RECORD OF SOCIETY OF ACTUARIES
1991 VOL. 17 NO. 3B

TAX POLICY FOR RETIREMENT INCOME PLANS

Moderator: RICHARD G. SCHREITMUELLER
Panelist: SYLVESTER J. SCHIEBER*
Recorder: JEANNE E. CASEY†

The climate in Washington, D.C., regarding tax policy for retirement income plans.

- Should there be a National Retirement Income Policy?
- Income taxes and excise taxes
- Current versus deferred taxation
- Is it in the country's best interest to allow qualified plans?
- Current revenue versus long-term savings
- Nonqualified alternatives
- What, if any, positions are being taken by actuaries?

MR. RICHARD G. SCHREITMUELLER: I'm an actuary with Alexander and Alexander Consulting Group in their Actuarial Resource Center in Atlanta, and a graduate of the University of Notre Dame. With me is another graduate of Notre Dame, Sylvester Schieber, who got his Ph.D. in economics there a few years ago. Syl then went with the government, to the Social Security Administration where he was in policy analysis. From there he went to the Employee Benefit Research Institute, serving as their Research Director for 2.5 years. And since 1983, Syl Schieber has been with The Wyatt Company in Washington, D.C., founding and directing their Research Information Center.

We're very happy to have Syl here because no one else can cover this subject the way he can. Last year Syl wrote a paper, titled "Why We Should Not Tax Employee Benefits," sponsored and published by the Association of Private Pension and Welfare Plans. He will give highlights of this important publication and provide some updates.

The title for this session is a little ambiguous. We're not going to say much about the ins and outs of how to tax retirement income plans. Rather, we're going to talk about why the tax policy works as it does and how it relates to pension policy. Pension policy and tax policy are hard to separate, as we'll see.

Actuaries and others often talk of a new or restated national retirement income policy. Those who have looked into this generally agree that a national pension policy, if we had an explicit policy, would be a statement of the main goals of the government programs and private programs in this country. It would not get into such details as whether you ought to have 5- or 10-year vesting. But it would get into national objectives regarding the level of income that people need in retirement and what the

* Mr. Schieber, not a member of the sponsoring organizations, is Vice President and Director of Research Information Center at The Wyatt Company in Washington, District of Columbia.

† Ms. Casey, not a member of the sponsoring organizations, is Public Relations Specialist with the American Academy of Actuaries in Washington, District of Columbia.

sources of that income should be. And, ideally, this would represent the will of the people about some of the tradeoffs we're willing to make, the price we'll pay in financial and nonfinancial terms. Elected and appointed officials would pay attention to this national policy, and any laws they pass would be examined in terms of how well they fit into this. Some of that ground was covered at last year's spring meeting in Dallas at a session led by Don Grubbs and Ken Steiner entitled "National Retirement Income Policy," *RSA* 16, No. 1, p. 103-125.

There are pros and cons of trying to state a national retirement income policy. Many people would say that we already have one, a de facto policy. It is not written down on tablets of stone but it's there implicitly in all the rules and laws on pensions and other sources of retirement income. It says that retirement income is a stool with at least three legs. First is government income from Social Security. Second, we encourage employee savings and personal savings to some degree. Third, we encourage employer-employee plans, where there's general agreement that plans should have broad coverage and basic benefits should be guaranteed. People should be able to count on getting them.

About a dozen years ago somebody said that's not enough, we need an explicit national policy. So President Carter appointed the President's Commission on Pension Policy; for a couple of years they pondered about this, held hearings, and right after Ronald Reagan came into office, they delivered their report. The President's Commission had a number of interesting suggestions for expanding pensions, most of which have been gathering dust on the shelves. But that was the last serious national effort of its type.

Many people would say national retirement income policy is made by Congress and the President a little bit at a time. That's the way this country works and the role of professionals and knowledgeable people is to educate them and the public on how plans can best be designed, how much good they can do, and how much we'll miss them if we don't have such plans. If Congress ignores the long-term implications in favor of tax policy that may be good for the short run, but not the long run. We must try to get Congress to maintain balance between pension policy and tax policy.

One reason to formalize a national retirement income policy is too much complexity. Since 1981 we've seen many, many new laws and rules. TEFRA and DEFRA have added many layers of complication and cost that we think of as counterproductive. Interestingly, all of that happened after the President's Commission delivered its report which said we need to give pensions higher priority. Some of the rules on plan design and funding have come to be known as Goldilocks rules, where plans can't pay benefits out that are too high or too low, too early or too late, they must be just right. Likewise, employers can't pay contributions into plans that are too much or too little, too early or too late. Because of such micromanagement, pension actuaries find it difficult to use their skills creatively and feel misunderstood and unappreciated. More important, employers get fed up and decide to get rid of their pension plans. The thought is that if only we had an explicit policy, maybe we wouldn't have so many of these rules. Yet even before these rules people thought it was a good idea to look into a national pension policy.

There are other reasons. Many elements of pension policy are driven by budget and social agendas rather than retirement income agendas. Whether people actually receive benefits is kind of an afterthought, a side effect. Why is this? In the 1980 election campaign, candidate Ronald Reagan said we should cut taxes, we should increase defense spending, and we should balance the budget. Well, two out of three ain't bad, but he couldn't balance the budget, quite the contrary. One of his opponents in 1980, candidate George Bush, called that voodoo economics but in 1988 the same George Bush said "Read my lips, no new taxes." He may back off on that a little, but that's the basic position of the President and other successful politicians. They've steered the public debate to where you can't look like you're raising taxes, you've got to find some other way to cut the budget deficit.

What happened in 1981 was a real watershed event, the Kemp-Roth tax bill that was enacted into law. Actually, I used to work for Senator Roth and over there we called it the Roth-Kemp bill, but I don't think anyone else did. First, they cut tax rates at the margin, very significantly. More important, they indexed the bend points in the tax rates. This meant that taxes no longer went up just due to inflation, allowing the government to spend more or cut taxes every so often. After 1981, those tax cuts are already built in. Since then we've had huge budget deficits every year, the political environment makes it very difficult to raise taxes and how do you get out of that? Well, you do it indirectly, such as by giving less favorable tax treatment to pension plans.

At the same time, in order to have their way on pensions, the tax experts find that a social agenda plays a very prominent part. Issues include vesting, portability, nondiscrimination, reversion of excess assets, spouse benefits and rights. These things are very peripheral to basic retirement income goals, but they tend to become very important, occupying much time and attention. They make the cost of administering a pension plan as high as it is. For an employer, at some point it's just more convenient not to bother maintaining a pension plan. Currently we find issues in the health business that are analogous, with mandated benefits driving up costs and making it difficult to cover people.

I believe the Washington climate favors tough rules for pension plans. Pension plans have many people taking advantage of them, so to speak, from a policymaker's viewpoint. They measure this by the tax expenditure concept, you'll hear more about it later, which says that the government through its beneficence in the tax structure is indirectly supporting these plans and, therefore, the plans must pay for that privilege. And the price they pay is all the rules and regulations. The opposite side of the coin is that pension plans and funds are a potential source of new tax revenue in very large amounts.

For example, within the past month a prominent pension analyst, Alicia Munnell of the Federal Reserve Bank of Boston, suggested a 2.5% annual tax on all pension funds. That would recoup the pension tax subsidy and the Treasury would come out even. She admitted that was a ceiling and you could have a lesser rate. To justify this she said that, given all the other demands on the budget, getting rid of tax expenditures that benefit a declining and privileged part of the population should get serious consideration.

In my experience, the Administration is not a major player on this and that's part of the problem. There is an imbalance in the process. No matter how burdensome the rules are from Capitol Hill, when was the last time you heard somebody from the Treasury or IRS say that we can't have this, we've got to keep the employer cost down? The White House does this every day on other kinds of legislation, telling Congress they've gone too far. It just does not happen on pensions. Rather, Capitol Hill will pass something really silly like Section 89 and the Treasury and IRS folks say we'll go you one better. We'll write regulations that are so tough you won't believe them, and sure enough nobody did and they had to repeal the whole Section 89.

Treasury and IRS do seem to have unwritten policies. Certain things, you'll never see them acknowledged or written down, but just look at any new rules and test them against a few principles. First, IRS doesn't really like subsidized early retirement very much. From the looks of the rules, they would just as soon not have it happen. Another thing they don't seem to have much use for is contributory defined benefit (DB) plans, which keep getting harder to maintain under the IRS rules. Cash balance plans may also be in this category, it's too early to tell. IRS rules are generally biased against qualified DB plans. Nonqualified plans, supplemental executive retirement plans, seem to come out all right. We don't see many roadblocks in the way of them. There's no advance funding for those plans so they're relatively benign from the Treasury and IRS point of view. Of course, nonqualified plans have their limits and there's only so far they can go.

A final advantage of a formal retirement income policy is the hope for new priorities and simpler, more cost-effective rules. You can have a kind of trickle-down effect where, if your key executives like the plan, maybe they'll put in a plan that everyone else will like, too. The rules will encourage more retirement plans and coverage. They will stimulate capital formation and savings. They'll get us ready for the baby boomers to retire in a couple of decades and take some pressure off Social Security.

What are some of the problems? Retirement income issues reach into many areas. Pensions and Social Security are explicitly involved, postretirement health and long-term care are implicitly involved. Postretirement health and pension benefits have much in common, especially now that postretirement health uses defined contribution and defined dollar arrangements. Within the Washington power structure, when you involve all these programs you must deal with different federal agencies, different congressional committees, different interest groups. They each have their own agendas and it's very difficult to get anything done in a rational way when you're trying to take on the whole world. This diversity may be a major barrier to a retirement income policy. If you could somehow restrict it to a more manageable area, you'd have a better opportunity to succeed.

Another problem is the length of time needed to put a policy like this together and in the meantime economics and demographics can change, including national productivity and priorities, and the state of the economy. For example, the role of insurance companies is on the table now and a year ago it wasn't. Unless the policy is flexible it can soon be obsolete.

A third problem is that a full-blown pension policy may be so broad that it becomes just an academic exercise. This argument says that you must have legislative language and really get down to voting and being held accountable before the political process pays you any respect.

A final disadvantage is that, instead of just putting out a white paper, it might be more productive to try to change the structure within which policy will be made in the future. In another session, for example, people asked whether the IRS should be regulating pension plans. A year ago I wrote an article that argued that they shouldn't, and I had a lot of reasons. The article explains how a change along these lines could accomplish more than trying to get a comprehensive policy on pensions without changing any of the structure. If you could get pension policy out of the IRS, then it might no longer be so tax-driven and you could instead very naturally have more emphasis on paying benefits and building up pension funds that accumulate capital. Ten or 15 years ago many people suggested having a super pension agency that would combine the three ERISA agencies, maybe even Social Security. You don't hear that suggestion anymore because it's very disturbing to the power structure and very unlikely to happen, so you might rather go for something with a slightly better chance.

Now let's take a brief look at the kinds of taxes involved in pension policy. First, looking at income taxes on pensions there are three basic rules, and it's important to clearly understand them.

1. As to employer contributions, employers get tax deductions for contributing to pension plans. That's absolutely fundamental yet it's not a tax break. I don't think anyone looks at it that way because the alternative is to pay the employee cash for which the employer obviously would get a deduction. So this rule is not viewed as a tax break or a tax expenditure but the other two rules are.

2. Next is taxation of investment return. The contribution goes into a fund and earns investment return on which no current tax is paid. The tax is deferred until the employee gets a benefit. You can show arithmetically that that's an advantage. You can accumulate more after-tax income than if it were taxed year by year.

3. Finally, the employee pays no tax until the money comes out. The personal income tax is deferred, and that's also a tax break. You can show this with numbers.

Actuaries tend to analyze these tax issues over the long run on a present value basis. But if your orientation runs only to the next election or two, you will take a short-run view and disregard what happens in the out years. This is a big reason actuaries have trouble communicating with politicians on such issues.

Another leg of the retirement stool is individual retirement accounts (IRAs). Currently IRAs are very limited, available in full only to lower and middle income workers. Originally, under ERISA in 1975-81, IRAs were available only to workers not covered by a pension plan. In 1982-86 they were available to any worker, whether covered under a pension plan or not, and so many contributed $10,000 over those five years. After 1986 they rolled the rules back. They said if you're earning more than a certain amount you get the tax-deferred investment return but you don't get the immediate deduction. That deduction, a bird in the hand, is what a lot of people want, so IRAs haven't been used very much since 1986.

The Congress now has a very interesting bill on IRAs, the Bentsen-Roth bill, which proposes two kinds of IRAs. First is a conventional kind, a deductible IRA. The bill indexes the $2,000 limit but other than that it's the 1982-86 IRA design, available to any worker. This seems to have very little chance; it adds substantially to the budget deficit. The second and more interesting kind does not. The employee puts in $2,000 but doesn't get a tax deduction. What the employee does get is tax-free interest and a tax-free benefit at the other end if the money stays in for five years. That might look attractive to some workers. The five-year rule exists because the congressional budget process goes out only five years. Anything in the sixth year or later is disregarded. You'll see a lot of legislation where spending or tax treatment starts or stops in five years, tied to the way the Budget Office keeps score.

Another proposal that may very well happen in the next year or two is to get rid of 5- or 10-year averaging. Those tax rules have strong supporters but they're viewed as kind of an anomaly. They encourage people to take lump sums and spend the money instead of using it for retirement, and they also cost the Treasury compared with a more conventional way of taxing lump-sum benefits.

Other tax issues we've mentioned. It's been suggested that we could tax fund assets or tax capital gains as the Senate suggested a year ago.

Just a word or two about excise taxes, something quite new. Most of the excise taxes on pensions have come along in the last few years, and five of these excise taxes are worth noting.

1. As pension actuaries we know an employer who puts in a nondeductible contribution is subject to a 10% excise tax.

2. Another excise tax doesn't happen very happen, at least it hasn't yet, regarding overstated pension liabilities. There's a tax if your liabilities are overstated and thereby the deductible contributions are overstated.

3. Then there are minimum distributions at age 70 1/2, rules that may be simplified. These minimum distribution rules carry a very stiff tax, 50%, for the employee on what should have been distributed and wasn't.

4. Another excise tax is on excess pension distributions. This is for people with very high lump-sum benefits. If they go beyond a certain amount, within the 415 limits of course, it's perfectly legal but there's a tax.

5. Finally, we have excise taxes on reversions of excess pension plan assets to the employer. These taxes have become confiscatory. The power to tax is the power to destroy and that's what happened to reversions.

Other kinds of IRS fees include penalties and user fees, which are both growing. We may take a dim view of them, but the other side of the coin is that it's better than disqualifying the plan, the death penalty.

With all these taxes on pension plans, we have a lot more ways to get our client into trouble or keep the client out of trouble than before. The IRS has a lot more ways to raise money from pension plans than before.

Social Security benefits, unlike pension benefits, traditionally were tax-free. Taxing Social Security benefits began in 1984. Prior to that, the tax treatment was not part of the tax code, it was an informal rule from the Revenue Service many years ago which said not to tax Social Security benefits. There was no great public debate, no one really complained about it. Certainly, the people who were getting Social Security benefits didn't complain. People in this country, by and large, tend not to complain if somebody who can use a tax break is getting one with little immediate cost. It was not very important at the time, but it started becoming important.

In the 1983 Social Security Amendments a lot of groups took a hit. This is one the old folks took, at least the ones who are well off, when we started taxing Social Security benefits. There's a fixed-dollar threshold, and any benefits above that amount have 50% of them included in taxable income, so 50% of such benefits get taxed.

A proposal that may very well be enacted some day would raise that from 50% to 85%. The rationale is to bring the tax treatment of Social Security benefits more into line with the way pensions are taxed. The worker has already contributed through the payroll tax so it wouldn't be right to tax the whole thing. A worst-case calculation made some years ago showed that employee contributions would not exceed 15 cents for each dollar of benefits, so the idea was to tax the other 85%, just as in a contributory pension plan. That would be for a very high-paid employee. A more typical employee's contributions would amount to about 10 cents on the dollar rather than 15, but anyway that's the theory. If this proposal were enacted, you'd have to set your replacement rate target a little higher under your pension plan. Your retirement income objective then, instead of being about 70% of gross pay, might be 72 or 73 or 74. And some people would work another couple of years to get the benefits they want if they figure that way. So these tax rules all can find their way back into people's behavior.

We find that some actuaries are taking positions on these matters. First, the American Society of Pension Actuaries (ASPA) has done considerable work on national retirement income policy. In February 1989, ASPA published an overview of the subject. They're now pretty far along, but it's been three years and they're still working on it. ASPA said that people need adequate retirement income, which they can get from four sources. These are the usual three that we've discussed plus phased retirement or part-time work. But they have to flesh that out, and ASPA finds it very hard to get agreement even from their own people who have the same basic interests. So imagine how difficult it is for policymakers coming from all points on the political spectrum to agree on national pension policy. After ASPA has this published, the hard part will lie ahead. They will have to educate the public, educate the lawmakers. That certainly is one approach to the problem.

The American Academy of Actuaries took a different approach. They did a feasibility study last year and decided not to formulate their own policy statement. However, they are now about to roll out a cable TV public service announcement. It does not get into many points we're discussing; rather it takes a strong stand against complexity and constantly changing laws. Executive Director Jim Murphy ends up saying "It's time for Congress to establish a national retirement income policy so that employers can spend less time making plan revisions and focus more on meeting their employees' retirement needs." The Academy felt all could subscribe to this.

Those are two institutional efforts on behalf of our profession. Among individual actuaries, Don Grubbs has done much work in this area. Don, I believe, has taken more of an issue-by-issue approach – portability, then simplification being two issues. Don hasn't tried to tackle the whole beast all at the same time, nor has he found it necessary to work through the institutions. His experience and background encourage people to listen to him. That's very much to be applauded.

Another, Jim Curtis, head of the firm of Milliman & Robertson, had an article in *Financial Executive* magazine, July-August 1990, on why we should have a retirement income policy. He has a very general approach, a gradual approach, starting with a survey. He suggests changing the structure for policymaking, formulating goals, educating the public, and having public forums. Jim does certainly take a stand on two things: (1) there needs to be a sharp reduction in compliance costs for pension plans, and (2) it would be a good idea to take employee benefits out of the political and budget arena. I've already mentioned that I wrote an article about why they ought to take pension regulation away from IRS, and that suggestion was on Jim's list of actions we should take.

MR. SYLVESTER J. SCHIEBER: I am going to narrow the focus of this discussion from the broad panoramic view that Dick Schreitmueller has provided. My focus will be on existing retirement policy as I believe it currently exists, embedded in our national tax policies. I will not be talking about developing a new formal and fully coordinated National Retirement Policy as Dick has done.

In order to understand the existing policy framework, we need to go back to 1974. For most people, talking about 1974 in the context of retirement policy brings to mind the Employee Retirement Income Security Act (ERISA). But, there were two major pieces of legislation in 1974 that affected pension policy. One of them was ERISA, which has had a major impact on retirement policy generally, and pension plans in particular. But a second bill was passed in 1974 that possibly was more important from a retirement policy perspective, namely the Congressional Budget Act.

The Congressional Budget Act legitimized the concept of "tax expenditures," which had been discussed in policy circles from the late 1950s. This law requires the Treasury Department each year to estimate the federal tax revenues that are not collected because of the preferences in the tax code. These foregone revenues are referred to in the budget parlance as tax expenditures. The Treasury Department estimates the tax expenditures as part of their annual budgeting process, and these estimates are included in the annual budgets that the President submits to Congress.

Lo and behold, when the Treasury began estimating the tax expenditures, one of the largest tax expenditures was the one attributed to tax-qualified pension and savings programs, and it has continued to be one of the largest over the years. Even though these estimates had crept into the formal budgeting process, no one paid much attention to them through the end of the 1970s. While they were largely ignored, the tax expenditures attributed to pension and savings programs increased.

In the early 1980s things began to change. At the end of 1981, we started to implement the tax cut that President Reagan had advocated and Congress had passed in 1981. When the Administration started to put together their budget for fiscal 1983, the federal government was facing extremely large deficits, unprecedented in peaceful times. In order to deal with these looming deficits, the Administration proposed cutting a number of expenditure programs. The cuts ranged so far there were public discussions about whether to consider ketchup as a vegetable for the school lunch program. Among other things, the Reagan Administration proposed to cut Social Security benefits, a proposal I would characterize as relatively draconian. The proposal was for almost immediate significant reductions in early retirement benefits under Social Security.

Representative Charles Rangel (D-NY), in the House Ways and Means Committee, hit upon these proposed expenditure reductions as a major equity issue. He took the position that if we were going to have expenditure reductions, we should also consider cutting some of the big tax expenditures that the Treasury Department had been estimating. The type of policy question he posed was: If we can consider cutting back on Social Security benefits that go to middle-class workers, can't we also consider cutting tax expenditures on pension benefits that are targeted toward higher-income workers? This type of question led Representative Rangel to propose cutting the Section 415 contribution and benefit limits for qualified plans. He held hearings in the House and then there were similar hearings in the Senate. Each of the respective bodies passed legislation moderately reducing some of the pension-related tax expenditures.

This tax legislation was different than previous legislation had been, because the Conference Committee reconciling differences in the House and Senate measures included a whole set of new pension-related provisions that had not been included or considered in the development of the bills that had been passed by either house. These new measures in the Conference Report were ultimately passed by both chambers as part of the Tax Equity and Fiscal Responsibility Act (TEFRA). The passage of TEFRA completely redefined the way in which benefits policy and tax policy were going to be made for the subsequent decade. I believe the Congressional Budget Act played a greater role in defining the change in the approach to pension policy during the development of TEFRA and other tax and pension legislation throughout the 1980s than the Employee Retirement Income Security Act. In the new approach to developing pension policy over the past decade, policymakers have generally not considered the level and distribution of the benefits these plans provide to our society.

Pension plans began their evolution outside the context of the tax policy arena. Their existence dates back to the 19th century, long before we had a federal income tax. There was a long history of plan growth as the percentage of the population covered by plans steadily increased from the late 1940s through the late 1970s. While the creation of plans got underway without tax stimulus, tax policy and tax preferences certainly stimulated the growth. The most recent example of the effects of the tax stimulus is the very rapid growth and proliferation of 401(k) plans after this incentive was solidified in the code in the late 1980s. In recent years, the percentage of workers covered by tax-qualified plans has been decreasing. This has led some policy analysts to become more critical of the tax expenditures related to the plans.

Measuring the tax incentives related to pension programs presents a variety of problems. One of these relates to the incentive being partly a tax deferral rather than a complete forgiveness of the tax liability. In the case of health care, you can make a case that the federal government is foregoing tax revenue because of the preferences related to employer-sponsored health benefits. If the employer paid the equivalent of the health benefits premiums as cash compensation, workers would have to pay taxes on it, but since the compensation is paid in the form of health benefits, no tax is collected. And it is never taxed. In the retirement plan area though, the tax preferences do not result in a complete loss of tax revenue because when the benefits are paid out they are taxed.

The question then becomes how can we measure these retirement incentives, the incentives that the tax system provides. I have participated in this debate for quite a number of years. I wrote the first article that the Employee Benefit Research Institute (EBRI) did on this issue 10 years ago. One thing people in the business or benefits community sometimes try to argue is that there is no tax preference for pensions, because they are ultimately taxed upon distribution. I believe that position is fundamentally wrong.

To make my point, I use a hypothetical case shown in Table 1. This example considers a hypothetical individual who is in the 28% tax bracket and who has $2,000 that he or she can either put into a tax-deferred account or, alternatively, put into a regular savings account. If the former route is taken, he or she will not have to pay taxes on the $2,000 itself or on the interest that accrues to it until a distribution is taken, when the 28% tax on the $2,000, because it is regular income, plus a 28% tax on the accumulated interest income is due.

In the regular savings account, the income is taxed at the time it is earned, and interest earned by the account is taxed each year. I assume for the sake of discussion that the initial savings would not be disbursed for 10 years and would accrue interest during each year of the period.

At the end of 10 years the normal savings account would grow to $2,886.09. The tax deferred account, on the other hand, would accrue to $5,187.48, but after paying taxes at the time of distribution, $3,734.98 would remain.

This example shows that there is some marginal benefit that accrues to an individual who participates in one of these accounts, $848.90 in this hypothetical case. The tax preference in the code results in added savings, and we have to acknowledge the simple arithmetic of the situation. Having said that though, I think we need to step back and look at how these things are measured and also look at the broader policy context environment in which they are used.

TABLE 1
Alternative Taxes and Benefits Accumulations Under
Normal Savings and Tax-Deferred Accounts at 28% Tax Rates

	Normal Savings Account			Tax-Deferred Account	
	Net Value	Tax Liability	End Value of Taxes	Net Value	Tax Liability
	(1)	(2)	(3)	(4)	(5)
Pre-Tax Income	$2,000.00	$560.00	$1,452.50	$2,000.00	$0.00
Post-Tax Investment	1,440.00	n/a	—	2,000.00	0.00
End of Year:					
1	1,543.68	40.32	95.07	2,222.00	0.00
2	1,654.82	43.22	92.65	2,420.00	0.00
3	1,773.97	46.34	90.29	2,662.00	0.00
4	1,901.70	49.67	88.00	2,928.20	0.00
5	2,038.62	53.25	85.76	3,221.02	0.00
6	2,185.40	57.08	83.57	3,543.12	0.00
7	2,342.75	61.19	81.45	3,897.43	0.00
8	2,511.43	65.60	79.37	4,287.18	0.00
9	2,692.25	70.32	77.35	4,715.90	0.00
10	2,886.09	75.38	75.38	5,187.48	0.00
Gross Benefits Paid	$2,886.09	—	—	$5,187.48	—
After-Tax Benefits Paid	2,886.09	—	—	3,734.98	—
Accumulated Value of Taxes Paid Plus Interest	—	—	$2,301.39	—	$1,452.50

Source: Calculated by the author.

Looking back through the history of retirement policy in the United States and the federal government, one place to begin a discussion about retirement policy is the year 1935 when the Committee on Economic Security was putting together the Social Security Act. The Committee's studies and reports convey clearly that Social Security was to be a base for retirement, but there was some expectation that individual workers also would participate in the accrual of income rights for their own retirement. The expectation was that somehow workers should save to provide some retirement income for their own retirement security. There was an indication that the Committee felt that employer-sponsored pension plans were one viable option for the added retirement savings that Social Security anticipated. This basic tenet of Social Security policy has been repeatedly reaffirmed by policymakers and policy analysts over the years.

The second issue is the example just shown where we compared the tax-preferred savings with a regular savings account. This is the base model that most policy analysts use when they begin their analytical descriptions of how the tax preferences for retirement savings work. The problem with that model is that if you follow the normal savings model, you pay taxes when income is earned; you pay taxes on the interest that accrues to your savings; and you end up paying a higher real ultimate tax rate on earnings anytime you defer consumption than if you spend it immediately. In fact, the U.S. tax code discourages savings.

To understand this point, consider someone in the 28% tax rate bracket, and say he or she has $2,000 of pre-tax earnings to save. Initially, tax on the $2,000 has to be paid if the money is to be put into a regular savings account, so only $1,440 is actually put into the account. For the sake of simplicity, assume we are in an economic environment where we are realizing 5% inflation, and an individual investor can invest money in an account that pays a 5% rate of return. At the end of a year, assume the account has paid the 5% rate of return, but the return is taxed. Under our assumptions, the investor has to pay a 28% tax on that 5% return. So, indeed, the purchasing value of that money at the end of the year is less after having saved it for a year than it would have been if you had consumed it immediately. The investor has to get a rate of return that is at least 28% above the inflation rate in order to maintain purchasing power, and would have to realize a higher rate of return than that to improve purchasing power.

The effect of this phenomenon over time can be shown numerically. For example, Table 2 shows $2,000 of pre-tax income subjected to a 28% tax and then invested at a 5% rate of return with a 5% inflation rate. The example assumes a 28% tax rate will be paid on interest returns each year. What occurs in this case is a very gradual erosion of the purchasing power or an increase in the effective tax rate that the saver incurs by deferring consumption. If you look at this over time, the table shows that the purchasing power is increasingly eroded the longer consumption is deferred. The erosion in purchasing power is caused by the increase in the effective tax rate. This practical result of saving under the regular tax system does not exactly comply with a stated policy goal of wanting people to save for their own retirement.

TABLE 2
Relative Value of Money in a Normal Savings Account Paying a Rate of Return Equivalent to a 5% Inflation Rate and Subject to 28% Tax Rates

Year	Nominal Value of Constant Purchasing Power	Nominal Value of Savings	Gross Interest	Net Interest	Purchasing Power of Savings as Percent of Original Earnings	Tax Rate on Original Earnings
0	$2,000.00	$1,440.00	$72.0	$51.8	72.0%	28.0%
1	2,100.00	1,491.84	74.6	53.7	71.0	29.0
2	2,205.00	1,545.55	77.3	55.6	70.1	29.9
3	2,315.25	1,601.19	80.1	57.6	69.2	30.8
4	2,431.01	1,658.83	82.9	59.7	68.2	31.8
5	2,552.56	1,718.55	85.9	61.9	67.3	32.7
6	2,680.19	1,780.41	89.0	64.1	66.4	33.6
7	2,814.20	1,844.51	92.2	66.4	65.5	34.5
8	2,954.91	1,910.91	95.5	68.8	64.7	35.3
9	3,102.66	1,979.70	99.0	71.3	63.8	36.2
10	3,257.79	2,050.97	102.5	73.8	63.0	37.0
20	5,306.60	2,921.18	146.1	105.2	55.0	45.0
30	8,643.88	4,160.59	208.0	149.8	48.1	51.9

Source: Calculated by the author.

If you look at the tax rates that actually occur over time on post-tax savings, you will discover that they vary in relation to marginal tax rates, savings periods, and the differences in nominal and real interest rates as shown in Table 3. The left-hand column shows the effective tax rate for people who consume immediately in a 15% tax bracket; the right-hand column shows the case of an individual in the 28% tax bracket. Earnings consumed immediately result in effective tax rates of 15% or 28% depending on the bracket. After 10 years, the 15% effective rate goes up to 21%. After 30 years it is up to 31%. In the 28% category, after 10 years, it is up to 37% and after 30 years, up to 52%.

TABLE 3
Effective Tax Rates on Current Versus Future Consumption
When Consumption Is Deferred Through a Regular Savings Account
at 5% and 10% Interest and Inflation Rates

At 5% Interest and Inflation Rates		
Statutory Tax Rate	15%	28%
Consumption Time Frame	Effective Tax Rate (%)	
Immediate	15.0	28.0
After 10 years	20.9	37.0
After 20 years	26.4	45.0
After 30 years	31.4	51.9

At 10% Interest and Inflation Rates		
Statutory Tax Rate	15%	28%
Consumption Time Frame	Effective Tax Rate (%)	
Immediate	15.0	28.0
After 10 years	25.9	44.4
After 20 years	35.4	57.0
After 30 years	43.7	66.8

Source: Calculated by the author.

This shows that the current tax system can result in some very high effective tax rates against which we at least conceptually measure the tax expenditures. The fact that the tax system erodes the purchasing power of a dollar of income earned if consumption is deferred does not seem to match the stated governmental policy that we want individuals to save to partially provide for their own retirement security.

There are additional problems in the way the budget numbers for pension-related tax expenditures are actually derived. They are developed on a cash flow basis that is inappropriate in this case. This method of estimating the numbers results in exaggerated estimates because there are cohort effects that should be considered. The cohort effects are important because much of the baby boom generation is currently working and accruing a pension. In the actual derivation, budget analysts estimate the reduction in federal taxes that will be collected this year because workers' pension accruals are not paid as regular income. They net out against these lost taxes the taxes that are actually paid by people who are retired and receiving a pension. The baby boom generation, the accrual generation, is disproportionately large at this point in time relative to the retiree population. Much of the tax preference being enjoyed by the baby boomers is simply a tax deferral that will ultimately be paid when benefits are paid. To treat the deferral of taxes as lost taxes for such a large cohort has to exaggerate the estimates significantly.

The cohort exaggeration is compounded by the plan maturity effects. For someone who is 75 years old, the percentage of pension coverage during his or her working career was far lower than it is for the pension coverage of a current worker. And so we have a relatively low-coverage generation getting benefits and they are being netted against a relatively high-coverage segment of the population. In fact, what we should be doing is estimating these on a present value basis.

The underestimation of taxes attributed to pension payments is also exacerbated by other preferences in the tax code, because these preferences are calculated on a marginal basis. The estimates include the additional taxes that the government collects from the elderly on their pensions. The taxes that are collected from the elderly on their pensions are actually lower than they would be if the elderly did not have the double personal deduction for income tax purposes, and if they did not have the preferential tax treatment they are getting from Social Security. There is a whole series of biases that are built into the numbers and we should be wary about using them in developing national retirement policy.

But having said that, I think that we need to step back from the numbers and begin to deal with the important conceptual issues behind them. The published numbers have become a distraction to a great extent. To some degree, the policy discussion has degenerated into policy analysts arguing about the numbers. That is really a waste of time. A significantly more productive framework in which to analyze federal retirement policy within the context of tax policy has been identified by none other than the Treasury Department. During 1988, they submitted a report to Congress entitled "Report to the Congress on Certain Employee Benefits Not Subject to Federal Income Tax" where they said: "The preferential treatment of fringe benefits may be justified if the consumption of the fringe benefits provides external benefits to society."

Within this context, it is extremely important to consider the benefits provided by the plans getting the preferential tax treatment. Yet, one of the problems with most of the analyses that have been done over the last 10 years, especially in the input to the tax policy deliberation, is that they have completely ignored this point. The real issue is the efficient delivery of socially desirable services and I contend that pension plans have been doing that to a significant degree. To address this issue, I wrote an article last year for the Association of Private Pension and Welfare Plans (APPWP) entitled "Benefits Bargain: Why We Should Not Tax Employee Benefits." In that report, I contend that we should not worry about the numbers in addressing the more important policy issues. We should take the numbers that the Treasury Department has put on the table and see how the conceptual arguments play out vis-a-vis the numbers that they have estimated. The numbers are quite large. In last year's budget for fiscal year 1990, the foregone revenues for employer pension plan tax expenditures were $46 billion. This category of tax expenditure dwarfed any of the others, even those related to employers providing medical benefits. But we can only consider the appropriateness of the size of the expenditure within the context of the benefits affiliated with it. We need to look at the magnitude of the benefits that are going to be provided and we also need to look at the distribution of benefits.

Table 4 shows the magnitude of benefits that were paid from pension trusts, health trusts, life insurance, and workers compensation in 1989, as compared with the tax expenditures.

TABLE 4
Benefits Paid by Selected Employee Benefits Plans
During Calendar Year 1988 and Federal Tax
Expenditures Attributed to Them During Fiscal 1989

	Benefits (Billions of Dollars)	Tax Expenditures (Billions of Dollars)
Pension and Profit Sharing		
Federal Civilian Retirement	$28.6	
Federal Military Retirement	19.5	
State and Local Employee Retirement	34.7	
Benefits Paid by Private Plans	137.2	
Total Pension and Profit Sharing	220.0	47.4
Private Group Health Insurance Funds	145.9	27.7
Private Group Life Insurance Funds	9.7	2.1
Worker's Compensation	24.2	2.8

Source: Benefits data came from Bureau of Economic Analysis, U.S. Department of Commerce *Survey of Current Business* (Washington, D.C., July 1989), Table 3.11, page 62, and Table 6.13, page 83. Tax expenditure data taken from Table 1 above. Separate estimates of the tax expenditures for federal, state and local, and private pension and profit sharing plans are not available.

From the comparison, we see the aggregate benefits that were distributed under tax-preferred plans were generally about five times the magnitude of the tax expenditures associated with them. So there has been some fairly effective delivery of services going on, but the distributional issues are still important.

The distributional question focuses on who is getting the benefits. There have been contentions by some policy analysts that the benefits are badly skewed toward higher-income workers, so I have tried to address the distributional issue on an empirical basis.

In order to assess the distributional issues, I pulled data from a variety of sources. Some of the data was drawn from internal company surveys The Wyatt Company has done, some from national surveys that the Department of Commerce through the Census Bureau has developed on national coverage rates under pension plans, and some from the Internal Revenue Service Statistics of Income Series that shows the tax rates that people pay on the basis of their adjusted gross incomes.

On the basis of pension coverage data from the Census Bureau and pension accrual data that The Wyatt Company had developed through our survey work, I estimated the distribution of pension benefits or the accrual of benefits across society. After I had estimated the distribution of benefits, I could estimate the tax expenditures using the tax rates from the Statistics of Income. I then estimated the federal income tax distributions by income class. An analysis of the findings follows.

First of all, in Table 5, the plan participation rates are skewed toward upper salary levels. At the lower end of the salary scale, less than $10,000 a year, 20% or less of the work force was participating in a pension plan. The participation rate increased fairly steeply up to about $25,000 where approximately two-thirds of the work force was participating in a pension plan. Between $30,000 and $50,000, participation approaches three-fourths of all workers.

The right hand column in Table 5 shows the participation rates for what I call the ERISA work force.

The ERISA work force is defined by the participation standards that are established in ERISA (i.e., people who are older than 21 years of age, working at least half time, and who have been with their employer for a year or more). I believe this is the work force that should be considered for this analysis rather than the whole work force because, in fact, ERISA laid out these standards as the standards that the pension community needed to meet. On that basis, once you get to the $30,000 earning level, we have about 80% of the ERISA work force, hardly the 46-49% that we often hear as the pension coverage rate in the U.S.

When considering the outcomes provided by our pension system, it is clear that the glass is not full. There is no doubt about it. Some policy analysts contend that because it is not full we ought to diminish the tax advantage or eliminate the tax advantage accorded pensions. My counter argument to that is that you can look at any federal program on the expenditure side, or on the incentive side, and not everybody eligible to participate in the program is participating.

If you look at the Supplemental Security Income (SSI) program for the elderly, the participation rate is about 60%. If you look at the Food Stamp program, the participation rate is about 60%. Are we going to scrap those programs because not everybody eligible to participate is actually enrolled in them? No! In the case of pensions, we can do things to try and encourage further participation, but it does not mean that we should scrap them just because we do not have universal participation.

On the distribution of benefits, I looked at the share of benefits going to individuals on the basis of family income levels. Similarly, the share of federal income taxes that are paid at each family income level was estimated from the IRS data.

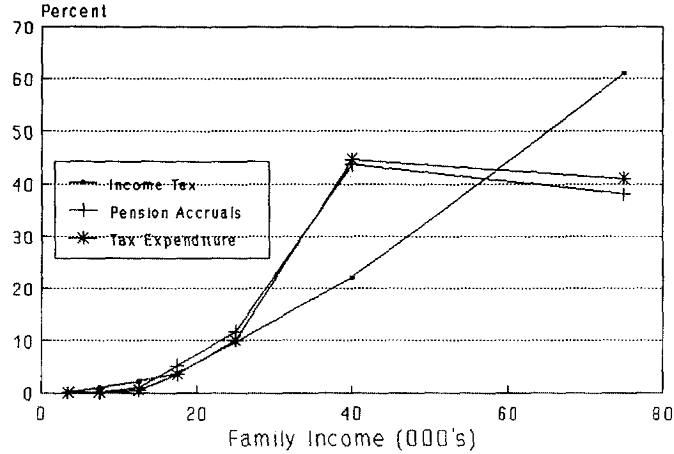
TABLE 5
Worker Participation in Employer-Sponsored Pension and Profit Sharing Plans in May 1988, by Family Income During 1987

	Percentage of Workers Participating	
	Total Work Force	ERISA Work Force
Workers' Earnings		
Less than $5,000	8.9%	22.3%
$ 5,000-9,999	20.5	29.2
$10,000-14,999	38.4	47.4
$15,000-19,999	50.9	59.8
$20,000-29,999	64.7	72.6
$30,000-49,000	72.9	79.5
$50,000 or more	67.3	75.5
Workers' Ages		
Under 21	6.0%	N.A.
21-24	23.9	34.9%
25-34	44.6	57.6
35-44	54.4	67.7
45-54	55.8	68.0
55-64	52.7	65.2
65 or older	25.3	N.A.
	Percentage of Workers Vested	
Workers' Ages		
Under 21	2.8%	N.A.
21-24	12.8	20.0%
35-44	29.7	39.4
45-54	42.0	52.9
55-64	46.7	57.3
65 or older	46.6	57.6
	23.4	N.A.

Source: Tabulations of the data tape by the author of the May 1988 Current Population Survey conducted by the U.S. Census Bureau, Department of Commerce. A worker is considered to be a participant if the employer had a pension plan, a profit sharing plan including a 401(k) plan, or a Keogh plan, and he or she was participating in it.

Chart 1 shows the accrual of pension benefits, the tax expenditures associated with them, and the share of federal income taxes paid by workers at various income levels. At the very lowest income levels, people tend to pay a slightly higher share of the federal tax burden than they are getting in terms of pension accruals. But somewhere around $15,000 of annual family income, the share of pension accruals begins to exceed the share of the federal tax burden and that persists up to about the $60,000 level.

CHART 1
Income Taxes, Pension Accruals, and Related Tax Expenditures
by Family Income Level



Source: Reprinted with permission from Schieber, Sylvester J., *Benefits Bargain: Why We Should Not Tax Employee Benefits* (Washington, D.C.: Association of Private Pension and Welfare Plans, 1990), p. 38.

On the basis of the analysis of the distribution of benefits and average tax rates, a measure of the distribution of pension-related tax expenditures was derived. Because tax rates are extremely low at the bottom end of the income scale, they do not translate benefits into tax expenditures very quickly. At the higher end of the income scale, the combination of higher tax rates and larger benefit accruals results in an accelerator effect on estimated tax benefits accruing at higher income levels. Roughly between $25,000 and $60,000 there is a clear result that people are getting a larger share of the tax benefits from the tax preferences affecting pension plans than their share of the federal income tax burden.

The results of this analysis lead me to conclude that the tax preferences for pensions are middle-class incentives. Those workers at the higher end of the spectrum receive a smaller share of the pension-related tax preferences than their share of the federal tax burden. Some analysts contend that we really should concern ourselves with the fairness of these programs because low-income workers are not getting their share of either pension or related tax benefits. But these analysts are completely ignoring the implications of the other major element of our federal retirement policy, namely Social Security.

A great deal has been written recently about the regressive tax rate that is used to fund Social Security. But if you look at Social Security across the income distribution and you take into account both the benefits and the taxes, the program is really progressively redistributive. It has a highly redistributive formula, meaning that lower-income people get much higher replacement of their final earnings than higher-income people. And so the redistributive nature of Social Security has to be taken into account when you are looking at the overall tax effects of the federal tax system on retirement savings.

A research paper that Dick Schreitmueller wrote a number of years ago when he was at the Social Security Administration estimated that younger cohorts of workers, on average, can expect to receive at least what they contribute to the system, plus just a little bit more. But when you have a redistributive system and a cohort is getting back about the value of their own contributions on a present value basis, it means that if the participants at the bottom of the income spectrum expect to get back more than they are paying in, the people at the top of the income spectrum can expect to get back less than they are paying in.

Social Security is an extremely efficient system for redistributing retirement benefits to lower-income workers who tend to have relatively high mobility, who have problems maintaining jobs, and who probably will never accrue significant benefits under an employer-based single pension plan. Its redistributive characteristic is something we need to take into account when considering federal pension policy.

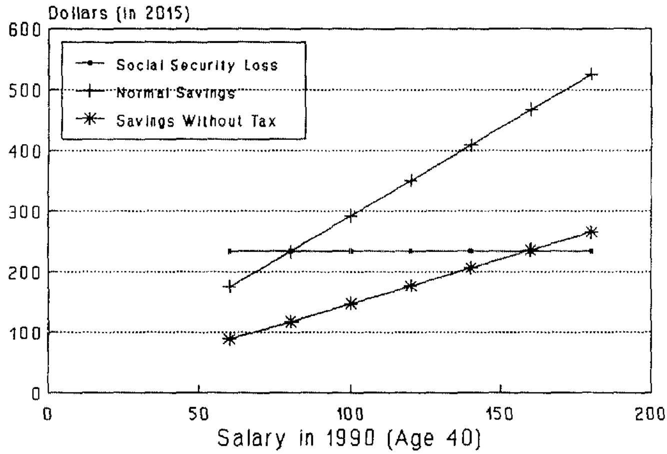
If you look back at the data presented earlier, the people who are likely to be Social Security losers are likely to be the pension winners. Once you get above the $25,000-$30,000 range, you have 65% participation rates in the pension system. Once you get to $40,000 in the ERISA work force, you have about 80% coverage. It is also important to keep in mind that 80% coverage at one point in time may, in fact, convert into much higher pension recipiency rates across a worker's lifetime. Just because someone is not covered does not mean that a year from now or five years from now he or she is not going to be working for an employer and accruing coverage. You have to look at it across a person's life span.

Another element of this analytical perspective is that the big pension winners may be very substantial Social Security losers. To make this point I looked at a variety of hypothetical individuals to compare the extent to which their pension-related tax expenditures might offset the present value of their Social Security losses at retirement (i.e., the present value of contributions minus the present value of their expected benefits). In one of the cases, I simulated the situation of a male worker, 40 years old in 1990, and who retires in 2015 at the age of 65. The results of the analysis would be only slightly different if a female worker was used because their life expectancy would be different, affecting their gain or loss situation under Social Security.

The results of this simulation are shown in Chart 2. The dollar denominations are in thousands and they are in 2015 dollars. The flat line shows the Social Security loss that such a worker would incur if he is at the Social Security maximum taxable earnings level and if he continues to have pay increases that keep him above the maximum. I assumed his pay would increase .5% more per year than the estimated Social Security wage base.

In addition to estimating Social Security losses, I also estimated the magnitude of the tax preferences that this worker would accrue from a hypothetical pension plan. For this analysis we picked a relatively generous plan and we assumed that the hypothetical individual would cash himself out at the point he reached retirement. The upper sloped line in Chart 2 shows the estimated tax benefits accruing to this worker if you use this normal savings model as the counter factual against which you compute your tax expenditure accumulation over this person's lifetime.

CHART 2
Social Security Losses and Pension Tax Incentives
for a 40-Year-Old Man in 1990 Retiring in 2015



Dollar Amounts in Thousands

Source: Reprinted with permission from Schieber, Sylvester J., *Benefits Bargain: Why We Should Not Tax Employee Benefits* (Washington, D.C.: Association of Private Pension and Welfare Plans, 1990), p. 45.

The lower sloped line shows the tax benefit accumulation if you do not tax the increase in the pension fund that is related to inflation growth. So, in the latter case, you are only taxing the real return, the positive return above the inflation rate as the counter factual against which you measure the tax incentives for the pension. Given the assumptions used in this simulation, a man earning about $75,000 in 1990 and who is age 40, under what I think is the unfair way of measuring tax expenditures, would roughly break even at retirement between his pension tax incentive and his Social Security loss. If you take what I think is the more reasonable assumption or method of measuring the tax expenditure, it is only a man earning about $160,000-170,000, and whose salary is expected to grow more rapidly throughout the remainder of his career than average wages, who would actually offset his Social Security losses. And such an individual would be butting up against the section 415 limits on pension contributions by the time he reached retirement. So a highly paid individual under the scenarios that I have laid out may only break even under the combined pension incentive offered under the federal income tax and Social Security systems.

This analysis needs to be taken farther than I have taken it thus far to simulate representative career patterns under actual pension plans. But it seems to me that this is the kind of analysis we need to begin to do when we are evaluating tax policy as it affects retirement programs in the United States.

In conclusion, government statistics suggest that $5 in pension benefits are being paid for each dollar of tax incentive provided to the plans. This does not imply that each dollar of tax incentive is leading to $5 of benefits. If you eliminated all the tax incentives, some of these programs would continue to exist but the incentives have helped to encourage plan creation. And the plans are very effective at delivering benefits, with more going to middle-class workers than to those in the higher classes. My analysis suggests that the preferences accorded pensions might not be offsetting the Social Security losses, especially for highly paid workers, and it seems to me that they are effectively applied to policy goals that are fundamental to government.

Social Security is part of the government's commitment that the people in this nation need to have adequate retirement income. Every bit of literature that is attached to the Social Security program, from its earliest founding up until the present day, suggests we need to have effective vehicles outside of Social Security especially for middle- and higher-income people. Further proof is that the government itself as an employer has had some of the earliest, and now has some of the most generous, pension programs that exist in this nation. And, if it is important to the government as an employer to have these programs, then it is not far fetched that it is equally important that other employers within our society also have them.

The final point is that the pension tax incentives are so broadly distributed that if we start to eliminate them we might as well concede what we are doing -- we are raising taxes. If we eliminate the tax incentives aimed at pension plans as a way to avoid raising taxes, it is a sham. There is no way that we can get around the facts. If you implement a new policy to collect additional taxes from 60-70% of an extremely broad class of people in this society, it has to be characterized as a tax increase.

The longer-term concern is that such a tax increase will cause us to reduce the funding of these programs from current levels. In fact, I already believe we need to be funding them on a more accelerated basis than we have been. If we cut back on funding from current levels, I believe it will lead to longer-term government expenditures than we now expect to make. The extra expenditures will be required just at the point in time when we can at least afford them -- when the baby boom starts to retire under Social Security.

MR. COLIN E. SOUTHCOTE-WANT: Is Congress going to do away with these large Omnibus Budget Reconciliation Acts (OBRA) in the future?

MR. SCHIEBER: For all practical purposes the budget accord last year replaced the old Gramm-Rudman targets with a new set of negotiated targets. Each year we still have to go through a budgeting process and end up with a budget bill at the end of the year that meets the targets. If you look at the budget negotiation process, the agreement that was forged last year was a five-year package. The deficit reductions included in the package are extremely back loaded. Almost none of the savings that are projected to occur over the five-year period accrue in the first two years. It just happens that this is the first year. Next year, an election year, is the second year. We are still going to go through a budgeting process each year to get program budgets in line with the negotiated totals. It is still going to be extremely difficult. Somebody else may disagree with me.

MR. SCHREITMUELLER: Last summer President Bush said he would not sign a budget bill if they just dumped one on him the size of telephone book. Although they sort of did that, I think it was somewhat less and was done sooner than it would have been otherwise. So there's some control at the White House.

MR. MICHAEL E. SWIECICKI: I'm with California Public Employees' Retirement System. In part, you said that it's better to change the regulatory structure than to try to get a big retirement policy in place. First, what would be the alternative to the Internal Revenue Service taking care of pension regulation? Second, quite often a single policy grows beyond what policymakers had expected. They may not think the single policy out that far, but quite often other people do. Some may put out "seed programs" that they know will expand. Is it possible to combine these thoughts in working toward a national retirement program? Suppose we're not really telling everybody the final implications of the initial single-policy program.

MR. SCHREITMUELLER: Let me try to answer the first part. My article in *Contingencies* magazine a year ago suggested moving the IRS pension regulation into a new agency under the Treasury Department. That seemed to be a reasonable compromise between what was needed and what was doable. The reason is it would not require any real change in Congress or the executive branch and it would be a small step in the right direction.

MR. SCHIEBER: When I was growing up I remember listening to press accounts of power struggles within the Russian government. There was always an aura that bad guys in bad governments have "power struggles." Since I grew up, I have lived in Washington for about 20 years and we have "power struggles" going on within our government similar to the ones the Russians have had over the years. There are power struggles within the congressional committees on Capitol Hill and there are power struggles within the administrative agencies that are down at the bottom of the Hill. And there are power struggles between Hill staffs and administrative staffs.

If you look at the Congressional Budget Act, it has put the tax committees and the tax agencies right in the middle of the retirement policy issue. If you look at the evolution of ERISA, ERISA was a do gooder attempt at social policy. The labor committees worked with the business community; they worked with labor; they worked with individuals. That whole dynamic that operated in the evolution of ERISA has changed. I believe the only way we will ever get to a National Retirement Policy is for the tax-writing committees and the tax agencies to lose their stranglehold on the policy process. I do not see that happening very frankly. And I am not even sure that a National Retirement Policy is a good idea.

MR. SCHREITMUELLER: The other suggestion was to plant a seed somewhere. I'm reminded of a talk I once heard about the Rayburn House Office Building, quite a marble edifice. The original legislation called for $10,000 and such other sums as may be needed from time to time to complete this building. Maybe that's the sort of open-ended measure we need, just to get our foot in the door. But it's like putting a bell on the cat. I'm really not sure how you do it.

MR. SCHIEBER: One way you would do it is raise the tax rates to the point that we no longer had a deficit problem. That would really take a lot of the spotlight off of needing to go after pensions and health benefits every year or two.

MR. SCHREITMUELLER: I agree with that completely. It seems to me that many of the same people who are most unhappy with the current situation are the same ones who wanted to cut back taxes in 1981 and would oppose any increase in them now.

MR. DONALD S. GRUBBS, JR: We have people with pensions and people without them. We can argue about what the percentages are, but as we look at that problem (and that achievement as well), the question is, how should we deal with it? The percentage of people with pensions has fallen for reasons that you talked about. The complexity of pension regulation is one reason. We need to fight that complexity issue by issue, but I'm not confident that we're going to be able to make much progress. Possibly there will be some simplification this year. If we can get simplification half as fast as the complexity is coming down upon us, I'll think we're doing well.

The other danger that could make the situation far worse is one that Syl mentioned. If we were to tax plan assets, that would be a further disincentive to private plans. We certainly need to guard against that happening. But even if everything goes as well as it might, I don't think anyone expects that private pension coverage is going to expand greatly. One thing that the President's Commission on Pension Policy showed is that we really have a two-tier world out there. People who have both Social Security and a private pension plan are doing relatively well upon retirement. Those who do not have private pension plan coverage are not doing well at all.

People do need retirement income. Everybody needs it. The answer is not to cut back on what the private sector can provide, but to find a way to cover people through the private sector. The only way that is ever going to happen is the way the President's Commission proposed: Require everybody to have private pensions. I don't know anyone who has suggested an alternative that's going to get everyone covered.

We need to look at tax expenditures versus social benefits. One issue of that sort is being addressed this year, that is, the tax on distributions. I have been an advocate of taxing every dollar that people receive the same, doing away with the tax on lump-sum distributions, and dropping the two grandfather clauses that take care of old codgers like me – the 10-year averaging and the capital-gains treatment. You might say we have a tax expenditure, but encouraging people to take lump sums instead of pensions is certainly not a social benefit. I hope this simplification has support.

MR. SCHREITMUELLER: That's a perfect example of the tension between pension policy and tax policy. The folks on the labor side of the argument would say everything you just said. The people whose middle name is "Revenue" would say, "Yes, but . . . ."

PANEL DISCUSSION

MR. RICHARD S. RASKIN: I see very positive value in having multiple agencies involved in the regulation of pensions. I see very positive value in that. The legislative and regulatory process can't move along as quickly with multiple agencies, but I think there's something positive to that. Quick moves, first in one direction and then another, confuse people. The movement makes it difficult to administer tax policies effectively. I think the fact that we have both Labor and Treasury Departments in the policymaking area and within the Administration works to the benefit of slower movement, and that's probably better.

I also want to comment on the idea of mandating universal coverage. I think Syl showed that the people at the very bottom of the economic ladder probably get a very adequate income from Social Security compared with their wage before retirement. However, requiring universal coverage may push these same people out of jobs. That is, it may be difficult for the employer to provide that benefit. We see that same debate right now with respect to mandating health insurance. Employers are saying, "If you require me to provide health insurance, I may not be able to have as many employees as I have now because I still need to be competitive with other suppliers of the goods that I produce. Those goods can be produced in other countries that don't have employer-based coverage requirements."

MR. SCHIEBER: People need to understand how policy is made in Washington, D.C. An elected representative, armed with a vision of exactly how he wants to fix retirement or tax policy, comes to Washington and hires a staff. Some of the staff may be from his hometown, but often he hires people that are left behind or else he works with committee staffs. The staff members turn over year after year. They wander back and forth from the administrative agencies to the Hill committees.

The real muscle power that puts together legislative proposals is the career staff in 90% of the cases. The professional staff members still work out all of the details of the various visions assigned. In most cases they are the ones that give our elected representative the vision in the first place.

Now think about getting a group of people who have been doing our tax policy the last 10 years to work for the mega committee in cooperation with the staff at the mega administrative agency. They will start pulling out proposals that they have had their desks for the past 10 years. They have all the details already worked out. The proposals are beautiful in a legislative sense, detailed, everything done but the voting. Under this scenario, you have a much narrower group of people to deal with. You do run some risks, but that is the way policy is made in Washington.

MR. SCHREITMUELLER: Right. You've got checks and balances. I think that what Dick Raskin is suggesting is that having several agencies adds another dimension to the checks and balances.

On the mandatory universal pension system, as Syl mentioned, I was struck by the fact that coverage increased as pay increased. It seemed as though maybe that was Adam Smith's invisible hand showing that lower-paid folks' choice is to have the cash. It's true that some lower-paid people don't contribute to some very generous pension arrangements. I'm not sure that I subscribe to the idea that big brother knows best in that situation.

MR. SCHIEBER: If you have somebody currently earning $10,000 a year and there is a group who are dependent on that individual as a primary income source, to have them deferring income so they can consume it 20 years later may not make a lot of sense in a social policy context. If we need to give those people higher retirement benefits, we should tilt the Social Security benefit formula even more than it is now. That is, give them even higher benefits than currently provided by the system.

MR. JOHN W. ATTERIDG: I see two problems in trying to deal with the social policy side of the issue. First, you have "the law of unintended consequences." For example, Congress made social policy with the OBRA 1987 in that they wanted more of the surplus in terminating contributory defined benefit plans to go to the plan participants. A very reasonable social policy. The way they did that was to redefine how much of the benefit was employee-paid. That created the fiasco of OBRA 87's redefinition requiring accumulating the contributory accounts with 120% of the federal midterm rate and even projecting that forward. So you had nonvested participants who might have a $1,000 account, and the present value of their employee-paid benefit would be $3,000. Big fiasco, and totally unintended.

The other problem with trying to deal with social policy is that very often the goals and the impact of a policy can be very different and hard to discern. A simple example is the proposal to permit nonworking spouses to put a full $2,000 into an individual retirement account. But the people who will benefit are the higher-paid who can afford to have a nonworking spouse – especially those who can afford to put an additional $2,000 into an IRA. Those will tend to be, by and large, Republicans and not exactly supporting the National Organization of Women. So in trying to analyze these social policies, you can get some very strange results.

MR. SCHREITMUELLER: It certainly helps to know what's politically correct at any point in time.

MR. SCHIEBER: But if you have something that is totally convoluted you can get it reversed. It may be a pain the neck to do and you may have to get organized, but we did get Section 89 reversed. Go back and look at the early tax reform package that came out of the Reagan Administration on the tax treatment of employee benefits. They were going to tax all health benefits. They were going to eliminate 401(k) plans. I contend that employees, employers, people in this room can affect policy. Do not go home and think that you do not have a role. You have to get educated. You have to participate in the political and policy development process and it is hard work. Maybe you need to get this organization more actively involved.

MR. SAMUEL M. KIKLA: A couple of years ago, there were some proposals to enable people to opt out of Social Security and put that money into an IRA-type of an account. And proposals like the one in Great Britain, which has a social retirement system that employers can opt out of – they either pay a tax or can set up their own plan. Do either of you have any information on whether these types of proposals are current or still have any support?

MR. SCHIEBER: In the U.S. the people who were making those proposals were essentially the same people who gave us supply side economics. In 1981 they argued that if we cut tax rates, the federal government would raise additional federal revenue. We cut tax rates and revenues went down. The same people argue we can have young workers save in IRA-type accounts as a replacement for Social Security. But if the young workers quit contributing to Social Security, who will fund the benefits of older workers and current retirees? These proposals do not have credibility in much of the policy community at this time. They are deficit raisers.

MR. SCHREITMUELLER: I would agree with that. I follow that issue pretty closely. One basic flaw with the idea of giving people the option to opt out of Social Security is that when you do that, unless you've done a lot of juggling of the books, you end up paying twice, once for the current generation of retirees on Social Security and again to set aside money for the ones who aren't yet retired. It's a very difficult thing to sell to the public.

I do think it's a policy debate in which actuaries can make a difference. The best piece I've seen on the topic was by an actuary, Bruce Schobel, who had an Op-Ed article in *The Wall Street Journal* a year ago. You might give him a call if you want a copy.