benefit Design

Employee benefits in the United States today are being redefined and redesigned in the face of a rapidly changing environment. The personality, attitudes, and characteristics of the American work force are changing. Workers in the 1980s are more aware and better informed than ever before, and they have new values and expectations regarding both their lives and their jobs. These changes have already begun to alter the way employers manage their businesses, and they can be expected to have an even more significant impact in the future. In order to prosper, management will have to understand the changes taking place, anticipate them, and adapt accordingly. While the United States has never had as much government or collective involvement in health care, pensions, insurance, and other employee benefits as most European countries, it is clear that the United States reached its peak of public-sector involvement in the late 1970s and has already substantially shifted away from a more pervasive governmental role toward more private-sector and individual responsibility.

Several very significant forces currently underway are responsible for the new direction in employee benefits. First, the government has recognized there are finite resources and, in particular, it cannot meet all the social needs or wants of its citizens. Second, and not unrelated, has been a desire to hold down the rapid growth in spending, and keep income tax rates within certain limits. This was not new with the Reagan administration, although President Reagan and his political party have long been most seriously committed to lower individual and corporate income tax rates and less government spending on social welfare programs. This has meant cuts in some programs and reduced growth in others. At the same time, reduced tax rates and special investment tax credits, coupled with the continuation of huge outlays for Social Security, Medicare, and the rebuilding of a U.S. defense capability have created enormous deficits for several years in a row. There is a lot of rhetoric in Washington and some action (e.g., Gramm-Rudman-Hollings) to bring down the deficit. Third, policymakers and others recognize that future demands for pensions and health care will grow sharply as the U.S. population ages and especially as the number of old-elderly (i.e., 75 years and older) grows. At the same time, the worker population is aging while employees are retiring earlier, though often they may then turn around and get another job or start a second career. Fourth, employee benefits are not only growing, they are also changing as a result of changes in attitudes and new information about what employees want, such as more benefits and, in some cases, more time off, instead of more income. Fifth, one of the most significant trends affecting the labor force and employee benefits is the increasing number of women working at all levels and in all kinds of jobs.

Until recently, if married women worked at all outside the home, they worked until the first child was born, then left the labor force—most often without returning unless their husbands died or were disabled. But this pattern has changed and it has not changed only because of economic conditions. Rather, it reflects a different view among women about their roles in society and their preference for careers or the financial benefits and freedom that come from earning their own income. For example, the number of working women grew more than 35 percent in the past 10 years, accounting for more than 62 percent in the growth of employment. Now 54 percent of all women, nearly 50 million, are gainfully employed—nearly double the 1960 figure.

Current Focus of Governmental Policy in Benefits

While the aforementioned forces are driving ultimate benefit design change for the long term, the short term will not be driven by demographic trends, employee needs, or even employer expectations, but rather by governmental policy. Changing demographics, inflation, regulation, and utilization have caused government to retrench and search for ways to shift the cost burden to business and/or the individuals themselves. However, at the same time, security (prefunding) and expense (narrowing options for tax-efficiency) may be the albatrosses which make this entire approach counter-productive. A stable governmental environment while perhaps a little too much "Alice in Wonderland," does present some intriguing possibilities, not the least of which is that benefits design and delivery would be driven by the needs of the end-users—the employee "marketplace." The most accurate statement may come from David Glueck of TPF&C [Towers, Perrin, Forster & Crosby, Inc.] who said, "only if employers, accountants, and lawmakers work together can a rational solution be developed." Is this asking for the impossible or merely the improbable?

Currently, the administration and the Congress are working toward modification of some, and elimination of other, established tax incentives awarded to employee benefit programs. Worries over budget deficits, tax fairness and simplicity, and the perception on the part of legislators that tax-favored employee benefit plans disproportionately favor the rich, high-income groups pose a threat to tax incentives that now encourage both program sponsorship and participation. As an employer and as a provider, Travelers Companies see three areas for significant concern.

Pensions

Many of those currently working have made retirement planning decisions based on established rules, but changes in benefits have occurred regularly beginning with the Employee Retirement Income Security Act [ERISA].

1. ERISA placed restrictions on the private pension sector to protect the interests of employees and their beneficiaries. It was designed to
   - increase private plan sponsorship;
   - increase employee participation and encourage assumption of responsibility for personal retirement planning rather than heavy reliance on government programs for retirement income;
   - prevent strain on government programs, which was occurring due to the rising number of retirees per active worker; and
   - prevent strain on government programs in the future because it ensured that private-sector benefit commitments to workers would be kept.
2. The Retirement Equity Act [REA] was not a comprehensive policy in the sense that ERISA was. Still, it provided further protection for spousal rights to employee benefits, but with some increase in administrative complexity and cost. However, tax incentives to employers were kept intact, giving the government leverage for further regulation without the attendant disincentive to plan sponsors. REA will likely perpetuate the effect of ERISA. But its effect has been difficult to ascertain in light of other "reforms" occurring almost simultaneously.
3. The 1982 Tax Equity and Fiscal Responsibility Act [TEFRA] and the 1984 Deficit Reduction Act [DEFRA] are revenue-oriented government policies, which are likely to affect future employee benefits in a way that may negate much of the positive effect that ERISA has had over the past 10 years. These policies affect the taxation of employee benefits as well as the cost and complexity of plan administration without leav-

ing the incentives for plan sponsorship and participation intact. TEFRA and DEFRA lack cohensive goals in terms of overall retirement policy. Theirs' is a piecemeal approach that results in contradictory provisions within one reform proposal. The policy of including pension reform provisions within tax legislation can have serious implications for employee benefits. It can add complexity without corresponding incentives to either employee or employer and lower incentives for individuals to assume responsibility for retirement planning. And constant rule changes make planning more difficult.

This clear conflict of interest between tax reform and pension reform supports the contention that employee benefits would fare better in the future were the two subjects dealt with individually in government policy. Amid the whirlwind of tax proposals, a proposal called the Retirement Income Policy Act [RIPA] was written, which took a comprehensive approach to the subject of retirement policy. Although its provisions were not necessarily all favorable, its cohesiveness made it a policy approach that could be dealt with much like ERISA. Unfortunately, RIPA was overshadowed by the tax reform effort. To the clear disadvantage of the employee benefits arena, gauges of tax base erosion and the tax expenditures associated with employee benefits are generally overstated in that they ignore the social value of employee benefits as a valid goal of tax policy.

It should be emphasized that if changes in tax policy allow private-sector benefits to diminish significantly, retirees and their dependents will again be heavily reliant on public programs and the mood of the economy rather than prefunded, guaranteed benefits. If this were to happen, legislators might well be faced with the conditions that led them to enact ERISA. It becomes increasingly important, then, for government policymakers to distinguish between socially valuable "incentives" and "loopholes," which are truly abusive and of little social value in achieving both pension and tax reform policies.

Group Life and Health

1. *Delivery system*—As we move forward in the reorganization, governmental regulation can either help or create roadblocks to the efficient delivery of health services, whether through HMOs, PPOs, or utilization reviews applied to the fee-for-service system.

2. *Health care for retired employees*—The recently enacted funded welfare benefit plan tax rules (Internal Revenue Code section 419 and 419A) make it very unattractive to prefund postretirement medical benefits. Only the larger employers are in a financial position to take on the unknown future costs of paying for retirees' medical expenses. This sounds a little like the scenario that lead to the enactment of ERISA in the pension area.

3. *Aging work force issues*—COBRA [Consolidated Omnibus Budget Reconciliation Act of 1985] calls for a study of the long-term care gap in coverage under both private and Medicare plans. Now, the gap for long-term custodial care in a nursing home is filled only by Medicaid, and only after all other assets are exhausted. A federal commission has been formed to develop guidelines for use by state regulators and the insurance industry to ensure that sound private long-term care products are developed and to foster consumer confidence.

Small Employers

1. The great gap in the private pension system, as well as other benefit plans, has been identified again and again as existing in the small employer segment. Government initiatives to close this gap could have an impact on large employers, although one might hope that carefully drafted legislation would avoid this. The current tax-oriented legislation will probably widen the gap in coverage because of the additional expenses and complexities that it would impose on small employers. If individual marginal tax rates are lowered significantly, this too will reinforce the undesirability of employee benefit plans for small employers. The owners and managers of small businesses may see the tax subsidy that is built into the benefits to be worth that much less compared to their taking currently taxable, nonexcludable compensation themselves to the exclusion of rank-and-file employees.
2. In our essentially voluntary employee benefits environment, the laws have been unable to resolve the tension between the Treasury Department and some small employers over the tax subsidy of benefits and their nondiscriminatory availability. The success of legislative changes could depend on whether small employers can be induced to offer broad-based and meaningful benefits to their very large segment of the employment market by means of some tax subsidy that benefits owners and managers of small employers, yet in a nondiscriminatory manner.
3. Recent legislation creates discrimination rules, vesting rules, and "highly compensated" employee definitions in life, health, and pension areas that discriminatorily limit many benefits for employees of small employers. A 401(k) plan ought to be as available for small as for large plans. But it will become a poor shadow of the 401(k) plans available in larger companies if currently proposed legislation is enacted.

Beyond the current focus on governmental intervention, there are a multitude of issues that require attention to create short-term employee satisfaction, respond to business needs, and provide the long-term security supposedly sought by government.

Now that the foundation has been established, I would like to spend the remainder of this paper addressing how The Travelers is attempting to meet these challenges and what specific issues we feel have the greatest priority for our employees. To a large extent, how we deal internally will parallel our external marketing strategy.

Self Analysis

Perhaps the most pertinent starting point is a self-analysis. Over the years, Travelers could best be characterized as conservative, paternalistic, and reactionary in providing benefits to our employees. Management attitudes and philosophies could be attributed to the business environment, which is quite cyclical and in which business decisions carry a long tail. Any one year's business results are the product of underwriting and investment decisions that are often many years old.

Progams currently in place are service-driven, "typical family" (husband, wife, and two children)-oriented and, in total, produce very competitive results in surveys. Choices are limited and, as a result, employee attitudes toward the generic term "benefits" have been deteriorating. Our work force demographics appear to mirror what we all read in business articles daily (greater portion of females, shorter tenure, and aging). Also, our retiree population is growing rapidly (a 33 percent increase over the last five years), as is the number of those terminating with a vested interest in our retirement plan (a 50 percent increase over the last five years). And, perhaps the most difficult of all circumstances has been created by the acquisition of several organizations with totally different demographics and totally different benefits programs designed to meet their needs. Obviously, we are ripe for change.

Where We Are Headed

An internal task force has been established with an objective to scope a leading-edge program and an associated one-to-three-year implementation schedule by the end of 1986. We intend to create a strategic action plan which, to the best of our ability, dispenses equity today and insures financial/cost effectiveness in the future, while meeting all governmental requirements. Easier said than done, to be sure.

Clearly we will be *moving toward a plan that provides options*. However, as we strive to do this, regardless of what some would lead you to believe, we really have a formidable task to meet the needs of everyone. I'd like to draw your attention to a chart presented by R. Eden Deutsch in the December 1985 issue of *The Futurist*:

TABLE XIV.1
The Work Force: Comparison of Key Characteristics, Selected Years

Pre-WWII Pre 1945	"TV Babies" 1946–1965	"Computer Babies" 1966–1975
	Preferred Work Environment	
Power hierarchy: work your way up the ladder of success.	Quality circles and teams; participatory management.	Autonomy; individual works alone, least amount of supervision.
	Goal	
Get the job done because it is good for the company, good for the nation.	Get meaningful experience from doing the job; personal growth.	Get job done so individual can use his own leisure time more satisfactorily.
	Work Medium	
Assembly line; human labor.	Mainframe computers.	Personal (desk-top) computers.
	Time Values	
9-to-5; overtime.	9-to-5; flextime.	Flextime; flexiplace.
	Information and Enculturation Media	
Radio in the living room; newsreels at the movie theatre.	Television news; rock-n-roll; transistor radios.	Walkman; VCRs; music videos.
	Consumption	
Brand-name buying; few choices available, few demanded.	More choices available.	More choices demanded.

Source: R. Eden Deutsch, "Tomorrow's Workforce: New Values in the Workplace," *Futurist* 19 (December 1985).

I would like to point out that in the year 2000 we will be dealing with retirement issues for those in the first column, those in the second will be our management, and the last column represents our "doers." To design an overall program that meets all of their needs comes close to "mission impossible."

As further evidence of the design problem, Honeywell Corporation reported on an interesting attitudinal survey in 1984. In response to the question, "would you still go to the office everyday if you could work at home using telecommunications?" The results were:

Age	Yes
18–29	36%
30–39	57%
40–49	60%
50–59	57%
60+	76%

Much of the planning being discussed today looks at the demographics and the attitudes of different age groups and assumes technology will be accepted. As the young of Honeywell age, they will undoubtedly want the social contact of the office. Other things will change as well.

If we are to meet our internal design goal, Travelers will have to solve or, at minimum, intelligently address several major issues. As if there is not enough pressure to resolve these issues for "Travelers the employer," much of our answer could set the stage for the marketing strategies of "Travelers the provider." While the list would be endless, the following are the major issues we have identified for particular emphasis and some associated directions.

Philosophy—Each organization has differing reasons for what benefits they provide beyond those that are legally required. Our paternalism will not be reversed overnight; however, we anticipate the core of our flex program will truly be the minimum *prudent* level of protection for major life events. Travelers cannot risk its reputation and future business on the possibility of financial disaster for an employee's family because of our benefit offerings. Our employees and constituency expect more of us than to permit such a situation. However, we do recognize that the emerging majority of our employees are less concerned about long-term security and those who are concerned are willing to pay the price for that security. The majority will choose to spend their discretionary benefits portion on the more temporal items, which are associated with social needs and translate into the immediate (e.g., cash or savings accounts, time off, day care, etc.). The program must permit long-range planning as well as short-term, but the bottom line is that we cannot transcend our fiduciary responsibility nor our legal, moral, and ethical obligations else we will not have employees to be concerned about.

Expense—Much of the expense issue is centered around 1) what legislation will require and 2) what we really wish to accomplish. Reality has proven that well-intentioned governmental efforts (such as Social Security and Medicare) simply cannot continue in their present form. We have only seen the beginnings of the cost shift to the private sector and our designs must anticipate the inevitability of the primary versus secondary focus. Medical expenses have been increasing to the extent that company-sponsored programs are targeted for containment strategies with each renewal, and this will become even more acute. Both of those expense features tend to dictate the second point. We will be forced to accept that regardless of what we want, we will not be able to provide unlimited medical care plus an expensive list of other benefit items. Company contributions will be able to provide catastrophic coverage and perhaps leave a little over for the employee to spend as he or she wishes. Expense pressures will be such that there will be a reversion to the 1950s type philosophy of coverage for lifechanging unplanned events, where financial disaster was imminent and the employee absorbed most of the routine budgetable expenses of child care, transportation, supplemental life, etc. Clearly our package will be smaller, expenses more tightly controlled, and while choices may be abundant, more of the associated cost will be absorbed by the employee than in recent memory. Legislators and regulators can attempt to increase revenues by limiting corporate incentives for providing benefits, revise funding for future liabilities, and place any other restrictions they wish, but corporations will not be able to respond to the "what have you done for me lately" attitudes of employees and unions. The cost will be passed back to the very people these moves were made to protect. Thus our officials will have to weigh textbook theory against reality and decide whether or not they are shooting themselves in the foot.

Design—Following on the philosophy and expense sections, obviously the core of our flex program will reflect a conservative approach to providing needed basic protection. This is not without a rationale because, in spite of what the "now generation" or any other generation says, they will feel differently at some point in the future. We will do our best to treat them "as adults," but how often have we all heard employees say, "I wish I had . . ." This is the test we must respond to in our fiduciary role. While we fully anticipate a multitude of choices within the plan, there are five that will monopolize our time and efforts:

1. *Wellness*—This is somewhat of a "Catch 22." On the one hand, the argument can be made that healthy workers are more productive and have lower health utilization, while on the other hand, the company and government are faced with extended pension payments and related aging expenses. We have, however, rejected the "pay-me-now-or-pay-me-later" attitude and immersed ourselves in a proactive integrated cost containment approach that is highly leveraged on wellness. Our strategy is to move toward an optimal level of organizational and per-

sonal health by developing a set of cultural values which support healthier lifestyle choices and lead employees to adopt a greater sense of personal autonomy for their individual and dependents' health and health care needs. We fully recognize that the results of wellness cannot be totally measured in the short term. Two broad areas have received the major focus of this program.

Medical self-care education has the most direct effect on the decision-making process of our employees as health care consumers. Through education we can assist our employees and their dependents in making appropriate choices concerning their medical care needs so they will develop a greater sense of involvement concerning health care decisions. Both the company and employee will benefit from a decrease in unnecessary procedures and office visits.

Lifestyle enhancement is designed to affect positively those elements of an individual's lifestyle which contribute to the development of disease, disability, and premature death. Lifestyle enhancement is a broad based communications effort to heighten the awareness employees have of how lifestyle habits affect their health and to create a corporate culture that values and supports those positive health choices. Ultimately we are creating a healthier work force, which in the long run will save the company countless dollars with minimal impact on pension expense. Our comprehensive program has

- provided a self-care book ("Take Care of Yourself"), and a monthly health newsletter is mailed to the home of all employees;
- permitted completion of a health appraisal which is scored and the employee receives a comprehensive booklet explaining the results. The results are used to create a detailed base line for our program measurement system;
- provided delivery of a binder to employees for retention of their newsletters and a personal health record;
- trained an individual in each field location to serve as a facilitator with program modules and other opportunities with local communities; and
- implemented focus programs for weight loss, physical fitness, smoking, stress reduction, and several others which are in the development stage. Interspersed with the focus programs will be other health related activities (e.g., health fairs, contests, etc.).

The fourth quarter of 1986 will mark the opening of an integrated health facility for all Travelers employees in our home office. It will be the largest, most comprehensive facility of its kind. The Taking Care Center, named after our health promotion effort, will offer a wide variety of activities and education classes. The facility is 48,000 sq. ft., consisting of a 5-lane swimming pool, an indoor track $\frac{1}{10}$ of a mile, 3,000 sq. ft. of aerobic dance floor, state-of-the-art strength training equipment, rowing machines, computerized stair climbers, exercise bikes, and cross-country ski assimilators. All our participants are screened for risk factors and given a fitness evaluation and a personalized exercise prescription (program). There are classrooms where discussions on stress management, nutrition, lower back care/prevention, etc., will be available for employees, retirees, and families.

We have chosen this approach because we are convinced that lifestyle habits are related to the most prevalent and costly diseases, and younger employees need early reinforcement as an incentive not to follow in the path of past generations. Our 1986 expenditure of $800,000 (exclusive of the Taking Care Center) on this program may appear excessive until we realize this is less than $30 per employee. Saving one office visit, one confinement, or one procedure for each family will easily justify the expenditure.

2. *Health*—Travelers has taken its lumps internally and externally from the national health care bill which quadrupled from 1970 to 1982 and is expected to more than double again between 1982 and 1990. We have implemented, as most have done, several steps including cost sharing via contributions and copayments, as well as cost containment via second opinions and preutilization reviews.

   The proper health plan flexible design will probably be our most difficult task. First, and probably easiest, we must create a design which permits the users and/or abusers to absorb more of the expense. This has been effectively accomplished in a number of indemnity plans where three choices appear adequate. The unknown will be the proper integration of a managed health care network including our own HMO and PPOs with other alternatives, which create active and informed users of the health care delivery system and hopefully create a resulting positive impact on the indemnity cost structure.

   Second, we must resolve a sensitive conflict with retirees (the highest consumers of health care services and the fastest-growing share of the population) where Medicare is attempting to shift the burden to the private sector. Not only are we faced with narrowed options for funding liabilities on a tax-favored basis, but more critical is recent litigation against plan alteration; meaning cost containment initiatives cannot be extended once benefit recipiency has begun. This is a difficult scenario, and resolution will require our most careful attention and creativity. These are the people who need health care the most and can least afford medical expenses indexed to inflation. It appears our design will have to transfer the expense of coverage to the retiree and provide greater pension benefits as an offset so they can make the choice of how or how much they will use the medical system. As with active employees, this will permit the tab to be paid by thee users and/or abusers.

3. *Death benefits*—There appears little interest among benefit planners to create change in the provision of death benefits. Most companies today provide minimum security of one to two times salary but emphasis has been on term coverage. With an increasingly mobile work force, companies are fast becoming aware of the dollars spent on life coverage which appear to have little impact on current employee satisfaction or attracting those from outside. As have many companies, we required heavy life coverage at the employee's expense, and expect new plan

design will continue this pattern. The prudent level will tend to be one times salary (because of the $50,000 tax-exempt limit) with various trade-up options, but the vehicle will no doubt switch from term to universal. The universal product is attractive to the company because employees will see accumulation possibilities and portability, which translate into satisfaction.

4. *Pensions*—This subject creates the greatest confusion as well as the greatest frustration because of the underlying paradox in current thinking. Often we hear that employees don't appreciate defined benefit plans because they can't touch the benefits and portability is unavailable. In contrast, the company desires to provide pension benefits for loyalty and productivity but vesting legislation causing administrative burden appears to make defined contribution plans appealing. Now, Congress appears to believe defined benefit plans are more appropriate vehicles, as evidenced by pending limits, restrictions, and tax effectiveness.

   Through about age 40, employees are seldom interested in the accumulative results of defined contribution plans except as they affect major purchases, but then after 40 or 50 they "wish they had . . ." Perhaps futurist David Pearce Snyder creates the proper perspective in financial planning: "Studies show that job satisfaction among U.S. workers is low. Most people simply hate their jobs—so they terminate them as soon as they can. However, in order to maintain their current lifestyles, more and more elderly people will be forced to take on part-time jobs to supplement their retirement incomes." It is doubtful that defined contribution plans alone can remedy this problem.

   The move to earlier mandatory vesting only forces companies to cash out most of those who leave. Regardless of plan design, many will still have paltry retirement incomes unless stringent reinvestment controls are established. Unfortunately, Congress has little to lose with earlier vesting, as pointed out by John Erlenborn, former U.S. Representative from Illinois:

   > What makes the changes to 5-year vesting quite likely is the political benefit of responding to organized groups who view 10-year vesting as inequitable to short-term workers. There is little down side risk to the legislator. The worker who doesn't have a defined benefit pension, due to the failure of the employer to start a plan or a decision to terminate, will blame the employer rather than the do-gooders who legislated earlier vesting. Most workers who will have defined contribution plans rather than defined benefits will not appreciate that the risk employers shouldered has been shifted to them. There are few in Congress, as well, who understand the real long-term effects.

   There is no doubt that under plans as presently designed in most companies retirement income will be dramatically affected by job choices in the past. Perhaps Dallas Salisbury, president of EBRI, put everything into perspective on April 10, 1986 when he addressed the Americans for Generational Equity Conference:

We'll all want a defined benefit plan when we get old, where the risk of investment loss is on the employer. The present shift away from defined benefit plans is worrisome. We'll see a dissolution of retirement income in the move away from defined benefit plans because 80 percent of early distributions from qualified plans are consumed on the spot. If you let participants withdraw funds from the plan, the retirement objective is lost. The principal strength of defined benefit plans is that the money does not come out of the plan before retirement.

As we approach our plan redesign it must clearly be with the objective of insuring that the funds are for retirement and not merely for savings. If trends hold, we will have serious trouble with our younger population because, in our savings plan, most have chosen the posttax option where their funds are readily accessible instead of pretax. As stated before, much will be left to employee choice, and that choice early on could be detrimental in the long run. So out of necessity our core program will contain a reasonable level of defined benefit retirement income. However, this will probably be significantly less than the current program so additional funding can be made through the defined contribution—401(k)—portion (if such plans continue to be offered now that there is little incentive for the higher-income group to participate) of the existing savings plan, or perhaps the universal life option. Our objective will be to hedge the losses but at the same time create as much visibility as possible. The major challenge will not be with the design for our new approach but the creative transition for our staff who are in the over age 40 and/or over 20 years of service category so they have the opportunity to generate an equitable retirement standard of living.

An unresolved issue: with an aging population, increased early retirements, and shortages in the work force, do we push back the retirement age?

5. *Long-term care*—While functional dependency can occur at any age, it is especially prevalent among the elderly. This is growing as an issue and undoubtedly will bear the greatest social significance in the next decade. It has been estimated that 40 percent of the elderly will need long-term care in the next decade, as compared to less than one percent of those under 45.

   Due to the greater risk of chronic disease and disability, the elderly are the primary users of long-term care. The median age of a person living in a nursing home is 81. Approximately 70 percent of the residents are over 75, while 34 percent are over 85 years of age (these "older" elderly are the heaviest users of long-term care). It is estimated that for every person over age 65 residing in a nursing home, there are twice as many people living at home or in the community requiring similar levels of care. Family members provide the vast majority of care to these elderly people who need help with the activities of daily living. By the year 2000, it is estimated that 2.1 million elderly people will be in nursing homes, up from 1.4 million in 1985. By 2040, 4.3 million elderly are expected to be institutionalized.

Long-term care is expensive, at approximately $100/day for skilled nursing, $75/day for custodial nursing, $50/visit for home care nursing, and $15/hour for a home health aide. Even more unfortunate is that many people believe they are covered for such expenses when, in reality, there are severe limitations and restrictions on most health coverages. The financial problems of even obtaining family or friends to care for an elderly person are exacerbated by the low level of savings evident in our society, longer life spans, population decline (therefore few who can offer care), more two-wage families who cannot offer time required, and families more geographically dispersed. The sources of nursing home funds are 51 percent private out-of-pocket, 46 percent Medicaid, 2 percent Medicare, and 1 percent insurance.

Aside from the growing elderly population, the most significant social reason for the provision of long-term care is family impoverishment. To obtain financing for a patient, the spouse or family *must exhaust all resources down to the welfare level.* Two Massachusetts studies found that of the elderly who live alone, 46 to 63 percent were impoverished in 13 weeks in an institution, 72 to 83 percent in 52 weeks, and 41 to 47 percent would be impoverished in 52 weeks simply for home health for an Alzheimer's victim. While the loss of nearly all assets may not concern the one institutionalized, there are severe family implications—especially for the surviving spouse.

In response to this problem, The Travelers is developing a group product that we will be adding to our benefits program by the end of 1987. Currently, about 30 individual products are available in the marketplace, but nothing is developed or marketed on a group basis where case management principles and group experience could limit expenses. In designing long-term care, our goal is to provide a benefit that promotes an individual's independence, utilizing the most appropriate levels of care. Skilled and intermediate care are essential, but the key to a successful long-term care product is the ability to offer home or community-based care under controlled conditions. To control home care, it is necessary to develop a reliable definition of what is needed and then monitor the delivery system and the duration by the use of a preferred provider network or a case management agency.

We expect our offering to be utilized most heavily by our older population, but there will be some younger employees who also will see a need. Rates will be age-related and, as a result, portability and the opportunity to insure other direct family members (including parents) are anticipated.

Communication—The key, as with any successful benefits plan, will not be the message but how that message is received. We cannot create a communication overload and must seek to find the proper balance of simplicity with programs that we must administer in specifics. Expense exceptions always seem feasible when communication is via the written word, but the complexity and magnitude of our approach will require individual counseling by well-informed and committed staff. This network of counselors hopefully will be able to provide overall financial counseling for all benefits and related issues if proper servicing is to be rendered.

Flexible plans create a tremendous ongoing communication need which unfortunately can only be resolved by face-to-face communications. Written materials, videos, and interactive possibilities all have their purpose and place, but in the end most of us prefer to make major decisions with someone else to grant us peace of mind. Not offering to fully inform employees creates severe cynicism and mistrust.

Our long-term communication strategy fully comprehends all the "bells and whistles" required to get the attention desired but most importantly we will arrange for closure on a personal basis whenever needed. Personal care and financial counseling must be emphasized because employees are not going to be overjoyed with our move toward funding only catastrophic coverages, and our job will be to help them understand and recognize the long-term commitment inherent in employee welfare programs. It will be imperative that employees fully understand what is being offered, why it is offered, what competitors are doing in totality, and the legislative and economic environment.

Other Benefits—There are a myriad of other benefits that will be addressed as we proceed through the study. At this point we consider some to be basic and are only unsure of their impact, while others are in the thought process, and we are unsure of what specific form or direction they will take.

1. *"Basic" Benefits*—The basics need no explanation (e.g., disability, educational reimbursement, etc.) other than to say they will be included, and the only question is to what extent. A nonqualified excess plan will probably be included in the basic arena as plan upper limits are legislated to become more restrictive. Up to now we have had minimal necessity for such plans.
2. *"Nonbasic" Benefits*—Some nontraditional items such as group legal, telecommuting, and split-dollar life bear continued research to determine to what extent—if any—they should be included in our overall package.

I'm unsure where to categorize employee stock ownership plans (ESOPs). The provision to allow up to $2,500 in pretax 401(k) contributions invested in an ESOP was withdrawn in the final tax package. Even without the tax-advantaged status, ESOPs provide more benefit to the company than to the employee. There is limited value to the employee that could build over time, which qualifies as a benefit, though the true benefit is the dispersion of stock. Regardless, it has interesting features, as well as doing what few benefits accomplish—creating a payback to both sides of the equation.

Special arrangements are in vogue and will be more so in future years. As important as they may be, however, they will still tend to be individually designed. The contributing factors are a mobile work force, a diminishing supply of executive talent, and an even smaller supply of specialists who are equipped to operate new ventures as we move to greater diversification of our products and services. To attract and retain such talent will require expanded use of supplemental executive retirement plans [SERPs], perks, and deferred compensation; but few of these will lend themselves to highly structured plans.

Summary

The pressures are upon us from without and within to respond to the nontraditional. In addition, the restrictions are growing, for better or worse, depending on your viewpoint as a legislator or recipient and the administrative network in providing plans. By 1988 we expect our internal package to be responsive to employee desires for greater autonomy and, concurrently, to permit the flexibility necessary for human resources to be responsive to legislative and expense changes as well as needs within our current business units and those acquired in the future. While the crystal ball is anything but clear, we hope over the next few months to resolve some of the existing ambiguities within the regulatory environment and situate ourselves such that our future plan design can, to the extent possible, deliver understanding and satisfaction to our work force.

XV. Benefits for the Future: Coping with Change

PAPER BY ANNA M. RAPPAPORT

Introduction

Tax reform, which implements major shifts in government policy, is big news in 1986. The effects are unprecedented in their effect on employee benefits, because the changes represented by tax reform affect the business of the employer and the needs of employees; they affect the resources available for people and the competitive environment; and they introduce numerous changes and complexities into the rules that govern employee benefit plans. Coping with change has been a theme that most business has had to face over the last decade. Change in areas other than government policy has also influenced virtually all aspects of business activity in the last few years and the environment in which business is conducted. Some of the major areas of change have included

- basic management ideas and philosophies;
- economic environment and the emergence of a competitive world economy;
- regulation;
- taxation;
- preferences of employees and the marketplace;
- technology; and
- demographics of buyers and the work force.

Change in the business environment has also influenced the way people are managed and paid. People are the biggest item of expense for many businesses, and employee benefits today represent a significant part—often 20 to 30 percent—of the amount spent for people. The employer-sponsored benefit program plays a major role in the financial security of Americans.

The purposes of this paper are to discuss key areas of change and provide data supporting that change, and to develop a process for response to legislation that enables the employer to respond in an integrated fashion so that consideration is given at the same time to the basic needs of the business, the needs and demographics of the employees, and the preferences of employee and employer. A foundation for the discussion of change and response to change will be laid with a discussion of the employer's decision-making environment and of the factors important in the development of employer decisions regarding benefits. This will be followed by a discussion of traditional and nontraditional sources of financial security and some key trend areas. The trend areas include the role of mergers and acquisitions, the evolution of public policy, and demographics. The paper then points to some areas of likely future change that should be considered in planning today.

Responding to Change

An Integrated Planning Process—Change occurs in various forms. For example, the needs of employees change as their family situations and demographics change, or as their personal tax situations change. The resources of the company available for benefits change as the basic economics of the company changes. The rules governing plans and the mandatory benefits that must be provided change when new laws are adopted. Some of these environmental changes make adjustment of benefits mandatory, whereas others make adjustment of benefits desirable but not mandatory. For example, a new tax law requires plan amendments, whereas a change in employee needs does not require an employer to do anything. However the change in employee needs is likely to strongly suggest change.

The 1986 tax reform legislation is very unusual in that it changes rules, employee needs, and the underlying economics of the business simultaneously. It creates new complexities for the multidivision organization. Basic benefit policy serves as the foundation for well-thought-out compliance. The larger organization has a basic choice in response to this tangled up set of issues: it can comply on a fragmented basis without first setting general benefit policy and strategy, or it can *set general benefit policy,* which serves as a background for compliance, and then integrate compliance over the entire organization through use of an organized planning process.

The author believes that the development of general benefit policy and the use of an integrated planning process is the appropriate method of response because it enables the organization to structure its response so that it is appropriate for the business and because it takes into account the entire business environment at the time.

An integrated approach to benefits planning calls for a back-to-basics approach in terms of analysis of both the internal company and the external business environments.

CHART XV.1
An Integrated Approach to Benefits Planning

Internal Environment ↘ Benefit Policy ↙ External Environment

Benefit Policy
↓
Objectives
↓
Design of Specific Benefit Plans
↓
Implementation of Benefit Plans Chosen

An integrated planning process is driven by the internal and external business environments, which together form the company's decision-making environment. It involves development of benefit policy and setting of objectives which form the basis for the plan.

The internal factors that feed into the company's decision-making environment can be described as the

- financial resources available for paying the work force including direct and indirect forms of compensation;
- demographics of the work force;
- labor relations environment within the organization;
- perceptions of employees about their own benefits;
- culture of the organization;
- automation, data bases, and method of access that exist within the organization;
- decision-making structure and the perceptions of the individual or groups along the decision-making path; and
- existing benefit plans and compensation systems, and the history of changes within the recent past.

The external factors that feed into the company's decision-making environment can be described as the

- benefits provided through government systems;
- competitive situation in the community in which the business operates, with "community" to be defined by the employer;
- demographics of the available labor pool;
- health care system available in the communities where the company operates;
- relevant laws and regulations; and
- technology which defines the opportunities for automation.

The decision-making environment defined by these factors is unique to each organization. Which factor is most important will vary from decision to decision and organization to organization. For example, if a plan is out of compliance with the law, the laws may be the most important. In another case, the financial constraints will be most important. In other situations, the labor relations environment will be of greatest significance. In yet other cases, the decision-making structure may be the main decision driver because it may serve to limit the practical options. Developing a general understanding of the environment and then prioritizing which forces drive in a particular situation is very helpful in organizing a thoughtful planning process. Several factors will usually influence one decision. The extent to which data is collected for environmental analysis will depend on the problem at hand and what is appropriate. Judgment is needed to determine when it pays to collect extensive data and when it does not pay.

Once the analysis of the environment is complete (or adequate for moving ahead), the next steps are policy and specific objective setting. Policy may be set implicitly or explicitly, and it is generally not changed very often. Policy statements can be formal and written, or informal and understood. However, lack of a consistent policy will lead to confusion in decision-making. Some of the questions to be considered in setting policy are as follows.

- Should benefits and other forms of compensation be used to effect and/or support change in the organizational culture?
- Are benefits viewed as providing a specified level of coverage for employees (defined benefit) or as offering a specified level of support for coverages in which the employee shares in the cost (defined contribu-

tion)? (These concepts can be applied to all forms of benefits, through use of contributory plans and/or flexible compensation programs. They have been traditionally thought of as applying only to retirement programs.)

- Is the role of the employer to provide benefits or sponsor programs which the employee can participate in?
- What is the balance between the obligation to shareholders and the obligation to employees?
- Are benefits seen as influencing the community's view of the employer and the image of the employer?
- What messages does the employer wish to give the community with regard to its employee relations image?
- How is the responsibility for financial security to be shared by the employer and the employee?
- Should employees be allowed choices about their own benefits?
- What is the responsibility to retirees and their families? Is it different for individuals who are not eligible for Medicare?
- Is competitive position compared to the marketplace an important issue in determining benefit plan designs and levels?
- If so, how should the marketplace be defined?

Once policy has been developed, the next step is the setting of objectives. Policy may not be developed currently, since it may have already been established. Sometimes they are developed together. The following are common objectives of benefit plans.

- Replace income lost because of death, disability, and retirement
- Cover catastrophic and unforseen medical expenses
- Cover budgetable medical and dental expenses
- Provide tax-effective forms of compensation
- Attract and retain employees
- Offer a competitive compensation package
- Be seen as innovative in the marketplace
- Protect and care for the family
- Offer employee access to insurance without evidence of insurability
- Offer employee access to mass purchasing opportunities and better prices due to economies of scale

- Develop vehicles to allow employee and employer to work together in meeting financial security needs of employee
- Encourage employees to make wise choices in using medical care
- Encourage employees to seek medical care at specified hospitals
- Support general organizational goals and culture

Which objectives are important in a specific situation will vary from employer to employer. It is most important that in any significant change, objectives be identified and stated explicitly. It is desirable to involve the highest level of decision makers who will approve plan design in the setting of policy and objectives. This can be quite difficult if they are very busy and have limited interest. However, involving this group early is likely to save time in the end. When a group of decision makers is involved in the policy setting and objective development, they are much more likely to understand and approve the plan designs later presented. When they are not involved in the process leading to the plan design, it is very common for the recommendations to be rejected, and for the process to be repeated several times before a plan design can be approved.

Once objectives have been set, then the information about the company's decision-making environment and its resources available can be used to recommend a new plan design. This design will then need to be costed and illustrations prepared to show that it meets the objectives with regard to employee need. Two major points should be kept in mind in constructing the plan designs. First, the total benefit package should always be kept in mind to make sure that the individual plans are part of a logical whole. Second, an event orientation is very helpful in organizing the benefit and planning process. What is meant by an event orientation is to consider together all benefits paid to retirees and all benefits paid on death, etc. This is important because retirement benefits may include a qualified pension plan, a supplemental plan for executives, a 401(k) plan, and postretirement life and medical insurance. Furthermore, the retirement plan probably includes continued benefits to survivors. The adequacy of a benefit package is different for retirees who have medical as well as pension benefits vs. those who do not.

The costs, description of the design, and benefit illustrations together with the linkages to the rationale and objectives provide a basis for securing management approval of a new plan design. Once such approval is obtained, then the next step is defining the implementation process. The implementation process is beyond the scope of this paper.

Perspective on the Future—Our basic theme is coping with change in the face of a situation where change is occurring in many different aspects of our environments, both internal and external. Some perspectives on the future can help us cope with an always moving target. We know that:

- the future is uncertain and cannot be accurately predicted;
- the future will be different from the present, and changes in the internal and external environment will operate to determine new constraints and business needs within which decisions must be made;
- the decisions we make today and the systems we build must be flexible and designed so that change will not "blow us out of the water"; and
- change often occurs long before it is universally, or even widely recognized. This is particularly true about social and demographic change.

Learning to recognize when change has occurred can help us get a lead on those who recognize it later. Demographic issues are particularly important as we consider benefits. The age distribution of the population is shifting. All of the people who will be hired within the next 15 to 20 years have already been born, and except for immigration, they are members of the current population of the country. Nearly all of the people who will retire in that period are currently working for the company. Population data available today provides a great deal of input about possibilities for future workers and retirees.

Studying the present can often help us to construct scenarios which will enable us to understand possible patterns for the future.

Responsibility for Financial Security

Before the emergence of the industrial society, the extended family and members of the community were responsible for each other without large scale formal financial security systems. Older and sick people had a place in the home and a role that they could handle. Family members cared for them when they needed care.

With the emergence of the industrial society and the nuclear family, formal financial security systems arose, and each nuclear family became essentially more independent. The sick were cared for more often in hospitals and institutions away from their homes. Individuals had to rely on themselves, their immediate family members, and formal financial security programs much more, since members of an extended family were often not available to provide help and care when needed. Mobility and the urban society often worked to separate families from their relatives. Beginning in the 1930s in the United States, government and employers started to take on a substantial role in the building of financial security systems that would be available to large groups of people. During the 1940s, 1950s, and 1960s, a psychology of entitlement developed. Public attitude studies repeatedly showed more than 90 percent of the public saying that everyone was entitled to security in a variety of forms. The implementation of financial security programs to respond to the needs of this changing society could be found in both government and employer programs. It was predicted that the role of the individual in providing for personal financial security would decrease, and in fact it was decreasing. Real earnings were increasing so that the increased payments for financial security systems did not really seem to cause any problems. The employer's role in financial security has been implemented through extensive programs of income replacement and health care benefits.

The 1984 U.S. Chamber of Commerce Survey of Employee Benefits reports the percentage of employers offering various types of benefits. This study is based on 1,154 reporting employers and does not include employees exempt from the Fair Labor Standards Act. The percentages offering various benefits are:

Pension	83%
Profit sharing	21%
Contributions to thrift plans	30%
Life insurance and medical	99%
Short-term disability	38%
Salary continuation or long-term disability	50%
Dental	50%
Employee education	67%

Spending for benefits and the level and types of benefits continued to expand throughout most of the 1970s. Spending for pensions and life and medical benefits increased from 5.4 percent in 1951 to 13.6 percent in 1983. Payments for time not worked increased from 6.0 percent of pay in 1951 to 9.4 percent in 1983. However, toward the end of the 1970s, a difficult economy with substantial inflation resulted in a situation where many workers were laid off, and many individuals found their real after-tax earnings going down. Taxes and inflation were taking away any increase in gross pay. At the same time, medical costs were going up much more rapidly than general inflation.

As a result of these factors and general business conditions at the end of the 1970s, a shift started to occur in the ideas about who was responsible for financial security. The change was that the individual would again have to take a larger role in responsibility for retirement and for medical care. Employers instituted changes in retirement programs to encourage employees to save for their own retirements. Section 401(k) plans were a substantial factor in that change.

A parallel change occurred in the management of many medical and life insurance benefit plans. In the early 1980s, cost containment provisions were added to medical plans to encourage individual responsibility for medical care and health. These were supported in many companies by major efforts at employee education. The life insurance automatically offered to everyone was often cut back and optional additional amounts offered so that the employer's responsibility was for a core benefit only.

Recently, some companies introduced flexible compensation programs, which allow employees to choose between different benefits, reinforcing the idea of choice and individual responsibility. Philosophically, this is a very different position from the notion that the employer will take care of everything. A key factor in managing these programs is defining the limits on the employer's commitment.

The 1986 tax reform legislation limits the availability of IRAs for those with middle and higher income and coverage in an employer plan. It is also likely to lead to lower limits in employer-sponsored savings programs. Together, these changes will limit the employee's ability to save for retirement as an individual, but this does not change the need for such savings. Employers should expand their efforts to help employees understand the importance of saving for retirement and beginning early.

There have been many changes of business ownership in the last few years, some friendly and some unfriendly, some by management and some by outsiders. The frequency with which large businesses have changed ownership has encouraged employees to wonder about their long-term relationship to the company. Many employees who formerly felt very secure about the long-term nature of their benefits wonder what will happen if the company changes ownership. The threat of takeover is viewed by many as a threat to the survival of the organization. This focus has shifted some companies to very short-term thinking and prompted them to take defensive measures to protect the company. Takeovers present a threat to the financial security systems, which have offered protection to employees. Takeovers sometime mean a drastic change in benefits with much lower protection, but in other cases the new management will continue the benefits. The possibility of takeover can be very disruptive to any longer term organized planning process.

Corporations whose securities are valued in the marketplace at a lower value than the valuation placed on them by a prospective buyer are takeover targets. Often, the buyer finances takeovers in part through loans and in part through assets of the corporation being acquired. If the company has more pension assets than needed on a termination basis, the possibility exists of using pension assets in excess of termination liabilities to help finance the takeover. The 1986 Tax Reform Act imposes a 10 percent excise tax on the amount of excess assets recouped by the employer at termination, which may reduce this threat; but it will not eliminate it. In a few cases, this has been done in unfriendly takeovers and has been highly publicized.

When a change in ownership does occur and benefits are changed, then it becomes critically important to develop objectives and policy before redesigning benefits. The change in ownership often means a major change in company culture, and there is always the potential for severe employee relations issues and poor morale. This is exaggerated when there was poor morale before the ownership changed.

Traditional and Nontraditional Financial Security Needs

Traditional Needs—Traditional financial security programs in the United States have focused on income replacement for loss of income due to retirement, death, disability, and unexpected medical expenses. This has been supplemented by short-term unemployment benefits. Job security was not seen as a major long-term issue. However, this has been changing in the last few years as large numbers of middle-aged workers have been displaced by downsizing, by changes in manufacturing and office environments, and by business operations being shifted to foreign competition or foreign operations of multinationals.

The traditional financial security model is based on income replacement with programs designed to replace net after-tax spendable income. Social Security benefits are seen as the base layer of protection. Employer and individual provisions for security fit on top of government benefits. For career employees, employers often assume a major role in providing these benefits. This is particularly true of larger and older companies. Employers differ in their philosophy as to what is their responsibility and what is the responsibility of the individual. The traditional financial security model is likely to continue as the base. However, the author believes that it will be supplemented by recognition of other financial needs.

Nontraditional Needs—There are several financial needs which can be seen as the emerging nontraditional needs for individual security. These include:

Job security
Need for skills maintenance and lifelong education
Financing of education
Child care
Home buying
Care of aging parents

Job security is emerging as a major financial concern. Many Americans probably assumed that they had job security for much of the period after World War II. However, since the decline of the smokestack industries and widespread downsizing in the last five yers, no one can prudently assume job security. A Louis Harris and Associates poll conducted in May and June of 1985 for *Business Week* confirms this concern. Workers were asked: "If you had to choose, which two or three of these are most important to you on your job?" The responses are as follows.

A good salary	63%
Job security	53%
Appreciation for a job well done	40%
A chance to use your mind and abilities	39%
Medical and other benefits	36%
Being able to retire early with a good pension	20%
A clean, quiet, comfortable place to work	19%

Source: "BW/Harris Poll: Confidence in Unions Is Crumbling," *Business Week*, 8 July 1985, p. 76.

Skills maintenance is necessary for job security and can be seen as an avenue to multiple options. Training for a new career also supports multiple options. Takeovers and mergers are a threat to job security. Human capital is a major form of wealth in the information society. Job security and the need for lifelong education go hand in hand. Job security must be viewed both in terms of current jobs and future options. The author sees this as the critical financial security issue of the future. Lewis J. Perelman in "Learning Our Lesson, Why School is Out," (*The Futurist*, [March–April 1986]: 13) states: "Despite the frenzied attention given to childhood education in the past three years, the most crucial unmet learning needs are those of adults. More than three-fourths of America's workers in 2001 will be people who are already adults today. A fifth of the current adult population is functionally illiterate and another fifth is only marginally literate. On the other hand, 15 percent or more of today's workers are over-educated or overqualified in that their knowledge and skills no longer fit the requirements of a changing economy. The majority of workers at all levels need substantial retraining every five to eight years, regardless of whether they change careers or stay in existing jobs." The best job security comes from having skills that are useful in the current job market. Few people get substantial retraining in the five-to-eight year time cycle suggested by Perelman.

Many older workers who have been seen as unproductive in the last few years probably had not kept skills up to date, so that they were not as familiar with new ideas and technology as some of the younger workers. Pension benefits are not effective in promoting security if skills become obsolete and the individual is not employable long before retirement age. Dealing with this issue will require a joint effort on the part of employers and employees. The cost of not dealing with it is likely to be felt in productivity and unemployment. This is a public policy issue which has not been addressed on a broad scale.

Formal education is becoming more and more expensive, with tuition in the best university programs exceeding $10,000 per year. The cost of a bachelor's degree at a top Ivy League college is now about $100,000. A family with three children who will go to graduate school after college may be faced with several hundred thousand dollars of educational expenses for their children by the time that they are all educated if they all go to private schools. Public universities usually offer a less costly alternative, but these universities are likely to be affected by budget deficits and cuts in federal spending. Most families cannot afford education in the more expensive private universities, so that the children are faced with getting loans or scholarships, working to pay part of the bills and supporting themselves while in school, or choosing less expensive schools or less education. If the adult family members also seek further education, this is additional expense.

Access to education and development of computer skills are likely to have a major impact on earning potential and financial security in the future. In many environments there is a large gap in the productivity of those with computer skills and the productivity of those without computer skills. It seems inevitable that those without such skills will be less employable in many occupations in the future than they are today, and some people may essentially become unemployable if they do not acquire such skills. Public policy has been to scale down support for educational expenses and reduce government guarantees of loans. The future of employer-provided educational assistance as a nontaxable benefit is unclear. The 1986 Tax Reform Act extends this benefit through 1987. Employer-sponsored thrift programs have been a source of funds to help support education for many. Changes in response to tax legislation will reduce the roles of these plans as a source of educational savings. What the employer's role will be in education of the employee and/or the children of the employee in the future is unclear.

Day care is a problem for many American families. Large numbers of children are cared for by someone else while parents are working. Some are cared for very well; some are not. Some have no formal day care at all and are on their own at quite early ages. A very small number of employers offer day care centers or other support for day care, and this number is growing. Most employers, however, consider this an individual problem of the employee and they do not offer support. The *Wall Street Journal* reports that 2,500 U.S. employers offer day care assistance, up from 110 in 1978 (*Wall Street Journal*, 27 May 1986, p. 1). Fifty offer on-site centers. In contrast, there are about a half million pension and profit sharing plans in the United States. Federal policy has not recognized proper day care as a national priority. Employers should, however, be much more concerned, since there is an immediate cost in loss of productivity when children of employees are not being cared for properly. Such loss can probably be found both in increased employee absenteeism and loss of productivity when present. In addition, lack of proper day care today will contribute to poor productivity, crime, and delinquency problems in the future as the people who did not get proper care become young adults and attempt to secure jobs. Employers are likely to have at least a wider role in influencing public policy in this area in the future. It seems unlikely that many will become direct day care center operators; however, if facilities that allow for corporate purchase on an advantageous basis are available in the marketplace on a widespread basis, employers may become a substantial factor in the purchase of services and in influencing the market.

For many years in the postwar period, Americans assumed that every family should be able to own their own home, usually a one-family house. Over the last few years, as housing costs have risen, and as interest rates have gone to levels totally unexpected 10 years earlier, it has become increasingly difficult for younger families to buy their first home. Many families find that the wife must work in order to support the purchase of the home. An Urban Institute study provides data on home payments and income at age 30. The study shows declining average earnings and higher mortgage payments:

Year	Average earnings for a man age 30	Ratio of his monthly earnings to mortgage payments
1949	$11,924	14%
1959	17,188	16
1973	23,580	21
1983	17,520	44

Source: "Growing Pains at 40," *Time*, 19 May 1986, p. 37.
Note: Data in 1984 dollars.

This data illustrates why home buying is often a trap that keeps both the husband and wife in the labor force whether they want to be there or not. Employer capital accumulation programs have served to help in the accumulation of down payments. The early distribution penalties in the 1986 Tax Reform Act make this less attractive, although the combination of lower marginal tax rates plus the penalty may still be less than the tax before the act was passed. In the United States, employer assistance in connection with home buying has generally been limited to the use of funds from a capital accumulation plan except in cases of relocation, where the employer may help pay the cost difference in housing and may buy the old house to allow the employee promptly to buy a new house. It is not clear what the employer's role will be in the future. Ideas are also emerging for greater use of housing in retirement security programs. The availability of a paid-for-house which can be lived in or sold is a significant factor in the economic well-being of many retirees. An idea that is gaining increasing acceptance is the reverse annuity mortgage, which allows the retiree to continue to live in the house but sell it for an income stream that cannot be outlived. Such programs are experimental at this time.

An increasing number of people are reaching retirement age with one or both parents living, and some of them shoulder substantial financial and other burdens in connection with the care of their parents. This reinforces the need for capital resources at retirement in addition to annuity income.

Federal Policy in Provision of Financial Security

The 1986 Tax Reform Act reflects a major shift in federal policy. Some of the key elements of tax reform are

- broadening of the tax base;
- lowering of marginal rates;
- shifting to a system where taxes will no longer be used as an incentive for various types of activity; and
- tightening of the restrictions on employee benefits, and introduction of new rules to ensure that tax-favored benefits do not favor the highly paid.

The provisions in tax reform that affect benefits do not reflect a basic change in policy, but rather a substantial increment to the policy direction that has evolved over the last few years. (Tax reform does reflect changes in policy direction but primarily in areas of other benefits.) The influence of federal policy on employee benefits in the United States is not new. Tax and government policy are important in the structuring of financial security systems generally in the Western nations. Federal policy in the United States has played a major role in the structure of financial security systems, and it has been a key factor in the design of employee benefit plans. Historically, it has supported systems for provision of financial security in many ways. Strong support for these programs can be traced to the start of the Social Security system in the 1930s. Such public policy support has taken diverse forms such as

- direct provision of income replacement benefits upon retirement, disability, and death through Social Security;
- direct provision of medical benefits to aged and disabled persons through Medicare;
- support for employer-sponsored financial security programs such as pensions, health insurance, disability benefits, and life insurance through tax incentives which made it attractive for employers to provide such programs;

- support for individual programs of financial security through favorable taxation of life insurance contracts. Death benefits are paid tax free to the beneficiary and there is currently no tax on interest credited to life insurance reserves;
- unemployment insurance laws and mandated Workers' Compensation programs; and
- construction of a social safety net through a variety of welfare programs designed to complement and fill in around the programs offered by employers and the normal government programs.

Until a few years ago, federal policy encouraged more security systems and expansion of such systems, so employers could offer more benefits. Social Security offered additional benefits as time went on, and benefit levels increased. However, in the last few years, the policy has become more mixed, with the federal support for financial security being squarely in opposition to measures that would serve to control and reduce the federal deficit. It is unclear how tax reform and the aftermath of Gramm-Rudman-Hollings will affect financial security programs. Where the new rules will require restructuring of benefit plans to make them nondiscriminatory, employers can choose to move up to the higher level plan or down to the lower level plan, or they can redesign to be someplace in the middle or to go to an entirely new structure. Current signs are pointing to limitations on support for direct federal programs and to employer decisions which will not increase their total spending for employer-sponsored security programs. As a result of this shift in direction, we have (as of September 1986) seen a number of changes such as

- reduction in future Social Security benefits enacted as part of the 1977 and 1983 Social Security Amendments;
- taxation of part of the Social Security benefits for higher-income individuals;
- extension of nondiscrimination rules in employee benefits to all tax-favored benefits with more complex rules—changes occurred in 1982, 1984, and 1986 with the most sweeping changes in 1986;
- reductions enacted in 1982, 1984, and 1986 in the maximum benefits that can be offered in qualified pension plans (Internal Revenue Code section 415 limits);
- changes in Medicare and shifting of costs from Medicare to the private sector;
- changes reducing the 401(k) limits in 1986;

- limits on benefits that can be provided from tax-favored plans, including specific complex rules and numerical tests;
- moves to encourage annuity payouts, taxes on early distributions from qualified retirement and capital accumulation plan, and limits on favorable tax treatment on lump-sum distributions;
- tougher vesting requirements;
- a tightening of integration rules; and
- mandated coverage continuation in health plans.

Further changes can be expected in the future. The proposals included in Treasury I and Treasury II but that did not make it into the final tax reform bill and the proposed Retirement Income Policy Act, provide some clues as to future changes. As long as there continues to be a deficit problem, and benefits are viewed as a way to increase government revenues, further change is quite likely. Areas to watch are:

- further reductions in 415 limits and 401(k) plan limits;
- taxation of benefits, possibly health plan benefits;
- further limits on use of retirement plans for nonretirement purposes;
- expanded use of excise taxes;
- vesting and funding rules for retiree medical plans; and
- mandated benefit extensions and health coverage for the unemployed.

Continued conflict between those political forces whose primary concern is economic security and rational retirement income policy, and those whose primary concern is deficit reduction policy is likely to produce inconsistent and confusing requirements and much uncertainty. From the viewpoint of employees and retirees, this creates the potential for future crisis. After many years of growth in both government and employer-sponsored financial security programs, there has been some retrenchment in both types of programs. Public policy in the past has strongly encouraged employers to offer financial security programs, but today the signals are mixed, and the administrative complexities in managing such plans have increased and the incentives to offer such programs have been reduced.

Work Place Trends

Demographics and Family Structure—There are several demographic trends that are of great importance in the management of human resources. They are also important to benefit management, since they affect employee needs and costs of the benefit programs. Some of the key trends that create benefit plan issues are

- large differences in the number of births in different years, with a major bulge, the baby boom, from 1945 to the early 1960s;
- decreasing mortality rates, particularly at older ages in recent years, so that life expectancy after 65 has been increasing as has the number of persons over age 80;
- differences in mortality rates between the sexes so that the older population is very heavily female;
- entry of large numbers of women into the work force so that the most common family pattern includes both husband and wife in the outside labor force;
- increasing divorce rates and the growth in the number of single-parent households; and
- increasing number of households with unmarried persons of opposite sex sharing living quarters.

The number of births has varied substantially year-by-year leading to substantial shifts in the number of people entering the labor force, substantial changes in the demand for various services such as education, and substantial changes in the age distribution of the labor force. Table XV.1 shows number of births by year.

TABLE XV.1

Number of Live Births in Various Calendar Years (numbers in thousands)

Year	Number	Year	Number
1910	2777	1955	4097
1920	2950	1960	4258
1930	2618	1965	3760
1935	2377	1970	3731
1940	2559	1975	3144
1945	2858	1980	3612
1950	3632	1983	3614

Source: U.S., Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States, 1985*, No. 27 (Washington, DC: U.S. Government Printing Office, 1985), p. 26.

This also means that the age distribution of the population is changing. The data in Table XV.2 illustrates what has been happening from 1960 to 1983:

TABLE XV.2
Distribution of the Population by Age (numbers in thousands)

Age Group	1960	1975	1983	Increase in Age Group 60 to 75	Increase in Age Group 75 to 83
Under 5	20341	16121	17826	−20.7%	10.6%
5–13	32965	33919	30116	2.9	−11.2
14–17	11219	17128	14633	52.7	−14.6
18–21	9555	16674	16770	74.5	0.6
22–24	6573	11331	13378	72.4	18.1
25–34	22919	31471	40335	37.3	28.2
35–44	24221	22831	29492	−5.7	29.2
45–54	20578	23757	22343	15.4	−6.0
55–64	15625	20045	22220	28.3	10.9
65 and over	16675	22696	27384	36.1	20.7
Total	180671	215973	234497	19.5	8.6

Age Group	Percentage in Age Group 1960	1975	1983
Under 5	11.3%	7.5%	7.6%
5–13	18.2	15.7	12.8
14–17	6.2	7.9	6.2
18–21	5.3	7.7	7.2
22–24	3.6	5.2	5.7
25–34	12.7	14.6	17.2
35–44	13.4	10.6	12.6
45–54	11.4	11.0	9.5
55–64	8.6	9.3	9.5
65 and over	9.2	10.5	11.7
Total	100.0	100.0	100.0

Source: U.S., Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States, 1985*, No. 27 (Washington, DC: U.S. Government Printing Office, 1985), p. 26.

Life expectancy at birth data shows the effect of decreasing mortality rates. Life expectancy at birth has increased from 46.4 years in 1900 to 69.9 years in 1980 for males, and from 49.0 years to 79.5 years for females (table XV.3). Thus, the gap by sex has widened from under three years to over seven years. At age 65, the male life expectancy has improved from 11.3 years to 14.0 years, and it is projected to increase to 15.6 years by 2040. For females, life expectancy at 65 has improved from 12.0 years to 18.4 years, and it is expected to improve to 20.6 years by 2040.

TABLE XV.3

Life Expectancy at Birth and at Age 65

Year	At Birth		At Age 65		Differences by Sex at Birth
	Male	Female	Male	Female	
1900	46.4	49.0	11.3	12.0	2.6
1920	54.5	56.3	12.3	12.3	1.8
1940	61.4	65.7	11.9	13.4	4.3
1960	66.7	73.2	12.9	15.9	6.5
1980	69.9	77.5	14.0	18.4	7.6
2000 proj.	72.1	79.5	14.8	19.5	7.4
2020 proj.			15.2	20.1	
2040 proj.			15.6	20.6	

Source: U.S., Department of Health and Human Services, Social Security Administration, Actuarial Study Number 92.

If life expectancies are used to measure retirement periods expected, we can see that the total time of retirement has increased materially over time. Age 65 was accepted as a standard in the United States when Social Security was adopted in the 1930s. The increase in the period after 65 from 1940 to 1980 is 18 percent for males and 37 percent for females. By 2040, the increase is projected to be 31 percent for males and 54 percent for females.

Conference Board data shows projected increases in the labor force by age and sex in the 1980s as compared to the 1970s (table XV.4). In the 1980s, there are fewer males under age 25 in the labor force than in the prior decade. The age mix of the labor force will shift to the middle years.

Labor force participation rates by sex show small decreases at all ages for males and substantial increases for females at all ages (table XV.5).

The number of divorces and divorce rates have increased markedly, leading to significant number of children living in single-parent households and to significant numbers of households headed by one person. Diversity in household patterns has become more common. The data in Table XV.6 shows the percentage of divorced persons by age and sex at various points in time.

There are fewer divorced males than females because males are much more likely to remarry. The tendency of men to marry younger

TABLE XV.4

Projected Changes in Labor Force by Age and Sex (in millions)

Sex	Age	1970–1980	1980–1990	Change Between Periods
Male	Under 25	4.1	−1.5	−5.6
	25–54	6.7	8.3	1.6
	55 +	0.02	−0.7	−0.72
Female	Under 25	3.6	0.3	−3.3
	25–54	9.6	11.1	1.5
	55 +	0.8	−0.1	−0.9

Source: Conference Board, *Economic Road Maps*, September 1981

TABLE XV.5

Changing Labor Force Participation Rates by Sex 1960 and 1980

Age Group	Male 1960	Male 1980	Female 1960	Female 1980
16–19	56.2%	60.7%	39.3%	53.1%
20–24	88.1	86.0	46.1	69.0
25–34	97.5	95.3	36.0	65.4
35–44	97.7	95.5	43.4	65.5
45–54	95.7	91.2	49.8	59.9
55–64	86.8	72.3	37.2	41.5
65 +	33.1	19.1	10.8	8.1
Total	83.3	77.4	37.7	51.6

Source: U.S. Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States, 1981* (Washington, DC: U.S. Government Printing Office, 1981), p. 381.

women, the pattern of birth by year, and mortality differences by sex have created a situation such that it is much easier for a male than a female to find a mate and remarry.

Another trend leading to diversity in household structures and in needs for employee benefits is the growth in the number of unmarried couples. In 1970, there were 523,000 such couples in the United States. This increases to 1,988,000 in 1984. Benefit plans do not generally recognize such couples as legitimate. Tax reform is likely to increase the number of unmarried couples living together because there are many situations where the taxes for an unmarried couple will be substantially lower than the taxes for a married couple with the same

TABLE XV.6
Divorced Persons per Percentage of Those Married with Spouse Present

Year	By Sex		
	Male	Female	Total
1960	2.8%	4.2%	3.5%
1970	3.5	6.0	4.7
1975	5.4	8.4	6.9
1980	7.9	12.0	10.0
1983	9.1	13.7	11.4

	By Age Group for Males			
	15–29	30–44	45–64	65 +
1960	1.6%	2.5%	3.9%	2.4%
1970	2.8	3.3	4.0	3.2
1975	5.1	6.1	5.7	3.2
1980	7.8	10.4	7.0	4.8
1983	9.8	12.1	8.1	4.3

	By Age Group for Females			
	15–29	30–44	45–64	65 +
1960	2.8	4.1	5.3	4.4
1970	4.6	6.1	6.6	6.9
1975	7.5	9.3	8.6	6.9
1980	10.8	14.7	11.2	8.9
1983	12.1	16.9	12.6	10.6

Source: U.S., Department of Health and Human Services, Bureau of the Census, *Statistical Abstract of the United States, 1985*, No. 49 (Washington, DC: U.S. Government Printing Office, 1985), p. 38.

income combination. The difference may be several thousand dollars per year, and it is quite possible that couples will once again choose to divorce for tax reasons.

The data in Table XV.7 summarizes the living arrangements of the adult population.

Technology and Employee Benefits—The computer has opened up many new opportunities for management of data and work in the office. It also has opened up opportunities for employees to work at home. It is used in benefits management for analysis and planning, creating and maintaining data bases, calculating benefit amounts and showing benefit status, keeping track of contributions and credits, generating personalized communications, and creating interactive

TABLE XV.7
Living Arrangements of Persons Age 15 and Older Percentage in Various Household Types, 1983

Group	Alone	With Spouse	With Other Relatives	With Other Persons	Total
			By Sex and Age Group		
Total	10.8%	56.9%	27.4%	4.9%	100.0%
			Males by Age Group		
15–19	0.6%	1.3%	95.8%	2.3%	100.0%
20–24	5.9	23.5	58.3	12.3	100.0
25–44	10.3	67.5	14.0	8.2	100.0
45–64	8.2	82.9	6.1	2.8	100.0
65+	15.4	76.8	5.7	2.1	100.0
Total	8.8	59.6	25.7	5.9	100.0
			Females by Age Group		
15–19	0.5%	5.5%	90.9%	3.1%	100.0%
20–24	5.4	37.0	47.0	10.6	100.0
25–44	6.2	68.9	20.7	4.2	100.0
45–64	12.1	70.9	15.1	1.9	100.0
65+	40.9	38.7	18.2	2.2	100.0
Total	12.7	54.4	29.0	3.9	100.0

Source: U.S., Department of Health and Human Services, Bureau of the Census, *Statistical Abstract of the United States, 1985*, No. 60 (Washington, DC: U.S. Government Printing Office, 1985) p. 44.

communications programs for employees. Benefits managers are able to know more about their benefits than ever before and are able to secure far more sophisticated financial analyses. Forecasts of pension funds allow "what-if" exercises over a longer time (e.g., 20 years), and allow investment managers to test the expected results from a variety of funding and investment strategies. Flexible compensation programs for larger employers are feasible only because computer support is available for maintaining data bases and for customized communication to employees. Many employers are installing computer-based human resource systems which perform a variety of functions, including some related to benefit programs. The computer has revolutionized the options available to employee benefit managers.

Until recently, the impact of technology was probably not evident to most employees. However, there has been a major increase in computer-based communications. Benefit statements provide personalized summaries of an employee's benefits and are the most traditional form of computer-generated employee communications. Enrollment forms for 401(k) plans and flexible compensation programs may show how the program will work for the individual employee and provide specific results based on the individual's age, pay, and status.

A new medium for employee communication is emerging. Personal computers can be used for interactive benefit communication that allows the employee to play "what-if" games at the time of the enrollment decision. Hanes Corporation is using a personal computer program for support of the enrollment process for the 401(k) plan. The employee can enter salary, date of birth, percentage to be saved, and expected return and will be shown how much will be saved over time. Tax calculations are also included. The process can be repeated as desired and a printout obtained of each trial. The program is set up to be fun, and it is colorful, almost like a game, so that people will be attracted to participation. Such programs were very innovative in 1985, and there are only a handful of them around, but they will probably be commonplace within the next three or four years.

Employee Values and Worker Rights—Changing employee values have a significant effect on the work place. Studies by the University of Michigan Social Research Center document declining satisfaction with work at essentially all pay and educational levels. Managers have also become confused and less satisfied in the last few years as some of their authority has eroded. Repeated studies by the Opinion Research Corporation also document declining satisfaction. Of this trend, the *Wall Street Journal* writes: "Loyalty—that intangible yet indispensable asset—is waning at a growing number of corporations. The concept is difficult to measure, but surveys, anecdotal evidence and interviews with executives across the country indicate that many managers and workers who once devoted all their energies to their jobs are now concluding that such devotion was misplaced." ("Loyalty Ebbs at Many Companies As Employees Grow Disillusioned," *Wall Street Journal*, 11 July 1985, p. 27.) Takeovers and downsizing have demonstrated to employees that in the long term the loyalty between company and employee cannot be counted on.

Surveys done in 1969, 1973, and 1977 for the Department of Labor showed how Americans changed the way they viewed their work. The key findings in these studies were declining satisfaction at all income and educational levels.

There has been a focus on personal choice, rights of the individual, and role of the individual. These values are expressed in the workplace through programs for worker participation; antidiscrimination legislation; individual decisions about career switching; and productivity declines.

The states as well as the federal government have become quite active in employment-related legislation. For example, in employee benefits, specific discrimination legislation includes

- federal requirements banning discrimination in favor of the highly paid in employee benefit plans;
- specific requirements with respect to employee benefits and age discrimination arising from the 1978 Age Discrimination in Employment Act and the regulations implementing that act; and
- specific requirements with respect to retirement benefits designed to address women's issues as found in the Retirement Equity Act passed in 1984.

Future Issues in the Work Place

The issues on the table today are complex. There are also some future issues, which, though not in the limelight at the moment, are likely to move into the forefront in the next few years. Benefit designers and planners should take these issues into account in the planning process. Two such issues are retirement ages and postretirement medical benefits.

Retirement Age Issues—In large companies with good benefits, we expect people to retire early, often at ages 60–62. In public pension plans, people retire at earlier ages in many cases. Some police and fire systems allow retirement before age 50. Military personnel also retire at very early ages. Social Security retirement ages today are generally 62 to 65. Some employers, however, experience much older retirement ages. For example, data for a nonprofit organization with several hundred employees shows an average retirement age of 67 to 68.

Currently, age 65 is the age for full Social Security benefits. Under current legislation, this will move gradually to age 67. As discussed earlier, life expectancies at age 65 are about 14 years for men and 18.4 years for women. This 14 years is up from 11.9 years for men in 1940. The 18.4 years is up from 13.4 years. Thus, the expected period of retirement for an age 65 retiree has increased 18 percent for men and 37 percent for women. Women are more likely to live alone than men, so that their needs may be more complex. They are more likely than men ultimately to require long-term care. Yet retirement ages have dropped, so that the increases in the average number of years after retirement are much larger, probably on the order of 40 to 50 percent.

Early retirement has been a convenient method of dealing with the need to reduce work forces in recent years, and it has been economically feasible since the number of older people was not that great compared to the number of younger people. Large companies often favor early retirement and are today willing to offer generous benefits to make early retirement attractive. However, retirement at ages 55 or 60 is certainly not necessary on a general basis because of health status, or physical or mental inability to perform work.

Furthermore, it is not clear what retirement means. For example, Mary Jones is age 60, a retired military officer drawing a pension of $12,000 per year and working as a middle manager in a local bank earning $35,000. Tom Smith is age 68 and runs a small business from which he earns $5,000 each year, but the value of the business is increasing. He was a policeman to age 50, then worked for 10 years as a security officer in a local company. He is drawing Social Security, a police pension, and a pension from the company where he worked. His total retirement income is $30,000. Is Mary retired? Is Tom retired?

The traditional life cycle pattern that underlies such human resource and government policy calls for three periods of life: growing up and education, work until retirement, and retirement and leisure. In fact, many people have much more varied and complex life cycles. This has been called a cyclical life pattern. Retirement may not be a sudden and total event. Instead, people may have multiple careers, perhaps with interruption between them for leisure and/or more education. Retirement may be a more gradual process. Retirement benefits are paid even when the retiree is working. Often they are supplemented by wages from other work or earnings from a small business. Likewise, entry into the work force may be a gradual process, with school and work intertwined over a period of years. There may be serious new periods of education in mid-life.

Older persons are not a homogenous population. There are many differences among individuals. This is significant because the age mix of the over 65 population is shifting with more individuals in the over age 75 and over age 85 groups. Instances of activity limitation and limiting chronic disorders are much higher in the population over age 75. The age distribution of the population will be radically different when the baby boom reaches age 65. Then we can expect one retiree for every two workers if retirements follow the pattern of most people retiring at ages 62–65.

In the long run, higher retirement ages seem to be inevitable. It is essential that the issue of optimal retirement ages be addressed and that public policy be developed that will make sense in light of the demographics and work force needs of the future.

Postretirement Medical Benefits—It seems that an acute crisis is coming in postretirement medical benefits. Today, a substantial majority of larger employers have such plans. There is a delicate balance governing employers' decisions about what benefits to provide. Current and recent events are forcing that balance to shift so that postretirement medical benefits plans will be much less attractive to employers in the future than in the past.

Medicare pays less than half of the bills of the retired over age 65 population and nothing for those retired and still under age 65. Medical costs are a major expense for retirees. The government has been cutting back on Medicare, and proposals for further cutbacks are under discussion.

Public policy is serving to discourage employers from offering these benefits. The result will probably lead to some retrenchment. Under the 1984 Deficit Reduction Act [DEFRA], funding of postretirement medical benefits through 501(c)(9) trusts was subjected to substantial strings. Investment income is not tax-deferred, as it is in the case of a pension fund. Additionally, separate accounts are now required for key employees. The effect of DEFRA is to eliminate, for practical purposes, 501(c)(9) trusts as a funding vehicle. The 1986 Tax Reform Act removes one of the impediments to prefunding, by allowing these benefits to be funded through a pension plan using section 401(h) of the Internal Revenue Code but it is too early to tell whether this will make any significant difference. The applicable restrictions, however, have made this unattractive to many employers.

There are no specific statutory provisions that prohibit modification or termination of postretirement medical plans, but several court cases limit the right of employers to terminate or modify plans in specific situations. At present, accounting for most plans is on a pay-as-you-go basis. It appears that the Financial Accounting Standards Board will adopt new rules which require cost recognition as people are working.

The net effect of the funding situation, potential accounting rules, and legal uncertainties is to create large amounts of risk for employers sponsoring these plans, risks not expected when the plans were adopted.

Policymakers need to deal with a fundamental issue: Should employers be encouraged to offer those benefits? If the answer is yes, then changes are needed to stabilize the environment and make prefunding attractive. Two changes that would be helpful are permitting voluntary prefunding and allowing pension plan surpluses to be used to help pay for these benefits. If the answer is no, and if Medicare benefits are not to be increased, then the cost in the form of increased Medicaid benefits needs to be considered, or, alternatively, we need to be prepared to face more people who cannot get care because of lack of financing.

Impact of Trends

Where is all of this going? A review of the trends leads to some future developments, which the author sees as likely. They are presented to provide support and assistance in the planning process.

- Postretirement medical benefits are becoming a high priority problem; new legislation may increase employer obligations for this coverage.
- Tax preferences for benefit plans have been reduced and may be further reduced, and tax considerations will diminish somewhat in importance as a factor in the structuring of benefit plans.
- Executive benefit programs offering additional benefits to executives will be feasible only on a nonqualified basis. Moves to such benefits will increase the proportion of benefits not subject to all of the protections applicable to qualified plans.
- Medicare and Social Security benefits will be gradually scaled back from current levels.
- There will be increased recognition of the importance of proper child care and its effect on productivity, crime, etc. Employers will assume a growing role, and there may be some legislated requirements.
- Work patterns will be redefined, with more alternatives to full-time work and full-time retirement. Individuals will plan their lives through multiple careers to achieve different types of work schedules. New concepts will be introduced when definition for retirement benefits is considered.
- Lifelong education and job security will be recognized as primary financial security issues. Employers and individuals will share the consequences of failure to maintain skills.
- Choice will be increased in employer-provided benefit programs, and individuals will have increased responsibility for decisions regarding retirement savings and health. Distinctions between benefits and direct compensation will blur as employees have more choice about how to be paid.
- Employers will continue to become active in trying to control health care costs and in influencing patterns of care. Except for health main-

tenance organizations and other controlled provider alternatives, first dollar and very low deductible health coverage will disappear within the next five years.

- New options and standards of care will be adopted in dealing with health care for older persons.
- More plans will be structured to feel like defined contribution or defined cost plans from an employer viewpoint, and employees will be expected to make up the difference in what the benefit costs and what the employer wants to spend.
- Microcomputers will be used to offer interactive facilities for communicating benefit plans to employees and to assist employees in personal financial planning. This will be commonplace for salaried employees within the next decade.
- There will be a great need for financial planning for individuals, particularly in the first few years after the 1986 Tax Reform Act because so many of the rules have changed.
- Federal policy will encourage employers to provide less financial security and will leave those individuals who do not make up the gaps in a vulnerable position. The individuals' responsibility for taking care of financial security needs will increase.

Conclusion

The bottom line today can be stated simply: employers who have adopted plans to protect the financial security of employees find that the rules are changing rapidly and that many of these plans cost more than expected. At the same time that rules and costs are changing, so are company resources and employee needs. An integrated planning process that focuses on the external and internal environment and leads to setting of benefit policy and objectives is the best way to respond to change with confidence that the method of response will be the best compromise given the needs and resources at hand. Larger employers whose basic goal is to provide financial security for their employees and who do so largely through employer-sponsored programs are increasingly asking: as the price is going up, is it still worth the price, or must the programs be modified to produce a more acceptable cost? Employers providing financial security have always faced a delicate balance between looking after employee needs and conserving firm resources. Some factors to be considered are

- meeting employee needs and offering economic security, through benefits as well as pay;
- using economic resources in an efficient way for the owners of the enterprise; and
- providing benefits as well as pay because it appears to be in the interest of both the company and the employees.

Employers' desire to provide benefits has been counterbalanced by the price in terms of benefits and compliance. Events of the last few years have changed the balance so that today benefits are being modified to keep costs more in line, make plans simpler to manage and to maintain control of. This leads to difficult choices. The themes of the next few years can be characterized by careful planning, making difficult choices, and spending money wisely.

XVI. Part Four Discussion

Employee Response to Cost Sharing

MR. SEIDMAN: I think we ought to put these issues in the context of the real world. One gets the impression from listening to some of the speakers today that employees are very anxious to assume new costs, that all you have to do is to explain to them why the costs should be shifted to them and they will accept this idea, because they know it will cut the cost of the program.

The fact is that reductions in health care benefits have been strike issues all over the country. You may be able to force unorganized employees to accept them, but with organized employees—and they do not always win, they have lost some of these strikes—these have been strike issues, and they will continue to be.

I notice that Mr. Velloney slipped over the idea that Travelers is going to introduce an employer-sponsored, *employee-paid* long-term care program. I would be interested to know what kind of a response you are getting to that program from Travelers employees.

The final point I would like to make is that there is a lot of talk about flexible benefits—that employees want flexible benefits. Maybe they do, and maybe they do not. But it seems to me that nobody has talked about what I think is inherent in flexible benefits—adverse selection.

If there is adverse selection in a flexible benefit program, compared with whatever program you had before, unless you are shifting the cost to the employees, you are going to have a narrower package of benefits overall, however flexible it may be, compared to what you would get if you didn't have adverse selection.

MR. VELLONEY: Let me respond to a couple of things. I think you asked what the response at Travelers was to the long-term care product. The long-term care product is not available yet, so there is no response, although we are expecting a very good response.

MR. SEIDMAN: Well, you are talking about two things. One is, you want to sell this as part of your insurance program to other employers. I was referring specifically to what you apparently are starting in your own company, which would be 100 percent employee-paid.

MR. VELLONEY: The product is still being priced. It's not on the market, but we hope it will be by the end of the year. We plan to add it to The Travelers program sometime in 1987. So we can have no response until we have a price. We have some generalized prices, a generalized view of what the program is going to be, and what the restrictions on it will be; but given the reactions that we have had through focus groups, we are expecting a very good response.

On the subject that employees will be just delighted to pay for all these things, I do not think any of us are expecting that they are going to be "delighted" about it. But again, we just finished conducting a series of focus groups within our home and field offices. Our attitude surveys for the last eight years indicate that Travelers employees will pay more, if you give them what they want.

MR. SEIDMAN: Who conducted these?

MR. VELLONEY: We are conducting them.

MR. SEIDMAN: Employer conducted?

MR. VELLONEY: Yes.

MR. SEIDMAN: Well, if I were an employee, I would be saying that, too.

MR. SALISBURY: Richard, did you conduct it yourselves, or did you use a consulting firm?

MR. VELLONEY: We had focus groups conducted by our employees. The facilitators are not the bosses of the people in the session. They are independent people, and we are not saying they are taking names. You can be, I guess, as pessimistic as you wish, but we feel comfortable with the results.

MR. SALISBURY: I would note that Florence Skelly mentioned that the survey work they have done indicates, particularly related to health care, that there is an employee willingness to pay more if it will maintain quality benefits.

MS. GAGLIARDI: I was going to second that, because before we installed our flexible benefits program we conducted focus groups using an external organization, and there was no one from the company present. It was clear to us that, although employees were not jumping up and down to pay higher costs, they understood why it might be necessary and if we could deliver what they wanted, what they needed, it was not that distasteful to them. So we felt that we did not encounter any problems in that respect.

MR. VELLONEY: One of the objectives of a flexible plan is to offer employees what they want, and there are trade-offs within the plan. They give up some things that they do not care about to get things that they really care about. We have a lot of young people who have little need for large amounts of life insurance. They would gladly trade for more vacation time.

MR. SEIDMAN: Then you do get adverse selection.

MR. VELLONEY: Absolutely. But that has to be factored into the cost structure of each plan element.

MR. SEIDMAN: Is that an additional cost of the program?

MR. VELLONEY: It depends on how you design the program and each individual plan element.

MR. LEONARD: I would agree with Bert Seidman that there is going to be adverse selection; and it is the case even where the company support is for the benefits provided, because in effect you are getting adverse selection in delivery of a higher benefit to the person who uses it. So there is always going to be adverse selection. It is just a question of who is going to pay for it and at what level.

MR. SEIDMAN: Yes, but you spread the cost in one case, and in the other case you focus it on the people who choose it.

MR. LEONARD: You could spread the adverse selection over people, too, not just absorb it in a company. There are options, or you could share it.

MS. GAGLIARDI: Some companies have tried to address the issue of adverse selection by instituting certain waiting periods that an individual would have to satisfy before they can elect certain kinds of coverages, so that, for instance, they were not just opting for the higher level medical plan before they were going into a hospital or opting for dental plans before they were going to have their teeth fixed. This is one of the ways of dealing with adverse selection.

MR. YOUNG: Three comments. I certainly want to support Anna Rappaport's point on the importance of job security. Certainly, our own experience—partly, of course, because of UAW [United Auto Workers] being in the auto industry—has been that job security took on very high priority in our discussions. While we have long had a form of income security in the sense of supplemental unemployment benefits, the focus was literally on job security, on people keeping their job. To do that, we found it necessary to disaggregate the problem, to focus on those activities that the employer essentially has control over, such as the rate of technological change or where they buy their parts, as opposed to fluctuations in market demand that they clearly have less control over.

Second, we've done a lot of work in educational activities, and one of the things that's been very helpful is to earmark money. There is a specific amount available for educational programs that is to be jointly developed by the company and the union. We do not have big arguments over whether a program can be afforded or whether money should be spent for an area. There is money available, and the arguments are over what is the best thing to do with it. Sometimes unions are more concerned than anyone else about whether the money is being spent wisely, since they know there is a limited amount of it.

The final point comes back to what Pat Dilley said. As we think about any of these long-term programs—and I am particularly thinking about health care for retirees but also child care and others—one of the advantages of a social insurance program that often is not recognized is that it tends to stabilize the cost among employers.

The Social Security system imposes the same cost on all employers. Private programs, of course, vary with the demographics of the work force. And that really should not be a competitive issue between employers. Perhaps we should argue about who is more efficient than someone else, but it should not be that one company has a competitive advantage because it has a younger work force or does not hire people who need child care.

Managing with Limited Resources

MR. JACKSON: Anna Rappaport mentioned the problem of the rising cost of buying a home today compared to 1950. I would observe that the homes bought in 1950 were cigar boxes that were laid out with rather minimal facilities in them. Also, mortgage interest rates in 1950 were 4 percent, and they are 14 percent currently. And benefits were only 15 to 20 percent then and 45 percent now. So I think there's a lot of reasons that ratio is up but it will surely come down as a result of the drop in interest.

I also have a question for Maggie Gagliardi. At the beginning of your presentation, there was a strong emphasis on the fact that now, and certainly for the next five years, your company and a good many others, are faced with stiff competition, with a need to control expenses and, therefore, a strong pressure on holding benefit costs down.

If you project five years in the future and assume that you get these costs under control, do you think, even if conditions are wonderful, that we'll ever get back to the good old days of tacking on more benefits every year? Or do you think this focus on cost control is good management that will be with us for a long time?

MS. GAGLIARDI: I believe it is finally recognized as an element of good management, quite frankly, and it is here with us to stay for quite sometime. And even if we get back to the point of tacking on benefits, it is not going to be in the same way that we practiced before. It is going to be with much more thought to the population as it may evolve. The fact is, because the population is aging, many of the issues that we talked about and that are inherent in causing rising benefit costs are going to be with us for many more years—20, 30, 40 years.

So I think that will face us, but as I say, I think the belt tightening that we have all been through has really made us much smarter in the long-term implications of the decisions that we make today, and we will learn that the hard way.

MR. CULLINAN: I would like to follow up on Paul Jackson's point. If you did the calculations for 1986 with 10 percent mortgage rates, that 44 percent would drop substantially. And I do not think that the homes that we are looking at now are at all comparable to what were typical back then. Certainly, there are none in my family who would buy the same house that my father and mother bought to raise a family of seven, five children. Now you find two people in a household, and you very often find two bathrooms. We do not have the same ratios that we had before. Moreover, there are a number of other aspects of household expenditures that have dropped significantly over this period.

I believe that in the mid-fifties we were talking about food costs being roughly a third of family expenditures. Now we are talking closer to 20 percent. So it is not completely the case that relative cost-of-living has risen; there are other compensations that are going on.

With regard to child care on-site facilities, Ms. Rappaport, are we dealing primarily with insurance liabilities? Or are we talking about something else?

MS. RAPPAPORT: I think that for a variety of reasons it will not be viable for the vast majority of employers to set up and run their own child care facilities. There are some situations where geography would be favorable. There are some where geography makes it almost impossible. There is a liability problem. It is complex to manage a day care center, but you may be able to contract with providers and have day care centers, and people who will operate them either on site or nearby.

There may be some communities where there are coalitions of people that could establish community facilities. There are a variety of different solutions. I see the first issue as recognition that there is a real problem. Then, I think there is really a need for a community approach that involves a combination of employers and community agencies and, hopefully, government to find the best approach in the community. It is not an easy problem, but the situation today is horrible.

MR. SMITH: I want to comment on Paul's point. The question really is—is industry learning to be more frugal. If we maintain a reasonably efficient economy and we continue to participate in the world market and the world manufacturing system and financial system, the United States is having and will continue to have a decreasing standard of living. And it will be incumbent on all of us to be a little wiser in our spending of money, whether it's corporate, personal, government, or what.

I remember not too many years ago we had big problems with the petroleum industry: we terminated a lot of people with a bucket of money, and someone in the field somewhere would be hired right back. Not the same people, but we had lay off between 300 and 400 with nice termination programs, and damn if they did not come in somewhere else next year, about 500 new ones.

That is not happening now. The gates have been closed. The ivy is growing over the gates, and I think we all should learn this—to manage better. And benefits do not have to go forever, because they were to achieve a certain kind of security. In the Fortune 1000, perhaps, much of that security has been achieved. Sure, we will have vicissitudes, as the CPI [Consumer Price Index] moves up and down; but we have done a pretty good job.

Conclusion

MR. SALISBURY: On that warm note, I would ask Robert Paul to make a concluding comment.

MR. PAUL: We are at a time in American history when we are going to be working with scarcer resources. The rapid economic growth of the 1950s that I and others around the table experienced is probably over, and we need to think through how we are going to handle an economy that will be growing and prospering, but which will not have the infinitely open variety that we experienced in the 1950s.

That means that we have to address the two questions that kept coming up today: Who is responsible for benefits? Is it the employer? Is it the employee? Or is it the federal government? We have never done a very good job of sorting that out, I don't think. I think we've failed, really, to sort this out appropriately during the 35 or 36 years since I began in this business.

Lastly, I was again struck by the fact that government officials frequently seem unwilling to listen at all to what is going on in the outside world in terms of what are the real benefit issues. Many times we are stuck with federal legislation that has to do with stopping some small employer from doing something that only a few small employers have done, and we are not focusing on the broad economic issues of trying to make this country grow and prosper, and to have private benefits expand and be useful to our economy.

I would think that we ought to find some way of having a more extended dialogue with people who work in Congress and the administration, in which we can talk through some of the structural issues of how benefit plans really work; because I have never yet been satisfied that, as I talk to government officials, that they fully understand how these benefit programs work.

For example, we heard the argument today that we should not give tax preferences to more than $200,000 worth of salary. In Great Britain, where they sometimes do things very unintelligently but in this issue I think they do it more intelligently, they limit private pensions to two-thirds of pay, but they do not say how much people should be paid.

We do not have a law in this country that limits pay. I am really not entirely clear why we have a law that limits the amount of pensions, and I do not see an argument from a tax point of view that persuades me of that, although I hear it all the time.

So I would urge that EBRI, other organizations and each of us individually try to find a forum in which we can talk some of these issues out a little more thoroughly. The people who were here from the government today are obviously caring, intelligent people; but anymore than I would understand their jobs, there is no reason why they should understand my job. And I think it is necessary for us to talk some more about all this.

Maybe we can do some more of that together.

Appendix. Forum Participants

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