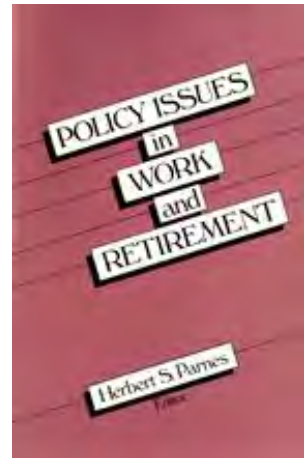




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Private Pensions, Inflation, and Employment

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Chapter 9 Private Pensions, Inflation, and Employment

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Some Prefatory Comments on Social Security

Attention continues to be riveted on issues and problems associated with OASDHI, almost as if the other parts of our system to provide financial security during old age were free of troubles. The list of fears and criticisms is now well known: Social Security is going bankrupt; we “can’t afford” the cost of future benefits; Social Security depresses savings and hence economic growth; various provisions of the insurance programs are inequitable and discourage work; and at a time when we are trying to balance the budget and reduce the size of the federal government, Social Security continues to grow at an uncontrolled pace.

All these criticisms are debatable, of course. In fact, the arguments continue hot and heavy—both in the policymaking arena and in academia. As a strong supporter of Social Security, I only point out here that while public anxiety—fueled by political rhetoric—has reached unprecedented levels, public support for Social Security remains high; people want Social Security made secure—not dismembered—*even if that requires higher taxes*.¹ Moreover, every bipartisan government commission appointed to review the system has emphasized the viability of the OASDHI programs and has recommended only marginal improvements.

Of course, most critics of Social Security today also profess to support the system. They argue, however, that major long-term changes are needed. Their proposed changes are almost all pointed in one direction—drastic cutbacks in benefits to reduce program costs. The logical question that follows from proposed action of that kind is: what else changes in reaction to cutbacks in Social Security (i.e., what takes the place of Social Security)?

In examining the ability of alternatives to pick up the slack from a pared down Social Security program, we should not ignore economic history. Despite what Martha Derthick says about bureaucratic elites engineering the expansion of Social Security, the development of OASDHI was to a very large extent a reaction to the failure of the alternatives—namely employment of the old and providing for old age through personal savings.² The vicissitudes of our economic system over the years have made both these alternatives largely untenable:

- a) Past periods of unemployment and inflation have made financial planning and preparation for retirement extremely difficult for individuals, if not impossible.³
- b) An inability to achieve sustained full employment—except in periods when the nation was preparing, fighting, or recovering from war,⁴ has caused the government to actively discourage employment by older workers and to develop pension mechanisms that encourage retirement.
- c) Finally, both Social Security and private pensions also have a long history as tools of business management to deal with cyclical and long-term shifts in demand.⁵

What then are the alternatives proposed today? Not surprisingly, we find that they are the same as in the past; private saving, private insurance and employment of the old. The focus of this conference is on employment, and my assignment is to relate private pensions to it. I shall restrict

myself, therefore, to the relationship between pensions and employment opportunities.

But one must begin by recognizing that there is some large measure of unreality in talking about employment as an alternative to Social Security—especially at a time when unemployment is at double-digit levels. Many economists insist that policy development should focus on the labor force disincentives created by various aging programs, especially Social Security, implicitly assuming that a full-employment economy was, is, and will be the reality. Worse yet, some analysts confuse the issues in a major way by failing to distinguish between theory and assumption on the one hand and the realities of the American market-oriented economy on the other. For example, a recent analysis by the Congressional Budget Office states:

Increasing numbers of nonworking older persons could reduce the amount of goods and services produced in the economy as well as personal incomes. This decreased production could also put upward pressure on prices and increase inflation. The smaller labor force of older workers probably would reduce overall unemployment, however, because many jobs not taken by older persons would go to younger ones.⁶

Of course, other things being equal, withdrawal of any substantial number of persons from the labor force will reduce potential national output. But as has been emphasized above, we have all too frequently failed to achieve our potential. Perhaps we should develop better policies to achieve sustained economic growth before agonizing about the problems the elderly may create if we are successful in meeting that goal.

We know with great certainty that demographic trends will lead to a decrease in the ratio between the population of

traditional working age and the older population (but not necessarily to dependent population of young and old combined). What we do not know is whether we will be able to do any better in the future than we have in the past in employing the potential labor force. Yet full employment is seen by many as the simple and obvious solution to most of Social Security's current and future problems.

Even if it is assumed that we will be able to generate sufficient jobs for all age groups in the future, including more jobs for the aged—we need to confront two other major issues: the fact that the elderly strongly prefer retirement to full-time work and the fact that increased longevity does not necessarily mean more surviving older persons will be able to work. With regard to the former, voluminous data⁷ now indicate quite clearly that workers have a high degree of preference for retirement over continued employment—even when pension benefits are relatively low.⁸ The data are much less clear with regard to the implications of increased longevity, but certainly available statistics do not indicate any marked turn-around in ability to work in the later years. Rather than the expected decrease in the proportion of men age 50-69 unable to work because of illness, data from the National Health Interview Survey show that the proportion actually increased between 1970 and 1980.⁹

There are still many health factors at work that reduce mortality but also reduce the employability of older persons. Examples include: improved survival for myocardial infarction among the disabled; the persistence of the incidence of arthritis or any of a number of other disabling conditions that do not generally cause death; the successful treatment of individuals with problems such as diabetes that previously caused early deaths but that are still disabling, and alcohol or drug abuse.

Robert N. Butler, former director of the National Institute on Aging, recently summarized the issue as follows:

It is not clear that morbidity rates in the older population are improving. While mortality from heart disease and stroke has gone down, the data do not clarify whether this means disease has been prevented and people are not at risk, or whether more people are surviving with impairments, thanks to medical and other support. A number of leading demographers and epidemiologists share the view that morbidity in later life probably is rising. One recent paper (by L. A. Colvez¹⁰) indicates that morbidity and attending disability increased rapidly from 1966 to 1976. The increases were sharpest for those aged 45 to 64.¹¹

Benefit Levels in Private Pensions

Putting aside the issue of the extent to which we can and should rely on public versus private mechanisms for income in old age, what is the impact of private pensions on employment in the later years? It is now commonplace for analysts to cite the dramatic drop in labor force participation rates among older persons and to point a suspicious finger at public and private pensions, especially the liberalization of coverage and benefit levels that has occurred over recent decades. Gordus for example, writes:

In 1870, about 20 percent of the males 65 years of age and over were retired. In 1970, nearly 75 percent of the male population over 65 had withdrawn from the labor force. This trend toward retirement reflects a demographic shift, a rising average age at death. The incomes of retired Americans are now maintained through benefits from private pension plans and from social security benefits. For over a

century, demographic change and the gradual development of pension benefits have combined to produce a relatively new phenomenon, retirement. More recently, the extension of pension benefits to those younger than 65, in combination with other factors, has produced an even newer phenomenon, early retirement.¹²

While pension developments have undoubtedly had an important impact on labor force behavior and decisions to retire, any precise quantification of the impact or a completely satisfactory explanation of “the retirement decision” has yet to be achieved. The four excellent reviews of our knowledge in this area by Mitchell/Fields, Foner/Schwab, Morgan, and Clark/Barker indicate the complexities of the issues and the limitations of research done thus far.¹³

With regard to private pensions, the literature discusses a variety of factors that may encourage employees to retire earlier. Mandatory retirement provisions are still very common in companies with private pensions. Private disability benefits are usually a part of private plans, complementing disability coverage from other programs. Benefits are usually paid only if an employee stops work and separates from the company. Pension benefit accruals, especially given the tax treatment of pension reserves, typically represent a sizeable accumulation of personal wealth—wealth available for consumption needs, however, only in the latter part of the life cycle. Finally, private plan formulas and payment provisions are often structured in ways that discourage continued employment.

Based on the most recent studies, there seem to be relatively strong indications that higher private pension benefit levels do in fact encourage retirement. This raises the question of what the level of private benefits is and the extent to which they have been changing over time.

We have just completed a study of these two questions at the Brandeis Policy Center on Aging.¹⁴ The major purpose of this study was to analyze the 1979 benefit levels—both retirement and survivor benefits—in a representative sample of private pension plans. Pension benefits were calculated for hypothetical workers retiring in 1979, using U.S. Bureau of Labor Statistics (BLS) data on 1,010 pension plans covering workers in establishments meeting certain minimum employment size criteria (50 to 250 workers, depending on industry).

Median pension replacement rates were estimated separately for male and female workers in various industries, by years of service. Distributions of replacement rates were also presented by sex and years of service. Total replacement rates were calculated by combining Social Security and private pension benefits. Using replacement rate targets necessary to maintain living standards in retirement for men whose earnings had been equal to the median wage, estimates were made of the proportion of such workers where pension benefits (together with Social Security) would achieve those targets.

Results of the 1979 survey analysis were compared with a prior BLS survey of 1,467 defined benefit plans in 1974. Because the 1979 survey did not include many of the large multiemployer plans, the comparison was restricted to single employer plans in 1974.

The median private pension replacement rate in the 1979 plans, for workers with 30 years of service and average earnings, was 27 percent for males and 34 percent for females. Median replacement rates varied from a low of 23 percent in the service industry to a high of 35 percent for females in manufacturing. Comparison of the 1979 and 1974 data suggests that a small improvement in plan benefit levels had occurred over the five-year period between surveys.

The *total* replacement rate (Social Security plus private pension) for a hypothetical male worker with 30 years service was compared for each plan with the “target replacement rate” necessary to maintain living standards in retirement without other income supplementation. Very few workers, 6 percent, were in plans that achieved that target in 1979. But if the spouse benefit under Social Security was included (e.g., the case of a married male worker with a nonworking wife), the proportion in plans achieving the target replacement rate rose dramatically to 59 percent.

Probably the most important limitation of the study is the fact that benefit level estimates were made assuming long and uninterrupted work histories of 20 and 30 years. In reality, many workers shift jobs frequently. And even if they acquire vested benefits before leaving a job, two or three vested pensions will rarely produce a combined benefit as large as one based on 20 or 30 years of continuous employment. Thus, the hypothetical calculations in the study should not be used to predict the adequacy of pensions for actual workers. Instead, they can be used to indicate the *potential* contribution of private plans to retirement income and to show the wide variation in benefit levels that occurs among plans.

If we keep in mind the long tenure assumption, the replacement rates calculated in the Brandeis study do give a good indication of the potential magnitude of private pensions as part of total pension income. Table 1 shows the median of the replacement rates provided by the 1979 plans in various industries and also estimated Social Security replacement rates. Earnings levels used in calculating the replacement rate for hypothetical workers were based on tabulations of data from the Social Security Administration’s “Current Work History Sample of Covered Workers” (CWHS).¹⁵

Table 1
1979 Median Replacement Rates for Hypothetical
“Average” Workers, by Sex and Industry

Industry ^a	Private pensions ^b	Social Security ^c	Total
Males:			
Manufacturing	27	28	55
Transp/Comm/Util	34	25	59
Trade	24	30	54
Fin/Insur/Real Est	30	28	58
Service	23	32	55
All industries	27	28	55
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Females:			
Manufacturing	35	41	76
Transp/Comm/Util	34	36	70
Trade	26	46	72
Fin/Insur/Real Est	26	40	66
Service	23	44	67
All industries	34	38	72

SOURCE: Based on data in James H. Schulz et al., *Private Pension Benefits in the 1970s—A Study of Retirement and Survivor Benefit Levels in 1974 and 1979* (Bryn Mawr, PA: McCahan Foundation, 1982).

a. The mining and construction industries are omitted because of small sample size.

b. Based on BLS, Level of Benefits Survey, a representative sample of U.S. establishments (excluding Alaska and Hawaii) with a minimum size of 50 to 200, depending on industry. Because this survey samples establishments rather than plans, inference is appropriate only to those establishments meeting the BLS size criteria and to the pension plans found in such establishments. Thus, the survey cannot be used as a guide to benefit levels (a) in very small establishments or (b) in those large plans (particularly multiemployer plans) covering many small establishments.

c. Calculated using the legislated benefit formula and rules appropriate for 1979. Benefits were calculated assuming that the worker was employed in Social Security covered employment during the years without private pension coverage, if any. Spouse benefits are not included.

In three of the five industries studied, the private pension replacement rate of a long-term, “average” male worker equaled or exceeded the Social Security replacement—indicating the major role that private pensions can play in the total pension income of some workers. For women, the role is smaller; Social Security replacement rates for women always exceeded the private ones. This is a result of the lower earnings levels of women and the weighted Social Security formula favoring low earners.

To the extent that the size of pensions is related to the retirement decision, the data indicate that private plans probably play a major role. However, the factor of inflation complicates any assessment of impact. Unlike Social Security, which is fully indexed, hardly any private plans automatically adjust benefits in payment status for inflation. Such adjustment that does take place is typically done on an *ad hoc* basis and rarely comes close to keeping up with the CPI. We would like to know the extent to which the failure of private pensions to adjust for inflation affects the employment decisions of older workers.

Inflation and the Elderly

Older persons living on fixed incomes used to be one of the most inflation-vulnerable groups in our society. Times have changed, however. Today, elderly persons have important protections against inflation:

- Social Security, federal supplemental security income (SSI) benefits, federal pensions, and food stamps are all indexed fully against inflation.
- Medicare and Medicaid benefits help to keep pace with medical costs that rise in part due to inflation.
- Most of the assets of the elderly are held in the form of real estate—the value of which has risen in most cases faster than inflation.

- The rising Social Security benefits of the elderly are not subject to federal income tax and hence not subject to erosion as a result of progressive tax brackets defined in money rather than real terms.¹⁶

There are two major sources of elderly income, however, that are still highly vulnerable to inflation: financial assets and private pensions. Most financial assets—bonds, checking accounts, savings accounts, and insurance policies—do not adjust when the general level of prices changes. Common stocks and mutual funds may promise better protection over the long run, but no guarantee of complete security from inflation over any particular short run period. As indicated above, almost all private pension plan commitments during retirement are specified in money terms, with no guarantee of any adjustment for inflation.

The possibility of continuing high levels of inflation in the years to come requires that we think seriously of providing appropriate safeguards for the most economically vulnerable age group of our population. The most serious problem of this kind at the present is the vulnerability of the “near-poor” aged. An overwhelming majority of elderly live on incomes *above* the official poverty level, but below \$10,000 a year. Many of these elderly families depend on their financial savings and their private pensions to provide the margin of support necessary for a modest but more comfortable life style.

Rising government expenditures caused by automatically indexed Social Security benefits have resulted in increased scrutiny of the adjustment mechanism and of the appropriateness of the Consumer Price Index (CPI) for making such adjustments. During inflationary periods, the prices of various goods change by different amounts. Since the expenditure patterns of individuals and families differ, the impact of any particular pattern of price increases will vary, depend-

ing on the expenditure patterns of various individuals.¹⁷ For example, if food and housing prices go up faster than the prices of other goods and services and if the aged spend a large share of their income on food and housing, the result is a larger increase in prices paid by the aged than the non-aged.

Thus there is a concern that the CPI, which is the measure used to adjust Social Security benefits, does not correctly reflect the buying patterns of the aged. Some organizations that speak for the aged argue that the CPI underestimates the impact of inflation on the elderly and advocate a special index for the elderly. More recently, others have argued that Social Security increases based on the CPI are too generous.

How well the CPI measures changes in living costs of the elderly depends on: *what* prices are rising or falling; how *rapidly* particular prices are changing; and the *reactions* (i.e., changing expenditure patterns) of particular groups of the elderly. All the studies of these issues suggest that using special price indexes for subgroups of the population like the aged will not necessarily be more equitable than using the regular CPI.¹⁸ Thus, the present indexed Social Security system seems to do a relatively good job of reducing the uncertainty and anxiety facing older persons in periods of rapid inflation.

Instead of a new index for the aged, we need to improve the existing CPI. The recent BLS change in handling housing costs is a step in the right direction, but a more general problem exists. There is a systematic, upward bias in the CPI, primarily due to the lag in accounting for new products and for quality improvement in products and services. With regard to quality change, the CPI does not measure the impact of changes in product performance. For example, the prices of motor oil, tires, light bulbs, appliances, etc. have increased. But because the service life of many such products

has also increased, not all the price increases are truly inflationary.

Economists have written about these problems for many years. Over 20 years ago a prestigious committee headed by economist George Stigler recommended major changes in the CPI. Unfortunately little has been done since then. With the amount of indexing that now takes place, it is imperative that we reassess the situation. I would like to see a major review of ways to moderate the existing bias in the CPI. By doing this, the costs of pension indexing could be reduced without hurting the living standards of pensioners.

As has been mentioned, while the impact of inflation on the elderly has been reduced, the two major remaining problems are the erosion of savings and the fact that private pensions do not fully adjust for price rises *during* retirement. The latter problem has received increasing attention in recent years, and consideration is being given to the ways that plans can be redesigned to reduce it.¹⁹ However, a related problem has been largely ignored.²⁰ Most vested benefits are frozen when a worker changes jobs. The worker does not benefit from subsequent improvements in the plan formula or even the inflation protection of many plans that base benefits on average earnings just prior to retirement. For example, given the inflation rates of the post-war period, a vested pension for someone changing jobs at age 45 (with, say 20 years of coverage) will give a worker almost nothing at retirement.

Why is so little attention given to this vesting problem? In part, it is because private pensions are so new. Many people affected by the problem (i.e., vested workers) are still many years from retirement. Yet, given the serious implications of the vesting-inflation issue for the future, the problem needs to be addressed. Perhaps an even more important reason that the issue has been ignored is cost. Employers with defined benefit plans currently keep their pension costs down by

giving little or no benefits to workers who leave the firms' employ in their early years. To deal with this problem effectively would require a major increase in pension expenditures by employers.

The Impact of Inflation on Retirement Decisions

Given the recent high rates of inflation and the fact that private pensions do not keep up with inflation, many observers have supposed that current workers will be reluctant to retire as early as recent cohorts of retirees. For example, Sheppard recently speculated that "there might be a new retirement consciousness developing in this country, which is making older workers reexamine the costs of retiring prematurely."²¹

While longitudinal data bearing on this question are relatively sparse, most of the available evidence indicates that retirements have slowed somewhat in recent years, but not in any appreciable way. An analysis by Parnes of the National Longitudinal Survey (NLS) data found that "the trend toward earlier retirement that had been discernible in the longitudinal data between 1966 and 1976 continued without interruption between 1976 and 1978."²² Parnes also found among *retired* men only slightly more interest in post-retirement jobs in 1978 than in 1976. (Parnes is currently analyzing data from a more recent NLS survey and will soon have additional information on this question.)

The Panel Study of Income Dynamics also provides longitudinal data bearing on the impact of inflation on retirement decisions. In 1979, the panel was asked whether inflation had caused them to change their attitudes toward retirement. According to Morgan, "the startling finding from the responses was the small effect of inflation."²³ The actions or plans of those already retired had changed hardly

at all. With regard to those age 45 or older who were not yet retired, however, there was a small but significant change in plans or expectations regarding retirement. About a fifth of the interviewees in that group indicated they would not be retiring as early as previously planned.

One of the most useful indicators of retirement trends is Social Security data on new benefit awards. Table 2 shows the number of Social Security benefits newly awarded and the proportion of these beneficiaries receiving reduced benefits for retirement before age 65. From 1973 to 1978 the trend was clearly in the direction of more early retirement. Since then the data indicate a relatively sharp drop in the proportion of men awarded benefits before age 65, but a very small decline for women.

What available evidence we have, therefore, indicates that the inflation of recent years may have moderated the rush to early retirement that developed in the 1960s and 1970s. The proportion of people retiring early, however, still remains very high, and we should not be surprised if the trend resumes its upward climb once inflation moderates.

Pension Retirement Incentives

While inflation's impact on benefit levels may be reducing the number of workers currently retiring at early ages, it is important to be aware of a number of factors in the design of private pension plans (in addition to benefit levels) that encourage retirement. It is clear that it is relatively easy to encourage workers in a broad spectrum of occupations and industries to retire at early ages through various pension incentive mechanisms. Probably the most important way to encourage early retirement is by simply making pensions available at early ages. Data on defined benefit plans covering about 23 million workers in 1974 show that 70 percent of these workers were eligible for early retirement benefits at

least by age 60 (provided service requirements, if any, were met).²⁴ Over half could retire as early as age 55, and 15 percent were in plans with even earlier eligibility ages (or no age requirement at all).

Table 2
New Social Security Worker Beneficiaries
and the Proportion Receiving
Reduced Early Retirement Benefits, 1968-1980

Year	Men		Women	
	Number (000s)	Early retirement ^a (percent)	Number (000s)	Early retirement ^a (percent)
1968	677	54	435	71
1969	691	53	449	71
1970	749	53	496	70
1971	752	57	507	73
1972	b	b	b	b
1973	897	54	650	66
1974	766	63	606	69
1975	873	61	539	80
1976	808	66	569	77
1977	855	68	616	78
1978	754	70	578	77
1979	811	67	612	77
1980	850	65	621	76

SOURCE: Table Q-6, published quarterly in the *Social Security Bulletin* (Washington, DC: U.S. Government Printing Office).

a. Reduced benefits awards currently payable as a percent of all awards moving to payment status (currently payable regular awards plus those originally awarded as not currently payable that moved to payment status).

b. Data are not available.

A Bureau of Labor Statistics analysis of a sample of private plans in 1978 indicates that retirement age policies have been significantly liberalized since 1974. "In 1978, approximately three out of four plans allowed retirement at age 55 or earlier, as compared with two out of three in 1974."²⁵ Moreover, many plans have lowered their normal retirement age (i.e., the age at which unreduced benefits are paid) below age 65, and other have eliminated age requirements entirely.

These numbers do not tell the whole story, however. When a worker retires before the "normal" retirement age, his or her benefit is usually reduced. But a large number of employers encourage their employees to retire early by absorbing some of the costs of paying pensions over a longer period of time. While some plans reduce benefits by the full actuarial discount, many plans, in effect, give actuarial bonuses to workers who retire early. Our study of defined benefit plans in 1974 indicates that powerful economic incentives are provided in many plans. For example, in 1974 there were about seven million workers covered by defined benefit plans that permitted retirement at age 60 with less than a full actuarial reduction in benefits. More recently The Urban Institute has tabulated early retirement reductions using the 1979 Bureau of Labor Statistics Level of Benefits Survey. They found that 78 percent of participants in plans with early retirement provisions were subject to less than full actuarial reductions in benefits.²⁶

In addition to encouraging retirement through regular retirement plans, many corporations have developed special and more limited benefit "offers" to encourage their employees to retire. A recent report on special incentive programs by Towers, Perrin, Foster and Crosby (TPFC) looks at the evolution of these mechanisms.²⁷ As pension consultants to major corporations, TPFC state at the beginning of their report: "Early retirement benefits are not always enough to make retirement affordable and attractive,

especially during periods of high inflation and economic uncertainty. Yet these are precisely the times when companies may need to encourage early retirement on a selective basis.”

As part of its report, TPFC discusses the special programs that have been instituted in ten major corporations. The average acceptance rate among those employees offered the special plans was 48 percent. In six out of the ten companies, moreover, over half the eligible employees took advantage of the inducements to retire early, with the acceptance rate going as high as 73 percent in one company and 67 percent in another.

Employment Policies and Older Workers

Even while employers struggle to allocate jobs equitably and efficiently in an economic environment of shrinking and shifting demand, we have been shocked by people proposing what was once thought to be unthinkable. It is now frequently recommended that the normal retirement age for Social Security be raised and/or that early retirement under Social Security be heavily penalized. Such proposals are stimulated in large part by rising pension costs and declining labor force participation among older workers.

Currently there is high unemployment and no general shortage of labor. But as the age structure of the population shifts, employers may be faced with an entirely different situation. Unlike the past—when both employers and unions encouraged workers to retire at increasingly early ages—employers of the future may want older workers to stay longer. But will employee attitudes also change? Most older workers want to retire as soon as possible; once retired, they adjust well to their new status in society and enjoy their increased leisure.

Any proposal to mandate a longer period of work life in the later years is likely to meet strong resistance from American workers, especially older workers. Pension plans were developed to provide compensation based on years of service on the job rather than on need per se. Thus, as observed by Friedman and Orbach in their excellent survey of retirement research, pensions have emerged “as an ‘earned right’ and (have) become instrumental in defining retirement status as appropriate for the older workers.”²⁸ It will be difficult to turn back the clock and convince future generations of workers that they are required to postpone their enjoyment of the retirement period currently enjoyed by so many older Americans.

There are two basic approaches to getting workers to remain in the labor force—the carrot and the stick. Which is better? Which should be emphasized? Should we achieve higher labor force participation on the part of older workers by severe penalties or by mandating work (compulsion), or should we emphasize incentives that will increase voluntary participation?

I think we should emphasize the carrot approach. Along these lines, there are many things we can do. For example, we must get management and workers to speed up the development of more flexible work opportunities and encourage a more positive attitude toward older workers. That is hard to do in an environment of high unemployment. I would recommend—

- that there be more research and demonstrations to help employers understand the feasibility and profitability of flexibility in work environments;
- that mandatory retirement be completely abolished (more for attitudinal and symbolic reasons than for its labor force impact, which would be negligible);
- that the Social Security retirement test be significantly liberalized.

The last of these recommendations deserves elaboration. The retirement test is currently \$6,000 for persons age 65 to 71 and \$4,400 for those age 62 to 64. For many years I have urged major liberalization of the test, rather than abolition. In an opening address to "Committee One"²⁹ of the 1981 White House Conference on Aging, I recommended that the test be set at the level of "average wages covered under Social Security." In 1981 that would have been about \$13,000. At this level, benefits would go mostly to those in need and those with modest incomes, i.e., the cost would be much, much less than if the earnings test were completely abolished. For example, if the test were set at \$10,000 in 1983, only about \$900 million would have to be paid out in additional benefits.³⁰ In contrast, complete abolition of the test at all ages would cost about eight billion dollars and, furthermore, would distribute the benefits in a very inequitable way. A simulation study on abolishing the retirement test that I carried out revealed that half of the new benefits from abolition of the test would have gone to the top one-third of aged income recipients, with incomes over \$10,000.³¹ Twenty percent would have gone to those with incomes over \$20,000!

The White House Conference Committee, after considering both a liberalized retirement test and abolishment of the test, formally adopted my proposal as a recommendation. Unfortunately, the present Administration took the recommendations of all the Committees and selected only a few that were generally consistent with their ideological predilections. These selected recommendations were the only ones put into the primary conference report ("A National Policy on Aging"), and included a recommendation from another committee that supported abolition of the earnings test. Thus, the recommendation for a liberalized retirement test was eliminated in this manipulative process. But the fact remains that the majority of a cross-section of Americans who

were delegates to the conference chose liberalization of the retirement test over its complete abolition when presented with a choice between the two.

Conclusion

We are entering into a new era of pension policy. The early years entered around, first, gaining acceptance of the idea of collective retirement income and, second, the actual implementation of both public and private pension plans. Now that these pension programs have been in operation for many years, attention has shifted to assessing how well they operate and projecting what they will cost. Issues of pension adequacy, pension equity, and pension burdens have moved to center stage.

During the past two decades we have witnessed a tremendous push toward early retirement. Social Security early retirement benefits now go to the majority of new retirees. Federal employees can retire on full benefits at age 55 with 30 years of service; in fact, the President's Commission on Pension Policy recently reported that 59 percent of retiring male civil servants (fiscal 1978) were age 60 or younger. Most state and local government employee plans also have very liberal retirement provisions. Early retirement is usually possible after 20 to 30 years of service—often as early as age 50 or 55.

While Social Security and public employee pensions are important, what I have tried to do in this paper is to emphasize the equally important role played by private pensions—not just in providing benefits for retirement, but in influencing employment/retirement decisions. Today private pensions play a key role and, as a consequence, they deserve the increased scrutiny and understanding of both academics and policymakers.

NOTES

1. See, for example, the public opinion survey for the National Commission on Social Security: Peter D. Hart Research Associates, Inc., *A Nationwide Survey of Attitudes Toward Social Security*, a report prepared for the National Commission on Social Security, mimeographed (Washington, DC, no date).
2. Martha Derthick, *Policymaking for Social Security* (Washington: The Brookings Institution, 1979). See, for example, Roy Lubove, *The Struggle for Social Security, 1900-1935* (Cambridge, MA: Harvard University Press, 1968); Gaston Rimlinger, *Welfare Policy and Industrialization in Europe, America, and Russia* (New York: Wiley, 1971); William Graebner, *A History of Retirement* (New Haven, CN: Yale University Press, 1980); W. Andrew Achenbaum, "Did Social Security Attempt to Regulate the Poor? Historical Reflections on Piven and Cloward's Social Welfare Model," *Research in Aging* Vol. 2 (December 1980).
3. See "Providing Retirement Income," Chapter 4 in James H. Schulz, *The Economics of Aging* 2nd ed. (Belmont, CA: Wadsworth, 1980), pp. 73-82.
4. Robert J. Gordon, "Postwar Macroeconomics: The Evolution of Events and Ideas," in *The American Economy in Transition*, ed. Martin Feldstein (Chicago: University of Chicago Press, 1980), pp. 101-182.
5. William Graebner, op. cit.
6. U.S. Congressional Budget Office, *Work and Retirement: Options for Continued Employment of Older Workers* (Washington: U.S. Government Printing Office, 1982).
7. See the summaries in James H. Schulz, Testimony. In U.S. House Committee on Ways and Means, Subcommittee on Oversight, *Strategies to Encourage Older Workers to Voluntarily Extend Their Worklives*, Hearings (Washington: U.S. Government Printing Office, 1980) and James H. Schulz, *The Economics of Aging* 2nd ed. (Belmont, CA: Wadsworth, 1980), Chapter 3.
8. Some would say this results from disincentives built into pension programs. While these disincentives play some role, I think the data indicate that declining health status, a declining "work ethic," rising leisure opportunities, and quick adaptation to the supposed "role loss" of retirement play a much larger role. See Ethel Shanas et al., *Old People in Three Industrial Societies* (New York: Atherton, 1968); Gordon F. Streib and Clement J. Schneider, *Retirement in American Society* (Ithaca, NY: Cornell University Press, 1971); and Robert C. Atchley, *The Sociology of Retirement* (New York: Wiley/Schenkman, 1976).
9. Jacob J. Feldman, "Work Ability of the Aged Under Conditions of Improving Mortality," Statement Before the National Commission on

Social Security Reform, mimeographed (Washington, DC, 21 June 1982).

Disability in the statistics reported by Feldman refers to persons who are not able to work at all because of one or more chronic conditions. Total recovery or rehabilitation for these disabled tends to be relatively rare.

10. L. A. Colvez and M. Blanchet, "Disability Trends in the United States Population, 1966-76: Analysis of Reported Causes," *American Journal of Public Health* 71 (1981), pp. 464-471.

11. Robert N. Butler, Testimony Before the National Commission on Social Security Reform, mimeographed (Washington, DC, 1982).

12. Jeanne Prial Gordus, *Leaving Early—Perspectives and Problems in Current Retirement Practice and Policy* (Kalamazoo, MI: W. E. Upjohn Institute, 1980), p. 16.

13. Olivia S. Mitchell and Gary S. Fields, "The Effects of Pensions and Earnings on Retirement: A Review Essay," NBER Working Paper No. 772, mimeographed (Cambridge, MA, 1981); Anne Foner and Karen Schwab, *Aging and Retirement* (Monterey, CA: Brooks/Cole, 1981); James N. Morgan, "Antecedents and Consequences of Retirement," in *Five Thousand American Families—Patterns of Economic Progress*, ed., M. S. Hill, D. H. Hill and James N. Morgan, Vol. IX (Ann Arbor, MI: Institute for Social Research, 1981), pp. 207-243; Robert L. Clark and David T. Barker, *Reversing the Trend Toward Early Retirement* (Washington, DC: American Enterprise Institute, 1981).

14. James H. Schulz, T. D. Leavitt, L. Kelly, and J. Strate, *Private Pension Benefits in the 1970s—A Study of Retirement and Survivor Benefit Levels in 1974 and 1979* (Bryn Mawr, PA: McCahan Foundation for Research in Economic Security, 1982).

15. The median earnings used were based on earnings for four-quarters workers age 50 to 59 in 1974—differentiated by sex and industry. Earnings were assumed to have risen at a five percent average rate up to 1974 but at actual average rates as measured by the percentage increase in average Social Security covered earnings for the years 1974 through 1978.

16. Indexing of federal income tax brackets is scheduled to go into effect and will provide this protection for all age groups.

17. I refer here both to what might be called customary patterns and also to *new* patterns resulting when people adjust their spending because of price changes.

18. A summary of the earlier studies appears in James H. Schulz, *The Economics of Aging* 2nd ed. (Belmont, CA: Wadsworth), pp. 45-46. More recent studies include Data Resources, Inc., *Inflation and the Elderly*, mimeographed (Lexington, MA, 1980); Michael J. Boskin and

M. D. Hurd, "Are Inflation Rates Different for the Elderly?" NBER Working Paper No. 943 (Cambridge, MA: National Bureau of Economic Research, 1982); and Paul L. Grimaldi, "Measured Inflation and the Elderly, 1973 to 1981," *The Gerontologist* 22, No. 4 (1982), pp. 347-353.

19. Keith H. Cooper, "Pensions, Inflation, and Benefit Indexing." In Aspen Institute for Humanistic Studies, *The Quiet Crisis of Public Pensions*, Report on a Workshop (New York: The Institute, 1980), pp. 43-46.

20. Munnell's discussion of the problem is an exception. See Alicia H. Munnell, *The Economics of Private Pensions* (Washington: The Brookings Institution, 1982), pp. 170-177.

21. The National Council on the Aging, "Is Inflation Slowing Retirement," Press Release, mimeographed (Washington, DC, 17 August 1981).

22. Herbert S. Parnes, "Inflation and Early Retirement: Recent Longitudinal Findings," *Monthly Labor Review* 104, No. 7 (July 1981), pp. 27-30.

23. Morgan, op. cit.

24. Tabulation of a BLS survey of plans covering 100 or more employees.

25. Robert Frumkin and Donald Schmitt, "Pension Improvements Since 1974 Reflect Inflation, New U.S. Law," *Monthly Labor Review* 102 (April 1979), pp. 32-37.

26. The Urban Institute, *Financial Incentives in Private Pension Plans*, Report submitted to Pension and Welfare Benefit Programs, U.S. Department of Labor (Washington: The Institute, 1982).

27. Towers, Perrin, Foster, and Crosby, *Limited Period Early Retirement Incentive Programs* (New York: no date).

28. Eugene A. Friedman and H. L. Orbach, "Adjustment to Retirement." In Silvano Arieti, ed., *The Foundations of Psychiatry*, Vol. 1, *American Handbook of Psychiatry*, 2nd ed. (New York: Basic Books), pp. 609-645.

29. Committee One was entitled "Implications for the Economy of an Aging Population." See Recommendation Number 2 as printed in *Final Report, the 1981 White House Conference on Aging* Vol. 3, Recommendations (Washington: undated).

30. Congressional Budget Office, op. cit.

31. James H. Schulz, "Liberalizing the Social Security Retirement Test—Who Would Receive the Increased Pension Benefits?" *Journal of Gerontology* 33 (March 1978), pp. 262-268.

Chapters 8 & 9 Discussion

Bert Seidman

When I discuss papers at meetings I usually find myself in the position of disagreeing fundamentally with the authors, but that is not true on this occasion. I have seldom had the opportunity to comment on two papers that offer so much sense and sensitivity, especially when so much nonsense and insensitivity are abroad about the issues that these papers treat.

A formulation that James Schulz used in his paper seems particularly appropriate. These papers do, indeed, distinguish between theory and assumption on the one hand and the realities of the American market-oriented economy on the other. I think it is very important that we do not get bogged down in theories and that we look at the realities.

Let me begin with Alicia Munnell's paper. I am in basic agreement with her overview of the Social Security system. In particular, I agree with the separation of the fiscal outlook of Social Security into three separate periods—the period up until 1990, the period from 1990 to about 2015, or perhaps more appropriately until 2025, and then the period after that. I will not repeat her analysis, but I believe that it correctly portrays the nature and extent of the fiscal problems that Social Security faces during each of the three periods as well as for the entire period until about 2060. I do not want to emphasize that, contrary to the allegations of some who are for drastic cuts in Social Security protection, those of us who oppose such cuts are not refusing to face up to the fiscal problems that Social Security faces. We who op-

pose Social Security cutbacks fully recognize that there is an immediate short term problem which must not be ignored. Indeed, it must be dealt with no later than the early months of next year, because if we do nothing at all it may not be possible to pay full benefits on time as early as 1984. But as Munnell has made crystal clear, there are readily available ways of meeting this short term problem that do not curtail benefits. Some of them are probably more politically feasible than others; but let me indicate what some of them are.

In the first place, it is possible to move up to 1984 the increases in the tax rate that are scheduled to take effect between now and 1990. Are people willing to pay increased taxes for Social Security? The answer is already "yes"; poll after poll has shown that although people's confidence in Social Security has been shaken by scare headlines, they are nevertheless quite willing, if necessary, to pay more in order to assure the solvency of the system and to guarantee that the protection they rightly expect will be available to them. If the scheduled increases in payroll taxes were moved up to 1984, it would be possible to credit part of the Social Security tax for income tax purposes. To make sure that poor people who pay little or no income tax are not adversely affected, there could be a refundable feature similar to the earned income tax credit in current law. This proposal has actually been made by a conservative organization, the Committee for Economic Development, which is made up exclusively of business organizations.

Another possibility would be to eliminate the deductibility for income tax purposes of the employer's share of the payroll tax and earmark the funds for Social Security. My own feeling is that this is probably less feasible politically, and probably less desirable. However, if either of those proposals were to be adopted, we could be reasonably sure that the Social Security trust funds would be adequate until 1990.

But to provide absolute assurance, there should be authority for the Social Security trust funds to borrow, if necessary, from the general fund. This would make it possible to get along with trust funds at lower levels than if we had to depend entirely on them for benefit payments even under the most adverse circumstances conceivable. After 1990, the fiscal outlook for Social Security improves greatly. A surplus begins to develop rapidly, and it would then be possible to repay to the general fund whatever loans may have been made to the Social Security trust funds.

With respect to the long term outlook, there are many imponderables. All we know is that we will have more elderly and fewer young people than we do now. But what we do not know is how many people will be employed or unemployed, the levels of wages and prices, the level of immigration and a host of other factors that could influence the fiscal outlook for Social Security after the first quarter of the next century.

Some of these factors have rarely been taken into consideration in discussions of Social Security's long term outlook. For example, the fact that wages are taxed for Social Security purposes but fringe benefits are not means that how much the system collects in payroll taxes depends markedly upon the proportions of total compensation represented by wages and by fringe benefits, respectively. The assumptions one makes about this issue can have a very considerable impact on the long term fiscal outlook of Social Security. The actuaries in the Social Security Administration have been assuming that fringe benefits as a proportion of total compensation will continue to rise indefinitely in the future at the same rate as they have in the past. I think that is highly unlikely; the dependence of workers on their money wages for daily living requirements will put a limit on how much of their compensation they will be willing to take in the form of fringe benefits.

Munnell makes a point in her paper that deserves additional emphasis. It is true that in the future we will have more older people in relation to those still in the labor force. However, if you consider what is called the total “dependent” population—a term that I do not particularly like—including both persons 65 years of age or over and children under the age of 18, the ratio to active workers 40 or 50 years from now will be lower than it has been in recent years. I see no reason why we will not at that time be able to transfer to the elderly resources which had previously gone to meet the needs of (larger numbers of) young people. Indeed, the strong political force that will be created by the large number of older persons at that time will almost guarantee that the necessary reallocation of resources will be accomplished.

Now I wish to say a word about James Schulz’s paper. He and others in this conference have rightly emphasized that changes in policies and programs should not be made on the assumption that there will be ample and suitable employment opportunities for the elderly; in other words, that we should not put the cart before the horse. We should not legislate cutbacks in Social Security protection now, either for the near term or the long term, because of unknown factors that may or may not occur in the distant future.

This admonition is especially relevant to the proposals for raising the retirement age for Social Security eligibility. This is an issue on which Munnell and Schulz seem to disagree. It is my understanding that Munnell sees some merit in a decision now to gradually raise the retirement age to 68 as a way of reducing the long term program costs. In his paper, Schulz points to all the problems and hardships that this would cause, and advocates use of the carrot rather than the stick in order to avoid these difficulties. That is, he would emphasize incentive mechanisms that would increase voluntary participation in the labor force but not penalize those

who either because of bad health or lack of suitable employment opportunities or both—and it is the combination of the two that afflicts many older people—would be unable to work. We are not sure of employment opportunities for the aged or of decreasing morbidity rates. (Robert Butler, until recently Director of the National Institute on Aging, has pointed out that morbidity rates may not be improving even though people are living longer.¹) We certainly should not, therefore, commit ourselves now to raising the retirement age in the future.

It is ironic that nobody is proposing to prohibit paying full private pensions to early retirees. As a matter of fact, we in the labor movement would oppose such a prohibition. However, if the retirement age under Social Security is raised, we would be faced with the paradox that the more fully protected workers who have both pensions and Social Security would have to wait even longer than they now do to get their Social Security benefits.

Neither paper takes account of the special needs of the “old-old”—people over the age of, say, 75. With increasing longevity, especially for women, and with no assurance that improved health will accompany longer life we will have a much larger and growing group of the very old with greater needs for income and services. This could require increasing expenditures if the old-old are to be adequately provided for, and could mean that we would have to allocate to our Social Security program as high a proportion of our total income as many of the European countries have done for a long time. But with a higher level of real national income that will prevail when the problem becomes acute, there is no reason to assume that this could not be done while still permitting active workers and their families to enjoy a level of living considerably higher than that enjoyed by today’s employed.

1. Statement before the National Commission on Social Security Reform, June 21, 1982.

Chapters 8 & 9 Discussion

James R. Swenson

Alicia Munnell and James Schulz are to be congratulated for their excellent, comprehensive papers. I wish to expand on several points made in those papers and discuss several of the authors' assertions.

The Munnell paper credibly describes the short and long term financing problems confronting the wage replacement portion of the Social Security program, namely the OASDI benefits. The short term problems, which have been caused by adverse economic conditions, were described by Senator Heinz as "critical but manageable." That is a reasonable characterization and is supported by information provided in the paper.

The long term problems are much more significant, particularly when the Medicare program is considered. The Munnell paper only makes a brief reference to the Medicare program. Since the Medicare program is of critical importance to both the financial and physical well-being of most Social Security beneficiaries, it should be considered within the context of the resources to be transferred from current workers to those beneficiaries.

In addition to the short and long term financing problems, the Social Security program is faced with a severe lack of public confidence. Headline stories about imminent bankruptcy have helped to create this reaction. Young workers are concerned that there will be no program when they reach retirement age. A survey conducted in 1979 found that three of every four persons between the ages of 25 and

44 had little or no confidence that funds will be available to pay their retirement benefits.¹ Faced with uncertainty, many of the elderly are terrified. They are afraid their benefits will be drastically cut. No responsible study group has ever recommended the kinds of cutbacks that many of the elderly fear. Furthermore, our legislators would not enact such Draconian measures.

It is essential that confidence be restored. The elderly must be reassured and their anxiety eliminated. Young people have to be convinced that the program will survive so that they will continue to be willing to pay the taxes needed to support benefit payments. I strongly agree with Munnell that the best way to restore confidence is to enact changes that bring revenues and expenditures into balance for both the short and long term. I further submit that confidence will best be restored by honestly achieving financial balance without resorting to the sham of general revenue financing; it is painfully apparent there are no general revenues available considering the projected budgetary deficit of \$150 billion or more.

However, there are reasonable solutions available that do not require general revenues and that do not require that any current benefits be cut. The consequences of such solutions will not be severe if timely action is not taken.

As indicated earlier, the short term problems are the result of unfavorable economic conditions. High rates of unemployment have contributed to a reduction in expected revenues. However, of even greater importance is the fact that prices, as measured by the faulty CPI, have increased much more rapidly than average wages. During the three years 1979 through 1981, CPI indexed benefits rose by 40 percent, whereas average wages rose by only 30 percent.² If benefits had risen by 30 percent, current benefit outlays would be approximately \$11 billion less this year and for

many years in the future, and short term financing problems would have been avoided. Moreover, intergenerational equity between workers and beneficiaries would have been preserved.

Presently, revenue growth depends on wage growth, while benefit growth depends on the CPI. Economist Henry Aaron of the Brookings Institution, in his testimony before the National Commission on Social Security Reform, said that this results in an "unstable" situation that should be corrected. This "unstable" condition must be addressed if future financing problems are to be avoided.

In an August 10, 1982 article appearing in the Wall Street Journal, Charles Schultze, Chairman of the Council of Economic Advisers to President Carter, argues persuasively for replacement of CPI adjustment in all federal entitlement programs with a wage index reduced by 2 or 2.5 percent. This deduction exceeds the assumed future increase in real wage growth. Therefore, he concludes that Congress could periodically decide if ad hoc adjustments are warranted.

The long term financing problems are much more serious, particularly if the Medicare program is considered, as it should be. The long term problems are largely the result of demographics. The tidal wave of the "baby boom" generation will have to be supported by the relatively smaller "baby bust" generation, and the problem will be compounded by every increasing longevity.

There are currently 3.2 workers supporting each beneficiary. Even after assuming an increase in birth rates, this is expected to decrease to a 2 to 1 ratio once the baby boom generation is retired.³ This projection is of minor concern to some who point out that the total dependency ratio, considering both those under 20 and those over 64, will not change dramatically and that resources can therefore be shifted from support of dependent children to support of the

elderly. While this is true in part, it must be recognized that the elderly receive a level of support three times as large as that received by children because the elderly maintain independent households.⁴ This fact gains significance when one realizes that the percentage of U.S. population over age 65 will exceed the proportion of the current population residing in Florida once the baby boom generation retires.

I am both a representative of the baby boom generation and a father. My children are part of the baby bust generation. Unless changes are made in the benefits that have been promised to my generation, my children and their employers will be required to pay taxes equivalent to 34 percent of payroll to support the wage related benefits discussed by Munnell and the Medicare benefits.⁵ I believe it is neither fair nor reasonable to leave that legacy to my children.

Incidentally, this 34 percent cost estimated is based upon the II-B "best estimate" assumptions, which project an increase in birth rates, a slowdown in the rate of mortality improvement, and a return to the very favorable economic conditions of the 1950s and 1960s. Costs would be even higher if these assumptions prove to be optimistic, as has been the case during the last decade.

Since the long term problem is a demographic problem, it warrants a demographic solution. The proposal to gradually increase the retirement age, as Munnell suggests, is a reasonable solution. Most study groups have recommended such an increase, and a New York Times survey conducted last year found public support for such a change by a 5 to 4 margin.

James Schulz correctly points out the fact that people do favor early retirement. Therefore, the approach being developed by House Ways and Means Social Security Subcommittee Chairman Pickle that would still permit actuarially reduced benefits to begin as early as 62 is preferable to ap-

proaches that advance the early retirement ages as the normal age increases.

Like Schulz, I too favor the “carrot to the stick.” However, demographic developments force our country to make some difficult choices. Since Social Security is an inter-generational transfer program, the difficult choices must be framed within the context of the following question: At what point in time can parents realistically expect that their children will be able to support them?

Several years ago, President Carter appointed the President’s Commission on Pension Policy to examine all aspects of retirement income. This Democratic controlled Commission concluded that “the nation has become too dependent on pay-as-you-go programs like social security to provide retirement income for elder citizens.” They recommended a long term shifting of dependency to a balanced program of employer sponsored pension plans, social security and individual saving.⁶

The Schulz paper points out the fact that private pension plans can provide a very significant level of retirement income for those who are covered. Munnell points out that only one-half of the workforce is covered by such plans. However, that statistic is misleading, since many of those who are not covered do not yet meet the ERISA participation standards of age 25, one year of service and 1000 hours of employment. Among that portion of the workforce who must meet these standards, more than two-thirds are covered.⁷ Furthermore, more than 90 percent of married couples can expect to receive employer pension benefits when they retire.⁸

Besides helping to assure an adequate level of retirement income, private pension plans offer an important advantage in that they offer flexibility to meet different needs and circumstances. For example, some industries, such as steel,

have jobs that are more physically strenuous. Therefore the United Steel Workers of America have typically negotiated pension plans offering generous early retirement benefits. This type of flexibility is virtually impossible to achieve with a monolithic plan covering all Americans. It is just one of the reasons why the government should actively seek to encourage the expansion and adoption of such plans.

Both authors have noted that private pension plan benefits to retirees have not kept pace with inflation despite periodic ad hoc adjustments. I regard this as a significant problem that employers must address. In Canada, there is increasing awareness of this issue, and the employer community is beginning to respond by supporting an approach referred to as the "excess interest method." Under this method, excess investment return, resulting in large part from inflation, is used to provide additional benefits. This approach has been used by the Rockefeller Foundation in the U.S.

However, the best way to solve these inflation-related problems is by adoption of appropriate fiscal and monetary policy designed to control inflation. While the Federal Reserve has been following such a course, neither Republican nor Democratic politicians have had the courage to do so.

Finally, individual savings can provide a very significant source of retirement income or can reduce the need for other sources of income. I agree with Munnell that individuals at the lowest income levels are not able to save. However, I strongly disagree that middle income workers will not be able to save if proper tax incentives are provided along with convenient means to facilitate the saving. As evidence, it should be noted that 72 percent of persons over age 65 live in their own homes, and 84 percent of those homes are mortgage free.⁹ Our tax policies have encouraged home ownership and the public has responded.

As another example, my employer, The Prudential Insurance Company of America, provides a thrift plan to all employees after one year of service. The company fully matches the first 3 percent of salary set aside by the employees. Beyond that, the employee can save up to an additional 10 percent of salary. Since the company contribution vests very quickly, it is not surprising that 90 percent of the eligible employees participate in the program. Moreover, contrary to Munnell's contention, two-thirds of the participants are able to set aside additional savings, and the levels of savings are very significant at every income level. For example, the total savings rate for all participants, including the company's 3 percent share, is 10.5 percent of salary. The only salary group with a savings rate less than 10 percent are those earning less than \$10,000 per year, whose rate was 9.7 percent.

In addition, last year's Congressional legislation permitting all wage earners to establish tax-deferred IRAs was a major step to encourage people to save for their retirement. The public has responded very favorably, and our company alone will have established approximately one-half million IRAs in this first year of eligibility. This figure is especially impressive considering that only one-tenth of all IRAs have been set up through insurance companies, and that Prudential accounts for only 10 percent of the total insurance industry.

Evidence of these kinds leads me to believe that the majority of the population is capable of setting aside significant savings for retirement. What has been needed are the proper incentives and the means to set aside such savings. National policy should continue and expand efforts to develop such arrangements.

In conclusion, Social Security is the essential base for providing retirement income, and steps should be taken to

restore public confidence in the program. Those steps should honestly restore financial balance for both the short and long term so that it will continue to serve its vital role not only for this generation but for future generations as well. Private pension plans and individual savings can and should play a major role in providing retirement income. Those plans offer flexibility needed to meet different needs and circumstances. In addition, those plans avoid the potential for inter-generational conflicts inherent in pay-as-you-go financed programs. Thus, there is need for legislation and regulation designed to encourage rather than discourage these sources of income. Retirement income can best be provided by a balanced program of Social Security, private pension plans and individual savings. Such a balanced program will assure adequate and secure sources of retirement income for all Americans.

NOTES

1. Survey conducted by Peter D. Hart, Research Associates, *Social Security in America's Future, Final Report of National Commission on Social Security* (Washington, DC: GPO, March 1981), p. 378.
2. U.S. Congress, Senate, Committee on Finance, *Social Security Financing*, Committee Print, No. 97-8. 97th Cong., 1st Sess. (Washington, DC: GPO, September 1981), p. 50.
3. U.S. Department of Health and Human Services, Social Security Information, *1982 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (Washington, DC: GPO, 1982) (hereafter cited as *1982 Trustees Report*), pp. 65 and 66.
4. *Social Security Financing and Benefits, Reports of the 1979 Advisory Council on Social Security* (Washington, DC: GPO, December 1979), pp. 309-313.
5. *1982 Trustees Report*, p. 64 and unpublished results of studies conducted by Actuarial Division, Health Care Financing Administration, U.S. Department of Health and Human Services.

6. *Coming of Age: Toward a National Retirement Income Policy, President's Commission on Pension Policy* (Washington, DC: GPO, February 1981), pp. 7 and 9.
7. Sylvester J. Schieber and Patricia M. George, *Retirement Income Opportunities in an Aging America: Coverage and Benefit Entitlement* (Washington, DC: Employee Benefit Research Institute, June 1981), p. vii.
8. Employee Benefit Research Institute, *Retirement Income Opportunities in an Aging America: Income Levels and Adequacy* (Washington, DC: Employee Benefit Research Institute, 1982), p. vii.
9. Dallas Salisbury, Employee Benefit Research Institute.

Chapters 8 & 9 Discussion

Michael K. Taussig

Alicia Munnell and James Schulz have produced two stimulating papers on various aspects of social pension policy. Munnell's paper gives an excellent, clear presentation of the main issues in social security financing. Schulz's paper is harder to describe; its title is somewhat misleading because he has as much to say about social security as about private pensions. His discussion of both these subjects includes a number of important, provocative points about pension policy issues. On the whole, the two papers complement each other well.

Munnell and Schulz do clash sharply on one crucial factual matter. Schulz argues that the available evidence shows that improvements in longevity have not been matched by similar improvements in the health of the aged. Munnell comes to the opposite conclusion. Pension policy decisions depend critically on who is right. We expect that continued improvements in medical care and technology will—in the absence of nuclear war or some other catastrophe of comparable magnitude—cause a large increase in the number of persons who survive until, and well past, the traditional retirement ages in this country. We do not yet know, however, whether the expected increase in longevity will cause a corresponding increase in the number of *dependent* aged persons. If the aged worker of tomorrow is healthier than her or his counterpart today, and if there are sufficient attractive job opportunities, then increased longevity will not necessarily mean increased dependency. Unfortunately, I am

not an expert on this complex subject and I cannot resolve the disagreement between the authors of the two papers. The fact that two such eminent authorities on social pension policy disagree about the weight of the available evidence suggests to me that this is a high priority area for more research.

Instead of dwelling further on the details of the papers, I will now briefly sketch my own perspectives on some of the issues in social pension policy. The basic features of social security financing in the United States today are remarkably simple. The system is financed almost entirely by a payroll tax levied on the wages and salaries of current workers. If payroll tax revenues into OASDI are not sufficient to pay the benefits payable under existing formulas to retired and disabled workers and to their dependents and survivors, then either more revenues have to be found or benefits have to be cut, or some combination of both. None of the options today for solving the short-run financing problems of the system is painless. However, the magnitude of the problem is too often exaggerated. As Munnell shows, the current shortfalls in OASDI revenue are small relative to the size of existing benefit commitments and are not expected to persist for more than the next half dozen years or so.

In my view, solving the short-run financing problems of social security by cutting benefits is wrong because it means breaking government commitments to dependent retired and disabled persons who are, for the most part, helpless in coping with large, unexpected cuts in their incomes. Any payroll tax increase would be preferable because it would spread the pain of reductions in living standards much more widely and fairly. My own preferred solution to the short-run financing problem of the OASDI system is to extend coverage immediately to all federal government employees. This step is long overdue on the basis of fairness to virtually all other

workers. It is my experience that people become instant cynics about the federal government and about social security in particular when they learn that the Congress chooses to exclude itself and social security bureaucrats from the “protection” of the social security programs they legislate and administer for almost all the rest of the population. The extension of coverage to federal government employees would end this scandal and would most conveniently solve completely all financing problems for social security until well into the next century.

As Munnell explains, the long-run financing problems of social security around the year 2014 and for some time thereafter are largely due to the aging of the baby boom cohorts and the expected continuation of the very low fertility of the 1960s and 1970s. I find it impossible to share the prevalent concern about this distant crisis because I believe there is little we can do now to affect the situation some 30 or 40 years in the future. We could, of course, sharply increase payroll tax rates in order to build up substantial OASDI trust funds. Economists throw cold water on this idea by observing that such a measure would help only if it caused a substantial increase in real capital formation and a higher rate of national economic growth. Even if it were guaranteed to work, I doubt that it would be acceptable to current workers. They would in effect have to pay for their own retirement benefits as well as for the benefits of current retirees. Alternatively, we could be more conservative about the level of benefits promised to current workers. As Munnell explains, one way this could be done is to switch from the current system of wage indexing of covered earnings to price indexing. Such a step would reduce the replacement rate under OASDI if real wages increase in the future. It should be obvious that this change would also be most unattractive to current workers looking ahead to retirement in the next century. If such measures are rejected, then the social

security financing problems of 2020 will have to be solved in 2020.

These thoughts lead me to question what Munnell calls the “individual lifetime perspective” as the rationale for a social security disability and retirement system. Both it and the annual tax and transfer perspective are valid in specific circumstances, but I lean more to the tax-transfer view. Every generation has to make a decision about the size and distribution of the net transfer from its current workers to its dependent nonworkers. We can try now to influence this transfer in the year 2020 by promising our young workers the present replacement rates in OASDI, but any such promise has to be fulfilled by the workers then alive. If we make promises now that the workers of 2020 refuse to honor, they will have ample means to cut drastically the size of the transfer. Thus, all the lifetime insurance aspects of social security could be swept away if any generation refuses to repay the compulsory savings of its retired and disabled workers.

Even if we could do something now to avert the expected long-run deficits of OASDI, it is not obvious to me that we should do anything. First, babies may come back into fashion in the 1980s and 1990s and grow up just in time to work and pay taxes to alleviate the expected social security financial problems. Second, as both Munnell and Schulz say, the opportunities for work are likely to be more attractive for older workers in 2020 than today. If continued work becomes attractive enough, both financially and otherwise, then the burden of dependency to be borne by social security could turn out to be far less than we project today. Third, if tight labor markets do exist in 2020 and if older workers are not interested in taking the available jobs, then allowing more immigration of young workers might be an attractive policy on many grounds. For one thing, the young immigrants could help pay for the social security benefits promised to the retired and disabled. Such optimistic scenarios

are not to be confused with scientific predictions, of course, but in my opinion, they are on the same footing as the projections of the OASDI actuaries. I derive great amusement from the spectacle of intelligent and well-informed people who take the official social security actuarial projections so seriously despite the fact that these projections have turned out to be dead wrong time after time. It would be an interesting exercise to trace the history of the social security actuarial projections for fertility, mortality, wages, prices and labor force participation against what actually occurred. Finally, as Munnell shows, even if we accept the pessimistic official projections for 2020 and beyond, the tax rates required of the relatively rich workers with few dependent children at that time are not out of line with the social security tax rates paid now by workers in other industrialized, democratic countries.

I will conclude my discussion of the two papers with a mention of important aspects of social pension policy that neither author addressed. The elderly have important sources of income other than earnings or OASDI and private pensions. Supplementary security income is an important source of income support for the poor and near-poor elderly. Also, many elderly persons still depend on support from their children, sometimes as members of extended families living in the same household. On the other end of the income spectrum, a small number of elderly persons finance their retirement largely out of accumulated personal saving. If the new rules affecting individual retirement accounts are effective, private savings will become a more important and widespread source of retirement income by 2020. I believe it is important to examine the possible growth of these alternative income sources for the elderly in assessing the sufficiency of pensions in the next century.

A related point is that both papers concentrate too much on the replacement rates provided by public and private pen-

sions as a criterion for the sufficiency of such benefits. The focus of some recent research has been on direct measurement of the total incomes of the elderly relative to the nonelderly. In some recent work of this kind, Sheldon Danziger, Jacques van der Gaag, Eugene Smolensky, and I have found that the elderly fare surprisingly well relative to the nonelderly when all relevant factors, such as the number of persons sharing the household income, are taken into account as much as current data allow. One of our findings of particular interest for this conference is that the elderly fare particularly well relative to the nonelderly at the same level of pretransfer income. Compared to the elderly, some other groups, such as children in one-parent families, are much worse off and are much less protected by our system of transfers.