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Dissenting Comments

Statement of Robert J. Myers, F.S.A.*

When I read the manuscript for this book, I was struck by the fact that it gave only cursory reference to the Social Security program, which serves as the floor on which the private pension system of the United States is built. Quite naturally, the book need not deal extensively with Social Security, but it should recognize that the design of private pensions is significantly affected thereby. A reader from another country would hardly realize the extensive nature of the Social Security program and its impact on the design of private pensions.

After an extensive review of the manuscript, I sent a number of largely factual comments about the Social Security program and other matters to Mr. Ippolito, but he chose not to recognize any of them, or even to debate the points with me. Accordingly, I am constrained to point out here these errors of omission and commission, recognizing, of course, that it is not necessary in a book on private pensions to go into all of the details of the Social Security program. Nonetheless, when something can be said accurately in about the same space, or in only a little more, it should be done.

The author mentions that, beginning in 1984, the Social Security benefits are subject to income tax for a small portion of the retiree population and implies that this is done in the same manner as for private pensions. Whether rightly or wrongly, the income-tax treatment of Social Security benefits is done in a quite different manner, and the author should have described it here.

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Still further in Chapter 1, Mr. Ippolito gratuitously recommends eliminating the earnings test in the Social Security program (which seems to have no relevance to the subject that the book deals with). Once again, there is an inadequate discussion of this topic. The earnings test does not impose "penalties" (as the author states)—what pension plan pays retirement benefits to persons who are not retired? Also, the author refers to the provisions of the law as "rules," which gives the erroneous impression that they are arbitrary regulations of the Social Security Administration. The most that is needed to solve the problem of work disincentives is not the elimination of the test, but rather the granting of larger delayed-retirement credits, so that they produce close to actuarial equivalence. Any solution in this direction would merely be to advance this date nearer the present time. For more details on this matter, see my paper "Income of Social Security Beneficiaries as Affected by Earnings Test and Income Tax on Benefits," *Journal of Risk and Insurance*, June 1985.

In Chapter 3, which deals with post-retirement benefit erosion, reference might well have been made to the Pension Research Council publication in this area—my book, *Indexation of Pension and Other Benefits*. Also, the author, in describing how to incorporate this element into his model, suggests using an average discount rate for the active and retired periods, instead of the accurate procedure of two separate ones; no computational problems of any magnitude should occur if the correct method is used. (The procedure of averaging often leads to significant errors!)

In discussing the treatment of payroll taxes in Chapter 12, the author is not sufficiently precise. First, he refers to the combined employer-employee tax rate of 14.1 percent (in 1985—but higher in subsequent years) as the "approximate 14 percent." Second, he does not recognize that a substantial part of this tax rate is for other than retirement benefits. Third, he does not recognize that the benefits are determined from a weighted formula, so that higher cash wages do not result in proportionately higher benefits.

The author urges (as do many, but not all, economists) that the employee really pays the employer tax. I argue that this may be true in the aggregate, but is not necessarily so on an individual-by-individual basis. Also, it may well be argued that the employer considers the employer tax as a "cost of production" and passes it on to the consumers (primarily the employees as a group) in the form of higher prices for goods and services. In the quantitatively imprecise field of economics, it is impossible to ever determine the true incidence of taxes!

Still later in that section, the author discusses the difficulties arising were the Social Security program to be on a voluntary basis, but he misses the real point when he ignores the elements of antiselection which would be present and the effect of the weighted nature of the benefit formula.

Then, in footnote 12 of this section, the author assumes in the calculations that "the worker/retiree ratio is constant and that productivity growth is zero." Such a simple, completely unreasonable assumption casts considerable doubt on the validity of the results.

Somewhat later in Chapter 12, in discussing the different income tax treatment of private pensions and Social Security benefits, the author states that such taxation of benefits, introduced in 1984, was the "equivalent" of his proposed solution of having both employer and employee taxes deductible when paid and benefits being completely taxable when received. This is not at all the case as to equivalency, either individually or in the aggregate. Further, the present method of taxation of benefits is not accurately described—for married workers, he states as being applicable to 50 percent of benefits "when income exceeds $32,000"; this oversimplified statement incorrectly ignores that only 50 percent of benefits is included in "income" and that only the excess of such adjusted income over the threshold is taxable if it is less than 50 percent of benefits.

Statement of Howard Young, F.S.A.*

Chapter 1 of this volume makes it clear that the author focuses on two major targets: pension plans covering unionized work forces (pp. 11–12) and public policy "distortions imposed on free market equilibrium" (p. 12). With respect to public policy, the author's bias is explicit: he asks whether public policy toward pensions makes sense "from a strict efficiency viewpoint (that is, ignoring equity concerns)" (p. 207). The bias regarding unions is less explicit, but I believe equally clear, given comments such as: "once workers are unionized, stockholders in the firm are faced with a classic potential holdup problem" (pp. 167–68). I have never seen, nor have several other economists whom I consulted, use of the term *holdup* in a respectable discussion of the collective bargaining relationship. Note also, "once organized, workers clearly represent a potential threat to the long-term viability of a particular firm" (p. 170).

After theorizing that unionized workers, along with all others, believe they have an implicit contract that says "the firm will keep the pension plan intact and pay indexed pensions at retirement and even beyond" (p. 8)—even if their collective bargaining agreement explicitly provides more limited promises, and even though there are periodic bargaining conflicts and even strikes, in order to improve the explicit pension contract—the author suggests that all parties (firm, union, and workers) agree to a "bonding" relationship which amounts to a standoff based on mutual destruction capabilities. Furthermore, it is asserted that this "bonding" relationship explains: (1) the development of ERISA and PBGC, including an assertion that corporate "resistance to ERISA . . . must have waned considerably by the early 1970s" (p. 180); (2) the

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higher ratio of pensions to wages, more widespread pension coverage, and larger portion of compensation devoted to pensions for unionized workers (p. 190); and (3) unions' preference for defined benefit plans (p. 193). In short, we are told that what many thought were collective bargaining initiatives and innovations were merely a result essentially predictable by market-theory economics. To one who has been involved in the bargaining and legislative process, that is an unbelievable conclusion.

With respect to public policy prescriptions, the author is entitled to his view just like anyone else. Given his stated goal "to eliminate artificial obstacles to voluntary private market solutions to generating retirement income" (p. 207), his recommendations could have been written before the study was done. However, it is not clear how the commendable proposal for the U.S. Treasury to issue indexed bonds for retirement savings (p. 311) is reconciled with those private market solutions. Does that mean government intervention is needed after all, despite everyone's recognition of the implicit contract for indexed benefits, in order to provide the kind of protection that truly can be provided by Social Security, except when the law is amended for budget purposes or otherwise?

This treatise is basically antigovernment and antiunion. Given these biases, the author's conclusions are not surprising but are nevertheless controversial, and in my view, highly objectionable.

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