SOCIAL SECURITY REFORM

Implications for Private Pensions
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Abbreviations

ERIC Erisa Industry Committee
ERISA Employee Retirement Income Security Act of 1974
IRA individual retirement account
OASDI Old-Age and Survivors Insurance and Disability Insurance
OBRA86 1986 Omnibus Budget Reconciliation Act
The Honorable Bill Archer  
Chairman  
Committee on Ways and Means  
House of Representatives  

Dear Mr. Chairman:

The projected insolvency of the Social Security\textsuperscript{1} Trust Funds raises concerns about our nation's ability to ensure adequate retirement income for current and future generations. While the accompanying debate focuses on the potential effects of needed reforms on both beneficiaries and workers, it should also be recognized that Social Security reforms could affect the income that workers receive from private pensions. For many workers, the income provided through private employer-sponsored pensions represents an important pillar of our nation's retirement income structure. The numerous proposals under consideration for improving the financial status of Social Security involve a mix of options, including reducing future benefits, raising the retirement age,\textsuperscript{2} raising revenues, and introducing vehicles for investing payroll taxes in marketable financial securities such as stocks and bonds. Such reforms, while directly affecting the retirement income provided through Social Security, will also alter the environment in which private pensions are sponsored and designed.

To better understand the implications of Social Security reform, you asked us to study the interactions between Social Security and private pensions. Specifically, we agreed to examine (1) the primary linkages between Social Security and private pensions and the way they interact to provide retirement income for workers and families, (2) the effects of traditional Social Security reforms on the structure of employer-sponsored pension

\textsuperscript{1}Social Security refers to the Old-Age and Survivors Insurance and Disability Insurance (OASDI) programs.

\textsuperscript{2}When Social Security was instituted, the age of eligibility for full benefits, or normal retirement age, was set at age 65. The Congress later enacted an early retirement age of 62 at which any worker could retire with actuarially reduced benefits. The normal retirement age is set to gradually rise to 67 by the year 2027 while the age for first eligibility for Social Security retirement benefits (early retirement age) remains at 62.
plans through changes in the costs and incentives faced by employers and workers, and (3) the effects of nontraditional reforms, such as individual accounts, on the structure of the private pension system.

Examining the relationship and interactions between Social Security and private pensions involves several areas of considerable complexity, and the conflicting nature of much empirical research complicates any assessment of the effects of Social Security reforms on private pensions. Our objective in this study is to provide an overview of the key potential implications that Social Security reform might have for private pensions. In conducting this assignment, we surveyed an array of literature relevant to the topic. We reviewed academic and policy studies of issues relevant to determining the responses of employers and workers to Social Security reform and changes in pension law and plan design. We supplemented this research with interviews of pension experts. Our work was conducted between January and August 2000 in accordance with generally accepted government auditing standards.

Results in Brief

Social Security and private pensions are key sources of retirement income that are linked through the employer costs associated with the compensation provided to workers. Because pension plans serve as a supplement to Social Security, many plans are integrated; that is, they explicitly incorporate Social Security benefits or contributions into their plan design. Employers also implicitly consider Social Security provisions in designing pensions that complement their human resource and other business strategies. For example, plan provisions may be linked to Social Security's normal retirement age or provisions for disability benefits. Because of these linkages, reforms in Social Security may affect worker and employer behavior, which in turn may have consequences for pension plan design, coverage, or benefit amounts.

Traditional reforms in the Social Security program, such as changing benefits or taxes or raising the normal retirement age, may alter the incentives of workers and employers, which could prompt adjustments in private pension plans. The effect of any specific reform will depend on the nature of the change (e.g., increase payroll taxes), its magnitude (e.g., cut benefits by 20 percent), its time horizon for implementation (e.g., increase payroll taxes in 2002), and its interaction with other provisions that comprise a comprehensive reform proposal. Employers' and workers' responses to reform will be shaped by a variety of factors, including the firm's size, the type of pension plan offered, and the economic status of the
worker. Employers will respond to reforms that affect compensation costs or the incentives for sponsoring a plan. For example, a reduction in Social Security benefits will raise compensation costs for employers with plans that directly offset the earned pension benefit with a portion of the worker’s Social Security benefit. In response, employers might redesign the plan feature, absorb the increased cost, or shift the cost to customers through price increases or to employees through employment or compensation reductions, among other possible changes. In reaction to increasing the normal retirement age for Social Security, employers could face added pension costs for subsidizing early retirement and may redesign their plans to raise the eligibility age for retirement benefits. Workers may also respond to Social Security reforms that increase their contributions or reduce expected benefits by adjusting their savings behavior—for example, by increasing participation in 401(k) plans or accumulating more savings through other vehicles. They might also choose to work more, retire later, or demand higher pension compensation.

The introduction of individual accounts raises a broad set of issues for private pensions, depending on how such a reform is structured, its scope (whether it is voluntary or universal), and its interaction with other reforms as part of a broader reform proposal. Like more traditional reforms, the effects of an individual account feature on the pension system will depend on the explicit and implicit linkages between Social Security and pensions and employers’ and workers’ responses to specific reforms. For example, the introduction of individual accounts could affect private pensions by changing the way employers integrate Social Security and pension benefits. Depending on the extent to which individual accounts affect employer costs, workers’ reactions to risk, and workers’ ability and propensity to save, private pension coverage and participation could increase or decrease. The design and implementation of individual accounts will affect employer costs and could present substantial challenges in coordinating pension plans with individual accounts within the current regulatory framework for pensions. At the same time, an individual account structure could provide an opportunity for many workers to expand their access to private securities markets and increase their ability and propensity to save for retirement. This might be possible if, for example, a voluntary individual account is linked to Social Security. Individual accounts could also expand the choice and flexibility available to workers in meeting their income needs during retirement.

Our retirement income institutions operate in a dynamic environment where workers, employers, and policymakers interact to pursue the goal of
retirement income security. The complexity of making policy change suggests that any reform should be taken with careful deliberation. At the same time, ensuring retirement income for those who most need it and encouraging the development of new opportunities to secure and expand the retirement income of future generations should be emphasized.

Background

Social Security is the largest source of retirement income for most American workers and their families. Since the program began paying benefits in 1940, Social Security has served as a publicly provided source of retirement income for workers. The program also provides benefits for dependents, survivors, and the disabled and covers about 96 percent of all workers. Social Security’s benefit structure is based on a formula that replaces specified percentages of lifetime average indexed earnings. The basic benefit formula is redistributive in that the percentage of lifetime earnings replaced (replacement rate) is higher for lower earners than it is for higher earners. Benefits for dependents and survivors are generally based on the earnings record of the worker from whom benefits are claimed. When Social Security was instituted, the age of eligibility for full benefits, or normal retirement age, was set at age 65. The Congress later enacted an early retirement age of 62 at which any worker could retire with actuarially reduced benefits. The normal retirement age is set to rise according to a phased-in schedule to age 67 by the year 2027.

Numerous Proposals Address Social Security’s Long-Term Solvency

Social Security is financed mainly through payroll taxes paid by workers and employers on covered earnings up to a maximum annual earnings level.3 The program is generally financed on a “pay-as-you-go” basis with the payroll taxes of current workers used to pay the benefits of current beneficiaries. Periodic surpluses of revenues over expenditures are credited to the Social Security Trust Funds, which represent future financial commitments by the government to the program. Current Trust Fund projections show that projected future revenues, including the amounts credited to the Trust Funds, will not be sufficient to finance full benefits in the year 2037 and thereafter.

3The maximum taxable earnings level in the year 2000 is $76,200.
The Congress has addressed Social Security's solvency in previous reform efforts, notably the 1977 and 1983 Amendments to the Social Security Act. These reforms focused on modifying the program's existing benefit and financing structures without introducing major changes in the program. The reforms tended to focus on traditional options such as increasing the payroll tax rate or covered earnings, altering the benefit formula, and increasing the age of retirement. For example, the 1977 Amendments made technical changes to the benefit formula, lowered benefits, and set higher future payroll tax rates. The 1983 Amendments made a number of changes, including advancing the payroll tax rate increases enacted in 1977, increasing the number of workers covered under Social Security, and enacting a gradual rise in the normal retirement age to 67, which began to be effective this year. Despite the importance of these earlier reforms, there is relatively little evidence regarding their effects that is directly applicable to understanding the implications of current reform efforts on private pensions. Part of the reason for the lack of evidence is that the effects of Social Security reforms on pensions are intertwined with broader economic trends and coincident changes in tax and regulatory policies.  

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4For example, major reforms of the income tax took place in 1981 and 1986. In addition, this and other legislation enacted in the 1980s substantially increased pension regulation.
The nature of the current reform debate changed when the 1994-1996 Social Security Advisory Council discussed a broader range of reforms. In addition to debating traditional reform options, the Advisory Council considered changing the basis for financing the program to include private investment. One option would involve government investment of Trust Fund assets in marketable financial securities. Another option would create an account for each worker, who could then invest in marketable securities. While both of these options might reduce the future cost of Social Security to employers and workers, the individual account option would have greater potential implications for Social Security's benefit structure. This report will focus on individual accounts rather than collective investment because of the implications for the benefit structure and because numerous proposals incorporating individual accounts with more traditional options have been put forth to address the program's long-term solvency.

Role of Private Pensions Has Evolved Over Time

Before the creation of Social Security, private pensions played a modest role in providing retirement income. However, from 1940 to 1970, the percentage of private wage and salary workers participating in private pension plans increased from 15 to 45 percent due to a variety of factors, including changes in tax and labor policies. This growth in pension participation has slowed, however, and has stabilized since 1970 at about one-half of the workforce. Historically, the pension system developed with defined benefit pension plans as the predominant form of coverage. Defined benefit plans generally provide benefits using a specific formula based on the earnings and tenure of the worker. Typically, defined benefit plans are funded completely by the employer, who bears the investment risk of such an arrangement. The other major type of pension plan is the


7There are different surveys of pension plan participants and different ways to measure pension coverage. Using Current Population Survey data, about 47 percent of the employed labor force is currently covered by a pension plan. Pension Plans: Characteristics of Persons in the Labor Force Without Pension Coverage (GAO/HEHS-00-131, Aug. 30, 2000).
defined contribution plan, which generally involves contributions by the employer to an individual account held for the worker, with the worker bearing the investment risk. Some defined contribution plans are structured to allow contributions by the employee. Often, defined contribution plans are provided by employers as a supplement to defined benefit plans.

The current framework of the private pension system was shaped largely by the Employee Retirement Income Security Act (ERISA) of 1974. ERISA imposed specific requirements for vesting—that is, the years of service after which participants are entitled to benefits—and set other minimum requirements to protect pension promises and workers' benefits. It established guidelines for the operation and funding of pension plans. ERISA also required plan termination insurance to protect workers' benefits under private sector defined benefit pension plans. In part to encourage plan sponsorship, pension plans have long been accorded favorable income tax treatment under the tax code. Employer contributions to pension funds, up to certain limits, are deductible expenses, and employee contributions and the contributions' investment earnings are deferred from taxation. The 1980s saw the institution of certain employee deferral defined contribution arrangements under section 401(k) of the Tax Code, which generally allow tax-deferred worker contributions in addition to employer contributions. The growth of 401(k) plans has been cited by experts as a major factor underlying the recent trend toward the greater availability of defined contribution plans, in addition to other factors, such as the increased costs of defined benefit plans partly associated with increased regulation and changes in income tax laws, which reduced the tax advantages of pensions.

Social Security and Pensions Are Key Sources of Retirement Income

Social Security provides about 38 percent of the aggregate cash income of the elderly (see fig. 1). Private pensions are a voluntary, employer-provided source of retirement income that comprises about 10 percent of aggregate elderly income. Also, some pensions are provided by public employers.

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8The Revenue Act of 1978 added Section 401(k) to the Tax Code. However, the regulations implementing this section were not proposed until 1981 and final regulations were approved in 1988.

9This category may include individual annuities and may not include the liquidation of savings (and interest) that originate as pension lump sums.
such as federal, state, and local governments. These comprise about 8 percent of aggregate elderly income.

![Figure 1: Percentage Share of Aggregate Cash Income by Retirement Income Source, Married Couples and Unmarried Individuals, Age 65 and Older, 1998](image)

Pensions generally supplement Social Security benefits. For all but the lowest and highest income quintiles, pensions are the second most important source of retirement income (see fig. 2). In contrast, the benefits provided by Social Security are most important to workers and households in the middle ranges of the income distribution. Social Security comprises over 80 percent of the retirement income for households in the first (lowest) and second quintiles of the distribution. For the third (middle) and fourth quintiles, Social Security still serves as the most important source of retirement income. For the highest quintile, pensions are a more significant source of retirement income than is Social Security (20.5 percent compared with 18.3 percent), but pensions represent a smaller share for this group than either personal savings or earnings. One factor underlying these data is that pensions are not a universal source of retirement income as is Social Security. As of 1999, about half of the working population was covered by a pension. Although a larger number of workers may obtain some pension coverage over an entire career,\textsuperscript{10} it is unlikely that pension coverage will ever match the nearly universal coverage provided by Social Security.

\textsuperscript{10}One effort to project future pension recipiency estimated that by 2018 about three-fourths of households would receive some income from pensions. Employee Benefit Research Institute, \textit{EBRI Databook on Employee Benefits}, 3rd ed. (Washington, D.C., EBRI, 1995).
Figure 2: Retirement Income by Source and Income Quintile, Households Age 65 and Older, 1998

Elderly Household Income (Dollars)

Note: The data presented here show pension income provided by both public and private employer-sponsored pensions. These two sources display largely the same pattern across income quintiles. Source: GAO computations based on data in Income of the Population, 55 or Older, 1998, Social Security Administration, Washington, D.C., Table VII.5, p. 123.

Social Security and private pensions are key sources of retirement income that are linked through the employer costs associated with the compensation provided to workers. Employers consider Social Security provisions in designing pensions that complement their human resource and other business strategies. Some of the interactions between Social Security and pensions are explicit, insofar as pension laws and regulations...
permit employers to formally “integrate” or take account of Social Security benefits and contributions in designing their pension plans. In addition, many pension plans may be indirectly or implicitly linked with other Social Security features, such as the normal retirement age or eligibility criteria for disability benefits.

### Pensions Are Designed to Address Employer Needs and Foster Adequate Income Replacement for Workers

Many employers choose to offer a pension plan to further their business strategies or objectives. Although employers are motivated to offer a pension plan for many reasons, the most important involve (1) the employer’s need to attract and retain a workforce in a competitive labor market and (2) the tax advantages, or preferences, associated with pensions. The employer’s pension plan decision also will be shaped by the nature and characteristics of the workforce available to the employer and the employer’s size and type of industry. These factors will enter into the decision about the type of plan the employer will choose to sponsor and the benefits it provides to individuals at different income levels.

Employers typically want to attract workers based on their productivity, motivate them to perform efficiently in pursuit of the firm’s goals, and retain them to reduce the costs associated with turnover. Pensions provide a tool for accomplishing these objectives. For example, pensions are a means of providing deferred compensation that may encourage workers to make long-term commitments to employers. This may have the benefit of reducing turnover, making for a more stable, productive workforce. At the same time, employers also want to manage the retirement of their workforce, and pensions are a means of offering incentives for workers to retire immediately or sooner or later than they would otherwise.

Employers also choose to sponsor pension plans because of the favorable federal tax treatment of pension contributions and asset returns. This

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12A related rationale is that pensions provide a higher level of compensation that encourages workers to exert greater effort on the job. It may be difficult to monitor employee performance (i.e., detect low effort) in certain occupations. The higher total compensation offered through a pension imposes a potentially significant loss or penalty on the worker in the event that low effort by the worker is detected. Thus, pensions help overcome monitoring problems and ensure employee effort. This may be particularly important for professional and managerial occupations.
favorable tax treatment lowers the cost of a dollar of pension compensation to workers relative to an additional dollar of cash earnings. Business owners and more highly paid employees find this tax treatment attractive. Also, the tax advantages of pensions have traditionally played a role in the financial management of the corporation, allowing firms some flexibility in minimizing their tax liability and funding plans less expensively. For example, a firm may contribute, subject to certain conditions and limitations, more to the plan during profitable years, thus lowering its tax liability, and less during times when profitability is poor.

In addition to motivations involving the labor market or tax preferences, workforce characteristics and other business-related factors enter into an employer’s decision to sponsor a plan and the form that plan takes. For example, the workforce characteristics of a small employer may differ from those of a large employer. Small employers may tend to employ workers for whom nonwage compensation is less important than wages. Such workers may be younger, less experienced, lower paid, and exhibit higher turnover and less attachment to full-time work than do workers in larger firms. An employer’s industry and occupational structure are also a consideration. Firms that use highly skilled labor may be more motivated to sponsor pensions than those using less skilled labor.

After deciding to sponsor a plan, employers must determine the design of the plan and the benefits to be provided for workers. One of the most basic decisions is whether the plan is based on a defined benefit or a defined contribution, a decision that determines whether the employer or the worker bears the investment risk associated with funding the plan. Employers, in designing plans and setting benefit levels, will also consider a variety of factors, including the total retirement income that is considered adequate. One common measure of retirement income adequacy is the replacement rate, which represents the benefit amount in retirement for a single worker or household in relation to a measure of pre-retirement earnings, such as earnings in the year before retirement. Currently, many benefit professionals consider a 70 to 80 percent replacement rate as adequate to preserve the pre-retirement living standard. Social Security and pensions play complementary roles in helping workers attain an adequate retirement income. Because the Social Security benefit level provides a proportionately higher benefit for earners at lower levels of the

distribution, some employers may balance this feature by designing plans to provide proportionately higher benefits to middle and higher income workers.

### Social Security and Pensions Are Explicitly Linked Through Integration Provisions

Social Security reform could affect the employer's pension plan decisions in cases where Social Security is explicitly linked to the pension plan's provisions. One way that Social Security and pensions are explicitly related is through the “integration” or the consideration of Social Security benefits or contributions in calculating a private pension benefit. The concept of integration relates to the employers' responsibility to provide Social Security contributions on behalf of workers and receive credit for these contributions in relation to their contributions or the benefits provided under their pension plans. In defined benefit plans, integration pertains to the benefits paid to participants; in defined contribution plans, it relates to the contributions made on behalf of workers by employers. Defined benefit plans commonly involve two methods of integration:

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14The standard that pension professionals consider an adequate replacement rate has changed over the years. While a 50 percent replacement rate might have been considered adequate in the 1930s, when Social Security was instituted, this standard has risen. See Sylvester J. Schieber, “The Employee Retirement Income Security Act: Motivations, Provisions, and Implications for Retirement Income Security,” paper presented at “ERISA After 25 Years: A Framework for Evaluating Pension Reform,” Washington, D.C., Sept. 17, 1999, pp. 8-9. Also note that the replacement rate considered to be adequate can be computed in a more sophisticated way, netting out Social Security taxes, other taxes, or working expenses that will not be paid in retirement. Thus, desired or target replacement rates can vary significantly by income level and other factors. See Bruce A. Palmer, “Retirement Income Replacement Ratios: An Update,” Benefits Quarterly, 2nd Quarter, 1994.

15Social Security currently provides a replacement rate of 53 percent for a low earner, 39 percent for an average earner, and 24 percent for a maximum earner. These figures are based on applying Social Security benefit rules to hypothetical retired workers who had various specified (steady) earning levels over their careers and attained age 65 in 2000. The average earner represents a worker who earned the average of covered workers under Social Security each year. The low earner earns 45 percent of this average. The maximum earner has annual earnings equal to the OASDI contribution and benefit base each year.

16Pension plan design is influenced by an array of other factors, such as pension regulation, which may counteract design features that benefit higher earners. For example, available data suggest that typical pension replacement rates for a 30-year career worker have been in the 20- to 40-percent range across the earnings distribution and that lower earners received slightly higher replacement rates than higher earners. Olivia S. Mitchell, “New Trends in Pension Benefit and Retirement Provisions,” Working Paper No. 7381 (Cambridge, Mass.: National Bureau of Economic Research, Oct. 1999).
• In the offset method, the employer designs the plan to provide a given benefit based on the employee's total compensation. A percentage of any Social Security benefit received is then deducted from the calculated pension benefit.

• In the excess or step-rate method, one layer of benefits is generally based on the employee's total compensation, and a second layer is based on compensation in excess of a specified dollar level termed the "integration level." This method is analogous to the way defined contribution plans are integrated with Social Security on the basis of contributions.17

Explicit integration provisions remain a common feature of many pension plans even though their form has changed over time. The Congress substantially revised integration provisions in the Tax Reform Act of 1986, and there was a subsequent decline in the prevalence of integrated plans and a strong shift toward the use of the excess method. From 1986 to 1997, the percentage of all defined benefit plan participants in medium to large firms with an integrated plan declined from 62 to 49 percent. Moreover, the percentage of participants in defined benefit plans using the offset method declined from about 43 to 13 percent of all participants, while the percentage of participants in plans using the excess method increased from 24 to 36 percent (see fig. 3).18

17For example, in a defined contribution plan, a "base contribution percentage" is applied to compensation below the integration level. For compensation above the integration level, a higher or "excess contribution percentage" is applied. The difference between these two contribution percentages is commonly referred to as the "permitted disparity." This difference is limited to either 5.7 percentage points or the base contribution percentage. In other words, it cannot exceed 5.7 percent (see McGill, Fundamentals of Private Pensions, Ch. 15). To have a plan design that relies on permitted disparity under Sec. 401(l) of the Tax Code, a plan must satisfy certain criteria called "safe harbors" under nondiscrimination rules, which seek to promote equity in the provision of pension benefits. In addition, the "integration level" to which permitted disparity applies is often the maximum taxable ceiling on covered earning under Social Security. The integration level may be lower than this ceiling but may not exceed it, and different permitted disparity rules apply. Pension benefits and contributions can be integrated with Social Security outside the permitted disparity rules as long as the plan meets the general nondiscrimination provisions of the Tax Code.

Pensions Are Implicitly Linked in Various Ways With Social Security

Because Social Security has a central role in providing retirement income, almost all pension plans are implicitly linked to Social Security, insofar as their design takes into account the provisions of and benefits provided by Social Security. Because pension designs have evolved over time, they have incorporated specific features related to Social Security. Examples of such implicit linkage involve the specification of the age of benefit eligibility (retirement age) and benefit provisions for survivors and the disabled.
An important implicit linkage with Social Security is pension plans’ specification of a normal retirement age. The retirement ages provided by Social Security form a basic framework around which plans design their provisions. Private defined benefit pensions generally include age and service provisions that determine when an employee becomes eligible for benefits. While some plans have age-only or service-only retirement requirements, most plans base retirement benefit eligibility on a combination of age and service. These age and service provisions allow employers to structure plans in ways that allow eligible workers to retire earlier than the ages set by Social Security. However, most plans allow workers who meet minimum service (vesting) requirements to claim pension benefits by age 62 or age 65. Another example of an implicit linkage with Social Security occurs when plans provide “bridge benefits,” which provide workers who retire from a private pension a supplement until the worker is eligible for a Social Security benefit at age 62.

Social Security and pensions are also implicitly linked through provisions concerning survivor and disability benefits. Employer-sponsored pension plans offer benefits for surviving spouses of retired workers, referred to as joint and survivor benefits. Some pension plans also provide disability benefits. Joint and survivor benefits are provided in addition to the survivor benefits received under Social Security. Private disability benefits often supplement Social Security disability benefits. In 1995, more than 60 percent of full-time employees were covered under long-term disability plans. Although not required by law, many plans calculate the private disability benefit by offsetting the amount received from Social Security disability benefits in a manner somewhat analogous to the integration of pension benefits with Social Security old age benefits.

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Traditional Social Security Reforms Could Affect Pension Plans by Changing the Incentives Facing Employers and Workers

Traditional reform options, such as reducing benefits or increasing payroll taxes, will likely affect the provision of employer-sponsored pensions. The effects on pensions will depend on the nature (e.g., benefit cut or payroll tax increase), magnitude (e.g., cut benefits 10 percent or raise payroll taxes 5 percent), and timing (e.g., raise taxes or the retirement age immediately or in 2015) of the reforms. Effects will also depend on whether Social Security and pensions are explicitly linked, such as through integration provisions, or implicitly linked. For any of the reforms under consideration, the ultimate effects on pensions will depend on employers’ and workers’ responses. Employers will likely respond to reforms that change their compensation costs or reasons for sponsoring plans. For example, Social Security reforms that reduce benefits could raise plan costs for employers with “offset” integration features, or employers could redesign their plans to eliminate that feature, absorb the costs, or take other actions. Workers will likely respond to reforms that change their Social Security contributions, their expected benefits, or their incentives to save, work, or retire. The interactions between workers and employers in response to Social Security reform will determine the form that pensions take and may affect other sources of retirement income.

Traditional Social Security Reforms Will Affect Integrated Pension Plans

Social Security reform proposals that incorporate traditional options such as reducing benefits or increasing payroll taxes will directly affect private pension plans that are integrated with Social Security. Benefit reductions could raise compensation costs for employers with plans integrated by using the offset method. Payroll tax increases implemented by changing the maximum taxable earnings level could affect the incentives present in plans using the excess method of integration. Such changes could cause employers to consider redesigning their plans to eliminate integration features, but they might also consider supplementing benefits to employees at higher earning levels through nontax-qualified plans.

Reform proposals that reduce benefits will most likely increase employer costs for plans using the offset integration method. Defined benefit plans that use the offset integration method generally reduce the accrued pension benefit by a portion of the benefit earned from Social Security. Thus, reform proposals that reduce benefits will automatically reduce the offset amount. As a result, the portion of the total pension benefit that will be provided by the pension will increase, thus increasing employer plan costs. A reduction in Social Security benefits only raises the required pension portion by the amount of the partial offset. For offset plan
participants, a Social Security benefit reduction may still result in a reduction in the overall retirement income amount because the Social Security benefit reduction is only partially offset by an increase in the amount coming from the pension.

Employers may respond to these changes in a variety of ways. For example, their responses could vary from modifying the offset provision to absorbing the cost, presumably in reduced profitability, or by shifting the cost through increased product prices or reduced employment. Alternatively, the employer could alter other forms of compensation, such as wage rates or health benefits, in addition to, or in lieu of, changing the pension plan. One factor that would mitigate the overall effect of higher employer costs in offset plans is that the prevalence of this method of integration in defined benefit plans has declined substantially since the Tax Reform Act of 1986 (see fig. 3). However, increasing the costs of using this method could reduce its prevalence even further.

Social Security reform proposals that increase revenues by increasing the taxable wage base could affect pension plans that are integrated with Social Security using the excess method. This could reduce plan costs but could also erode the effectiveness of the provision. This is because the excess method permits pension plans to have a higher contribution or accrual rate for employees above the “integration level,” which in most such plans is the maximum taxable ceiling on earnings covered by Social Security.22 As a result, if the level of maximum taxable earnings is raised, employers might adjust upwards the integration level of plans, thus reducing the number of covered workers eligible for higher contributions or accruals. This could reduce employer costs but could make the plan a less attractive incentive device both for the higher-earning employee and the employer interested in providing higher compensation for certain employees.23 Plans might be restructured with implications for benefit amounts, and some employers might reevaluate their motivations for plan sponsorship. One possible scenario is that employers might redesign their

22In general, the integration level may be less than, but may not exceed, the maximum taxable earnings level. Bureau of Labor Statistics data show that for employees of medium and large establishments in defined benefit plans using the excess method of integration, over 90 percent are in plans that have a Social Security breakpoint as the integration level.

23Even nonintegrated plans may use the maximum taxable earnings level as a basis for the use of permitted disparity in complying with the nondiscrimination rules of the tax code. Changing the maximum taxable earnings level might thus alter the balance between groups of workers that are highly compensated and those that are not.
plans to provide more equal accruals across the earnings distribution and then supplement the benefits of their highly paid employees through the use of nontax-qualified plans, which is a current trend in the pension field.\textsuperscript{24} Such a development could result in lower benefits for lower and middle earners and could make higher earners and employers less interested in maintaining qualified pension plans.

**Traditional Social Security Reforms Will Also Affect Pensions Through Other Implicit Linkages**

Traditional Social Security reforms will also have implications for private pensions through implicit linkages between Social Security and pensions. Two implicit linkages involve increases in Social Security ages for normal and early retirement and increases in payroll tax rates. Proposals to raise Social Security's retirement ages and payroll tax rates could increase employer costs, with employers possibly responding by reevaluating their plan designs. Although little evidence on the effects of changes in the retirement age is available, increases in the retirement age would likely lead employers to review existing early retirement incentives in light of current labor market conditions and their long-term human resource objectives.

Many employers have used defined benefit pensions as a tool for workforce management, especially in reducing turnover or encouraging early retirement. The ability to offer early retirement incentives through a pension allows employers to choose when to induce turnover if the firm views this goal as beneficial. Employers can then hire newer workers at lower compensation levels, or they can motivate midcareer employees with greater opportunities for advancement. Data suggest that plans with age-only retirement provisions tend to peg these provisions more closely to the Social Security age for normal retirement (65) and around 55 for early retirement.\textsuperscript{25} However, more typically, plans have age and service requirements; over time these have tended toward age 62 as the normal


retirement age, with provisions allowing earlier retirement, such as at age 55.

If Social Security retirement ages are raised, it is unclear whether or how employers might adjust retirement ages in private pensions. For example, while the 1983 Amendments enacted an increase in the retirement age that has begun to be phased in, little is known about how this has affected the retirement ages used in pensions. Employers will likely continue to determine pension retirement ages according to their workforce management objectives. One factor that may induce employers to adjust the retirement ages of pensions is when plans offer some form of “bridge benefit,” which provides a pension benefit supplement to early retirees until they become eligible for Social Security retirement at early or normal ages. In such cases, higher Social Security retirement ages with no compensating adjustment in the plan’s retirement age could result in substantially higher pension costs to the employer. This could create an incentive to change the plan’s provisions for retirement age toward any higher Social Security retirement ages or to make other plan changes.

Raising Social Security retirement ages could potentially create a larger gap between Social Security and private pension retirement age provisions and cause employers to rethink their retirement incentives in the context of current labor market trends. Some evidence indicates that employers might respond by seeking to retain the effectiveness of their retirement incentives.26 Although some employers will want to continue to use pensions as a tool to reduce or adjust the composition of their workforces, recent evidence indicates that some employers may now want to retain

26One study of pension plans covering 1960 through 1980 reported evidence of an association between retirement incentives in private pensions and retirement incentives embedded in the Social Security benefit structure. The researchers noted that this evidence is consistent with the hypothesis that employers offset Social Security incentives to retire early by increasing pension incentives to delay retirement. In spite of the strong relationship reported, the authors found no statistically significant relationship between Social Security and changes in pension rewards for deferring retirement between ages 62 and 65. They found that Social Security incentives for retiring at or after age 65 were typically reinforced by similar incentives in private pension plans. See Rebecca A. Luzadis and Olivia S. Mitchell, “Explaining Pension Dynamics,” The Journal of Human Resources, Vol. 26, No. 4 (1991), pp. 679-703.
older workers. For example, some firms have been developing pension structures in which workers accumulate benefits more evenly over their careers, in contrast to the “back-loading” typical of traditional defined benefit plans. The introduction of “hybrid” arrangements such as “cash balance plans” could have the effect of reducing early retirement subsidies found in traditional defined benefit plans and could make it more attractive for firms to retain older workers in the future. Thus, to the extent that employers are implementing pension plan provisions that encourage workers to retire later, the potential effects of raising the Social Security retirement age on private pensions may be mitigated.

In contrast, defined contribution plans do not have the same incentive properties for early retirement found in many defined benefit plans. Defined contribution plans generally allow workers to withdraw their accumulations or benefits as a lump-sum, without penalty, beginning at age 59½. Thus, changing Social Security retirement ages may have implications

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27Mitchell notes an example of a pension requirement that may have discouraged firms from hiring older workers. Before the 1986 Omnibus Reconciliation Act (OBRA86), plans could impose participation limits on (older) workers who joined the firm within 5 years of the plan's normal retirement age. Such provisions limited the pension accruals for these workers and made it less expensive for the firm to hire them. OBRA86 eliminated maximum age restrictions on workers, thus making it more expensive for firms to hire older workers. See Mitchell, “New Trends in Pension Benefit and Retirement Provisions,” p. 10.


29Hybrid pension plans combine features of defined benefit and defined contribution plans. For example, cash balance plans have a benefit structure that looks similar to a defined contribution plan in that benefits are expressed as a lump-sum individual account balance. However, cash balance plans (which legally remain defined benefit plans) operate like defined benefit plans in that the employer bears the investment risk to meet a given return on the account.


31Defined contribution arrangements typically have a more even distribution of accruals over time than typical defined benefit plans. One expert suggests that the attractiveness of defined benefit plans as a workforce management tool may have declined relative to defined contribution arrangements. Richard A. Ippolito, “The New Pension Economics: Defined Contribution Plans and Sorting,” The Future of Private Retirement Plans (Washington, D.C.: EBRI, 2000).
for the age at which individual workers choose to take their benefits. It is likely that some workers would delay retirement as they try to meet retirement income goals.

Raising payroll taxes could lead employers to reduce plan benefits or even terminate some plans, which could reduce worker pension coverage. Higher payroll taxes would directly raise the compensation costs of employers in the short term and would likely trigger a series of economic adjustments to wages, prices, or employment. Pensions or other elements of compensation, such as health benefits or wages, could be reduced, leaving workers’ overall compensation and the firm’s profitability unchanged. Employer responses such as reducing plan benefits or terminating a plan could depend in part on the size of the firm. Because smaller employers are generally more sensitive to changes in their compensation costs, payroll tax increases could make them more likely to terminate their plans, compared with larger firms. If this is the case, then overall pension coverage might show a modest decrease, and the existing disparity in coverage and compensation between large and small firms might be exacerbated. In general, even though payroll taxes have been increased in the past, it is difficult to disentangle the effects of payroll taxes on employers and pensions from other influences.

Workers May Respond to Traditional Social Security Reforms That Affect Contributions or Future Benefits

A key element in evaluating the effect of traditional Social Security reforms on pensions involves workers’ responses to such reforms. While employers play a primary role concerning the decision to sponsor and design a pension plan, worker demands can play a substantive role in influencing these decisions. In addition, workers make individual decisions that have implications for their future retirement income. These include decisions about consumption and saving, how much to work, and when to retire. Social Security reform could affect the private pension system through its effect on workers’ saving and consumption decisions. Most traditional reforms involve workers paying more for promised future benefits or accepting lower benefits. Workers could experience either a reduction in their current income available for consumption—if payroll taxes are

32It has long been argued that employers do not bear any direct burden of the payroll tax because it is “passed on” to workers through these economic adjustments. Even if this conclusion is accepted, pensions might be affected because they constitute a way in which the economic adjustments could be implemented. There has been examination of the effects of changes in the Social Security payroll tax generally, but for the most part, this literature is inconclusive with regard to the effects on employers and pensions.
increased, for example—or a lower anticipated retirement income, which would occur if benefit levels were reduced.

Workers’ response to traditional Social Security reforms could take different forms. They might act to offset the effect of reforms by saving more, or working more and retiring later. Alternatively, they might not change their savings or employment levels but experience a reduced living standard or draw down other assets. If Social Security reform reduces anticipated retirement income, many analysts would expect that workers might, to some degree, want to offset this effect by increasing their saving outside the Social Security program. Workers could demand higher pension compensation or save individually by contributing to 401(k)s or individual retirement accounts (IRAs). Past research has considered whether the existence of Social Security and workers’ anticipation of future benefits reduced their savings in other assets. While some analysts found evidence of reduced saving, others disputed such an effect. More recent research has examined whether the creation of IRAs or 401(k)s has led to a net increase in individual saving. Some economists contend that the contributions to these savings vehicles are offset by a reduction in other forms of saving, while others find that contributions are not completely offset and hence yield a net increase in savings by workers. The conflicting nature of these empirical debates illustrates the difficulty in drawing conclusions about the effects of proposed Social Security reforms on private pensions or national saving overall.

Another related area in which Social Security reform could have implications for private pensions concerns workers’ decisions about how much to work and when to retire. Some analysts believe that if workers perceive a current or future decrease in income due to lower future benefits or higher payroll taxes, most would work more to make up for lower anticipated income. These reactions can also apply to their choice of retirement age. Workers anticipating less retirement income may choose to

33This could also prompt calls for raising limits on allowable pension contributions or benefits.


stay in the workforce longer than they might otherwise. Thus, benefit cuts or tax increases may create incentives for workers to work more in the current period or work more years to offset the effect of these changes. Such effects could imply that over time workers might tend toward higher labor force participation, more hours of work, or delayed or phased-in retirement. In turn, employers may redesign pensions to address such worker preferences. The movement toward defined contribution plan designs, which tend to reduce early retirement incentives, may be a trend consistent with these effects.

Structural Reforms to Social Security Could Have Implications for the Private Pension System

Including individual accounts as a reform feature raises key issues for the private pension system. Implications for the private pension system will depend on how the individual account is structured (e.g., how it is financed and administered), its scope (e.g., whether it has voluntary or universal participation), and its interaction with other reform provisions (e.g., whether other benefits are reduced). Like more traditional reforms, the effects of an individual account reform feature on the pension system will occur through explicit and implicit linkages between Social Security and pensions and employer and worker responses to specific reforms. Because individual accounts have generally been proposed as a part of more comprehensive reform packages that include traditional reforms such as cutting benefits, it is difficult to disentangle their possible effects on private pensions.

Proposals for Individual Accounts Vary in Form and Raise Many Issues

The implications of individual accounts for the private pension system will depend on how the accounts are structured and administered. These issues include the magnitude and nature of the accounts’ funding, how the accounts are administered, whether participation is voluntary or universal, the degree of choice and control accorded to workers in regard to investment of account funds and the form in which benefits are received, and the interaction of individual account features with other reform provisions.

The most basic structural issues concern the magnitude of the accounts’ financing—that is, the amount or the percentage of payroll devoted to the

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account—and the nature of that financing. While proposals vary, a number of them focus on creating accounts with a contribution of 2 percent of Social Security taxable payroll. This feature determines the future role accounts will play in Social Security financing and whether investment returns might alleviate the need for traditional reforms. The amount devoted to the account will also determine workers’ retirement income, contingent on investment performance.

The nature of the individual accounts’ financing also has implications for the private pension system to the extent that it affects the contributions employers make on behalf of workers. Some proposals implement individual accounts through a “carve-out,” which generally maintains the current level of payroll tax rates but devotes a portion of payroll taxes (e.g., 2 percent) to the individual account. Other proposals implement the individual accounts by means of an “add-on,” which generally creates accounts that supplement the current Social Security program and increases overall contributions to the system. In general, while add-on accounts would appear more likely to directly increase employers’ costs, assessing the implications of these different structures for private pensions is complicated because it is necessary to consider the entire reform package, which may include benefit cuts or other revenue measures such as general revenue financing or government borrowing. Also, the degree to which Social Security benefits are reduced or offset against the account is an important design issue. The accounts can be integrated into the Social Security benefit structure in a way that preserves all currently legislated benefits as a floor. This would limit the risk borne by the worker, while allowing the worker to share in the rewards if the account exceeds the returns implicit in the current Social Security benefit structure. This feature will also affect the overall cost of a Social Security reform package to workers and employers.

Another key issue concerns whether the accounts would be structured to allow workers to hold the account entirely outside the Social Security program or whether the accounts would be set up through government institutions that would play a role in administering and channeling funds to investors. Employers are concerned about the resources and administrative costs they would have to devote to managing the accounts and financial flows. Proposals differ in the degree to which the

37Proposals that include this feature are discussed in Social Security: Evaluating Reform Proposals (GAO/AIMD/HEHS-00-29).
administration of the accounts is either centralized through government institutions or decentralized through employers and the financial industry. Some believe that retaining some government role could reduce administrative burdens on employers and workers, but others emphasize the advantages of expanded choice that could be made available to workers.

The scope of an individual account reform—that is, whether the account is mandatory or voluntary—also could have implications for the private pension system. Some proposals include mandatory account provisions because they would appear to be more directly linked to Social Security, and in particular, to the universal nature of the program.\(^{38}\) Mandatory accounts thus provide a degree of certainty about the structure of Social Security that employers can take into account in responding to reform and in possibly redesigning their plans. The linkage between voluntary accounts and Social Security would appear to be more tenuous and more complicated to analyze. For example, some voluntary account designs are structured to supplement Social Security and would be hard to distinguish from retirement saving vehicles such as IRAs. Such similarities could result in low participation and minimal impact on most workers’ retirement income and on pension plans generally. Alternatively, voluntary accounts could be targeted to specific groups, such as young workers, lower income workers, or those who are not currently covered by a private pension. Such designs could address some of the concerns about the adequacy of benefits and gaps in coverage.\(^{39}\)

Another important individual account design feature concerns the degree of choice and control that workers would have over their funds and the degree of flexibility that workers might have in accessing the funds in their accounts. Providing workers more options in which to invest their funds allows them to diversify risk and perhaps earn higher returns. However, this can increase the costs of the system. Allowing greater flexibility in accessing funds could give workers greater control over the decision to

\(^{38}\)There are different rationales for the mandatory and universal nature of Social Security. One rationale is that a government program can more easily deal with adverse selection in providing annuities compared with the private sector. Another rationale involves protection against those who would “free ride” on government support unless required to participate and contribute.

\(^{39}\)Note that, depending on which workers contribute to Social Security individual accounts and the way in which contributions are treated, the ability of existing pension plans (such as 401(k)s) to pass nondiscrimination tests could be affected.
They could also have greater control over the form in which they receive their retirement income over their lifetime because they could choose annuities or keep a portion of their funds invested. However, allowing greater access to funds before retirement and greater choice in the form in which retirement income is received could complicate administration, increase costs, and possibly reduce future retirement income.40

The interaction of an individual account feature with the other provisions of a comprehensive reform also has consequences for the private pension system. In this instance, the net effects on the private pension system would depend on the other provisions included in the reform and the structure of the individual account feature. Individual accounts could either moderate or exacerbate these effects, depending on the exact features of the broader reform.

Individual Accounts Could Have Broad Implications for Integrated Plans and Employer-Worker Decisions

Structural reforms that create individual accounts could have an array of implications for private pensions. Some arise from the explicit and implicit linkages between Social Security and pensions and will depend on the responses of employers and workers. For example, individual accounts could affect private pensions if the employer chooses to change the type of integration provisions used. To the extent that individual accounts affect employer costs or workers' reactions to risk, both employers' incentives to provide pension coverage and workers' incentives to participate in pensions could be affected.

One expert suggests that integrated pension plans may be affected through the definition of the Social Security benefit.41 The issue could arise where a portion of the individual's total benefit comes from both the individual account and from Social Security. Plans currently must estimate the participant's Social Security benefit to calculate the appropriate offset. With an individual account, estimating the benefit amount to determine the appropriate benefit offset could become more complicated and perhaps costly for the employer. This might compel employers to abandon the

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offset method in favor of the excess method of integration. For this method, they need only satisfy the rules regarding permitted disparity and do not need to calculate the total Social Security benefit accurately.

Depending on their structure, individual accounts could increase employer costs by increasing contributions and imposing an administrative burden to maintain the accounts. Employers may respond to the higher costs associated with contributions to an add-on account in ways similar to those described for payroll taxes; worker behavior may also be affected. While large employers appear to be better able to handle the costs and administrative demands of an individual account system, smaller employers may face greater difficulties, such as reduced profitability, that could reduce their willingness to provide pensions.

Worker reactions to the introduction of individual accounts will be shaped by the way in which they assess risk in relation to their retirement income. If individual accounts achieve higher rates of returns than beneficiaries receive under Social Security, and these returns are captured in a way that improves program financing, the accounts could reduce or mitigate the benefit cuts and tax increases otherwise needed to pay promised levels of Social Security benefits. Therefore, individual accounts might reduce workers’ need to adjust to lower anticipated benefit levels or the higher taxes included in some reform proposals. However, individual accounts would also likely increase the level of risk or uncertainty associated with anticipated retirement income. Under individual account proposals that provide for a broad range of investment choices, workers might be able to choose an appropriate level of risk by adjusting investments within the account, or they might reallocate their pension-related assets to readjust the level of risk of their overall portfolios. For example, workers could offset an increase in risk from the individual account by adjusting the allocation between fixed income assets and equities in their 401(k).

Note that depending on the structure of a reform proposal, introducing individual accounts could increase in the near term the unfunded costs of Social Security (sometimes referred to as “transition costs”). However, proponents of individual accounts argue that in the long term, the total costs of meeting existing benefit promises under Social Security will be lower for individual accounts than for traditional reforms. Martin Feldstein and Andrew Samwick, “The Transition Path in Privatizing Social Security,” in Privatizing Social Security, Martin Feldstein, ed. (Chicago: The University of Chicago Press, 1998), pp. 215-64.

The discussion here focuses on investment risk, but workers can face many other types of risks regarding retirement income such as longevity risk, inflation risk, and the risks of death and disability.
accounts. Workers might also exhibit increased demand for annuity-type products or perhaps even defined benefit pension arrangements. The ability to adjust to the introduction of individual accounts could be more problematic for workers who have limited knowledge of investment principles or who have few or no alternative assets—a sizable portion of the population. For example, data suggest that about one-quarter of all families nearing retirement have less than $25,000 in assets such as stocks, bonds, home equity, and bank accounts.

Implementing Individual Accounts Presents Challenges and Opportunities

Individual accounts raise a broader set of issues for private pensions compared with traditional reforms. The design and implementation of individual accounts will affect not only employer costs but could present employers and workers with substantial challenges in coordinating existing defined benefit and defined contribution pension plans with individual accounts under the current regulatory framework for pensions. At the same time, an individual account structure could provide an opportunity to expand access to private retirement income while increasing the choice and flexibility available to workers.

Employers might seek to offset any higher costs arising from individual accounts by reducing or restructuring their existing pension plans. If the accounts achieve investment returns that are below historical trends or the implicit returns to Social Security, the adjustments that employers and workers may have to make to maintain expected retirement income could be exacerbated. For example, if accounts perform below expectations, workers may desire to delay retirement, which could make it more difficult for employers who may want to offer early retirement incentives to older workers. A related issue concerns the degree to which employers would

44Some evidence about change in asset allocation is found in Cori E. Uccello, “401(k) Investment Decisions and Social Security Reforms,” Working Paper No. 2000-04 (Center for Retirement Research, Mar. 2000). The author finds that when workers have both a defined benefit (guaranteed) plan and a supplemental 401(k) plan, there is a tendency to invest more aggressively in the 401(k) account. This suggests that workers with a guaranteed form of retirement income such as Social Security will invest more aggressively. Conversely, if the guaranteed portion is reduced—by substituting an individual account, for example—workers might have a tendency to invest less aggressively. Uccello concludes that the implication for this is that the return to the individual account might be lower. As a result, the advantages of moving to an individual account system might be overstated.

want to, or have to, coordinate their existing pensions with individual accounts. For example, pensions and individual accounts could have very different rules for distributing benefits. A 401(k) account currently permits workers to take lump-sum distributions without penalty at age 59½, while Social Security individual accounts might restrict distributions until the age of eligibility for Social Security (62 or later). Existing regulations for receiving lump sum distributions and the annuity options available to the worker might also be different for pensions and individual accounts, complicating administration by the employer. Addressing these challenges could result in substantial changes in the structure of the pension system, with possible implications for worker coverage and workers’ overall retirement income.

At the same time, individual accounts could present an opportunity to improve the nation's retirement income system by providing workers with new opportunities to save for retirement and by expanding workers’ flexibility in managing their retirement assets. One of the most frequently cited problems with the private pension system is that it does not cover all workers. A mandatory, universal system of accounts could provide a defined contribution account to all workers, which would give them access to private investment returns. While workers may offset their individual account saving by saving less elsewhere or borrowing more, the ability to do so may be limited for some and therefore an increase in total saving is possible.46 It may be argued that individual accounts could increase workers’ awareness of the need to save for retirement or become more knowledgeable about investment options. Individual accounts might also increase employers’ incentive to develop new pension vehicles to coordinate with individual accounts.

While a voluntary system of individual accounts might draw low participation, the system could be structured to foster the goal of increased coverage if it is targeted to those groups with low pension coverage. Such an account design might also affect the ability and propensity of workers to save if such a voluntary supplemental saving option were linked with Social Security. While many employers are concerned about the potential administrative costs of an individual account system, there may be

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46A recent study found evidence that 401(k)s held by low-earning groups are more likely to represent an addition to net household wealth compared with high-earning groups that hold 401(k)s. Eric M. Engen and William G. Gale, The Effects of 401(k) Plans on Household Wealth: Differences Across Earnings Groups (Washington, D.C.: The Brookings Institution, Aug. 2000).
compensating advantages. Some experts have noted that while individual accounts, either as a supplement to or as a partial substitute for Social Security, might entail higher administrative costs, these costs might allow employers to provide workers with greater options and services compared with Social Security.\textsuperscript{47} Given a range of investment options, individual accounts could also provide workers a means of spreading market risk and perhaps give them more flexibility in terms of retirement choice later in their careers by allowing them to phase into retirement.

\section*{Concluding Observations}

While Social Security and private pensions are linked in many ways, they remain distinct institutional frameworks for providing retirement income. Given that little is known about the effects of changes in either of these systems alone, determining the possible effects and interactions of Social Security reform across these very different structures is a difficult task. Furthermore, with the proposed introduction of individual accounts, the current Social Security debate has introduced the possibility of a major structural change in the program. Such accounts, often proposed in combination with other more traditional reforms, raise an even broader set of possibilities and questions.

Our retirement income institutions operate in a dynamic environment where workers, employers, and policymakers interact to pursue the goal of retirement income security. Numerous concurrent influences, such as changes in tax and regulatory policies, also affect how these institutions develop and evolve, and the reform debate should explicitly consider these other issues. The limited knowledge we have of these influences and the complexity of instituting policy change suggests that any reform should be taken with caution and careful deliberation. At the same time, establishing agreement on the fundamental principles underlying the reform should be emphasized. These principles should include ensuring retirement income to those who most need it and encouraging the development of new opportunities to secure and expand the retirement income of future generations.

We provided draft copies of this report to the Social Security Administration, the Department of Labor's Pension and Welfare Benefits Administration, and an external reviewer who is a university-based pension expert. They provided us with technical comments, which we incorporated where appropriate. In general, they concurred with our treatment of the issues as appropriate for an overview of the topic and noted that many issues discussed in the report could benefit from further research.

We are sending copies of this report to the Honorable Charles B. Rangel, Ranking Minority Member, House Ways and Means Committee; other interested congressional committees; the Honorable Alexis M. Herman, Secretary of Labor; the Honorable Lawrence Summers, Secretary of Treasury; and the Honorable Kenneth S. Apfel, Commissioner of Social Security. We will also make copies available to others on request. If you have any questions concerning this report, please contact me at (202) 512-5491 or Charles Jeszeck at (202) 512-7036. Other major contributors include Kenneth J. Bombara and Gene Kuehneman.

Sincerely yours,

[Signature]

Barbara D. Bovbjerg
Associate Director
Education, Workforce and Income Security Issues
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