

From D. Lewin, O.S. Mitchell, P. D. Sherec, eds
Research Frontiers in Industrial Relations
and Human Resources

IRRA, 1992

CHAPTER 17

Social Insurance and Benefits

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All developed countries provide protection against economic risk through public and/or employer-administered programs.¹ How much is provided, and the mix of public vs. private, vary substantially across national boundaries. In the United States there has been growing tension over the appropriate mix and the level of generosity. Recent debate about creating a system of national health care or about mandating employer-provided health care is but one symptom. What was the contribution in the 1980s of academic research—mainly in economics and industrial relations—to the debate over, and understanding of, social insurance and employee benefits?

It will be argued here that while much useful research was undertaken, there were deficiencies in the resulting literature. At times, narrow issues and narrow perspectives were unduly emphasized, thus widening the gap between research and application. However, the gap was two-sided. Practitioners and policymakers often failed to acquaint themselves with, or to apply, research findings or perspectives. In any case, public policy addressed the issues piecemeal, perhaps because—as will be described here—the U.S. benefits system is highly decentralized.

Finally, the question of how social insurance and benefits fit into the changing employment relationship was seldom asked. The standard model of a large firm providing benefits in the context of stable employment was eroding in the 1980s. Yet academic theorizing about benefits tended to take the standard model as given for all time and, indeed, had rationalized it as optimal. Thus, proposals to accommodate the changing employment relationship by making benefits more portable and consistent with employee mobility were unlikely to come from academics. By the end of the

The least likely person to receive benefits is a part-timer at a small enterprise.³

Unionization has an effect similar to size: union establishments feature higher compensation and are benefit-intensive (Freeman 1981). On the other hand, unionization is negatively correlated with the use of savings and thrift plans. Such programs tend to emphasize individual advance provision for retirement rather than collective entitlements. Not surprisingly, unions prefer the latter approach.

Although not shown in Table 1, public-sector employers, like unionized private employers, put more compensation into benefits than do private. Also, the kinds of benefits offered vary between the public and private sectors. For example, defined-benefit pensions are more popular (and defined contributions less popular) in public vs. private employment (Wiatrowski 1988). Historically, both union employment and public-sector employment have been associated with long job tenures and the preferences of older workers.

With regard to legally required social insurance, the size/cost relationship reverses. Larger establishments tend to spend less as a fraction of total compensation on Social Security and unemployment insurance (UI) than do smaller ones, probably because of the ceiling on taxable earnings.⁴ The same is true of unionized establishments. Relative to total labor cost, workers' compensation costs fall with size of firm, suggesting economies of scale in administration. Workers' compensation is mandated private insurance in most jurisdictions. The fact that smaller firms find it proportionately more expensive undoubtedly explains their general opposition to other proposed legal mandates such as compulsory health insurance.⁵ Workers' compensation costs also rise with unionization, perhaps reflecting a tendency of union workers to be located in riskier than-average industries and occupations. In addition, unions often refer their members to attorneys who handle claims under workers' compensation and could generally be expected to inform members of their legal rights. Hence, the positive correlation is entirely reasonable.

For core employees in larger firms, both insurance and pension provision are the norm, as Table 2 illustrates. Offering medical and life insurance has become standard practice. Pensions are somewhat less common, but still cover a heavy majority of full-time workers.

TABLE 2

Percent of Full-Time Employees Participating in Selected Employee Benefit Programs, Medium and Large Firms, Private Sector, 1989

	All Employees	Prof. & Admin. [*]	Tech. & Clerical ^{**}	Production & Service
Medical care	92	93	91	93
Dental care	66	69	66	65
Life insurance	94	95	94	93
Pension ^{***}	81	85	81	80
Defined benefit	63	64	63	63
Defined contribution ^{****}	48	59	52	40

^{*}Professional and administrative employees.

^{**}Technical and clerical employees.

^{***}Less than sum of defined benefit and defined contribution plans because some workers have both types of plans.

^{****}Includes savings and thrift plans, deferred profit sharing, employee stock ownership, money purchase plans, and stock bonus plans.

Source: U.S. Bureau of Labor Statistics, *Employee Benefits in Medium and Large Firms*, 1989, bulletin 2363 (Washington, D.C.: GPO, 1990), p. 4.

Defined-benefit pensions—in which the benefit is typically determined by a formula relating to age, seniority, and final earnings—are the most common form. However, defined-contribution plans, which are basically employer-provided savings arrangements, are also quite common. And many workers now have both types of plans. Production and service workers are less likely than other categories to have defined-contribution plans. Union preferences for defined benefits and the lesser attractiveness of secondary tax-favored savings arrangements for blue-collar workers are significant factors in explaining the gap.

Since smaller firms are less likely than large ones to provide benefits, and since part-time workers are less likely to be eligible for benefits, Table 2 greatly overstates the coverage of private benefits for the overall wage and salary work force. Consistent and reliable economy-wide data for the United States are surprisingly hard to come by, although they tend to be much better than those reported for other countries. One study, based on Current Population Survey data, found that only 46 percent of all full-timers in the private sector were covered by some kind of pension in 1988. When coverage is defined to include only basic pension plans (and not savings plans such as 401k's), for all workers (full and part time) the figure dropped to 34 percent (Woods 1989). Even for the

full-timers, the data indicated a gradual decline in coverage since the 1970s. About two-thirds of all persons with work experience in 1985 were reported covered by a work-related health insurance plan (Mitchell 1990).

The proportion of compensation received by workers in the form of direct wages and salaries has tended to fall historically, as can be seen from Table 3. Much of the decline, however, is due to increased costs of legally required social insurance. Regarding private benefits, the picture has been mixed in recent years, despite the widely held belief that the benefit share of pay inexorably rises over time. As will be discussed below, employer contributions to pensions as a percent of total compensation fell in the 1980s due to high rates of return on pension-fund assets. In contrast, health care cost containment efforts failed to stop the relative inflation of employer-provided medical plans.

TABLE 3

Trends in Components of Compensation

	Percent of Total Compensation in Each Category by Year						
	1929	1939	1949	1959	1969	1979	1989
Wages & salaries	98.7	95.5	94.9	92.4	89.6	83.9	83.6
Legally required	n.a.	n.a.	3.6	4.4	6.1	8.8	9.6
Pensions & profit sharing	n.a.	n.a.	.9	1.7	2.0	3.3	1.6
Health insurance	n.a.	n.a.	.4	1.1	1.7	3.4	4.7
Life insurance	n.a.	n.a.	.1	.3	.4	.4	.4
Other*	n.a.	n.a.	.1	.1	.1	.1	.2
Total compensation	100.0	100.0	100.0	100.0	100.0	100.0	100.0

*Consists largely of directors' fees and supplemental unemployment benefit insurance contributions.

Source: U.S. Bureau of Economic Analysis, *The National Income and Product Accounts of the United States, 1929-82: Statistical Tables* (Washington, D.C.: GPO, 1986), Tables 6.4, 6.5, 6.12, 6.13; "The U.S. National Income and Product Accounts: Revised Estimates," *Survey of Current Business* 70 (July 1990), same tables.

The final stylized statistical fact is the heavy government subsidy provided through the tax code to private employee benefits. As Table 4 shows, the federal tax revenue losses related to employer-administered retirement and insurance benefits far exceed the

TABLE 4

Tax Expenditures for Selected Employer-Provided Benefits, Fiscal Year 1990

	Revenue Loss \$ billions
Pensions	\$45.4
Medical	26.4
Life insurance	2.6
Accident/disability insurance	.1
ESOPs	1.9
Note: Homeowner mortgage deduction	\$37.6

Source: U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 1992* (Washington, D.C.: GPO, 1992), Table XI-1.

more widely discussed homeowner mortgage interest deduction. Beyond the federal costs, additional tax revenue losses accrue to state governments. The major role played by the tax system in establishing and sustaining the modern American system of employer-provided benefits simply cannot be ignored.⁶ Moreover, the wedge that the subsidy creates between employee value and employer cost complicates the area of benefit measurement. Even in the budget-conscious climate of the 1980s, only a few researchers were willing to suggest major cutbacks in the tax subsidy to core benefits (Munnell 1988). Perhaps this was because such suggestions seemed bound to be ignored, despite the regressive effects such subsidies often entail.

Decentralized Provision and Regulation

The most important stylized fact about the U.S. benefit system is not statistical. Rather it is the decentralized nature of the private (and some public) components of the system.⁷ Legally required social insurance covers the vast majority of employees. Thus, only a small proportion of the work force (mainly in government) is not covered by Social Security. But private coverage of benefits such as pensions is at the discretion of employers. The result is a patchwork of variegated and often less-than-fully portable benefit programs. Layoffs, in particular, can put benefit coverage at risk.

A study of displaced workers who had health insurance coverage on their old jobs revealed that among those finding new jobs, about one-sixth had no coverage. Noncoverage rates were, of course, substantially higher for those remaining unemployed or out of the labor force (Podgursky and Swaim 1987; Herz 1991). The conflict between employer-linked benefits and pressures for greater employee mobility (both voluntary and involuntary) has, not surprisingly, begun to express itself in public policy initiatives.⁸

There is cross-national irony here. In the United States, where labor mobility rates have been relatively high, the private benefit system is designed for long-term job attachments. Put another way, the American benefit system has an antimobility effect, since job changing is effectively often penalized (Mitchell 1983). But in Europe, where mobility rates have long been low, the benefit system is consistent with job changing thanks to the tendency to use national benefit funds external to the firm.

U.S. benefits are also regulated on a decentralized and often uncoordinated basis. Thus, employers can escape from the rigors of state laws regulating insurance carriers by self-insuring their health benefits. Self-insurance puts them under the coverage of weaker federal regulation pursuant to the Employee Retirement Income Security Act (ERISA). It might be expected that larger firms would be best equipped to administer self-insurance. Indeed, seven out of 10 firms with 1,000 or more workers are self-insured. But the practice of self-insurance has spread as well to over one-fourth of those smaller firms that provide medical plans. Yet small firms do not have the law of large numbers in their favor when dealing with health risks (Sanchez 1991). Moreover, if a self-insured employer becomes financially unable to pay for promised benefits, adversely affected employees have relatively little recourse.

Similarly, employers can rid themselves of the rigors of ERISA-related regulation and mandatory termination insurance of defined-benefit pensions by liquidating their pensions and giving employees annuities issued by private insurance carriers. Such liquidation typically amounts to a loss of pension wealth by employees, as will be discussed later. But it also leaves them with the lesser protection of state insurance regulators. And, again, should the insurance carrier encounter financial difficulties, retirement payments are put in jeopardy since federal termination insurance no longer applies.⁹

Academic research has not focused much on regulatory incentives and disincentives of this type. The basic stylized facts of Tables 1 through 4, in contrast, are well known to researchers specializing in the compensation area. But with no one looking at the overall regulatory structure—and with regulation reacting to perceived problems on a piecemeal basis—the U.S. benefit structure ends up requiring a substantial private bureaucracy. That is, apart from governmental regulators, there need to be benefit administrators, experts, and counselors within employers. A major benefit “industry”—employers, unions, management consultants, and insurance carriers—has sprung up to lobby and interface with government regulators and lawmakers. The result has been complexity and instability of regulation.¹⁰

A Brief History of U.S. Benefits

Analysis of historical documents from the period before the 1930s reveals a lack of clear distinction in that early era between public vs. private provision of benefits. European systems, particularly early German social security and various collective “mutual benefit funds” in other countries, attracted considerable attention among social reformers in the United States. Even within public provision in the United States, there was no clear line drawn between what would today be considered “welfare”—e.g., programs such as AFDC which are means-tested, and those that would be viewed today as social insurance—e.g., retirement entitlements under Social Security. Proposed and actual state-run “widows’ (or mothers’) pension” schemes in the 1920s were an example of this ambiguity. Widows’ pensions were financed out of general revenue rather than employer/employee contributions and were means-tested. Yet they eventually evolved into survivors’ insurance under Social Security, which, in contrast, is funded out of employer/employee contributions and is not means-tested.

As another example, the 41 so-called “state old-age pension acts” in existence when the Social Security Act was passed in 1935 were essentially relief laws, not pensions in the modern sense (Parker 1936). These programs, the earliest of which dated from 1915, became the basis of federal-state means-tested old-age assistance, which still continues. The use of the word “pension” during and prior to the 1930s to describe private company plans, government

firms also served as a model for the new government program (Jacoby 1991).

Leverage from various social movements of the 1930s helped in the enactment of Social Security. Notable among these was the Townsend movement—a populist proposal aimed at ending the depression by providing the elderly with a guaranteed income conditional on both retirement and quick consumption. Social movements were again harnessed after enactment of Social Security to widen its coverage and increase benefits.

The growth of the trust fund surplus in the years immediately after the program's enactment was denounced by early Keynesians on the left as the root of the 1937 recession and by critics on the political right as a dangerous accretion of government resources. Program proponents took advantage of these charges to run down the surplus through expansion of benefits. They thereby locked in Social Security as *the* national pension system (Bernstein 1985; Achenbaum 1986). The seeds for the notion that Social Security is an inviolable "compact with the people," in Wilbur Cohen's words 50 years later, were planted at that time (Cohen 1985, p. 127).

Technical complexities of the Social Security program were also used to expand benefits. Congress was persuaded to adopt an escalator formula in the 1970s which in fact produced benefit increases exceeding the rate of inflation. This "error" was eventually corrected, but not before benefits were significantly elevated relative to wage levels. Today, even long-service workers with generous defined-benefit pensions in the private sector can expect to receive anywhere from a third to a half of retirement income from Social Security.¹¹ Not surprisingly, Social Security enjoys strong support from the electorate. When the system's financial crisis began to unfold in the late 1970s and early 1980s, public confidence in the program's viability began to decline. Academic discussion turned toward fundamental changes in the system which were, in some cases, outside political realities. But politicians across a broad spectrum moved quickly to fix the problem within the existing framework.

Substitution of Public for Private Benefits

For private, work-related benefits, the legal distinction concerning who pays for benefits—employer or employee—became important because of tax treatment.¹² In the late nineteenth and early

relief programs, and social insurance illustrates the blurry lines that once separated such programs.

Benefits provided by firms were termed "welfare work" in the early part of the twentieth century. The phrase had a connotation of doing "good works." Employer welfare benefits were often seen as part of a continuum running from provision of such benefits by various fraternal, ethnic, or religious mutual aid societies to the beneficial programs of unions and to various embryonic government programs. Exactly what ideally was supposed to be in the employer's benefit "package" was also unclear. Medical insurance as it is understood today—i.e., reimbursement of doctor and hospital bills—was rare. Paid sick leave and disability were more likely to be viewed by employers as constituting the core of the health plan, perhaps combined with some kind of company clinic or "hospital." Workers' compensation, which states were increasingly mandating, was often seen as a health plan. In any case, health was not necessarily the focus of welfare work. Thus, housing, savings institutions (savings and loans, credit unions), and burial insurance might also have been part of a corporate program of welfare work.

When government stepped in and provided a previously existing private benefit, employers sometimes discontinued their programs or modified them. Thus, in a 1939 survey, about half of pension plans discontinued during the previous decade were reported to have terminated due to the passage of the 1935 Social Security Act. Of 164 pre-1935 plans still active, the proportion reported to have been "revised" due to the Act was also one-half (BLS 1940). Even today, many private pensions are formally "integrated" with Social Security, suggesting a substitution between public and private programs.

Social Security

Social Security's political popularity resulted from careful sculpting by its initiators and proponents. The distinction between the program's redistributive aspects and insurance aspects was left deliberately fuzzy, owing to popular aversion to accepting charity and relief and to distrust of government. Failure of some private pension plans during the depression, even though such plans covered only a very small fraction of the work force, helped justify government administration of Social Security. But, somewhat paradoxically, the existence of welfare programs within certain

twentieth centuries, however, the tax element was of little significance. And since workers moved from job to job more frequently than today, the existence of many union-run benefit plans at the time was hardly surprising. Such union plans were used as organizing tools, an idea which was revived in the 1980s by the AFL-CIO as it sought ways of offsetting membership losses.¹³ But there was also an ideological element of workers controlling their own economic fates that contributed to the establishment of union-run plans. Thus, at least 25 labor-affiliated banks, through which workers could save for retirement, were in existence in the mid-1920s (BLS 1924).

Today, unemployment insurance is seen as "naturally" a state-run program. Except for the few supplemental unemployment benefit (SUB) plans in certain unionized industries, private unemployment insurance is often thought to be impossible to provide due to moral hazard and, possibly, adverse selection. However, in the 1920s and early 1930s, there were in existence company, union, and joint company-union unemployment benefit plans (BLS 1931). These were later eclipsed by the state-federal UI program created in 1935, not to mention the Great Depression.¹⁴ But had government not stepped in, the private plans might have revived and evolved more fully.

Moral hazard and adverse selection problems exist with virtually all forms of private insurance. Some people with fire insurance burn down their property to collect from their policies; individuals with terminal health problems may attempt to acquire life insurance. Yet sufficient controls can often be put in place to make the offering of insurance feasible. The same might have been true regarding UI, particularly if offered through the employer. As in the case of other areas where public policy influenced private benefit offerings, researchers should not make the mistake of assuming that the observed outcome was inevitable.

Looking Backwards: Private Benefits Without a Government Role

It is thus useful to ask what employee benefits looked like before the age of tax incentives, government-provided social insurance, and the general expansion of regulation. In addition, it is especially useful to look at a period prior to the eruption of a major threat of unionization during World War I. Since unions were potential benefit providers, employers suddenly had wartime incentives to install benefits simply to compete with unions. But the pre-World

War I period was "uncontaminated" by such influences. Data for the pre-World War I period are, of course, limited. Nevertheless, some information is available thanks to early work by the U.S. Bureau of Labor Statistics.

Table 5 presents data collected from a 1913 BLS survey of employer "welfare work" (Otey 1913). Surveyed employers included such well-known names as Metropolitan Life, the Union Pacific Railroad, R.H. Macy & Co., H.J. Heinz, and General Electric. Consistent with the style of BLS publications of that era, the study did not present statistical tabulations. Instead, to produce Table 5, a count was made of references to 18 particular types of benefits or programs described in the 50 case studies found in the

TABLE 5

Proportion of Firms in 1913 Study with Presence of Selected Welfare Practice

Practice	All Firms	High Commitment Firms	Low Commitment Firms
Formal welfare dept. or secretary	16%	44%	0%
Employee representation plan	2	11	0
Company housing	16	0	44
Training/apprenticeship program	18	33	22
General education facilities	10	11	0
Eating facility	68	78	44
On-site medical facility or attendant	42	78	22
Other recreational/cultural facility ^a	86	89	89
Special attention to lighting/ventilation	36	56	11
Other noteworthy health and safety policies	6	22	0
Sickness/disability pay	72	100	11
Pension plan	20	22	11
Stock or profit-sharing plan	8	11	0
Death benefits	56	89	0
Accident benefits ^b	10	33	0
Mutual benefit association	54	100	0
Paid vacation plan	18	22	11
Formal link to savings institution or plan	18	44	11

^a Presence of a locker room is not counted.

^b Plans providing compensation for loss of limbs and similar injuries excluding sickness/disability plans.

Note: The 50 firms described in the 1913 study were ranked by the proportion of the 18 welfare programs listed above which they provided. The top nine firms on this ranking are reported as "high-commitment firms"; the bottom nine are reported as "low-commitment firms."

Source: 1913 BLS survey of employer "welfare work" (Otey 1913).

report. Selection of the 18 programs was made on the basis of judgment; these were the arrangements which the BLS report's author seemed to feel were important forms of welfare work. The 50 firms were ranked by the proportion of benefits or programs provided, and the top and bottom nine firms in the ranking were arbitrarily dubbed "high commitment" and "low commitment" firms, respectively, for their commitment (or lack thereof) to welfare work.¹⁵

Apart from the data on the table, four characteristics of early welfare work can be ascertained from the report. First, there was a heavy overlay of paternalism at many firms. Thus, sickness benefits at one firm (which meant paid sick leave) were denied to those whose maladies were the result of indiscretions such as bicycle racing and intoxication. A variety of cultural activities (employee choirs, libraries, social clubs, etc.) were included at some firms to uplift the untutored immigrant work forces of the period. Welfare secretaries were sometimes appointed to serve as counselors to whom employees could take their problems. But these secretaries could also serve as monitors available to weed out those who did not fit in with what would today be termed the "corporate culture."

Second, employers often saw themselves as catalysts helping employees help themselves. Thus, benefits were frequently provided through company-established and affiliated mutual aid societies to which employees paid dues. Connections with savings institutions might also be provided to encourage employees to learn the virtues of thrift. Employees would thus learn not to be overly dependent on employer beneficence for their illnesses or retirement.

Third, the benefits that today might be considered part of a core package were not so important then. Pensions existed only in about a fifth of the surveyed firms. And the rules for eligibility were such that few workers were likely ever to draw benefits. There may have been no vesting at all and no pre-funding of benefits. Payment to retirees might be discretionary with the employer. Indeed, a company might overtly proclaim that its pension system should not be regarded by workers as an entitlement.

No true medical insurance seems to have existed. It is difficult to know how much care workers might have received from the company medical facilities mentioned in the BLS report. However, these facilities appear to have been aimed mainly at on-site accidents.

Death benefits were often found in welfare programs but for sums basically limited to burial insurance. In contrast, death benefits under modern employer-provided life insurance often exceed annual salary.

Fourth, although some employers claimed to obtain productivity advantages from providing welfare work,¹⁶ there is little evidence in the report of any systematic attempt by employers to measure these purported gains. For those companies that engaged heavily in welfare work, there was a sense that the various services offered were all "good things" to be doing. All employers could produce some rationale for what they provided; none would say they were simply giving away money. But documentation of the alleged gains was scarce.

Although contemporary benefit administration has become more professional, it is likely that similar employer responses would be found if a comparable survey were taken today. Those firms that offer benefits would say that there are gains to morale or productivity. But few would systematically endeavor to prove it. Indeed, many would dismiss the idea that their basic benefit package was designed to encourage any specific behaviors other than general appreciation of employer good will. As Lazear (1990, p. 273) has reported with regard to pensions:

Human resource administrators often resist the idea that pensions can be used to affect incentives. Even personnel people think of pensions and other deferred compensation as a fringe with few effects other than the enhancement of the recipients' income.¹⁷

Government as Employer, Provider, or Mandating Authority

In the early part of the twentieth century, the question of how to provide benefits, through government or private arrangements, was less of an issue when government itself was the employer. As part of a study of possible pension arrangements for federal civil servants in 1916, the U.S. Bureau of Labor Statistics examined plans in foreign countries and at the state and local level (BLS 1916). Only four states at the time had comprehensive pension arrangements for their own workers. But 159 municipalities had pension plans. In contrast, the BLS listed only 117 private companies with pensions, 51 of which were railroads or utilities. Thus government, although

Eventually, medical insurance followed life insurance. And it ultimately became largely employer-provided thanks to the tax code. Gaps in employer-provided coverage, however, have given rise to recent calls for federal- or state-mandated programs. Under these proposals, all employers would be required to provide a basic health plan or pay into some government-created program.

Benefits for Elderly Employees and for Retirees

For elderly workers over 65, the presence of Medicare requires coordination of employer-provided health insurance with the government's program. Legislative changes in the age discrimination area effectively have made employers provide the initial coverage for such workers, with Medicare acting as supplement. But for retirees, some employers provide supplemental retiree insurance, using Medicare as the primary insurer. Employers have recently been pulling back on their retiree coverage due in part to cost and in part to new accounting standards requiring that future unfunded retiree health insurance coverage appear explicitly in corporate balance sheets. This pullback, in turn, intensified pressure for an enhanced national program.²⁰

Optimality or Historical Accident?

Economists might well be troubled with the vision of the U.S. benefit system as the product of a series of historical accidents, social movements, and regulatory currents, each building on one another in a rather haphazard fashion. There is a tendency to want to see a profit/utility maximizing strategy behind the system, at least as it operates at the firm level. Of course, sociologists and historians might have trouble viewing benefits as having any firm-level optimizing rationale behind them; the social interplay of forces might seem to them to be the more natural explanation. But the historical record suggests a blend of the two approaches.

The brief summary just given reveals that a variety of complex influences has brought forth the contemporary American system. Employee "tastes" have been conditioned by past practice and are not immutable. For example, about six out of ten Americans have employment-related health insurance. This coverage comes either from their own work experience or the work of spouses or parents. Of those covered by private health insurance, but not by Medicare or Medicaid, eight out of ten have it from an employment-related

servicing its own employees, was often viewed by reformers as providing a role model for private employers who, in turn, were seen as not doing enough.

The issue of government vs. private provision remains a live issue today. Politicians have generally learned that careless utterances about privatizing Social Security are to be avoided. But professional economists, presumably those without political ambitions, sometimes make such suggestions. With regard to medical insurance, there have been periodic pushes for government-run health plans. Such ideas in the American context go back to the period 1915-20 when a drive for state laws developed momentum (but ultimately failed).¹⁸ At the time, the American Medical Association (AMA), whose later opposition to national health insurance was crucial in preventing the adoption of such a program, was still uncertain of its position. It contented itself with specifying desirable principles to be incorporated in a hypothetical program, should one be created. The AMA's ambivalence was understandable. After all, health insurance meant subsidizing the use of physicians' services. But it also might mean government regulation of what could be charged for those services.

Ultimately, AMA opposition arose from the fear of controls on fees and other matters. This opposition continued until 1990-91, when the AMA again began to look favorably at a national program of some type for the noninsured.¹⁹ AMA opposition in the 1930s and 1940s eliminated health insurance from early proposals for the Social Security program and killed a plan pushed by President Truman after World War II. But the AMA could not kill the 1960s Medicare proposal because of the program's sympathetic targeting of the elderly and because of its sentimental link to recently assassinated President Kennedy. However, successful blockage of a federal medical program for the non-elderly left the field open to private health insurance.

The open field ultimately produced the preponderance of employer-provided health plans that exists today. Insurance carriers discovered in the World War I period—when welfare work crested—that they could sell life insurance in profitable volumes through certain large employers who provided it at no direct cost to workers. The carriers persisted in this marketing endeavor in the 1920s, even though in that era employers simply offered employees the opportunity to buy group life insurance at their own expense.

source (U.S. Bureau of the Census 1990, p. 100). Given this state of affairs, it seems natural today for workers to look toward employers as *the* source of health insurance. Indeed, those firms that do not provide such benefits to regular employees, especially if they are large companies, might be seen by job seekers as signaling that they are bad places to work. It thus becomes rational for firms to offer health insurance simply because others do so. What is true for health insurance is also true for other benefits.

When benefits are not provided as expected, there is a tendency for policymakers to look for ways to induce or require recalcitrant employers to do their duty. The battle then becomes one of incentives, through the tax code or via other forms of subsidy, or mandates. Thus, the issue of mandated health insurance (and other benefits such as family leave) developed in the 1980s and continued into the 1990s. Mandates also tend to be the compromise between liberals (who prefer public to private provision, but may grudgingly accept mandates) and conservatives (who prefer private to public provision, but may reluctantly accept mandates). Finally, in an era of taxpayer resistance, mandates appear more attractive than direct government programs because they do not run through official budgets.

Research on Employer-Provided Health Insurance

The interests of researchers, practitioners, and policymakers were most closely joined in the 1980s on the topic of health care cost containment. By the end of the decade, the United States found itself spending substantially more on a per capita and percent-of-GNP basis than other advanced countries and yet achieving no obvious payoff in terms of such gross outcomes as life expectancy. There are, of course, conceptual problems with the widely used health expenditure/GNP ratio; the numerator is in gross terms while the denominator is essentially value-added. Nonetheless, the United States seemed to be doing more "caring" without achieving more "curing."²¹

Employers complained bitterly about rising costs of their health plans, although, as noted earlier, they may not have fully considered the degree to which their workers may ultimately pay for these trends. Rising medical costs added to pressure on Congress to provide coverage for those individuals who did not have employer-provided or government-provided insurance. Academics tended to

explore options for cost containment within the existing system. To the extent that Congress looked for guidance on broader options which would transform the system, it was more likely to turn to the U.S. General Accounting Office and Washington types than to university academics.

Rising Health Costs

The ratio of national health expenditures to GNP rose from 4.5 percent in 1950 to 11.1 percent in 1988.²² Although there have been occasional pauses in the upward march of this ratio, no dramatic downturns have been observed. It is easy to find ingredients in the recipe for rising health costs. With copayments ranging from zero to relatively small amounts, individuals are encouraged to consume more health services. It is difficult to provide insurance against medical risk without at the same time providing a *de facto* subsidy to the use of medical services. Moreover, the tax code, it is often argued, leads to excessive insurance, particularly for first-dollar amounts (as opposed to "catastrophic" care). Rising costs raise the demand for insurance, which in turn raises demand.

In addition, health consumers are at an information disadvantage in judging appropriate expenditures. They must rely on providers (physicians, hospitals, etc.) to tell them what they need. This reliance opens up a potential principal/agent problem, particularly if the agent is aware that the principal is insured and will carry little or none of the cost. Expectations of patients regarding outcomes are high and the threat of malpractice suits may produce further inducements for consumption of expensive tests. In addition, nonprofit providers may have only limited incentives to hold down costs and may stimulate use of high-quality (expensive) procedures and seek to maximize use of professional services.

The problem with these bits and pieces is that they all suggest that there should be more health services consumed as a percent of GNP, and probably at higher prices, than an uninsured and unsubsidized market would provide. But they do not necessarily suggest indefinite relative inflation and a continually rising share of GNP. Perhaps the analogy might be the union wage effect. The union differential in theory is thought to reach an equilibrium after the union fully exploits its bargaining potential. It is not expected to rise forever.

incentives to hold down costs. Modern HMOs are modeled after the Kaiser Plan, a program initially established for Kaiser steelworkers that gained a major foothold in California. Even today, after years of federal encouragement of HMOs, these programs remain especially concentrated in the western region (Bucci 1991). Generally, both HMOs and a related innovation—preferred provider organizations (PPOs)—have expanded at the expense of conventional fee-for-service plans. (PPOs require the insured to use a panel of selected providers or receive significantly reduced reimbursements.)

Both HMOs and PPOs have the effect of limiting consumer choice. This result seems to be part of the universal trade-off: less choice in exchange for cost containment. There is some evidence that constrained-choice plans do cut expenditures. HMOs in part ration access to care via queuing as a substitute for marginal cost pricing. Time value of the insured then acts to hold down usage of HMO services. But since consumer tastes toward queuing and other aspects of service will vary, the HMO option will work best for a homogeneous consumer population, assuming there is enough competition to provide various “qualities” of HMOs. Still, part of the apparent cost cutting effect of HMOs may simply result from their ability to “cream” the market of healthy persons.

To the extent that employers believe that HMOs and PPOs will reduce costs, research does suggest that employees can be induced to shift toward these plans, especially if the HMO or PPO option involves some reduction in patient out-of-pocket expenses. Co-payments also reduce health expenditures in fee-for-service programs. Employers have incentives to reduce costs even with full recognition of the incidence effect.²⁴ That is because a firm that can deliver a given set of health benefits at lower cost than competitors will be at an advantage in the labor market. Such a firm could, in principle, pay lower total compensation or recruit higher quality workers.

Thus, in the 1980s, there was a proliferation of employer experimentation with second opinions, controls on hospital admissions, use of hospices, etc. But there was also a strong element of faddism in these efforts, with “managed care” (typically hiring a consultant to review and screen prospective expenditures) being the latest. American management has been prone to faddism in other labor areas: consider “total quality management” or “quality circles”

However, the empirical history of the union wage effect indicates that such theoretical steady-state equilibria are not necessarily found in practice. The U.S. union/nonunion wage differential has exhibited long waves of expansion and decline. Perhaps something like that process is at work in determining the ratio of health care expenditures to GNP. If that is the case, however, the contractionary phase has yet to be observed, despite all of the efforts since the 1960s at health care cost containment. Indeed, rising health care costs may trigger additional expenditures on other types of collateral benefits. It has been argued, for example, that “wellness” programs, employee assistance programs, and the like are a good investment for employers seeking to hold down the costs of their health care plans.²⁵ Research in this area has been limited, and claims of economic gains for employers are often made by advocates.

The sad fact is that it cannot be said on the basis of the empirical evidence that there is an equilibrium to the health expenditure/GNP ratio. There is even uncertainty about why individuals want health insurance, absent a tax subsidy. Is it just for the risk of catastrophic expenses? Or is there a “moral choice” element? It has been suggested, for example, that by having comprehensive insurance, individuals are spared having to trade off cost vs. benefit regarding possible treatments for loved ones. The moral choice—placing a value on someone’s life—is avoided if there is insurance available that will pay for whatever treatment is available.

Are There Cost Containment Solutions?

Researchers have generally shied away from offering wholesale solutions for rising health costs. Some researchers have made suggestions for improving particular elements of the system, e.g., malpractice litigation reform. Policymakers have also focused on specific system components. An obvious example is federal encouragement of health maintenance organizations (HMOs), beginning in the early 1970s. Under the original federal HMO Act, employers were required to offer an HMO option if they offered any health plan at all, assuming there was an HMO in their area. (Amendments to the Act adopted in 1988 relax various rules and will end the dual-choice requirement in 1995.)

HMOs offer health care through their own facilities (or contracted facilities) on a flat, monthly fee basis; they thus have

of risk assessment—such as genetic testing for disease susceptibility—no longer seem far off. Thus, if a mandated plan of employer-provided health care is adopted, it will almost certainly come with rules forbidding rejection of coverage on account of health status. However, unless financial transfers between insurance carriers are made (so that all employers pay a uniform premium based on average labor-force risks), there will then be temptation to discriminate in hiring against health risks. Obviously, such actions would work against other public policies such as nondiscrimination on the basis of handicap.²⁵

A New Health Insurance System?

In the late 1970s, predictions were often made that national health insurance would soon be adopted. In the late 1980s, the predictions shifted toward mandated, employer-provided health insurance. Obviously, such programs are more likely to be adopted at the national level by Democratic than Republican administrations. The 1991 *Economic Report of the President* (pp. 136-43) described the misincentives inherent in health insurance and blamed overregulation at the state level for inability of private insurers to offer a "bare-bones, low-cost" policy to the uninsured. But mandates were not suggested.

However, with large employers beginning to look favorably at a national plan, and with the AMA endorsing some kind of universal program, the federal political balance is moving toward a significant change in the national health system. And at the state level, it is quite possible that the political appeal of universal coverage could attract endorsements across the political spectrum.²⁶ Given these shifts, there is clearly a need for academics to add overall redesign of the health insurance and delivery system to their research agenda.

Pension Research

No review of pension research in the 1980s would be complete without formal reference to the major studies of pensions and retirement behavior sponsored by the National Bureau of Economic Research (NBER). Apart from the compendium of historical data noted earlier, several symposium volumes have appeared. In addition, current studies of pensions continue to appear in the NBER's important working paper series. The NBER's sponsorship

as examples. Thus, it is not surprising that enthusiasm for particular health care cost containment strategies would sweep the marketplace from time to time.

In part, the faddism in health care cost containment occurs because the findings of academic researchers regarding particular approaches are modest and qualified. And what academics actually know about cost containment does not necessarily reach the practitioner market. However, consultants selling cost-constraining strategies are unlikely to be modest or qualified about the promised results. And they have strong incentives to make themselves accessible.

Third-party payers (insurance companies, government authorities in programs such as Medicare) also have incentives to hold down expenditures. Private insurers who can offer given packages at lower cost will be naturally attractive to employers for the reasons just cited. And government agencies face budgetary constraints. One common method of cost containment is to control reimbursement schedules for providers. However, there is the potential for cost containments to work against one another or to shuffle costs to some outside party. Success by Medicare and Medicaid authorities in holding down costs for their patients may lead to cost shifting toward private patients and their insurers. But there are limits to this strategy, particularly if there are profit-making providers in the market who can refuse patients and who will tend to use marginal cost pricing. The costs are then pushed to local public hospitals (which cannot turn away patients) and, thereby, to local taxpayers.

Screening potential new hires for health risks is rational from the viewpoint of employers. Thus, firms may exclude new hires with preexisting conditions from their health plans. Apart from the anti-mobility effects this exclusion creates, it also has the effect of shifting costs directly to the new hire. In fact, even copayments and deductibles have that effect. While these devices may tend to overcome the effects of overinsurance, part of the way they save money is simply by transferring costs directly to the patient. The shifting effect by itself does not reduce the national health bill, although the behavioral effect might.

Since there are incentives to screen high-risk workers out of health plans, there will undoubtedly be pressures to limit employer ability to do so through new public policies. Futuristic possibilities

From the finance perspective, the felt need by Congress to compel employers to fund their pensions, and to protect workers from breaches in funding, is peculiar. The returns on assets properly accumulated in pension trusts are not subject to taxation. Hence, if anything, firms should want to overfund pensions to take advantage of the tax shelter (Tepper 1981). The problem should be to keep them from overfunding. Indeed, regulators have assumed that firms will want to overfund and have adopted tax regulations to prevent it. So why don't all employers automatically fully fund their pensions up to the legal limit?

One response has been that the existence of termination insurance makes it optimal to underfund and to shift some risk to the PBGC. The difficulty with this explanation is that it neglects the historical background of underfunding that originally led to the passage of ERISA. Before creation of the PBGC, firms should have been funding to the maximum allowed by tax law. But they weren't. Were managers trying to fool shareholders by accumulating pension liabilities that they thought could not be seen through the corporate veil? Apparently not, since pension liabilities seem to be reflected in stock prices (Feldstein and Seligman 1981).

Corporate restructuring in the 1980s added to the puzzle. So-called corporate raiders sometimes took "excess" assets from pension funds and used them for other purposes. Or incumbent managers might take such assets as part of a defense against a raid.²⁷ Pensions could be terminated and the employees given annuities which satisfied the legal requirements of ERISA but, for reasons discussed below, inflicted losses on employees. Possibly there was a transfer of wealth from workers to shareholders in such cases. But there is some evidence that premiums paid for firms that were taken over were larger than the asset reversion, suggesting that wealth transfer was but one of several motivations behind takeovers (Pontiff, Shleifer, and Weisbach 1990).

One interpretation that might be made of the underfunding puzzle is that it represents an efficient incentive plan for employees. In effect, the retirement fate of each worker is tied up with the economic performance of the firm. But firms have other, more direct options of providing such incentives—e.g., profit sharing. The potentially drastic consequence of the (pre-PBGC) underfunded pension as an incentive—you bet your (retirement) life on the company's health—makes the pension-as-clever-profit-sharing story dubious.

has attracted substantial attention of economists to the pension area, an interest which was reflected in the standard journals and books by other publishers.

Pensions raise issues apart from the usual concerns of labor economists and industrial relations researchers. They have an important financial side due to the large portfolios involved. The financial approach to pensions spilled into the benefit evaluation side of pensions, too. Modern finance is intimately connected with the study of risk. And pensions can be viewed as financial instruments dealing with risk, not just as saving plans. Beneficiaries are insured against the economic risk of living "too long" and thus exhausting their resources. In addition, the accumulation of pension assets has become an important form of saving. Thus, pensions must be viewed as significant components of the macro economy. And finally, of course, there is the view of pensions as a micro-level personnel practice with possible consequences for employee behavior.

The Financial View of Pensions

Although it may seem natural to Americans that defined-benefit pensions should be backed by pension trust funds, there are alternative ways of handling corporate pension liabilities. In Germany, for example, it is common practice for companies simply to carry a bookkeeping reserve of accrued pension liabilities for tax purposes but not to set up independent pension funds. The system can work so long as government and financial institutions effectively operate to avert major bankruptcies.

In the early days of pensions in the United States, unfunded plans were also not unusual. Formal pension trusts were commonplace, however, by the 1950s, but even then pensions were often not fully funded. And some pensions remained completely on a pay-as-you-go basis. Where trusts were used, but insufficient funding was applied, reserves might nevertheless mount as long as there were many more active workers than retirees. But should the firm go bankrupt, adequate funds to pay accrued pension liabilities might be lacking. "Horror stories" of elderly workers losing expected benefits were instrumental in the passage of ERISA in 1974. The new act established funding standards and created a federal agency, the Pension Benefit Guaranty Corporation (PBGC) to insure private pensions against termination.

In short, the underfunding of pensions is a puzzle unless corporate managers view pension promises more lightly than public policy would like them to. When unionized firms negotiated pensions in the late 1940s and 1950s, the defined-benefit form may have been chosen simply because it was compatible with immediate benefits to impending retirees. The long-term implications of pension promises may not have been fully appreciated. Firms at the time may have viewed these plans only as near-term promises to those close to retirement. They may not have seen them as absolute entitlements for workers whose retirements might lie 20 or more years in the future.

From the employer's perspective, fully funding those future retirements years in advance would have made the entitlements absolute. So, despite the tax advantages, firms may have been reluctant to make such contributions to trust funds. Even if unions did understand the long-term liabilities they were negotiating, they may have gone along with the limited-funding approach as part of a bargaining compromise. Unions obtained near-term retirement packages for their members. The future would be dealt with when it arrived.

This fuzzy commitment by employers toward pension payments is a messier view of the pension promise than many would like. But it may well be the actual answer to the underfunding mystery. Public employers, it should be noted, are not covered by ERISA and do not have to meet federal funding requirements. Underfunding of pensions by governments is a common practice, again suggesting that employers do not like ironclad commitments if they can be avoided.²⁸

Social Investment

Unions played a major role in the passage of ERISA. But apart from that effort, they showed little interest in pension investment strategy until the late 1970s when the idea of "social investment" began to take hold. It was argued that pension investment policy could be used to punish antiunion employers. Related to that idea was the possibility of using pension investment for other purposes such as pressuring American multinationals to withdraw from South Africa.

Such strategies do not fit well in standard economic analysis. In principle, "bad" firms could be punished only if divestment by

pension funds led to a decline in their stock prices. Unless most investors refrained from holding the stock of such firms, however, the main effect might be a portfolio shuffle; divesting social investors would sell the shares but other investors would purchase them, leaving stock prices unchanged. There certainly were portfolio reshuffles in the 1980s involving union-influenced and certain public employer pension funds. However, evidence has not been produced showing such policies reduced share prices.

Nonetheless, divestment strategies can be linked to public relations campaigns, protests at stockholder meetings, and support by pension trustees for positions and slates not favored by management. The general issue of corporate campaigns by unions was studied in the 1980s, but the particular effects of social investment could stand more research. It would be useful to disentangle the pure disinvestment threat effect from the impact of bad PR.

Closely related to social investment strategies were attempts to use pension funds to stimulate demand for union labor, particularly during periods of depressed labor markets. Pension investments were channeled in some cases to unionized construction projects. In principle, ERISA standards require that pension trustees not invest in projects with below-market returns.²⁹ And in theory, if the projects could produce market returns, they would not need to obtain loans from particular pension funds; other lenders would be happy to provide the funding. However, the range of returns observable in the market and the difficulty in assessing risk leave a range of discretion and the possibility of a hidden subsidy to favored projects. Again, it would be useful for researchers to examine cases of job creation via pensions. There are significant public policy issues here regarding permissible pension investment standards.

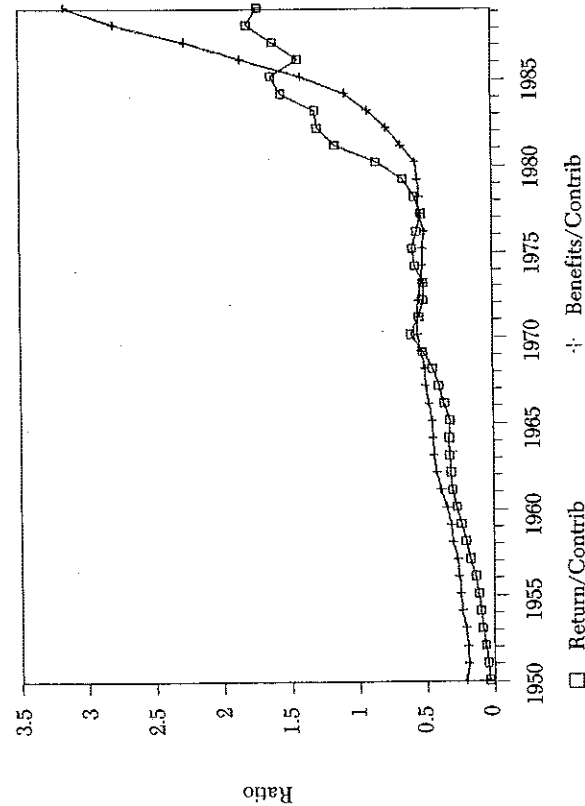
Pensions as Saving

The importance of pensions as a component of personal saving is often not well understood. Indeed, many people who look at the personal saving rate reported in the national income accounts probably do not realize that pension saving is included. In effect, pension saving is treated as merely another private decision by individuals despite the formal administrative arrangements surrounding pensions. This methodology is in keeping with a view that

saving via pensions substitutes perfectly for other forms of saving over which there is more direct individual control. It also assumes that any pension saving beyond the overall level the individual would undertake can be undone through borrowing. These assumptions are open to question.

Figure 1 shows a dramatic shift in the ratio of pension benefits paid out to contributions paid in during the 1980s. The sharp rise in the ratio was due to movements in both contributions and benefits. Returns on assets rose during the 1980s. In effect, as higher returns on assets pushed up funding ratios, employers cut back on contributions.³⁰ Nonetheless, Figure 1 shows that net pension saving (contributions + returns on assets - payouts) fell dramatically. The acceleration of benefit payouts was an important factor in the drop. While some of the benefit increase may have been due to a maturing of pension plan liabilities, much of it was due to cash distributions to relatively young workers. ERISA vesting standards may have played a role; with lower vesting standards workers who

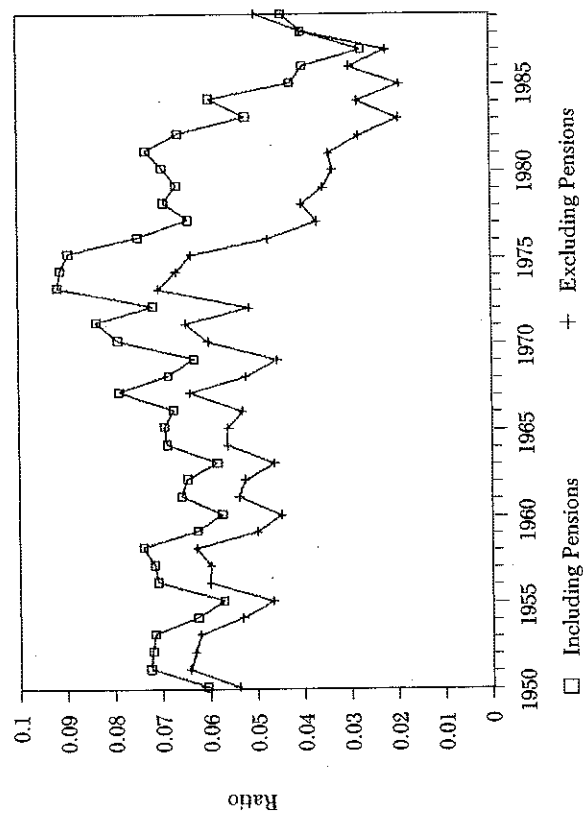
FIGURE 1
Ratios: Return on Assets/Contributions and
Benefits/Contributions



quit or were laid off were more likely to have some pension entitlement. In addition, termination and liquidation of defined-benefit pensions in the 1980s may have played a part in raising total pension distributions.

The intersection of the two lines on Figure 2 (showing saving including and excluding pensions) represents a drop from a net pension saving rate of close to 4 percent of personal disposable income down to zero by the late 1980s. However, the data of Figure 2 are only rough estimates of the actual movement.³¹ Nonetheless, as Figure 2 demonstrates, the removal of the estimated pension effect from the official personal saving rate changes the magnitude and timing of reported personal saving decisions. In particular, the drop in saving after the Reagan tax cuts in 1981 appears to have been largely concentrated in pensions. The tax cuts, it may be recalled, were supposed to stimulate private saving. While there is no sign of that, the cuts do not seem to have perversely reduced the saving directly controlled by individuals.³²

FIGURE 2
Personal Saving/Disposable Income Including and
Excluding Pension Saving



There has been some recognition of the pension-saving effect in the literature. However, the effect clearly deserves more study. Pension-saving behavior, for example, might have a bearing on the saving-interest rate elasticity or on the structure of interest rates. Finally, pensions and Social Security may have played an important role in the declining labor force participation of the elderly, especially males. Even if these programs had no effect overall on total saving, they tilt wealth toward an asset which can only be used by retiring or, in the case of a pension, at least quitting.³³ Moreover, the asset cannot generally be directly bequeathed (except to a spouse). Thus, the saving, finance, and labor force perspectives ultimately come together. Long-term macro policy relating to growth and productivity needs to take account of the pension effect.

Regulatory Issues

ERISA influences both the financial side of pensions and the benefit side. On the financial side, it establishes funding and investment standards and also creates a termination insurance mechanism through the PBGC. That the two should go together is fairly obvious (although perhaps not to those who deregulated savings and loans in the 1980s while continuing to insure their deposits!). Nonetheless, there are misincentives, particularly in the cases of firms near or in bankruptcy, to push their pension liabilities to the PBGC, the so-called PBGC "put."

Pension insurance began to show the same strains as deposit insurance in the 1980s. As liabilities are dumped at the PBGC, premiums for termination insurance are raised and regulations become more onerous. Thus, the decline in use of defined-benefit plans (which are insured) relative to defined-contribution plans (which are not) should not be surprising. Economists associated with the PBGC have looked, almost wistfully, at private solutions. Risk-adjusted premiums seem a logical solution but they do not appeal to Congress, in part because in the transition high premiums might push precariously perched plans over the edge.

Thus, the system has a dynamic towards more regulation and more discouragement of defined-benefit plans relative to defined contribution. For reasons unrelated to the PBGC's problems, such a shift would not necessarily be such a bad thing. It would deal with the labor mobility/pension portability issues discussed later.

On the benefit side, the most visible ERISA impact is on vesting. In 1986, the general vesting rule was cut by amendments to ERISA

from ten to five years.³⁴ This shift was a binding one for most defined-benefit plans, although many defined-contribution plans already met the rule. By itself, vesting might be expected to reduce the antimobility effects of pensions, although those employees just short of the vesting period standard might delay outward mobility until they qualified. But the effect is complex because, for older workers, being vested probably also means having significant potential equity in the plan. For the median worker, who won't be very senior, the amount that is vested (or will soon be vested) is quite small.³⁵ Hence, the pure impact of vesting is not likely by itself to be large.

Financial rules and benefits may come together in the case of funding standards and escalator clauses. Very few private defined-benefit pensions provide formal indexation of retiree benefits. Of course, relatively few active workers have formal indexation of their wages. Nonetheless, those that do are in the union sector, the home of the big expansion of defined-benefit plans in the 1950s. Indeed, the widespread use of escalation in the union sector came at about the same time that the pension expansion occurred. Hence, the lack of private pension escalator clauses is surprising.

State and local government pension plans, which are not covered by ERISA, often do have formal indexation. This public/private discrepancy suggests that ERISA may be a significant factor in holding down explicit pension escalation. Moreover, it is not unusual in private plans to give retirees ad hoc inflation adjustments from time to time, although these typically do not fully compensate for inflation.³⁶ Hence, there seems to be a worker demand for inflation protection in pensions (even though the Social Security portion of retirement income is indexed).

It appears that the nonuse of formal escalation avoids strict funding standards under ERISA. Making a practice of ad hoc adjustments requires no funding, so long as it is discretionary. Given that many employers seem to prefer not fully funding their pensions, an issue discussed earlier, lack of post-retirement pension escalation is probably linked to ERISA.

Employee Behavior

Implicit contract theory suggests looking at the employment relationship as an ongoing one. In one version of the theory, workers are "underpaid" at the beginning of the contract and "overpaid" at

the end (relative to productivity), as a kind of substitute for a performance bond. If workers do not perform to an adequate standard, they risk being terminated and losing the premium earnings later in their careers. At the end of their careers, since workers are overpaid, firms in this model will want to use a mandatory retirement rule to end the contract.

Within this framework, pensions fit in two ways. First, the value of the accruing pension benefit under a defined-benefit plan is typically a curve that slopes upward at an accelerating rate with tenure. Indeed, large capital losses face long-service workers who exit employment as they enter the final years of their careers. So, pensions could be the means by which the theoretical under- and overpayment is accomplished.

Second, mandatory retirement was made illegal for most workers in 1986. As a result, pensions could be used as substitutes for mandatory retirement rules by placing kinks in the benefit schedules at the desired retirement age. Indeed, workers who stay beyond normal retirement age in defined-benefit plans typically begin losing effective pension value. In short, there are various characteristics of pensions which seem to fit nicely into the implicit contracting model. A number of studies have been done suggesting that pensions are in fact part of implicit contracts.

There are two sides of the implicit contract to be looked at: the worker side and the employer side. Workers probably do look at their pensions as long-term commitments from the employer. A symptom of this view has been anger when, as part of corporate restructurings, pensions were terminated and workers given legally required substitute annuities. The legal requirement for funding and annuities is the shutdown value of the plan. In effect, the employer, to terminate a pension, is allowed to treat each employee as if he/she had suddenly quit. Those who are not vested receive nothing, even though many likely would have vested eventually. Those who were riding up the accelerating benefit curve associated with defined-benefit plans are knocked off before the curve peaks. In any implicit contract view, workers are shortchanged.

On the other hand, there is some question about how much workers know about their own pension plan provisions. Unions may increase workers' knowledge concerning pension entitlements, although evidence is unclear on this point. Still, it is a common complaint among personnel managers that workers do not

understand their benefits. Without clear knowledge, the implicit contract model's anti-shirking effect is compromised.

Defined-benefit pensions do have the effect of tying workers, especially as they approach early retirement age, to the firm. Despite vesting, the accelerating benefit curve means less-than-full portability. Is this immobility effect something employers really want? One response is simply to say that if they didn't want it, they would have used defined-contribution plans instead. Possibly. But it is also possible, as noted earlier, that the defined-benefit plans were installed in the past as a way of providing quick retirement incomes to those close to retirement, something hard to provide under defined-contribution plans. There may not have been clear planning about the future.

In this view, the antimobility and imperfect portability effects of defined-benefit pensions are merely side products of decisions made long ago. Indeed, both public and private employers finding themselves in need of downsizing in the 1980s often incurred the extra costs of compensating workers for the antimobility effects of their pensions by offering them expensive early retirement bonuses. Those who do retire early are as likely to have pensions, which often last until Social Security cuts in, as those who retire later. But most plans do not normally have such features, leaving workers to depend on ordinary savings, 401k withdrawals, and distributions from defined-contribution plans. Hence, creating special incentives for early retirement, even when there are early retirement options already in the plan, can be costly to firms.

The phenomenon of employers inducing early retirements voluntarily rather than simply laying off excess workers can be taken as a sign of an implicit contract. But the need to bribe workers to give up quasi-entitlements also illustrates the difficulty employers face in figuring out what incentives they will need over periods of 20 to 30 years. Employers may have a general stake in being viewed by workers as "fair"; offering early retirement incentives in place of layoffs may be part of maintaining that image. That is a long way, however, from the carefully targeted, career-based anti-shirking pension postulated in the implicit contract model.

Similarly, firms may have used mandatory retirement rules in the past, and may now use pensions that decline in value after normal retirement age, simply to avoid the unpleasantness of sacking older workers. It's tough to look old Harry in the eye and

starts with known stylized facts, econometric techniques cannot be counted on to sort out which models are correct.

In the future researchers will need to talk more with practitioners. Even complex models usually have simple enough starting assumptions and/or implications to be communicated to practitioners for a reality check. The asking of practitioners what they are doing, and why, can no longer be scorned as a research tool. Examination of historical evidence and responses of other countries to similar problems is also necessary.

At the same time, practitioners in the human resource field need to begin thinking more rigorously about their own policies. Too many dollars are at risk to do otherwise. Perhaps personnel managers didn't design pensions with specific behavioral effects in mind. But such effects occur and they need to be considered. Why, for example, set up benefit systems that impede mobility when, in an era of economic instability, the ability to shed employees may be crucial?

The same is true for policymakers. They need to look at consequences of programs and rules. Academics can help in that endeavor. Is it really surprising that the PBGC is running into financial difficulties when the law creates incentives for employers to dump their pension liabilities? Were such outcomes impossible to foresee in 1974 when ERISA was passed? If small employers are added by legal mandate to the patchwork of employer-provided health plans, will that not add to the demand for medical services? If so, what is the implication for health care cost containment? And what should be done about it?

Finally, the U.S. benefit system must be viewed as a whole. Efforts to solve problems on a one-by-one basis miss the big picture. The employment relationship is changing; in the future it is likely to look more like a spot market and less like an implicit, long-term contract. In a world of corporate restructuring, exchange rate shifts, and deregulated competition, employees are put at excess risk if their health care and retirement income is tied to the fate and beneficence of a single employer.

Social insurance schemes, which are portable, fit well into this new economic order. Company-specific benefits, when they are not fully portable, do not. The latter can be made more portable through appropriate public policies. Moves are being made in some European countries to achieve this objective. The United States needs to begin moving in the same direction.

tell him that his performance appraisal ratings are down and it's time to go. It is even tougher if Harry strikes back with an age discrimination suit. Recourse to elaborate models of career under- and overpayment may not be needed to explain pension retirement incentives.

What Is Needed in the Future?

More than anything else, research in the social insurance and benefits area in the future needs a check on reality, relevance, and need. As an example, models of the effect of Social Security on saving behavior continued in the 1980s to treat the system as if it were pay-as-you-go long after it began accumulating large reserves for the impending retirement of the baby boom. Unemployment insurance researchers continued to produce a fountain of papers on the potential impact of UI on unemployment duration. Yet the more critical issues for the UI system in the 1980s had to do with funding and coverage. Unfortunately, there seems to be no way of calling a moratorium on lines of research that have reached diminishing returns.

Research in the social insurance and benefits area during the 1980s resembled research in other aspects of economics and industrial relations. Models became more sophisticated. Researchers became more willing to consider issues which had previously been left to practitioners. All of that was to the good.

But economics also faced a crisis in the 1980s, the outlines of which are still only dimly perceived. At one time, the simple textbook model of the firm, worker, and consumer was just that—simple. It started with a few strong assumptions about rationality and proceeded in a context of frictionless markets and perfect information to strong conclusions. Sometimes the conclusions seemed silly. Economists were not naive, however, they just did not have the mathematical skills needed to play with more complicated approaches.

Now that phase in economic research has ended. And it turns out that rationality is not very constraining. The recipe is simple: add an information cost here, a menu cost there, and a transactions cost somewhere else. Stir in some market imperfections and uncertainty. Virtually any observed outcome can then be explained as a rational response. The problem, therefore, is not insufficient modeling, but too many plausible models. And since empirical investigation often

Endnotes

¹ Due to space limitations, citations throughout this chapter to literature in the field are kept to a minimum. Apologies are therefore due to the many authors who contributed to the literature in the social insurance and benefits area but whose names are not cited. An earlier version of this chapter is available from the author with full citations. Please request "Social Insurance and Benefits," working paper no. 201, UCLA Institute of Industrial Relations, 1991.

² The Chamber of Commerce of the United States has for many years published a survey of benefit costs. After the U.S. Bureau of Labor Statistics discontinued a similar survey in the late 1970s, the Chamber of Commerce survey was often cited regarding such costs. Unfortunately, it is difficult to obtain information concerning the Chamber's sampling practices. And the data are not readily made available to researchers. Thus, academic researchers have more typically used data from the Current Population Survey or from tax-related records of the Internal Revenue Service.

³ Source: BLS, press release, USDL 91-260, Washington, D.C., June 10, 1991.

⁴ The ceiling on UI is much lower than for Social Security. With lower turnover, there will be less tax liability since the probability that an employee will work long enough to hit the ceiling increases. Characteristics associated with low turnover (large size, unionization) will tend to reduce UI and, to a lesser extent, Social Security costs.

⁵ Pension plan administration has also been found to exhibit economies of scale. See Andrews (1989), pp. 78-81. Note that smaller firms may be more likely than others to have minimum-wage workers who by law cannot absorb the incidence of health insurance costs.

⁶ Some researchers have argued that if the tax subsidy were eliminated, the impact would be relatively modest. The difficulty is that once an employer-provided system has been put in place for many years, the immediate effect of a subsidy withdrawal might well be small. But this need not mean that the impact of the subsidy in creating the system was modest. Moreover, the kind of offering might well be different. In Britain, where no tax subsidy is available for private employer-provided insurance, those employers who do offer plans do so on a take-it-or-leave-it basis, typically for higher income employees.

⁷ Although the UI system was created originally to be federal legislation, each state has its own set of laws and administrative procedures. Workers' compensation is almost entirely a state-run system.

⁸ Examples include a Bush administration initiative to enhance pension portability in 1991 (the "POWER" proposal) and so-called "COBRA" rules adopted in the 1980s allowing continuation of health benefits (at employee expense) after layoff.

⁹ The U.S. Department of Labor filed suit in 1991 attempting to force employers who terminated defined-benefit plans and replaced them with annuities to take responsibility for the failure of bankrupt insurance carriers to service these annuities.

¹⁰ Perhaps the worst example of this instability was the enactment and then repeal of Section 89 of the Internal Revenue Code in the late 1980s. Section 89 was supposed to spread benefits to lower-paid workers and certain part-timers. Note, however, that instability has also been found at times in public policy regarding government-provided social insurance. During the 1980s, a major initiative in catastrophic health coverage for the elderly under Medicare was enacted and then repealed.

¹¹ Higher income workers will tend to receive relatively less from Social Security and more from their private pensions than lower income workers. This shift in mix is due to the tilt toward the lower paid in Social Security benefit schedules and to the integration of private pensions with Social Security. For data, see BLS (1990), p. 96.

¹² However, employers can now use salary reduction options largely to negate the distinction. Smaller employers are often unaware of this possibility.

¹³ The modern prevalence of employer-provided plans—and the tilt in the tax code toward such plans—makes it difficult for the AFL-CIO to offer competing benefits. However, it can offer such items as discount credit cards that have no tax significance and thus are not generally offered by employers.

¹⁴ Private unemployment insurance systems could not easily cope with systematic risk, such as depressions, through diversification. Hence, it is not surprising that private efforts failed. It is possible, however, simply to save sufficient resources so that the consequences of major layoffs can be financed. A possible analogy outside the labor market is insurance for risks such as earthquakes and other natural catastrophes.

¹⁵ The term "high commitment" should not be taken to imply any company interest in worker participation in decision making. Indeed, only one of the 50 firms had an employee representation plan.

¹⁶ Thus, one telephone company said it provided lunches to its operators so that they would not have indigestion from their own poorly selected meals and thus would not inflict wrong numbers on callers in the afternoon.

¹⁷ It might be argued that the use of special early retirement options in pensions in firms trying to downsize in the 1980s disproves Lazear's argument. However, such ad hoc arrangements arose, in part, because pension planners originally failed to appreciate how much of a lock-in effect their programs had on employees. Pension planners appear to be able to correct past mistakes; it is less clear that they anticipate them.

¹⁸ Several states created commissions to study the issue and make recommendations regarding the establishment of a state plan. The verdicts of these commissions varied from positive to negative, but no state plans were created.

¹⁹ This reversal of position may have stemmed in part from a reading of public opinion and a sense that it would be better to influence whatever changes were coming rather than oppose them. The AMA's own polling efforts suggested considerable support for a universal system of health insurance.

²⁰ The idea that having to report retiree health care liabilities on the balance sheet causes businesses to withdraw such benefits does not comport with notions of perfect financial markets. Mere balance sheet reporting should not affect market valuation if market transactors already knew of the liabilities. To the extent that reporting standards are a factor, therefore, models of markets based on perfect assumption are called into question. About five million retired workers, mainly from large firms, were estimated to have retiree health plans in 1990. However, the number expected to draw such benefits (unless they are cancelled) was expected to grow rapidly (U.S. General Accounting Office, 1990).

²¹ It has been noted that high-income countries may require more expenditure to produce a given amount of curing. Hence, the curing vs. caring conclusion may not be appropriately drawn from cross-national data.

²² Source: U.S. Department of Health and Human Services (1991), p. 184.

²³ Health status is known to have significant effects on labor supply. Thus, in some cases, it might be argued that employers have an incentive to invest in providing health insurance to their employees to keep them healthy. This point is not evident, however, since presumably it would pay the employee to make the investment to avoid costly periods of absence or nonparticipation in the work force.

²⁴ However, firms do not have the same incentives to seek remedies that would lower costs across all employers since no competitive advantage is then derived.

²⁵ There is not much research available on differential health care costs by sex. Some research suggests that women's health expenditures substantially exceed men's, although some of this differential is said to be due to men's substitution of home care (by their spouses) for market-provided medical care. However, women in the work force are more similar to men in the work force than all women are to all men regarding health service usage. More work is needed in this area to determine the potential for sex-based discrimination on the basis of health care costs, especially as occupational segregation diminishes.

²⁶ The administration of conservative Republican Governor George Deukmejian in California began publicly exploring mandated health care in 1990. The governor pulled back from the plan when opposition began to arise. However, polls at the time suggested that the proposal would have been quite popular.

²⁷ The employees might have been given an ESOP in place of a pension; ESOP shares might then dilute the proportion of outstanding shares held by the raider. Changes in the law have now made it more difficult than it was in the 1980s for firms to terminate pensions and capture the excess funding.

²⁸ Of course, public employers receive no tax benefits from placing assets in a pension trust.

²⁹ There have been cases in which the U.S. Department of Labor has challenged what it considered to be sweetheart arrangements between developers and construction union pension funds.

³⁰ Earnings are imputed by summing the difference between contributions and benefits since 1948 and applying the yearly AAA corporate bond yield to estimate the rate of the return on the pension asset stock.

³¹ The roughness of the estimate comes from the procedure used to determine pension earnings. See the previous note for details.

³² Again, the reader is reminded that the separation of individual from pension saving violates the (questionable) notion that the two are perfect substitutes and that individuals can offset pension decisions.

³³ Social Security "taxes" earnings of retirees aged 62-69 beyond a limited level, thus restricting labor supply.

³⁴ Multiemployer plans have a laxer standard. In 1991, the Bush administration proposed bringing them under the same five-year rule.

³⁵ Median (interrupted) tenure on the job in 1987 was 4.2 years. Source: BLS, press release, USDL 87-452, Washington, D.C., October 22, 1987.

³⁶ Social Security benefits are indexed. So retirees will receive partial escalation of their total retirement incomes (Social Security + pension) even in the absence of ad hoc pension inflation adjustments.

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IRRA, 1992