Pension Reform Today and in 1974

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[1] In the early 1970s, a Democratic Congress and a Republican President (Nixon) became concerned about the lack of pension funding, vesting, and coverage for most Americans. They decided to do something about it. The result was the Employee Retirement and Income Security Act of 1974 (ERISA) -- a piece of legislation believed by many to be responsible over the last three decades for improving the well-being of millions and helping to build up retirement plan assets of trillions. The up-front revenue cost was very large, and many employers and pension experts were forced to learn and abide by new rules, but Congress and the president were willing to tolerate both costs.

[2] No doubt ERISA was a partially flawed and imperfect act, and its backers did not anticipate later developments such as the vast growth in number and types of 401(k) and similar plans. But what is most striking in comparing today with 30 years ago is that there was willingness at that time to think big and do big things if that was what was required. Moreover, the start of the legislative process was usually the development of fairly detailed and elaborate analysis by the Treasury and the Congress offering to policy-makers options to enhance the public good according to various principles and standards. Interest groups would comment on and influence those options, but they did not lead the process.

[3] Process issues may be boring. Certainly most newspapers will not even report on them or allow discussion of them to occur on their op- ed pages. It doesn't get the adrenaline flowing as much as a good fight or an attack on public personalities. But to the extent that government fails to advance along with the nation's prospects and abilities, more often than not it is a systemic problem having to do with process. This president and Congress, I believe, are not less qualified or less concerned with the public good than elected officials in the early 1970s. But today they are much less likely to undertake major reform.

[4] As only the latest example, the 401(k) problems surrounding Enron are relatively minor compared to the broader issue of adequacy of pension coverage and the lack of retirement plan saving by or on behalf of most employees (see Economic Perspective, February 12, 2002). But the attention given to Enron does present an opportunity to newly engage the broader issue. If the issue is not engaged mainly because the start of the process simply doesn't occur.

[5] If Treasury wanted to do something, for instance, it would gather together a team of knowledgeable and trained individuals with limited attachment to various special interests. Many of them would be long-time civil servants. They would be asked to examine retirement plan issues thoroughly and produce a report on their findings. The report would begin by providing a history of retirement plan policy -- where it has come from and where it is going. It would point out its great weaknesses -- both lack of adequate benefits for most people and the extraordinary complexity in current pension plan design. Then it would offer options for dealing with those problems.

[6] One can anticipate as a consequence that it would have to point out the enormous inequities of the current system -- that some people are getting large benefits unavailable to others in almost similar circumstances. The inequities run in parallel with the complexities that come from decades of building one legal requirement or option on top of another, so much so that today a significant chunk of employer and employee pension saving is eaten away in administrative cost. It would delve into the extraordinary inconsistency of current law (including, by the way, that 401(k) plans do not receive the level of subsidy available to other retirement plans that benefit from an exclusion from social security tax). It would discuss the risks of both defined benefit and defined contribution type of retirement plans and relate them to the ability of social security to back up those risks with some level of minimum benefit. It would sort out issues surrounding mandates, which are used both in social security and in proposed individual accounts. And the

study would examine the effectiveness of a system of subsidies based primarily on a tax deferral and attempt to ascertain whether some further subsidy such as a credit might be required.

[7] That such a study is not forthcoming reflects the modern politicization and balkanization of the reform process. Almost every issue I just raised is quite controversial and threatens some group or another. There are a number of people in the retirement plan world who are quite content with their place in it, thank you, and see no reason to stir the pot. Addressing inequities means that some current winners would have to lose to restore parity to others. An honest examination of mandates would hint that many in both political parties tend to simplify and distort issues surrounding this issue. Even moderate simplification reforms threaten to eliminate options used currently by some people and would force them to bear the cost of learning how to operate in yet another world.

[8] I suggest, however, that the magnitude of these political problems is ordinary for any true reform process. ERISA couldn't have been passed if there wasn't a willingness to step on some toes. At least its framers didn't start out with narrow goals and ask interest groups to design the proposals. Few real reform processes can start without a willingness to engage in rigorous study of how complex systems can be redesigned to serve broad public interests. Many years ago the Treasury Department could be counted on to take such a lead on occasion. No longer. It really hasn't produced a major reform study since the 1984 tax reform study that led to the Tax Reform Act of 1986. It has been a follower, not a leader. When Treasury does design proposals these days, it is only after so many political promises and deals are made outside the department that it cannot even offer legitimate trade-offs necessary to meet the objective of the policy. While the department generally has or can gather the talent needed to address major issues like retirement plan reform, this talent for the most part is kept on the sideline. In the end, the department merely proposes tweaks to the system, as it did in supporting pension reform last year or as it will do in adding narrow additional opportunities to diversity portfolios in light of Enron. But it hasn't addressed the major retirement plan issues of greater transparency, simplicity, and more substantial coverage.

[9] Allowing a process to start right does not guarantee success. A study might not come up with good recommendations, and even good recommendations may end up to be politically infeasible. Nonetheless, if the administration and Congress really wants retirement plan reform, they have to risk taking the first step.

Other Publications by the Authors

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