

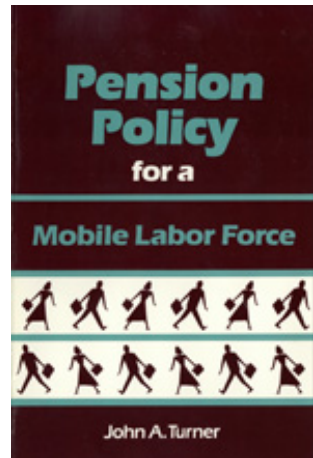
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# Job Mobility and Pension Portability

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# I

## **Job Mobility and Pension Portability**

**M**ovement and change enliven American culture. Nowhere is that more evident than in the labor market. But employers create a conflict between job mobility and retirement security when they cut future pension benefits for workers who quit a job before reaching retirement age. Presumably, employers do this to discourage workers from changing jobs.

Neither U.S. workers nor employers commit to a lifetime contract. After several early-career job changes, however, workers often do stay permanently with one employer. Once they reach age 40, one of two male and one of four female workers remain on the same job until retirement 20 to 25 years later (Quinn, Burkhauser, and Myers 1990, p. 34). Jobs with pensions promote even more job stability, especially for women.

Job change contributes to an efficient labor market, increasing market flexibility and aiding economic growth and competitiveness. Pensions, conversely, bind workers to jobs, and possibly allocate resources inefficiently. Employers, some argue, should be encouraged to restructure pension plans so that they no longer discourage workers from changing jobs. Need for such restructuring is heightened by the aging of the U.S. workforce, since job mobility declines as workers grow older.

Many employers favor little job change, however, preferring a stable workforce. Longevity is the benefit employers expect in exchange for their investment in worker skills. Workers do leave jobs, however. They quit for personal or family reasons, such as the relocation of a spouse or the need to care for a child or an elderly parent, or they are laid off—frequently for reasons beyond their control.

## HISTORY OF U.S. PENSIONS

A brief history of pension coverage in the United States provides background for the discussion of pension portability. Private pension plans began during the last quarter of the nineteenth century.<sup>1</sup> By 1930 many large employers, including AT&T, General Electric, and DuPont, had pension plans. The number of plans stopped growing during the Depression, but resumed growth in the 1940s. From 1940 to 1972 pension coverage of full-time workers rose from 17 to 52 percent.

Pension coverage grew through 1970 due to union collective bargaining in retail, construction, manufacturing, transportation, and mining industries. In industries with many small unionized firms, multiemployer defined benefit plans administered jointly by a union and an employer-appointed board of trustees are the most common plan type. Large unionized firms typically have defined benefit plans, as well.

Since the early 1970s pension coverage has fallen slightly, and basic coverage has shifted from defined benefit toward defined contribution plans. Firms also increasingly have provided defined contribution plans to supplement benefits for workers already covered by a defined benefit plan.

Defined contribution plans covered one-third of the workers in plans started before 1975, but they have covered four-fifths of the workers in plans started after 1975. In 1975, 78 percent of the participants in pension plans were in primary defined benefit plans. By 1989 that number had fallen to 64 percent, and a projection suggests that by 2000 the figure will have fallen to 51 percent (Hay/Huggins 1990a).

Pension coverage changes since the early 1970s have been due largely to changes in the labor force. Coverage remains high among large firms and among unionized firms. Such firms are employing a falling share of the labor force, however, and employment has grown rapidly in small nonunionized firms in service industries. Pension coverage has always been low among workers in these firms.

The fastest growing industries from 1979 to 1988 were services and specifically finance, insurance, and real estate. Pension coverage rates also rose most rapidly in those groups: from 30 to 38 percent for service industry workers, and from 54 to 59 percent for finance, insur-

ance, and real estate workers. Those industry coverage gains offset somewhat a drop in workers employed in manufacturing, where coverage had been high. The large shift in jobs to the service sector, however, with its below-average coverage rate, depressed pension coverage rates.

## PRIVATE PENSIONS AND JOB CHANGE

When private pensions were started in the late 1800s, firms used them to charitably retire older workers whose productivity was waning. The plans also helped maintain a loyal workforce. Firms frequently did not provide pensions to “early leavers”—workers leaving before retirement.

Expectations have changed. Workers now commonly view pensions as deferred pay that even short-tenure employees have a right to accrue. These expectations, plus concern about retirement income adequacy, make pension benefit loss incurred by job leavers a public policy issue affecting the majority of the workforce. In 1988, 68 percent of males and 51 percent of females working full time were in a private pension plan in either their current or a past job. Of all full-time workers with over 15 years on their current job, 78 percent had participated in a pension in a current or past job. Twenty-three percent of full-time workers age 45 to 54 had been in a pension plan on a prior job (Piacentini 1990b).

Worker myopia when changing jobs may cause low retirement income. Due to the growth of defined contribution plans, which commonly allow job leavers to cash out, employers frequently pay preretirement lump sums to departing employees. In the late 1980s, 60 percent of vested job leavers received at least partial lump sum cash-outs of their pension benefits. Fifty-one percent of vested job leavers received lump sum benefits for their entire pension (Piacentini 1990b).

Because so many job leavers cash out their pensions, some policy-makers argue that federal law on pension policy should lock-in pension benefits. When workers and employers do not react to this restriction by reducing the generosity of plans, locking-in pension benefits raises net savings in pensions. Higher savings via pensions not offset by a fall in other savings raise gross individual and national savings.

Because pensions often reward long tenure through various plan features, and because there is little or no portability, job leavers frequently end up with lower benefits than job stayers, even when they do not cash out their pensions. Consider two workers with equal incomes through their careers. Worker A spends his/her career with one employer, while worker B changes employers several times. Worker A will receive a much larger pension than B, even if B's employers had pension plans identical to those of A. The benefits differ solely due to B having changed jobs.

### **PENSION REFORM FOR A MOBILE LABOR FORCE**

Three labor market changes form the background against which pension reform is considered. First, intermittent workers have difficulty accumulating adequate retirement income. With more women entering the workforce, federal retirement income policy is challenged by some women's small retirement incomes due to their discontinuous work histories. Also, workers in some industries have high job turnover, making it less likely that they will accumulate sufficient pension benefits to ensure adequate retirement income.

Second, social security expansion has ended, and a slight contraction is predicted. Social security is projected to pay less generous benefits relative to earnings during the early part of the twenty-first century (Doescher and Turner 1988). This places pressure on private pensions and individual savings to raise retirement income in order to offset the contraction. Third, jobs have shifted to economic sectors having low pension coverage rates and relying less on defined benefit plans. These changes affect the options available to job leavers who are covered by a pension.

#### **Defined Contribution and Defined Benefit Plans**

To understand pension policy, one must understand the basic ways defined contribution and defined benefit plans differ. Defined contribution plans allocate employer contributions to individual accounts like savings or mutual funds accounts. Such plans require employers to contribute a fixed share of pay or allow employers to vary contribu-

tions (as in a profit-sharing plan). Defined contribution plans may accept worker contributions, and often require them as a condition for matching employer contributions. Assets are typically pooled for investing. Investment gains and losses are allocated *pro rata* to worker accounts, and the worker bears the investment risk. In these plans, a worker's pension benefit at retirement equals the accumulated contributions plus investment earnings and losses allocated to the account. The employer may pay the account balance to the worker as a lump sum, pay it out over a period of time, or use it to purchase an annuity paying benefits for a specified period, like 20 years, or for life.

Defined benefit plans promise a retirement benefit figured by a formula, which usually includes earnings and tenure. The formula, for example, might be \$20 a month times years of tenure with the employer, or it might be 1 percent of final salary times tenure. In defined benefit plans, the employer must make contributions—figured by an actuary under government regulation—sufficient to fund the promised benefits. When investment earnings fall short of promised benefits, the employer is financially responsible for the shortfall. Pension beneficiaries may share risk, however, by receiving smaller cost-of-living increases when the firm or the plan does poorly.

### **Effects of Benefit Loss from Job Change**

When job leavers lose pension benefits they also lose tax benefits afforded by pensions. This raises questions about tax equity. Should tax benefits reward job tenure? Because long job tenure has been more common among men than women, does this policy discriminate against women?

Pension benefit loss deters workers from changing jobs or careers. The “golden handcuff” effect may lower economic efficiency by preventing workers from moving to their most productive job situation. This problem may be critical in declining industries that need to shrink but have tied workers to jobs by pensions. Similarly, if pensions have inhibited job change, they have hampered the labor market's ability to adjust.

Rather than worrying about golden handcuffs, however, some analysts are concerned about short job tenure. They argue that Japanese lifetime jobs encourage employers and workers to invest in worker

productivity. Long tenure with an employer may be needed to recoup the investment from job-specific training. Thus, while both training and eliminating barriers to worker mobility are critical for fully using U.S. human resources, the goals conflict.

### **Pension Portability**

Pension portability has been defined as the capacity to carry pension benefits from one job to the next. It has been closely linked to preserving vested benefits when a worker ends a job before retirement. The portability concept has recently been expanded to include accrued but unvested benefits. Of more importance, analysts have recognized that even when vested, job leavers' benefits erode in value due to inflation, reducing the real value of vested pension benefits; thus, the portability concept has expanded to mean preserving the real value of pension benefits when a worker ends a job before retirement.<sup>2</sup> Portability loss is the shortfall of actual retirement benefits from benefits that would have been paid had the worker not changed jobs.

Pension portability is achieved in three ways: through portability of benefits, service, or assets. Benefits are portable when the worker has a vested right to accrued benefits. With vesting, a worker changes jobs without losing nominal pension benefits, but the benefits can erode in real value due to inflation. Service is portable when years of service under a prior employer's plan count in figuring pension benefits with a new employer. Service portability is found in multiemployer plans, but also could be achieved by wage or price indexing the benefits of job leavers. These options reduce real benefit loss for workers changing jobs.

Pension assets are portable when the worker receives a cash distribution of accrued benefits and rolls it over to an Individual Retirement Account (IRA) or another employer-provided pension plan. Asset portability is commonly available in defined contribution plans, and is increasingly available in defined benefit plans. Asset portability is often called "preservation" because the rollover or interplan transfer preserves preretirement cashouts as retirement savings.

Corresponding to the three avenues to pension portability, there are three ways a job leaver may lose pension benefits. First, workers lose benefits by not having worked long enough to vest (deferred vesting).

Second, workers lose benefits because plans offer lower benefits for workers who quit before retirement (design aspects of pension plans). This loss includes those cases where employers base cost-of-living adjustments on tenure. Third, workers lose benefits by treating the pension plan as severance pay rather than a retirement plan (consuming benefits before retirement). All three losses may be the result of a voluntary decision to change jobs or may be due to a layoff.

Legislative changes requiring vesting after five years for most workers have reduced portability losses incurred from nonvesting. Approximately one-third of the remaining portability losses are due to other aspects of plan design, while two-thirds are due to workers cashing out benefits before they retire. Options for reducing portability losses due to plan design, on the one hand, and worker behavior, on the other, would distribute benefit costs differently. Plan design options could be expected to raise benefits accrued by short-term workers. Worker behavior options, by contrast, do not affect accrued benefits, but influence what workers do with these benefits.

Other countries have reduced pension portability losses more than the United States. Such policies include shorter vesting (Canada), a government or private clearinghouse for job leaver benefits (Netherlands, Japan), indexed benefits in defined benefit plans for workers quitting prior to retirement (United Kingdom), and a ban on lump sum payments to job leavers (Netherlands, Canada).

In 1972, Dan McGill wrote a book analyzing U.S. pension portability and focusing largely on pension vesting. When McGill wrote, non-vesting caused a major share of portability losses. Since 1972, the U.S. pension system has changed dramatically. The Employee Retirement Income Security Act of 1974 (ERISA) set minimum vesting standards which have since been tightened; now most workers vest within five years in a private pension plan.

Pension analysts have increasingly realized that vested workers lose benefits by changing jobs, however, and that those losses greatly reduce the benefit protection that vesting was thought to provide. Though pension portability has been an issue for many years, the remarkable changes in the U.S. pension system, the changes in the U.S. labor market, and better understanding of pension economics have raised the portability issues this book addresses.



## OUTLINE OF THE BOOK

This book analyzes what happens to the pension benefits of workers who quit or are laid off jobs. Presenting empirical evidence wherever possible, the book progresses from an overview to an informal analysis using simple logic and descriptive data, then proceeds to a more formal analysis using economic theory and econometric studies.

The first six chapters of the book describe why pension benefit losses are a significant problem and examines the number of workers affected and the amount of loss they incur. As background on quits and layoffs, chapter 2 portrays a labor market undergoing changes that often result in reductions in retirement benefits. Chapter 3 further describes job change by examining data on individual workers, and the particular impact of mobility on women's pension benefits. Job mobility often reduces future pension benefits, and chapter 4 investigates the size of these losses. Chapter 5 examines receipt and subsequent use of preretirement lump sum distributions, which constitute two-thirds of portability losses. Chapter 6 discusses issues concerning the pension benefits of laid-off workers.

Chapters 7 through 12 analyze possible policy responses to the pension benefit loss of job changers. Chapter 7 describes pension plan features that already reduce portability losses. Chapter 8 debates the pros and cons of pension portability reform in five areas: equity, tax and budget policy, regulation, economic effects, and financial responsibility. Chapter 9 describes and evaluates policy options designed to reduce portability losses. Chapter 10 examines how policies mandating portability would affect employers and workers. It also surveys studies relating pensions and job change, because some portability policies may increase job change. Chapter 11 examines the role of layoffs in portability losses. Chapter 12 discusses policies towards pension portability in Canada, Japan, the Netherlands, and the United Kingdom. These countries have pension systems similar to that of the United States, yet each has dealt differently with portability. Chapter 13 concludes the book with a selective list of policies that would reduce the pension benefit losses of job changers.

Several issues related to pension portability have been omitted from the discussion. The first is greater pension coverage. While it would

further a goal of portability—to raise retirement benefits—it is not itself a portability issue. The second is pension loss when a plan ends. Like the loss when a worker separates from an employer, some policies for dealing with those losses—such as indexing benefits—are the same. But as with coverage, considering these issues would greatly expand the book. The third issue is firm-initiated early retirement for older workers. Though not considered here, many pension issues for these older workers are the same as those for younger workers facing a layoff. The fourth omitted issue is pension portability in the public sector. The book deals only with the private sector, although public sector workers face similar pension issues.

## NOTES

1. Much of the discussion of pension coverage is based on Beller and Lawrence (1992).

2. Some analysts define portability more narrowly, distinguishing the ability to transfer benefit rights between jobs from the preservation of real vested benefit rights with a former employer.