A Tax Policy Center Symposium

SAVING PRIVATE PENSIONS

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The Pension System and Alternative Paths to Reform

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PANEL ONE

MR. WILLIAM GALE: My name is Bill Gale, for those of you who don't know me. I'm a Senior Fellow here, Co-Director of the Tax Policy Center. I'd like to welcome you to this afternoon's symposium with the humble title of Saving Private Pensions.

I'd also like to thank the Brookings Institution communications staff who helped put this event together on very short notice.

Originally I thought I would be introducing Congressman Earl Pomeroy, but he actually has work to do this afternoon. He's on the Ways and Means Committee and they are marking up the Tax Bill which is sort of like the one meeting all year that he actually has to be at. So he could not make it.

The last time we scheduled him to speak at a Brookings pension conference was in 1999 and it was the day before that hurricane came through town. I can't remember what it was called but it was in September. So the whole town vacated and he canceled his talk and went home for the weekend.

This time he's presiding over a fiscal train wreck in Congress so agreeing to speak at this conference seems to breed natural disasters. We'll have to find a way to get him here without endangering the fate of the republic some time in the future.

So I thought what we would do for the first 45 minutes is just sit quietly and think about what Pomeroy would actually have said and what we would have asked in response. [Laughter] Or we can move on and move to the second session. So we'll probably do that, I guess.

Just a couple of housekeeping items. First, we're on the record. Second, there will be a transcript posted in due time. It usually takes a week or two to get that transcript transcribed and edited and all that.

Third, everyone speaking in this panel and the next panel represents their own views, not the views of any of the organizations with which they are affiliated.

In the first panel what we'd like to do is give sort of an overview of the issues. I'm going to talk for about 10 or 15 minutes on the pension system itself. My colleague Peter Orszag is going to talk for 10 or 15 minutes on strategies or general proposals for reform.

In the second session we will turn to more specific issues and proposals. The second session will be chaired by Gene Steuerle who is a Senior Fellow at the Urban Institute, and with Peter and I and Lynn Berman as also a Co-Director of the Tax Policy Center.

I'm going to be talking mainly off the handout that I provided. If anyone needs copies there should be copies on the table or coming around.

The way that I start to think about the pension system is to note that the onset of a lengthy retirement period is a relatively new phenomenon. A hundred years ago we would not have worried so much about providing for needs in retirement for the simple reason that not many people had lengthy retirement periods and those that did basically lived with the rest of their families and were supported by their families.

So it's actually a major social and economic achievement to have established a lengthy retirement period at the end of a working life. So in a sense pensions are sort of a good problem to have but they are still a problem and they raise a number of issues that need to be addressed.

That general issue combines with the aging of the population, the lengthening life span, and the imminent retirement of the baby boomers to give an urgency to all of these issues, especially when combined with observed low saving rates in the United States.

So thinking of pensions in the context of retirement income, people basically have four sources of income. Actually now that I think of this they have five sources. I'll mention the fifth in a second.

The most obvious is Social Security. Social Security provides a nearly universal and sort of a basic benefit. It was never meant to provide for all retirement needs and it certainly doesn't do that.

The second layer or tier if you will is what we've called pensions and tax deferred savings.

There is an issue with what a pension is versus what a tax deferred savings account is. I'm going to refer to them jointly. There are people that feel very religious about the fact that a 401(k) is not a pension plan. It's a deferred compensation arrangement. But I'm going to lump them altogether into one plan, so I'm speaking of DB, DC, individual retirement accounts, etc., when I say either pensions or pensions and tax deferred saving.

Coverage here is less universal and the distribution is less progressive or more regressive than Social Security in the second tier.

Then there's a third tier which you can call other assets. For most people this means housing. So far at least people have been reluctant to tap their housing wealth in retirement, but it also includes things like businesses and discretionary financial assets that tend to be highly concentrated.

So for example business income is not a reliable source of consumption in retirement for the vast portion of households. For a very tiny portion, it will be a significant amount of income.

The fourth leg or fourth tier would be work. Now it seems a little odd to talk about working in retirement, but a lot of people who are over the age of 65 and are retired by conventional measures stay in the labor force.

The fifth source here that I mentioned earlier would be family. Fifty years ago that would be taken seriously as a sort of fifth possibility. Now I think it's relatively well understood that the family is not likely to be the source of financial support.

All of this comes back to the basic point and the point of the seminar or the symposium is that pensions have to play prominently in providing retirement income for current and future generations Social Security won't do it, other assets won't do it, work won't do it because then it's not retirement, and

family won't do the job either.

So what should the pension system be doing? I've supplied what we view as a reasonable mission statement for the pension, but I want to emphasize this is our view. This is not official policy as encoded in some legislation. It's listed here as to encourage or provide adequate and secure retirement income in a cost efficient and equitable manner.

There are a couple of things to note there. One is, it's adequate retirement income. It's not unlimited retirement income. A consumption tax would give you unlimited tax preferences on saving. A pension system and an income tax should give you preferences up to some adequate level if preferences are chosen as the mechanism. But there's no reason to give pension benefits that go beyond an adequate level of retirement income.

The secure part is also important. Adequate sort of refers to an average income level. The risks of pensions have become evident in recent years.

Cost efficient doesn't need to be defended. And equitable is, of course, always a matter of judgment but equity seems to be an important part of public policy.

So with that lofty statement which I think is general enough that no one could object to it, that of course also makes it useless as a guide to policy.

Let's talk about specific objectives of the pension system.
The first one obviously is to raise overall private saving. If a pension system doesn't do that it clearly has failed. But I don't think that's enough to establish the success of a pension system or a pension provision.

In particular it needs to raise the private saving by people who otherwise would not be saving enough. It doesn't do any good from an adequate requirement income perspective for Warren Buffet to put money in a 401(k). That's not going to affect the adequacy of retirement income.

A third criteria which I think is also important is that it not only has to raise saving and not only has to raise saving for precisely the people who need to have their saving raised, it needs to raise saving by more than it reduces the public revenue loss. That is national saving needs to go up, not just private saving.

If all we're doing is reducing tax revenues and transferring them to selected groups we don't need a big complicated pension system to do that. We can simply make the transfers.

So ultimately the saving objective focuses on all three of those.

The equity issue can relate to either income or what I think is more appropriate is to adequacy levels. That is a pension system that subsidizes the saving of people who are already saving more than they need for retirement doesn't seem like a very equitable pension system. A pension system, a fair

system would subsidize, encourage the saving of those who need to save more for retirement.

The third issue is handling risk effectively. I'll come back to this. I think that the pension system does a very poor job of handling risk.

The fourth issue is to encourage later retirement. The reasons for this are two-fold. One is the retirement sort of crisis that is occurring, the funding crisis generally. But the second is a life spans increase, as work moves to white collar industries, there isn't any social reason why people need to retire at 55. So at the very least the pension system shouldn't encourage early retirement. I've stated it a little more strongly here, it should actually encourage later retirement, but I'd be happy to retreat to the weaker point if that's contentious.

The last two are pretty simple. Minimize the public revenue losses. Whatever you do resources are limited so you want to do it in the most efficient way.

The last point is simply keep it simple. We have a voluntary pension system. If it gets too complicated people won't participate.

Looking around the room I see a lot of people who know a heck of a lot about pensions so I'm not going to describe to you the differences between a DB plan and a DC plan, a cash balance plan. It's listed in this very informative table on the second page, but I will simply make the point that a DC plans gives workers a lot more control over their assets. It also exposes them to a lot more risk and forces them to make a lot more choices. And of course as everyone in the room knows, over the past 25 almost 30 years now, we've had a massive shift from DB to DC plans.

The other fact which will stun no one in the room is that cash balance plans are hybrids and they contain features of DC and DB plans.

So let's turn quickly to the evaluation of the system. The first issue is equity. Who gets pensions and who benefits from pensions?

The coverage rate has hovered around 50 percent over the last 30 years. Coverage and other aspects of the pension system are tilted toward high-income households. As income or wages rise the following things happen. First, eligibility for pensions tends to rise or coverage tends to rise. Second, participation rates, given eligibility, tend to rise. Third, among participants, contributions as a share of wages rise. Fourth, of course, wages rise as income rises. Lastly the tax rate rises. So if you do a calculation of, if you think of the factors that should affect who gets the benefits from pensions, all of those increase as income rises.

That's offset by two items. One is there are contribution limits in dollar terms that limit the amount that very high income households can contribute. The other is that getting a pension is different from actually benefiting from a pension. Somebody has to pay for those pension benefits and I think most economists think in the aggregate that workers bear the burden of pension costs. That is an employer will pay a certain amount for a worker, and whether it goes to pensions or health or wages is of

secondary importance to the employer. But we don't know quite whether it's an individual worker pays for his or her individual pension or workers at a firm pay for their pension, or workers at an industry as a whole pay for their pension. So we don't know quite the level of aggregation at which the offset occurs, which is an important caveat.

Generally it seems like participation coverage the tax benefits associated with participation rise fairly significantly with income.

The next question is how well are families saving? Again, it's hard to know exactly but it appears that a significant minority of families don't save enough to maintain their living standards in retirement.

Who are these people? They tend to be people with lower wages, less formal education, people who rent their house, people who are non-white, and people that don't have a pension. Likewise people who are higher income and more educated and homeowners, etc., tend to be doing better in terms of retirement adequacy.

That's sort of a statement about saving. The next piece of the puzzle is how to pensions affect saving. Those of you who have seen me talk on this know this is a controversial issue. The estimates range between zero and 100 percent of pensions being net additions to saving, so it's just an empirical issue now.

But contributions to pensions are more likely to raise saving among precisely the group that's not saving enough. Lower income workers, less educated, low wealth, etc. Contributions to pensions are less likely to be net additions to saving among high income, high wealth people.

The intuition here is pretty simple. You have this tax benefit from contributing to a 401(k), for example. There's a painless way to get the tax benefit and a painful way to get the tax benefit. The painless way is to take money that you've got somewhere else, or money that you would have saved anyway and put it in the 401(k). That gives you the tax break and you haven't affected your living standards or anything else. You've just moved the money around.

The painful way is to take money that you would have spent on your current living standards, whether it's clothes or food or housing or vacation, and take that money and put it into a 401(k).

Given the choice between contributing in a painful way and a painless way, most people that are able to contribute in the painless way do so. At least that's my reading of the evidence.

So you have this situation that's a little backwards in the sense that 401(k)s are used very heavily by precisely the people that don't need them. Households that are already saving a lot and therefore have the assets that they can move over are doing that. Whereas households that are not saving a lot and therefore need to cut their current living standards in order to participate in a 401(k) tend to contribute less and tend to participate less often.

Put that together, combine the equity issue and the saving issue, we've got the distribution of

pensions going mainly to higher income, high wealth households but those are also the households that are more likely to be savings adequately for retirement even in the absence of pensions. And those are households that are less likely to create new saving by participating in pensions.

The conclusion says essentially, from this analysis, that the pension system is basically tilted the wrong way. It's providing all these benefits that are A, expensive; to people who B, don't need it; and C, don't use it in a socially productive manner by raising savings.

So our general conclusion from a paper that Peter and I wrote that's out there, is that changing the system around, retilting it toward moderate and low income households would be more equitable, more effective in raising private saving, more effective in improving the adequacy of saving, and more effective in raising national saving than the current system is.

Let me just mention briefly the three other issues that I wanted to talk about. Risks, complexity and retirement. I'm going to skip the last two and just focus on risks in the interest of time.

As I said, I don't think the pension system does a good job managing risks. We are in a very strange situation recently where the stock market fell and interest rates fell. Usually they move in opposite directions. That's wreaked havoc on defined benefit plans. The decline in the stock market has reduced their assets; the decline in interest rates has raised their liabilities. So firms have faced extreme pressures there.

On DC plans the standard joke is your 401(k) has turned into 201(k) which is saying that workers face asset return risk. This is made worse by investment in employer stock which gives you the higher risk but not the higher return that otherwise would come with higher risk. The higher return comes with diversifiable risk.

Then there are risks in retirement. If people don't annuitize their wealth they might outlive their wealth and they might get low returns on their assets.

So the pension system has a lot of work to do and I think the other talks following this will talk about what it is we might actually do to fix these things.

With that, I'll turn it over to Peter.

MR. PETER ORSZAG: Thanks, Bill.

I'm going to talk about some recent proposals and try to evaluate them against the intermediate objectives that Bill delineated for what a pension system or pension reforms should do.

I list those on the first page of my handout. I also have a handout. Again, raise household saving and increase retirement income adequacy, boost national saving, promote efficient handling of risk, encourage continued work are at least not encourage early retirement, then simplicity.

What I want to do is take a look at the 2001 tax legislation, the new Portman/Cardin legislation, the so-called Portman/Cardin III, a few proposals including Groom/Shoven and Halperin/Munnell, then a series of incremental reforms.

I realize that I'm leaving out lots of proposals that have been put forward, but then again I'm only supposed to talk for ten minutes so hopefully that will at least partially cover the waterfront.

The 2001 tax legislation included a series of pension and IRA changes which had been designed in large part by Representatives Portman and Cardin, or at least included in earlier legislation that they had cosponsored. I list, this is a selective list because obviously there are many many provisions, but it nonetheless gives you a flavor for some of the more important changes that were included in the 2001 tax legislation.

The elective deferral limit, that's the amount you can contribute each year to a 401(k) type plan, was increased from $10,500 to $15,000 with that increase phased in over time.

Another constraint that applies to all defined contribution plans across the board which had been $35,000 or 25 percent of pay, whichever was lower, has been changed to $40,000 or 100 percent of pay.

IRAs, previous limits had been $2,000 per year for contributions to deductible IRAs or Roth IRAs. The 2001 tax legislation raises those amounts, again over time, ultimately hitting $5,000 by 2008.

The maximum amount you can take into account in computing the pension benefit or contribution had been $170,000 so if you were earning $400,000 a year and the contribution rate under the pension was ten percent of pay, the contribution on your behalf was $17,000 because you could only take into account up to $170,000 in earnings. The 2001 tax legislation raised that to $200,000.

Amounts that you could take out per year from a defined benefit plan were increased with proportionally larger increases at earlier retirement ages than at age 65.

A Roth 401(k) was created in which Roth treatment, that is sort of flipping the traditional deduction and then tax treatment so that you contribute with after-tax dollars but withdrawals are not taxed was also included in the legislation.

Then there was a savers credit which I will describe in a little bit more detail in a moment.

If you evaluate these changes against the types of objectives that Bill delineated, they basically don't stack up very well. Most of the thrust here is increases in the benefit and contribution limit that apply to tax-preferred savings vehicles. And I think there's a big question about how much such increases will affect lower to moderate income earners for whom the limits basically are not particularly relevant. They're not binding. So you just start to look at some of the data.

Of all eligible taxpayers and the dates for this vary, but basically you're getting about five to seven percent of eligible taxpayers who had been contributing anything to an IRA at all before the 2001

tax legislation was passed, only about three to five percent of eligible taxpayers were making the maximum contribution to an IRA. Only about five percent of 401(k) participants were constrained by the previous selective deferral legal limit.

So you're getting something like 95 percent of the relevant pools of workers or taxpayers who are just not directly affected by those limits. Similarly the increase in the compensation limit from $170,000 to $200,000 directly affected only about one percent of the top earners. There are some indirect effects on defined benefit funding formulas which we could discuss, but in terms of its direct effect, it was of benefit only to the top one percent of workers.

So what the legislation as a whole represents is a push towards greater subsidies for higher income households, or greater access to tax deferred savings for higher income households which is exactly the opposite of the way that we think the pension system should be moving.

There are some other features of the 2001 tax legislation. It did make it easier to roll over funds from a 403(b), from different kinds of defined contribution plans that somewhat simplified the pension system. On the other hand, we now have, or we will have a Roth 401(k). If anything, that complicates the system. So the net effect on simplicity, there are a whole bunch of other provisions obviously also, but the net effect on simplicity is unclear.

In terms of encouraging later retirement, as I mentioned the legislation includes, basically allows greater early retirement subsidies under defined benefit plans than had been permissible under previous law. So if anything it goes the wrong way, at least with regard to that provision.

There are whole bunch of other potentially adverse effects at least on employer provided plans that could arise from for example increases in the IRA contribution amounts, potentially displacing interest in employer provided plans among at least some small businesses, and basically the end of, as far as I can tell, the end of so-called money purchase plans which are a type of defined contribution plan in which participation is automatic rather than elective.

Under prior law there had been incentives for small businesses to set up money purchase plans in order to hit one of the constraints, especially for the owner. Now because of the changes that were made in the 2001 tax legislation, that incentive is basically gone.

So it's interesting. If you had gone into Schwab or Fidelity or any small business provider several years ago they would have said you need to couple a profit sharing, a 401(k) plan, with a money purchase plan in order to get up to the maximum 25 percent of pay that was allowed. If you now go in, they don't mention money purchase plans and actually Fidelity and Schwab are sending out, because there are changes that are required to pension plans, they're sending out forms saying you can now drop your money purchase plan. You no longer need it in order to hit that maximum.

I want to talk a moment about the saver's credit. The saver's credit is perhaps the most auspicious part of the 2001 tax legislation. It's a progressive savings credit, tax credit, that matches contributions made by lower and moderate income households into 401(k)s or IRAs at its lowest, for the lowest income

categories. That's for joint filers with incomes below $30,000 it's a 50 percent tax credit which means if you put in $2000 into an IRA you get a $1000 tax credit back. On an after tax basis, that's basically a dollar for dollar match which is quite a generous matching formula and is targeting exactly the type of people where those additional contributions would improve retirement income adequacy and where I think we should be focusing attention.

The problem is that the credit is non-refundable. That means that even though on paper that 50 percent credit rate looks great, in practice it's largely a mirage. I provided a table based on the Urban Brookings Tax Policy Center tax model which just goes through the numbers of tax filing units who no paper qualify for that 50 percent credit based on their income.

For example if you look at joint filers, married couples filing jointly, there are almost 16 million such couples who on paper would qualify for the tax credit because their income is in the relevant range. However only four million of them would actually receive any tax benefit at all through this credit for making a contribution to an IRA or 401(k). In other words the credit would deliver zero benefit to them even if they made a contribution, because their income tax liability is wiped out by other provisions.

Finally, only 3,000 of them, so 0.0 percent of the joint filers who qualify based on their income would receive the maximum 50 percent credit for the maximum contribution that they could make into an account. So you'll often hear a 50 percent credit, and you can put in $2,000 a year and isn't that great. It's largely a mirage.

Similarly, and I'm going to mention in a moment, Portman/Cardin and other recent proposals increased the credit rate without making the credit refundable. Obviously increasing the credit rate is just going to mean that for the vast majority of families, at least 75 percent or so, there's no effect whatsoever on them because they already receive zero. You increase the credit rate, they still receive zero.

That brings me to Portman/Cardin III which was introduced in the House a couple of weeks ago and will be marked up either tomorrow or more likely next week. It includes a series of provisions, most prominently acceleration of all those increase from the 2001 tax legislation that I described which were mostly phased in over time. So the 401(k) increases phased in over time, and the IRA limit is phased in over time. Portman/Cardin III would take all of those phased-in increases and make them effective immediately. It would also make them permanent.

These pension provisions from the 2001 tax legislation like the rest of the 2001 tax law, all sunset in 2010 or before. Portman/Cardin III would remove those sunsets.

Then it adds a whole bunch of new provisions. Expansions in income limits for joint filers, being able to make contributions into IRAs, I'll describe that in a second, changes in the minimum distribution rules which govern when you have to start pulling money out of a retirement account, a tax break on income that has been annuitized, some expansion in the savers credit although again that's mostly a mirage, changes to the asset test under the supplemental security income program. Currently under that program there's a dichotomy between defined benefit plan -- If you're covered by a defined benefit plan that does not disqualify you for supplemental security income. If you have defined contribution assets,

that does. This provision would provide a limited correction to that.

There are a whole bunch of other provisions which I think will be described in more detail. I hadn't realized that Pamela Perun and Gene Steuerle will also talk about Portman/Cardin III in their presentation.

I would note at least in my copy of their paper, the last page is a tacked on transcript from National Public Radio about the Corzine Chemical Security Bill which I think has more to do with printing sharing at Brookings than about their paper, so I would assume they'd like you to tear that off. [Laughter]

Portman/Cardin III basically, just quickly on the analysis of it, it reduces revenue according to Mr. Portman by more than $100 billion over the next ten years. It continues the movement towards providing expanded opportunities for tax-preferred saving by high income households with relatively little emphasis on lower and moderate income households. And it includes a variety of other provisions that Bill and I described as problematic in a Tax Notes piece that should have been out front.

For example, delaying the minimum distribution requirement to age 75 would weaken the role of the tax preferred savings accounts as providing income for retirement. The more you push back that age the less this tax preference is being used to finance consumption during retirement and the more opportunities for using it to build up estates. Pushing the age from 70 and a half to 75, the age at which you'd need to star taking money out of your defined contribution plan, is a first step towards eliminating those rules and that would be a substantial alteration of the basic purpose and function of these tax preferences.

I'd also note, despite the argument that at least one of the sponsors of the legislation made that this would promote work among the elderly, if anything it has the opposite effect. Under current law under 401(k) plans you have to start withdrawing funds at age 70 and a half or when you retire, whichever is later. So if you're 72 years old and you don't want to start drawing funds out of your 401(k) because you really want that tax-free inside buildup, you have to keep working now.

If you delay the minimum distribution requirement age until 75 you don't have to keep working. So if anything this actually cuts in the opposite direction from what the sponsors are claiming.

I'm going to not really describe Groom/Shoven and Halperin/Munnell except to say that very briefly, just because of time, Groom/Shoven would basically get rid of the limits that apply to tax-preferred saving, eliminate the non-discrimination rules that apply under current law, and dramatically increase the amount that higher income workers could put away in their tax preferred vehicles. This would obviously be a lot simpler than the current system but it would also substantially reduce federal revenue and have potentially quite small effects on private saving as those high income households merely transferred other saving that they would have been undertaking in any case into the tax preferred vehicle. It's basically moving us towards either a consumption tax or a wage tax, depending on exactly how it is constructed.

Halperin/Munnell would basically take lower earners out of the employer provided system. What they would do is set up a system of universal accounts for workers who earn less than $20,000 with government contributions and matching tax credits into those universal savings accounts.

The employer plans would then not have to cover those workers. So the people under $20,000 would basically be taken out of the existing system. Then the employer provided plans would be subject to a tighter set of non-discrimination rules and coverage requirements. Then they would tax pension fund earnings at a five percent rate.

That proposal would presumably actually score pretty well on the saving front, but could lead to additional complications as you'd need new rules for the universal savings accounts, the workers who are earning less than $20,000 a year, and exactly how you handle people who are close to that boundary, and in the absence of the proposed tax on pension investment earnings which I think I described as not likely to be politically viable at the current time, which seems like an understatement, it would also reduce government revenue and therefore potentially have an adverse effect on national saving.

So let me just turn briefly to a set of incremental reforms which we could discuss during the question and answer time if people are interested. If we can't get the big reform, and if we don't want to be moving further in the Portman/Cardin type of direction what can you do that's sort of not revolutionary but would at least in our opinion be moving in the right direction. I think the answers are several fold. One is that you could expand the savers credit in particular by including some refundability so that all of those filers that ostensibly qualify but would not receive any benefit from it would receive some incentive from the credit.

Research has shown that changing the default choices in 401(k) plans matters a lot. If workers are in the plan, unless they specifically say they're out of the plan participation rates are a lot higher and I think Mark Iwry may talk a little bit about that. Similarly, the “Save More Tomorrow” plan that has been designed by behavioral economists in which you promise today to contribute a share of your future pay increases to the savings plan seems to be very effective. And encouraging these sorts of plans could potentially be quite important.

There still are, especially in state labor laws, some problems for setting up some of these plans. Portman/Cardin III actually would solve some of those problems.

Financial education and diversification I'll leave to the next panel.

Simplification. We think that if you're going to start playing with things like the minimum distribution rules that instead of delaying the age at which you have to start taking money out, exempting some relatively modest amount of assets per person would be a more effective simplification.

For example, the 2001 survey of Consumer Finances suggests that more than two-thirds of households on the verge of retirement headed by someone aged 55 to 64, owned defined contribution and IRA assets of less than $50,000. It suggests that if you came up with some rule where exempting $30,000, $40,000, $50,000 from the minimum distribution rules, you would take that issue off the table

for the vast majority of retirees.

I'll just skip over and would be happy to discuss some of the other suggestions.

But basically our conclusion is that as the baby boomers are nearing retirement the pension system is not serving the functions that it should. It covers only half of the workforce at a point in time. It is complicated. It directs the bulk of its benefits to households who likely would have been saving adequately for retirement in any case and who disproportionately shift assets from other forms of saving into the tax-preferred vehicle to take advantage of the tax preference, and doesn't do a very good job of either providing incentives for or covering the lower and middle income households for whom an increase in retirement savings would improve retirement income adequacy and would represent a net increase in private savings.

Recent policy shifts including the 2001 tax legislation and the Portman/Cardin III which looks like it will likely pass at least the House if not both the House and Senate, continue along this path. They make more generous contribution and benefit limits available to higher income households and do relatively little to try to boost retirement saving among moderate income households.

So not too surprisingly, we think some change of course is necessary. There are more aggressive reforms that should be considered but if we can't achieve those more aggressive reforms in the short run, a somewhat more modest set of incremental reforms could be considered along the lines that we described.

Now we're going to take questions.

QUESTION: It seems to me that a key element of real reform is to make tax credits refundable if the goal is really to promote what you want rather than to bring in a consumption tax in a piecemeal way. So my questions are first, are there any members of our government who fighting for this now? Refundability of saving credits. I'll leave it at that.

MR. GALE: I can answer the first part. Not in the Administrative branch.

MR. ORSZAG: I think there is some interest in the legislative branch but the politics of refundable credits are complicated and have become more complicated in recent years as the child credit has become partially refundable, and concerns about error rates in some of the other, well in the EITC in particular have prompted the EITC recertification effort that is currently occupying the IRS.

QUESTION: [inaudible]

MR. ORSZAG: I don't have a number in my head. I can get it to you. My memory is it's in the tens of billions, it's not in the hundreds of billions over ten years.

QUESTION: Marilyn Gwax with Cox News.

When you ask who gets pensions, and the answer is the coverage rate is 50 percent. I'm not clear.

Do you include both defined benefits and defined contributions in that? And if so, which is bigger? In other words, what percentage of people get a traditional gold watch and a pension where every month a check comes?

MR. GALE: The 50 percent figure does include both DB and DC plans. The exact numbers are in, I guess they're not in this. But there is some overlap as well.

Currently about 61 percent of participants are in DC plans and 83 percent of the contributions are in DC plans. But there's also some overlap. A significant minority population has both.

So the short answer is I can't give you the exact number that's just DB or just DC. That number is findable.

QUESTION: If I can just add something, the gentleman who asked the first question about who's supporting refundability in the government. There have been efforts on Capitol Hill to promote refundability of the savers credit. There was a Democratic alternative to Portman/Cardin when the bill was moving through the House in which there was a lot of impetus for refundability. Senator Bingaman introduced a bill last year that involved a surrogate for refundability. That is I worked with him on the bill and because of the political issues surrounding refundability that Peter just referred to, it tends to face barriers among a lot of sectors in the Congress.

There's a savings bond approach and there have been other approaches that people have tried and the Bingaman Bill uses the savings bond approach to give people something in lieu of refundability. It's in effect refundability by giving people a savings bond that they can and indeed must hang onto until retirement, even if they have no tax liability to offset.

MR. GALE: That's a good point. The refundability doesn't have to be in terms of cash on the barrel head. It can be in terms of a contribution that is not liquid. It cannot be cashed in until some certain date. That might reduce to some extent concerns about refundability being gamed by tax filers.

QUESTION: Karen Ferguson, Pension Rights Center.

My recollection is that both with respect to the 2001 tax law and the current Portman/Cardin III bill, the claim of the sponsor is that by increasing the limits for these various plans, particularly 401(k)s, this will encourage more small business owners to set up plans. I just wanted to know whether that was in fact what they were saying and how you would respond to that.

MR. GALE: There's two issues. One is that if you raise the contribution limits you might entice more small business owners to set up plans because they personally would benefit more.

The second issue is, existing plans, if you raise the limit and the small business owner put in more, that would require the owner then to either encourage the workers to boost their contributions or to make the contribution him or herself on behalf of the worker.

That's the theory. As far as I know there's no evidence on this either way. The other aspect to note is that, an issue I mentioned earlier which is that somebody pays for the pension provision. So an increase in a pension contribution that sounds like a benefit, but if it comes at the cost of a wage boost or what would have been a wage boost then there's an issue about sort of who's actually paying for that pension benefit.

So it's a theory and it's out there but I wouldn't describe it as established.

Likewise when the President issued his plan in the budget this year for lifetime saving accounts and retirement saving accounts, there was a concern the other way that by making, by creating these very large contribution limits outside of the qualified retirement plan, that you'd have negative effects on small business coverage because small business owners would just contribute to an LSA and an RSA and they'd say to heck with the pension and all the rules and stuff like that and they'd drop the 401(k).

So those concerns are also unsubstantiated but the work both ways.

MR. ORSZAG: I would just add, and there are a whole host of other potential provisions that do go the other way in addition to increases in IRA limits which may discourage plan formation, although again the empirical magnitude there is unclear. Even given the number of plans, Bill mentioned that if the higher income owner was putting in more, the non-discrimination rules will generally require an increase in contributions for other members of the firm. But there are provisions that were included in the 2001 tax legislation which go in the other direction.

The increase in the compensation limit, for example, could allow lower contributions that are made on behalf of both the higher income owner and rank and file workers if the owner has some target saving amount.

There were other changes that were made to the non-discrimination and top-heavy rules which could weaken that.

Then finally, a lot of 401(k) plans are set up as safe harbors in which that sort of rule isn't really relevant.

A second point is we don't have any empirical evidence. We do have some admittedly imperfect survey evidence from EBRI where they go out and they ask firms why they haven't set up plans. The results bounce around a little bit from survey to survey, but basically that usually is not among the leading contenders for why the firm doesn't have a plan.

Finally, if we want to start throwing theories out, it's also the case that the reduction in marginal tax rates that was included in the 2001 tax legislation reduces the incentive to set up a pension plan. So that could go the other way too.

I agree that these are statements that have been made quite forcefully by the proponents of the legislation, but in the absence of empirical evidence backing them up I think some skepticism is

warranted.

MR. GALE: I think it's also easy to get lost in the details of the argument. The basic point is if anyone were to come up with the top ten ways to encourage coverage and participation among low and moderate income workers, the structure of EGTRRA and Portman/Cardin III is just not what you would come up with. It's sort of thrown in as a bone to say oh, it's not as bad as you think, but this is not fundamentally a plan that's structured to go after low and middle income workers.

MR. MARK IWRY: Just to add to what Bill and Peter have said in response to your question, Karen, when you put numbers on the IRA increases that are proposed, you have a $10,000 to $12,000 a year IRA for a married couple. If one of those spouses owns a small business then they might well consider not having a 401(k) that allows them to contribute $12,000 to $14,000 -- the range being people under age 50 or 50 and over -- 12 to 14 rather than 10 to 12. The 10 to 12 might well satisfy their appetite for tax-favored saving, yet the successive Portman/Cardin bills have each combined by sort of political compact increases in the limits in employer plans with increases in the limits in IRAs that in a sense when they're high enough start to compete with employer plans.

When you saw the President come out with his LSA proposal that was not coordinated with the Hill and was not worked out in a careful quid pro quo so that both the employer community and the financial services community would tolerate the increases in limits for the other, the employer community and certainly many of us who are part of that or associated with that or work with that join them, objected to the increases in the, in effect the increases in the IRA limits that the Administration had proposed.

QUESTION: This is sort of a conceptual question. I'm Tom Donelin from Barons.

You discussed primarily increasing participation of low and moderate income workers, but the title of the symposium is Saving Private Pensions, and my question is, from what? [Laughter]

MR. ORSZAG: From their current failure to raise retirement income adequacy and -- from their current failure to meet the objectives that we delineated.

MR. GALE: If we had called the symposium Maintaining the Viability and Cost Effectiveness and Equity and Saving Effects of the Current Private Pension System, it would have --

MR. ORSZAG: You probably wouldn't have come. [Laughter]

MR. GALE: Right. But the idea is basically, we're spending upwards of $200 billion a year on private pensions. That's a big number. It's legitimate to ask is that money well targeted? Is it well structured? Is the system doing what it's supposed to do? Are there better ways to do that? That's essentially the focus.

The title was my fault. After Saving Private Ryan I always wanted to write a paper called Saving Private Saving. [Laughter]

MR. ORSZAG: You came close.

QUESTION: If we are serious about improving pension benefits for lower income employees, why don't we just increase Social Security benefits?

MR. GALE: That's certainly one way to do it. Another way to do it is mandatory add-on which I guess would be the same thing in some sense as increasing Social Security.

There are difficult issues in pensions, there are difficult issues in Social Security, and once you turn to Social Security you raise another whole set of issues.

You're absolutely right to make the point that Social Security and pension reform should be considered in the context of each other. That's why I started out in the context of the overall retirement system, although my comments this afternoon didn't focus on them that much. And there are alternative ways of meeting these goals.

I think the sense right now is politically that there might be more support for something called private pensions than for just an expansion in the basic Social Security benefit. If you expanded the basic Social Security benefit you'd run into the funding problem and you'd probably be enmeshed in an even more complicated set of political choices. But I'd be happy to have that option on the table as part of an overall Social Security pension reform.

Let's do a quick switch with the second panel, and I'll hand it over to Gene.