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An Economic Appraisal of Pension Tax Policy in the United States

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CHAPTER 5

Pension Tax Policy: A Summing Up

BASIC PRINCIPLES

This monograph has covered much material, so it is useful to recap some of the more important issues and bring together the various policy conclusions and proposals for an efficient tax policy for the United States. There is much in the pension system that is complex, some of which is attributable to a vast regulatory machinery that has been built around the pension industry. In their essence, however, pension plans, whether firm-offered defined contribution or defined benefit plans or individual retirement accounts, merely represent vehicles for workers to set aside part of their wages during their worklife to help finance consumption during retirement.

The fundamental principle that lay behind pension tax policy—in particular the tax-exempt character of pension trust funds—is that wages are taxed only once, whether these wages are used to finance immediate consumption or consumption during retirement. If it were not for this provision in tax law, wages used to finance immediate consumption would be taxed at the marginal rate as specified in the Internal Revenue Code. If used to finance consumption during retirement, wages would be assessed a so-called second tax. One tax is levied when wages are earned. A second tax is levied in a series of assessments against interest earnings as workers try to translate today's dollars into tomorrow's dollars.

The double tax amounts to a large increase in the income tax assessed on wages, but only if they are used to finance deferred consumption. For example, in Chapter 2, I demonstrated that when the interest rate is 10 percent, a 50-year-old worker, normally assessed a 15 percent income tax rate on earnings used to support immediate con-

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sumption, would pay an effective tax rate of 32 percent if earnings were saved in a tax-exposed vehicle for consumption at age 65. The imposition of the higher tax would almost surely result in workers retiring at later ages, enjoying lower standards of living during retirement and reducing the length of the work week during working years, all in reaction to an artificially higher price set by the government on retirement consumption. These distortions would take individuals away from their optimal combinations of work and leisure and reduce productivity in firms, thereby imposing economic costs of nontrivial magnitudes on the U.S. economy.

RETIREMENT DECISIONS

Pension tax policy eliminates the double tax on savings for retirement and, in so doing, removes artificial distortions from retirement decisions that otherwise would depend only on worker preferences and productivity. In this sense, the basic elements of pension tax policy reflect the principles of *neutrality*: they work in the direction of keeping the federal government out of the business of influencing retirement savings and consumption behavior that ought to be determined in the private market.

It turns out that the neutrality theme has been extended to the social security system. In major changes to the system in 1977 and 1983, Congress enacted new rules to eliminate social security from playing a major role in influencing retirement behavior. Before these changes, the system exerted large penalties on individuals who worked past age 65, and, at the same time, provided strong penalties on those retiring at ages much earlier than age 65. In 1977, the penalties imposed on early retirement were eliminated and, in 1983, a policy was effected that gradually will eliminate the penalty on delayed retirement past age 65 by the year 2005.[1] The underlying tax policy towards social security, however, still imposes a bias in favor of too much retirement.

This bias occurs because one half of social security contributions are subject to tax, but the second half is never taxed except insofar as taxable income (including tax-exempt interest) exceeds $25,000 or $32,000 for individuals and married couples. Thus, a subtle distortion is introduced into the tax code in favor of the social security system. Earnings contributed to this system are taxed at lower effective income tax rates than either earnings devoted to immediate consumption or saved through pensions for retirement. This problem, however, was addressed in 1983.

The 1983 Social Security Amendments put into motion a schedule that ultimately will tax the "second half" of social security benefits, eliminating the bias in the system favoring retirement consumption over immediate consumption. Congress did this by deliberately not in-

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dexing the taxable income threshold amounts, thereby leading to the ultimate erosion of these amounts. In the long run, virtually all wage earnings set aside to fund the social security system will be taxed once (half when contributions are made and half when benefits are taken), thereby approximating the tax policy applied towards private pensions.

Thus, taken together, pension tax policy and social security policy have made the federal government a more neutral player in future retirement decisions. There is, in these systems, however, one inconsistency which could easily be fixed. Because of progression in the income tax formula, wages saved through pensions for retirement are more likely taxed at lower rates than those paid during work years. This sets up an artificial incentive in the direction of too much retirement and too little work. This anomaly can be eliminated either by assessing taxes on pension income at marginal rates that characterize working years or assessing taxes at the time contributions are made rather than when benefits are taken.

The latter option would raise the same present value tax revenue as the former, but would be practical only for defined contribution plans and individual retirement accounts, not defined benefit plans.[2] Either of these adjustments would eliminate the so-called smoothing effect in pension tax policy. To keep the systems parallel, taxable social security benefits also must be taxed at rates that characterize those paid during working years.

DEFINED BENEFIT VERSUS DEFINED CONTRIBUTION PLANS

In addition to influencing retirement decisions directly, tax policy can also influence the types of pension plans that cover workers. The issue is important because, as discussed in Chapter 1, the two basic types of pension plans have different attributes and can have important effects on workers' well-being and overall productivity. Defined contribution plans are akin to tax-preferred savings accounts: they provide less opportunity for workers to hedge against poor investment performance and usually do not provide for annuities free of selection bias. Firms have less opportunity in these plans to encourage both long term tenure in the firm and retirement during predetermined age ranges. Thus, if pension tax policy is written so as to artificially assess higher taxes against defined benefit plans, economic inefficiencies are predictable.

In 1987, in the Omnibus Budget Reconciliation Act (OBRA), Congress enacted legislation that had precisely this effect. By rewriting pension funding laws, Congress effectively assessed an excise tax of sorts on most defined benefit plans, particularly those sponsored by firms populated by young to middle-age workers. These taxes are currently in the range of 10 to 12 percent of benefit payouts for these firms

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but could increase to the range of 20 percent if interest rates were to reattain levels that prevailed in the late 1970s and early 1980s.

One justification for the new rules is the inability of the previous Internal Revenue Code provisions to prevent persistent overfunding of promised benefits. The OBRA rules abandon the concept of funding for ongoing benefits and instead set limits tied to termination benefits. As long as trust funds invest primarily in low-risk assets, the rules will lead to lower funding levels in pension plans and will cause substantial underfunding on an ongoing basis for many plans.

It is not obvious, however, that this approach will be successful if pension portfolios invest more heavily in riskier assets. Simulations of pension funding under the new policy over lengthy periods of time show that by holding risky assets in the pension portfolio, the firm can generated substantial overfunding even under the new rules. What the new rules likely will be successful in accomplishing is encouraging the use of defined contribution plans and riskier portfolio strategies.[3]

One solution to the overfunding problem is to return to the principle of funding for ongoing benefits. Worker savings are reflected in ongoing benefits, not termination benefits.[4] Instead, the maximum funding rules should be revamped to prevent systematic and persistent overfunding. The new shorter amortization periods for investment gains and losses (it is now 5 instead of 15 years) ought to be retained. This provision alone, however, will not work. The law also must require *all* these amortized amounts to be applied in full against "normal" contributions to the plan, even if this means refunding some contributions to the firm (to be treated as ordinary taxable income). The effects of all erroneous actuarial assumptions, not just those reflecting investment returns, should be amortized in the same way.[5]

The net effect of this rule is to control overfunding in defined benefit pension plans without imposing an artificial tax bias that affects the choice of type of plan and the level of risk in pension plan portfolios. With these rules put in place, the government would substantially reduce its influence over both the type of pension plan offered by firms and the composition of pension portfolios.[6]

FIRM-OFFERED PENSIONS VERSUS IRAs

The above changes in pension policy would impose similar treatment on pension plans with different incentives and portfolios, but they would not award equitable treatment to pension plans offered by financial institutions. One of the most far-reaching and costly aspects of current pension tax policy is the availability of tax-exempt status exclusively for firm-offered pension plans. Individual retirement accounts are available in amounts up to less than 10 percent of permissible contributions to defined contribution plans and, for workers already cov-

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ered by a pension plan, the tax provisions are less generous than those afforded pension plans.

The "preference principle" itself would not be operationally important if it were not for the so-called discrimination rules enacted by Congress in 1942. These rules make it difficult for the firm to offer different pension plans to different groups of its work force, unless the groups are comprised of similar mixes of high- and low-wage workers.[7] By imposing a one-plan-for-all rule regardless of wage level, Congress apparently intended to limit the use of pensions by high-income workers, force low-income workers to save more for retirement, and effect off-budget transfers from high- to low-income workers.

While the original motivations may have had validity in 1942, they are now outdated. Most importantly, a large, universal social security system, begun in 1935 and still in its infancy in 1942, has grown into a major source of retirement income, particularly for low-income workers. These workers receive age-65 replacement rates up to 100 percent of their wages, and there is a deliberate subsidy built into the system from high- to low-income workers. The pension system covers only a small portion of low-income workers. For those covered, the combination of social security and pension annuities generate extraordinary replacement rates which, in turn, encourage premature retirement from the work force.

In addition, perhaps in 1942, control of "overuse" of pensions by high-income workers could have been accomplished only indirectly through artificial constraints on pension plans. Clearly, this is not efficient today. Pension limits can be enforced directly by routine electronic monitoring of individual tax returns during retirement years. Limits on allowable annuities ($112,500 per year, indexed to prices[8]) have obviated the need for indirect limitations imposed by discrimination rules.

While the original purposes of the 1942 rules are now satisfied by the social security system and new technology to monitor tax returns, the rules themselves have not been repealed. This is unfortunate because the efficacy of the discrimination rules appears to be the only rationale for retaining the preference in pension tax policy for firm-sponsored pension plans. This preference principle provides strong incentives to save for retirement through firms, and essentially requires firms to offer pension plans to be competitive in labor markets. If financial institutions could offer competing pension plan vehicles directly, workers might not entrust their retirement monies with many firms now providing pensions.

A tax policy that, for all intents and purposes, requires the worker-firm savings relation, inevitably creates potential agency problems. If workers are forced to entrust their retirement savings to firms that otherwise might not be chosen in a free market to be custodians for work-

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ers' funds, then arguably it behooves the government to police the agents for potential abuse. This policing function has taken the form of regulatory machinery created largely by the Employee Retirement Income Security Act of 1974 (ERISA). ERISA controls the operation of pension plans, including reporting and disclosure rules, vesting and participation rules, minimum funding rules, as well as mandatory pension insurance coverage through a government agency.

Ironically, the data suggest that pension fraud[9] was never an important problem prior to 1974, and, even if it was, the regulations are written in such a way as to be ineffective in preventing firms that are intent on cheating workers out of most of their pension savings.[10] Instead, the law has been effective in transferring billions of dollars from workers in well-funded, healthy firms to a minority of primarily high-wage, unionized workers in dying industries who are covered by extraordinarily generous pensions. In addition, owing to the moral hazards it creates, the insurance is likely to invite more pension terminations than otherwise would occur.

The easiest way to deregulate pensions is to eliminate the preference in pension tax law for firm-sponsored pension plans: that is, to afford individual retirement accounts the same tax treatment as firm-sponsored pensions. Contributions to pension plans and IRAs should be unconstrained. The control of "overuse" of pensions should and can be controlled by enforcing the limits on annual payouts during retirement as enacted in the Tax Reform Act of 1986. Limits on each pension plan are redundant, increase the regulatory cost of pensions, and potentially distort workers' and firms' choices of pension plan and optimal savings patterns.[11] The availability of unlimited IRAs would alter the combination of vehicles used to save retirement monies, but not necessarily alter total savings.

To be sure, the new rules would change savings rates for some individuals. Under current tax law, most workers in a firm are forced to have virtually the same savings rate, regardless of differences in desired savings rates. In a free market, some workers undoubtedly would choose to save more and others less. Similarly, most workers in the firm are now required to be subject to the same penalties for quitting and the same costs of retiring from the firm at older ages. Under a policy that permitted IRAs to compete directly with pension plans, firm-sponsored pensions would survive only if they offered substantial productivity advantages. Otherwise, workers would save for retirement in the amounts and in the types of vehicles that suited their own preferences.

To let pension plans fairly compete with IRAs, most regulations on firm-offered pensions should be repealed. Firms should be permitted to use the plans they prefer, using whatever rules and combinations of incentives and types of plan that maximize productivity accounting for

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workers' preferences. Competition among firms would ensure that only the most efficient pension plans would survive the market test.

If workers had free choice to use either IRAs or pension plans to save for retirement, the need for government to regulate the potential agency problem the government itself created would be difficult to justify. Presumably, in a free market, the only firms left offering pensions would be those with sufficient reputations to overcome workers' concerns of retirement income security. The government could retain fiduciary regulations of pension plan sponsors akin to regulations applied against financial institutions offering IRAs—like banks, investment companies, and insurance firms.

Similarly, there would be no reason to require pension insurance coverage. If workers remaining in pension plans under a free-market system wanted insurance protection, there is no reason to believe that such protection would not arise in the private market. As a last resort, if Congress insisted on continued mandatory insurance, the guarantee levels under the insurance should be reduced dramatically. Low- to middle-income workers should not be required to pay for extraordinary benefit levels to high-wage workers as is currently done.[12]

All of the proposals made above are summarized in Table 5–1. If all these policies were effected (many, of course, are already in place), the net outcome would be that the government would retain little direct influence on individuals' choices of retirement age, retirement savings, retirement consumption, types of pension plans, composition of pension plan portfolios, and incentive effects of pensions. These policies would greatly reduce the indirect efficiency costs of current policy, as well as the direct regulatory costs. The continuation of the social security system would ensure minimum retirement consumption for all workers and prevent "spenders" from taking advantage of "savers." Otherwise, retirement decisions and all pension decisions would be made in a private market, dependent only on worker preferences and labor productivity.

APPLICATION TO RETIREE HEALTH BENEFITS

While this volume has addressed only savings for retirement, the arguments used to justify application of the consumption tax principle to pensions can equally well be used to justify a one-tax principle to all postponed consumption. I have side-stepped this issue because, while it makes economic sense to move in the direction of a consumption tax, such a move has revenue implications, the solution to which would take us far beyond the subject of this volume. It is equally important, however, to recognize illegitimate applications of the pension tax principle to all retirement savings, including those used to pur-

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TABLE 5–1 Towards a Neutral Pension Tax Policy

Category	*Current*	*Proposal*
Basic Tax Policy		
Contribution deduction	Yes	Retain
Tax-exempt trust	Yes	Retain up to 100% of ongoing benefits; either • impose better funding rules (5-year amortization and symmetry); • or treat earnings on excess assets as taxable corporate income.
Tax deferral	Benefits taxed at rates during retirement.	Retain but eliminate income smoothing: • tax benefits at rates paid during work years or • tax contributions (more feasible in defined contribution plans).
Social Security		
Penalty for work after age 65	To be gradually eliminated by the year 2005.	Retain
Penalty for early retirement	Essentially eliminated in 1977.	Retain
Tax policy	Tax 50% of contributions; tax 50% of benefits if taxable income exceeds $25,000 or $32,000 (couple) but freeze thresholds at current nominal levels to gradually erode with inflation.	Retain or accelerate erosion of thresholds.
Related Issues		
Vehicles eligible for tax-exempt accumulation	Firm-offered plans only (with inconsequential exceptions).	Expand to IRAs (subject to same limits as def. cont. plans).
Payout limit	$112,500 per year during retirement, including all tax deferred income (except social security benefits).	Retain
Tax qualification rules	Discrimination rules, integration rules, antibackloading rules.	Eliminate
Contribution limits	$30,000 for DC plans, $90,000 projected benefits for DB plans.	Eliminate (redundant to payout limits).
Agency regulation	Vesting, participation, minimum funding.	Eliminate
	Mandatory insurance	Make voluntary or retain at minimal levels.
	Fiduciary regulations	Retain

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chase retiree health benefits. This issue is so closely related to the tax and pension issues addressed above that it requires some attention, particularly since it is an issue currently in the midst of some policy debate.

In particular, an issue parallel to pension payments is the practice of firms offering health insurance policies to retirees as part of the retirement package. These policies cover workers until they are entitled to Medicare at age 65 and often supplement this coverage after 65. These health programs can be viewed in a similar way to pensions. They represent implicit savings by workers for a supplemental retirement benefit beyond the direct payment of pensions.

Retirement health benefits, however, are *not* treated like pension benefits in the tax code. Tax-exempt trust accounts are not availed to corporations to accumulate implicit worker contribution for health insurance coverage during retirement. Because of the apparently obvious parallel in the two schemes, a common policy prescription is to extend pension tax policy to retiree health benefits. The parallel, however, is apparent, not real.

In the case of pensions, earnings saved to finance consumption during retirement are taxed once at the time they are received as benefits. According to the symmetry property of the consumption tax, as long as tax rates assessed against benefits are equal to those faced during working years (when contributions are made), this practice is analytically equivalent to taxing all pension *contributions* once, then treating benefits as tax-free income (see Chapter 3). In contrast, earnings used to purchase current health insurance are exempt from taxation at any time. This practice sets up a tax bias in favor of too much health insurance and too little consumption of other items.

For example, consider the numbers in the first two rows of Table 5–2. The numbers show that an individual facing a 15 percent income tax rate on income actually pays a 15 percent income tax on earnings used to purchase immediate non-health insurance consumption; but if earnings are used to purchase health insurance, a zero income tax is paid.[13] This difference in tax treatment creates a distortion that artificially reduces the apparent cost of health cost by 15 cents on each dollar spent.

Individuals at the 28 percent marginal tax rate face an even larger tax distortion: for each one dollar devoted to consumption items such as food, clothing, and education, only 72 cents remains after taxes are assessed. But if the same dollar is used to purchase health benefits, the entire one dollar is available for this consumption. This creates incentives to have "Cadillac" health benefits because the government makes it appear that they are available at "Ford" prices.

If workers faced the choice between spending an incremental 72 cents on more health benefits or on some other consumption item with-

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TABLE 5–2 Tax Rates for Retiree Health Insurance

Category	Statutory Tax Rate	
	15 Percent	*28 Percent*
Immediate consumption		
Health insurance	0.0	0.0
Other	15.0	28.0
Age-65 consumption		
Health insurance		
Current tax policy	20.1	34.3
Pension parallel	15.0	28.0
Other		
Using pension	15.0	28.0
Not using pension	32.1	52.6

NOTE: Numbers in table are percents. Worker's current age is assumed to be 50; interest rate is 10 percent.

out effectively receiving a 28 cents rebate of sorts if they chose to purchase extra health insurance, workers might well prefer "Ford" policies at "Ford" prices. This means that they might have policies with more deductibles, fewer routine benefits, more outpatient care, etc. By subsidizing the real price of insurance coverage, all workers as a group pay for incremental coverage they do not fully value. In terms of Figure 2–1, which demonstrated the costs of government interference with market prices, the price of health insurance policies is artificially reduced, leading workers to purchase incremental units of coverage worth less than the cost of providing it.

The issue is not one affiliated with a redistribution of income or an encouragement of low-income workers to increase health coverage. Since low-income workers do not pay taxes, the thrust of these tax distortions is in the direction of encouraging primarily higher-income workers to have too much insurance coverage.

We can now consider use of wages to purchase health insurance policies during retirement. In effect, current tax policy does not extend the special tax-free treatment of investment earnings on pension savings to retiree health insurance. In effect, workers must save for this benefit outside a tax-exempt trust fund. Thus, while savings for retiree health benefits escape the so-called first tax on earnings, they are subject to the "second tax." For example, consider a 50-year-old worker saving for health insurance coverage at age 65. The interest rate and the inflation rate are 10 percent; the real rate of return is zero.

If the worker devotes one dollar of wages towards saving for these benefits that are offered by the corporation in fifteen years, he is not taxed on the original one dollar in wages. However, over time, this im-

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plicit savings, in effect, accumulates at a post-tax rate of return. The worker saves either at an 8.5 percent interest rate or 7.2 percent, depending upon whether he is in the 15 or 28 percent tax bracket. Since the inflation rate in the example is 10 percent, his savings will lose real value: at age 65, his original one dollar of real savings is worth either 79.9 or 65.7 cents depending on the tax rate. The effective tax rate on his original one dollar of savings for retiree health insurance is either 20.1 or 34.3 percent.

These effective tax rates would differ depending upon the interest rate and time period of savings. Current tax policy however, that attaches a "second tax" on earnings from implicit savings for retiree health insurance coverage is in the ballpark of an income tax attached to other wages at the time they are earned (these rates are 15 and 28 percent).

These numbers are shown in the bottom portion of Table 5–2. One dollar in earnings saved for retirement through a pension is taxed at the statutory income taxes rates equal to either 15 or 28 percent. As shown earlier (see Chapter 2), the same dollar saved outside the pension would face an effective tax rate equal to roughly twice these amounts, or 32.1 and 52.6 percent. In contrast, if the same dollar is saved for postretirement health benefits, it faces a tax rate equal to 20.1 or 34.3 percent.

If retiree health benefits are awarded tax-free accumulation, the price distortion towards immediate purchases of incremental insurance coverage is extended to the purchase of incremental insurance during retirement, thereby encouraging too much expenditure on retiree health coverage. *If tax-exempt status is awarded to retiree health benefits, then to put these benefits on a parallel treatment to pensions, the value of these policies should be included with pensions as taxable income during retirement; or implicit contributions to finance this insurance should be subject to taxation during work years.* The tax revenue implications of awarding tax-exempt status to retiree health savings accounts is roughly offset by additional revenues that would be generated by treating retiree health benefits as taxable income.

A better idea would be to eliminate all the distortions in the tax code that favor health insurance coverage.[14] This change could be effected by including the value of employer health insurance coverage as currently taxable income to workers. Similarly, the value of retiree health insurance coverage can be included as taxable income during retirement, and corporate contributions set aside to pay for retiree health coverage can be accumulated tax free. In this framework, workers' earnings, whether they are devoted to the purchase of immediate consumption or retirement consumption, and whether they are used to support extra insurance coverage or other consumption, all would be

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TABLE 5–3 Parallel Treatment of Retiree Health Benefits

Category	*Current Policy*	*Parallel Policy to Pensions*
Health insurance policy for workers	Tax-exempt to corporations and individuals.	Include value as taxable income to individuals.
Health insurance policy for retirees	Same	Include value as taxable income to retirees.
Tax Status of health benefit trusts	Taxable	Tax-exempt

taxed at the same rates; and a true parallel would be created in the tax code between retiree health coverage and other pension savings. A summary of these proposals is listed in Table 5–3.

FINAL REMARKS

For historical reasons, tax policy towards pensions has been intertwined with a large body of companion regulation embodied in the social security system, pension law, and the tax code itself. The restrictions implicit in this regulatory framework has provided significant interference with free market retirement decisions. The federal government has recently made significant headway towards reducing these restrictions, giving workers and firms more influence over retirement decisions. These changes, most notably in the social security system, together with the central tenet of the tax code towards pensions (that is, consumption tax treatment of savings for retirement), has established "neutrality" as a principal theme for national retirement policy. This drift in policy undoubtedly has led to large economic benefits for current and future workers.

There are, however, additional changes in tax and regulatory policies that can enhance these benefits. These benefits can be generated by recognizing the neutrality principle as a main theme in national pension tax and retirement policy and applying it consistently. A central message of this volume is that movements in this direction can be done without interfering with a social security system that ensures at least a minimal level of retirement consumption for everyone, particularly low-income individuals.

Moreover, pursuit of this principle does not imply a conflict with the need to raise federal tax revenue. In fact, while most of the proposals in Table 5–1 would be expected to be revenue neutral, several would raise additional revenue (most notably the removal of income

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tax smoothing) while, at the same time, reducing economic distortions caused by current tax policy. Instead of pursuing a policy of raising miscellaneous revenues by interfering with various existing tax provisions for pensions on an ad hoc basis—and thereby threatening the viability of the current retirement system—the same revenue can be raised by building on the principle of neutrality, which has emerged as perhaps the most enlightened theme for a rational national retirement policy.

ENDNOTES

1. Penalties for retiring early were attributable to the so-called recalculation effect. Benefits were tied to average nominal wage histories back to 1951; thus, by working to later ages, workers significantly increased their annuities by replacing inflation-eroded earnings from the 1950s with more recent earnings. In 1977, the formula was changed so that benefits were tied to wage histories indexed to a national wage base.

   Retirement past age 65 was discouraged by an "earnings test." Social security benefits were offset by 50 cents for each one dollar of wages earned (beyond some threshold). Annuity amounts after age 65 were not actuarially fair: they did not offset the benefits lost by working one more year. In 1983, the system was changed so that by the year 2005, actuarially fair annuities will be paid for all ages after 62.
2. The problems of assigning contributions to workers in a defined benefit plan would be overwhelming, and would result in volatility in taxable income to individuals. In addition, a "rebate" system would have to be developed so that if workers quit, they could recapture taxes paid on the portion of their real accrued pension benefits lost upon quitting.
3. In addition, because the new limits make it impossible to prefund ad hoc post retirement inflation adjustments, the system biases firms to offer pension plans with contractual COLAs (which can be funded). The provision of contractual COLAs, together with initial benefits indexed to wages, makes it difficult for workers to share the downside of investment risk in the portfolio. As a result, benefits are expected to be lower for the same flow of implicit worker contributions, reflecting the loss of their share of the higher return derived from the risk premia embedded in riskier portfolios. In other words, the tax distortion in favor of less risky portfolios also works to reduce corresponding benefits in these plans.
4. These benefits should be defined to include anticipated levels of ad hoc post-retirement COLA policies based on experience in the plan.
5. Some of these assumptions might include quit rates, mortality rates, wage growth, and postretirement inflation adjustments.
6. ERISA itself does not impose important limitations on firms' choices of pension portfolios except, in most cases, to prevent investing more than 10 percent of assets in the plan sponsor's own securities and to diversify across many securities (which does not rule out all-stock or all-bond portfolios).
7. There are some exceptions. For example, workers covered by collective bargaining agreements can be covered by a separate plan.

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8. Transitional relief is provided by permitting individuals to use the higher of $150,000 in nominal terms or $112,500 indexed to prices beginning in 1988.
9. Here *fraud* is defined to mean the firing of older workers just prior to vesting or termination of the pension plan midstream in the contract.
10. See Richard A. Ippolito, "Pension Security: Has ERISA Had Any Effect?" *Regulation* (No. 2 1987), pp. 15–22.
11. For example, there is no reason to afford tax policy to a high-wage earner who saves over his entire life or may have access to multiple pensions, and, at the same time, to constrain tax policy towards other high-wage earners who prefer to save disproportionately later in life, and who may have access to only one pension plan. In addition, the way the limits work in defined benefit plans, they may not be comparable with limits attached to defined contribution accounts, thereby creating the potential for bias in the choice of pension plan type.
12. I have dealt with the insurance issue extensively in Ippolito, *The Economics of Pension Insurance*, 1989.
13. Even though technically the insurance is purchased by the firm, it is part of the fringe benefits package that ultimately is provided at the expense of lower cash wages (see Chapter 1).
14. This idea has been espoused, for example, by Martin Feldstein, formerly Chairman of the Council of Economic Advisors.