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PENSION ASPECTS OF THE ECONOMICS OF AGING: PRESENT AND FUTURE ROLES OF PRIVATE PENSIONS

A WORKING PAPER IN CONJUNCTION WITH THE OVERALL STUDY OF "ECONOMICS OF AGING: TOWARD A FULL SHARE IN ABUNDANCE"

PREPARED FOR THE

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LETTER OF TRANSMITTAL

Senator HARRISON A. WILLIAMS, Jr.,
Chairman, Special Committee on Aging,
U.S. Senate.

DEAR SENATOR WILLIAMS: You have asked me, as a member of the task force which reported to you earlier this year on the economics of aging, to submit a supplemental working paper on private pensions and their relation to income maintenance problems of the elderly. Transmitted herewith is the paper which you requested.

Although I take complete responsibility for the contents, conclusions, and any errors contained in the paper, I wish to acknowledge the advice and assistance of a number of experts in the field of private pensions. These persons are:

Miss Pearl Charlet, manager of research, Edwin Shields Hewitt Associates.
Mr. Walter W. Kolodrubetz, Office of Research and Statistics, Social Security Administration.
Mr. Donald Landay, Chief, Division of General Compensation Structure, Bureau of Labor Statistics.
Mr. Theodor Schuchat, retirement editor, North American Newspaper Alliance.
Mr. Alfred Skolnik, Chief, Interprogram Studies Branch of the Office of Research and Statistics, Social Security Administration.
Mr. Edward W. Spannaus, research associate, Institute of Industrial Gerontology, National Council on the Aging.
Mr. Arnold Strasser, Director, Employee Benefits and Annual Earnings Projections, Bureau of Labor Statistics.

In addition, I wish to acknowledge the fact that Miss Dorothy McCamman, consultant to your committee, provided a great deal of assistance in helping me organize and execute this paper in the relatively short time available.

All the above persons met in Washington in September to discuss private pension developments in the United States, especially in relation to the problems raised in the task force paper, "Economics of Aging: Toward a Full Share in Abundance." The group attempted to identify a number of specific private pension issues which were thought to be crucial in evaluating the present and future role of private pensions in the aged income maintenance process.

In addition, various members of this group provided me with ideas and suggestions for the paper and improvements in the paper as it moved through its various stages toward final development.

Also, I would like to acknowledge the fact that sections II–A and III–A of my paper are updated excerpts from articles by Miss Char-

let and Messrs. Skolnik and Kolodrubetz which originally appeared in the Joint Economic Committee compendium, "Old Age Income Assurance."

While the paper does not discuss all the important issues regarding the role and operation of private pension plans. I hope that it is sufficiently comprehensive (and provocative) and, hence, will serve as a basis for further discussion and inquiry in this area by your committee.

JAMES H. SCHULZ,
Associate Professor of Economics,
University of New Hampshire.

PREFACE

For its study of the "Economics of Aging: Toward a Full Share in Abundance," the U.S. Senate Special Committee on Aging has already issued one working paper which surveys the major issues and several others dealing with specialized subjects.[1] Each document has made a major contribution to the overall committee study.

Today, the committee is publishing another study on a subject of utmost importance to its deliberations on present and future trends in retirement income. As Dr. James Schulz makes clear in his letter of transmittal, this latest working paper has been written with the advice of several knowledgeable persons, but the actual drafting and conclusions are his.

Dr. Schulz is especially qualified to deal with pension aspects of the economics of aging. In 1968, his projections on future pension income trends filled a much-needed information gap and showed a clear-cut need for far more widespread attention to the subject. Later, while a member of the first task force which reported to this committee on the economics of aging, Dr. Schulz again provided valuable information on pension trends while calling for more information on that subject. His fellow task force members agreed with him about the need for additional exploration in this area, and the Committee on Aging is now preparing for hearings next month along the lines recommended by the task force.

Dr. Schulz's working paper will serve as a springboard for much of the discussion at the hearing because he has, once again, provided disturbing evidence on at least two important points:

> One. That private pensions, while performing a major service to the economy and to millions of Americans, now serve far fewer than is commonly assumed and will continue to fall short of expectations unless greatly improved.
>
> Two. And that many common assumptions about the level of private pension projection are based more on wishful thinking than upon hard fact.

The need for hard facts becomes more and more evident as Dr. Schulz presents his findings. While neither he nor the Committee on Aging offers recommendations on pension coverage at this point, Dr. Schulz has performed an important service by emphatically telling us why we

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[1] Part 1. Survey Hearing, Washington, D.C., Apr. 29–30, 1969.
Part 2. Consumer Aspects, Ann Arbor, Mich., June 9, 1969.
Part 3. Health Aspects, Washington, D.C., July 17–18, 1969.
Part 4. Homeownership Aspects, Washington, D.C., July 31–Aug. 1, 1969.
Part 5. Central Urban Area, Paramus, N.J., July 14, 1969.
Part 6. Retirement Community, Cape May, N.J., July 15, 1969.
Part 7. International Perspectives, Washington, D.C., July 25, 1969.
Part 8. National Organizations, Washington, D.C., Oct. 29, 1969.
Part 9. Employment Aspects, Washington, D.C., Dec. 18–19, 1969.

must have a more precise answer to the question he raises in his opening paragraph:

> What should be the future role played by private pension plans in enabling persons to obtain what they judge to be an adequate level of income in retirement?

HARRISON A. WILLIAMS, Jr.,
Chairman, U.S. Senate Special Committee on Aging.

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Pension Aspects of the Economics of Aging: Present and Future Roles of Private Pensions

(By James H. Schulz, Ph. D., Associate Professor of Economics, University of New Hampshire)

INTRODUCTION

The U.S. Senate Special Committee on Aging, through a series of working papers and hearings, has sought to survey the extent of our knowledge regarding the economic security of the elderly population. The committee has looked at the economic situation and problems of today's elderly. But, most importantly, the committee has also focused attention on the situation which will prevail in the future. It is adequate knowledge about this future situation which is the key to developing sound social policy in the area of aged income maintenance.

In "Economics of Aging: Toward a Full Share in Abundance,"[1] a task force surveyed the whole general area of income maintenance as it relates to the elderly. In addition to providing information about the present characteristics of the aged population, their economic position, and their needs (and projections for the future aged), the task force working paper surveyed various potential means for improving the economic situation of the aged.

One such means considered was the expansion and broadening of private pension plans. Concerning such plans, the task force highlighted the following facts:[2]

1. Even under earlier projections now known to be optimistic, only a third to two-fifths of all aged persons in 1980 are expected to have income from private group pensions.
2. The fact that private pension coverage is concentrated among higher paid workers will mean that those in the greatest need in old age will be least likely to receive private pensions.
3. Virtually none of the thousands of private pension plans makes provision for adjusting the benefit of the retired worker to increases in living costs.
4. Private pension plans normally provide little or no protection for the survivors of covered workers.

This paper moves beyond the initial observations of the task force (which were by necessity limited and general in nature) and at-

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[1] U.S. Senate Special Committee on Aging. "Economics of Aging: Toward a Full Share in Abundance," 91st Cong., first sess. (Washington, D.C.: U.S. Government Printing Office, 1969). Out of print. Reprinted as app. I of Survey Hearings on "Economics of Aging: Toward a Full Share in Abundance," pt. I, pp. 149–228.
[2] *Ibid.*, pp. 38–39.

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tempts to provide additional discussion about a number of important issues in the area of private pensions. Once again, however, the discussion is not comprehensive in nature but is limited to those issues which are in the judgment of the author particularly crucial in evaluating the present and future income maintenance situation of the elderly.

I. INCOME MAINTENANCE AFTER RETIREMENT

Of all the numerous issues surrounding the establishment and administration of private pension plans in the United States, one issue stands out: What should be the future role played by private pension plans in enabling persons to obtain what they judge to be an adequate level of income in retirement?

A. The Three-Way Choice

The task force has stated: "Every American—whether poor or rich, black or white, uneducated or college trained—faces a common aging problem: How can he provide and plan for a retirement period of indeterminate length and uncertain needs? How can he allocate earnings during his working lifetime so that he not only meets current obligations * * * but has something left over for his own old age?"

This is the central issue. It is not so much a question of giving older Americans rights or giving older Americans what is their due or fulfilling an obligation arising from the fact that older Americans were born before us. Rather the provision of adequate economic resources in old age requires intelligent planning to assure a more even distribution of each family's income over its lifetime. This, however, is not an easy task—given the uncertainties and complexities of retirement planning and the vicissitudes of the economy.

It is becoming increasingly apparent that our society as a whole must come to grips with two questions: (1) What standard of living do we, the young and nonretired, want when we get old and (2) having decided that, we are faced with the three-way choice: What should be the respective roles of the individual through personal saving, private industry through private pensions, and government through public pensions in planning and providing for that standard of living in old age?

Given the needs of today's aged Americans and prospects for rising retirement expectations in the future, some people might suggest that we really will never be able to develop adequate programs for the aged because there are so many other competing social needs. The major economic issue is not, however, whether—in the face of other needs such as general poverty, urban blight, and education—we can have adequate programs for the aged. Rather, the issue is better posed as to whether we want a higher standard of living in our younger years at the expense of a lower standard during retirement. This issue is extremely difficult to deal with because we are faced essentially with a question of how to provide ourselves with a satisfactory level of income after work stops in a society which has traditionally oriented its income provision almost solely to the performance of work.

To better provide for old age, people must either save more during their working years or they must develop institutions which will provide each succeeding aged generation with the required amount of income transfer from the working population to the retired or semiretired. These options mean either higher taxes, higher private pension or insurance contributions, or higher personal savings in the working years.

B. What Role Private Pensions?

John McConnell has succinctly summarized the commonly voiced view as to the relative roles of public pension, private pensions, and personal saving as follows:

> When the Social Security Act was passed, the purpose of old-age insurance was said to be the provision of a floor of income support. It was expected that individual savings would supplement the basic OASDI benefit. Following the rapid expansion of private pension plans during and following World War II, it became quite common for both the proponents and opponents of old-age insurance to refer to the American system of income maintenance as a three-legged stool, or a three-layer cake, although the pitiful nature of the income received by most older people from all sources made the analogy of the cake seem something of a mockery. It is quite clear that the spread of private pension plans has confused the role of OASDI and of private pensions and savings. There is a tendency to argue that OASDI should provide only minimum subsistence, and that private pensions will supply enough when added to OASDI to equal an adequate income. Private saving will assure a comfortable existence. This view of the three elements is reflected in the formulas used to determine the amount of private pension benefits, since the private benefit is superimposed on the OASDI benefit to fulfill the popular formula which yields 65 percent of average wages for the low-income group scaled downward so that combined benefits will yield 50 to 35 percent for the various gradations of the high-income group.[3]

But serious controversy continues to exist over what should be the "floor" provided by public pensions. John McConnell continues in his article:

> * * * it is impossible to assume that the population 65 will generally receive an *adequate* retirement income through a combination of OASDI and private pension benefits. Faced with the prospect that not more than 20 percent of those over 65 (25 percent of all beneficiaries of OASDI) will receive private pension benefits, if the Nation is serious about providing an adequate income for older retired people it will have to do so through a greatly improved public old-age insurance system."[4]

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[3] "Role of Public and Private Programs in Old Age Income Assurance," in U.S. Joint Economic Committee, *Old Age Assurance,* pt. I, 90th Cong., 1st sess. (Washington, D.C.: Government Printing Office, 1968), p. 45.
[4] *Ibid.,* p. 46.

Contrast McConnell's statement with the views of Robert Tilove, and the controversy stands out in harsh reality:

> There are schools of thought that place little value on private pension plans. The report entitled "Old-Age Income Assurance: An Outline of Issues and Alternatives" submitted to the Subcommittee on Fiscal Policy of the Joint Economic Committee expressed the view that that aggregate of private plans was not well suited—from the standpoint of equity or efficiency—to accomplish the public purpose of providing adequacy of income in old age and that "one may suspect that the cost of the system to the Nation exceeds by a considerable margin the benefits to the aged." The viewpoint implied was that whatever private pension plans claim to accomplish in terms of public good could be accomplished better by a public program. Overlooked by that approach is the fact that what has been accomplished by employers and unions in supplementing social security with private plans was not accomplished, and might never be accomplished at all, through legislation. It also overlooked the value for a democratic, pluralistic, and dynamic society of arrangements that can be developed outside of government, on the initiative of employers and unions, and without depending on majority consensus.[5]

Thus, the critics of private pension plans argue that the benefits are currently inadequate and, more importantly, that even if they were adequate, they would not be available to large numbers of retired persons and their families who did not achieve eligibility while working. The defenders of private pension plans have little to say about ultimate coverage and the income maintenance alternatives of nonplan members; instead, they argue that private plans are rapidly improving for those employees covered and that such plans provide coverage which responds to needs which are unmet by present (and possibly future) public pension systems.

[5] Income for the Elderly Through Work-Life Extension, Asset Conversion, and Pension Improvement," in U.S. Joint Economic Committee, "Old Age Income Assurance," part I, 90th Congress, 1st session (Washington, D.C.: Government Printing Office, 1968), p. 35.

II. THE GROWTH AND RATIONALE FOR PRIVATE PENSIONS

In order to help evaluate the role which private pensions can or should play in the U.S. system of retirement income maintenance, we must look at the system as it exists today and its prospects for the future. This must be done against the historical background of private pension plan growth in the United States and the various tenets which have been developed to justify this growth. "Assessment of how well plans work depends upon what they are supposed to do, and this depends largely upon the purposes of those who establish and support them." [6]

A. The Current Private Pension System and Its Growth [7]

Although the first formal private pension plans for industrial workers were introduced about a hundred years ago, it is only since 1940 that they have emerged as a major economic and social factor in the economy. While some growth took place from 1900 to 1940, most of the early plans were initiated by employers in large enterprises, with a few plans established by unions. The employer plans were typically noncontributory and unfunded, and they carefully avoided establishing "rights." The pension was usually discretionary and was considered a gratuity.

During the 1920's, insurance companies began to sell group annuities, and following the establishment of social security there was a considerable upsurge in the establishment of insured plans as supplements to the public program. Between 1940, when private plans included about 4 million persons, and 1950, the number of persons covered more than doubled, to almost 10 million. This growth was, in large part, attributable to favorable Federal tax laws, wartime wage stabilization measures, and high corporate profits during the war which encouraged the growth of pensions and other fringe benefits as a substitute for wage increases.

The surge in introduction of plans covering large numbers of workers after 1949 resulted from a number of interrelated influences. First, union pressures for economic security provisions increased after the favorable decision by the Supreme Court in 1949 supporting the National Labor Relations Board's determination that pensions were a proper issue for collective bargaining. In addition, the Steel Industry Fact-Finding Committee in 1949 included the recommendation that the industry had a social obligation to provide workers with pensions. Second, wage stabilization policies during the Korean con-

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[6] Merton C. Bernstein, "The Future of Private Pensions" (New York: Free Press, 1964), p. 9.

[7] For an excellent summary of the historical evolution of private pension plans see Pearl E. Charlet, "Public Policy and Private Retirement Programs—A Suggestion for Change," in U.S. Joint Economic Committee. "Old Age Income Assurance," pt. I. 90th Cong., 1st sess. (Wahington, D.C.: Government Printing Office), pp. 170–203.

flict, as well as continued favorable tax treatment, provided incentives to establish qualified plans. Development and expansion of negotiated multiemployer pension plans, particularly in construction, transportation, and trade and services, opened up coverage to millions of workers in smaller firms. Many of the plans established during the last 15 years were negotiated plans for large groups of production workers, so the private pensions spread coverage and potential benefits to mobile, lower income worker groups.

A1. *Coverage and Beneficiary Trends*

More than 28 million persons are covered by private pension and deferred profit-sharing plans today, virtually all of whom are also building up credits under the social security system (table 1). In the 18-year period since 1950, when pension plans first became a major issue in collective bargaining, the coverage almost tripled; the absolute growth amounted to 18.8 million workers. However, there has been a drop in the rate of growth; the last 8 years accounted for only 7.4 million of the increase.

TABLE 1.—ESTIMATED COVERAGE UNDER OASDHI AND PRIVATE RETIREMENT PLANS, DECEMBER OF SELECTED YEARS, 1940-80

[Numbers in millions]

			Covered under OASDHI [1]				Covered under private retirement plans	
			Total					
Year	Paid employment (including self-employment and Armed Forces)	Private wage and salary workers [2]	Number	As percent of paid employment	Wage and salary	Self-employment	Number	As percent of private wage and salary workers
1940	47.1	33.5	30.4	64.5	30.4		4.1	12.2
1945	57.3	38.1	38.9	67.9	38.9		6.4	16.8
1950	61.3	43.5	40.4	65.9	40.4		9.8	22.5
1955	65.7	47.8	56.2	85.5	49.5	6.7	15.4	32.2
1960	67.1	50.1	59.0	87.9	51.8	7.3	21.2	42.4
1965	74.5	54.8	66.4	89.1	60.1	6.3	25.4	46.4
1966	77.0	57.3	69.0	89.6	62.8	6.2	26.4	46.1
1967	77.9	58.2	69.9	89.7	64.1	5.8	27.6	47.4
1968	79.4	59.8	71.3	89.8	65.4	5.9	[3] 28.6	47.8
Projections: [4]								
1980	94.6	72.9	85.9	90.8			42.3	58.0

[1] Coverage in effect, including State and local employees for whom coverage has been arranged, railroad employees, and all members of Armed Forces.
[2] Full-time and part-time workers, annual average.
[3] Preliminary.
[4] President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs, "Public Policy and Private Pension Programs," January 1965, app. A, table 2.

Source: Social Security Administration.

Private retirement plans are of two types—pension and deferred profit-sharing plans. A private pension plan is usually defined as one established by an employer, union, or both, that provides determinable cash benefits for life to qualified workers upon retirement. Benefits are usually financed by regular contributions by the employers and,

in some cases, by the employees. On the other hand, contributions and benefits under deferred profit-sharing plans are not known in advance but depend upon the profits of the employer. Most workers are covered by pension plans. Several million workers, however, are covered by deferred profit-sharing plans either exclusively or as a supplement to a pension plan.

About one-half of the over 28 million workers covered by private retirement plans are under collectively bargained plans that have been negotiated between management and unions. The substantial number of workers belonging to plans under collective bargaining results to a large extent from multiemployer plans which cover more than a third of the workers under collectively bargained pension agreements. Multiemployer plans are generally organized on an industry basis to meet situations where, for example, employers are too small to set up their own plans. Under these plans, all employers contribute into a pooled central pension fund from which their employees, who may have shifted from one employer to another in the industry, draw pensions. These plans covered fewer than 1 million workers before 1950. In the late fifties, they were extended in many industries, so that by 1960 they included over 3 million persons. At present, over 5 million workers are in these plans.

A high proportion of those potentially within reach of private pension coverage have already been included. Since 1950, the annual growth in coverage has exceeded the growth in the labor force and the cumulative effects of this difference have been substantial. The proportion of wage and salary workers covered by pension plans in private industry has increased by 1–2 percentage points a year since 1950, and now equals about 48 percent of the employed private wage and salary work force.

There has been some slowdown in the rates of growth since 1960. This slackening indicates that, under the existing structure and operation of private pension plans, a large proportion of the employed labor force is having difficulty in securing supplemental retirement protection. The most accessible groups are already covered, and future expansion must be in industries in which small businesses are prevalent. Current trends indicate that the vast majority of newly established plans are in this category.

The flow of persons into benefit status has been impressive. Reflecting the maturing of many plans, the number of persons receiving private pension benefits today is 20 times greater than in 1940—160,000 persons in 1940 and about 3.8 million in 1968 (table 2). The number

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should grow rapidly, so that it is estimated that the number of beneficiaries will be about 6.6 million in 1980.

TABLE 2.—BENEFICIARIES UNDER OASDHI AND PRIVATE RETIREMENT PLANS, DECEMBER, SELECTED YEARS, 1940-80

[In thousands]

Year	Retired workers aged 62 and over receiving old-age (primary) benefits under OASDHI [1]	Beneficiaries under private retirement plans [2]
1940	112	160
1945	518	310
1950	1,771	450
1955	4,474	980
1960	8,061	1,780
1965	11,100	2,750
1966	12,293	3,110
1967	12,748	3,420
1968	13,097	[3] 3,760
Projections: [4] 1980	18,261	6,600

[1] For 1966, 1967, and 1968, includes persons with special age 72 benefits. Excludes disabled beneficiaries under age 65.
[2] Includes an undetermined number of retired and disabled workers under age 62 and widows.
[3] Preliminary.
[4] President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Funds, "Public Policy and Private Pension Programs," January 1965, appendix A, table 3.

Source: Social Security Administration.

Private retirement plans in 1968 were estimated to be paying pensions to perhaps 2¾ to 3 million persons who were age 65 and over. These annuitants, plus their wives, are estimated to comprise about one-fifth of the entire population aged 65 and over. It is anticipated that over the next dozen years the proportion of the aged with dual protection—from both OASDHI and private pensions—may rise to 25 to 30 percent.

A2. *Selected Characteristics of Private Plans*

An overall view of the private retirement structure reveals astonishing diversity in financing and coverage arrangements, in the types of benefits provided, and in the scope and level of protection afforded. This diversity has been influenced by a wide variety of factors—the financial ability and interest of the individual firm or industry, the extent of collective bargaining, industry and labor-market forces, and the consideration given to the basic social security program—old age, survivors, disability, and health insurance (OASDHI).

A recent Bureau of Labor Statistics study of pension plans, based on a sample of reports and documents filed with the U.S. Department of Labor's Office of Labor-Management Welfare-Pension Reports pursuant to the Welfare and Pensions Plan Disclosure Act, yields some significant data on the characteristics of current private pension plans. By the end of September 1966, financial reports for over 30,000 plans had been filed. The worker coverage figures relate to 1964–65. The data exclude deferred profit-sharing plans, plans of nonprofit organizations, and plans with fewer than 26 workers.

Almost 40 percent of the plans covering 70 percent of the workers indicated that the plans were mentioned in collective bargaining agreements between management and unions.

The variations in the impact of collective bargaining and the other underlying forces in the development of private retirement plans have resulted in concentrations of coverage in certain industries and occupations. The high coverage in most manufacturing industries can be attributed, in large part, to the spread of private pension coverage to unionized workers in mass-production industries since 1950. Three out of five of all private plans with the same proportion of workers are in manufacturing industries, so that probably 75–80 percent of all employed workers in manufacturing now enjoy private pension coverage (mostly in collectively bargained plans) in addition to their basic OASDHI protection. By way of contrast, only a small proportion of employed workers in trade and services are included in these plans.

In some nonmanufacturing industries, however, such as motor and water transportation, communication, public utilities, and finance, pension coverage is almost universal. Coverage in the construction industry, while below that of these industries, is more extensive than found in trade and services. For mining and extractive industries, coverage has been extended to a high proportion of the work force, mostly through collective bargaining.

The growth and development of negotiated multiemployer plans has been responsible for heavy concentration of pension coverage in certain industries. The plans have developed, for the most part, in industries and occupations marked by seasonal employment, frequent job changing, small firms, and high rates of individual employer mortality. These plans are marked by portable pension credits, so that employees may accumulate credits by working for any employer belonging to the plan. In mining, construction, water and motor transportation, and wholesale trade, most covered workers are included in collectively bargained multiemployer plans. In manufacturing industries, heavy concentrations of coverage of these plans are found in apparel and food products.

B. The Rationale for Private Pension Plans

Numerous and varied theories have been put forward in explanation of the rapid development of private pension plans. Little purpose is served by arguing one rationale against another. Much more important than the cause is the effect of this growth in strengthening the economic security of American workers. Nevertheless, the major theories deserve consideration, especially since they may offer important clues to future private pension developments.

Melone and Allen in their book on pension planning have provided us with an excellent summary of early and more recently cited justifications for establishing private pension plans:

> Early industrial pension plans were viewed as gratuities or rewards to employees for long and loyal service to the employer. Closely related to this view is the concept that private pensions constitute a systematic and socially desirable method of releasing employees who are no longer productive members of the employer's labor force * * *. As the economy became more and more industrialized and pension plans became more prevalent, there was increasing interest in the view that em-

ployers had a moral obligation to provide for the economic security of retired workers. This point of view was expressed as early as 1912 by Lee Welling Squier, as follows: "From the standpoint of the whole system of social economy, no employer has a right to engage men in any occupation that exhausts the individual's industrial life in 10, 20, or 40 years; and then leave the remnant floating on society at large as a derelict at sea." This rationale of private pension has come to be know as the *human depreciation concept.*[8]

Alternatively, it is also said that private pension plans had their origin in the interest of the employer in retaining his valuable employees and in reducing the amount and cost of labor turnover. Related to this reason is the multifaceted theory of increased production: (1) The security given to the individual makes him a better employee, encouraging him to stay with and work harder for the company; (2) by retiring superannuated workers whose productivity has significantly decreased, the total production of the company is raised; and (3) by providing opportunities for promotion through retirement of older workers, the morale (and therefore the productivity) of younger workers is raised.

The "human depreciation" rationale tends to have many supporters because of the continual process of skill obsolescence which takes place as a byproduct of technological change—change which causes a similar obsolescence of capital equipment. The large upsurge during the past decade of research and development expenditures has, moreover, caused this rationale to take on a special significance. The validity of the human depreciation concept has been challenged, however. Some have argued that employment sometimes actually slows down the aging process instead of accelerating it. Others argue that the process of aging cannot be attributed to the employment relationship but is, instead, basically physiological.

Finally it is argued that: "Analogy between men and machines is inherently unsound. A machine is an asset owned by the employer, and depreciation is merely an accounting technique for allocating the costs of equipment to various accounting periods. Employees, on the other hand, are free agents and sell their services to employers for a specified wage rate. An employee, unlike a machine, is free to move from one employer to another."[9]

Perhaps the rationale for private group pensions which has achieved the widest acceptance is the "deferred wage concept." This concept views total wages as the sum of wages paid plus the value of various fringe benefits (paid leave, insurance benefits, pensions, etc.). "The assumption is made that labor and management negotiators think in terms of total labor costs. Therefore, if labor negotiates a pension benefit, the amount of funds available for increases in wages are reduced accordingly."[10]

Attention has already been called to the stimulating effect on private pension plan growth which resulted from the Social Security Act and

[8] Joseph J. Melone and E. T. Allen, Jr., "Pension Planning" (Homewood, Ill.: Irwin, 1966), pp. 14–15.
[9] Ibid., p. 16.
[10] Ibid., p. 17.

the Internal Revenue Code of 1942. One pension authority takes account of all the above enumerated factors but stresses the *timing* of the dramatic upturn dating from 1950:

> The most rapid extension of pension plans dates from 1950. That timing was determined to some extent by the depression of the 1930's. Consider those workers who are now * * * confronted with the problem of adequate retirement income. They are men and women who were in their forties—and presumably at the height of their earning capacity—during the depression. For a generation with that history, it is obviously idle to question whether a man should or should not be expected to provide for himself. Back in the year 1920, how could the young man of 30 have anticipated his future earnings and budgeted his standard of living with such foresight and success as to go through the years 1930–36 with enough savings left over to provide for his retirement in 1958? [11]

Each person, therefore, may make his choice among the diverse explanations of the growth of industrial pension plans and supply his own underlining for emphasis as to the rationale.

That private pension plans have grown so rapidly is in itself evidence that they are a response to a wide felt fundamental need; they can be expected to continue to grow so long as this need remains unmet.

C. Conflicts in Plan Purposes

In evaluating the role of private pensions in the economy, one should be aware of a number of conflicts of purpose which have developed as pension plan coverage has spread throughout private industry. Five basic areas of conflict among participants in the planning of private pensions are discussed below. These are:

1. Differing preferences between employers and employees regarding retirement flexibility and the age of retirement.

2. Differences between older and younger workers regarding the relative importance of past service credits, benefit levels, and vesting provisions.

3. A difference between large and small firm employees in the importance of social security benefits.

4. A conflict between employers and the general interest of the economy with regard to labor mobility.

5. Conflicts over allocation of the pay package.

The first conflict centers around the question of what should be the age of retirement and whether it should be compulsory. From the employer's standpoint there seems to be a general desire to institute a compulsory age of retirement and to keep it low and uniform for all

[11] Robert Tilove, "Pension Funds and Economic Freedom" (New York: The Fund For the Republic, 1959), p. 3.

workers. "The larger the company the greater (is) the propensity to have a policy with some element of compulsion. This is probably due to the fact that as company size increases, the relationship between management and the individual employee becomes more impersonal, middle and top management are less cognizant of the individual employee's capabilities and needs, and the possibility of changes of unfair, discriminatory or differential treatment as between employees increases." [12] Also, as indicated in a study by Brennan, Taft, and Schupack, employers behave as if the productivity of older workers is lower than younger workers—seeking to lower the average of their work force.[13] And finally, as indicated in section B, above, there is pressure from the younger worker (and sometimes from the union) to keep advancement opportunities open and to maintain morale.

In contrast with such management desires regarding the retirement age specified by pension plans, the workers' interest is in promoting flexible retirement policies. A great deal has been written about the benefits of flexible retirement policies which permit those workers to continue working who have psychological and/or income needs to continue working.[14] These need not be repeated here.

A second source of conflict in the purposes of private pension plans arises between older and younger workers. The older workers typically had little or no pension coverage during their earlier years of work. Now established in their "final job" and looking forward to their day of retirement (either apprehensively or with great expectation), they are most concerned about the adequacy of the pension they will receive. Hence older workers tend to favor emphasis upon high benefit levels and the granting of past service credits toward these benefits. "The employer also has a definite interest in granting past service credits because generally his most immediate concern, when he sets up a pension plan, is to provide pensions for long-service employees at or near retirement age." [15]

Younger workers, while surely also concerned about benefit levels, have a greater stake in the development of better vesting provisions which will allow them to build up pension credits as they move from job to job. The conflict, therefore, is summarized by the research staff of the American Enterprise Institute as follows:

> Resources available for pensions usually are limited. Therefore, decisions about the total "pension package" necessarily involve trade-offs among the alternative uses of these limited resources. Often the choice—whether made in management-labor negotiations or by management unilaterally—is to sacrifice either early vesting or normally amortized financing of unfunded liabilities, or both, in favor of past service credits or larger pensions * * * There is general agreement

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[12] Fred Slavick, "Compulsory and Flexible Retirement in the American Economy," (Ithaca, N.Y.: Cornell University, 1966), p. 36.

[13] Michael J. Brennan, Philip Taft, and M. B. Schupack, "The Economics of Age" (New York: Norton, 1967).

[14] See, for example, F. Le Gros Clark, "Work, Age and Leisure" (London: Michael Joseph, 1966) and George L. Maddox, "Retirement As a Social Event in the United States," in J. C. McKinney and F. T. de Vyver, eds., "Aging and Social Policy" (New York: Appleton-Century-Crafts, 1966).

[15] American Enterprise Institute for Public Policy Research, "The Debate on Private Pensions," a condensation of AEI Analysis No. 4 (Washington, D.C.: AEI, 1968), p. 4.

that grants of past pension credits do constitute the crux, in the main, of the problems with which the proposals on pension vesting, funding, and reinsurance seek to deal * * * If past service credits are not granted, vesting costs are materially reduced. Consequently, available pension resources can be allocated to earlier vesting of individual pension rights. Moreover, without past or prior service credits, the problem of financing initial, unfunded liabilities does not arise.[16]

A third area of conflicts occurs between employees of large and small companies. The costs of providing pension coverage in small companies with few employees is comparatively high. This results from the inability of small companies to realize the economies of scale associated with the establishment and administration of plans covering a large number of persons.

Workers in small firms which cannot or do not provide pension coverage must rely in retirement on social security benefits, supplemented by any savings they may have. But with both private and public pension systems operating which provide retirement benefits to the *same* workers in a large number of cases, it is unrealistic to assume that the pension levels of either public or private pensions are *not* influenced by the benefit levels of the other. Thus, raising benefit levels for workers covered by private pensions probably results in less political pressure and less apparent "need" for increases in social security retirement benefits. But workers *not* covered by private pensions are inevitably the losers in any slow-down in the rate of social security increases.

Further, there is the conflict between employers and the general interest of the economy with regard to labor mobility. Bernstein has summarized the value of mobility as follows:

> The opportunities and incentives of our economic system, which we prize, are dependent in large measure upon the ease of workers' mobility. Such mobility is essential to the economy's ability to adapt itself to evershifting demands. Only by changing jobs can many workers develop skills, accumulate valuable experience, increase their earnings, or escape from a declining business or industry. Innumerable personal considerations such as health and family obligations often dictate job changes. These and many other considerations are strong justifications for ease of mobility.[17]

The employer, on the other hand, often sees the pension plan as a means of reducing costly labor turnover and promoting worker loyalty. Some have even argued that if employers are prevented from using pension plans for this purpose, they will be unwilling to continue sponsoring this form of fringe benefit.

Hugh Folk has presented theoretical arguments suggesting that pensions reduce labor mobility and that employers tend to exploit workers who leave employment before attaining vested pension rights.[18] Folk also surveys the available statistics which, while not

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[16] Ibid., pp. 5–6.
[17] Bernstein, op. cit., p. 14.
[18] Hugh Folk, "Private Pensions and Labor Mobility," University of Illinois Bulletin, Vol. 64, No. 76 (Feb. 9, 1968).

entirely convincing, indicate that labor mobility may have decreased considerably since World War II.

Finally, there is another conflict which, while not specifically a conflict regarding the purpose of private pensions, is so basic that it cannot be ignored. The task force in its original paper observed, "Most parents today face a common problem; How can they allocate earnings to meet current obligations to their family and still have something left over for retirement?" [19]

Consumption opportunities and perceived "needs" today must be balanced off with requirements for retirement income in the future. Employees and/or unions must choose among various alternative distributions of the pay package between current wages, future pension benefits, other reduced benefits, or reduced hours of work. The existing evidence which indicates high rates of voluntary withdrawal of their "own contributions" in pension plans upon separation from employment suggests that workers are under great pressure to consume now.[20] As McClung has suggested, "evidently, members of employer-employee contributory plans who withdraw upon separation or would withdraw if separated do not value employer contributions at anywhere near their objective worth." [21]

The implication of this evidence is important; to the extent that the employee underestimates his "needs" in retirement, he will lend support to the various factors operating in the economic system which result in relatively low incomes in retirement [22] and help perpetuate the aged poverty problem into the future.[23] One such factor is, of course, the extent to which employees support wage package options in perference to higher private pension benefit levels, vesting levels, beneficiary provisions, et cetera.

These five conflicts, and others, have contributed to the difficulties of developing a public attitude or policy regarding private plans and no doubt account for a large amount of current criticism levied against private plans by the participants themselves.

D. Some Myths Concerning Private Pensions

There are a number of generalizations made about private pensions which currently enjoy widespread acceptance but which, at best, are true only if highly qualified. This section will discuss a number of these misconceptions as an additional way of clarifying the role of private pensions in the economy. It is inevitable that this type of analysis, to some extent, takes the form of setting up the proverbial "strawmen." Although the more sophisticated forms of these oft-voiced generalizations may include the qualifications mentioned or

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[19] U.S. Special Committee on Aging, op cit., p. VIII.

[20] The origin of this pressure may be self-generated (i.e., personal preference) and/or it may be influenced to a large extent by societal pressures to buy through group norms or advertising (in the manner suggested by Vance Packard and John K. Galbraith).

[21] U.S. Joint Economic Committee, "Old Age Income Assurance: An Outline of Issues and Alternatives," 89th Cong. second sess. Washington, D.C. Government Printing Office, 1966), p. 21.

[22] See the task force report for an elaboration of these factors, U.S. Special Committee on Aging, op. cit., especially pt. 3.

[23] The situation being suggested is one where workers decide not (refuse) to provide adequately for retirement and then bemoan their economic situation when old and demand higher incomes as a matter of "right."

take account of the considerations enumerated below, it does not hurt to emphasize them—especially given the many times the generalizations appear in writing and discussions without qualification.

Myth 1: Private pensions are a product of the free choice of workers in negotiation with management and are more compatible with the ideals of freedom than compulsory public pensions.

If we look at the reality of private pension plan initiation and operation we see that freedom of choice nearly always plays a very minor role. For the vast majority of workers who are now or will be covered by private plans there was not, is not now, and will not be, any choice. Almost all private pension schemes are compulsory. Regarding the details of the plan, workers must register their individual preferences through union representatives (if they are unionized) or be content with the pension benefits which management "gives" them.

Concerning union negotiated plans, two points should be made. First, surveys of the provisions of various plans show that existing private pension plans contain few, if any, options. Workers usually cannot choose, for example, between pensions protected against inflation versus nonprotected pensions, optional employee contributions versus only employer contributions, and earlier versus later vesting.[24] Nor—to the best of our knowledge—do workers have any control whatsoever over how the pension funds are to be invested.

Second, there is much evidence to indicate that decisionmaking power in unions usually becomes concentrated in the hands of a minority—just as in other groups. Thus, Bernstein, after interviews with union staff people, observes the following:

> Many experts in this field believe that older workers care about pension plans, while younger workers are unconcerned or are interested in more immediate benefits. While this may well be so, there is insufficient solid data to support such an assumption. In some unions the effective membership—those who will most likely stay in the industry and the union—is concentrated among the older members. And these are the men whom the officers must please over the long haul. They are also the members most interested in pensions and least troubled by stringent age and service eligibility requirements. Hence they prefer their representatives to concentrate on high benefits, which encourage limitations upon the number who will qualify.[25]

Thus, decisions are made by the union with regard to bargaining priorities, and pension plan provisions are evolved. While this sort of decisionmaking process is by no means illegitimate—and is also common to all types of groups other than unions—the point should be made that the process is certainly not one which emphasizes freedom of decision; further, the distinction between representative union decisionmaking and representative congressional decisionmaking does not seem to be great.

[24] See, for example, U.S. Bureau of Labor Statistics, "Digest of 100 Selected Pension Plans Under Collective Bargaining, Spring 1968," BLS Bulletin 1597 (Washington, D.C.: Government Printing Office, 1969).
[25] Bernstein, op. cit., p. 13.

Myth 2: While social security must ever remain a monolithic uniformity, private pension plans are flexible and can be tailor-made to meet differing situations and conditions.[26]

While it is certainly true that private pension plans encompass a smaller number and fewer types of workers than social security, one should not overlook the heterogeneity of workers included in a great many private pensions. Workers from widely different occupations or from different size firms are often included under the same pension plan. Or, as in the case of the Teamsters Union, workers from entirely different industries are covered by a common private pension plan. Such diversity of coverage makes it difficult to design a pension plan which will serve the specific needs of all the workers covered. Furthermore, as will be discussed in detail in section IV below, the flexibility provided by private pension plans is possible only at the cost of diminished security to many of the workers covered by the plans.

While it is true that private pension plans permit adaptation to the special circumstances of particular groups of employees, one would find it difficult to justify the wide disparity in private pension provisions currently existing for this reason. Rather, it seems clear that much of the disparity exists today as a result, not of the special circumstances of employees, but because of the conflicts between employers and employees over the purposes of private pensions (see section II–C above).

Thus, a private pension plan which provides for early retirement with adequate income in an occupation where physical deterioration on the job occurs at an early age is an example of such flexibility. But a plan which has high service and age requirements for vesting as a result of a desire to provide past service credits to the more senior employees is no doubt responding to the power position of the older employees (in the company or union) at the expense of the younger employees.

Myth 3: Private pension plans are vital to assure the saving necessary to provide sufficient investment in a growing economy.

Table 3 shows the magnitude of business saving relative to nonresidential, fixed investment during the last decade. The figures indicate a fundamental fact: in the key growth sector of *corporate* production, the overwhelming majority of funds needed to finance new investment comes from the *internal* funds of these corporations. As Galbraith has observed, "The decisions on what will be saved are made in the main by a few hundred large corporations." [27]

There is no evidence to indicate that there has been an insufficient amount of saving in our economy relative to investment propensities. Instead we have had to periodically worry about an excess of total

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[26] Except for slight modification, this statement is identical to a statement which appears in Robert C. Tyson, "Let's Keep Our Dual Retirement System," *Harvard Business Review*, vol. 46 March-April, 1968), p. 6.

[27] John Kenneth Galbraith, "The New Industrial State" (New York: New American Library, 1967), p. 53.

private saving over private investment—causing lower Government saving (i.e., bigger deficits) through automatic and/or discretionary fiscal policy.

TABLE 3.—BUSINESS SAVING AND INVESTMENT, 1958-68

[Billions of dollars]

	Gross business saving [1]	Total nonresidential fixed investment
Year:		
1958	49.4	41.6
1959	56.8	45.1
1960	56.8	48.4
1961	58.7	47.0
1962	66.3	51.7
1963	68.8	54.3
1964	76.2	61.1
1965	84.7	71.3
1966	91.6	81.3
1967	93.1	83.6
1968	97.5	90.0

[1] Undistributed corporate profits, corporate inventory valuation adjustment, capital consumption allowances, and wage accruals less disbursements.

Source: U.S. Council of Economic Advisers, The Annual Report (Washington, D.C., Government Printing Office, 1969), tables B-11 and B-18.

A comprehensive study of the economic aspects of pensions by the National Bureau of Economic Research has concluded:

> Our research has supported the proposition that pension saving is a net addition to personal saving. Less clearly established, perhaps, is the extension of this conclusion to state that it is a net addition to total national saving. The impact on saving by business and Government is not clear, but it seems doubtful that it is materially affected.
>
> There is also some evidence that this major impact has already been felt. If it is desirable to sustain the growth of saving in the economy, some other economic policies may be more fruitful in the future * * * [28]

Myth 4: The current large number of workers covered by private pensions and the high incidence of some kind of vesting protection will cause a significant improvement in private pension benefits for future retirees.

Certainly there will be more workers receiving private pensions in the future, and the pension benefits received will undoubtedly be higher. The key question, however, is how significant will the improvement be and how long will it take? The fact that over 28-million workers are covered by private pension plans or deferred profitsharing plans and that roughly two-thirds of these workers are covered by plans with some form of vesting, tells us little about ultimate benefits. Even the more liberal of current industry plans require 10 years of service for any vesting benefits. Most plans also require that a minimum age requirement be met, and many require more than 10

[28] Roger F. Murray, "Economic Aspects of Pensions—A Summary Report," National Bureau of Economic Research (New York, Columbia University Press, 1968), p. 66.

years of service (most commonly 15 years).[29] Relatively slow improvement seems to have occurred (see section III–D) since Bernstein concluded: "The indications are that, despite the fact that vesting provisions are common in plans, only the very long-term employees are protected by vesting as presently practiced. The millions of others who change jobs * * * are not." [30]

Regarding the level of future private pension benefits, table 4 shows the results of a simulation projection of private pension income for the retired population in 1980. Two alternative income distributions for couples and unmarried individuals are shown. The first projection is based upon the benefit levels as specified in private pension plan formulas in the year 1964. The second projection assumes that private pension benefit levels *increase 3 percent each and every year after 1964.*[31]

The projections show that present levels of private pension benefits will be of little help to the next generation of retirees. Sixty percent of private pension recipients are projected to receive less than $1,000 a year in private pension benefits. Even if a significant upward trend in benefit levels is assumed, about three-quarters of the private pension recipients in 1980 will be getting less than $2,000.

TABLE 4.—PROJECTED PRIVATE PENSION INCOME DISTRIBUTION FOR RETIRED COUPLES AND UNMARRIED INDIVIDUALS, 1980

[Percentage distribution]

Private pension income	Couples [1]		Unmarried individuals [1]	
	1964 level	3 percent trend	1964 level	3 percent trend
Total percent	100	100	100	100
Under $1,000	60	35	72	49
$1,000 to $1,999	33	39	23	34
$2,000 to $2,999	6	17	4	11
$3,000 to $3,999	1	6	1	3
$4,000 to $4,999	(2)	2	(2)	1
$5,000 and over	(2)	(2)	(2)	(2)

[1] Recipients only. Trend refers to annual increase in level of benefits. Same recipient rate assumed for each run.
[2] Less than 0.5 percent.

Source: Adapted from James H. Schulz, "The Economic Status of the Retired Aged in 1980: Simulation Projections," Social Security Administration, Research report No. 24 (Washington, D.C., Government Printing Office, 1968), table 20, p. 69.

[29] Donald Landay and Harry E. Davis, "Growth and Vesting Changes in Private Pension Plans." *Monthly Labor Review,* Vol. 91 (May 1968), pp. 20–35.
[30] Bernstein, op. cit., p. 248.
[31] For details of the projection analysis see James H. Schulz, "The Economic Status of the Retired Aged in 1980: Simulation Projections," Social Security Administration, Research Report No. 24 (Washington, D.C.: Government Printing Office, 1968).

III. SOME KEY ISSUES

The various specific issues which have been discussed in the debates and literature on private pensions are numerous. Not all these issues are discussed in this paper; instead, the remainder of the paper focuses on a number of issues which are particularly important with regard to their impact on the retirement income situation of present and future older people. The macroeconomic impact of private pensions on the economy, issues regarding tax treatment of private pension, reinsurance schemes, levels of plan funding, the question of who should control plan funds, and so forth—while important questions—are not discussed.

A. Private Pension Coverage—Potentials for Expansion

Over the years Congress has enacted several pieces of major legislation that have contributed to the growth of private retirement plans. These include:

(1) Tax exemption for employer payments to trust funds, and the earnings thereof, created as part of a retirement plan for employees. (Enacted 1921 for profit-sharing plans; 1926 for pensions.)

(2) Tax-sheltered annuities for employees of non-profit organizations. (Enacted 1939.)

(3) Authority to establish joint labor/management pension trusts. (Enacted 1947.)

(4) Extension of tax exemption to retirement funds for self-employed persons. (Enacted 1962.)

Coverage under private retirement plans is continuing to expand with about a million workers added to plan rolls each year. However, the work force is growing by approximately the same number of persons so that little if any progress is being made in reducing the number of persons without pension coverage. Any attempt at appraising the potential for expanding private coverage must take into account the characteristics of the principal groups not covered. Exhibit A, which has been prepared by Pearl Charlet, identifies these groups, their numbers, and their current prospects for coverage; it also summarizes the progress now being made in transferring them to covered status.

Exhibit A

End of 1967.—Workers currently without pension coverage—Who are they? How many are there? What are the prospects for their coverage? And what progress is being made?

Who are they?	How many?	What are the prospects for coverage?
Unemployed	2, 975, 000	As a class, this group will probably never qualify for pension coverage since even the nearly universal coverage of social security does not provide coverage for periods of unemployment. The fundamental problem is to transfer workers from this category to a gainfully employed group. Since 1963 nearly 1.2 million persons have moved from the unemployed to the working group.
Unpaid family workers	1, 054, 000	This group—also largely without social security coverage—is a marginal part of the labor force at best. With the possible exception of individual tax incentives which might apply to forms of income other than "earnings from work," it appears unlikely that this group will ever be eligible for pension coverage, certainly under existing conditions their prospects are virtually nonexistent. The number of unpaid family workers has diminished by about 367,000 since 1963, and presumably some have become affiliated with groups having pension potential.
Government workers	1, 987, 000	Many of this group are employed by small local governments where coverage is generally available by voluntary participation in an already established State-operated system. Also included in this group are a few persons who for various reasons do not qualify for participation in the programs of the government agency for which they work. The coverage prospects for the group as a whole are reasonably good.

		Since 1963 the total number of workers on government payrolls has increased about 2.1 million, while pension coverage for this group went up nearly 2.4 million. Pension coverage for the category increased from 74.8 to 82.2 percent during the 4-year period.
Self-employed	7, 086, 000	This group is composed of 1,996,000 self-employed persons in agriculture and 5,090,000 self-employed in nonagricultural industries. The self-employed have been "potentially eligible" for pension coverage since the enactment of special legislation in 1962. Although 56,000 plans were approved by the end of 1967 only about 84,000 persons are covered which includes an undetermined number of "employees" of the self-employed. A major deterrent to the growth of self-employed coverage during the early years of eligibility was the fact that their tax incentive was considerably less than that enjoyed by employees of corporations. Legislation to eliminate this discrimination was enacted in 1966 for taxable years beginning after 1967. As a result, the number of persons coming under self-employed pension coverage in 1968 alone was nearly double the number added in the prior five years (163,000 in 1968 compared with 84,000 in the years 1963–67). The number of self-employed persons in the labor force has decreased about 1,500,000 since 1963. It can be safely assumed that some of these persons have become wage and salary workers and have acquired pension coverage. The evident growing popularity of H.R. 10 plans, coupled with the general movement of self-employed persons to paid employment, considerably enhances the prospects for eventual pension coverage of this category of the labor force.

EXHIBIT A—Continued

Who are they?	How many?	What are the prospects for coverage?
Agricultural workers	1,303,000	A sizable portion of this group is employed by the 2,000,000 self-employed farm operators who are now eligible for pension coverage. As such they could be covered by plans established by their employers in the same manner as agricultural workers who are employees of corporations. However, from a realistic viewpoint, the agricultural worker group will probably never attain a high level of pension coverage because of the itinerant nature of many farmworkers. This is also a diminishing segment of the labor force, showing a decrease of about 372,000 workers since 1963.
Wage and salary workers in private nonagricultural industries.	26,187,000	This group accounts for the balance of all workers presently without pension coverage. Although pension coverage in this group is increasing at the rate of about 1.0 million persons each year, the total number of wage and salary workers is rising even more rapidly as the result of new entrants into the labor force and diversion from other segments of the the labor force. So in effect while the number of covered persons is increasing, we are actually losing ground as far as reducing the number not covered. From 1963 to 1967 this segment of the work force increased 5.7 million persons while pension coverage grew slightly more than 3.6 million. In 1963, 49.9 percent of all wage and salary workers were covered by pensions; in 1967 the portion with coverage was 51.2 percent. The available data on pension coverage does not indicate whether the approximate million persons being added each year results from the establishment of new plans or from additional employees covered under existing plans.

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It is generally agreed that small employer groups are at a serious disadvantage in establishing retirement plans, from the standpoint of cost of establishment and cost of administration. As a result, it is assumed that the number of persons without pension coverage includes a high proportion of workers employed in small employee groups. The latest figures available indicate that in 1967 over 26,000,000 persons (49 percent of the 53,000,000 wage and salary workers other than agricultural and domestic workers) worked for firms with fewer than 100 employees; over 20,000,000 (39 percent) worked for firms with fewer than 50 workers; and over 13,000,000 (25 percent) were in establishments with fewer than 20 employees.

A significant development affecting small corporate employers occurred late in 1968 when the Treasury Department announced streamlined procedures for expediting the establishment of corporate retirement plans by utilizing master and prototype plans comparable in concept to those developed for H.R. 10 plans covering self-employed individuals and their employees.

Although this streamlining of qualification procedures represents a step forward in facilitating pension coverage for many workers, it must be recognized that a substantial portion of this segment of the labor force still may never attain coverage under existing legislation. In a free economy, there will always be businesses that will not voluntarily provide retirement income or that cannot afford to do so. There will always be transient and marginal workers who willingly work for such employers and who prefer current to deferred income. There will always be many part-time and temporary employees.

NOTE.—At the end of 1967 a total of 40,592,000 workers were without pension coverage, compared with 42,228,000 at the end of 1963. The portion of the labor force without pension coverage was reduced from 57.9 percent at the end of 1963 to 52.5 percent at the end of 1967.

Source: U.S. Treasury Department, U.S. Department of Labor, U.S. Department of HEW, and Institute of Life Insurance.

It is evident from exhibit A that the pension potential of workers currently without coverage can be further classified as follows:

Poor (5,322,000 workers)	Unemployed and unpaid family workers. As long as pension coverage is confined to the employment relationship, these groups are automatically excluded.
	Agricultural workers. This is perhaps the least likely of all working groups to attain pension coverage.
Fair (26,187,000 workers)	Wage and salary workers in private non-agricultural industries. Prospects for coverage actually range from "poor" to "excellent," but as a group it is only "fair" for reasons to be explored in later comments.
Good (1,987,000 workers)	Government workers. The mechanism for coverage is generally in operation, and it is only a matter of time before the group attains optimum coverage.
Excellent (7,086,000 workers)	Self-employed workers. Coverage for most of this group is a matter of self-determination.

The segment of the work force where efforts to expand pension coverage appears most urgent is the private industry wage and salary worker group. Not only does this group represent nearly two-thirds of all persons currently without coverage, it also is the category most likely to serve as the conduit through which the unemployed can ultimately be brought under private plans. Therefore, it is appropriate to concentrate attention on this group and to analyze its pension potential.

As indicated in exhibit A, it is generally assumed that a high percentage of wage and salary workers without pension coverage work for small employers. This assumption is confirmed by data reflecting employer tax deductions for retirement plans. Table 5 expresses these deductions as a percentage of total business receipts in 1965 for each of the forms of business enterprise. It further shows the effect of asset size on corporate retirement plan deductions.

TABLE 5.—*Employer deductions for retirement plans by type of employer*

Type of business	*Percent of 1965 business receipts*
Proprietorships [1]	0.008
Partnerships [1]	.070
Small business corporations [2]	.198
All other corporations, by asset size	.649
Under $100,000	.152
$100,000 but under $250,000	.181
$250,000 but under $1,000,000	.246
$1,000,000 but under $5,000,000	.383
$5,000,000 and more	.941

[1] Excluding deductions on behalf of owner-employees.
[2] Those firms legally incorporated with 10 or fewer shareholders who elect to be taxed through the shareholders rather than as corporations.

Source: U.S. Treasury Department, Statistics of Income, 1965 Business Income Tax Returns.

The lack of pension coverage is obviously concentrated among small employee groups. Employers include proprietors, partnerships, and small incorporated businesses. A profile of these small employers would include the business proprietors found on any typical small town

Main Street or any large city neighborhood shopping center: The small retailer, the local restaurant, the service station, repair services, the barber and beauty shop, the doctor and dentist, the auto dealer—and many, many more small employers of wage and salaried workers. The profile would likewise include partnership operations such as law firms, consulting engineers, accounting firms, and real estate firms—together with small manufacturing plants operated as corporations or by self-employed owners.

A number of reasons can be cited to explain why pension plans have not been widely adopted by small employers.

1. Exclusion of self-employed persons from coverage prior to 1963

Although proprietors and partners could set up pension plans for their employees prior to the enactment of the Self-Employed Retirement Act, very few did. The typical exception was the proprietary or partnership business employing substantial numbers of high-skill persons in competition with corporate industry. Such businesses are usually engaged in rendering services of a nature which is prohibited from incorporation under many State laws.

In general, self-employed persons had little motivation to establish plans for employees when they could not personally participate. Even when participation became available in 1963, the motivation was commensurate only to the limited tax incentive granted to owner-employers. The subsequent change in the law to permit "full" tax incentives after 1967 resulted in a demonstration in 1968 that tax incentives are a powerful motivation in extending private coverage (163,000 persons added to self-employed pension coverage in 1968 alone, compared with a total of 84,000 in the prior 5 years).

Recognizing that noncorporate employers are now at the stage of tax incentive motivation that corporate employers attained some 40 years ago, is it likely that the elimination of this major deterrent to pension coverage for wage and salaried workers employed in noncorporate business will bring about their eventual inclusion in private plans?

For an answer to this question, we must look both to the limited experience of self-employed pensions and to the remaining reasons cited for the reluctance of small employers, both corporate and noncorporate, to establish retirement plans.

The limited experience of self-employed participation in retirement plans leads to the conclusion that during the initial period of their existence H.R. 10 plans have been most popular among self-employed persons who have no full-time employees meeting the requirements for mandatory coverage (3 or more years of service). Information based on 1965 business income tax returns indicates that only 18 percent of all retirement plans covering self-employed proprietors

also included employees in the plan (30,781 plans covering proprietors with employees participating in only 5,457 of these plans). This proportion reflects the first 3 years of coverage experience under the Self-Employed Retirement Act. In addition, 13,042 proprietors maintained retirement plans for employees, in which the owners did not participate. Such plans could have been established either before or after the Self-Employed Retirement Act became effective, but it is logical to assume that a large percentage of them predated the act. (It is unlikely that so many employers would have excluded themselves from coverage if the plans had been established after the effective date of the act.)

It is apparent, even from the limited experience available, that the Self-Employed Retirement Act offers an attractive incentive for private pension coverage to the self-employed person who has no employees that must also be covered. But the extension of coverage to employees of noncorporate business is still subject to the same set of reasons that exist for the comparatively low level of pension coverage in small corporations.

2. High cost per employee of establishing and maintaining a plan

The cost of designing and implementing a retirement plan and trust fund is virtually unaffected by the number of persons covered. The same steps and procedures are required for 10 or for 10,000 employees, and the charges for advisory, actuarial, and legal services will not vary to any proportionate extent. While some of the costs of establishing a trust funded plan can be avoided by adopting an insured pension, the small employer is at a disadvantage because of limitations on the choice of contract and provisions available to him; he is also at a disadvantage in the matter of premium rates since the economics of mass coverage are not available to him. The cost of administering a plan, either insured or trusted, will reflect the size of the employee group to a large extent, but the per capita cost for a small group will invariably be higher.

Thus to the extent that employer dollars available to devote to retirement income are eroded by excessive cost of establishing and administering a plan, the value of tax incentives is diminished for the small employee group.

A pioneering step to simplify the establishment and administration, and consequently the cost, of small plans was made at the time the Self-Employed Retirement Act was passed. By utilizing master and prototype plans, individual self-employed persons can adopt a retirement program for themselves and eligible employees at a fraction of the adoption cost of the typical hand-tailored corporate plan.

Late in 1968 the Treasury Department extended the use of master and prototype plans to corporations. Funding agencies (such as banks, insurance companies, and regulated investment companies) and trade and professional associations may

now develop and sponsor master and prototype plans which corporations can adopt. Master plans prescribe the funding vehicle to be used, while prototype plans would permit the adopting employer to make his own funding election. Such plans can be either a standardized or a variable form, which permits a specified range of employer choice in such areas as coverage, contributions, benefits, and vesting. After a master or prototype plan is approved by the Internal Revenue Service as meeting the requirements for tax exemption, individual corporate employers can adopt the plan and obtain a determination of tax qualification by submitting a special four-page form application.

When the machinery of master and prototype plans becomes fully operative and available, the high cost of establishing and maintaining a retirement program should become a less significant factor in the extension of coverage to small employer groups.

3. Lack of pressure from employees or unions

Labor unions have tended to focus their organizing activities on larger employers. With the exception of certain trades where union membership is a long-established tradition (such as printing, building, and trucking), small employers are generally exempt from the pressure of collective bargaining agents to establish pension plans. And where employees are members of trade unions, the pressure usually is for contribution of a set amount to a joint labor/management pension fund, with little or no employer involvement in the operation of the program once the payment is made. Nor does trade union pressure for pensions extend beyond its own members in an employer's business operation.

Employees who are not represented by collective-bargaining agents—whether they work for small or large companies—generally are not vocal in requesting retirement coverage. The preference of many workers—especially those under age 45 or 50—is to take the cash and let the pension go.

4. High turnover in small business

This is a frequently cited reason, which cannot be proved statistically since turnover is investigated and recorded only among manufacturing companies without regard to size of the employing unit. But reflection for a moment on the characteristics of the small business establishments that the ordinary citizen patronizes at frequent intervals will yield the impression of a work force that supports this reason.

Certainly the small neighborhood business tends to attract casual workers who are not seeking long-term career employment. For example, housewives, students, and retired persons prefer work near their homes. Small business offers employment to certain types of workers who are habitual job changers: waitresses, beauticians, service station attendants, to name a few. Seasonal and part-time workers also gravitate toward small employers.

5. Many small business firms are young in years

Until a business has been operating long enough to have employees with substantial service records, the question of pensions is not very urgent particularly if no strong outside pressures exist. The priority for funds in a young business is more apt to be for business expansion than for pensions.

6. Small employers view pensions as personal costs

The small employer—incorporated or not—who owns his own business tends to view retirement plan contributions as a personal cost. Unlike the widely held corporation, he cannot spread the cost among numerous shareholders. Nor does the business owner look at his own pension "benefit" as a form of additional compensation in the same way the corporate manager sees it. To the owner it represents a tax-deferred form of savings which gives him the same tax advantage enjoyed by professional managers and by all employees.

7. The small employer personality

The small business owner is frequently an independent personality with strong work drives and a dedication to the belief that each individual is responsible for his own financial future. In a family enterprise, he may be highly motivated to conserve business profits for his heirs rather than diverting them to employee security.

Significant advances have been made in recent years in removing barriers to the extension of private pension coverage. Still it is evident that even if every employer in the United States adopts a plan to provide employee retirement income, there will still be gaps in coverage and inadequacies in ultimate benefits available in the retirement years. These gaps and inadequacies are not limited to those areas currently without coverage. They apply equally to segments of the population who are now participants in pension plans. Gaps in coverage can always be expected as long as workers move from employer to employer and private plans exclude participation during initial periods of employment.

B. Private Pension Benefit Levels

If one were forced to select one body of information which is important, above all others, in evaluating the impact or role which private pensions will play in providing income security in retirement, it would no doubt be information on private pension benefit levels. Even 100 percent immediate vesting would be meaningless without benefit levels which are, in some sense, adequate. Hence, it is an astounding fact to report that today we do not know what the level of private pension benefits is and how they are changing over time. Although the Welfare and Pension Plans Disclosure Act requires that the provisions of all pension plans covering more than 25 workers

be filed with the U.S. Department of Labor, *this great wealth of information remains relatively unanalyzed.*

In 1965, a study of private pension plans benefits appeared,[32] but because of extremely unrealistic assumptions, the findings are of little usefulness.[33] More recently, a study was made of 100 negotiated pension plans and trends were examined between two periods—1961–64 and 1964–68.[34] Once again it would be pure folly to generalize about what are the trends in private pension benefits from this unrepresentative sample of plans—which in many cases are plans of the pension "leaders."

The two studies mentioned above and studies of individual firms do give us a very rough feeling for the improvements that are taking place. In general, eligibility requirements for pensions usually depend upon the completion of substantial periods of service (usually 10 or 15 years) and attainment of retirement age (normally 65) with the same company. A large proportion of plans have vesting provisions so that a long-service employee who terminates his employment with a firm before eligibility for regular retirement will retain the pension credits accrued from that employer's contributions. The high frequency of job turnover, however, tends to limit the number of persons who actually qualify for a private pension in old age. Projections from data collected in the 1963 Survey of the Aged show that only about 20 percent of the aged are receiving private pension income. These persons are the economically elite among retired OASDHI beneficiaries, and have median incomes of about $1,000 more than those without private pensions.

The benefit formulas in private plans are extremely varied, presumably reflecting the needs, financial ability, and desires of a particular employer or industry, as well as collective bargaining pressures. Most private plans are based on the premise that retirement benefits should be a function of years of service, either with a particular firm or in the case of multiemployer plans, with a group of firms. *Gearing benefits solely to length of employment has the effect of providing fairly large pensions for the career worker but small benefits for the individual with a less permanent attachment to the particular employer.* Many conventional plans relate benefits to earnings as well as to service so that benefits tend to be proportionate to earnings. If greater credit is given for earnings above the OASDHI wage base than for earnings below this amount, the effect is to provide relatively large pensions for regularly employed, middle management employees and executives with above-average earnings. Under collectively bargained plans, the tendency is to provide uniform benefits that vary by length of service but not earnings, thus placing low-paid workers in an advantageous position. Minimum benefit provisions in plans with earnings-related

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[32] Donald J. Staats. "Normal Benefits Under Private Pension Plans," *Monthly Labor Review,* Vol. 88 (July 1965), pp. 857–63.

[33] For a discussion of the severe limitations of these estimates. see my "Aged Retirement Income Adequacy—Simulation Projections of Pension-Earnings Ratios," in U.S. Joint Economic Committee. *Old Age Income Assurance, op. cit.,* Part III.

[34] Harry E. Davis, "Negotiated Retirement Plans—a Decade of Benefit Impovements," *Monthly Labor Review* (May 1969), pp. 11–15.

formulas also tend to favor the below-average wage earner. Under plans contributed to by employees, benefits tend to be greater than those provided in plans financed in full by the employer.

About three-fourths of workers in private plans are in plans financed in full by the employer; that is, noncontributory plans. The remaining covered workers are in plans which require that a portion of the costs be borne by employees (contributory plans). The employee's portion in these plans is usually a fixed amount or percent of compensation, while the employer pays the balance of cost, usually about two-thirds. A few union-operated plans are financed in full by workers' contributions. Almost all collectively bargained multiemployer plans are noncontributory and are financed by specified employer contributions to a central fund. Similarly, collectively bargained single-employer plans, particularly those in highly organized mass production industries, usually are financed in full by the employer. The net result of these arrangements is that the employer makes about 85 percent of the contributions to all retirement plans.

Heidbreder, Kolodrubetz, and Skolnik have made the following general observations concerning developments affecting benefit levels:

1. There is a growing tendency to base retirement benefits on compensation in terminal years of employment, especially in plans including white collar and professional groups.
2. The history of bargaining experience of the past 15 years and the favorable experience in private pension financing have clearly shown that pension plans have not been static programs.
3. Flat dollar amounts in formulas using length of service as a variable have shown a persistent increase over time.
4. The use of step-rate formulas, providing greater benefits for higher paid persons, has increased, and the percentage factors used in computing benefits have increased.[35]

Having said this, however, we are still left with the question: how much private pension income will future private pension recipients receive when they retire? The question remains largely unanswered.

C. Survivor's Benefits

The task force report, "Economics of Aging: Toward a Full Share in Abundance," emphasized that widows and other aged women living alone are currently a particularly economically disadvantaged group. "Six out of every 10 of them have incomes below the poverty line. In fact, the number of poor women living alone has actually increased over the years—from 1.8 million in 1959 to 2.1 million in 1966—a reflection of the increasing number who live independently even at the price of poverty." [36]

Given the existence of a poverty problem among older women, it is surprising that so little attention has been paid to the adequacy of survivors' benefits existing in present public and private pension plans. In the case of private pensions, for example, neither Nelson McClung's survey article, "Old Age Income Assurance: An Outline

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[35] Elizabeth M. Heidbreder, W. W. Kolodrubetz, and Alfred Skolnik, "Old Age Programs," in U.S. Joint Economic Committee, *Old Age Income Assurance, op. cit.*, pt. II, pp. 52–94.

[36] U.S. Senate Special Committee on Aging, *op. cit.*, p. 14.

of Issues and Alternatives,"[37] nor the report of the President's Committee on Corporate Pension Funds[38] mentions this problem.

This inattention is in stark contrast to evidence indicating the key role that could be played by public and private survivor benefits. For example, in a pioneering study, "Survivor Benefits" (Detroit: Michigan Health & Social Security Research Institute, 1968), Eugene Loren and Thomas Barker recently surveyed UAW union members and their survivors and found that total resources available to survivors were inadequate for long-term needs. *More importantly, they found that without group survivors benefits vast numbers of survivors would be virtually destitute.* About 75 percent of the surveyed UAW families had financial resources at the worker's death of less than $3,000; approximately half of the dependent surviving units had little or no net assets to supplement survivor benefits or work income.

Detailed data on the operation of group plans other than for UAW employees are sparse; the general information that does exist clearly suggests that private pension plans are contributing very little to the income maintenance of persons who survive after a worker's death. In some private plans the worker himself must directly bear the entire burden of protecting his spouse; he must elect a reduction in his retirement pension to cover the actuarial cost of a survivor's benefit for his spouse. Apparently few workers, for various reasons, exercise this option. Other plans *automatically* continue benefits to survivors after the death of, in some cases, the *active* worker, or, in other cases, the *retired* worker.

A Bureau of Labor Statistics study of plans in effect during the winter, 1962–63, which had the automatic survivors feature found the following:

> Death benefit provisions * * * were found in a third of the pension plans covering slightly more than a third of the workers * * * while about equal proportions of single-employer and multiemployer plans had them, a somewhat higher percentage of workers in multiemployer plans had this added protection * * *.
>
> The industry patterns of death benefit provisions showed wide differences. Plans in manufacturing industries had the lowest prevalence of death benefits; less than 30 percent of the plans and workers * * *. In contrast, in communications and public utilities, a third of the plans with over two-thirds of the workers had them, chiefly because they were provided by all of the telephone company plans. Because several large Teamster plans had death benefits, almost 30 percent of the plans with over half the workers in the transportation industry had this protection. In finance, over half the plans with a slightly lower proportion of workers had a death benefit. In the mining industry, because the Mine Workers' plan provides death benefits from another part of the welfare and retirement fund, only a limited number of workers were in plans

[37] U.S. Joint Economic Committee, Subcommittee on Fiscal Policy (Washington, D.C.: Government Printing Office. 1966).
[38] *Public Policy and Private Pension Programs*, A Report to the President on Private Employee Retirement Plans (Washington, D.C.: Government Printing Office, 1965).

with survivor protection. While only 30 to 40 percent of the workers in construction, trade, and service industry plans were in plans with death benefits, the proportion was greater than in plans in manufacturing industries.[39]

In the Bureau of Labor Statistics *Digest of 100 Selected Pension Plans Under Collective Bargaining, Spring 1968*,[40] we find more up-to-date information on a smaller group of plans which "were selected because they illustrated different approaches to pension planning, or because of widespread interest in the plan, as manifested in inquiries received by the Bureau." Of the 100 plans surveyed, 44 percent made provision for a death benefit before retirement and 43 percent after retirement.

Thus we find even in this "unrepresentative" group of plans, a sample which overrepresents the bigger firms with the "better" pension programs, that only 44 out of 100 plans have automatic death benefits. More important, however, is the information summarized in table 6 which shows the nature of the death benefit after retirement; survivor benefits paid when death occurs *before* retirement are *not* tabulated but are often similar.

TABLE 6.—*Summary of death benefits after retirement*

Type benefit	*Number of firms*
A fixed period of payments:[1]	
5 years of monthly payments	8
3 to 4 years of monthly payments	5
½ to 1 year of monthly payments	3
Worker's contributions plus interest	11
Lump-sum payment:	
\$3,500 to \$7,500	2
\$1,000 to \$3,500	5
\$400 to \$500	2
A percentage of normal benefits:[2]	
100	2
90	1
55	1
50	2
Other	2

[1] Usually less payments received.
[2] Many of these benefits are reduced for previous benefits paid.

Source: Tabulated from information in U.S. Bureau of Labor Statistics, *Digest of 100 Selected Pension Plans Under Collective Bargaining, Spring, 1968*, Bulletin No. 1597 (Washington, D.C.: Government Printing Office, February 1969).

The most common kind of death benefit is to pay a monthly payment to the survivor but only for a half to 5-year period. *After that, benefits cease entirely—ignoring the fact that the survivors' living expenses continue and no doubt increase over time.*

Another common survivor's benefit is one which appears in plans where the employee has made previous contributions to the pension fund; usually this contribution is about 2 to 3 percent of his salary. The survivor benefit merely returns the employee's contribution to his survivor, together with the interest accured on it.

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[39] *Private Pension Plan Benefits,* Bulletin No. 1485 (Washington, D.C.: Government Printing Office, 1966), pp. 93–94.
[40] Bulletin No. 1597 (Washington, D.C.: Government Printing Office, February 1969).

The third most common type of survivor's benefit is a lump-sum payment. Here the most frequently paid amount by firms using this device is $1,000 to $3,500.

The least common type of death benefit is one which gives the survivor a benefit which is some percentage of the normal retirement benefit of the retiree. Table 5 shows that three plans pay benefits which are 90 or 100 percent of the normal benefit. Even these generous death benefits, however, are usually reduced as a result of any previous benefits paid to the retiree before his death.

In addition to survivor's benefits, many firms also provide life insurance benefits to their employees. The value of this insurance at death varies widely, but based upon a selected group of plans surveyed by the Bureau of Labor Statistics, we see that the value of coverage varies from a low of about $1,000 to a high of $6,000 (with a few exceptions below or above this range).[41] Unfortunately a number of these insurance benefits are reduced substantially at age 65. For example, insurance in the auto industry (during 1966) is reduced 2 percent monthly until it equals 1½ percent of the amount in effect immediately prior to initial reduction multiplied by the years of coverage up to 20 years. Or, among many tobacco workers, the life insurance benefit is reduced 10 percent at age 65 and reduced by a like amount on each of the next four succeeding birthdays.

One cannot help but feel, after surveying current practices, that existing death and life insurance benefits are designed not so much to reflect the needs of the employees and their survivors but to insure that benefits remain within the severe cost constraints of the employer.

D. Vesting

The social consequences of private pensions—the impact on society as a whole of differing individual choices made by a great number of private individuals—is especially apparent when we consider vesting.

Vesting refers to the provision in pension plans that guarantees those covered by the plan that they will receive all or part of the pension benefit for which they have qualified, whether or not they are working under the plan at the time of their retirement. Through vesting, the pension rights of otherwise qualified workers are protected whether they were discharged, furloughed, or quit voluntarily.

Typically, plan provisions set as qualifications for vesting, minimum age and/or minimum length of service requirements. A plan may thus require that a worker have 10 or 15 years of service and be over age 40 before he acquires any vested right to a pension benefit. Although there is great diversity among the vesting provisions of private plans, two major types may be identified.

If a plan provides that an eligible worker retains full right to his accrued benefits once he meets the specified requirements—after age 40 and 10 years of service, let us say—then the plan is said to offer

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[41] See U.S. Bureau of Labor Statistics, *Digest of 100 Selected Health and Insurance Plans Under Collective Bargaining, Early 1966*, Bulletin No. 1502 (Washington, D.C.: Government Printing Office, 1966).

deferred full vesting. If a plan provides that a worker gains rights to a certain percentage of his pension benefits upon meeting the minimum age and/or service requirements, and that his percentage of entitlement rises through the ensuing years of employment to an eventual 100 percent, the plan is said to offer deferred graded vesting. About 70 percent of those covered by plans with vesting have deferred full vesting.[42] Nearly all the others covered by plans with vesting have deferred graded vesting; immediate full vesting is extremely rare.

As we have seen above, by no means are all workers in the private sector covered by private pension plans. Of those under such plans, not all will attain vested rights. The fraction of workers in plans with vesting now stands at about two-thirds. Vesting is no more prevalent in collectively bargained plans than in those installed by employers on their own initiative.

Retirement in good health before the customary age—early retirement—has been mentioned as an alternative to vesting. About one worker in five is covered by a plan that lacks vesting but does permit early retirement. A worker may prefer to leave his current employer and work elsewhere, perhaps at a lower wage, or he may wish to trade a smaller annual pension benefit for a longer period of retirement. Early retirement is found in pension plans covering three-fourths of the workers under private pension plans. Furthermore, the employer must assent to the worker's choice of early retirement in the case of plans covering about two-fifths of the workers. Typically, early retirement provisions call for attainment of age 55 or 60 with 5, 10, or 15 years of service with the employer or permit early retirement at any age after 20 years or more.

Chart 1 shows the results of two surveys of vesting provisions. It shows that in recent years there has been very little increase in vesting coverage and little liberalization of vesting provisions. The one major change has been that a significant number of workers covered by plans with age 40 and 10 years of service vesting requirements are now able to get some vesting after 10 years, regardless of age.

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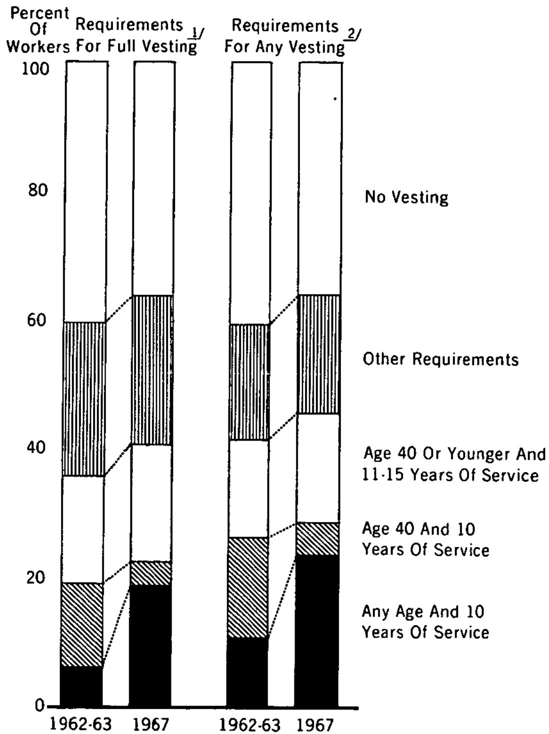
[42] Donald M. Landay and Harry E. Davis, "Growth and Vesting Changes in Private Pension Plans," *Monthly Labor Review* (May 1968), pp. 29–35.

Chart 1. Age and Service Requirements for Vesting, 1962–63 and 1967



[1] Plans with graded vesting provisions classified by their age and service requirements for full vesting.
[2] Plans with graded vesting provisions classified by their age and service requirements for initial vesting.

Source: U.S. Department of Labor.

Of what value are vesting or early retirement provisions to those who are potentially eligible under them? In January 1965, the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs attempted to answer this question. A newly hired 25-year-old employee was assumed to have entered a private plan with vesting and early retirement provisions. The Committee then calculated that:

> * * * 90 percent of the plans were found not to provide any protection to the worker within the first 10 years of his service or until age 35. If he remains until age 40, with 15 years of credited service, he still would not be qualified for vested benefits in over two-thirds of the plans. By age 50, with 25 years of service, 45 percent of the plans would have requirements which this hypothetical worker could not meet * * * [43]

As a result of the liberalization in recent years of age and service requirements (discussed above), the estimates of the President's Committee have been updated by the Bureau of Labor Statistics. Based on data for 1967, the probability of all workers acquiring vested rights (if they begin working at age 25 in jobs covered by pension plans) was about 22 out of 100 after 10 years of service.

Further evidence on this question was given in testimony by Henry T. Ivers, chairman of the board of trustees of the Western Conference of Teamsters Pension Trust, to the Joint Economic Committee in 1966. The relevant section of the hearings is reproduced below.[44]

> Senator JAVITS. Now actuarially what percentage of your membership on the average did you figure would qualify for a pension?
>
> Mr. IVERS. I cannot answer that question because I am not an actuary, but we have assumed that under the operation that we now have that something in excess of 50,000 will qualify for pensions.
>
> Senator JAVITS. So that one-sixth of the total membership will qualify; is that right?
>
> Mr. IVERS. Yes.
>
> Senator JAVITS. You said about 300,000.
>
> Mr. IVERS. 350,000.
>
> Senator JAVITS. And you figure one-sixth will qualify?
>
> Mr. IVERS. A little better than that.
>
> Senator JAVITS. All right. Now, pursuing Mrs. Griffiths' question, has your experience to date borne out that estimate?
>
> Mr. IVERS. We are not old enough.
>
> Senator JAVITS. You are not old enough to tell?
>
> Mr. IVERS. No.
>
> Senator JAVITS. But your estimate is that one-sixth of the total for whom there are contributions will get benefits. Will that one-sixth get the contributions which were paid in for the

[43] The Committee, "Public Policy and Private Pension Programs, a Report to the President on Private Employee Retirement Plans," (Washington, D.C.: Government Printing Office, 1965), p. 39. Data for 1967 are from Landay and Davis, *op. cit.*, p. 34.

[44] U.S. Joint Economic Committee, Subcommittee on Fiscal Policy, hearings on "Private Pension Plans," pt. 1, 89th Cong., second sess. (Washington, D.C.: Government Printing Office, 1966), p. 38.

other five-sixths as well as the contributions paid in for them?

Mr. IVERS. That is the only way the plan could be supported. Your death and attrition rates are what support the plan. You could not pay the benefits that we pay if a hundred percent of the people were going to qualify for it because there just is not enough money. You would certainly have to get a much, much higher contribution rate.

It is evidence similar to this which caused Thomas R. Donahue, as Assistant Secretary of Labor for Labor-Management Services, to remark in testimony, "In all too many cases the pension promise shrinks to this: 'If you remain in good health and stay with the same company until you are 65 years old, and if the company is still in business, and if your department has not been abolished, and if you haven't been laid off for too long a period, and if there is enough money in the fund, and if that money has been prudently managed, you will get a pension.'" [45]

The older worker who loses his job, for one reason or another, after many years of service but before qualifying for a private pension benefit has suffered a retroactive pay cut. The older worker who must forfeit his pension benefit if he chooses to change employers is uncomfortably close to serfdom. Neither situation is hypothetical. Both occur all too frequently and, as public opinion is coming to acknowledge, older workers caught in both situations are victimized by flagrant inequity.

Although public policy demands equity in the matter of vesting, public policy, as formulated in the relevant provisions of the Internal Revenue Code, does not grant equity. Private pension plans may qualify for preferential tax treatment without regard to their vesting provisions, or lack of them, save only that any vesting that is proffered must be equally available to all employees, whatever their wage rate or salary. Favorable treatment under the Federal tax law is vital to private pension plans. Therefore, in order to foster and liberalize vesting, many have urged mandatory minimum vesting requirements, arguing that voluntary improvement of private plans is too slow in coming.

During the decade of the 1950's there was a pronounced trend toward more liberal vesting provisions. As shown above, however, during the 1960's this trend has slackened. As Assistant Secretary Donahue testified before the Committee on Labor and Public Welfare "at this rate we will have to wait until about the year 2000 before substantially all plans have even a modest vesting provision." [46]

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[45] U.S. Committee on Labor and Public Welfare, Subcommittee on Labor, hearings on "Pension and Welfare Plans," 90th Cong., second sess. (Washington, D.C.: Government Printing Office, 1968), p. 217.

[46] U.S. Committee on Labor and Public Welfare, *op. cit.*, p. 220.

Estimates indicate that some approaches to mandatory minimum vesting requirements would not be expensive. The President's Committee, for example, estimated that deferred full vesting after 20 years of service would seldom add more than 6 percent to the cost of providing normal retirement benefits at age 65. Deferred graded vesting, with at least half the accrued normal retirement benefit vested after 15 years of service and full benefits after 20 years, would seldom add more than 8 percent to plan costs. S. 3421, which was considered by the 90th Congress, would have required full vesting of regular retirement benefits after 10 years of service, excluding years of service prior to age 25. The Department of Labor estimated in 1968 that this requirement, which would immediately cover some 10 million workers, would cost one-third of the private pension plans nothing or at most an additional 3 percent. About one-fourth of the plans would be faced with cost increases of between 3 and 6 percent. Less than half the plans, most of which lack any vesting provisions, would incur costs greater than 6 percent.[47]

It has long been contended that many workers change jobs unaware that they have gained vested rights to a pension benefit. When they qualify for its payment by reason of age, perhaps many years later, they may fail to apply for their pension benefit. This failure to collect their vested benefit may improve the actuarial status of the private pension fund and slightly lower the plan's true costs, but it works a hardship on the retiree and perhaps increases the need for Old-Age Assistance or other similar payments.

A solution which has been proposed (as far back as the 1961 White House Conference on Aging) would be to require private plans to report acquisition of vested benefits to the Social Security Administration when, for example, wage payments and tax collections are reported. The fact of vesting could then be noted on the individual wage records maintained by the Social Security Administration and then reported to the worker when he applies for his public retirement benefit. This procedure would, of course, amount to the designation of the Social Security Administration as a clearinghouse for information about eligibility for private pensions and would thus be a step toward full portability of pensions.

E. Communication and Disclosure

A great deal of discussion has taken place regarding employee expectations under the private pension system. However, there is little factual evidence about how much employees really know about and expect from their plan. Certainly, as formal communication regarding pension plans has spread and become more sophisticated, individual workers' awareness of the plans and the provisions has increased and their decisions have been and will be affected more strongly. But it cannot be assumed that participants in a pension plan have complete knowledge of their probability of receiving, say, a vested pension. One may reasonably ask the question as to whether the terminating worker knows that he is entitled to a vested pension,

[47] U.S. Committee on Labor and Public Welfare. *op. cit.*, pp. 220–221.

and what conditions have to be met to protect this right or to achieve it. Certainly, based on documents and letters submitted by the Labor Department in the recent hearings on private pension plans, one would be led to believe that there are a substantial number of persons who do reach retirement age or terminate employment and have been disappointed to find that they do not qualify for a pension they anticipated, or there are no funds available.[48]

Most of this evidence and reasoning strongly suggests that employers (as well as unions) have not done a sufficient communications job specifically directed at informing employees of the rights and limitations under their plan. This has included misleading or inadequate summaries of pension plan provisions as well as almost complete lack of education and training specifically directed at informing employees of the cost and value of their pension program.

The pension promise for plan members is usually explained in plan booklets that typically illustrate the simple and routine cases. The illustrative benefits section, for example, usually uses the most optimistic projections of both private plan and social security benefit levels to indicate the value of the plan to the employee. Since pension plans and other benefit plans have grown even more complex, the adequacy of such pamphlets in clearly stating the limitations of the pension plan may be understood by the insurers, actuaries, lawyers, consultants, employers, and unions, etc., but it is probably a little hazy for the persons to whom the pension plan actually applies.

At the present time the Government has a number of agencies that presumably could function in this area. First, the Treasury Department requires that members of qualified plans be informed of their rights under the plan. But, apparently there is no avenue open for employees to take action to protect their interest, even if they understood that they had some to protect. Second, through the Welfare and Pension Plans Disclosure Act, the Labor Department requires (among other things) that persons covered by pension (and welfare) plans receive information regarding their plans, including plan provisions. However, in practice the presentation of material to be distributed to the plan participant may take any form within the framework required by the act.

In order to strengthen the communication of employee rights under pension plans, administrators might voluntarily (or be required) to inform plan participants of pertinent factors bearing upon the status of their pension promise. Private pension (and public) plans are now too complicated to be effectively communicated through simple booklets and generalized statements. The plan should be clearly presented so the worker can know how the plan affects him. First, full disclosure of the pertinent material regarding plan provisions and limitations could be required to be made to each plan member. Limitations, especially, should be given a prominent place in the pres-

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[48] U.S. Senate Committee on Labor and Public Welfare. Pension and Welfare Plans, hearings before the Subcommittee on Labor, 90th Cong., second sess. (Washington, D.C.: Government Printing Office, 1968).

entation rather than being relegated to the fine print at the end of the booklet. For example, it could be required that the booklet explaining the pension plan given each employee clearly and conspicuously outline the limitations of eligibility for benefits of the plan. Furthermore, a statement of accrued benefits under their plan should be given each employee. For example, it could take the form of an annual statement of accrued benefits with a clear statement of whether these benefits are vested or not.

Furthermore, the terminating (or retiring) employee could be given a statement or certificate of his accrued rights under the plan, with specific information on how to secure these rights. This should include statements about any limitations bearing on these rights.

Many profit-sharing and pension plans already issue such statements to employees.[49] For example, the private pension fund of the Teachers Insurance and Annuity Association—College Retirement Equities Fund (TIAA-CREF) issues a statement regarding retirement pension benefits accumulated. All employees covered by TIAA-CREF receive annually a "report of premiums and benefits" which shows (*a*) the total premiums paid during the previous year, (*b*) the age at which the annuity is scheduled to begin, (*c*) the annuity income *already purchased* (i.e., the benefit which would be received if no further premiums or dividends were credited—under a set of specified assumptions) and (*d*) the value of the death benefit. Appendix A shows these TIAA-CREF report forms, along with the accompanying explanation sent to the covered employees.

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[49] See Bert L. Metzger, "Investment, Practices, Performance, and Management of Profit Sharing Trust Funds" Evanston, Ill.: Profit Sharing Research Foundation, 1969), ch. 19, for examples of forms used to report profit sharing performance to employees.

IV. CONCLUSION: WHAT PRICE FLEXIBILITY?

As was discussed above, private pension plans are instituted for a variety of reasons. A major purpose, of course, is to provide career employees with a retirement income supplemental to the social security benefits provided through the Federal old-age, survivors, disability, and health insurance (OASDHI) program. At the maximum benefit level, OASDHI benefits replace only about one-third of a retired worker's average monthly earnings; with an eligible wife, about half. If a worker is under age 65, his OASDHI benefit is subject to an actuarial reduction. In addition, earnings above the taxable wage maximum of $7,800 per year are currently not creditable for social security benefit purposes. Hence, for workers with above-average earnings, the OASDHI benefit replaces even smaller proportions of total earnings.

Another objective of private pension plans is to meet certain internal personnel and manpower problems. A private pension plan permits employers, in an orderly and humanitarian way, to terminate the services of workers with diminishing capabilities. It helps to reduce labor turnover and its attendant costs. It helps to build morale among employees by rewarding long and faithful service and by giving employees a sense of security. It provides a means for keeping the channels of promotion open, thereby offering incentive and opportunity to younger workers.

Finally, private pension plans are often instituted as the result of external industry or labor pressures. Many large firms cannot afford to be without this form of security for their employees if they are to meet the competition provided by other firms in the recruitment and retention of experienced personnel.

> ***Flexibility or tyranny?*—The mixture of motivation in instituting private pension plans leads to varied views as to their role. When the plans are viewed from the standpoint of their income-maintenance features, their purpose and goals undoubtedly take on a predominantly public hue. When viewed from the standpoint of their role as a management tool in meeting personnel and labor force problems, their public purpose becomes submerged to private interests.**

In view of their significant role as a source of retirement income, there is a great public interest that private plans develop to their fullest potential, that they be provided with incentives to grow, and that they improve their basic soundness and equity. Concern has been expressed that the plans developed to date have not been as effective as they could be because they contain stringent eligibility qualifications, lack portability, do not provide sufficient assurance that the pension expectations of workers will be realized, and may interfere with free job choices. There is also concern that the private pension

system falls short of providing universal coverage because many employers have neither the will nor the resources to institute such protection for their employees, especially if engaged in marginal, seasonal, or small-scale operations.

These weaknesses have often led to proposals that standards be established for private pension plans that would assure a minimum level of vesting, funding, benefit payments, and protection in case of plan termination. These proposals, however, are often objected to because they infringe upon the private motivations for instituting and maintaining private pension plans, namely, the desire of management to use a private pension plan as a tool in meeting circumstances and problems peculiar to their own situation.

It is generally recognized that the greater the extent to which the private pension system is subject to standards and regulations, the less the flexibility an individual plan has in meeting conditions peculiar to its firm or industry.

The question often posed then is whether the social purposes of private pension plans are of such significance as to justify the adoption of measures that might limit the use of such plans in achieving certain management objectives. It has been said that as supplemental protection, the private pension system can be most useful in performing those types of functions that a basic national income-maintenance program such as OASDHI cannot do well. A major element in performing these functions is the flexibility with which private firms, employees, and unions can make individual decisions based on individual circumstances and needs.

It is feared that attempts to introduce minimum compulsory standards may unduly burden the maintenance of existing plans or hamper the establishment of new plans. They may introduce pension rigidities, discourage improvements, and result in minimum standards becoming maximum standards. They may interfere with decisions regarding the allocation of resources available for pension benefits. It is pointed out that the terms of private pension plans need to vary not only to meet the needs of particular groups of employees but also to take into consideration "ability to pay" factors fashioned by the economic circumstances of particular companies and industries. The cost of a pension plan can vary widely depending on the age of the company, and the composition of its employees by age, length of service, sex, and other factors. This almost endless variety of circumstances, it is said, argues strongly for a wide measure of freedom in the formulation of new plans and in the evolution of existing plans.

The areas where flexibility is deemed most important concern vesting and eligibility requirements, level of benefits, degree of funding, and retirement policies. What does flexibility mean in these areas and to what degree is there a need for such flexibility? What are the tradeoffs between the need for flexibility and the need for assuring the basic soundness and equitable character of private pension plans? In other words what price is the country paying for this flexibility, and is the price too high?

Vesting and eligibility.—Eligibility requirements for benefits in private pension plans are inevitably geared to meet the special needs and financial conditions of the individual firm or industry. Partly because of an employer's desire to provide an incentive for an employee to stay with the firm, and partly because funding arrangements often make it necessary to equate individual benefits with individual contributions, relatively stringent age and service requirements for qualifying for a pension are in effect in most plans.

The variation in vesting and eligibility provisions is deemed desirable from the standpoint of management because it permits a plan to be molded according to manpower requirements and labor force composition of the individual firm. Management may wish to give higher priority to the payment of adequate pensions to those workers who have demonstrated their loyalty by working a lifetime with the firm than to the protection of short-term employees through vesting. This becomes especially critical when a pension plan has limited income and cannot afford both. If the plan has high turnover, the employer may want to avoid early vesting because it would result in an expensive and unwanted diversion of available funds. He may prefer to use the funds to finance past service credits or provide more rapid funding.

Eligibility requirements can also be varied to meet changing economic conditions. When the need is to accommodate to technological or economic unemployment, early retirement provisions can be invoked or liberalized. If the problem is one of a rapidly aging labor force with diminishing productivity, the pension plan can relax its eligibility provisions.

But what is the price of flexibility in eligibility requirements? In too many cases flexibility means differential treatment between the employee who works for one firm as against the employee who works for several during his career. In the absence of vesting requirements, the latter is likely to end up with no protection or with pieces of protection that are far below what the career employee receives by staying on the job. This discrimination against highly mobile workers is also at odds with the oft-asserted allegiance paid in our society to the desirability of labor mobility as an essential ingredient of a productive and efficient economy. The prospective loss of valuable pension rights through stringent eligibility and vesting requirements tends to keep able and skilled workers tied to a declining industry or firm and inhibits the freedom of long-service workers, particularly among executive, professional, clerical, and skilled groups voluntarily to shift to other companies.

Level of benefits.—The benefits provided by private pension plans range widely, influenced by such factors as level of wages, the method of financing, financial position of the firm or industry and the type of benefit formula used. In the mass-production industries, which have a predominant number of pension plans developed under collective bargaining and covering primarily production workers, there is a

tendency to relate benefits to years of credited service only, at least for minimum benefits. Gearing benefits solely to length of employment puts a premium on long-term service and has the effect of providing fairly large benefits for the career employee but small (minimum) benefits for the short-term, transitory employee. Some of the plans provide a uniform (flat) benefit to all who fulfill specified service requirements. Because of limited resources and the fact that all workers are treated alike, regardless of preretirement earnings differences, these plans may end up with a level of benefits that is inadequate for those workers with better-than-average earnings.

Most nonnegotiated plans, on the other hand, relate the benefits to the individual's earnings and length of credited service. A common formula, for example, provides for benefits equal to 1 or 1½ percent of each year's compensation, or of the average compensation in the most recent or highest years, multiplied by the number of years of creditable service. To take cognizance of social security benefits, some plans give greater credit for earnings above the OASDHI wage base than for earnings below that amount.

The use of an earnings factor combined with length of employment maintains, to some degree at least, differentials in retirement income commensurate with differentials in preretirement earnings. Yet, once again a premium is put on long service and under many of these plans, on high-paid jobs.

The choice of benefit formulas and levels is one of the advantages cited for private pension plans, because it permits plans to be tailor-made to specific employer-employee relations. Where there is little differential in wage levels among its employees, it is administratively simpler for a firm to choose a formula based on service alone. Where a firm has a large white-collar force with a broad range in salaries among personnel, a wage-related formula would be more appropriate and satisfying to employees. Where a firm has limited financial resources, it can adopt a modest level of benefits or limit other components of the plan such as those dealing with vesting, eligibility, and disability or survivor benefits. If it is a new plan, it can choose to allocate its resources so as to provide past service credits, thus assuring employees approaching retirement age with adequate benefits.

But what is the price of benefit flexibility? To what extent are benefits adequate? To what extent do wage-related formulas coordinated with social security favor the highly paid wage earner at the expense of the lower paid worker? To what degree is the short-term employee discriminated against and left with a small pension because of benefit formulas that place a premium on long-term service? To what degree are preretirement earnings ignored in determining formula characteristics because of inhibiting economic and financial considerations?

These are the questions of paramount interest to the worker and the public, especially since private pension plans are granted a favorable tax status, presumably because of the significant role they play in the Nation's total retirement security program.

Degree of funding.—Plans have the option of choosing the extent to which they will fund their future commitments. If they wish to

receive favorable tax treatment for moneys set aside to meet future liabilities, they must meet certain Internal Revenue Service requirements—funding equal to the current service costs plus the interest charge on unfunded (past service) accrued liabilities. But a plan need not set aside any money for future liabilities; although not commonly done, it can pay benefits as due out of current income and assets.

This flexibility permits plans which have little concern over meeting future commitments—for example, multiemployer plans where the chances of plan termination are minuscule—to devote their current income to providing the largest possible current pensions. Other plans see similar advantages in funding at a minimum level.

The price paid for funding flexibility is the risk that under certain circumstances, the assets needed to satisfy accumulated pension obligations will not be available when needed. The risk is greatest when a plan faces unexpected termination and is not fully funded—that is, has not paid sufficient money into the pension fund to finance retroactively granted pension credits for past services of the employees.

Proposals have been made for minimum funding standards and for plan termination insurance to assure the fulfillment of pension promises, but such proposals in themselves imply a reduction of plan flexibility in terms of timing of a firm's contributions to the trust fund, types of pension fund investments, types of benefits provided and their liberality, etc.

Retirement policies.—Since private plan provisions and their administration are left to the discretion of private employers, unions, and labor-management agreements, private plans can adapt their retirement policies and practices to meet differing situations and conditions. Some industries find it desirable to provide for a flexibly administered retirement system, whereby an employer can take into consideration the differing capacities of individuals of the same chronological age, the current needs of the business, and the general economic situation. Other concerns feel it is good personnel practice to give each employee the broadest option for retirement—early retirement, normal retirement, or continued employment past the normal retirement age. Still others find it more efficient and economical to insist upon mandatory retirement at a designated age. During periods of heavy or chronic unemployment, unions may also favor mandatory retirement provisions as an equitable way to ease the unemployment problems of union membership.

When conditions dictate retrenchment, the firm can adopt early retirement policies which may feature unreduced benefits, or even supplemental pensions, so as to ease the burden on those who are displaced. Vesting provisions may also be liberalized for the benefit of departing younger workers. When a firm is expanding, the emphasis can be on using the pension plan as an instrument for attracting new employees and retaining present ones, perhaps by incorporating new kinds of features such as widow and survivor benefits.

What is the price of retirement age inflexibility? To what extent are pension plans, when utilized to encourage early retirement and withdrawals from the labor force, working at cross purposes with the national commitment to use to the greatest extent possible the productive capabilities of the older work force? To what extent do pension plans discourage the hiring of employees in the older age brackets because of the pension costs that are associated with employing older workers? To what extent are pension plans administered so as to keep to a minimum the number of qualified pensioners?

How Fast Improvement?

Many people, in response to the above questions, argue that given present trends, private pension plans of the future will be greatly improved and will avoid many of the less desirable provisions currently in effect. The argument is made that private pension plans cannot improve everything at the same time.

While there is an element of truth in such an argument, it is also true that some private pension plans, such as TIAA-CREF, *exist now* which are superior to the vast majority of other plans. Appendix B contains an illustrative group of such plans and descriptions of their provisions.

The superiority of these exemplary plans cannot be attributed simply to normal growth and development over time; conscious commitments lie behind their innovative provisions.

It is not that private industry lacks the technical know-how to improve pension plans now. What is lacking is a sense of urgency to undertake such reforms.

If this lack of enthusiasm for *pension reforms now* were a result of a decisionmaking process based upon adequate information about private and public pension levels relative to retirement needs, then perhaps policymakers would be more willing to heed the words of economist Milton Friedman when he argues, "If a man knowingly prefers to live for today, to use his resources for current employment, deliberately choosing a penurious old age, by what right do we prevent him from doing so?" [50] In actuality, however, the employee is faced with great uncertainty and little knowledge about the ultimate benefits he will receive or what his needs will be in retirement.

Pechman, *et al.*, have succinctly summarized the individual and group saving problem:

> Decisions about saving for retirement, however, are vastly more difficult than nearly any other economic decision which most people are called upon to make. They depend on anticipation of wants in a much later period—possibly four or five decades. They require an individual to consider his future stream of earnings and other income, and to recognize several

[50] *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), p. 188.

possibilities: that he will be married and have a family; that he may be unemployed involuntarily for considerable periods of time; and that he may become disabled or die prematurely. To save intelligently, the individual must also be able to appraise the probable future purchasing power of the income from various assets. Most important of all, the individual may not be aware of his mistakes until he is close to retirement, when the consequences are irremediable.[51]

Moreover, as Galbraith has emphasized in his book *The Affluent Society*, billions of dollars are being expended to convince people to buy "now" more of various goods and services in the private sector, while no similar effort takes place to extol the virtues of public goods. This creates an appalling lack of "social balance" in the American economy, and it is not surprising, therefore, that many workers choose higher pay to spend now in preference to a nebulous pension benefit which will be useful during some distant "old-age."

PRICE OF FLEXIBILITY—SUMMARY

In summary, under the private pension system developed to date, each plan is free to give priority to its own needs and to operate independently of other plans. The advantages of such flexibility must be weighed against the submergence of the individual's and the public interest that frequently results.

For example, is it in the employee's and public interest that a large proportion of workers who build up credits under private pension plans never qualify for an eventual pension because of insufficient periods of service with any one company? Is it in the employee's and public interest that the final pensions earned by short-term workers are so much less than those earned by career employees because there are few provisions for transferring and accumulating pension credits from a host of jobs? Is it in the employee's and public interest that private funds be permitted to promise the payment of future benefits without providing sufficient guarantees that the money will be there when needed? In short, to what extent can it be assumed that pension plan provisions geared to meet the special problems of individual firms are also of maximum benefit to the worker, the public, and the economy?

[51] Joseph A. Pechman, Henry J. Aaron, and Michael K. Taussig, *Social Security—Perspectives for Reform* (Washington, D.C.: The Brookings Institution, 1968), p. 61.

APPENDIXES

Appendix A

TIAA-CREF REPORTS TO MEMBERS

(FRONT SIDE)

tiaa **TEACHERS INSURANCE AND ANNUITY ASSOCIATION,** 730 THIRD AVENUE, NEW YORK, NEW YORK 10017

REPORT OF PREMIUMS AND BENEFITS UNDER YOUR TIAA ANNUITY CONTRACT FOR CALENDAR YEAR 1968

1	2	3	4	5
Your Contract No.	The sum of all premiums paid in 1968 was	The age your annuity is now scheduled to begin is *Years* *Months*	The total yearly Single Life Annuity income (starting at age shown) already purchased by December 31, 1968 was	The value of the death benefit on December 31, 1968 was

TIAA annuity contracts do not provide for cash surrender or loans and cannot be assigned.

SPECIMEN

CHAIRMAN

F-728-10-68 (A 11,570-)

Please Read Explanation On Reverse Side

TIAA ILLUSTRATION (NOT GUARANTEED)

Item 4 on the TIAA report shows the annuity income *already purchased,* i.e., the amount you would receive from TIAA if no further premiums or dividends were credited to your contract. The *full* amount of your retirement income from TIAA will depend also on future premium amounts, dividends declared by TIAA, your age at retirement, the income option you choose, and other factors. Although it is not possible to predict the effect of each factor on your TIAA annuity, the following illustration may be helpful in planning for your retirement years:

Your TIAA annuity income

would be   per year beginning in   , at the age shown in item 3 . . .

IF periodic premiums equal to the last one paid in 1968 were continued without change until your annuity income begins . . .

and

IF you begin your annuity income at the age shown in item 3 and elect the Single Life Annuity option (see "Your Choice of Retirement Income" on back of this slip) . . .

and

IF TIAA's current dividend scale neither increases nor decreases.

BACK SIDE

Your Choice of Retirement Income

When you retire, you will choose the annuity income option most suited to your needs at that time. The Single Life Annuity shown in this report and illustration provides a larger monthly income for you than the other options, with all payments ceasing at your death. All other options provide an income to a beneficiary, and therefore provide smaller incomes than the Single Life Annuity.

For example, one popular choice at retirement is the Joint and ⅔ to Survivor option. For a husband and wife who are both age 65 this option pays about 13% less than the Single Life Annuity. At the death of either spouse the lifetime payments to the survivor are reduced to ⅔ the amount that would have continued if both were alive. If *both* annuitants should die within ten years after payments begin, the ⅔ amount continues to their beneficiary for the balance of the ten-year period.

We will be glad to prepare illustrations of this or any other TIAA-CREF option upon request.

EXPLANATION

Item 2—Premiums:
The premiums shown in Item 2 are those paid in 1968. If part of your premiums are paid through salary deduction, please bear in mind that deductions from December salaries are usually applied to pay premiums due January 1. Deductions made in December 1968 for January 1969 premiums will therefore appear in next year's report.

Item 3—Age:
This is the age at which lifetime annuity payments to you are presently scheduled to begin. You can elect to have payments begin at an older or younger age, and your annuity income will be commensurately larger or smaller, respectively.

Item 4—Your Annuity Income:
The figure shown in Item 4 is the total amount of yearly Single Life Annuity income, beginning at the age shown in Item 3, already purchased by the premiums paid and interest credited to your contract since it began. It is 12 times the monthly income you are already guaranteed to receive at the age shown, assuming no further premiums were paid and no further TIAA dividends were declared.

The amount shown is a Single Life Annuity income, which provides the largest income during your lifetime, but provides no payment for a surviving beneficiary. You can elect this option or one of several other options at the time annuity payments begin. The other options provide an income for a surviving beneficiary and therefore an income that is smaller in amount than the Single Life Annuity.

Item 5—Death Benefit:
The figure shown in Item 5 is the total amount that has accumulated in your contract from premiums and interest, including dividends. If you die before annuity payments begin, the full accumulation at that time is paid to the beneficiary you have named, under one of the options available. After annuity payments to you have begun, the death benefit, if any, depends on the annuity income option you select.

Annuity contracts do not provide for cash surrender or loans and cannot be assigned. If premiums are discontinued at any time, you retain to your credit the total amount of annuity already purchased. The right to correct any clerical error in this report is reserved.

(FRONT SIDE)

cref **COLLEGE RETIREMENT EQUITIES FUND,** 730 THIRD AVENUE, NEW YORK, NEW YORK 10017

REPORT OF PREMIUMS AND ACCUMULATION UNITS UNDER YOUR CREF CERTIFICATE FOR CALENDAR YEAR 1968

1	2	3	4	5	6
Your Certificate No.	The sum of all premiums paid in 1968 was	The age your annuity is now scheduled to begin is *Years* *Months*	The total number of your accumulation units on December 31, 1968 was	The value of each accumulation unit on December 31, 1968 was	The value of the death benefit on December 31, 1968 was

CREF certificates do not guarantee a fixed dollar amount of annuity payments. They do not provide for cash surrender or loans and cannot be assigned. All CREF premiums, values and benefits are payable in U.S. currency.

SPECIMEN

CHAIRMAN

Please Read Explanation On Reverse Side

CREF ILLUSTRATION (NOT GUARANTEED)

Business activity has its ups and downs – the investor in common stocks must expect them – but in the long run an accumulating share in the growth and earnings of major American industries seems a good way to help provide a suitable retirement income. Your CREF accumulation value will change monthly until you retire, and your CREF annuity income will change once a year during retirement, reflecting primarily changes in the value of CREF's investments. These changes are, of course, unpredictable. However, the following illustration may be helpful in your retirement planning:

Your CREF annuity income

would be per year beginning in , at the age shown in item 3 . . .

IF periodic premiums equal to the last one paid in 1968 were continued without change until your annuity income begins . . .

and

IF you begin your annuity income at the age shown in item 3 and elect the Single Life Annuity option (see "Your Choice of Retirement Income" on back of this slip) . . .

and

IF CREF's combined dividend and capital gain rate is 4% each year and CREF's experience as to mortality and expenses coincides with the CREF factors now in use.

(BACK SIDE)

About Your TIAA and CREF Illustrations

The illustrative annuity incomes shown to the right of your TIAA and CREF reports are based on certain assumptions. For a number of reasons, your actual TIAA-CREF income will differ from these illustrations – your premium amount may change; you may retire at a younger or older age than that shown; the dollar amount of your CREF income during retirement will change once a year, reflecting CREF's investment experience; TIAA's dividend scales will change; and so forth. However, we hope these illustrations will be helpful in planning your retirement income, and we invite your inquiries for additional information about your annuities.

EXPLANATION

Item 2—Premiums:

The premiums shown in Item 2 are those paid in 1968. If part of your premiums are paid through salary deduction, please bear in mind that deductions from December salaries are usually applied to pay premiums due January 1. Deductions made in December 1968 for January 1969 premiums will therefore appear in next year's report.

Item 3—Age:

This is the age at which lifetime annuity payments to you are presently scheduled to begin. You can elect to have payments begin at an older or younger age, and your unit-annuity income will be commensurately larger or smaller, respectively.

Item 4—Number of Accumulation Units:

Each premium buys accumulation units, the number bought depending on the value of a unit at the time the premium is credited to the Fund. The number of your accumulation units shown in Item 4 includes not only the units purchased by premiums, but also an additional number of units purchased by your share of the dividend and miscellaneous income earned by the Fund.

Item 5—Accumulation Unit Value:

The dollar value of the CREF accumulation unit changes monthly, and is determined by the market value of all investments in the Fund as of the last day of each month. The figure shown in Item 5 is the value of the CREF accumulation unit on December 31, 1968, the last day of the period reported.

Item 6—Death Benefit:

The figure shown in Item 6 is the December 31, 1968 value of all the accumulation units you own. If you die before starting your CREF annuity income, the then current value of your accumulation units is used to provide an income of a certain number of annuity units each month for your beneficiary, under one of the options available.

At the time your CREF retirement income begins, the then current value of your accumulation units is used to provide you a lifetime income of a certain number of annuity units each month. After this income has begun, the death benefit, if any, depends on the annuity income option you select.

The dollar value of the annuity unit, and therefore the CREF income to you or the beneficiary, changes once a year, reflecting primarily changes in the market value of CREF's investments.

CREF certificates do not provide for cash surrender or loans and cannot be assigned. If premiums are discontinued at any time, accumulation units already purchased continue to participate in the Fund. The right to correct any clerical error in this report is reserved.

Appendix B

SELECTED PLAN DESCRIPTIONS

Below are brief descriptions of a selected number of "highly developed" private pension plans which demonstrate the feasibility of immediately instituting various pension reforms.

1. Teachers Insurance and Annuity Association (and College Retirement Equities Fund)

TIAA was founded in 1918, to provide retirement security for faculty of institutions of higher learning, while allowing maximum mobility between institutions. CREF, the variable annuity portion of the system, was developed in 1952. The TIAA-CREF system now covers 89 percent of the faculty of private colleges and 34 percent of the faculty of public colleges. Faculty, clerical, administrative, and service employees are eligible for participation. Each participating institution determines contribution levels and eligibility requirements for its particular plan.

TIAA-CREF has contained for many years features that are often considered desirable for all private pension plans. These include its vesting and portability provisions, the full funding of liabilities, high benefit levels, a variable annuity feature, and variety of survivor options.

All TIAA-CREF contributions—both employee and employer—become fully vested *immediately*. Each employee owns his individual contract; it has no cash or loan value, and neither can it be forfeited if contributions are discontinued.

Members can transfer employment freely between any of the covered institutions and maintain participation in the plan. If a member becomes employed at an institution that is not covered under TIAA, he can continue contributions on his own if he wishes.

TIAA is a fully funded plan. All present obligations are fully covered; a sum of money is set aside to provide future retirement income earned by present service.

Virtually all TIAA-CREF plans use the money-purchase or "defined contribution" method of fixing contributions, in which a fixed percentage of salary is contributed. This may be a level percentage such as 10 or 15 percent of salary (with the employee's contribution usually being about 5 percent), or a "step-level" pattern, for example 10 percent of salary under $7,800 and 15 percent over $7,800.

The CREF feature was instituted in 1952 as a means of permitting members to invest their pension funds in common stock investments as a hedge against inflation. In institutions with joint TIAA-CREF

plans, members may allocate from 25 to 75 percent of their contributions to CREF, the balance going to TIAA annuity purchase. Contributions purchase "accumulation units," which are portions of the CREF investment portfolio. As the value of the portfolio goes up or down, so goes the value of the accumulation units. An accumulation unit worth $10 in 1952, for example, was worth $45.34 at the end of 1968. CREF benefits are then based on a fixed number of "annuity units" payable each month; the value of this unit reflects the continuing performance of the investment fund.

Six months after CREF was established, more than half of TIAA's then 600 cooperating colleges, universities, independent schools, and similar institutions had taken formal action to make it available to their faculty and staff. At present, practically all of the present 1,800 institutions with TIAA have CREF option available. What is particularly interesting to observe is that, given the opportunity to choose, about 94 percent of the employees currently covered by TIAA have decided to also participate in CREF.

The early planners of TIAA were concerned both with the mobility of teaching personnel and with the financial soundness of the plan. Early pension plans in private industry were often designed to assure employee loyalty and to tie employees to the firm. Many universities and colleges, on the other hand, were concerned with the ease of mobility for teaching personnel from one institution to another. They were also anxious to provide retirement security for faculty members so that they could be retired easily when their teaching ability diminished with age. These considerations led to the incorporation of full funding and immediate vesting in TIAA plans.

A related reason for the incorporation of these generally desirable features into TIAA plans was that the *plan members themselves were involved in the early design of the plan.* Many industrial plans, on the other hand, were set up completely from the point of view of the employer; employees weren't generally participants in designing the plans until after the Inland Steel decision in 1948.

2. Armstrong Cork Co., Lancaster, Pa.

The Armstrong plan, covering about 12,000 employees, provides for *full vesting after 5 years of plan membership.* One year of service is the membership requirement, so vesting actually occurs after 6 years of employment.

The plan consists of two portions, a noncontributory employer-financed portion and a contributory portion. Employee contributions are 2 percent of annual earnings under $7,800 and 4 percent of annual earnings over $7,800. Each portion of the plan pays benefits based on one-half of 1 percent of earnings under $7,800 and 1 percent of earnings over $7,800. Currently payable benefits for an employee with 35 years' service and average earnings of $4,800 are $70 per month under each portion of the plan, thus totaling $140 per month.

The plan provides for joint and survivor options, and a lump-sum death benefit equal to the employee's contributions minus benefits received.

3. The Boeing Co.

The Boeing Co. plan, covering 90,000 employees, contains a variable benefit feature somewhat similar to CREF. Benefits (relative to other private plans) are above average, and the plan is funded for past and current liabilities.

Vesting is deferred graded. Membership requirements are 3 years, with no age requirement. After 5 years of membership (8 years of employment) 45 percent of member's credits are vested. This percentage increases 15 percent a year, so that after 9 years of membership, full vesting is provided.

4. UAW-Transportation Corporation Plans

The United Automobile, Aerospace, and Agricultural Implement Workers of America (UAW) have basically similar pension agreements with General Motors, Ford, Chrysler, and International Harvester. While vesting provisions are not exceptional (deferred full vesting—10 years of service) the UAW pension agreements have included a number of highly innovative provisions.

Benefits are based on years of service, job classification, and the employee's maximum hourly pay rate. Benefit levels paid, relative to other pension plans, are above average.

The plans provide flexible retirement provisions which permit employees to retire as early as age 60 with a monthly pension of up to $400. Some long-service employees have the option of retiring between ages 55 and 60. There is also provision made to permit an employee to retire between ages 55 and 65 with higher lifetime pensions than for voluntary retirement; this is possible if the employee is disabled or meets certain special criteria.

Under the plans, a widow (of any age) of an active worker who died before retirement but while eligible to retire is automatically eligible for a survivor's pension. This pension is equal to 55 percent of the worker's accrued benefit, adjusted for either early retirement or a joint survivor option. Retired employees are paid benefits which automatically include a survivor's benefit unless they specifically reject the survivor's benefit at the time of retirement (in favor of a higher benefit without survivor's protection).