RETIREMENT PENSIONS:
NATIONAL SCHEMES, SOCIAL INSURANCE AND PRIVATE FUNDS

U.S.A.

Steven L. Willborn

I. Introduction

Two principal pension systems provide retirement benefits in the United States. The first is a mandatory, public system, known as Social Security.[1] Participation in this system is nearly universal, with both wage-earners and the self-employed participating. Co-existing with the public system is a complex private pension system, supported by generous tax benefits. Although both wage earners and the self-employed participate in this system, too, only about half of the workforce is covered by a private pension and, in general terms, that half is the higher-paid half of the population.[2]

Social Security, formally known as the "OASDHI Program,"[3] originated in the 1930s as part of President Roosevelt's New Deal.[4] Until recently, Social Security has been financed on a pay-as-you-go basis: Current workers paid a tax on their earnings to support pensions for currently-retired workers. This type of financing is not tenable in the future, however, because the ratio of active to retired workers is expected to decline so much that the tax rate would have to be prohibitively high to support the current level of benefits. As a result, in recent years the program has been structured to produce an excess of revenues from taxes on current workers above expenditures required to pay the pensions of currently-retired workers. The excess revenues have been placed in a trust fund to help cover future expenditures when the ratio of active to retired workers is especially low. This change in the structure of financing and, more generally, the issue of how to maintain the viability of Social Security as a universal retirement pension program, has been and continues to be a highly volatile and controversial subject of political debate.

The private pension system, as a general matter, can be divided into two broad components. The larger component consists of pensions which are obtained by workers through their employment. Although employers are not required to offer pensions, the tax laws strongly encourage them to include pensions as part of the compensation package. Once offered, federal law closely regulates the pensions. The other major component of the private pension system consists of individual retirement accounts, known as IRAs. The tax laws also encourage the formation of IRAs, although the maximum amount which can be contributed into them is significantly less than permitted for employer-provided pensions. Unlike Social Security, the private pension system is actuarially-based; as a general matter, workers fund their pensions during their working years and receive pensions in amounts which are directly related to their prior contributions and the earnings on those contributions.[5]

II. General Aspects of the National Pension Scheme

---

[1] 42 U.S.C. § 401 *et seq.*

[2] For more information on the beneficiaries of private pensions, see Section 3.B.1. below.

[3] "OASDHI" stands for old-age, survivors, disability and health insurance.

[4] A good history of social security in the United States can be found at <http://www.ssa.gov/history/history.html>.

[5] This is not to say that each individual worker will receive an amount in retirement that is equal to the amount of their individual contributions plus earnings, although some may. Some types of pension systems may be actuarially-based for a group of employees (e.g., for all employees of a particular employer), rather than for individual employees, and most systems permit individuals to annuitize payments over one or two lives.

Discussion of the general aspects of the national pension scheme is complicated because of its relatively distinct public and private components. On the one hand, the two components must be discussed together because it is only together that they comprise a national scheme pursuing national goals. On the other hand, the public and private components of the system are based on quite different principles and focus on different goals, which require separate consideration. In general terms, the national pension scheme has two principal goals. First, the scheme is designed to provide an adequate level of basic benefits to ensure against widespread poverty amongst the elderly. This is a primary function of the public component of the program, Social Security. Social Security replaces a significantly higher proportion of the pre-retirement income of lower-income workers than of higher-income workers to protect against poverty in retirement[6] and, through this mechanism and others, it has been quite successful in pursuing this anti-poverty goal.[7] Second, for those above the poverty level, the national pension scheme is designed to provide a post-retirement income for low- and moderate-income Americans that will permit a lifestyle in retirement that is fairly commensurate with the retiree's pre-retirement lifestyle. Social Security contributes to this goal by providing a basic level of benefits. The private component of the system supplements Social Security by providing incentives to save for retirement during working years. The goal is that these savings, when added to the Social Security base, will provide income in retirement fairly equivalent to pre-retirement income. For reasons that will be discussed below, however, the national pension system is not entirely successful in meeting this second goal.

Because they focus on different goals, the public and private components of the national system are based on different underlying principles:

** Social Security is a *mandatory system*; virtually all workers are required to pay Social Security taxes during their working years and are entitled to benefits in retirement. The private system, in contrast, is voluntary. Employers may or may not offer pension benefits as a part of the compensation package; in many instances, employees may choose whether or not to participate in a private plan.

** Social Security is *redistributional*. It provides higher benefits to low-income workers than to high-income workers, relative to their respective contributions to the program; similarly, because of its pay-as-you-go financing structure, it redistributes income across generations. The private system is *non-redistributional*. Individual workers, or distinct groups of workers, receive benefits in close proportion to contributions to the system plus earnings.

** Social Security is *uniform* nationally. It provides for basically the same taxes and the same benefits across the nation. The private system is highly *variable*. Many workers do not participate in the private system at all; others have very significant amounts in the system.

** Social Security is financed principally on a *pay-as-you-go basis*. Current workers are taxed to provide benefits to currently-retired workers. The private system is financed on an *investment basis*. Current workers are setting aside and investing current income to provide monies for use during retirement.

** Social Security is structured to provide a *defined benefit* at retirement. Virtually no attempt it made to match an individual's benefits to the amount of the individual's contributions to the system or even a generational cohort's benefits to its contributions. The private system consists of both defined benefit plans, which promise a certain benefit at retirement, and defined contribution plans, which promise at retirement only the amount contributed to the plan plus investment earnings. But the trend in private plans is toward the *defined contribution* model and, even for defined benefit plans, a concentrated effort is made to match contributions during a relevant group's working life (plus earnings) to the amount of benefits promised during retirement.

---

[6]See Table 1 below.

[7]The poverty rate of the elderly has decreased steadily from 29.5 percent of the elderly in 1967 to 10.5 percent of the elderly in 1997. Social Security Administration, *Social Security: Accountability Report for Fiscal Year* (Washington, D.C.: U.S. Government Printing Office, 1999), p. 2. This is lower than the poverty rate of the non-elderly.

The United States has not ratified ILO Convention Numbers 102 or 128, but its social security schemes appear to be in general compliance with their requirements.

III. Classification and Description of the National Pension Scheme

The national pension scheme in the US is best classified as one consisting of the co-existence of public and private regimes in parallel. Social Security is the public scheme. In general terms, there is mandatory, universal participation in the system, which provides a basic level of retirement benefits to everyone. The private scheme consists of employer-sponsored and individual pension plans, which are encouraged by generous tax benefits, but not mandatory. In general terms, about half of the population participates in a private pension plan and that half of the population tends to be the wealthier half. The public and private components of the system are largely independent. Virtually everyone participates in the public Social Security program; benefits received from the private system are generally used to supplement the basic amount received through Social Security.

A. Description of the Public Social Security System

The federal Social Security Act, and related laws, protect against a variety of risks.[8] They provide retirement pensions for workers and their dependents, disability insurance, medical care for the aged and disabled, black lung benefits, unemployment insurance, and a variety of benefits for the poor (such as food stamps, energy assistance, medical insurance, and living expenses). This description will focus on the retirement pension portions of the social security program.

Coverage

Social Security is a mandatory, federal program with broad coverage. In 1998, 92% of the population over age 65 received Social Security benefits.[9] Workers must work for a period of time in work subject to the Social Security payroll tax to be eligible for old-age benefits. Although there are many technicalities, in general terms, workers must work for about ten years in covered employment to be eligible to receive these benefits. Survivors of workers who have worked the required period of time are eligible for survivor benefits. Survivors include current spouses, children, dependent parents, and (in certain circumstances) divorced spouses.

Benefits

Workers who have worked the required period of time become eligible for full, old-age benefits at age 65. Workers can choose to begin to receive old-age benefits as early as age 62, but their monthly benefits are reduced if they begin payments earlier than age 65. Similarly, workers can elect to delay receipt of benefits beyond age 65. If they do so, they can receive slightly enhanced monthly benefits.

The basic amount of disability benefits is determined based on a calculation which takes into account the worker's prior earnings. In general, the worker's prior earnings taken into account are the average monthly earnings received by the worker over his or her lifetime, up to a maximum amount, and indexed upwards to account for inflation. Considering only earnings up to a maximum amount ($72,600 for 1999), in effect, places a ceiling on the amount of benefits available. These prior earnings are known as the "average indexed monthly earnings."

---

[8] A good review of the programs within Social Security is available in Social Security Administration, Social Security Handbook (13th ed. 1997), which is available on-line at <http://www.ssa.gov/OP_Home/handbook/>. For a good review of the retirement component of the system and comparisons with other countries, see Brian J. Kreiswirth, The Role of the Basic Public Pension in a Retirement Income Security System, *Contemporary Labor Law & Policy Journal* 19 (Spring 1998): pp. 393-454.

[9] Social Security Administration, *Social Security: Accountability Report for Fiscal Year* (Washington, D.C.: U.S. Government Printing Office, 1999), p. 3.

The benefit amount is calculated from the average indexed monthly earnings. For 1999, the benefit amount is 90 percent of the first $505 of those earnings, plus 32 percent of any amount between $505 and $3,043, plus 15 percent of any amount above $3,043. The precise dollar amounts to which these percentages apply vary slightly each year, as they are increased by yearly cost-of-living adjustments.

Workers receive greater benefits to the extent they earn more during their work lives and to the extent they delay retirement. Although this means that higher paid workers receive higher benefits in nominal dollars, Social Security is structured to replace a higher proportion of pre-retirement income for low-paid workers than for high-paid workers. See Table 1 below. Two parts of the benefit calculation cause this result. First, the method considers only earnings up to a maximum amount in determining the benefit amount. Thus, amounts earned above the maximum amount are not considered in the calculation and, consequently, do not operate to increase benefits. Second, the benefit formula replaces increasingly lower percentages of prior earnings as earnings increase.

Table 1. Pre-Retirement Earning Replaced, By Income Level and Spousal Status, January, 1998.

Pre-Retirement Earnings	Pre-Retirement Earnings Replaced By Social Security
Maximum Earnings ($65,400)	
Worker Alone	24.6%
Worker & Spouse	37.0
Average Earnings ($27,019)	
Worker Alone	41.7
Worker & Spouse	62.6
Low Earnings ($12,159)	
Worker Alone	56.1
Worker & Spouse	84.2

Source: Social Security Administration, *Social Security: Accountability Report for Fiscal Year* (Washington, D.C.: U.S. Government Printing Office, 1999), p. 3.

In 1997, the average benefit of a retired worker alone was $765 per month, while the average benefit of a retired worker and spouse was $1,158.[10]
The amount of benefits for survivors of workers depends on the deceased worker's earnings, the survivor's age, and the type of survivor benefits. Survivor benefits are generally stated as a percentage of the benefits to which the worker would be entitled at retirement. For example, a widow or widower who is age 65 or older is entitled to 100 percent of the deceased worker's benefit; a widow or widower who is age 50-64 is entitled to 71-94 percent; a widow of any age with a child under 16 is entitled to 75 percent; and a child is entitled to 75 percent. In 1997, the average benefit of a surviving spouse was $722 per month, of a surviving minor child was $500 per month, and of a surviving elderly parent was $636 per month.[11]

Financing
The Social Security program is funded by a payroll tax on current workers and employers which provides monies for payments to retired workers. Thus, although workers may feel as if they are saving for their own retirements through their payroll taxes, the system is more accurately described as a continuing transfer program from currently-employed workers to retired workers.

[10] Social Security Administration, Annual Statistical Supplement (Washington, D.C.: U.S. Government Printing Office, 1997), Table 1.B2.

[11] *Id.*

The social security payroll tax supports three programs: the Old Age and Survivors Insurance Program, the Disability Insurance Program, and Medicare. In 1999, the payroll tax for all three programs combined was 15.3% of earnings up to $72,600. The earnings base on which the tax is imposed ($72,600 in 1999) increases annually as average earnings increase. Self-employed workers pay the entire amount. For employed workers, the employee and employer both pay half (7.65%). In 1997, this payroll tax produced about $521 billion in revenues.

The Old Age and Survivors Insurance Program receives the largest share of this revenue: 10.7% of taxable earnings flows to the Old Age and Survivors Insurance Program; 1.7% to the Disability Insurance Program; and 2.9% to Medicare.[12] Thus, in 1997, the payroll tax produced $364 billion for the Old Age and Survivors Program. This constituted about 90% of the revenues for the program. The other 10% came from earnings on the Old Age and Survivors Trust Insurance Fund, which is described below, and revenue from taxes paid on Old Age and Survivors benefits. Thus, the total revenue available to the Old Age and Survivors Insurance Program in 1997 was $397 billion.

In recent years, the income of the Old Age and Survivors Insurance Program has exceeded its liabilities for benefits and administrative expenses. In 1997, for example, income exceeded expenses by $75 billion. These extra monies are placed in the Old Age and Survivors Insurance Trust Fund where they are invested in Treasury bonds guaranteed by the United States government. As of the end of the 1997 fiscal year, the Trust Fund contained $589 billion.

The Trust Fund is intended to ensure that the Old Age and Survivors Insurance Program is fiscally sound in the future when the ratio of income to expenses is expected to reverse. The ratio of income to expenses is expected to reverse primarily because the ratio of active workers to pension beneficiaries is expected to fall significantly in upcoming years as the post-World War II "baby boom" generation reaches retirement age.[13] Currently, there are 3.3 active workers for each pension beneficiary. That ratio is expected to fall to about 2.0 during the 2040s and to 1.85 by 2070. Under current assumptions, expenses are expected to exceed income for the first time in 2013 and all of the Trust Fund assets are expected to be exhausted by 2034. These long-range estimates are all very sensitive to many economic assumptions, such as the growth in the work force and in wages.[14]

Administration

Social Security is a federal program, administered by the Social Security Administration, an independent federal agency.[15] The payroll tax is a federal tax which goes to the Social Security Administration and the benefit payments are handled through the federal agency. The Administration has 10 regional offices and 1,348 field offices located across the country.

---

[12]In years 2000 and after, the share going to the Old Age and Survivors Program is scheduled to drop to 10.6% and the share going to the Disability Insurance Program is scheduled to increase to 1.8%.

[13]Remember that the system is, in essence, unfunded; it operates as a transfer program from currently working workers to retired workers receiving benefits. Consequently, the burdens on those currently working increase as the proportion of retired workers increases. When members of the "baby boom" generation begin to retire in about 2010, the proportion of retired workers will increase significantly.

[14]The financial numbers above are derived from the 1999 Annual Report of the Trustees of the Social Security and Medicare Trust Funds. See Section VI(a) below.

[15]For a history of the administrative structure of Social Security, see <http://www.ssa.gov/history/orghist.html>.

B. Description of the Private Pension System

In addition to Social Security, the public pension system, there is a very large private pension system in the United States. The private pension system can be divided into two general categories: Occupational pensions and individual pensions. Public policy encourages both types of pensions, primarily through generous tax advantages.

***1.* Occupational Pensions**

Occupational pensions are regulated by federal law, the Employee Retirement Income Security Act.[16] The law, which is extremely complex, imposes many requirements on occupational pension schemes, including the obligation to make adequate disclosures both to participants and beneficiaries and to government regulators; to make pensions available to nonhighly-compensated employees if they are made available to highly-compensated employees; to protect employees from forfeiture of their pensions when they change jobs; to require plans to be administered with high care; and to ensure that defined-benefit plans are funded adequately to make the promised pension payments.

Two basic types of occupational pensions exist. In defined benefit plans, employers promise employees a "defined benefit" at retirement.[17] The amount of the benefit is determined by a formula specified by the plan which, in most plans, uses length of service and final salary as variables. For example, the formula may promise an annual benefit equal to .02 (the generosity factor) times years of service times final salary. Thus, if a thirty-year employee had an average salary of $50,000 over her last three years of employment, she would be entitled to an annual pension of $30,000 (.02 x 30 x $50,000). Employees do not have individual accounts established for them in defined benefit plans. Instead, the employer and, sometimes, the employees are responsible for making contributions to a trust adequate to ensure that the promised pensions can be paid from the pooled fund. The amount of contributions required will depend on a complex actuarial analysis which takes into consideration factors such as the age and length of service of employees, projections of future salary increases, and the rate of return on plan investments.

In defined contribution plans, employers promise only to pay a defined amount into a retirement account established for each employee. The employer makes no promise about the amount of the employee's benefit at retirement. Instead, at retirement, the amount available to the employee depends entirely on the amounts contributed into her individual account and on her account's investment experience.

Historically, defined benefit plans were the predominant form of pension plan. As recently as 1975, more than two-thirds of pension plan participants were in defined benefit plans. Now, however, a majority of plan participants are in defined contribution plans. A number of factors have contributed to this shift toward defined contribution plans, including economic factors (for example, the types of firms offering defined benefit plans experienced slow growth in the 1980s and 1990s), legal factors (for example, compliance with laws is more costly for defined benefit plans) and the preferences of both employers and employees (for example,

[16] 29 U.S.C. §§ 1001 *et seq.* The Employee Retirement Income Security Act does not cover a few specified types of occupational pensions. The most significant uncovered category of pensions are the pension plans provided by state and local government for their own employees. These plans enjoy the tax advantages provided to other occupational pensions and in most respects are organized and operated like private occupational pension schemes, but they are regulated by state law, rather than by the Employee Retirement Income Security Act. *See generally* Steven L. Willborn, Public Pensions and the Uniform Management of Public Employee Retirement Systems Act, *Rutgers Law Review* 51 (Fall 1998), pp. 141-172.

[17] This section draws heavily from Steven L. Willborn *et al.*, *Employment Law: Cases and Materials* (Charlottesville, Virginia: Lexis Law Publishing, 1998), pp. 773-74.

defined contribution plans are easier to link with current performance and permit greater employee mobility).[18]

Beneficiaries
Employers are not required to provide pensions for their employees. The law, however, encourages employers to provide benefits by providing generous tax benefits. In essence, employers are permitted to deduct payments for pensions for tax purposes, but employees are not required to report the payments as income until they withdraw the money from the system in retirement, which may be decades in the future. This delay in tax liability is a significant tax benefit.[19]

The voluntary nature of occupational pensions means that some workers have pensions, while others do not.[20] Overall, about 55% of the nonagricultural workforce participate in a pension plan. A much higher percentage of the workforce is covered if four categories of workers are excluded: 1) part-time workers; 2) workers with less than one year on the job; 3) self-employed workers; and 4) workers under age 25. With these workers excluded, about 70% of the nonagricultural workforce participates in a pension plan.

Workers with certain characteristics are much more likely to be covered by a pension plan. First, high-income workers are much more likely to be covered than low-income workers. Eighty-five percent of workers earning more than $50,000 per year participate in a pension plan; only about a quarter of very low income workers participate in one. Second, workers in some industries are much more likely to covered. About 80% of workers in the public sector and in the communications industry are covered; only about 8% of agricultural workers are covered. Third, unionized workers are more likely to be covered by a pension plan. Over 80% of unionized workers are covered; less than 45% of non-unionized workers are covered. Fourth, older workers are more likely to be covered. About 55% of workers aged 45 to 64 are covered, while only about a third of workers under age 25 are covered. Finally, men are slightly more likely than women to be covered. About 57% of men in the nonagricultural workforce are covered, compared to about 53% of women.

Benefits
The nature of benefits received through occupational pensions depends on whether the pension plan is a defined contribution plan or a defined benefit plan.

As indicated above, in a defined contribution plan, the participant has an individual account which has accumulated money over the participant's work life. The money comes from employer contributions, employee contributions, and earnings from investments. Plans generally provide a variety of ways in which the accumulated monies can be distributed after retirement; the participant may be permitted to receive the amount as a lump sum at retirement, as amounts withdrawn periodically until the money is exhausted, or as an annuity which will guarantee payment of a certain amount for life.[21]

---

[18]Douglas L. Kruse, *Pension Substitution in the 1980s: Why the Shift Toward Defined Contribution Plans*? (National Bureau of Economic Research Working Paper No. 3882, 1991).

[19]For an analysis of the tax benefit, see Steven L. Willborn *et al.*, *Employment Law: Cases and Materials* (Charlottesville, Virginia: Lexis Law Publishing, 1998), pp. 759-60.

[20]The information in this section relies heavily on John H. Langbein & Bruce A. Wolk, *Pension and Employee Benefit Law*, 2d ed. (Westbury, New York: Foundation Press, 1995), pp. 24-29.

[21]Federal law imposes some requirements on the use of this money. For example, to make it more likely that the money is used for the purposes intended by the tax subsidy (to provide for retirement savings), federal law imposes tax penalties on withdrawals made before a worker reaches retirement age and requires participants to begin withdrawing money from these accounts at about age 70.

Regardless of the way in which it is distributed to the participant, however, the total amount of the benefit will equal the amount contributed to the account plus investment earnings. As of 1996, the average amount in defined contribution accounts was $37,323.[22] For two major reasons, however, this number provides a low estimate of the money available at retirement to participants in defined contribution plans. First, the amount includes only the amount an employee has in a retirement account with his or her current employer. Employees commonly have accounts with more than one employer because they have commonly changed employers sometime during their work lives. Second, the amount includes all accounts, including very young accounts, and consequently does not reflect the amount workers can be expected to have in “mature” accounts at retirement. Workers in their 60s with 30 or more years of work experience have $156,000 in their accounts, on average. When younger cohorts of workers reach retirement age, the amount is likely to be larger because, on average, they began these type of accounts earlier in their careers.

In a defined benefit plan, the participant has a right to the “defined benefit” promised by the employer. As indicated above, the benefit is generally determined by a formula which increases the promised benefit as the participants’ wages and length of service with the employer increase. Although the benefit formulas vary, they generally operate to replace higher proportions of a participant’s pre-retirement income 1) for workers at lower earnings levels and 2) for workers with longer tenure. This is illustrated in Table 2 below:

Table 2. Retirement Benefits as a Percentage of Pre-Retirement Earnings, Defined Benefit Plans of Medium and Large Private Establishments, 1991

Final	Years of Tenure with Employer			
Earnings	10	20	30	40
$15,000	14.2	27.4	29.3	49.0
25,000	12.0	22.9	32.5	40.2
35,000	11.2	21.4	30.8	37.9
45,000	10.8	20.9	30.2	36.8
55,000	10.8	20.8	29.0	35.4
65,000	10.8	20.1	29.1	35.3

Source: Bureau of Labor Statistics, U.S. Department of Labor, *Employee Benefits in Medium and Large Private Establishments, 1991* (Washington, D.C.: U.S. Government Printing Office, 1993), Table 90.

Financing

Occupational pensions are financed by contributions from employers and employees and by earnings from investments made with those contributions.

Defined contribution plans are always fully funded because the employer promise is simply to pay out at retirement the amount in the employee’s account – no more and no less. Thus, the financing occurs through employer and/or employee contributions and that funding is precisely equal to the promised benefits.

Defined benefit plans, on the other hand, can be significantly over- or under-funded. In general terms, the employer attempts to set contributions at a level which will permit the employer to pay the promised benefits when they come due. Calibrating the two (contributions with benefits) requires complex actuarial calculations which take into account factors such as the age and length of service of employees, projections of future salary increases, and the rate of return on plan investments. In most instances, these calculations accurately predict the future so that the promised benefits can be paid from the contributions and investment earnings. Occasionally, however, a plan becomes severely underfunded. For example, a plan may become underfunded because the plan’s investment experience is very bad, because the company is going through very difficult economic times and cannot make the necessary contributions, or for other reasons.

---

[22]The numbers in this paragraph come from Employee Benefit Research Institute, *401(k) Plan Asset Allocation, Account Balances and Loan Activity* (Washington, D.C.: EBRI, 1999).

Defined benefit plans are required to participate in a governmentally-regulated insurance scheme to ensure that workers receive their promised benefits even if the plan is unable to do so from accumulated assets. This program is administered by the Pension Benefit Guarantee Corporation (PBGC). Defined benefit plans are required to pay a premium to the PBGC for this insurance of $19 per participant, plus an additional $9 per participant for every $1,000 of unfunded vested benefits. If a plan is unable to pay the benefits promised, the PBGC pays the benefits instead, but can seek repayment of its expenditures from the employer. The law contains a number of complex provisions (e.g., to require a certain level of funding for defined benefit plans) to ensure that this insurance scheme works fairly and efficiently.

2. Individual Retirement Accounts

In addition to occupational pensions, many Americans also have individual tax-favored retirement accounts, known as Individual Retirement Accounts or IRAs. Individuals are permitted to contribute up to $2,000 yearly into a tax-preferred individual account. IRAs come in two basic types which differ in the nature of the tax preference: 1) For regular IRAs, the individual is entitled to subtract from his taxable income the amount contributed to an IRA account (up to $2,000) during the year in which it is contributed to the account and is not taxed on any investment earnings from the account, but is required to pay taxes on money as it is withdrawn from the account in retirement and 2) For Roth IRAs,[23] the individual is subject to ordinary taxation on amounts contributed to an IRA account in the year in which it is contributed, but is not required to pay any taxes on the investment earnings either as it is earned or when money is withdrawn from the account during retirement. Thus, for regular IRAs, the tax preference is deferral of taxation on amounts contributed and on investment earnings, while for Roth IRAs, the tax preference is permanent exemption of investment earnings from taxation.[24]

Beneficiaries

Workers, other than certain high-income workers, can make voluntary contributions into IRA accounts. As of 1993, 35.8 million people had IRA accounts, or about 19 percent of the population over age 20.[25] Retired individuals, however, were much more likely to have IRA accounts; about one-third of retired individuals had accounts.

Benefits

Total IRA assets in 1993 were $987 billion. The average account size was $27,583. Thirty-one percent of IRA owners had balances of $5,000 or less. Ten percent had balances of $50,000 or more.

At retirement, individuals must begin withdrawing money from their IRA accounts at about age 70. Individuals have considerable flexibility in how they make these withdrawals; they can withdraw the money in a lump sum

---

[23] Roth IRAs are named after the United States Senator who introduced the legislative bill which was passed to authorize this type of retirement account.

[24] From the perspective of the individual, these two types of accounts produce the same tax benefits. That is, if other factors are held constant, the tax advantage of deferring taxes on both contributions and investment earnings until they are distributed is exactly the same as taxing contributions when they are made, but never taxing investment earnings. John H. Langbein & Bruce A. Wolk, *Pension and Employee Benefit Law*, 2d ed. (Westbury, New York: Foundation Press, 1995), p. 157. From the perspective of government tax revenues, however, the two IRAs differ in the timing of reduced revenue. Regular IRAs result in lost tax revenues immediately because the tax subsidy occurs by not taxing contributions when they are made, while Roth IRAs result in lost tax revenues later because the tax subsidy occurs by never taxing investment earnings.

[25] The data in this and the following sections come from the Employee Benefit Research Institute's web site at <http://www.ebri.org/ret_findings.htm>.

or they can purchase various types of annuities with the money (for example, a single life annuity or a joint and survivor annuity).

Financing

IRAs are defined contribution-type accounts. The accounts are generally funded entirely by voluntary contributions of up to $2,000 per year by the individual workers, plus the investment earnings on those contributions.[26]

IV. Reform of the National Retirement Pension Scheme – Trends

Reform of the national retirement scheme has been, and continues to be, an important and volatile political topic. Social Security, the public scheme, has been the topic of the most political debate because of its size and the way it is funded. Much more marginal changes have been made and suggested for the private pension scheme.

To date, the changes to Social Security have fallen within Hypothesis B: Adjustments to account for future financing problems. A number of changes to the system have either already occurred or are scheduled to take effect in future years to account for strains on the system that will occur as the large post-World War II generation begins to reach retirement age. For example, 1) the payroll taxes which fund Social Security were increased to provide additional monies (the last increase was phased in during 1990; no further increases are currently scheduled); 2) the age of normal retirement is scheduled to increase from age 65 to age 66 during the years 2000-2005 and from age 66 to age 67 during the years 2017-2022; 3) actuarial reductions for early retirement are scheduled to increase beginning in 2017; 4) credits for delaying retirement beyond age 65 have been increased beginning in 1987 and are scheduled to continue to increase gradually through 2004. More changes along these lines are expected.

Additional changes to Social Security are virtually inevitable, but their precise nature is impossible to predict. Some are arguing for more changes along the lines of those already taken, that is, changes within Hypothesis B in the nature of adjustments to account for future financing problems. Proposals along these lines include reducing expenditures (for example, by cutting benefits, increasing the retirement age more, decreasing cost-of-living adjustments, or reducing benefits for high-income beneficiaries) and/or increasing revenues (for example, by increasing the payroll tax, taxing benefits more, or using general tax revenues to supplement the payroll tax revenues). Others are arguing for more radical changes which would fit within Hypothesis A (shifting to a partial defined contribution plan with private sector involvement). Proposals along these lines generally call for substantial investment of Social Security revenues in the private stock market, either in individual or pooled accounts.[27] These debates have been highly contentious, exposing sharp differences in approach between the two principal political parties and even within the parties.

Changes have also been made to the private pension scheme. These changes have clearly been within Hypothesis A and have been primarily directed at expanding the opportunities for individuals to contribute more into individual retirement accounts and at making it easier administratively for employers, especially small employers, to offer private plans to their employees.

---

[26] Employers can set up and fund IRAs for their workers, but this is not a common type of employer-sponsored pension arrangement, nor does it constitute a large proportion of all IRAs (that is, the vast majority of IRAs are not arranged through employers).

[27] For good reviews of the proposals, see American Institute of Certified Public Accountants, *Understanding Social Security: The Issues and Alternatives* (1998)(available at <http://www.aicpa.org/members/socsec.htm>); General Accounting Office, *Social Security: Different Approaches for Addressing Program Solvency* (1998)(available at <http://www.gao.gov/AIndexFY98/abstracts/he98033.htm>).

V. Assessment and Critical Comments

The public pension scheme, Social Security, has been one of the most successful social security schemes in the United States. For two-thirds of the elderly population, Social Security is either all or the major source of retirement income. Without Social Security income, 60 percent and 41 percent of the unmarried and married elderly population, respectively, would live on an income below the official poverty line; with Social Security, the numbers are 16 percent and 3 percent.[28] The numbers indicate that, although imperfect, the program is at least approaching its primary goal of providing an adequate level of basic benefits to ensure against widespread poverty amongst the elderly.

The current political debates about reform of the system have, as indicated above, exposed differences in conceptions about the proper role of Social Security. Some, primarily in the Republican Party, believe that the system should be re-designed to permit individuals to reap more of the rewards of good returns on monies invested in the system, albeit at greater exposure to individual risk if the returns are not as good as expected. Others, primarily in the Democratic Party, want Social Security to continue to provide at least a basic level of benefits for all Americans without large differences between individuals based on particular investment returns which they might have been able to obtain if permitted to invest individually. These debates are currently unresolved and on-going, but the status quo is a Social Security system that is primarily within the latter conception.

The prospects for the long-term future of Social Security are uncertain, except for one point: Vigorous debate about its proper role in the national retirement scheme is certain to continue.

[28]Social Security Administration, *Social Security: Accountability Report for Fiscal Year 1998* (Washington, D.C.: Governmental Printing Office, 1999), pp. 2-3.

VI. Statistical Data

(a) Comparison of Covered Workers to Social Security Beneficiaries

Year	Covered Workers[1]	Beneficiaries[2]	Beneficiaries Per 100 Workers
Actual			
1950	48,280	2,930	6
1960	72,530	14,262	20
1970	93,090	25,186	27
1980	113,656	35,118	31
1990	133,692	39,470	30
1998	148,459	44,076	30
Projected (Intermediate Assumptions)			
2000	151,105	44,914	30
2010	162,882	53,314	33
2020	168,480	68,276	41
2030	170,705	81,354	48
2040	174,887	86,057	49
2050	177,798	88,696	50
2060	179,693	93,517	52
2070	181,546	97,463	54

[1]Workers employed in work sometime during the year for employment on which Social Security taxes are paid.

[2]People receiving benefits under either the old-age or disability portion of the Social Security program. A high proportion (85-95%) of the beneficiaries are recipients of old-age benefits.

Source: Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, *1999 Annual Report* (Washington, D.C.: U.S. Government Printing Office, 1999), Table II.F19, p. 122-23 (available at <http://www.ssa.gov/OACT/TR/TR99/index.html>).

(b) Incidence of Defined Benefit and Defined Contribution Pension Plans, Medium and Large Private Sector Establishments

Year[1]	Defined Benefit	Defined Contribution
1980	84%	--
1985	80	53%
1989	63	48
1991	59	48
1993	56	49

[1]Selected years for which data available.

Source: Bureau of Labor Statistics, *Employee Benefits Survey* (Washington, D.C.: U.S. Government Printing Office, 1999).

(c) Percentage of Full-Time Employees Participating in Retirement Plans, Medium and Large Private Sector Establishments

Year[1]	Defined Benefit	Defined Contribution	All Plans[2]
1991	59%	48%	78%
1993	56	49	78
1995	52	55	80
1997	50	57	79

[1]Selected years for which data available.

[2]Includes both defined benefit and defined contribution plans, but employees participating in both are counted only once.

Source: Bureau of Labor Statistics, *Employee Benefits Survey* (Washington, D.C.: U.S. Government Printing Office, 1999).