Statement of
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NOTICE

This statement is not available for public release until it is delivered at 9:00 a.m. (EDT), Tuesday, July 12, 1988.

Thank you, Mr. Chairman, for this opportunity to testify on the topic of pension portability. Pensions not only affect the level of income people receive in their old age, but, in an economy with considerable job mobility, they also raise questions of fairness--both in how benefits are distributed relative to their costs and in how the tax advantages of pensions are distributed. Pensions also are an important element in how many businesses manage their affairs and have been the explicit subject of collective bargaining. Any new federal mandates to make pensions more portable must be carefully weighed against possible effects on established business practices, the collective-bargaining process, and the willingness of employers to sponsor plans.

My testimony today first reviews the conditions that cause pension portability to be a matter of continuing policy debate. This review will be followed by some examples of how job mobility can affect the size of a person's pension in retirement, and by some projections for today's workers of their pension benefits and the associated tax advantages. After reviewing past legislation dealing with pension portability, I will outline and analyze proposals for additional changes that would increase benefits for mobile workers, or make it easier for such workers to consolidate their benefits from several pensions and preserve them for retirement.

WHY PENSION PORTABILITY IS AN ISSUE

Several conditions combine to make portability among pensions a potential public policy concern. Those conditions are:

- o Workers typically change jobs several times over their lifetimes, some more than others;
- o The pension system is not uniform among employers and is dominated by defined benefit plans; and
- o The current federal tax system gives participants in tax-qualified pension plans a better return on their retirement savings than others can achieve outside such plans.

Labor Force Mobility

Most workers change jobs over their working lives. Younger workers especially shift among jobs until they find a "good fit" and then settle in for long work spells. The probability of staying on the current job for another 10 years rises until workers are in their 40s. Men tend to settle in sooner than women and have longer job tenures. Men and women typically hold three to four full-time, year-round jobs over their working lives.

Although workers tend to settle into jobs by the middle of their work career, a significant number still change jobs during that time and, as a

result, sacrifice the advantages, such as pension benefits, that often accompany long tenure. Professor Robert Hall of Stanford University has estimated that 20 percent of workers in their early 40s, who had already been on their job for 15 to 20 years, would leave that job within the next 10 years. Other workers fail to build up long tenures in any one job. Among recent applicants for Social Security benefits, one-third of the men and two-thirds of the women had spent less than 20 years on any one job.

Reasons for leaving a long-held job before retirement range from economywide trends to personal events. The severe recession in 1981 and 1982 and the recent competition from imports cost the jobs of many experienced workers in manufacturing. Even when the overall economy is doing well, specific firms fall on hard times and lay off workers. Workers also change jobs for solely personal reasons, such as disputes with supervisors, health problems, or, increasingly, the transfer of a spouse.

With the entrance of the baby-boom generation into the labor market and the growing participation of women in the labor force, job changing may appear to occur even more frequently now than it did in earlier years. There is, however, no evidence to date that current workers will be more or less mobile over their entire working lives than were workers in earlier generations. In the last 5 years, the median job tenure has been stable--4.4 years in 1983 and 4.2 years in 1987.

Diversity in Pensions and the Importance of Defined Benefit Plans

Though pensions are heavily regulated, the basic decisions of whether to have a pension, of what type, and at what level are left to employers and, to a much lesser extent, workers. Under current conditions, employers and unions design pensions that they perceive as meeting their long-term economic interests. These objectives may or may not always conform with the interests of individual workers who, for one reason or another, move from job to job.

The existing pension system contains two basic models--the defined benefit plan and the defined contribution plan. The issues of pension portability are most acute for defined benefit plans. The defined benefit plan is the dominant type of pension. According to 1985 Department of Labor figures, roughly 70 percent of covered workers have a defined benefit plan as their basic pension. In defined benefit plans, the employer promises certain retirement benefits to the firm's workers, usually based on their years of service and their current dollar salary at the time they leave the plan. The salary base of a worker who leaves a plan at retirement will coincide, at least initially, with the worker's cost-of-living in retirement. For a worker who leaves a plan long before retirement--for example, at age 40--that salary base will have eroded in purchasing power by the time the worker is eligible to draw his or her pension from the plan, typically at age 65. Thus, for participants of defined benefit plans, job changing not only affects whether a worker satisfies participation and vesting requirements, but it

also profoundly limits the value of a worker's benefits available at retirement.

In contrast, in defined contribution plans, the employer makes a contribution to each participant's account, usually as a percentage of salary. The pension income of people covered over their lifetimes only by defined contribution plans--for example, university personnel in the TIAA-CREF system--derives from those contributions and their investment earnings. Accordingly, except for participation and vesting requirements, job mobility generally does not affect the value of an individual's retirement benefits from any particular defined contribution plan. In 1985, such plans constituted the major pension for about 30 percent of covered workers. This percentage reflects considerable growth in the 1980s in the number of workers who are covered by defined contribution plans as their basic pension. In addition, about 40 percent of covered workers have some kind of defined contribution plan--for example, profit-sharing plans and salary reduction arrangements--as a supplement or complement to a base pension, almost always a defined benefit plan.

Most issues associated with pension portability would disappear in a universal and uniform pension system that covered all employers and was designed to accommodate job mobility--for example, a mandatory defined contribution tier such as that recommended by the 1980 President's Pension Commission, or a system of defined benefit plans organized around occupations such as exists in France. In all but name, such a system

would be tantamount to an additional Social Security tier. It also could have far-reaching repercussions for labor markets, similar to ones discussed later in regard to options for the current system.

Differing Tax Treatment of Retirement Savings

Because pensions receive preferred treatment under the federal income tax, access to pensions is an especially important issue of public concern. The current federal income tax allows pension participants to earn a before-tax rate of return on their retirement savings within a tax-qualified plan. In addition, these savings are taxed at lower tax rates in the retirement years, although this will become a less important factor in the wake of tax reform. Under current conditions, individuals with essentially equivalent lifetime incomes have divergent access to, and benefits from, tax-qualified pensions. The availability of Individual Retirement Accounts (IRAs) only partially mitigates this problem.

If all retirement savings were given the tax treatment now allowed only qualified plans and IRAs, or, alternatively, if normal income tax rules were applied to pensions--for example, by taxing pension trusts on their investment earnings--the tax equity dimension of pension portability essentially would disappear.

EFFECTS OF JOB MOBILITY ON PENSIONS AND FUTURE PENSION RECEIPT

Job mobility and existing defined benefit pension practices affect what people receive from pensions in two key ways. First, depending on how many times they change jobs, individuals with similar lifetime incomes can have different pension amounts at retirement, and, therefore, can have different gains in retirement incomes from the tax advantages associated with pensions. Second, even among people with the same number of jobs over their lifetimes, their pensions and the associated tax advantages differ according to the length of time in a person's last job. The first section below illustrates these points with examples of particular individuals; the following section presents a simulation of future pension receipt that demonstrates these results for a whole cohort of today's workers.

Examples of the Effects of Job Mobility on Lifetime Pension Benefits

In developing the examples shown in Table 1, we have used an illustrative salary projection and a typical defined benefit pension plan that the Congressional Research Service prepared for this hearing. The salary projection is for workers now entering the labor force and incorporates three factors: inflation at 4.0 percent, general productivity increases at 1.4 percent, and personal merit increases. Accordingly, the workers' salaries rise from $20,000 in 1988 to $252,873 in 2031. Inflation is the major reason for this greater-than-tenfold increase.

TABLE 1. ILLUSTRATIVE EFFECTS OF JOB MOBILITY ON LIFETIME BENEFITS FROM DEFINED BENEFIT PLANS
(Salary and pension amounts in current dollars)

Individual	Final Salary Average in Job a/			Years in Pension			Annual Pension Amount from Job b/			Total Annual Pension
	One	Two	Three	One	Two	Three	One	Two	Three	
A	44,802	226,114	--	15	28	--	6,049	64,482	--	70,531
B	95,329	226,114	--	28	15	--	24,025	34,544	--	58,569
C	c/	c/	226,114	c/	c/	25	c/	c/	59,877	59,877
D	22,343	89,995	226,114	4	23	16	d/	18,630	36,847	55,478
E	26,661	89,995	226,114	7	20	16	1,680	16,200	36,847	54,727

Source: Examples prepared by the Congressional Budget Office using salary history and pension plan developed by the Congressional Research Service.

a. Salary histories assume that earnings increase over time for three reasons: inflation (4 percent each year), general productivity increases (1.4 percent each year), and personal merit increases.

b. The pension formula provides an annual benefit equal to the average of the worker's final five years in the pension plan multiplied, for each year covered by the plan, by 1 percent for wages below the Social Security wage base and 1.5 percent for wages above that wage base. Benefits are reduced to reflect the cost of a joint-and-survivor annuity.

c. Individual C is not covered by a pension in first or second job.

d. Individual D does not vest in pension in first job.

The pension plan formula provides a worker with an annual benefit equal to the average of the worker's final five years in the pension plan multiplied, for each year covered by the plan, by 1 percent for wages below the Social Security wage base and 1.5 percent for wages above that wage base. Benefits are reduced to reflect the cost of a joint-and-survivor annuity. Though each employer is assumed to sponsor a defined benefit plan that uses this same formula, tenure under one plan cannot be credited toward benefits in another plan. Thus, an individual starts again in each plan every time he or she moves to a new job.

As a general rule, the more times an individual changes jobs among defined benefit plans, the lower the total pension amount will be at retirement. This can be seen by comparing individuals A and B, workers who hold two jobs during their careers, to individuals D and E, who hold three jobs. The fewer job changes by A and B mean that they have more of their years credited toward higher salaries than do individuals D and E. Consequently, they have higher total pensions.

The length of time spent in a person's last job is also important. Though workers A and B each hold two jobs, the first 15 years of worker A's total pension benefits are weighted according to her salary average of roughly $45,000 when she leaves her first job at age 37, and the last 28 years are weighted according to her salary average of roughly $226,000 when she retires at age 65. Worker B is in the opposite situation: the first 28 years are weighted according to an average salary of roughly $95,000 at age 51, and the last 15 years are weighted

according to the $226,000 salary average at retirement. Because of the additional 13 years that individual A spends in her last job, she receives roughly $12,000 more in annual pension benefits.

Under some circumstances, the length of time in a person's last job can be more important than the number of job changes or even coverage by a pension during the early portion of a person's working life. Though individual C holds three jobs and is not covered by a pension plan until age 40, his continuous coverage in one plan thereafter places him in a better position than anyone except individual A. Similarly, though worker D does not vest in his first pension, he loses little because his salary is relatively low when he leaves his first job. Thus, his total pension is very close to worker C's.

Simulation of Future Pension Receipt

The overall effects of current pension practices, as well as the effects of incomplete pension coverage, are illustrated in Table 2 for married couples and Table 3 for single individuals. The tables report the results of a simulation of projected pension benefits for a sample of about 7,000 people, now aged 34 to 43, in the year 2019 when they will be between the ages of 65 and 74. The simulation is discussed more fully in the Congressional Budget Office study, Tax Policy for Pensions and Other Retirement Saving (April 1987), and supporting material. The simulation generally assumes that recent and future patterns of labor mobility and

TABLE 2. SIMULATED RETIREMENT INCOMES, PENSION BENEFITS, AND TAX ADVANTAGES FOR RETIRED COUPLES IN 2019 (Projection for workers ages 34 to 43 in 1988)

Income Quartile	Years in One Plan	Distribution of Retirees by Plan Tenure (In percent)	Projected Retirement Income (In 1988 dollars)	Pension Benefits		Tax Advantages	
				In 1988 dollars	Ratio by Plan Tenure a/	In 1988 dollars	Ratio by Plan Tenure b/
Lowest	Less than 20	69	18,038	2,250		738	
	20 or more	31	22,552	8,785	3.9	3,672	5.0
Second	Less than 20	53	27,862	4,020		1,276	
	20 or more	47	32,358	12,935	3.2	5,022	3.9
Third	Less than 20	43	37,362	8,210		2,726	
	20 or more	57	42,486	19,535	2.4	7,709	2.8
Highest	Less than 20	33	53,253	11,412		3,864	
	20 or more	67	65,150	33,792	3.0	12,482	3.2
All Quartiles	Less than 20	49	30,737	5,546		1,830	
	20 or more	51	44,628	21,122	3.8	8,066	4.4

SOURCE: Congressional Budget Office.

a. Ratio of the pension benefits for workers with long tenure (20 years or more) under one pension plan to the benefits for those with shorter plan tenure (less than 20 years).

b. Ratio of the tax advantages associated with pension benefits for workers with long plan tenure to the tax advantages for those with shorter plan tenure.

TABLE 3. SIMULATED RETIRMENT INCOMES, PENSION BENEFITS, AND TAX ADVANTAGES FOR RETIRED SINGLE PEOPLE IN 2019 (Projection for workers ages 34 to 43 in 1988)

Income Quartile	Years in One Plan	Distribution of Retirees by Plan Tenure (In percent)	Projected Retirement Income (In 1988 dollars)	Pension Benefits		Tax Advantages	
				In 1988 dollars	Ratio by Plan Tenure [a]	In 1988 dollars	Ratio by Plan Tenure [b]
Lowest	Less than 20	96	5,211	478		51	
	20 or more	4	8,092	3,886	8.1	1,471	28.8
Second	Less than 20	80	9,584	1,178		59	
	20 or more	20	11,618	5,168	4.4	1,628	27.6
Third	Less than 20	70	15,058	2,484		522	
	20 or more	30	18,187	8,888	3.6	3,061	5.9
Highest	Less than 20	47	27,251	6,077		1,758	
	20 or more	53	36,732	21,246	3.5	7,479	4.3
All Quartiles	Less than 20	73	12,346	2,040		487	
	20 or more	27	25,734	14,103	6.9	4,920	10.1

SOURCE: Congressional Budget Office.

a. Ratio of the pension benefits for those with long tenure (20 years or more) under one pension plan to the benefits for those with shorter plan tenure (less than 20 years).

b. Ratio of the tax advantages associated with pension benefits for those with long plan tenure to the tax advantages for those with shorter plan tenure.

pension practices will not be very different from the historical patterns that have prevailed since the 1950s. Although the simulation does not reflect recent legislation, for reasons discussed later, we believe that its basic results still hold.

These projections suggest that pension benefits will be significantly larger for workers with long tenure in one plan--illustrated here as those who stay in one pension plan for 20 years or more--compared with the benefits for those with relatively short tenure (less than 20 years in any one pension plan). For most workers the pension benefits projected for those with long plan tenure are two to four times larger than those with relatively short plan tenure.

Because the tax advantages of pensions closely track the benefits, a similar pattern exists for the tax advantages. These advantages are the gains in retirement income that the simulation projects for workers because they can receive a before-tax, rather than an after-tax, rate of return on retirement savings within their pensions. For most workers, the projections indicate that the tax advantages are three to six times larger for those with long plan tenure than for those with shorter tenure.

Among retired single individuals in the bottom half of the income distribution, however, these differences are more pronounced. Most of these individuals are projected to have long periods during which they are not covered by a pension, which lowers the size of the average

pension for those with short tenure and makes the tax advantages associated with their pensions very small.

The simulations also indicate that plan tenure is strongly correlated with income: people with higher income are more likely to stay in one plan for least 20 years. Long plan tenure also is correlated with marital status at retirement: about half of all retired couples have long plan tenure, but only about one in four singles obtain 20 years or more in one plan.

The differences between workers with long plan tenure and other workers raise two equity issues--how the overall costs of pensions to workers are distributed relative to benefits, and how the tax advantages of pensions are distributed. In the view of some analysts, workers who have been covered at one time or another by a particular defined benefit plan have borne that plan's costs through proportional wage reductions, while only a relatively few--long-tenured workers who stay until retirement--receive most of the benefits. Hence, it is sometimes said that short-stayers "subsidize" long-stayers in defined benefit plans. Another view of how workers bear the costs of pensions, however, holds that defined benefit plans elicit greater productivity from workers, and, because those productivity gains are greatest from workers who stay with the sponsoring firm the longest, these workers properly receive most of the pension benefits.

The tax equity issue is clearer. At all income levels, workers who stay with one plan for a long time, especially late in life, receive a greater amount of their retirement income from the tax advantages associated with pensions than do others with equivalent lifetime incomes. In addition, since long plan tenure is associated with higher-income workers, some upward skew in the tax advantages also exists. Nonetheless, all retirees--regardless of their plan tenure or income level--bear the costs of these tax advantages over their working lives through, for example, higher tax rates. The fact that tax advantages for pensions constitute the largest exception to normal income tax rules (measured by cash-flow revenue losses) raises questions about whether the tax preference is achieving its goal of increasing retirement income for all citizens in an equitable and efficient manner.

EFFECTS OF RECENT LEGISLATION

Legislation regulating pensions dates back to the late 1930s. The Employee Retirement Income Security Act (ERISA) of 1974 is the most significant piece of recent legislation and has been subsequently amended in major ways, especially in the 1980s. To understand why large disparities in benefit accruals are likely to continue, it is useful to review the key legal factors that determine pension receipt--eligibility rules and nondiscrimination rules--and to analyze them in light of inflation.

Eligibility Rules

In the 1980s the Congress, especially in the 1986 Tax Reform Act, further tightened ERISA's minimum rules for participation, vesting, and breaks in service, and it also limited the ability of an employer to exclude certain groups of workers from a plan's coverage. Although these recent changes will cause more people to become eligible for a pension, these new pension benefits probably will be relatively small in dollar amounts for the reasons illustrated by Table 1. Accordingly, the basic patterns in Tables 2 and 3 will not be altered very much. Most analyses indicate that the recent reduction in vesting from ten years to five years will add relatively little to aggregate retirement income. Further restrictions in vesting are likely to yield a similar result. A forthcoming study by the Hay/Huggins Company for the Department of Labor shows very modest gains in additional retirement income if the law were changed to require full and immediate vesting.

Nondiscrimination Rules

Since the 1940s, the tax code has limited the extent to which plans may make distinctions among workers in benefits and contributions. Legislation in the 1980s tightened those limits in various ways, especially in the extent to which pensions can take Social Security benefits into account in their formulas. But, with the exception of determining whether a plan gives too large a share of benefits to top

management (the "top-heavy" rules), these rules operate in terms of projected nominal benefits rather than the present value of accrued benefits, which takes into account the time value of money and the effects of inflation. These rules have therefore had relatively slight effects on the real lifetime benefits of workers who change jobs frequently.

Until inflation became a persistent factor in the economy, the effects of job changing on the real value of defined benefit accruals were less evident and were less important than other factors, such as vesting. As a consequence, the Congress only recently has focused on this phenomenon, and then only in the context of a closely related matter: how a plan's termination affects the real value of workers' expected pensions. However, unlike a plan termination where individuals involuntarily experience an erosion of the value of their expected pension benefits, a person who voluntarily changes jobs presumably weighs the loss of a larger pension from his or her old job against the gain in compensation and opportunity in the new job. A different focus, suggested by these hearings, is on the many intermediate situations--such as layoffs in a declining industry, people relocating for family reasons, the effects of divorce on pension rights, and so on--that fall between an involuntary plan termination and a fully voluntary job change.

OPTIONS FOR INCREASING PENSION PORTABILITY

Policies that might address pension portability generally fall into two categories--those that would impose "service portability," or its functional equivalent, on defined benefit plans, and those that would increase "asset portability."

Service Portability

Service portability is the ability to have work performed for different employers credited to one or more pension plans so that the lifetime value of pension benefits is not affected by job changes. Service portability can occur either because service under several employers is pooled in one plan, as in Social Security, or because a successor plan credits service that a worker performed under a previous plan.

Except for participation and vesting requirements, service portability is not important for defined contribution plans. Because job changes do not affect the value of accrued benefits in defined contribution plans, these plans already have the functional equivalent of service portability.

In defined benefit plans, however, the absence of service portability affects both eligibility and the value of accrued benefits. Under current requirements and practice, service portability in defined

benefit plans occurs only within the narrow framework of collectively bargained, multiemployer plans and a few single-employer plans with reciprocity arrangements. Multiemployer plans cover about 16 percent of covered workers. Only about 8 percent of all single-employer plans have reciprocity arrangements. Some limited reciprocity also exists between multiemployer plans.

In theory, all sponsors of defined benefit plans could be required to recognize a worker's service from a previous employer's plan. Such a requirement could work only if all defined benefit plans had very similar rules and pooled their liabilities. In effect, a full system of rules like those that now apply to multiemployer plans would have to be developed economywide. It is doubtful that businesses and other employers would continue to sponsor single-employer defined benefit plans in such an environment of uniformity.

Other alternatives that would impose the functional equivalent of service portability on defined benefit plans are less sweeping.

- o Defined benefit plans could be required to adjust the benefits they owe to separated participants for whatever inflation occurs between the time a worker separates from the plan and the plan's retirement age. As a result, all the pensions paid to an individual from the defined benefit plans in which he or she was a participant, rather than just the pension from the last plan,

would reflect the individual's cost-of-living at the time of retirement.

- Defined benefit plans could be required to have a defined contribution component in what is commonly called a "floor offset" arrangement. In these arrangements, a worker receives the higher of the annuity promised by the defined benefit plan or the annuity financed by his or her defined contribution account. Workers with long tenure still receive advantages from the defined benefit plan, but those with shorter service receive more from the defined contribution annuities.

- The nondiscrimination rules could be modified so that plans are tested generally, as well as for top-heavy status, on the basis of present value rather than on the basis of projected nominal benefits. Each plan would have to decide how it would satisfy this more stringent nondiscrimination test.

- A more modest requirement would be to have all employers, including sponsors of defined benefit plans, offer a voluntary salary reduction arrangement to their employees, subject to the usual nondiscrimination tests for elective deferrals. This approach would allow workers who are otherwise not covered by a qualified plan, or who do not expect to stay very long under a defined benefit plan, to save more on their own initiative in a type of defined contribution plan.

To different degrees and with different effects on costs, these alternatives would increase portability in pensions and achieve greater tax equity. For example, the forthcoming Hay/Huggins study mentioned earlier concludes that most of the losses currently associated with job changing by participants in defined benefit plans would be eliminated if plans were required to inflate benefits for separated workers between separation and retirement. If such a requirement were imposed on plans, either plan costs would have to increase with commensurate reductions in current pay, or the benefits paid to workers with longer service would have to be adjusted downward to hold aggregate plan costs constant. CBO's calculations indicate that, if the effects were solely in the form of reduced current compensation, the affected workers would have roughly 0.4 percent to 2.8 percent of their lifetime compensation permanently shifted from current wages to pension benefits. The exact amount shifted would vary with the level of job turnover in the worker's defined benefit plan.

In principle, either response--reduced current wages or reduced benefits for long-tenured workers--would mean that pension benefits would be more evenly distributed and less dependent on tenure in any particular job. But these same changes could undermine the motivations for employers to sponsor defined benefit plans--namely, to bind workers to the long-term interests of the firm and to reduce turnover. Absent this so-called "lock-in" effect, it is possible that few employers would continue to sponsor defined benefit plans, especially in view of their increasing complexity and financial risks.

Some analysts have suggested recently that defined benefit plans hurt the economy precisely because, in a time of increasing global competition, they impede labor mobility. They argue that defined benefit plans should therefore be discouraged or modified to reduce their lock-in effects. On the other hand, a number of studies have argued that defined benefit plans can increase a firm's production and lead to a greater coincidence of interests among employers and workers.

The inconclusive nature of this debate suggests that the future of defined benefit plans should be left to the usual give-and-take of the labor market, especially the collective-bargaining process. After all, the pension system has always had an alternative--defined contribution plans--in which an individual's accruals, once vested, are not affected by job mobility. TIAA-CREF and similar arrangements in the education and nonprofit sectors demonstrate that where both employers and participants want retirement benefits to be relatively unaffected by job changing, a defined contribution pension system can be designed and can operate successfully over a very long time period.

Nonetheless, the defined benefit plan remains the basic form of pension for most workers, which suggests that such plans are continuing to meet what employers and workers perceive to be their needs. Of course, defined contribution plans carry greater investment risks for the participants. But defined benefit plans also carry their own kind of risks--for example, the effects of a plan termination on the value of benefits. As employers and workers weigh these competing risks, as well

as the other advantages and disadvantages associated with each pension type, preferences may shift toward defined contribution plans, as seems to have been happening in recent years. Alternatively, employers and their workers could voluntarily negotiate changes in defined benefit plans, such as the indexing option mentioned earlier, that would increase benefits for workers with shorter tenure. Nothing in current law prevents such innovations if both parties want them.

The recent revision of the pension system for federal government workers illustrates yet another alternative that is becoming increasingly widespread--namely, the complementary use of defined benefit and defined contribution plans to build a pension portfolio. The defined benefit plan in the new system remains attractive for long-service employees, while Social Security coverage and the new thrift plan--a type of defined contribution plan--are more helpful to short-service federal employees than was the old system. As a result of the new pension system, the federal work force should experience some greater job turnover in the future, but not as much as if the system had shifted entirely to Social Security and a single defined contribution plan. If, after experience with the new system, the federal government determines that it wants more or less mobility among its own workers, the relative weight given the thrift plan and the defined benefit plan could be altered. Similarly, as federal employees become increasingly familiar with a mixed system, they may begin to express a preference for a changed balance between the two plans. Indeed, the balance could be different in different agencies: what makes good pension policy for the Social Security Administration,

which needs a large and stable work force across the country, may not make sense for the National Institutes of Health and its need for constant exchanges with a particular research community.

Asset Portability

Asset portability is the ability of an individual to move the value of accrued benefits from one tax-advantaged vehicle to another. Although asset portability can help maintain the tax-free status of accrued benefits, it does not affect the value of an individual's accrued benefit from any particular plan at the time of separation. In defined contribution plans, an individual's accrued benefit at separation from the plan is the amount in his or her account balance. Such amounts typically are paid out as lump sums, although some defined contribution plans offer, even require, annuity payouts instead. In defined benefit plans, an individual's accrued benefit at separation is the annuity to which the individual is entitled at the plan's retirement age. These deferred annuities can be converted to lump sums that have equivalent present values.

Two changes are commonly suggested to enhance asset portability--increasing the availability of lump-sum distributions to mobile workers, and further encouraging the preservation of those distributions until retirement.

Increase the Lump-Sum Distributions to Mobile Workers. Within certain statutory guidelines, each plan decides whether to allow separating workers the option of "cashing-out"--that is, taking their accrued benefits with them as a lump sum. Requiring plans to offer a cash-out option would allow workers more easily to combine several small pension accumulations into larger rollover IRAs that eventually could be converted into a single annuity at retirement. Such a change in the law also might better assure that workers collect the full amount of their pensions. Plans lose touch with separated workers, and those workers sometimes fail to apply for their deferred annuities at retirement. On the other hand, expanding cash-out options for workers could lead to liquidity problems for some plans and to more preretirement consumption by workers of their pension accumulations. Allowing more cash-outs also would diminish the premium base for the Pension Benefit Guaranty Corporation.

Encourage Pension Preservation for Retirement. The ability to preserve the tax-free status of distributions from tax-qualified pensions has existed since 1975 when rollover IRAs first became effective. Rollover IRAs, however, have not been much used, although that may change in the future as the effects of the 1986 Tax Reform Act are felt. Tax reform largely eliminated favorable treatment for lump-sum distributions, and it imposed a 10 percent additional tax on certain uses of the proceeds from any qualified plan or IRA. These steps, by themselves, may cause more people to use the rollover IRA option.

Additional restrictions could be placed on the preretirement use of accrued pension rights. For example, tax-qualified pensions could be required to place any preretirement distribution into a rollover IRA. Alternatively, pensions could be prevented from cashing out workers whose accrued benefits exceed a particular dollar level. At the same time, the additional tax on preretirement uses of plan distributions or rollover IRAs could be increased. These restrictions, however, still would not prevent individuals, especially those in the top half of the income distribution, from borrowing against their other assets--especially their houses--in the amount of the accrued pension benefits that they cannot directly use. It is questionable, therefore, whether such restrictions could actually force people to save more for retirement.

CONCLUSION

In conclusion, I wish to emphasize four points. First, the current pension system poses serious issues of tax equity. In particular, people with equivalent lifetime incomes may get very different gains in retirement income from the tax advantages of qualified plans, depending on their work histories. Second, the principal reason for these disparities is the way that defined benefit plans--the mainstay of the current pension system--operate. Those who change jobs more often and later in life generally receive less from defined benefit plans than those who work for fewer employers. Restructuring defined benefit plans to increase service portability, or its equivalent, could provide more

equitable treatment for mobile workers, but would have considerable and unclear effects on labor markets. Third, changes in asset portability will not fundamentally alter the pension amounts available at retirement. Finally, though the issue of pension portability will continue to pose a public policy dilemma, it may begin to resolve itself over time if more employers and workers begin to voluntarily shift toward defined contribution plans, at least in the form of supplementary retirement savings.