# Safe and Sound



# A Ten-Year Plan for Promoting Personal Financial Security

# **An Employer Perspective**

June 2004



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## Foreword

The long-term public policy strategic plan that appears on the following pages is the culmination of two years of intensive research, meetings and deliberations undertaken by the American Benefits Council, under the leadership of a special task force of our Board of Directors and with the input of the membership-at-large and many others. The time spent in its development was certainly appropriate, since its purpose is to establish health and retirement policy goals to be achieved over the next 10 years.

In early 2002, the American Benefits Council's Board of Directors unanimously voted to proceed in the development of a long-term plan for restructuring the employee benefits system. The Board recognized that as an organization we will continue to be engaged in numerous short-term legislative, regulatory and judicial efforts to improve the voluntary, private sector employee benefits system. However, the Board also felt that it is both the responsibility, as well as the traditional role, of our organization to help public policymakers develop a longer term vision of how the health and retirement benefits systems could be improved and reformed.

In late 2003, the Board of Directors unanimously adopted this long-term public policy strategic plan, *Safe and Sound: A Ten-Year Plan for Promoting Personal Financial Security.* 

There are many noteworthy aspects of this strategic plan.

- It assembles in one document perhaps one of the most comprehensive analyses available of the dimensions of the health, retirement and demographic challenges facing our nation. We hope employers, scholars and public policymakers alike find the report, and its extensive appendices, to be a treasure trove of valuable information and analysis.
- It looks at health, retirement and equity ownership in the context of how they can and should fulfill the need for *personal financial security* — a concept that is central to the themes developed in this report.
- It describes the respective roles that must be played by all the key stakeholders in ensuring a sustainable employee benefits system. It focuses in particular on the shared efforts to be expected of the three key stakeholders — individuals, employers and the government.
- Although the plan outlines the enhanced future role and greater responsibilities of individuals in ensuring personal financial security, it does not envision or advocate that employers or government will do less. Rather, the challenges that lie ahead are so enormous that *all* stakeholders will have to do even more in the future to ensure personal financial security than they are doing now. However, part of what employers and government will be doing will be to help individuals more effectively ensure their health and retirement security.

- In each of the four areas that the strategic plan addresses future retirement systems, future health care systems for active employees, future retiree health and long-term care systems and future stock plans we have set forth a vision statement that directly explains the opportunities and expectations for the main stakeholders in the system.
- The American Benefits Council was determined that this strategic plan should be action oriented and that its results should be measurable. Accordingly, we have done what few public policy strategic plans have been willing to do: establish precise numeric goals to be achieved by a specific date. Each of the strategic plan's nine goals is accompanied by an extensive "context" description so that readers and public policymakers can understand how and why each of the goals was selected. In addition, the context provides a baseline from which the fulfillment of the objectives by the year 2014 goal can be measured.
- The American Benefits Council did not think it was appropriate to set goals without also suggesting how they can be achieved. So following each one we have set forth initial policy recommendations that are intended to help accomplish the goals. As the strategic plan makes clear, these recommendations alone may not achieve each of these objectives, but several of the recommendations will actually help meet multiple goals.

- Moreover, the American Benefits Council will not simply sit back and assume that our work is done. We will continue to develop additional recommendations, and evaluate ideas from other groups and lawmakers.
- In establishing the goals and the corresponding recommendations we have attempted to be both bold and pragmatic at the same time. The goals are, we believe, visionary and admittedly not easy to accomplish, because the challenges that lie ahead are truly daunting. Yet, with the collective efforts of many and a determination born of the realization that the stakes are so high that the nation can not afford to fail, we also believe that the goals are attainable. Particularly in the development of the health care goals and recommendations we note that past attempts to completely reshape the health system have utterly failed. Thus, we have focused on steps that have a reasonable chance of being adopted and, if so, can make a dramatically positive difference in the health system.

This strategic plan presents a decidedly employer perspective on the challenges and the possible solutions, because the American Benefits Council represents its employer members. But we have genuinely attempted to avoid making this document merely an employer "wish list." Throughout the report we have aimed to be forthright about the expectations of ourselves as well as other stakeholders in the system. That raises the important question of how we expect this strategic plan to be used.

First and foremost, of course, it will serve as a guide to the American Benefits Council in further refining the details of the policy recommendations set forth here and in developing additional proposals. It will also serve as a template against which to assess proposals from other organizations and policymakers.

In addition, however, since we have been straightforward about the expectations of employers, we hope and intend that this plan will be appealing to other stakeholders as well, since it sets forth what they, too, can do to help ensure Americans' personal financial security.

One thing is certain: it will be difficult enough to meet the challenges presented by an aging society and solve the serious problems manifested in our health care and retirement systems even if all interested parties work together collaboratively. It will be absolutely impossible to succeed if we do not face the challenges and work together. Consequently, whether our society pursues the goals and recommendations described in this report, or in others' strategic plans, an honest dialogue and sincere effort to forge consensus will be essential.

This strategic plan is a work-in-progress in that we will periodically review it to determine if we are ahead or behind schedule in reaching our goals. On virtually all of the goals, progress must start immediately, because our nation simply can not wait 10 years to begin to see improvements in various aspects of health, retirement and equity ownership policy. As appropriate, the American Benefits Council's policy committees and Board of Directors may propose adjustments to the strategies based upon developments — hopefully positive ones — in public policy and employee benefits practices.

Without decisive action, our nation's already seriously troubled health and retirement systems are headed for a major crisis. Recognizing this, the American Benefits Council sets forth this strategic plan as a blueprint for change. We are optimistic that if the goals articulated here are achieved, then by the year 2014 the United States will have an employee benefits system that is *Safe and Sound*.

James a. Klein

James A. Klein President

American Benefits Council

June 2004

## THE AMERICAN BENEFITS COUNCIL

The American Benefits Council is the national trade association for companies concerned about federal legislation and regulations affecting all aspects of the nation's employee benefits system. The Council's members represent the entire spectrum of the private employee benefits community. They either sponsor directly or administer retirement and health plans covering more than 100 million Americans. Representing professionals in the benefits field, the Council regularly serves as both a strategic and a technical resource on benefits issues for lawmakers, the media and other industry trade associations. It is an active participant as a "friend of the court" in judicial cases affecting benefits. As such, the Council is uniquely positioned to propose and articulate a long-term vision and road map for the promotion of personal financial security and to identify the role employer-based plans can play in helping to achieve this goal.

### ACKNOWLEDGMENTS

The development of this strategic plan is the result of countless hours of efforts by many dedicated individuals.

The idea for a long-term public policy strategic plan was first conceived when Steve O'Neill, Cooper Industries, served as Chair of the American Benefits Council Board of Directors. Work on the plan occurred during the two-year period that Carol Kelly, AdvaMed, and then Chip Howden, Southern Company, each served as Chair of the Board of Directors. Formal release of the completed plan is now taking place during the term of Mike Harrison, Avaya, as the new Chair of the Board. All four of these individuals have provided leadership and dedication to ensuring a continued focus on this important initiative.

Collectively, the Board of Directors deserves enormous recognition for its willingness to devote so much time at numerous Board meetings to review and discuss both the policy direction and substance of the plan. The Board continually challenged, encouraged and ultimately unanimously endorsed the work of the task force that was principally responsible for envisioning and developing this report. The members of the task force held numerous in-person meetings, conference calls, and sub-group sessions to work on different elements of the plan and they drafted and exchanged countless documents.

The group included: Task Force Chair, Steve O'Neill, *Cooper Industries*; Frank DiBernardino, *Vienna HCA*; Kathy

Gubanich, Vanguard Group (and Chair of the Council's Health Policy Committee); Randy Hardock, Davis & Harman; Chip Howden, Southern Company; Randy Johnson, Motorola (and Chair of the Council's Retirement and Investment Policy Committee); Melissa Kahn, MetLife; Bob Krinsky, Segal Company; and Mike Ryan, Towers Perrin. For all the thousands of words that now comprise this report, there simply are not enough words, nor adequate ones, to express the dedication of these volunteers to making sure that the American Benefits Council would produce a long-term public policy strategic plan that can make a real difference in elevating the dialogue of, and leading to the enactment of, sound employee benefits policy.

Three individuals from Towers Perrin added great value to the work of the task force. Kathryn Abernethy served as the facilitator of the group's work during its initial phase and helped us chart and then stay on course. She was succeeded by Mike Ryan who masterfully handled dual duties as a task force member and facilitator. Deb Berns kept a running record of the task force's deliberations and frequently had the unenviable job of putting onto paper decisions that the task force was struggling to conclude.

Council staff members Paul Dennett, vice president, health policy, and Lynn Dudley, vice president and senior counsel, actively participated throughout the duration of the task force's work and brought their considerable substantive knowledge and legislative

perspectives to the task. John Scott, formerly a member of the Council's staff and now a Ph.D. candidate at Cornell University was instrumental in the initial compilation of the demographic material that laid the groundwork for the plan. Jamey Delaplane, both as the Council's vice president, retirement policy, and, later, as our special counsel with the law firm Davis & Harman, also participated throughout the plan's development and contributed enormously to the task force's efforts. The Council's Director, Communications, Deanna Johnson Keim, APR, and Communications Associate Jason Hammersla, were instrumental in handling numerous aspects of the content, design and production of the report.

Many people outside the organization offered invaluable information and perspectives. Brent Moulton, Bureau of Economic Affairs; Bob Cleveland and Carmen Denavas, both of the U.S. Census Bureau; George Long, Bureau of Labor Statistics; William Shipman, Carriage Oaks Partners LLC; Scott Roderick, The National Center for Employee Ownership; Bradford Holmes, Forrester Research, Inc.; and Asma Emnena, Financial Engines, all were responsive to our requests for information.

Several staff members of the Employee Benefit Research Institute (EBRI): Steve Blakely, Craig Copeland, Paul Fronstin, Jim Jaffe and Ken McDonnell all provided essential data. Dallas Salisbury, president of EBRI, and Sylvester Schieber, Watson Wyatt Worldwide, also both graciously agreed to review the entire report and appendices for accuracy and also provided very valuable perspectives that added to the caliber of the final product.

Finally, much of the credit for the completion of this strategic plan goes to Robert Stowe England who tirelessly researched facts, found studies, performed calculations and drafted large portions of the report for the Board's and task force's review. Throughout this process he ensured that the Board's and task force's insistence that conclusions and proposals be supported with evidence and sound reasoning was always being met.

This strategic plan process has been one of the most rewarding experiences of my tenure with the American Benefits Council. On behalf of the membership-at-large, I extend my thanks and appreciation to all who participated in its development.

James A. Klein

## **EXECUTIVE SUMMARY**

Employer-sponsored voluntary employee benefits are a vital part of the *personal financial security*<sup>1</sup> enjoyed by Americans. Workers in the United States, who have one of the highest living standards in the world, are expected to continue to make major strides in raising those living standards over the next decade. There is much encouragement from recent higher productivity gains, which began in the mid-1990s and have remained high during the most recent recession and early recovery. Since labor income often rises with productivity, the outlook for further strong advances may give workers a solid foundation on which to further build and maintain their personal financial security.

There are, however, clouds on the horizon of employee benefits. In almost every area – retirement income, active and retiree health and long-term care — the employee benefits system is headed for a crisis.

#### **Retirement Plan Trends**

In the area of pensions and retirement saving, current trends suggest that more workers may face the prospect of a reduced living standard in retirement. Changing workforce patterns, shorter job tenures, changes in employees' preferences in employee benefits, regulatory burdens, funding requirements, and accounting rule changes have led more employers, especially small businesses, to switch from defined benefit plans to defined contribution plans. This is a major factor in the decline in the number of workers retiring who receive a pension annuity, even though 43 percent of retirees from defined benefit

plans can take a lump sum, if they wish, and even though 25 percent of participants in defined contribution plans may select an annuity instead of a lump sum, according to the Bureau of Labor Statistics. Workers have contributed to this shift by preferring lump sums over annuities when give a choice. As a result of these trends, far fewer workers are likely to receive a pension annuity when they retire today than was the case a generation ago.

Defined contribution plans have demonstrated their ability to provide a vehicle for retirement savings for more and more of the workforce. Prior to the last recession, for example, participation rates for private sector full- and parttime wage and salary

There are clouds on the horizon of employee benefits. In almost every area, the employee benefits system is headed for a crisis.

workers rose from 40 percent to 47 percent between 1987 and 2000, mostly due to the adoption of defined contribution plans by more small businesses. The participation rate has dipped slightly since 2000, but is likely to begin rising as the current recovery gains strength.

Whatever the mix of types of benefit plans in the future – be it defined benefit, defined contribution or hybrid plans – it is critical that sufficient incentives be in place to ensure adequate employee benefits for retirement.

# "Rank-and-file workers in the United States today have greater control over their pensions and retirement savings than ever before." —Representative John Boehner (R-OH)

Since more of the responsibility will fall on workers, it is important they save adequately for retirement. Recent data are not encouraging.

## What is "personal financial security?"

Personal financial security, as used in this document, is a broad term that describes a state of being secure in the expectation one will be able to sustain one's living conditions and general welfare throughout retirement and in the face of potential adverse events.

For example, the current national low personal savings rate is probably inadequate to accumulate enough saving for most workers to maintain their pre-retirement living standards in retirement. The gross U.S. personal savings rate has averaged 7.5 percent over the past five years and is lower than that of

many other developed nations and may be lower than what is needed to assure a secure retirement for many workers. One could accumulate sufficient retirement savings to replace 70 percent of one's income, if one saved 7.5 percent of one's income for 45 years.

However, not all workers start saving seriously for retirement in their 20s. Some

wait until their 30s, 40s, and even 50s. Further, households also need to save for other important goals and needs, such as buying a home, college tuition, medical bills, emergencies and periods of unemployment.

Supporters of defined benefit plans face a difficult challenge in their efforts to see that defined benefit plans remain a viable option for a significant portion of the workforce. They still play an important role. More than 19 percent of full-time and part-time private sector workers are participants in a defined benefit plan. In 1998 private sector defined benefit plans paid out \$107.8 billion in benefits, mostly in the form of annuities disbursed from plan assets. They also purchased an additional \$3.4 billion in annuities from commercial insurers.

However, funding rules, accounting rules, market declines, and low interest rates used for a variety of pension calculations, including determining plan liabilities, have led some companies to freeze their defined benefit plans and deterred others from starting new defined benefit plans or hybrids, such as cash balance plans. Concerns about the volatility of the funding liability have complicated the task of preserving these plans and pose a challenge for designing

new plans that will be attractive to employers.

## Health Plan Trends

Retirees will increasingly need to assume more of the responsibility for post-retirement health care, as fewer companies offer this benefit. While 20 percent of employers offered retiree health plans in 1997, only 11 percent of private sector employers offered such plans in 2000. Employees aged 55 to 64 likely will not be able to obtain post-retirement health care from their employers, as companies will increasingly not be interested in offering incentives for early retirement as the labor market tightens in the years ahead. Even the small number of employers that still sponsor retiree health benefits will increasingly limit the amount of benefit provided.

For example, employers will increasingly limit their post retirement benefits to former workers over age 65 to a Medicare supplemental plan. At the same time Medicare costs are also rising and the government is assuming an added financial responsibility for prescription drugs. With an aging population Medicare costs will skyrocket and pressures will grow to contain spending. Medicare's trustees project in their annual report for 2004 that Medicare spending, combined for Parts A and B, will rise from 2.6 percent of the Gross Domestic Product in 2003 to 3.4 percent in 2006 with the implementation of the new prescription drug benefit. By 2035, it will total 7.7 percent of GDP, nearly triple the current level.

Mounting health care costs are pushing more active and retiree health care programs



toward a crisis, which could lead to further cutbacks and higher out-of-pocket costs for participants. Continuously rising costs are cited as a major reason why more than 43.3 million non-elderly Americans are not covered by health care insurance.

If present adverse trends continue, U.S. workers in 2014 may not have the same level of personal financial security they enjoy today.

Finally, more retirees are likely to require longterm care services because low fertility rates will leave fewer children to care for aged parents and also because more people are living long enough to require custodial care. In short, if present adverse trends continue, American workers in 2014 — just 10 years from now — may not have the same level of overall personal financial security they enjoy today, even if they have higher incomes. Further, fewer newly retiring workers will be able to maintain their living standards in retirement; and most will not be prepared for health care and long-term care expenses. Such unwelcome outcomes could happen because the voluntary employer-provided employee benefits system may not continue to play as extensive a role as it has played in the past.

Trends in worker job tenures, worker attitudes toward benefit types, and the employee benefits system suggest that individuals will have to assume a greater role in providing for their own retirement security and in making informed decisions about health care. These challenges, and others, must be addressed now, as there will be

"O.K., right about now I'll bet you're thinking, What's the catch?"

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significant costs if these issues are left for future generations to solve.

The American Benefits Council (the Council) has examined the trends that threaten the current employee benefits system and has devised a long-term strategic plan, detailed in this document, to present its vision of what the employee benefits system should look like over the next decade and how the benefits system can help workers build and protect personal financial security.

The plan describes significant demographic trends that are reshaping the American workforce and identifies the stakeholders who are responsible for facilitating change. It also sets out vision statements, goals, and initial policy recommendations to be achieved within the next 10 years. These should help individuals, employers, and government play their respective roles in a broad effort aimed at improving the ability of American workers and retirees to achieve and maintain personal financial security.

## Shared Efforts of All Stakeholders Needed to Implement New Systems

Individuals, employers and the government are the three primary stakeholders in the employee benefits system. All three must play a role in ensuring a sustainable benefits system.

This vision rejects the notion that in order to fix this impending crisis, individuals should take complete control of their own future retirement and health care needs, and rejects, as well, the suggestion that government should take over the employee benefits

# "Without affordable health insurance ... Americans and their families risk not only their health but their financial well-being."

— Representative Nancy Johnson (R-CT)

system in order to preserve benefits. This vision embraces the concept of *shared* responsibility.

In this paper, when we describe the responsibilities of employers to address the challenges facing the employee benefits system, it should be noted that the benefits system is a voluntary one and that the responsibilities that employers assume need to be made consistent with meeting not only employees' needs and expectations but also the employer's business imperatives.

The key responsibilities of the three primary stakeholders are as follows:

Individuals in their varied roles as consumers, employees, and retirees should assume primary responsibility for being informed about their retirement needs, planning for their own financial security, and taking appropriate action to save and manage their retirement assets and to make rational cost-effective health care decisions;

**Employers** should be primarily responsible for sponsoring programs that help workers and retirees in their efforts to achieve and maintain

personal financial security, while also meeting the employer's business imperatives; and,

Government should be primarily responsible for formulating public policy to promote a strong economy, supporting the creation, well-being and maintenance of the voluntary employee benefits system, and providing a safety net in connection with retirement income, health care, disability income, and job loss.

Other stakeholders have a significant interest and obligation to support the greater good of the system. These stakeholders include: actuaries, consultants, insurance brokers, attorneys and the trial bar, educators, health care providers, health care plans, investment managers, quasi-governmental bodies, researchers and developers, producers, and third party administrators. Their roles are outlined in Appendix B.

# Future Benefit Systems Must Meet Key Objectives

To achieve the objectives set forth in this paper, stakeholders will have to work together to design and maintain new and/or reformed benefit systems. If they are to be

successful, these new and/or reformed benefit systems should be designed to be innovative, flexible and cost effective. They should also increase coverage, aid in plan administration and provide tax incentives to encourage all stakeholders to play an active role.

In the section of this paper titled, "A New Architecture for the Employee Benefits System," these objectives are defined and specific goals are set to be achieved within 10 years, by 2014 or sooner, along with initial policy recommendations aimed at moving the United States toward achieving the goals. Below are some key objectives and the goals this paper sets forth to address them.

#### **RETIREMENT INCOME**

Future retirement systems should have tax and other incentives that strongly encourage employers and employees to make contributions to retirement savings programs at a level that will allow workers to accumulate enough assets to provide income sufficient to maintain their living standards in retirement. Elevating the level of retirement education in schools and the workplace will be essential in accomplishing this objective.

## Goal 1: Raise Financial Literacy

By 2014, virtually all households will have access to some form of investment education and advice and nearly 75 percent of households will have calculated the amount of retirement savings needed to maintain their standard of living throughout retirement, as well as the savings rate necessary to achieve this target.

# Goal 2: Increase the Share of Workers in Workplace Retirement Plans

By 2014, 96 million (74 percent) of full-time and part-time private sector employees will participate in workplace retirement plans.

## Goal 3: Raise Retirement Savings

By 2014, the gross personal savings rate, which covers saving for all purposes, will reach 15 percent of disposable income. In addition, many, if not most, individual workers across the income spectrum will be saving at a rate between 7 and 15 percent of earnings specifically to provide a retirement income that is at least 70 percent of preretirement earnings.

## ACTIVE WORKER HEALTH CARE

Future active employee health care systems should promote broad coverage and empower Americans to be effective health care consumers. This will require an overhaul of the health care delivery system to provide greater disclosure of health care outcomes and other information, to expand the role of the individual as consumer and provide greater access to the health care system for more employers and more people.

## Goal 4: Make Health Coverage More Affordable

By 2014, health care costs will return to a more sustainable annual rate of increase in the single digit range that more closely tracks the overall increase in the gross domestic product (GDP).

## Goal 5: Increase the Quality of Health Care Services

By 2014, at least 50 percent of Americans with health care coverage will be enrolled in

a health plan design that provides userfriendly, comparative information on the quality and performance of health care providers and services and the majority of all others with coverage will have the option to choose to enroll in such a plan.

# Goal 6: Increase the Number of People with Health Insurance Coverage

By 2014, 243 million or 91 percent of nonelderly Americans will have some form of health insurance. This will represent a reduction by half the proportion of the nonelderly population that is uninsured

# RETIREE HEALTH CARE AND LONG-TERM CARE

today.

Future retiree health systems should promote health security in retirement. To accomplish this, Medicare will need to be modernized and will have to provide more comprehensive

coverage. Congress should establish appropriate tax incentives to promote saving by employees to fund their retiree health needs and long-term care and to allow employers to pre-fund their post-retirement health benefit programs, as well as encourage them to offer long-term care coverage.

# Goal 7: Make Retiree Health and Long-Term Care Accessible and Affordable

By 2014, retiree health insurance will be more affordable and accessible because all

individuals and employers will have access to new, integrated vehicles to finance retiree health care and long-term care needs. These vehicles will be supported by tax preferences such as those currently available for the health care needs of active employees.

### Goal 8: Modernize Medicare

This plan sets out

goals and initial policy

recommendations to be

achieved within the

next ten years.

statements,

vision

By 2014, Medicare will be transformed from an outdated, fee-for-service health insurance plan with significant coverage limitations and exceptions to one that provides all

retirees and long-term disabled individuals with more comprehensive coverage, affordable private health plan choices, and health services delivered with an emphasis on quality and efficiency.

#### **STOCK OWNERSHIP**

Future stock ownership plans can advance personal financial security through the accumulation of capital. This

will require policies that encourage the availability of employer-sponsored stock ownership plans and incentives to maximize the accumulation of stock by workers.

# Goal 9: Boost Broad-Based Opportunities for Employees to Own Stock

By 2014 there will be a 50 percent increase in the number of employees who receive stock in broad-based stock option plans, stock purchase plans, and employee restricted stock (or restricted stock unit) plans.

## **INTRODUCTION**

Torkers and retirees in the United States enjoy one of the highest living standards in the world. Americans on average also have a far greater per capita accumulation of financial assets than citizens of other developed nations, and 68.3 percent of American households own their own homes. This solid foundation on which Americans have built their personal financial security is enabled, supported and protected by the employee benefits system.<sup>2</sup>

Voluntary employer-provided employee benefits, such as retirement income, active and retiree health, long-term care and stock accumulation plans, play a vital role in supporting individuals in their efforts to achieve and maintain personal financial security. Employee benefits help workers and retirees deal with many of the risks that can undermine personal financial security.

Yet, while the outlook for gains in income and living standards is positive, the employee benefits system, the subject of this paper, will have to adjust to demographic and workplace trends, as well as the changing needs and expectations of workers and employers towards benefits.

The American Benefits Council (the Council) has adopted a long-term strategy, outlined in this document, which can help meet the challenges and changes facing the employee benefits system. This plan, in turn, can help the employee benefits system maintain its vital role in helping Americans build, preserve and enhance their personal financial security.

The Council's long-term plan deals with some issues related to Medicare. The future of employer-provided retiree health care and the recommendations made in this paper are intertwined with the shape and structure of Medicare programs and any further reforms that might reshape it. However, this paper does not attempt to address the many important issues surrounding Social Security, which is facing a crisis over the long term. The Council has, however, previously examined the issues surrounding Social Security and set forth a road map for reform.<sup>3</sup> It has also set forth principles to guide comprehensive Medicare reform, several of which were adopted with the passage of the Medicare Modernization Act of 2003.4

The importance of addressing the potential crisis in the employee benefits system goes beyond the immediate issue of personal financial security. To the extent that these issues are addressed in a timely manner, it also contributes to helping enhance the longterm national security of the United States. It can do so by avoiding an outcome that will so burden the government with the costs of benefits that it would crowd out spending on other important budget items such as research, infrastructure, and education. Importantly, if national resources are absorbed overwhelmingly for health and retirement needs, it could impinge on the ability of the U.S. government to bear the cost of not just national, but global security.

Should the burden of employee benefits fall disproportionately on the shoulders of government (and taxpayers), it will come at a time when America's traditional security partners will be facing an even more costly aging burden than we are and, thus, will be

less able to help the United States share the cost of global security.

According to defense expert Daniel Gouré, the United States needs to increase its defense spending substantially over the next decade to replace aging equipment and modernize its forces if it is to maintain global security and avoid a defense "train wreck." The expanded battle against terrorism under way since 2001 has added to that defense burden and contributed to rising budget deficits.

It is also important for the United States to address issues that threaten the personal financial security of its citizens in order to better assure social stability. Nations that have ignored significant threats to their citizens' financial well being have done so at their own peril.

The financial profile of American workers and retirees compares favorably to that of workers and retirees in other developed countries. In the United States per capita income stood at \$36,300 in 2002,6 while the per capita income of some of the major developed countries was somewhat behind the United States on a purchasing power parity7 basis. In the affluent countries of Japan, Canada, France, Germany, the United Kingdom and Italy, for example, per capita income in 2001 was at a level ranging between 69 percent and 80 percent of the U.S. level.8

At the end of 2002, American households had a combined net worth of \$39.1 trillion.9 According to Eurostat, American workers held nearly double the combined financial assets held by citizens in the 15 nations<sup>10</sup> of the European Union, even though there are far more Europeans than Americans in this comparison (378 million in the EU-15 in 2001 versus 274 million in the United States). More importantly, the total value of personal financial assets in the United States represents a sharply higher multiple of the size of the U.S. economy (338 percent of Gross Domestic Product or GDP) than the EU's financial assets represents for the 15 nations in the European Union (226 percent of GDP).<sup>11</sup>

The relatively higher living standard and greater affluence in the United States indicates that workers here have more resources at hand to help them establish personal financial security. This opportunity also underscores the importance of the employee benefits system in helping Americans build and protect that financial security.

Those developed nations offering universal health care, a group that does not include the United States, are finding it increasingly difficult to sustain these programs. Nations will also find it increasingly difficult to sustain generous publicly-funded pension systems. Both Europe and Japan will see the

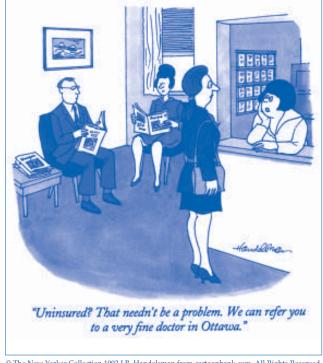
"Despite this country's incredible wealth, we are not a nation of savers."

— Senator Craig Thomas (R-WY)

proportion of the elderly in their populations rise faster than in the United States, and to higher levels, between now and 2014 and thereafter. The more difficult outlook in Europe and Japan is not noted here to make the case that the United States is not facing a similar problem. It serves, however, as a wake-up call for the United States to take steps to address its problems while there is still time to do so and avoid some of the heavier costs and consequences that might occur if the United States does not take timely steps to address these challenges.

The United States, for example, continues to wrestle with how to slow down rising health care costs, as well as how to bring health insurance coverage to 43.3 million uninsured Americans. <sup>12</sup> U.S. health care expenses are expected to continue to rise at a pace faster than the growth in the economy.<sup>13</sup> These higher costs make it more difficult for many employers to offer health care to workers and retirees and will very likely lead to higher out-of-pocket charges for beneficiaries in programs that are maintained. Higher health care expenses are especially difficult for small businesses, where increases in the cost of health care insurance are often larger than the average rate of increase in premiums for all purchasers of health insurance.

Even when employers are able to continue offering health care insurance, rising costs make it more difficult for some employees, especially lower wage workers, to elect health coverage either for themselves or their dependents. This leads to an increase in the uninsured. Higher health care expenditures will also put enormous strains on Medicare and Medicaid. Higher costs for active



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workers also raise the cost of labor for American businesses as they compete in a global market place with countries that have not seen similar increases in medical benefit expenses for their workers.

Despite the economic slowdown of the past few years, in the next 10 years U.S. workers – barring unforeseen external shocks to the economy – are expected to have the wind at their backs from broader economic trends. For example, positive productivity gains that have characterized the U.S. economy since the mid-1990s are likely to continue in the coming years. 14 All stakeholders should work to promote policies that help ensure workers are able to continue to build financial security from rising incomes with the support of a vibrant employee benefits system.

# THE EMPLOYEE BENEFITS SYSTEM FACES ADVERSE TRENDS

Despite optimism about rising living standards over the next decade, strong challenges lie ahead for working and retired Americans. Changes in job tenure, worker benefit preferences, government regulation, accounting rule changes, the decline of defined benefit plans, and longer life spans mean more of the burden of saving for retirement will fall on workers.

## The Aging of America

The U.S. population is growing older. That is to say, the proportion of elderly in the population is rising and, in the process, pushing up the median age of Americans. In 2000, 12.3 percent of the population was 65 years old or older and the median age was 35.3, the highest ever. 15 By 2025, the share of elderly will rise to 18.5 percent and the

The aging of America is being driven by better health care, longer life expectancies, lower fertility rates and the retirement of the baby boom generation.

median age will be 39.3, 16 according to official projections. This aging of America is being driven by a combination of factors: better health care, longer life expectancies, lower fertility rates, and the retirement of the baby boom generation.

The ratio of elderly to the working age population — the elderly dependency ratio — is also projected to rise, from 20.8 per 100

workers in 2000 to 23.4 in 2015 and 31.2 in 2025,<sup>17</sup> according to official projections. Some demographers argue, however, that current official forecasts are overly conservative in their assumptions on projected longevity gains and overly optimistic in their assumption that fertility rates will rise significantly. Thus, demographers suggest, the aging dynamic may be more pronounced in all countries than what is officially predicted.<sup>18</sup>

What are the implications of an aging society for personal financial security? As people live longer, they will need to receive retirement income benefits for more years. This will require that more money be saved for retirement. It will also strain public retirement systems, like Social Security. It may mean that more people will spend down their assets before they die. There is some good news here, too, for personal financial security. Advances in health are likely to allow people to work longer if they so choose — giving them more time to save, accumulate more assets, and contribute longer to public and private retirement systems.

In the future Americans will spend more on health care services *both* because people will live longer *and* because they will make greater use of health care services and procedures that prolong life.

There is a parallel trend of declining disability rates at all ages among the elderly. These trends, driven by advances in medical care, have been observed in studies in the United States<sup>19</sup> and abroad.<sup>20</sup> In spite of these encouraging trends, the improvements in disability and quality of life throughout one's

older years will drive up dramatically total health care spending on all people over 65 because there will be more elderly people. Further, spending on the very old — those 85 and over — could skyrocket as their numbers swell.

The aging of society will require all stakeholders — principally individuals, employers and the government — to work together to help assure that American workers and retirees build and sustain their personal financial security. These primary stakeholders and other stakeholders will have to reevaluate their current roles to see how all can work together for the common good and better address the challenges that lie ahead for public and private benefit systems.

Individuals, employers and the government (i.e., the taxpayers) can expect greater financial pressure to sustain the nation's retirement income and health care security. Working together, the stakeholders will need to work for public policies that can facilitate: (1) later retirement ages and alternative pathways to retirement; (2) more flexibility in work/leisure arrangements and benefit plan design; (3) the accumulation of assets to help finance greater health and retirement income

requirements; and (4) the long-term financial stability of the Social Security and Medicare systems.

## Aging and Public Spending on the Elderly

Aging populations all over the globe will force many countries — including the United States — to make hard choices in terms of providing additional financial support to health and retirement systems.

The World Bank, in a landmark study in 1994, said that most of the world's social security and retiree health programs are unsustainable. Many official studies since then have similarly calculated that the burden for many nations will be enormous and that most developed country governments would find it difficult to either raise taxes sufficiently or borrow sufficiently to sustain current benefit levels.

In the United States the Board of Trustees for Social Security projected spending on benefits is expected to rise from 11.07 percentage points of taxable payroll in 2004 to 16.83 percentage points in 2030, and then to 19.29 percentage points in 2078.<sup>22</sup> This will represent an increase from 4.3 percent of the

"Advances in medical care have allowed people to live longer, and more and more people are at risk of outliving their savings or being forced to return to the workforce in their advancing years."

— Representative Earl Pomeroy (D-ND)

GDP in 2004 to 6.3 percent in 2030 and 6.6 percent in 2078.<sup>23</sup> Similarly, the trustees found that spending on Medicare, which is funded from payroll taxes, premiums and general tax revenues, could rise from 2.6 percent of GDP in 2003 to 3.4 percent of GDP in 2006, with the implementation of the prescription drug benefit to 7.7 percent of GDP in 2035 (and 13.8 percent of GDP in 2078) if no changes are made in the program.<sup>24</sup>

The Congressional Budget Office has projected that spending on Social Security benefits will rise from 4.2 percent of GDP in 2003 to 5.9 percent in 2030 and 6.2 percent in

**Unless taxation reaches** 

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2050.<sup>25</sup> The CBO also projected that the federal government's share of Medicare and Medicaid spending will rise from 2.3 percent in 2003 to 8.4 percent in 2030 and 11.5 percent in 2050.<sup>26</sup> The December 2003 CBO report concluded: "Unless taxation reaches levels that are unprecedented in the United States, current spending policies will probably be financially unsustainable over the next 50 years."<sup>27</sup>

A CBO study of baby boomers in the United States, which reviewed and summarized a range of prior studies on baby boomers, found that about half of baby boomers are accumulating assets at a pace that will allow them to maintain their standard of living after they retire. <sup>28</sup> The other half of households, however, are not accumulating enough assets to maintain their standard of living if they retire as planned. Many in this half of today's working-age boomers will see a modest

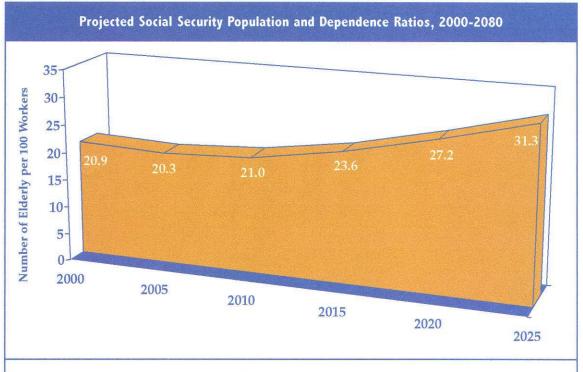
decline in their living standard, which can be made up by working longer, the study found.

The CBO study, however, found a substantial fraction of low-income boomer households are accumulating very few assets. The study reported the net worth of households whose earners did not graduate from high school appears to have declined during part of the 1980s and 1990s. "If current trends continue, many of those baby boomers are likely not only to face a lower standard of living when they retire, but also to find themselves largely dependent on government benefits."<sup>29</sup>

The CBO study's conclusions have a caveat that most of the studies in its survey assumed that Social Security, Medicare and other government benefits will be provided as specified in current law. The study suggests budget pressures could lead to lower benefits than now anticipated. "Because many baby boomers are likely to depend heavily on government benefits for the bulk of their income in retirement, their prospects

may be less rosy than recent studies imply," the study warns.<sup>30</sup> It also suggests that to the extent boomers recognize the looming budgetary constraints, it may lead more of them to increase their saving or to retire at a later age than planned, the study concludes.

In view of the budgetary pressures on Social Security and Medicare and the mixed prospects for baby boomers in retirement, it is all the more important for the employee benefits system to remain strong and viable.



SOURCE: Social Security Administration, "Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds" (2003).

## Fewer Workers Covered by Workplace Retirement Plans

According to the most recent federal data from a survey of employers,<sup>31</sup> 49 percent of 103 million full-time and part-time private sector workers<sup>32</sup> in 2003 participated in a workplace retirement plan.<sup>33, 34</sup>

Another government survey of the general population, however, found participation rates in employer-sponsored pension plans has declined in recent years. In 1999, for example, a survey of Americans found that 51.5 percent of all full-time workers in both the public and private sector participated in a pension plan.<sup>35</sup> These numbers are higher than the employer surveys of the private sector because it includes federal, state and local public sector plans, where coverage is generally 98 percent or higher. By contrast, in 2001, participation rates had fallen to 50.1 percent.<sup>36</sup>

While workers can save on their own without an employer-sponsored plan, data suggest savings rates are much higher when employees have the opportunity to save through an employer-provided plan. If one looks at federal income tax return data, the proportion of filers who claim an IRA or Keogh deduction has been both fairly modest and steadily declining over time. From a peak of 16.2 percent in 1986, it fell to 3.5 percent in 2000 and 2001.<sup>37</sup> In contrast, the participation rate in workplace plans is 66.2 percent of those eligible for 401(k) plans (a population of workers that represents 32.6 percent of the private sector workforce).<sup>38</sup> Even when no employer match or contribution is offered in a 401(k) plan, contribution rates are high, according to Employee Benefit Research Institute and Investment Company Institute data base sample of 1.7 million participants. Analysis of this data base found that employees contribute an average of

7.4 percent of their salary when there is no employer contribution.<sup>39</sup> In plans with employer contributions, participants contributed slightly less, 6.8 percent.

## Workers Live Longer in Retirement

Life expectancy numbers frequently publicized in the press may be misunderstood by the public. The most commonly reported number is for average life expectancy at birth – although news reports do not always include the word "average" or the phrase "at birth." In 2000, average life expectancy at birth was 76.9 years. Workers who retired in 2000, however, were expected to live six years longer than that to 82.9 years. <sup>40</sup> It is higher because one's survival to a given age raises the statistical likelihood of a longer life.

For retirement, then, the key number to watch is average life expectancy at 65, normal



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retirement age, and the point at which most Americans begin to receive payments from a pension or may begin to draw on retirement savings. There is an important difference in longevity between men and women. For women, average life expectancy at age 65 was 19.2 years in 2002; for men, 16.3. Or, to state in another way, the average 65-year-old woman in 2000 was expected to live to age 84; the average man, to age 81.

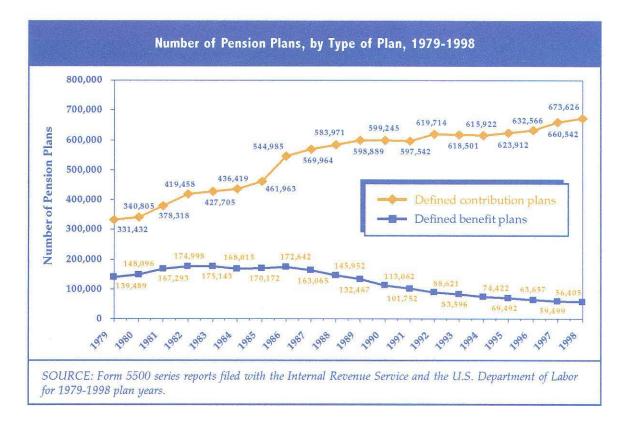
Average life expectancy for those age 65 in 2000 was three years higher than it was in 1970. Thirty years earlier life expectancy at birth was 70.9 years; 65-year-olds could expect to live 15.2 more years. <sup>41</sup> In the future, average life expectancy at age 65 is likely to rise even higher.

For those planning their retirement, longer life brings with it the risk of outliving one's retirement income and reserves set aside for health care and long-term care.

## **Changing Pattern of Retirement Benefit Distributions**

A number of trends have converged to dramatically change the portion of the work force who receive an annuity-type income from a pension plan when they retire. Far fewer workers than a generation ago are retiring with the expectation of receiving an annuity or regular monthly pension check of a stated amount for the rest of the their life, no matter how long they live.

One factor in the decline in the prevalence of pension annuities is the move from defined benefit plans to defined contribution plans, although some defined contribution plans offer annuities and installment payments.



Another factor is a growing preference by retirees for lump sums instead of annuities when offered a choice.

The portion of the workforce covered by a defined benefit plan was cut in half in a single generation, falling from 38 percent in 1978<sup>42</sup> to 19 percent in 1998.<sup>43</sup> In 1977, employers with defined benefit plans had in place a policy of pension distributions that provided 76 percent of those eligible to retire with a pension annuity rather than offering a choice of an annuity or a lump sum.<sup>44</sup> Meanwhile the portion of workers with a defined contribution plan as their primary pension rose sharply from 7 percent to 27 percent, moving the defined contribution plan into first place as the dominant type of plan in the workforce.<sup>45</sup>

Other trends are also affecting the type of distribution employees take when they retire. For example, increasingly retirees in defined benefit plans select lump sums instead of annuities. In 2000, 45 percent of full-time private sector employees worked at firms with defined benefit plans that offered a lump-sum option, according to the Bureau of Labor Statistics. 46 In contrast, 25 percent of full-time employees worked at medium and large private sector firms in 1997 with defined contribution plans that offered annuities and 41 percent offered payment installments, according to BLS. 47 Even so, only 7 percent of respondents in the University of Michigan Health and Retirement Survey with a defined contribution plan converted their balance into an annuity. 48

The decline in the number of defined benefit plans has been nothing short of stunning. According to a Congressional Research Service paper, in 1983 there were 175,000 defined benefit plans. <sup>49</sup> By 1998, there were only 56,400 plans. The decline in the number of plans has been mostly among small plans.

## "Savings aids our economy by providing a ready source of longterm investment capital."

— Representative Rob Portman (R-OH)

The number of workers in small plans fell from 1.86 million in 1983 to 648,000 in 1998. There was, however, an even bigger decline in the number of workers enrolled in a defined benefit plan at large companies. In 1983, the number of active participants in defined benefit plans at large companies stood at 28.1 million. By 1998, it had declined 21 percent to 22.3 million. <sup>50</sup>

The decline in the number of defined benefit pension plans has been nothing short of stunning. The decline in pension annuities appears, in fact, to be driven by the personal preferences of employees when they retire. According to a study of 1,500 participants who terminated employment,

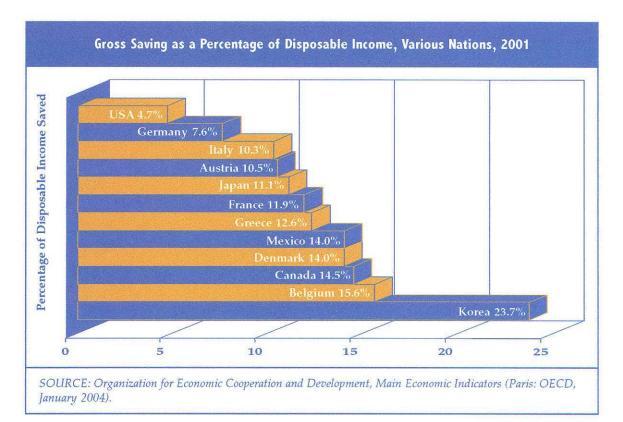
88.5 percent elected to take their retirement benefit as a lump sum, while only 11.5 percent elected an annuity.<sup>51</sup> The preference for lump sums increased as interest rates fell and lump sums have appeared to be a more attractive choice. Lump-sum payouts are based on the interest rate assumption used to calculate how much money is needed presently to earn the annuity provided to the retiring worker. When interest rates are low, the amount of the lump sum is higher. While workers are generally choosing lump sums over annuities, other research indicates that

retirees with pension annuities were more satisfied with their life in retirement and suffered fewer symptoms of depression. <sup>52</sup>

## **Savings Rates**

Due to changing trends in retirement benefits and changing patterns of retirement plan distributions, workers will increasingly be responsible for determining how much they need to save for retirement. They will also be responsible for planning and budgeting their funds to last throughout their retirement years. Yet, workers may not be fully aware of the risks they face. If one looks at overall saving rates for Americans, for example, it would appear workers may not be saving enough now to ensure they can sustain their living standards in retirement, pay for health insurance to supplement Medicare, and also pay for long-term care. Further, gains in productivity may slow significantly by the 2020s due to the broad macroeconomic impact of aging.<sup>53</sup> It will be important to put in place new sustainable benefit systems before population aging potentially slows the advance in living standards for workers and leaves them more vulnerable to adverse trends already evident in the workplace.

A look at recent saving trends gives some hints about the adequacy of saving in the United States. According to the latest international comparisons from the Organization for Economic Cooperation and



Development, the gross savings rate for Americans was 4.7 percent of their disposable income in 2001.<sup>54</sup>

The U.S. savings rate for households is among the lowest in industrialized countries, falling below the level for Australia (5.2 percent of disposable income) and the United Kingdom (6.2 percent). It lags far behind the savings rates of such developed nations as Japan (11.1 percent), Canada (14.5 percent), Belgium (15.6 percent), France (11.9 percent), Germany (7.6 percent), Italy (10.3 percent), Sweden (14.0 percent) and Switzerland (23.5 percent).<sup>55</sup>

Using the OECD method, U.S. gross personal saving stood at 5.8 percent in the first quarter of 2004,<sup>56</sup> and overall was at a 6.4 percent average level for the prior six years.<sup>57</sup> It is significantly lower than the levels that prevailed earlier. In the 10 years from 1983 to

1993, for example, it averaged 12.5 percent. From 1993 to 1997 it averaged 9.7 percent. A gross savings rate of 7.5 is well below a level that over time would be likely to provide most Americans with a sufficient level of assets by retirement age to assure they will be able to sustain their lifestyle after they retire, while also allowing consumers to save for other necessary objectives. It will therefore be important for Americans to increase their savings rate to build and protect their personal financial security.

A study<sup>58</sup> by the Employee Benefit Research Institute in collaboration with the Millbank Memorial Fund calculates that Americans will need an additional \$400 billion more than they are expected to save to cover basic expenditures in retirement and any expense associated with an episode of care in a nursing home or from a home health care provider for the decade between 2020 and

2030. The study simulates retirement income and savings from Social Security projections and current patterns of saving in taxpreferred retirement savings vehicles, including defined benefit plans, defined contribution plans, and IRAs of all types. It also simulates retirement expenditures on living, health care and long-term care. It calculates the shortfall between expected income and expected expenses by age and income cohorts from 1936 to 1965.

The study finds most couples in the top two quartiles of income born after 1945 can close the gap by increasing their saving rates five percentage points.<sup>59</sup> Most couples in the lower two income quartiles born after 1945 can close the gap by saving an additional 10 percent to 17 percent.<sup>60</sup> While single men and women need to save more than couples to close the gap, single women in the lowest quartile face an impossible task of saving significantly more than an additional 25 percent of savings on very modest incomes. In addition, those born in 1945 and earlier will need to save more to meet their needs while those born in later years can meet their needs with less of an increase in savings.

#### **Health Care Costs**

Constantly rising costs pose a challenge to the provision of health care both in the public and the private sector. A study sponsored by the Centers for Medicare and Medicaid Services (formerly the Health Care Financing Administration) has predicted health care

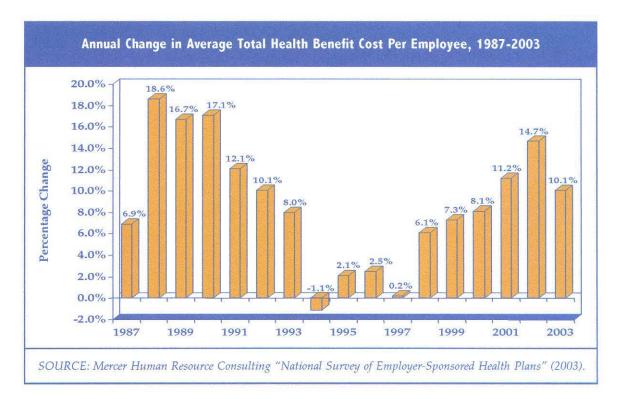
spending in the United States will reach \$3.4 trillion in 2013, more than double the \$1.5 trillion spent in 2002. 61 As a portion of the economy, health care spending will rise from 14.9 percent of GDP in 2002 to 18.4 percent in 2013, according to the study. 62

Rising health care costs also mean more of workers' disposable income will go to pay health care premiums, leaving less to save for retirement.

Rising health care costs also mean more of workers' disposable income will go to pay health care premiums, leaving less to save for retirement. Rising health care expenses also will likely increase the number of uninsured workers.

"In a nation with the best doctors, the best hospitals, and the best medical technology in the world, tens of millions of Americans have no opportunity to benefit from that care because they can't afford it."

— Senator Edward Kennedy (D-MA)



At the same time, the proportion of workers who enjoy employer-provided retiree health care coverage is also expected to decline steadily. For retirees, rising health care costs pose a potentially greater burden as they have fewer opportunities to increase their income to offset those expenses.

Health care costs have dramatically increased for the average American. In 1950, an individual's medical care costs made up just 3.7 percent of consumer expenditures. In 2000, medical care expenditures were almost 15 percent of personal consumption.<sup>63</sup> Employers, likewise, have been experiencing rising health care cost pressures. Employer costs for health plans, for example, rose 10.1 percent in 2003, after rising 14.7 percent in 2002.<sup>64</sup> In 2004 employers expect costs to jump another 14 percent.

Health care expenses and retirement saving are interrelated. As the cost of health care grows rapidly, it crowds out available employer resources to contribute toward pension and retirement saving plans. Similarly, as individuals pay higher out-of-pocket expenses for health care, they have less to contribute to retirement savings. Obviously, new initiatives are needed to contain and manage health care costs in order to help working and retired Americans build and maintain their personal financial security.

The less than one-third of retirees who have some type of employer-provided health care benefit<sup>65</sup> will increasingly need to assume more responsibility for the portion of their retiree health care not covered by Medicare because fewer companies will offer a postretirement health benefit. While 20 percent of employers offered retiree health plans in 1997, only 11 percent of private sector employers offered such plans in 2000.<sup>66</sup>

Meanwhile, Medicare costs are slated to rise, not only from the increasing ranks of the elderly, but also from an enrichment of benefits, including the new prescription drug benefit, as well as from steadily rising health



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care costs. According to the Congressional Budget Office, spending on Medicare will rise from 2.4 percent of GDP in 2003 to 8.3 percent in 2050, and possibly higher if health care costs are not kept to a growth rate of GDP plus 1 percent.<sup>67</sup> This projection includes spending on the new prescription drug benefit. Using the GDP plus 1 percent assumption, combined Medicare and Medicaid costs would rise from 3.9 percent of GDP in 2003 to 11.5 percent in 2050.68 If, however, health care costs rise at annual rates closer to the historic long-term growth trend seen from 1960 to 2000 (or about 2.5 percent above GDP), costs will rise more sharply. The combined cost of Medicare and Medicaid could double to 7.8 percent in 2020, reach 15.1 percent in 2038 and 21.3 percent in 2050.69 The fiscal burden that this might pose could well be translated into cuts in benefits, such as raising the age of eligibility for Medicare.

# THE CHANGING AMERICAN WORKFORCE

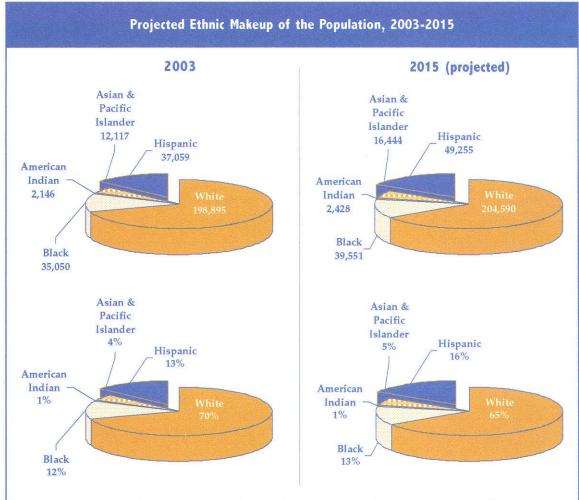
American society and the American workplace will undergo significant demographic changes in the next decade. While these changes are examined in more detail in Appendix A, *Demographic and Workplace Trends and Their Implications*, an overview is offered here.

## An Increasingly Diverse Workforce

The United States is a diverse country — racially, ethnically, socially and economically — with an increasing participation in economic life by women and minorities. Also, there have been significant changes in the makeup of the family. Marriage rates have declined, divorce rates remain high, and more women are entering the workforce. Only one in four working-age women were in the labor force in 1940. By 2000, however, over 70 percent of married women with children under age 18 were active in the labor force. Fewer and later marriages have contributed to a decline in fertility.

Trends in single parent families, later marriages, fewer children per family unit and children being born to parents at later ages — all may have an impact on the types of benefits offered. For example, there is likely to be an increase in the need for long-term care.

By 2015 the number of Hispanics in the U.S. population is projected to rise to 16 percent<sup>70</sup> (from 12 percent in the 2000). The Asian population will rise to 5.3 percent (from 3.8 percent). While the proportion of African-



By 2015, the number of U.S. Hispanics in the population is projected to rise to 16 percent (from 12 percent in 2000). The Asian population will rise to 5.3 percent (from 3.8 percent). While the proportion of African-Americans will be almost unchanged at 12.7 percent, the non-Hispanic white population is expected to experience a decline of six percentage points to 65.6 percent from its current level of 71.5 percent.

SOURCE: U.S. Census Bureau.

Americans will be almost unchanged at 12.7 percent<sup>71</sup>, the non-Hispanic white population is expected to experience a decline of six percentage points to 65.6 percent from its current level of 71.5 percent.<sup>72</sup>

The coming ethnic demographic shift may translate into a workforce with lower overall educational achievement, if past trends persist. For example, while currently 26

percent of the white population has four or more years of college, only 16.5 percent of African-Americans and 10.6 percent of Hispanics received college degrees.<sup>73</sup> These trends underscore the need for greater educational opportunities for *all* Americans. Financial and benefits literacy, already a problem, could become worse if overall educational levels fall in the workforce. Yet, Americans will actually require more

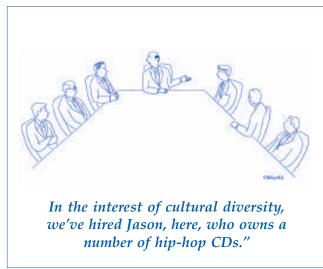
financial and benefits knowledge as individuals assume greater responsibility for saving for retirement, making decisions about investing their savings, and making informed choices about health care and long-term care.

## Labor Market and Workplace Trends

Due to lower fertility rates over the last few decades, fewer new young workers will enter the labor force than in the past. As a result, labor force growth in the first decade of this century is likely to be at a pace that is only 75 percent of that experienced in the 1990s. New labor supply will fall even further in the 2010s.<sup>74</sup>

In the future, more and more jobs are likely to be in professional and service occupations and involve the use of a computer. More workers are likely to be telecommuters, and more will be able to work from home.<sup>75</sup>

Increasingly, the workforce will be made up of workers who are not full-time employees who receive a full range of employee benefits.



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More of the workforce will include "flexible workers" who do not have traditional employment relationships, workers in alternative work arrangements (independent contractors, on-call workers, temporary help agency workers and workers provided through contract firms), as well as workers who work flexible or limited hours.

In recent years, employers increasingly have provided for phased retirement, which allows people to retire for the purpose of collecting benefits, but to continue working, sometimes only part-time. A survey of a number of private sector employers found that while 16 percent of employers provide a formal phased retirement program now, an additional 40 percent are interested in initiating such a program.<sup>76</sup>

## **Implications of Workforce Trends**

Slower labor force growth and tighter labor markets should result in a greater emphasis on benefits. As employers compete for their services, workers will demand not just higher wages but improved benefits and working conditions. The demand for workers may also reinforce the ongoing trend of greater labor force participation by older individuals.

Workers in the future are likely to continue to have many jobs during their working career. This trend, underway for many decades, will continue to present a challenge for workers to accumulate sufficient assets to provide an adequate retirement income.

The continued increase in the share of all working-age women who are in the workplace, and the corresponding growth in the number of two-income families, where the

# "We must face the realities of modern life ... that more people are working, and that they are living and working longer."

— Representative Benjamin Cardin (D-MD)

family unit is comprised of two working spouses, may change the worker demand for certain types of benefits. For example, one working spouse might be interested in family health care coverage from his or her employer while the other spouse may be more interested in other types of benefits. This will accelerate the drive toward more flexibility in plan design.

## **Economic Trends and Implications**

Recent trends in the economy and financial markets underscore the need for long-term planning and the importance of financial education for individuals to achieve and maintain personal financial security. The stock market, for example, experienced an extended bull market from the early 1980s to the spring of 2000. The market then went into a prolonged downturn, further aggravated by the terrorist attacks of September 11, 2001, before it began to recover in the second half of 2003. Declining interest rates aggravated the declines in the stock market by causing the present value of the pension benefit obligation to skyrocket; and, with that, the amount of underfunding in defined benefit pension plans.

In addition, health care costs have increased dramatically for the average American. In 1950, an individual's medical care costs made up just 3.7 percent of that person's total consumer expenditures. In the year 2000, medical care costs were almost 15 percent of

personal consumption.<sup>77</sup> Employers, too, are hit with higher payments when health care costs rise. Rising health care costs particularly in a weak economy may prompt many small employers to eliminate health care coverage or decide against adopting a retirement plan.

Rising health care costs also make it more difficult for many lower income workers to afford their share of health care premiums. As a result, many drop coverage either for themselves or their dependents. These trends, without systemic changes, will unquestionably increase the number of people without health care coverage and retirement benefits.

Despite market fluctuations, there appears to be no weakening of the desire of Americans to own equity shares. In 2001, 51.9 percent of all households held stock either directly or indirectly,<sup>78</sup> an increase from 48.9 percent in 1998. Part of the expansion in equity ownership has been driven by employersponsored stock ownership programs, including employee stock purchase plans that provide stock options to rank-and-file workers. For example, a 2000 survey by the National Association of Stock Plan Professionals and PricewaterhouseCoopers reported that 44 percent of 345 large domestic companies with stock option plans made grants to *all* employees, including hourly workers.79

#### What the Trends Mean

Demography shapes our national and individual destinies. Increases in the proportion of the elderly in the U.S. population will put enormous financial strains on the employee benefits system and on individuals preparing for retirement. In addition these trends have ominous implications for the future of Social Security and Medicare, where there will be fewer workers to finance the benefits for the growing ranks of retirees. This will make it all the more important that individuals be prepared to shoulder the costs associated with retirement. This is especially true for the

Longer life spans mean workers will have to accumulate more assets for retirement than in the past.

growing ranks of workers whose retirement income will be from a defined contribution plan, where more of the burden of determining how much to save and even how to invest falls on the individual.

In addition, longer life spans mean workers will have to accumulate more assets for retirement than in the past. They will also need to be able to afford supplemental retiree health insurance, out-of-pocket medical expenses, and pay for long-term care. Three recent years of declines in the stock market complicated that task.

Employers help individuals achieve their goals by providing attractive plans, offering

matches for employee contributions and structuring investment options. Indeed, employer contributions to all types of pension plans and insurance funds totaled \$723.4 billion in 2003.80 Together with changes in workforce and business trends, rising health care costs put strains on the ability of employers to provide a full range of employee benefits that help individuals build and maintain financial security. At the same time, employers face the task of closing current shortfalls in pension funding resulting from lower interest rates and sustained declines in asset values. Employers are also challenged by accounting rules that increase the volatility of pension funding obligations.

# THE CHALLENGE OF DESIGNING FUTURE BENEFIT SYSTEMS

Over the next decade demographic challenges, ever escalating health care costs and other potential adverse trends will require adjustments in the retirement and health care benefit systems. If serious efforts do not produce new plan designs and new funding mechanisms, workers in 2014 may find themselves without the level of support that employee benefits traditionally have provided to help workers and retirees build and maintain their personal financial security.

# Plan Designs Must Be Innovative, Flexible and Cost-Effective

In order to respond to the diverse and changing needs of employees and plan sponsors, the employee benefits system must

become more flexible and innovative than most current arrangements. For example, benefit plans will need to offer participants a choice to allocate resources between current needs (such as health care coverage, disability support, and life insurance) and future needs (such as adequate retirement income, retiree health coverage, and long-term care coverage).

Federal pension and health care law and regulation should allow for sufficient flexibility in plan design to create benefits systems that can be modified as needed in response to changing needs. New plan designs should also allow employers to remain globally competitive and avoid unnecessary government mandates. The mechanisms for the delivery and financing of benefit systems also need to be innovative and flexible.

The provision of retirement income benefits and health care coverage is not feasible unless it is affordable. Unless costs are contained, the level of benefits an employer can offer will be reduced. The challenge to the employee benefits system is to provide a meaningful level of benefits at an affordable cost, paid for in an equitable manner.

### A Role for All Stakeholders

As retirement security and health care coverage are objectives that society values, the costs associated with such coverage should be shared among all stakeholders. Since affordability of the benefits is a complex

issue, it should be viewed from the broadest possible perspective.

Clearly, the primary stakeholders — individuals, employers, and government — need to work together to assure that the benefit systems 10 years from now provide an appropriate level of benefits for workers and retirees. All three groups, to one degree or another, have been the victim of adverse events and trends that challenge benefit

systems. The primary stakeholders, however, cannot achieve a smooth transition to a new, sustainable and appropriate level of benefits without the help of all the other stakeholders in public and private benefit systems.

The provision of retirement income benefits and health care coverage is not feasible unless it is affordable.

Other stakeholders have both a keen interest and obligation — beyond their self-interest — to contribute positively to the system. These other stakeholders include actuaries, consultants, insurance brokers, attorneys and the trial bar, educators and education systems, health care providers, health care plans, investment managers, quasi-regulatory bodies, researchers and developers, producers, and third party administrators. The respective roles of these other stakeholders are described in Appendix B, *Other Stakeholders*.



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Other stakeholders can make a positive contribution towards the goals and recommendations set forth in this report. Vendors of pension plans, for example, are actively developing low-cost solutions to the need for financial education and could take on an expanded role in improving financial literacy. Educators can work toward making financial literacy part of the curriculum for all students.

If the nation is to adopt new public policies to enable workers and retirees to build and maintain personal financial security, all stakeholders must adopt a new model for setting public policy on benefits issues. This new model must incorporate a greater willingness by all stakeholders to seek compromise and redefine what serves their self-interests.

For example, **employers** must acknowledge that when workers' benefits become insecure, it tends to foster more efforts to impose government solutions. **Employee and retiree advocates** must recognize that undue burdens on plan sponsors translate into less coverage. **Government policy-makers** need to be candid about fiscal imperatives so promises can be kept. There should be honest debate about who will pay for new policies and coverages.

#### Role of Individuals

Increasingly, it will be necessary for all individuals to assume primary, but not sole responsibility for more areas of their personal financial security than in the past, especially with regard to retirement saving, health care and long-term care. Individuals must also shoulder primary responsibility for learning about how to live a lifestyle consistent with wellness principles and for being knowledgeable, engaged consumers of health care.

Another key responsibility of individuals is to make the most of financial educational opportunities to understand the issues surrounding the choices they will have to make with regard to planning for and saving for retirement, investing retirement assets, accumulating wealth, and managing assets in retirement. Individuals are responsible for maximizing tax preferences available for wealth accumulation, as well as being informed about proposals designed to enhance and protect their personal financial security.

### **Role of Employers**

The benefits system is a voluntary one and the responsibilities that employers assume need to be made consistent with meeting the employees' needs and expectations, as well as the employer's business imperatives.

Consistent with the voluntary nature of the benefits system, employers will continue to sponsor benefit programs that help workers and retirees build and maintain personal financial security. Employers can also help empower individuals to take on greater responsibilities and make the best of the choices they have within

employer-sponsored plans. Employers can assist them in such matters as learning how much they need to save, learning how to allocate retirement savings, as well as how to manage those investments over their career and into retirement.

As plan sponsors, employers can use marketplace purchasing principles and practices. This not only improves access to benefit programs, but also boosts delivery efficiency and raises the quality of programs. Employers, as plan sponsors, should continue to demonstrate their ability to develop innovative approaches and solutions to the design, funding, administration, delivery, and communication of employee benefit plans.

Employers can actively participate in the legislative and regulatory process to encourage the adoption, maintenance, wellbeing and vibrancy of employee benefit plans and to ensure that the best interests of all stakeholders are understood and addressed.

#### Role of Government

All stakeholders have a

role and a responsibility.

acknowledge that when

more efforts to impose government solutions.

**Employee and retiree** 

that undue burdens on

plan sponsors translate

makers need to be candid

about fiscal imperatives so

debate about who will pay

into less coverage.

Government policy-

promises can be kept.

for new policies and

coverages.

There should be honest

advocates must recognize

workers' benefits become

insecure, it tends to foster

**Employers must** 

It is critical for policy leaders to develop and maintain public policy that supports the voluntary efforts of employers to provide access, funding, and education for key aspects of personal financial security, such as employer-sponsored pensions, retirement

> The government holds ultimate responsibility for the development and implementation of tax and regulatory policy. It is vital that these policies facilitate the well-being and vibrancy of plans in the private sector. Policymakers and government leaders should seek to enact and adopt productive tax policy that

encourages sufficient savings and appropriate benefits coverage for workers. They should avoid burdensome regulations that stipulate mandates or add significant costs to the administration of broad benefit programs. The regulatory framework should promote uniform rules across the nation.

saving vehicles, wealth accumulation through company stock purchases, health care insurance for active and retired workers, and longterm care insurance. Public policy should also focus on modernization and improved quality and consistency of services from providers and systems that deliver benefits to workers and retirees.

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The government should encourage individuals to understand, accept responsibility for, and work to achieve and maintain a high level of personal financial security. Governments from the federal to the state and local levels can do more to educate high school and college students, as well as workers, about the importance of striving to achieve personal financial security and about how one can reach that goal. Information provided workers should include explanations of the key role that employee benefits play. Government should also provide research funds to organizations that develop, measure, and enhance the quality of employee benefits.

The government should also provide a safety net for personal financial security with regard to retirement income, health care, disability income, and job loss. While government revenues fund the safety net, the private sector, whenever possible, should provide the delivery mechanisms for such benefits. As the leader in technology, innovative design, and quality improvement, the private sector can often respond more quickly to meet demands.

# A New Architecture for the Employee Benefits System

The purpose of this long-term strategic plan is to present the American Benefit Council's visions, goals, and recommendations for building a new, more effective and sustainable employee benefits system over the next decade that achieve the following broad objectives:

- Retirement systems should have incentives that encourage employers and employees to contribute adequate amounts to retirement income and savings programs, and encourage employees to manage their assets to last throughout retirement;
- 2. Active employee health care systems should promote broad coverage and empower purchasers to be effective health care consumers.
- Retiree health and long-term care systems should help ensure adequate health care security in retirement while still allowing retirees to continue to have the level of income they have come to enjoy.
- 4. Stock plan ownership arrangements should advance personal financial security through accumulation of capital.

This long-term strategic plan should be viewed as a living document. For each of the benefit systems addressed in this plan the Council adopted a *vision statement*, followed by *goals* and *recommendations*.

Each of these parts of the overall plan are subject to periodic reevaluation and adjustment as the Council reviews progress in addressing the challenges outlined in this paper and as other changes may reorder priorities.

The *recommendations* below may not represent all the initiatives that are likely to be required to achieve the stated goals. In that sense, they should be viewed as initial or

illustrative recommendations with the expectation that further recommendations may be forthcoming to help achieve the goals enumerated. Some goals will likely be achieved before 2014. Others may take longer. As a benchmark of our progress, the goals will be regularly reassessed. When they are found to be either too modest or overly ambitious, they can be adjusted accordingly. In some cases individual recommendations support more than one goal.

The Council has not calculated the cost attached to each of the recommendations in this plan, but acknowledges that the expense of financing the recommendations will be a crucial element of any policy decision.

#### **FUTURE RETIREMENT SYSTEMS**

#### **Vision Statement**

As individuals assume primary responsibility for their own personal financial security, it is essential they be equipped with the tools needed to achieve this goal. In our vision, individuals are empowered through education, technology and incentives to determine the retirement income they need; to understand the available sources of retirement income; to save the amounts they need; and to manage their retirement savings to produce a sustained retirement income throughout their lifetime.

In this vision, employers assist their employees in accumulating the assets needed to produce an adequate retirement income by continuing to develop, sponsor, and fund (to the extent economically feasible) efficient and tax effective retirement income and savings plans.



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In this vision, government continues to provide a foundation for retirement income through the Social Security system, on which individuals and employers can build income from additional sources.

Government also provides tax incentives and a streamlined regulatory regime to promote retirement benefits programs especially employer-sponsored plans of all types from traditional defined benefit plans through hybrid plans to defined contribution plans. Government also encourages the development of innovative plan designs that help individuals attain personal financial security.

Despite the best collective efforts to promote retirement income security, it must be recognized that many individuals are not able to maintain an adequate standard of living in retirement without government assistance.

In this vision, the *other stakeholders* expend intellectual capital, provide data and research, and use advanced technology to support the actions and efforts of individuals, employers and government. They can do this by developing innovative plans, products, programs and educational materials that promote retirement income and saving systems. These plans and programs should work to expand coverage, increase quality and improve cost effectiveness.

# GOALS

## Goal 1: Raise Financial Literacy

By 2014, virtually all households will have access to some form of investment education and advice and 75 percent of households will have calculated the amount of retirement savings needed to maintain their standard of living throughout retirement, as well as the savings rate necessary to achieve this target.

## Context

The number of people who have access to investment advice is very small. Estimates suggest that only 16 percent of 401(k) participants have an investment advisory service available to them. 81 When advice is offered, participants do not always seek it out. One report indicates that only 24 percent of those who are registered to receive advice actually take steps to obtain the service. 82

However, if public policies are adopted that facilitate investment advice, employers and providers can be expected to develop ways to provide access to investment education and advice to virtually all households.

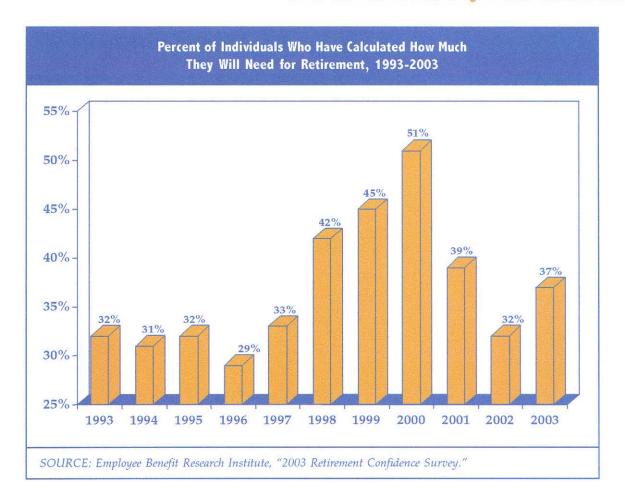
One of the first steps toward building an adequate retirement income is to calculate how much one needs to save to reach one's retirement goals. In 2004, 42 percent of U.S. workers reported that sometime in the last three years they or their spouses have calculated how much money they will need to save in order to live comfortably in retirement, according to the Retirement Confidence Survey.<sup>83</sup> Over the past decade the proportion of workers who have engaged in this key retirement planning activity in the annual retirement confidence survey has varied from a low of 31 percent in 1994 to a high of 53 percent in 2000.

The goal of 75 percent was chosen because it represents a significant increase from the peak level reported in the 2000 Retirement

Confidence Survey. The amount-needed-to-save calculation was chosen as a goal because it indicates that a worker has achieved enough financial literacy to begin retirement planning and is prepared to take steps to act on what has been learned.

Estimates suggest that only 16 percent of 401(k) participants have an investment advisory service available to them.

Workers, however, may be underestimating how much they need or may not be able to make a determination at all.<sup>84</sup> Thirty-eight percent of those surveyed in 2004, for example, expected they will need an income of less than 70 percent of their pre-retirement earnings. By contrast, most retirement advisers suggest that a retirement income of



at least 70 percent or more of pre-retirement earnings is needed to maintain an individual's pre-retirement lifestyle. (Some advisers suggest 100 percent of pre-retirement income.) Respondents in the survey did not determine what savings rate they needed to adopt in order to meet their retirement goal.

# Initial Policy Recommendations:

Provide public sector and private foundation funding to develop educational tools that can be used by employers, government and other stakeholders in educating workers about saving, investment and income management principles. Education efforts also include information about

longer life spans people are expected to have in the future, and how workers can financially prepare for longevity risk.

- Establish financial education as a high school and college graduation requirement.
- Enact legislation to allow employees to receive financial education and advice through their workplace and/or from a retirement plan administrator. If provided through the employer, qualified advisers affiliated with plan investment offerings may participate (with certain worker protections provided) and employers should be protected from fiduciary liability for the specific advice provided to individual participants.

Include in the Social Security Administration annual statement mailed to workers information on how to calculate a rough estimate of the amount one needs to save that, when combined with one's projected Social Security benefit, will provide a replacement level income of 70 percent of one's pre-retirement earnings.

# Goal 2: Increase the Share of Workers in Workplace Retirement Plans

By 2014, 96 million (74 percent) of full-time and part-time private sector employees will participate in workplace retirement plans.

#### Context

According to the most recent federal data from a survey of employers, <sup>85</sup> approximately 49 percent of 103 million — or about 50 million full-time and part-time private sector workers <sup>86</sup> — in 2003 participated <sup>87</sup> in a workplace retirement plan. <sup>88</sup> An increase to 96 million would raise participation rates to

About 50 million fulltime and part-time private sector workers in 2003 participated in a workplace retirement plan. 74 percent in 2014 when the size of the private sector salaried and wage workforce<sup>89</sup> is projected to be about 130.3 million.<sup>90</sup> This represents a 50 percent improvement over current participation rates.

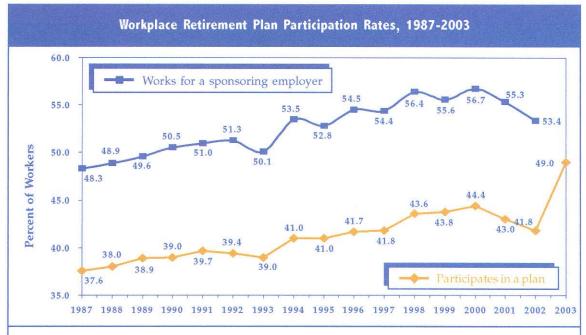
Looking at the increase from the perspective of 2003, and the most recent survey data, such a proportional gain would have increased by half the number of private sector salary and wage workers who participate in

a workplace retirement plan, adding 25 million full-time and part-time workers and raising the number of participants from 50 million to 75 million.

Different segments of the workplace population have widely differing participation rates. In 2003, for example, medium and large businesses (100 employees or more) had a participation rate of 65 percent, while small businesses (99 or fewer workers) had a participation rate of 35 percent. 91 Further, the participation rate for full-time workers of all private sector businesses was 58 percent, significantly higher than the 18 percent for part-time workers. 92 And, there was an even higher participation rate for full-time workers at medium and large businesses, which had an 80 percent participation rate, while fulltime workers at small businesses had a 42 percent participation rate.93

One can see from recent historic experience that employers have been able to increase the level of participation significantly. From 1987 to 2000, the participation rate for private sector wage and salary workers rose 7 percentage points from 40 percent to 47 percent, according to an analysis<sup>94</sup> of the data sets in the U.S. Census Bureau's Current Population Surveys by the Employee Benefit Research Institute.

A significant increase in participation rates over the next decade can occur mostly from increases in participation rates at small businesses, as occurred between 1987 and 2000. There is also room for improvement at medium and large business, as well as among part-time employees at all businesses.



SOURCE: Employee Benefit Research Institute Issue Brief No. 256, "Employment-Based Retirement and Pension Plan Participation: Geographic Differences and Trends" (2003).

If participation is to increase, more employers will have to offer retirement plans. This outcome, in turn, depends on devising innovative and flexible plans that are attractive to employers, especially small- and mid-sized businesses.

Expanding participation in workplace plans is important for other reasons. It appears to be the best way to increase retirement saving. If one looks at federal income tax return data, the proportion of filers who claim an IRA or Keogh deduction has been both fairly modest and steadily declining over time. From a peak of 16.2 percent in 1986, it fell to 3.5 percent in 2000 and 2001.95 In contrast, the participation rate in workplace plans is 66.2 percent of those eligible for 401(k) plans (a population of workers that represents 32.6 percent of the private sector workforce).96

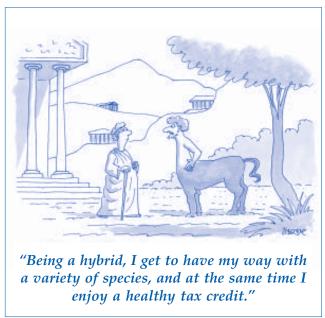
A different challenge faces defined benefit plans. Such plans, which provide a guaranteed income in retirement, now cover 19 percent of full-time and part-time workers<sup>97</sup> in the private sector.<sup>98</sup> The number of plans insured by the Pension Benefit Guaranty Corporation declined dramatically from approximately 114,000 in 1985 to about 32,000 plans in 2002.<sup>99</sup> In 1998, defined benefit plans in the private sector paid out an extraordinary \$107.8 billion in direct benefits and an additional \$3.4 billion to insurance companies for the purchase of annuities for beneficiaries.<sup>100</sup>

Funding rules, market declines, and low interest rates used for a variety of pension calculations, including determining plan liabilities, caused some employers to freeze their defined benefit plans. These developments have also deterred other employers from starting new defined benefit plans including hybrids, such as cash balance plans. Concerns about the volatility of the funding liability have complicated the task of preserving these plans and devising policies to get more companies interested in traditional defined benefit and hybrid defined benefit plans.

All types of defined benefit plans, including hybrid plans, can play a role in increasing participation rates in workplace retirement plans. To the extent that further erosion of the defined benefit system can be halted, the task of expanding coverage through other types of plans becomes less daunting.

Also, to the extent that new, innovative hybrid designs can attract more employers to offer defined benefit plans, it can help increase participation rates in retirement plans. Further, enrolling more employees in defined benefit plans potentially can provide more workers a guaranteed income in retirement.

Efforts are under way to develop new types of plans, such as a combination of a 401(k) plan and a guaranteed benefit from defined benefit plan or hybrid into a single plan, or DB(k).



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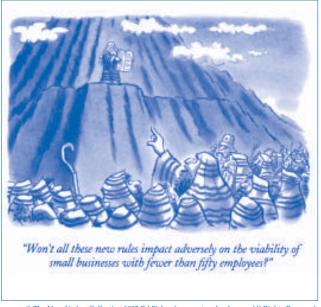
New types of simplified guaranteed annuity plans could also be offered in combination with a 401(k) plan. Efforts are also underway to devise new funding rules to reduce the volatility in funding liabilities for employers who sponsor defined benefit plans. To the extent such policies can be established, they could help preserve and/or expand participation in defined benefit and hybrid plans.

# Initial Policy Recommendations:

- New policies should ensure that employers have a range of plan designs available so they can select the retirement plan design that best suits their workforce needs. This would include enhancing all existing plan design types and encouraging new simplified plan designs that offer employer tax incentives, reduce administrative requirements, and provide for worker education on saving for retirement.
- Authorize the creation of a "clearinghouse" model plan through federal legislation so workers who change jobs frequently can contribute to one retirement plan. This plan would be modeled on a multi-employer plan model that could provide individuals with one account that would stay with them when they change jobs. Employer contributions to the plan would be voluntary and no financial or administrative requirements would be imposed on employers (other than transferring worker contributions to the plan). This model plan would accept differing levels of employee contributions and employer contributions, and would

be able to accommodate different investment vehicles. Any financial services firm meeting certain qualification criteria would be able to offer the "clearinghouse" model plan.

- Enhance default mechanisms (e.g., automatic enrollment, lifestyle funds, retirement target funds) to be sure that individuals who decline to make a choice are more likely to be enrolled in a plan (and be savers) and to invest their assets appropriately for their age and for the best risk-adjusted return.
- Eliminate rules that restrict workers and employers from creating flexible working relationships and benefits arrangements such as phased retirement programs.
- Maintain support for the voluntary use of company stock in retirement plans through employer contributions or by making company stock available to employees as an investment alternative in the retirement plan. Employees should be educated about the special risks of company stock ownership in retirement plans.
- Support plan funding reforms that reduce the volatility of the funding obligation in defined benefit plans. Support policies that provide for new types of defined benefit plans that can offer guaranteed levels of retirement income. Such guaranteed annuity plans could be offered alone or in conjunction with a 401(k) or other defined contribution plan.



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# Goal 3: Raise Retirement Savings

By 2014, the gross personal savings rate, which covers saving for all purposes, will reach 15 percent of disposable income. In addition, many, if not most individual workers across the income spectrum will be saving at a rate between 7 and 15 percent of earnings specifically to provide a retirement income that is at least 70 percent of preretirement earnings.

#### **Context**

The choice of a 15 percent household savings rate was based on the need to raise saving levels to a level closer to that of other developed nations and to make it high enough to cover both retirement saving and other household saving needs. The Organization for Economic Cooperation and Development (OECD) reports, for example, that in 2001 the U.S. savings rate was

4.7 percent, while the other six members of the seven largest developed nations averaged a 10.3 percent gross personal savings rate. <sup>101</sup> Using the OECD methodology, the U.S. savings rate averaged 6.4 percent for the six years from 1998 to 2003. That was much lower than levels during the decade from 1983 to 1992, when the U.S. gross personal savings rate averaged 13 percent. The rate averaged 10.4 percent from 1993 to 1997. The gross household savings rate is, of course, not a proxy for how much households are saving for retirement. However, it does reflect partly, and perhaps largely, the level of saving for retirement.

The U.S. savings rate averaged 6.4 percent for the six years from 1998 to 2003, much lower than levels during the period from 1983 to 1997.

If one assumes that most workers begin to save between 21 and 35 years of age, then an overall household savings rate of 15 percent would likely be high enough to encompass what households need to save for retirement and still leave room for other forms of saving, such

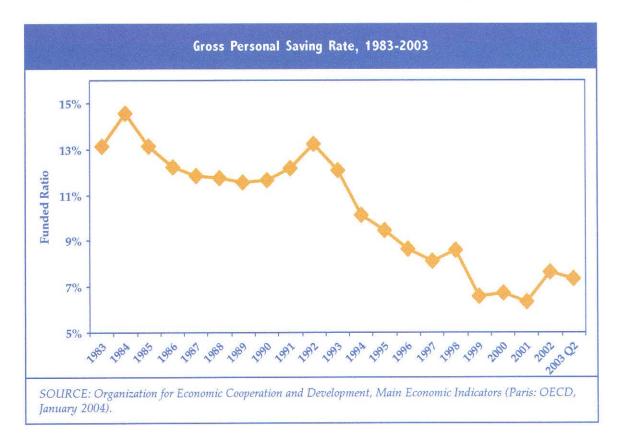
as saving to buy a home, for emergencies, for college education, and medical care. To the extent workers delay too long past age 30 to begin saving for retirement, however, a 15 percent household savings rate would not be adequate to assure a 70 percent replacement rate in retirement for most workers.

The calculation of how much one needs to save for retirement must be made on an individual basis. That amount most

importantly depends on how early in one's working life a person begins to save. The earlier a worker starts, the lower the savings rate required to reach an income level after retirement close what the worker earned before retirement. The amount one needs to save also depends on assumptions about a number of other factors, including the rate of return on retirement savings, the rate of future wage and salary growth, and how many years one expects to live after age 65.

If one begins to save at 21, one could accumulate a 70 percent replacement rate (not counting Social Security) by saving 3.5 percent of one's income, provided it is invested in a portfolio allocated 60 percent to stocks, 40 percent to bonds. 102 Few people start saving for retirement at age 21, however. If a person earning \$35,000 waits until age 35, for example, he would have to save 12.6 percent of his income to retire at age 65 with a 70 percent replacement, including Social Security. 103 The rate rises to 15.2 percent for a worker making \$55,000 a year. It is higher because Social Security replaces less of one's income as income rises. If one wants to also save for other needs, such as Medicare supplemental policies and out-of-pocket health expenses, one would have to save at an even higher rate. If one wants to be sure that one does not outlive their assets, one will also have to save at an even higher rate.

A study<sup>104</sup> by the Employee Benefit Research Institute in collaboration with the Millbank Memorial Fund calculates that Americans will need an additional \$400 billion more than they will have saved to cover basic expenditures in retirement and any expense associated with an episode of care in a



nursing home or from a home health care provider for the decade between 2020 and 2030. The study simulates retirement income from Social Security projections and savings from current patterns of saving in taxpreferred retirement savings vehicles, including defined benefit plans, defined contribution plans, and IRAs of all types. <sup>105</sup> It also simulates retirement expenditures on living, health care and long-term care. It calculates the shortfall between retirement savings and expenses by age and income cohorts from 1936 to 1965.

The study finds that most couples in the top two quartiles of income born after 1945 can close the gap by increasing their savings rate by just 5 percentage points. <sup>106</sup> However, most couples in the lower two income quartiles born after 1945 would need to save an additional 10 to 17 percent in order to close the gap. <sup>107</sup> Those born in 1945 and earlier will

need to save more to meet their needs while those born in later years can meet their needs with less of an increase in savings. Single men and women need to save more than couples to close the gap. However, single women in the lowest quartile face an impossible task of saving more than an additional 25 percent of savings on very modest incomes.

The study does not, however, translate the additional retirement savings needed to meet retirement needs for the various cohorts in the study into an explicit aggregate savings rate for the entire economy. Its findings do, however, generally support the goal of raising overall savings for the economy to 15 percent from recent levels of 6.4 percent. That would be enough to close to retirement savings gap for the great majority of Americans born after 1945 provided the savings were spread relatively evenly across the population.

# Initial Policy Recommendations:

- Provide an enhanced saver's tax credit for low-income individuals above and beyond current law, which provides a partial tax credit for employee contributions made to defined contribution plans and Individual Retirement Accounts.
- Provide new tax credits to employers to finance contributions that represent for each employee a uniform percentage of wages and salaries and/or to finance supplemental contributions for lowincome workers.
- Provide increased tax incentives to all individuals to encourage them to maximize retirement savings and to ensure that their savings last throughout retirement.
- Simplify onerous plan administration and compliance requirements (e.g., nondiscrimination testing) in order to maximize individual savings and encourage employers to start up and/or maintain qualified retirement plans.

# FUTURE HEALTH CARE SYSTEM FOR ACTIVE WORKERS

#### **Vision Statement**

The current health care system is in crisis and is unsustainable unless significant changes occur soon. In our vision, a major overhaul of our health care delivery system is imperative in order to make it less burdensome, less litigious and more focused on achieving high-quality and consistent results. We

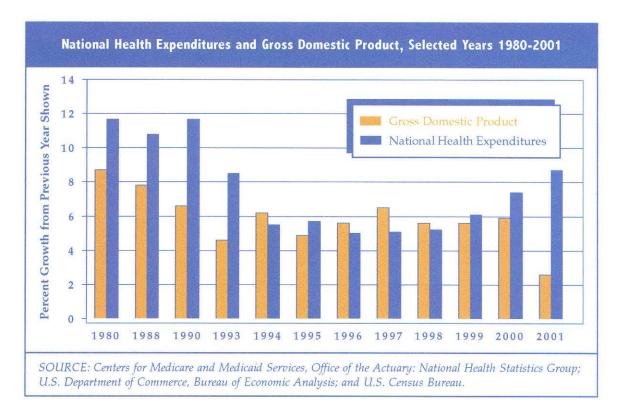
assert, however, that past attempts at onetime comprehensive solutions have failed and have actually impeded innovation and reform.

Our vision does not embrace extreme "solutions" that rely exclusively on either individuals or the government to take control of the health care system. In our vision, the successful reform of the health care system can be achieved through practical and meaningful steps that actually have the possibility — both substantively and politically — to be implemented. These measures can only succeed if all stakeholders commit to the sustained effort that will be required.

In this vision, the reformed health care system empowers *individuals* through education, technology, and incentives to be actively engaged in the choices that lead to healthier lives and to be able to make well informed decisions about the appropriate use of health care services.

*Employers* continue to play a leading role in providing access to vital health care services, in driving improvements in the health care system and in sharing the cost of health care services with their employees.

Government provides tax incentives and a streamlined regulatory regime that support a health care system characterized by healthy individual lifestyle choices, expanded coverage, broad flexibility in health plan design and high quality, cost effective health care services, and protection of health care system stakeholders from unwarranted liability.



In this vision, the *other stakeholders* expend intellectual capital, provide data and research, and use advanced technology to develop innovative plans, products, programs, educational materials and delivery systems to support the actions and efforts of individuals, employers and the government.

In addition, information on quality, efficiency, and patient satisfaction with hospitals, physicians, treatment protocols and health plans is made available to consumers so that health decisions are made on an informed basis. These efforts are structured and designed to promote a cost-effective and affordable health care system with expanded coverage, increased quality, and evidencebased individual health care decisionmaking. Other stakeholders also work closely with the primary stakeholders to develop and implement innovative strategies to contain the rapidly escalating costs of health care services that are undermining the health care security of all.

The goals set forth are bold. By contrast, some of the recommendations represent measured steps toward improving the system. This approach has been taken because in the past, when comprehensive reforms were tried, they utterly failed. For this reason, the paper is focused on bold but achievable goals and pragmatic recommendations that can incrementally improve the system.

# Goal 4: Make Health Coverage More Affordable

By 2014, health care costs will return to a more sustainable annual rate of increase in the single digit range that more closely tracks the overall increase in the gross domestic product (GDP).

#### Context

The Centers for Medicare and Medicaid Services track total health care spending in the United States. Their latest data show that total health care spending at all levels – private and public – rose 9.3 percent in 2002. 109 At the same time the Gross Domestic Product (GDP) grew at only 3.6 percent. Thus, in 2002 the pace of gains in health care spending were nearly three times the rate of growth for the economy, clearly an unsustainable situation.

In the past the United States has been able to bring health care spending into line with economic growth, but only for a short period of time. For example, after a big spurt in health care spending in the late 1980s and early 1990s, GDP growth outpaced gains in health care spending in 1994, 1996, 1997 and 1998. Since 1999 health care spending has increasingly outpaced gains in the GDP.

In 2002, the pace of gains in health care spending were nearly three times the rate of growth for the economy, clearly an unsustainable situation. Taking a longer term view, health care spending has, on average, risen faster than the GDP, but not at the very high rates seen in recent years. During the four decades from 1960 to 2001, health care spending averaged 2.5 percentage points higher than the growth of GDP.<sup>111</sup>

Between 1990 to 2001, health care spending averaged 1.5 percentage points higher than the GDP. If the United States could bring health care spending growth rates closer to a level 1 to 1.5 percentage points above GDP, it would go a long way toward moderating the scope of spending in the future.

A goal of bringing total health care spending closer to GDP growth rates assures that the portion of the economy allocated to health care spending — already quite high — does not sharply increase its relative share, although the United States may not be likely to prevent health care spending from taking a larger share of GDP. For businesses, keeping health care spending closer to GDP growth rates can help assure that the cost of providing health care to employees can be relatively stable and sustainable.

Addressing the issues surrounding medical errors can enhance the quality and affordability of the system. According to a report by the Institute of Medicine, at least 44,000 people, and perhaps as many as 98,000, die in hospitals yearly as a result of medical errors that could have been prevented. The cost of medical errors in hospitals, including the expense of additional care made necessary by the errors, lost income and household productivity, and disability, is between \$17 billion and \$29 billion a year.

The Institute of Medicine's study prompted the formation of The Leapfrog Group for Patient Safety, a consortium of larger employers working to get hospitals to implement measures to improve patient safety and the quality of care. However, there is concern that aggressive medical malpractice attorneys could transform the Leapfrog standards into performance expectations. For example, some worry that if hospitals violate the Leapfrog standards, it

could lead to more medical malpractice lawsuits that would drive up malpractice premiums and raise the overall costs of medical care. The General Accounting Office, in a recent report, 113 cites rising malpractice claims as the "primary driver" of higher medical malpractice insurance premiums.

These developments illustrate that efforts to reduce medical errors alone will not necessarily reduce costs, but must be accompanied by tort reform affecting medical malpractice.

Some of the initial policy recommendations to restrain the growth in health care spending and inflation include, but are not limited to the following: (1) the adoption of reforms that empower consumers to make better informed health care decisions, (2) a reduction in medical errors and excessive liability, (3) greater flexibility in health plan design, and (4) the education of individuals to be more effective consumers of health care.

### Initial Policy Recommendations

• Improve the quality and performance of the health care system by developing, through private and public sector initiatives, consistent, evidence-based measures. In addition, increase funding for outcomes-based research for health care services supplied by hospitals, physician specialists, clinical laboratories and other health care providers that can be used by purchasers and individuals to identify the "best performers" in the health care system.



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- Increase the incentives for individuals to lead healthier, more active lifestyles that would reduce the incidence of obesity and other avoidable diseases. In addition, expand the availability of workplace wellness programs and health plan designs that promote wellness and cover cost-effective preventive services.
- Significantly reduce the current unacceptably high levels of medical errors, inappropriate care and the provision of health care services that result in patient harm or death. Medical errors can be reduced by adopting national goals directed at achieving measurable annual improvements in health care quality, consistency and positive patient outcomes.

- Curb excessive liability and unsustainable cost increases caused by "defensive medicine" by enacting federal medical liability reform legislation with firm, reasonable limits on damages and other sensible tort reforms.
- Allow greater flexibility in the design of health plans by strengthening ERISA preemption and eliminating specific benefit mandates or conditions on health coverage at either the state or federal level that interfere with the ability of either insured or self-insured health plans to offer more affordable health plans.

Goal 5: Increase the Quality of Health Care Services

By 2014, at least 50 percent of Americans with health care coverage will be enrolled in a health plan design that provides user-friendly, comparative information on the quality and performance of health care providers and services and the majority of all others with coverage will have the option to choose to enroll in such a plan.

health plan.

Only about 1 percent of Americans are now enrolled in some type of consumer-driven

liability for costs for the first several thousand dollars of claims to the employee. The plan includes an employer-funded account that workers can use for a variety of medical expenses, including premiums. The plan provides workers with catastrophic health care coverage for expenses above the high deductible, although some plans have first dollar provisions that cover initial expenses up to a modest limit. This example is one of potentially many plan models we can expect to emerge to help consumers be more cost conscious and to assist them in making better quality choices.

Employers, especially those that currently sponsor Preferred Provider Organization

> (PPO) health plans, 115 are expected to offer CDHP-type plans over the next few years. As many as 40 percent of the people currently in PPO plans are expected to move to some type of consumer-driven health plan, with a big boost coming between 2006 and 2007, according to a study by Forrester Research. 116

The type of CDHP plan available today may not necessarily be the preferred choice in the future. Employers may consider other types of plans that shift less of the risk to the employee, for example. Employers will be looking for plans that help make consumers more cost and quality conscious. Such plans

## Context

Currently, only about 1 percent of Americans are enrolled in some type of consumer-driven health plan. 114 One form of these plans currently available typically transfers the

might, for example, rate or rank health care providers. Some employers might also adapt existing PPO and Health Maintenance Organization (HMO) plans to incorporate changes that make consumers more cost and quality conscious about the health care services available to them. They may wish, for example, to group health care providers into different quality tiers, each of which would be available to the plan's enrollees, but with a different out-of-pocket cost.

Plans designed to make consumers more quality and cost conscious are expected to affect the health care market place when the number of people enrolled in the plans reaches about one-fourth of the market. Forrester calculates this will happen by 2010. At this level of market penetration, such plans are expected to begin to encourage more transparency and responsiveness by health care providers to cost-conscious and cautious consumers.

As plans that provide better information to consumers compete for more enrollees, consumer-driven plans are expected to lead health care providers to respond more openly and effectively to improve quality within the system and make an effort to provide the kind of customer satisfaction that will attract and keep health care customers. By expanding the market share of consumer-driven plans further to 50 percent by 2014, it will strengthen the benefits of the consumer-driven approach to health care.

The benefits expected from consumer-driven plans will, of necessity, require an increase in consumer access to information on health care and providers. <sup>117</sup> In that regard, the Institute of Medicine's Committee on Quality of Health Care in America recommends a high-level national effort to improve the use of information technology in the field of medicine. It recommends that Congress, the executive branch and leaders of health care organizations, public and private purchasers, and health informatics associations and

vendors should make a renewed national commitment to building an information infrastructure to support health care delivery, consumer health, quality measurement and improvement, public accountability, clinical and health services research, and

The benefits expected from consumer-driven plans will require an increase in consumer access to information on health care and providers.

clinical education. This challenge is daunting, the committee states, and in the absence of a national commitment and financial support, progress will be "painfully slow." 119

Finally, the points made in the context section for Goal 4 regarding medical errors and medical malpractice are equally applicable here to quality in medical care.

# Initial Policy Recommendations:

- Develop clear, publicly-disclosed information that individual consumers can easily understand and use to compare health care providers and services on the basis of standardized measures of their quality, safety, patient satisfaction and efficiency.
- Significantly expand the availability of different forms of health plans that support and reward individuals who become more actively engaged in making well-informed decisions about the appropriate use of quality health care services.
- Encourage much greater use of advanced information technology to support employers and employees in evaluating and choosing the health care services and providers best suited to their needs.
- Expand the availability of public and privately-funded educational tools to assist individuals with their increased decision-making responsibilities in the health care system and assist them as participants in consumer-directed health plans.

# Goal 6: Increase the Number of People with Health Insurance Coverage

By 2014, 243 million or 91 percent of nonelderly Americans will have some form of health insurance. This will represent a reduction by half the proportion of the nonelderly population that is uninsured today.

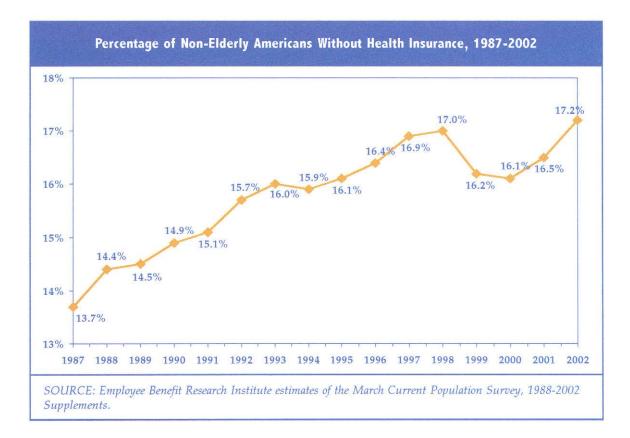
#### **Context**

In 2002 82.7 percent or 208.4 million of the U.S. non-elderly population of 251.7 million was covered by some type of health insurance, while 43.3 million or 17.2 percent were uninsured. A year earlier, 83.5 percent or 206.6 million of the U.S. non-elderly population of 247.5 million was covered while 16.5 percent or 40.9 million were not.

An analysis of the 2001 data reveals that within the insured population, 162.3 million or 79 percent were covered by an employer-based plan. Almost half of those were dependents. <sup>121</sup> In addition, 16.4 million were covered by individual policies, and 37.9 million were covered by public programs, including Medicare (5.6 million), Medicaid (28.3 million) and Tricare/CHAMPVA <sup>122</sup> (6.6 million).

An increase from 82.7 percent to 91.4 percent would have been equivalent to adding 21.65 million nonelderly to the ranks of the insured in 2001 and would have increased the insured population from 208.40 million to 230.05 million. Such a gain also would have *cut in half* the number of uninsured nonelderly from 43.3 million to 21.65 million.

In 2014, the nonelderly population will be 265.2 million, according to projections by the U.S. Census Bureau. <sup>123</sup> An increase from 82.7 percent (219.3 million) to 91.4 percent (243.2) will represent an additional 23.9 million insured nonelderly Americans.



Both employment-based and public health insurance can contribute to an expansion of coverage and a reduction of the uninsured population. In each of these two sectors, periodic trends of reduced coverage have emerged since 1987, according to an analysis of changing patterns of coverage by the Employee Benefit Research Institute. 124

Between 1987 and 1993 the number of uninsured increased from 13.7 percent to 16.0 percent due to an erosion of employment-based health benefits. The decline in workplace benefits was greater than growth in coverage by public programs.

Between 1993 and 1999, however, the portion of the population covered by employer-based health benefits rose while the portion covered by public programs slipped. The net result was the proportion of uninsured was only modestly higher by 1999 at 16.2 percent.

Medicaid coverage declined during the 1990s because welfare reform and a strong economy lifted more people out of welfare and into the employment sector – but into jobs without health benefits. At the same time continued downsizing of the military during the 1990s reduced the number of people covered by Tricare or CHAMPVA. 126

Between 1998 and 2001 the number of children covered by Medicaid or State Children's Health Insurance Programs (S-CHIP) increased from 20 to 23 percent. However, despite declines in the portion of children covered by employment-based health benefits in 2000 and 2001, the percentage of children without health insurance fell from 14 percent to 12 percent between 1998 and 2001.

To the extent coverage can be expanded in both the employment sector and the public sector, the chances for reducing the pool of uninsured are increased.

A study by Jennifer Haley and Stephen Zuckerman<sup>127</sup> identified two distinct groups of uninsured: those uninsured for the short-term, less than a full year, and those uninsured for the long-term, more than a year.

Between 1993 and 1999, the portion of the population uncovered by employer-based health benefits rose while the portion covered by public programs slipped.

The researchers analyzed the data from the 1999 National Survey of America's Families by the Urban Institute, which surveyed nonelderly adults and children in 42,000 households. Based on the responses, 36 million nonelderly were uninsured at the time of the survey.

However, 49 million were uninsured at the time of the survey or at some point during the 12 months preceding the survey. Within that population of 49 million, 22 million were uninsured for the short term, while 27 million were uninsured for a year or more. Thus, both

pools of uninsured — the long-term and the short-term — were quite large.

Haley and Zuckerman concluded that different policy recommendations may be needed to address the temporary or short-term uninsured than might be appropriate for the more challenging group of long-term uninsured.

## Initial Policy Recommendations:

- Make health coverage more affordable for lower-income individuals by providing tax incentives to help them purchase coverage through employer-sponsored plans or in the individual insurance marketplace.
- Improve existing programs such as Medicaid and State Children's Health Insurance Programs (S-CHIP) by gradual expansion in funding and eligibility criteria to meet the health care needs of those who lack employer-sponsored health coverage.
- Expand the availability of health care services in rural areas and other underserved communities through improved public funding of clinics and

"I believe we can reduce the numbers of uninsured by building on initiatives like the Children's Health Insurance Program (CHIP) and Medicaid, as well as through employer tax credits."

— Senator Max Baucus (D-MT),

community health centers, appropriate reimbursement for services by Medicare and other federal health programs, and through improved incentives for health care providers to practice in the areas of greatest needs.

- Americans by providing federal reinsurance for the catastrophic expenses of state high-risk pools. This would make it possible to provide a more affordable, basic level of health insurance coverage for all those who lack access to employer-sponsored coverage or who do not qualify for coverage under a health assistance program for low-income individuals and families.
- Limit the potentially devastating costs of major acts of terrorism to health plans and employers through a combination of private and public sharing of the financial risk of such highly unpredictable events.

# FUTURE RETIREE HEALTH AND LONG-TERM CARE SYSTEMS

#### **Vision Statement**

As members of the baby-boom generation begin to migrate into retirement, it is essential they and future retirees be equipped with the tools they need to provide for their own health security in retirement. In our vision, individuals are empowered through education, technology and incentives to understand and make provision for the continuum of health and long-term care services they will require as they age and their health conditions change.



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In this vision, *Government*, through a reformed and more comprehensive Medicare program, continues to be the primary source of post-employment health care coverage, and through Medicaid continues to have a significant role in protecting those with low incomes or unusually costly or prolonged medical conditions.

Government also provides tax incentives and a regulatory regime that encourage individuals to adequately prepare for their post-employment health and long-term care needs and promote the development of effective savings and insurance vehicles to provide for these needs.

*Individuals* have primary responsibility for health care costs not covered by Medicare and for the cost of long-term care. At the same time, *employers* assist employees in

# "Current law must be clarified to ensure the availability of retiree health benefits." —Representative Rob Andrews (D-NJ)

preparing for post-retirement health needs by continuing to develop, sponsor and fund (to the extent economically feasible) programs that integrate retirement savings with expanded options for planning and funding for retiree health and long-term care needs.

In this vision, the *other stakeholders* expend intellectual capital, provide data and research, and use advanced technology to support the actions and efforts of individuals, employers and government to adequately provide for post employment health and long-term care. In addition to developing innovative plans, products, programs and educational materials, other stakeholders work closely with the primary stakeholders to develop and implement innovative strategies to contain the rapidly escalating costs of post-employment health and long-term care services before they undermine the personal financial security of the elderly.

The goals below are followed by specific recommendations. In some cases individual recommendations support more than one goal. Many of the efforts recommended above in the section titled "Future Health Care System for Active Workers" also apply to retiree health and long-term care services.

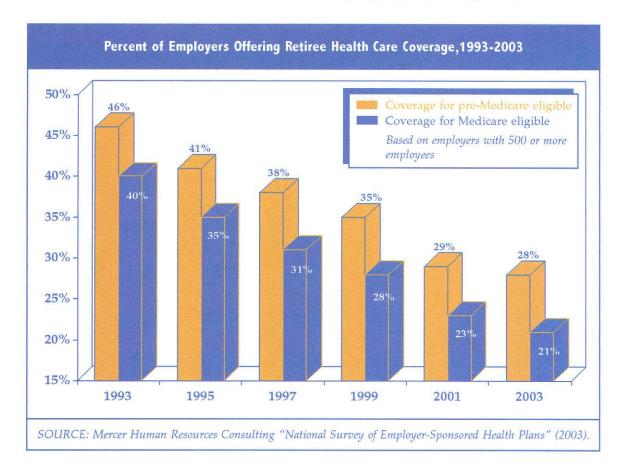
These important efforts include especially those recommendations aimed at increasing the quality of health care services, reducing medical errors and patient harm, and encouraging the development of new technologies and educational tools to help individuals make better-informed and more confident decisions in the reformed health care system of the future.

# Goal 7: Make Retiree Health and Long-Term Care Accessible and Affordable

By 2014, retiree health insurance will be more affordable and accessible because all individuals and employers will have access to new, integrated vehicles to finance retiree health care and long-term care needs. These vehicles will be supported by tax preferences such as those currently available for the health care needs of active employees.

#### Context

Both individuals and employers are currently without tax-favored vehicles for financing the costs of retiree health care and long-term care. Since rule changes<sup>128</sup> have required corporations to account for their mostly unfunded retiree health care programs on their balance sheets, companies have faced pressure to reduce their exposure to these benefit liabilities. The result has been a steady decline in the portion of the working-age population with a future retiree health benefit for a decade before an upturn in coverage in 2002. The provision for an early retirement health insurance benefit has



declined from 46 percent in 1993 to 34 percent in 2002 for workers at firms with 500 or more employees. 129 The provision of health insurance benefits from former employers for Medicare-eligible retirees has fallen from 40 percent in 1993 to 27 percent in 2002. 130

The decline in employer-provided coverage is a response to an accounting rule change coupled with the lack of a tax-favored funding vehicle to pre-fund the cost of the retiree benefit for workers while they are still employed. To the extent that companies could pre-fund these programs, they would be more likely to retain them, as full pre-funding would remove the liability from the balance sheet.

In addition, workers can be encouraged to save for the cost of health care premiums for an employer-provided retiree health plan if tax-favored instruments are provided for them. Workers need to be able to buy insurance for additional coverage beyond Medicare since Medicare pays for only about half the medical costs for retirees, according to estimates by the Employee Benefit Research Institute.<sup>131</sup>

Workers who would like to pre-fund the cost of an employer-provided group Medigap policy will need to accumulate savings of \$75,000 if they wish to have sufficient funds to pay premiums though age 85, according to calculations by EBRI.<sup>132</sup> If one is saving to buy a Medigap policy and is paying individual premium rates, one would have to save much more to pay for the higher premiums.

To be able to fully fund the premiums for a Medigap policy for someone who expects to live to age 85 would require saving \$223,000, according to EBRI. 133 Few active workers are aware they will need this level of funds to pay for their medical needs in retirement.

In addition, providing funding mechanisms for employers and individuals would also help people save for long-term care. To the extent employers can provide access to long-term care insurance to active workers, it would make long-term care more affordable by making it available to people when they were young enough to buy it at a low premium.

## **Initial Policy Recommendations**

- Significant and comprehensive educational efforts should be initiated to ensure that all Americans understand their responsibility to prepare for their health care needs in retirement through insurance and enhanced retirement savings.
- Create mechanisms to allow individuals and employers to advance fund anticipated retiree health and long-term care costs in a tax-favored manner and integrate these programs with more traditional retirement savings programs.
- Allow an income tax deduction for the qualified health care expenses of retirees

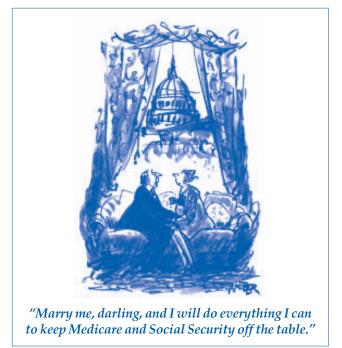
- without access to an employer-provided plan.
- Allow retirees to pay their share of health insurance premiums out of retirement plan distributions on a pre-tax basis.
- Encourage employers to provide employees with access to long-term care insurance coverage by permitting longterm care insurance to be offered as a cafeteria plan benefit or through a flexible spending arrangement. Allow an abovethe-line income tax deduction for individuals for the purchase of long-term care insurance.
- Explore and promote innovative solutions to enhance health security in retirement, such as the development of a combination of long-term care insurance, annuities and reverse mortgages.

#### **Goal 8: Modernize Medicare**

By 2014, Medicare will be transformed from an outdated, fee-for-service health insurance plan with significant coverage limitations and exceptions to one that provides all retirees and long-term disabled individuals with more comprehensive coverage, affordable private health plan choices, and health services delivered with an emphasis on quality and efficiency.

"Medicare is part of our country's social fabric, and we're not only saving it, but we're also improving it."

— Senator Charles Grassley (R-IA)



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#### Context

This paper is being released at a time when Congress has enacted Medicare reform and added a prescription drug benefit. To the extent that future Congresses further address Medicare reform, they should pursue policies that encourage fair market competition, provide sound information to help beneficiaries make more confident choices within the health care system, and provide incentives for continuous quality improvement. Market-oriented reforms must also be protected against inconsistent and costly state benefit mandates or other similar measures imposed on the health plans offered to Medicare beneficiaries.

Market-based reform should also include a wide selection of high quality private health plan options — such as those originally

envisioned by the Medicare+Choice program. But, the program must be significantly expanded beyond what is available today to be a true choice for most beneficiaries. Any expansion of coverage must be based on adequate and stable financing in the short and long term.

## Initial Policy Recommendations

- · In addition to recent Medicare reform and prescription drug coverage legislation, insure adequate and stable funding for the competing private health plan options available under Medicare so all beneficiaries have a fair and real choice between obtaining coverage through a private plan or under the traditional government program.
- Establish Medicare as a market-based purchaser of health services by actively promoting the ability of beneficiaries to choose health care services based on user-friendly, comparative information on quality, efficiency, and patient satisfaction that will be routinely reported by health providers.

#### FUTURE STOCK PLANS

#### **Vision Statement**

Programs that allow employees to become owners of company stock enable them to share directly in the fruits of their own productivity and the success of their company. Employers find these programs to be effective recruitment, retention and motivational tools that permit them to align employee and shareholder interests, reward employee performance and enhance

international competitiveness. These programs can also be an important source of the capital accumulation needed to attain personal financial security.

In our vision, *individuals* make informed decisions about participating in the company stock programs offered by their employers based on an understanding of the risks and tax consequences of such programs and their potential as a tool for capital accumulation in the well-diversified portfolio that personal financial security requires.

Government provides a flexible statutory and regulatory regime that encourages employers to develop and offer a wide variety of company stock programs that help employees attain personal financial security and help companies meet their business and compensation objectives.



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In this vision, *employers* may choose from a broad array of company stock programs – including but not limited to employee stock purchase plans, employee stock ownership plans, employee stock option plans, and employee restricted stock (or restricted stock unit) plans – to meet their employee compensation and related company objectives. These options give employers the opportunity to assist employees in accumulating the capital needed to build and maintain personal financial security.

Other stakeholders expend intellectual capital, provide data and research and use advanced technology to develop innovative programs, plans and products and educational materials that promote the widespread use of company stock programs to help foster personal financial security.

# Goal 9: Boost Broad-Based Opportunities for Employees to Own Stock

By 2014, there will be a 50 percent increase in the number of employees who receive stock in broad-based stock option plans, stock purchase plans, and employee restricted stock (or restricted stock unit) plans.

#### Context

Currently an estimated 8 to 10 million employees hold stock through broad-based stock option plans (both incentive stock options and non-qualified stock options). Also, an estimated 12 million to 16 million participate in employee stock purchase plans, according to the National Center for Employee Ownership. <sup>134</sup> These two groups overlap to some extent, but it is unclear how much of an overlap there is since there is no survey that measures the total number of

employees who own company stock through these plans. 135

Experts on stock ownership suggest the total combined universe of the plans identified would probably be no higher than the high end of the estimated range for stock purchase plans (or 16 million employees, as noted above). Further, while the movement to expense stock options appears to be slowing down the volume of stock option grants offered by corporations, other types of programs, such as restricted stock plans, are being set up to continue to provide ways for employees to own employee stock.

During the 1990s the practice of providing stock options grew very rapidly. The National Center for Employee Ownership estimates, for example, that only 1 million employees were covered by broad-based stock option plans in 1990. By the end of the decade the number of employees participating in these plans peaked at 8 to 10 million, where it has remained. Growth in stock options, barring any major shift in employer thinking, is likely to proceed much more slowly over the next decade. For this reason, a goal of increasing the number of employees by 50 percent would represent a significant improvement. However, policy and practice related to broad-based stock plans is very much in flux.

#### **Initial Policy Recommendations**

 Maintain accounting, disclosure, securities law, domestic and international tax law and administrative regimes that will encourage employers to make broad-based stock programs available to their employees.

- Recognize that changes in the accounting treatment for stock options may deter employers from providing broad-based stock arrangements, necessitating the institution of additional tax incentives to encourage employers to maintain these programs.
- Pursue income tax and payroll tax policies that support the adoption and maintenance of employer-sponsored stock option and stock purchase programs, and

Policy and practice related to broad-based stock plans is very much in flux.

that minimize the tax burden on employees participating in these programs. Such policies should include the following: First, ensure that employees are not required to pay tax on stock acquired through employersponsored stock programs prior to the time they receive cash in conjunction with the sale of the stock. Second, exempt incentive stock option transactions from the Alternative Minimum Tax (AMT). Third, clarify through legislation that the exercise of incentive stock options (ISOs) or options acquired through employee stock purchase plans will not trigger payroll tax obligations.

 Avoid mandates on employers that would dictate which employees must receive stock options or that would impose new nondiscrimination requirements on stock plans. "The challenge now before the Administration, the Congress and the industry is to strengthen businesses' ability to deliver the retirement income and security that workers deserve and depend upon, but to do it in such a way that we don't discourage employers from offering and maintaining plans for their workers."

— Assistant Secretary of Labor, Employee Benefits Security Administration, Ann Combs

# **CONCLUSION**

A broad array of demographic, workplace and economic changes in the decade ahead provide challenges to personal financial security and threaten a crisis for the employee benefits system in its current form. These challenges include the aging of America, changes in composition of the workforce, evolving changes in social structure and families, and continuously rising health care costs.

Population aging and rising health care costs will increase the burden of Social Security, Medicare, and Medicaid for taxpayers, and may increase pressure to reduce benefits. This makes it all the more important that the employee benefits system is preserved and adapted to changing times in order to better meet the needs of a changing workforce and to help individuals and households better prepare themselves for the challenges ahead.

The burden of saving adequately, investing retirement savings, and making good and cost-effective health care decisions will fall increasingly on the individual. Employers can continue to see that the employee benefit system can help individuals in their efforts to build and maintain their personal financial security. The government will also play a key role in setting the regulatory framework that can sustain and enhance the employee benefits system. Government leaders can also reform Social Security and Medicare in ways that make the programs sustainable over the long term.

This strategic plan has laid out a vision for how the employee benefits system can continue to be a vital part of the personal financial security of Americans. If the employee benefits system is to remain vital, plans will need to be increasingly flexible and adjustable to the challenges that lie ahead. The plan addresses four benefit areas: workplace retirement plans, active worker

health care, retiree health care and long-term care, and, finally, stock plans.

The plan establishes nine key goals. In the area of retirement they are to (1) raise financial literacy, (2) increase the share of workers in workplace retirement plans and (3) raise retirement savings.

In active worker health care, this plan sets the following goals: (4) make health coverage more affordable, (5) increase the quality of health care services, and (6) increase the number of people with health insurance coverage.

In retiree benefits, this plan establishes two goals: (7) make retiree health and long-term care accessible and affordable and (8) modernize Medicare. Finally, in stock ownership, this plan has a single goal: boost broad-based opportunities for employees to own stock.

The plan offers an array of initial policy recommendations to achieve the goals it sets forth. The American Benefit Council will review its goals and recommendations and adjust and modify them as necessary. If these initial policy recommendations are followed and all stakeholders work together and fulfill their respective responsibilities, it will advance the United States toward the broad goal of keeping the employee benefits system a strong and vibrant part of the total compensation of employees. It will also help ensure that Americans will be better able to build and maintain a high level of personal financial security. It will also help prepare workers to provide the income, health care and custodial care they will need for longer, better lives in retirement.

## Notes

<sup>1</sup> Personal financial security, as used in this document, is a broad term that describes a state of being secure in the expectation one will be able to sustain one's living conditions and general welfare throughout retirement and in the face of potential adverse events. This is usually achieved by working and saving for the future and taking appropriate steps and precautions against potential adverse events and developments. Personal financial security for working age people is most often associated with having a good job with good prospects and owning a home, although the definition of personal financial security would likely vary from person to person. Beyond that foundation, both insurance and employee benefits play a vital role in protecting what one has achieved. The risks that might undermine personal financial security include the following: (1) employment: the financial risk of lost income that employees face when they lose their jobs; (2) health: the financial risk employees face when they or their family members are sick or injured on or off the job, including unexpected expenses and/or loss of income; (3) longevity: the financial risk that individuals face in their retirement years if they should outlive their assets; and (4) death: the financial risk employees and their families' face from premature death; (5) liability: the financial risk employees and their families' face due to their personal actions or those of their family members.

- <sup>3</sup> Association of Private Pension and Welfare Plans, "Looking to the Future: A New Perspective on the Social Security Problem," April 6, 2000.
- <sup>4</sup> American Benefits Council, "Statement of Principles for Medicare Reform and Prescription Drug Coverage," February 2003. Web site: <a href="http://www.americanbenefitscouncil.org/documents/revreformprinciples0103.pdf">http://www.americanbenefitscouncil.org/documents/revreformprinciples0103.pdf</a>.
- <sup>5</sup> Daniel Gouré, "International Security and the Aging Crisis, A White Paper on the Security Implications of Global Aging," Center for Strategic and International Studies, January 12, 2001, Mimeo.
- <sup>6</sup> The World Fact Book (Washington D.C.: Central Intelligence Agency, 2003).
- <sup>7</sup> Purchasing power parity is a theory stating that exchange rates between currencies are in equilibrium when their purchasing power is the same in each of the two countries.
- <sup>8</sup> The purchasing power parity equivalents are as follows: Japan at \$28,700; Canada at \$29,300; France at \$26,000; Germany at \$26,200; the United Kingdom at \$25,500; and Italy at \$25,100. Source: CIA *Fact Book*, 2002.

<sup>&</sup>lt;sup>2</sup> See footnote 1 for discussion of the term "personal financial security."

- <sup>9</sup> Flow of Funds Accounts of the United States (Washington, D.C.: Federal Reserve Board of Governors), Table B.100, March 6, 2003, p. 102.
- <sup>10</sup> The European Union 15 nations are: Belgium, Denmark, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, Netherlands, Austria, Portugal, Finland, Sweden, and the United Kingdom.
- <sup>11</sup> John Verrinder, "Saving Rates in Europe," *Statistics in Focus* No. 33 (2002), published by Eurostat, February 7, 2002.
- <sup>12</sup> March 2003 Current Population Survey from the U.S. Census Bureau and represents data for 2002.
- <sup>13</sup> Towers Perrin. "Towers Perrin 2004 Health Care Cost Survey," September 2003. Study summary posted at <a href="http://www.towersperrin.com/hrservices/global/default.htm">http://www.towersperrin.com/hrservices/global/default.htm</a>.
- <sup>14</sup> Angelique Augereau, Mike Cho, Brad Johnson, Brent Neiman, Gabriela Olazabal, Matt Sandler, Sandra Schrauf, Kevin Strange, Andrew Tilton, Eric Xin, Leslie Hill Jenkins, and Cindy Neil, *U.S. Productivity Growth* 1995-2000 (Washington, D.C.: McKinsey Global Institute, October 2001).
- <sup>15</sup> U.S. Census Bureau, 2000.
- <sup>16</sup> World Population Ageing, 1950 to 2050 (New York: United Nations, 2002), p. 462.
- <sup>17</sup> Social Security Administration, 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, Table V.A2.
- <sup>18</sup> Shripad Tuljapurkar, Nan Li, and Michael Anderson, "Stochastic Population Forecasts for the G-7 Countries," Appendix in Robert Stowe England, *The Fiscal Challenge of an Aging Industrial World* (Washington, D.C.: Center for Strategic and International Studies, 2002), pp. 116-140.
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- <sup>21</sup> World Bank, *Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth* (New York: Oxford University Press, 1994).

<sup>22</sup> Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Trust Funds* (Washington, D.C.: Social Security Administration, 2004), p. 2.

<sup>23</sup> Ibid.

<sup>24</sup> The Boards of Trustees, Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, *The 2004 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds* (Washington, D.C.: Social Security Administration, 2004), p. 2.

<sup>25</sup> Congressional Budget Office, "The Long-Term Budget Outlook," Congress of the United States, Washington, D.C., December 2003, p 8.

<sup>26</sup> Ibid.

<sup>27</sup> Ibid, p. xi.

<sup>28</sup> Congressional Budget Office, "Baby Boomers' Retirement Prospects: An Overview," Congress of the United States, Washington, D.C., November 2003, p. 2.

<sup>29</sup> Ibid.

30 Ibid.

<sup>31</sup> U.S. Bureau of Labor Statistics, "Employee Benefits in the United States, 2003," *News*, UDSL: 03-489, September 17, 2003, Table 1, p. 3. From the Web site at <a href="http://www.bls.gov/news.release/pdf/ebs2.pdf">http://www.bls.gov/news.release/pdf/ebs2.pdf</a>.

<sup>32</sup> The 2003 National Compensation Survey obtained data from 2,924 private industry establishments, representing about 103 million workers. Of this number, 79 million were full-time workers and the remainder – slightly over 24 million – were part-time workers. The survey does not include workers employed by state and local governments, the federal government or the military.

<sup>33</sup> The National Compensation Survey also found that in March 2003, 57 percent had access to a workplace retirement plan. Thus, about 8 percent have access to a retirement plan, but do not participate in the plan. This was reported in April 2004 in the following Publication: U.S. Department of Labor, Bureau of Labor Statistics, "National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2003," Table 1, p. 3.

- <sup>34</sup> The coverage rates for state and local government workers are higher. In the last survey of state and local workers, the U.S. Department of Labor found a 98 percent participation rate in workplace retirement plans, with an impressive 90 percent participating in a defined benefit plan. Source: U.S. Bureau of Labor Statistics, Employee Benefits in State and Local Governments, 1998. Bulletin 2531 (Washington, D.C.: U.S. Department of Labor, December 2000), p. 5.
- <sup>35</sup> Current Population Survey, Annual Demographic Survey, March Supplement, March 2000, Table NC8, "Pension plan coverage of workers, by Selected Characteristics, sex, race, and Hispanic origin, and poverty status, (All races)(Both sexes), 1999 (Washington, D.C.: Bureau of Labor Statistics and the U.S. Census Bureau, September 2002). Available at <a href="http://ferret.bls.census.gov/macro/032000/noncash/nc8\_001.htm">http://ferret.bls.census.gov/macro/032000/noncash/nc8\_001.htm</a>.
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- <sup>37</sup> U.S. Department of the Treasury, Internal Revenue Service, *Statistics of Income Bulletin*, (Winter 1984-1985, Winter 1986-1987, Winter 1990-1991, Winter 1993-1994, Winter Fall 1995, Winter Spring 1996, Fall 2001, and Winter 2002-2003).
- <sup>38</sup> Craig Copeland, "Retirement Plan Participation and Features, and the Standard of Living of Americans 55 or Older," EBRI Issue Brief Number 248 (Washington, D.C.: Employee Benefit Research Institute, August 2002), Figure 2, p. 8.
- <sup>39</sup> Sarah Holden and Jack VanDerhei, "Contribution Behavior of 401(k) Plan Participants," EBRI Issue Brief Number 238, October 2001 (Washington, D.C.: Employee Benefit Research Institute, 2001).
- <sup>40</sup> Elizabeth Arias, "United States Life Tables, 2000," *National Vital Statistics Reports* 51:3 (December 19, 2002), Table 1, p.2.
- <sup>41</sup> National Center for Health Statistics, "Life Tables," *Vital Statistics of the United States*, 1970, Vol. II, Section 5, (Rockville, Md.: National Center for Health Statistics, 1970), Vol. II, Section 5, Table 5-3, p. 5-11.
- <sup>42</sup> From Department of Labor data for 2000 and 2001, as reported in Constantijn W. A. Panis, "Annuities and Retirement Satisfaction," Pension Research Council Working Paper PRC WP 2003-19, The Wharton School, University of Pennsylvania, Mimeo, 2003, p. 8.

- <sup>43</sup> U.S. Bureau of Labor Statistics, *Employee Benefits in State and Local Governments*, 1998, Bulletin 2531 (Washington, D.C.: U.S. Department of Labor, December 2000, Table 1, p. 5.
- <sup>44</sup> U.S. Bureau of Labor Statistics, *Employee Benefits in Medium and Large Private Establishments*, 1997, Bulletin 2517 (Washington, D.C.: U.S. Department of Labor, September 1999), Table 133, p. 107.
- <sup>45</sup> Panis, p. 8.
- <sup>46</sup> U.S. Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry in the United States*, 2000. Bulletin 2555 (Washington, D.C.: U.S. Department of Labor, January 2003), Table 76, p. 66.
- <sup>47</sup> Ibid, Table 167, p. 129.
- <sup>48</sup> Michael D. Hurd and Constantijn W. A. Panis, "An Analysis of the Choice to Cash Out, Maintain, or Annuitize Pension Rights upon Job Change or Retirement," RAND Working Paper, Santa Monica, Calif., 2003, Mimeo.
- <sup>49</sup> Patrick J. Purcell, "Pensions and Retirement Savings Plans: Sponsorship and Participation," (Washington, D.C. Congressional Research Service, October 22, 2003), p. 5.
- 50 Ibid.
- <sup>51</sup> Watson Wyatt Worldwide. "Choosey Employees Chose Lump Sums!," *Insider*, Watson Wyatt Worldwide, April 1998, p. 1.
- <sup>52</sup> Panis, Table 3, p. 23.
- <sup>53</sup> Dave Turner, Claude Giorno, Alain De Serres, Ann Vourc'h, and Pete Richardson, "The Macroeconomic Implications of Ageing in a Global Context," Economics department working paper 193 (Paris: OECD, 1998).
- <sup>54</sup> Organization for Economic Cooperation and Development, Main Economic Indicators (Paris: OECD, January 2004), p. 236.
- <sup>55</sup> Ibid., pp. 236-239.
- <sup>56</sup> The gross U.S. personal savings rate as used in this report is more than double the widely published net personal savings rate reported in the media. The U.S. Department of Commerce's Bureau of Economic Analysis publishes a net personal savings rate, but does not publish a gross

personal savings rate among the tables in the National Income and Product Accounts, which are published quarterly. One can calculate the gross personal savings rate using the latest most complete set of data from the first quarter of 2004. The first step in the calculation is to calculate the noncorporate consumption of fixed capital by subtracting corporate consumption of fixed capital, \$762 billion from Table 1.14, line 2, from private consumption of fixed capital, \$1,111 billion from Table 5.1, line 14. That subtraction calculation yields \$349 billion in noncorporate consumption of fixed capital for the first quarter of 2004. This number represents mostly depreciation of the cost of housing plus fixed capital and equipment and other property in sole proprietorships. Add to this number the net personal saving of \$161.4 billion from Table 2.1, line 33, to reach a gross personal saving total of \$510.4 billion in the first quarter 2004. Next we calculate a number by taking the total disposable personal income from Table 2.1, line 26 (\$8,504.8 billion) and adding in the total noncorporate consumption of fixed capital (\$349 billion) to yield a total adjusted disposable personal income of \$8,853.8 billion. The next step is to take the gross personal saving or \$510.4 billion, the numerator in this equation, and divide it by the adjusted disposable personal income of \$8,853.8 billion, to arrive at the gross personal savings rate of 5.8 percent. This approach is used to make U.S. numbers comparable to those of other countries, which do not subtract housing depreciation from their personal savings totals. The Organization for Economic Cooperation and Development uses this method in its international comparisons. The U.S. personal savings rate includes employee contributions to defined contribution plans, but does not include employer contributions to defined benefit, defined contribution, profit-sharing plans, and health and life insurance funds (Table 2.1, line 7), which totaled \$723.4 billion in 2003.

<sup>&</sup>lt;sup>57</sup> The U.S. gross personal saving rate, using the OECD approach, is 8.10 percent in 1998, 6.32 percent in 1999, 6.26 percent in 2000, 5.74 percent in 2001, 6.27 percent in 2002, and 5.51 percent in 2003.

<sup>&</sup>lt;sup>58</sup> Jack VanDerhei and Craig Copeland, "Can America Afford Tomorrow's Retirees: Results from the EBRI-ERF Retirement Security Projection Model," EBRI Research Brief 263 (Washington, D.C.: Employee Benefit Research Institute, November 2003), p. 1.

<sup>&</sup>lt;sup>59</sup> Ibid, p. 5.

<sup>&</sup>lt;sup>60</sup> Ibid, Figure 3, p. 6.

<sup>&</sup>lt;sup>61</sup> Centers for Medicare and Medicaid Services, "National Health Care Expenditures Projections: 2003-2013," February 6, 2004, from the Web site at <a href="http://www.cms.hhs.gov/statistics/nhe/projections-2003/highlights.asp">http://www.cms.hhs.gov/statistics/nhe/projections-2003/highlights.asp</a>. Some data also from Stephen Heffler, Sheila Smith, Sean Keehan, M. Kent Clemens, Greg Won, and Mark Zezza, "Health Spending Projections for 2002-2012: *Health Affairs* web exclusive, February 7, 2003, from the Web site at <a href="http://content.healthaffairs.org/cgi/reprint/hlthaff.w3.54v1">http://content.healthaffairs.org/cgi/reprint/hlthaff.w3.54v1</a>, Exhibit 2, p. W3-56.

- 62 Ibid.
- <sup>63</sup> U.S. Bureau of Economic Analysis.
- <sup>64</sup> Mercer Human Resource Consulting, *National Survey of Employer-Sponsored Health Plans* 2003, (New York: Mercer Human Resource Consulting, 2004.)
- <sup>65</sup> Mercer Human Resource Consulting, *National Survey of Employer-Sponsored Health Plans*, New York, 2003, Figure 39, p. 41.
- <sup>66</sup> Employee Benefit Research Institute, "Retiree Health Benefits: Savings Needed to Fund Health Care in Retirement," Issue Brief No. 254, February 2003.
- <sup>67</sup> Congressional Budget Office, "The Long-Term Budget Outlook, "Congress of the United States, Washington, D.C., December 2003, p 32.
- 68 Ibid. p. 32.
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- <sup>70</sup> U.S. Census Bureau, Populations Division, Population Projections Program, Washington, D.C., January 13, 2000, Tabulation NP-T4-D."Projections of the Total Resident Population by 5-Year Age Groups, Race, and Hispanic Origin with Special Age Categories: Middle Series, 2011 to 2105." Web site: <a href="http://www.census.gov/population/projections/nation/summary/np-t4-d.txt">http://www.census.gov/population/projections/nation/summary/np-t4-d.txt</a>.
- <sup>71</sup> In 2000 12.3 percent of the population identified itself as black, non-Hispanic.
- <sup>72</sup> U.S. Census Bureau 2001: Table 15.
- <sup>73</sup> U.S. Census Bureau 2001: Tables 215, 216.
- <sup>74</sup> Nyce and Schieber 2002.
- <sup>75</sup> Mariani 2000.
- <sup>76</sup> Watson Wyatt Worldwide, "Phased Retirement: Reshaping the End of Work" (Washington, D.C.: Watson Wyatt Worldwide, 1999).
- <sup>77</sup> U.S. Bureau of Economic Research.

- <sup>78</sup> Ana M. Aizcorbe, Arthur B. Kennickell, and Kevin B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances," *Federal Reserve Bulletin* vol. 89 (January 2003):1-32.
- <sup>79</sup> National Association of Stock Plan Professionals 2000.
- <sup>80</sup> U.S. Department of Commerce's Bureau of Economic Analysis, National Income and Product Accounts, Fourth Quarter 2003, Table 2.1, line 7.
- <sup>81</sup> Spectrem Group, 401(k) Participant Attitudes and Behavior, 2000, published by Spectrem Group, 2001.
- <sup>82</sup> Financial Engines Advisors LLC provided this information in September 2003.
- <sup>83</sup> Ruth Helman and Variny Paladino, "Will Americans Ever Become Savers? The 14<sup>th</sup> Retirement Confidence Survey, 2004," Issue Brief No. 268 (Washington, D.C.: Employee Benefit Research Institute, April 2004)., p. 9.
- <sup>84</sup> Sixteen percent of the respondents calculated they needed to save less than \$250,000; 7 percent said they needed to save between \$250,000 and \$499,999; 10 percent figured they needed to save between \$500,000 and \$999,999, while 22 percent said they needed to save \$1,000,000 or more. Thirty-two percent said they were unable to calculate an amount while 3 percent said they could not do the calculation.
- <sup>85</sup> U.S. Bureau of Labor Statistics, "Employee Benefits in the United States, 2003," News, UDSL: 03-489, September 17, 2003, Table 1, p. 3. From the web site at <a href="http://www.bls.gov/news.release/pdf/ebs2.pdf">http://www.bls.gov/news.release/pdf/ebs2.pdf</a>.
- <sup>86</sup> The March 2003 National Compensation Survey obtained data from 2,924 private industry establishments, representing nearly 103 million workers. Of this number, 79 million were full-time workers and the remainder slightly over 24 million were part-time workers. The survey does not include workers employed by state and local governments, the federal government or the military.
- <sup>87</sup> The government collects data for both "access to" and "participation in" retirement benefit programs and other employee benefits. The portion of the private sector workforce with access to retirement benefit programs is somewhat higher than those who participate in those programs. In the March 2003 National Compensation Survey, the Bureau of Labor Statistics found that 57 percent of private sector workers have access to some type of employer-sponsored retirement benefit program. This included 20 percent who have access to a defined benefit plan and 51 percent who have access to a defined contribution plan. The data are reported in the following

report: U.S. Department of Labor, Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry in the United States, March* 2003, Washington, D.C., April 2004, Table 1, p. 3.

- <sup>88</sup> The coverage rates for state and local government workers are higher. In the last survey of state and local workers, the U.S. Department of Labor found a 98 percent participation rate in workplace retirement plans, with an impressive 90 percent participating in a defined benefit plan. Source: U.S. Bureau of Labor Statistics, *Employee Benefits in State and Local Governments*, 1998. Bulletin 2531 (Washington, D.C.: U.S. Department of Labor, December 2000), p. 5.
- of whom save for retirement in Keogh plans, IRAs and SEP-IRAs, which are reported separately to the Internal Revenue Service. The numbers for participation in the private sector cited above are from the National Compensation Survey, March 2003, which includes incorporated self-employed workers, but not unincorporated self-employed workers. The annual March Current Population Survey does include the unincorporated self-employed workers since it is a survey of all the population. For example, the number of unincorporated self-employed was 26.2 million out of a total workforce of 150.9 million, which is also comprised of 19.6 million public sector workers and 105.1 million non-self-employed private sector workers, according to an analysis of the March 2002 Current Population Survey by Craig Copeland (Employment-Based Retirement and Pension Plan Participation: Geographic Differences and Trends, Employee Benefit Research Institute, Washington, D.C., April 2003, Figure 1, p. 6).
- <sup>90</sup> The projection is based on keeping constant the proportion of the 15 to 64 age group who are employed as a salaried or wage earner in the private sector.
- <sup>91</sup> U.S. Bureau of Labor Statistics, *Employee Benefits in the United States*, 2003, News, UDSL: 03-489, September 17, 2003, Table 1, p. 3. From the Web site at <a href="http://www.bls.gov/news.release/pdf/ebs2.pdf">http://www.bls.gov/news.release/pdf/ebs2.pdf</a>.
- 92 Ibid.
- <sup>93</sup> Ann C. Foster, "Factors Affecting Employer-Provided Retirement Benefits," *Compensation and Working Conditions* (Winter 1998):10-17.
- <sup>94</sup> Craig Copeland, "Employment-Based Retirement and Pension Plan Participation: Geographic Differences and Trends," EBRI Issue Brief Number 256 (Washington, D.C.: Employee Benefit Research Institute, April 2003).

- <sup>95</sup> U.S. Department of the Treasury, Internal Revenue Service, *Statistics of Income Bulletin*, (Winter 1984-1985, Winter 1986-1987, Winter 1990-1991, Winter 1993-1994, Winter Fall 1995, Winter Spring 1996, Fall 2001, and Winter 2002-2003).
- <sup>96</sup> Craig Copeland, "Retirement Plan Participation and Features, and the Standard of Living of Americans 55 or Older," EBRI Issue Brief Number 248 (Washington, D.C.: Employee Benefit Research Institute, August 2002), Figure 2, p. 8.
- <sup>97</sup> U.S. Bureau of Labor Statistics. *National Compensation Survey: Employee Benefits in Private Industry in the United States*, 2000, Bulletin 2555 (Washington, D.C.: U.S. Department of Labor, January 2003), Table 94, p. 79.
- <sup>98</sup> U.S. Bureau of Labor Statistics, *Employee Benefits in State and Local Governments*, 1998, Bulletin 2531 (Washington, D.C.: U.S. Department of Labor, December 2000), Table 1, p.5.
- <sup>99</sup> PBGC Pension Insurance Data Book 2002, pages 44, 72. Also, according to the most recent Department of Labor statistics available, the total number of defined benefit plans has decreased from a high of 170,102 in 1985 to about 56,405 in 1998. *Private Pension Plan Bulletin, Abstract of 1998 Form 5500 Annual Reports*, U.S. Department of Labor, Number 11, Winter 2001-2002, Table E1.
- <sup>100</sup> They also cover 90 percent of the workforce of state and local governments. Source: U.S. Department of Labor, Pension and Welfare Benefits Administration (now the Employee Benefits Security Administration), *Abstract of 1998 Form 5500 Annual Reports*, Private Pension Plan Bulletin, Number 11 (Winter 2001-2002).
- <sup>101</sup> OECD, Main Economic Indicators, 2003, pp. 236-239.
- <sup>102</sup> Calculation by William G. Shipman, Chairman of CarriageOaks Partners LLC, Manchester-by-the-Sea, Mass. Calculation assumes a 7.49 percent real rate of return for a worker who works 45 years. The portfolio would be invested 60 percent in stocks (90 percent of those in large caps and 10 percent in small caps) and 40 percent in bonds (half in corporate bonds and half in government bonds). The assumptions are based on arithmetic average returns for the asset classes between 1926 and 2002. The 3.5 percent retirement savings rate combined with an annual 7.49 percent return on accumulated savings would be sufficient to allow for a retiree at age 65 to receive for 19 years an annual distribution equal to 70 percent of the retiree's pre-retirement wage or salary. During the 19-year distribution period the annual rate of return is assumed to decline by 200 basis points. Real wage growth during the accumulation phase is assumed to be 1 percent per annum. Annual saving is assumed to take place at the beginning of the year.

- <sup>103</sup> Dan M. McGill, Kyle N. Brown, John J. Haley, and Sylvester J. Schieber, *Fundamentals of Private Pensions*, 8<sup>th</sup> edition (Philadelphia: University of Pennsylvania Press, forthcoming in 2004), chapter 17, Table 17-10, p. 41 of manuscript.
- <sup>104</sup> Jack VanDerhei and Craig Copeland, "Can America Afford Tomorrow's Retirees: Results from the EBRI-ERF Retirement Security Projection Model," EBRI Research Brief 263 (Washington, D.C.: Employee Benefit Research Institute, November 2003), p. 1.
- <sup>105</sup> The study relies on a six-year time series of data from more than 10 million 401(k) participants in more than 30,000 plans, as well as a time series of several hundred plan descriptions used to provide a sample of the various defined benefit and defined contribution plan provisions. In addition, the study relies on several public surveys based on participants' answers the Survey of Consumer Finances, the Current Population Survey, and the Survey of Income and Program Participation to model participation, wages, and initial account balance information.
- <sup>106</sup> VanDerhei and Copeland, p. 5.
- <sup>107</sup> Ibid, Figure 3, p. 6.
- <sup>108</sup> The study does not count savings outside tax-preferred savings vehicles that are available to meet retirement needs. It provides alternative calculations for savings to meet expected needs in other scenarios, including one involving reduced benefits under Social Security reform and another where retirees sell their homes and convert the equity into an annuity.
- <sup>109</sup> Centers for Medicare and Medicaid Services, National Health Care Expenditure Tables, "Table 1: National Health Expenditures Aggregate and per Capita Amounts, Percent Distribution, and Average Annual Percent Growth, by Source of Funds: Selected Calendar Years 1980-2002," from Web site at <a href="http://www.cms.hhs.gov/statistics/nhe/historical/t1.asp">http://www.cms.hhs.gov/statistics/nhe/historical/t1.asp</a>.
- <sup>110</sup> Ibid.
- <sup>111</sup> Congressional Budget Office, "The Long-Term Budget Outlook, " Congress of the United States, Washington, D.C., December 2003, p 4.
- <sup>112</sup> Institute of Medicine, Committee on the Quality of Health Care in America, Linda T. Kohn, Janet M. Corrigan, and Molla S. Donaldson (Eds), *To Err Is Human: Building A Safe Health System*, Washington, D.C.: National Academy Press, 2000.
- <sup>113</sup> U.S. General Accounting Office, Report GAO-03-702, "Medical Malpractice Insurance: Multiple Factors Have Contributed to Increased Premium Rates" (Washington, D.C.: GAO, July 28, 2003).

- <sup>114</sup> Jon R. Gabel, Anthony T. Lo Sasso, and Thomas Rice, "Consumer-Driven Health Plans: Are They More Than Talk Now?" *Health Affairs* Web Exclusive, November 20, 2002, <a href="http://www.healthaffairs.org/WebExclusives/Gabel Web Excl 112002.htm">http://www.healthaffairs.org/WebExclusives/Gabel Web Excl 112002.htm</a>.
- <sup>115</sup> Bradford J. Holmes, Eric G. Brown, and Sara E. McAulay, "Consumer-Directed Health Plan Leaders Poised For Growth," TechStrategy Brief (Cambridge, Mass.: Forrester Research, Inc., July 2003).
- 116 Ibid.
- <sup>117</sup> Jim Jaffe, "Consumer-Driven Health Benefits: A Continuing Evolution?" *EBRI Notes* 23:9 (November 2002):1-7.
- <sup>118</sup> Institute of Medicine, Committee on Quality of Health Care in America, *Crossing the Quality Chasm: A New Health System for the 21<sup>st</sup> Century*, (Washington, D.C.: National Academy Press, July 2001).
- <sup>119</sup> Ibid, p. 16.
- <sup>120</sup> US. Census Bureau, Health Insurance Coverage 2002, "Table 1. People Without Health Insurance for the Entire Year by Selected Characteristics: 2001 and 2002," from Web site at <a href="http://www.census.gov/hhes/hlthins/hlthin02/hi02t1.pdf">http://www.census.gov/hhes/hlthins/hlthin02/hi02t1.pdf</a>.
- <sup>121</sup> Paul Fronstin, "Sources of Health Insurance and Characteristics of the Uninsured: Analysis of the March 2002 Current Population Survey," Issue Brief No. 252, Employee Benefit Research Institute, Washington, D.C., December 2002, Figure 1, p. 4.
- <sup>122</sup> Tricare, formerly CHAMPUS, is a Department of Defense health insurance program for military retirees and families of active duty, retired and deceased service members. CHAMPVA, the Civilian Health and Medical Program for the Department of Veteran Affairs, is a health benefits program for disabled dependents of veterans and some survivors.
- <sup>123</sup> U.S. Census Bureau, Populations Division, Population Projections Program, Washington, D.C., January 13, 2000, Tabulation NP-T4-D. "Projections of the Total Resident Population by 5-Year Age Groups, Race, and Hispanic Origin with Special Age Categories: Middle Series, 2011 to 2105." Web site: <a href="http://www.census.gov/population/projections/nation/summary/np-t4-d.txt">http://www.census.gov/population/projections/nation/summary/np-t4-d.txt</a>.
- <sup>124</sup> Fronstin, pp. 3-4.
- <sup>125</sup> Ibid., p. 4.

- <sup>126</sup> Ibid, p. 5.
- <sup>127</sup> Jennifer Haley and Stephen Zuckerman, "Is Lack of Coverage a Short- or Long-Term Condition?" Kaiser Commission on Medicaid and the Uninsured, Washington, D.C., June 2003.
- <sup>128</sup> Financial Accounting Statement No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," was approved by the Financial Accounting Standards Board in December 1990.
- <sup>129</sup> Mercer Human Resource Consulting, *National Survey of Employer-Sponsored Health Plans*, New York, 2003, Figure 39, p. 41.
- <sup>130</sup> Ibid.
- <sup>131</sup> EBRI estimates from the 1999 Medical Expenditure Panel Survey.
- <sup>132</sup> From Paul Fronstin and Dallas Salisbury, "Retiree Health Benefits: Savings Needed to Fund Health Care in Retirement," EBRI Issue Brief No. 254, Employee Benefit Research Institute, Washington, D.C., February 2003, Figure 14, p. 20.
- <sup>133</sup> This calculation is based on annual 7 percent premium increases and a 4 percent annual increase based on age.
- <sup>134</sup> The National Center for Employee Ownership, *Current Practices in Stock Option Plan Design* (Oakland, Calif.: NCEO, 2001).
- <sup>135</sup> The National Center for Stock Ownership estimates that 8.8 million workers own stock worth more than \$400 billion through Employee Stock Ownership Plans, stock bonus plans, and profit-sharing plans. There are also 11 million workers who have purchased employer stock worth more than \$160 billion through 401(k) plans. From "A Statistical Profile of Employee Ownership," April 2003 at <a href="http://www.nceo.org/library/eo\_stat.html">http://www.nceo.org/library/eo\_stat.html</a>.

## **Q**UOTATIONS

Representative John Boehner (R-OH), from his Web site, "Issues: Ensuring a More Secure Retirement System".

Representative Nancy Johnson (R-CT), from the press release "Johnson Holds Hearings on the Uninsured," March 9, 2004.

Senator Craig Thomas (R-WY), from the press release, "Sam Johnson rolls out new savings proposal," March 31, 2004.

Representative Earl Pomeroy (D-ND), from his Web site, "Ensuring Retirement Income Security".

Representative Rob Portman (R-OH), from the press release, "New Savings Plan to Help People and Our Economy," February 16, 2004.

Senator Edward Kennedy (D-MA), from a statement at the Democratic Policy Committee hearing on the uninsured, January 6, 2004.

Representative Benjamin Cardin (D-MD), from the press release, "Cardin/Portman Introduce Pension Reform Bill," October 3, 2002.

Senator Max Baucus (D-MT), from his Web site, "Issues: Health Care".

Representative Rob Andrews (D-NJ), in his "Washington Update," February 10, 2004.

Senator Charles Grassley (R-IA), from his press release on Medicare, December 2003.

Assistant Secretary of Labor, Employee Benefits Security Administration, Ann Combs, from remarks before the Profit Sharing /401(k) Council of America, September 12, 2003.

## **APPENDIX A:**

## DEMOGRAPHIC AND WORKPLACE TRENDS AND THEIR IMPLICATIONS

#### The Transformation Ahead

This appendix provides more details about the broad changes that are expected to reshape American society, the workplace, and the employee benefits system. These changes — many already well underway — include an aging of the population, increasing ethnic diversity of the population, new patterns of educational attainment, changes in social and family structures, an increase in the participation of women in the workplace, an increase in part-time workers, and new job tenure patterns. They also include the continuing fallout from market volatility and economic uncertainty on plan funding and individual efforts to build and maintain personal financial security. The nature of the challenges these changes pose for individuals, employers and the government is presented in the main section of this document.

It is important to understand how society, families and the workplace are going to change. This understanding will help policymakers formulate policies that assist individuals to build and preserve their personal financial security. It can also ensure that employers, the government and other stakeholders continue to play a vital, supportive role for individuals.

Help for individuals can include providing education, support and vehicles for saving for retirement. It can include facilitating access to affordable health care throughout life, as well as education to assist consumers in playing a vital role in improving the quality of health care and tempering the pace of rising costs. And, it can also include education, support and vehicles for managing one's financial assets after retirement so those assets can better sustain pre-retirement lifestyles throughout the remainder of one's life.

#### **Aging**

In coming decades, the proportion of the population that is elderly will significantly increase. This will, in turn, place more demands on retirement and health benefit systems, including those in the private and public sectors. The additional financial burden on taxpayers and benefit systems will be partly offset by advances in medical care that will permit longer working lives. Medicare trustees projected in their 2004 annual report that Medicare spending will rise from 2.6 percent of GDP in 2003 to 3.4 percent of GDP in 2006, with the implementation of the prescription drug benefit.<sup>2</sup> By 2035 it will be 7.7 percent of GDP, nearly triple the current level.<sup>3</sup> There is also concern that U.S. consumers of health care are not getting an efficient return on their health care spending.

In addition, longer life spans will require workers to accumulate more assets for retirement than may have been necessary in the past. They will also need to be able to afford supplemental retiree health insurance, out-of-pocket medical expenses, and pay for long-term care.

## Society and Family

In the coming decade Hispanics and Asians will represent an increasing proportion of the population, the proportion of whites will decline, while the share of African-Americans will remain about the same. These changes are not likely to alter the supporting role played by employee benefit systems nor the type of benefit plans, but may increase the need for providing more communications in languages other than English. A high number of single parent families, later marriages, fewer children per family unit and children being born to parents at later ages all will have an impact on the provision of benefits and the nature of the shared effort by individuals, employers and public plans.

#### Workforce

The continued growth of the number of women in the workplace, and the corresponding expansion in the number of two-income families with both the husband and wife working, may change employee demand for certain types of benefits. For example, one working spouse might be interested in family health coverage from his or her employer while the other spouse may be more interested in other types of benefits. Thus, workforce changes and family composition will accelerate the drive toward more flexibility in plan design.

Slower labor force growth rates and tighter labor markets may result in a greater emphasis on benefits. As employers compete for their services, employees may demand not just higher wages but improved benefits and working conditions. The demand for workers will likely increase labor force participation by the elderly.

An increase in personal ownership of computers will make the access to benefits information, health care services and retirement investment choices more readily available, although not all employees will have access.

While the general population may continue to improve its overall educational attainment levels, this will not necessarily translate to the higher levels of financial and employee benefits literacy that will be imperative to serve an aging

The continued growth of the number of women in the work-place may change employee demand for certain types of benefits.

society. This type of literacy will be especially essential as individuals are increasingly required to take greater personal responsibility for their financial security.

#### **Aging Trends**

The U.S. population is growing older — that is, the portion of elderly in the population is rising and, in the process, is pushing up the median age of Americans. In 2000, 12.3 percent of population was 65 years old or older and the median age was 35.3, the highest ever. By 2025, the share of elderly will rise to 18.5 percent and the median age will be 39.3, according to official projections. And, in 2050, the portion of elderly will rise to 21.2 percent and the median age will reach 40.7. The aging of America is spurred by a combination of factors: better health care, longer lives, and the retirement of the baby boom generation, as well as by lower fertility rates.

The mean fertility rate — the average number of children born to a woman in her lifetime has dropped from 3.61 in 1960 to 2.07 in 2002. It is expected to decline to 1.90 by 2025.6 The decline in fertility, combined with increasing longevity, expands the portion of the population that is 65 and older. The increasing predominance of the elderly in our society is captured by the elderly dependency ratio, which is the proportion of persons aged 65 and older to the number of people of working age, 15 to 64. The elderly dependency ratio is expected to rise from 20.3 per 100 workers in 2003 to 23 in 2014 and 31.3 in 2025,<sup>7</sup> according to official projections.

However, some demographers argue that current official forecasts are overly conservative in their assumptions on projected longevity gains and overly optimistic in their assumption that fertility rates will rise significantly. Thus, demographers suggest, the aging dynamic may be more pronounced in all countries than what is officially predicted. Some predict elderly dependency rates could rise to a hefty 39 per 100 workers by 2050.

Increased life expectancy is a strong indicator of improvements in health for older Americans. In 1900, life expectancy at birth was about 49 years. By 2000 life expectancy had increased to 74.1 years for men and 79.5 for women. It is expected to continue to increase throughout this century. By 2025 the projected life expectancy at birth will be 77.6 for men and 83.6 for women; by 2050, it will be 81.2 for men and 86.7 for women. <sup>10</sup> Currently, people aged 65 have a life expectancy of 18 years, compared to 13 years

in 1900. Women aged 85 can expect to live another seven years while 85-year-old men have a life expectancy of six years.<sup>11</sup>

Physical impairments increase with age and chronic health conditions have not declined. However, despite the general tendency to lose functionality as people age, health measures generally indicate that the old of today are really less "old" than their predecessors in similar ages even though significant variation occurs across groups. Major studies in the U.S. <sup>12</sup> and abroad <sup>13</sup> have confirmed a decline in disability rates among all age groups, including the elderly.

A new standard of energy and vitality in the population seems to have pushed the notion of "old age" well into the 70s and beyond. <sup>14</sup> For example, from 1994 to 1996, 72 percent of older Americans reported their health as good, very good or excellent with little difference in gender. <sup>15</sup>

Between 1984 and 1995, older Americans<sup>16</sup> reported improvements in physical functioning in the ability to walk a quarter mile, climb stairs, reach up over one's head, and stoop, crouch or kneel.<sup>17</sup> From 1982 to 1994, the percentage of older

Major studies in the U.S. and abroad have confirmed a decline in disability rates among all age groups, including the elderly.

Americans with chronic disabilities declined from 24 percent to 21 percent. Declining disability rates at all ages mean people can work longer, if they wish. They can also longer sustain a good quality of life.

Paradoxically, even as disability rates decline in all age groups, the absolute numbers of Americans with chronic disabilities is rising because of the increase in the size of the population of people over 65. In fact, the total number of persons with chronic disabilities actually increased from 6.4 million to 7 million from 1982 to 1994.<sup>18</sup> This means that disabilities associated with a given age are being postponed to a later age than was the case in the past. Thus, while improvements have been made and will continue to be made in the ability of older Americans to work and/or enjoy a better quality of life, there will likely be more elderly Americans with chronic and other health conditions in need of services.

Financial need, combined with better health, may prompt many older Americans to stay in or return to the workforce. Financial need, combined with better health, may prompt many older
Americans to stay in or return to the workforce. In recent years the labor force participation rate of workers aged 55 to 64 was rising at a time when the stock

market and other economic indicators were declining (see below). Given that more Americans are in defined contribution plans than in the past, recent market downturns may have forced older Americans to delay retirement plans.<sup>19</sup>

(The portion of the workforce covered by a defined benefit plan was cut in half in a single generation, falling from 38 percent in 1978<sup>20</sup> to 19 percent in 1998.<sup>21</sup> In 1977,

employers with defined benefit plans had in place a policy of pension distributions that provided 76 percent of those eligible to retire with a benefit of a pension annuity rather than offering a choice of an annuity or a lump sum.<sup>22</sup> Meanwhile the portion of workers with a defined contribution plan as their primary pension rose sharply from 7 percent to 27 percent, moving the defined contribution plan into first place as the dominant type of plan in the workforce.<sup>23</sup>)

#### Rising Health Care Costs

The aging of the United States will also contribute to the ongoing trend toward higher health care costs for society and both active workers and retirees. In 2002, for example, according to the Centers for Medicare and Medicaid Services, total health care spending at all levels — private and public — rose 9.3 percent. At the same time the Gross Domestic Product (GDP) grew at only 3.6 percent.<sup>24</sup> Since the late 1980s, in fact, health care spending has grown faster than the economy every year except for 1994, 1996, 1997 and 1998. Health care spending is likely to continue to increase faster than the economy and, thus, represent a larger share of budgets from the federal government to individual households.

A study sponsored by the Centers for Medicare and Medicaid Services (formerly the Health Care Financing Administration) has predicted health care spending in the United States will reach \$3.4 trillion in 2013, more than double the \$1.5 trillion spent in 2002.<sup>25</sup> As a portion of the economy, health care spending will rise from 14.9 percent of GDP in 2002 to 18.4 percent in 2013, according to the study.<sup>26</sup>

The expected steady surge in health care spending is troubling. Concerns arise not just because higher spending levels on Medicare and Medicaid have a potential negative economic feedback from higher budget deficits. There is also a question of whether high levels of spending are providing Americans with better health compared to other countries. The answer is "no", according to a study by Anderson et al made public in May 2003 that the United States spends more per capita on health care than other developed countries but gets fewer services.<sup>27</sup>

According to Anderson et al, in 2000 the United States spent 13 percent of GDP or \$4,631 per capita on health care.<sup>28</sup> Yet, in most measures of aggregate utilization of health care services, such as physician visits and hospital visits per capita, the U.S. level was below the median for the 29 developed countries in the Organization for Economic Cooperation and Development.<sup>29</sup>

The study also concluded that greater spending by the private sector was the main reason U.S. overall spending ran so much higher. U.S. government health care spending per capita, for example, was 5.8 percent of GDP or \$2,501 per capita in 2001. That level was not much higher than the \$1,982 per capita government spending throughout OECD countries. However, in the United States private health care spending — health insurance premiums and out-of-pocket spending — was \$2,580 per capita, more than five times the OECD median of \$451.

While the population is living longer, there is a parallel trend of declining disability rates at

all ages among the elderly. These trends, driven by advances in medical care, have been observed in studies in the United States<sup>32</sup> and abroad,<sup>33</sup> as noted above. In spite of these encouraging trends, the improvements in disability and quality of life throughout one's older years will drive up dramatically health care spending on people over 65 because there will be more elderly

people. The costs of disability are merely postponed to later ages. With rising absolute numbers of elderly, spending will jump. Further, spending on the very old — those 85 and over — could skyrocket, as their numbers swell.

Spending on the very old — those 85 and over — could sky-rocket as their numbers swell.

## Implications of an Aging Population

The aging of society will require all stakeholders — principally individuals, employers and the government — to work together to assure that American workers and retirees build and sustain their personal financial security. These primary stakeholders and others must reevaluate their current roles to see how all can work together for the common good and better address the challenges that lie ahead for public and private benefits systems.

Individuals, employers and the government (i.e., the taxpayers) can expect greater financial pressure to sustain the nation's retirement income and health care security. Working together, the stakeholders will need to work for public policies that can facilitate:

(1) later retirement ages and alternative pathways to retirement; (2) more flexibility in work/leisure arrangements and benefit plan design; (3) the accumulation of assets to help finance greater health and retirement income requirements; and (4) the long-term financial stability of the Social Security and Medicare system.

Aging populations all over the globe will force many countries — including the United States — to make hard choices in terms of providing additional financial support to health and retirement systems.

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The World Bank, in a landmark study in 1994, found most of the world's social security and retiree health programs to be unsustainable.<sup>34</sup> Many official studies<sup>35</sup> since then have similarly calculated that the burden for many nations will be enormous and that

most developed country governments would find it difficult to either raise taxes or borrow sufficiently to sustain current benefit levels.

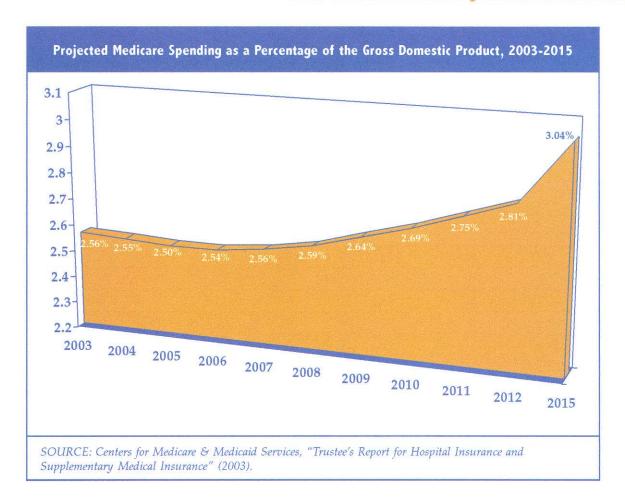
In the United States the Board of Trustees for Social Security projected spending on benefits to rise from 11.07 percentage points of taxable payroll in 2004 to 16.83 percentage points in 2030, and then to 19.29 percentage points in 2078.<sup>36</sup> This will represent an increase from 4.3 percent of the GDP in 2004 to 6.3 percent in 2030 and 6.6 percent in 2078.<sup>37</sup> Similarly,

the trustees found that spending on Medicare, which is funded from payroll taxes, premiums and general tax revenues, could rise from 2.6 percent of GDP in 2003 to 3.4 percent of GDP in 2006, with the implementation of the prescription drug benefit to 7.7 percent of GDP in 2035 (and 13.8 percent of GDP in 2078) if no changes are made in the program.<sup>38</sup>

The Congressional Budget Office has projected that spending on Social Security benefits will rise from 4.2 percent of GDP in 2003 to 5.9 percent in 2030 and 6.2 percent in 2050.<sup>39</sup> The CBO also projected that the federal government's share of Medicare and Medicaid spending will rise from 2.3 percent in 2003 to 8.4 percent in 2030 and 11.5 percent in 2050.<sup>40</sup> The December 2003 CBO report concluded: "Unless taxation reaches levels that are unprecedented in the United States, current spending policies will probably be financially unsustainable over the next 50 years."<sup>41</sup>

In view of the budgetary pressures on Social Security and Medicare, it is all the more important for employee benefit systems to be strong and viable.

How will an aging society affect overall spending on retirement benefits and health care? The effect on government budgets and pension plans will not necessarily be straightforward, as there are some compensating factors associated with aging that could reduce government spending and strengthen plan funding. For example, as people live longer, they will expect to receive retirement income benefits for more years, thus increasing the cost for pension funds.



But, longer working lives may in fact result in stronger financial support for our public and private retirement systems as workers contribute longer into the system.

Barring the development of a cure, the more people there are who live longer, the larger the number of people who will suffer from Alzheimer's, for example, a debilitating disease accompanied by memory loss that often requires very expensive and sometimes prolonged care.

The aging of America makes it all the more important that individuals are prepared to shoulder more of the costs associated with retirement. This is especially true for the growing ranks of workers whose retirement income will derive mostly from savings in a defined contribution plan, where more of the burden of determining how much to save and how to invest falls on the individual.

In addition, longer life spans mean that workers must accumulate more assets for retirement than required in the past. They will also need to be able to pay for supplemental retiree health insurance, out-of-pocket medical expenses, and long-term care.

Employers help individuals achieve their goals by providing attractive plans, offering matches for employee contributions and structuring investment options. Indeed, employer contributions to all types of pension plans and insurance funds totaled \$723.4 billion in 2003.<sup>42</sup> Together with changes in employee and business trends, rising health

care costs put strains on the ability of employers to provide a full range of employee benefits that help individuals build and maintain financial security.

The aging of society will require all stake-holders to reconsider their role in the system.

The aging of society will require all stakeholders to reconsider their role in the system. The primary stakeholders — individuals, employers and the government (i.e. taxpayers) — can expect greater

financial pressure to find ways to sustain the nation's retirement income and health care security. Public policies should seek to facilitate: (1) later retirement ages and alternative pathways to retirement, (2) more flexibility in work/leisure arrangements and benefit plan design and (3) the accumulation and management of assets to help finance larger health and retirement income requirements.

#### Family and Social Trends

The United States is a diverse country with greater participation in economic life by women and minorities than in most developed countries. For example, about 59.2 percent of women (16 to 64) participate in the labor force in the United States. By contrast the participation for working-age women in Europe is 54.9 percent. The participation rate for African-Americans in the United States is 63.3 percent, which compares to a 66.2 percent participation rate for whites. In addition, there have been significant changes in the composition of U.S.

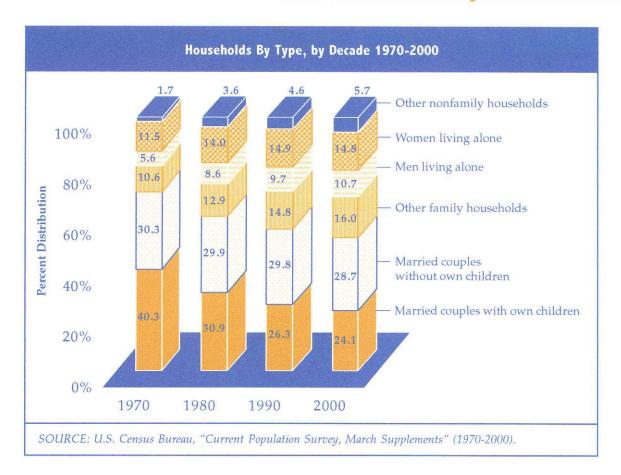
families and a decline in marriage and fertility rates in the past 30 years, although marriage rates stabilized during the 1990s. 46 These demographic trends are likely to continue and be reflected in the workforce.

#### **Ethnic Diversity**

American society will become more ethnically diverse over the next decade. The U.S. Bureau of the Census estimated the U.S. population in July 2003 at 290.8 million.47 In 2000, Hispanics made up almost 12 percent of the population, just behind African-Americans who comprised 12.3 percent. By 2015, Hispanics are expected to constitute almost 16 percent of the population with African-Americans increasing their share modestly to 12.7 percent. The share of the population that is Asian is expected to grow from 3.8 percent in 2000 to 5.3 percent in 2015. The white population is expected to experience a decline of six percentage points from its current level of 71.5 percent.<sup>48</sup> Moreover, 2 percent of Americans identified themselves on the census long form as belonging to more than one race.49

#### **Immigration**

Currently, 28 million people, or 10 percent of Americans are foreign-born. The Immigration and Naturalization Service estimates legal immigrants of working age (and with a listed occupation) may have supplied about 40 percent of the growth of the U.S. labor force in the mid-1990s. By 2000, over half of the U.S. foreign-born came from Latin America, another 26 percent immigrated here from Asia and 15 percent came from Europe. By 2100, post-2000 immigrants and their offspring are expected to provide two-thirds of the U.S. population growth. Today, foreign-



born individuals in the United States are likely to be less educated, younger and poorer than native-born Americans.<sup>50</sup>

#### Education

The overall increase in educational opportunity and attainment in the United States is one of the great successes of the past half-century. Since 1960, the number of high school graduates has doubled. Today over 80 percent of those aged 25 and older have received a high school degree. The number of college graduates increased from 7.7 percent of the 25 and older population in 1960 to 25.6 percent in 2000. Despite this overall trend and the approximate parity on a gender basis, significant racial and ethnic differences persist in educational attainment. For example, while 25.8 percent of the white population had completed four or more years

of college in 2001, only 14 percent of African-Americans and 8.7 percent of Hispanics received at least a four-year college degree.<sup>51</sup> Moreover, U.S. students do not outperform their counterparts in other industrialized countries on standardized tests, and there is a shortage of qualified technically-trained workers. Some observers claim American secondary schools and colleges do not offer students sufficient education to understand financial and workplace benefits. The fact that studies show those who have an adequate financial education do a better job of planning for retirement income security underscores the need to begin or enhance financial benefits education.52

#### Income

Class and racial differences in educational attainment can translate into differences in

economic success. Indeed, despite the economic success experienced by overall, significant class and racial differences still exist and may be worsening. For example, the median net worth of families with income of \$100,000 is more than 5 times that of families making less than \$100,000.<sup>53</sup> Income distribution has apparently widened. In 1979, the top 20 percent of households received 44.1 percent of all income while the lowest quintile received 4.2 percent of income. By 1997, the top 20 percent of households accounted for 49.3 percent of income while the bottom 20 percent only received 3.6 of all

Significant class and racial differences still exist and may be worsening.

income. In addition, the median income for white families in 1999 was \$42,504 whereas the median income for African-American families was \$27,910 and \$30,735 for Hispanics.<sup>54</sup>

#### **Communications**

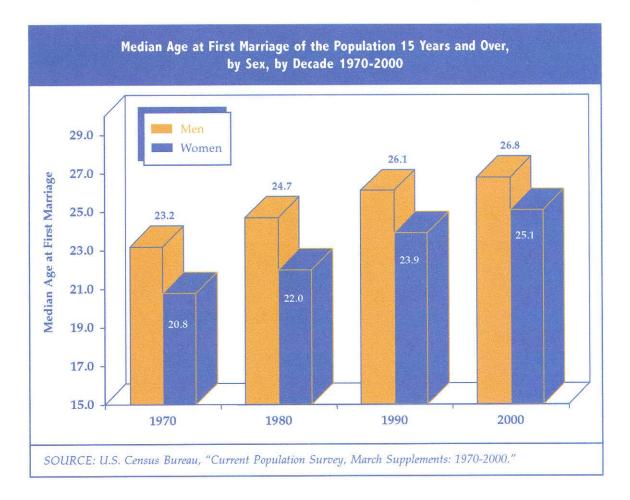
With an increasingly diverse population, there are potentially greater barriers to communications across ethnic and racial groups. Nearly 18 percent of the population aged 5 and older spoke a language other than English at home in 2001.<sup>55</sup> It may become more important for employers, like marketers, to try to get their message to workers and customers in languages other than English. For example, according to *American Demographics* magazine, 63 percent of California's minority population are more likely to purchase a product or service if it is advertised in an ethnic-oriented publication.<sup>56</sup>

#### **Family**

Since 1970 the composition of U.S. families and households has become more diverse. Marriage and fertility rates, too, have changed in the past 34 years. For example, the percentage of households made up of married couples with children declined from 40.3 percent in 1970 to 24.1 percent in 2000, although most of the decline occurred before 1990, when 26.3 percent of households were made up of married couples with children. The share of married couple households without children declined only modestly, from 30.3 percent in 1970 to 28.7 percent in 2000.<sup>57</sup> Meanwhile, single parent households with children rose from 10.6 percent in 1970 to 16 percent in 2000, with most of the increase before 1990, when single parent households with children represented 14.8 percent of households. The number of people living alone also increased dramatically, going from 17.1 percent of households in 1970 to 25.5 percent in 2000. The number of people in a household also became smaller over time, falling from 3.14 people in 1970 to 2.62 people in 2000.58

#### Marriage

The median age at first marriage rose 23.2 years for men and 20.8 years for women in 1970 to 26.8 years for men and 25.1 years for women in 2000.<sup>59</sup> The rising trend stabilized after 1990, when the median age at first marriage was 26.1 for men and 23.9 for women. As a result of marrying latter, more young adults remain at home longer. In 2000, for example, 56 percent of men aged 18 to 24 (7.5 million) lived with their parents.<sup>60</sup> There has also been a modest increase in the number of people who never married. In 1970



28.1 percent of men 15 years and older never married. By 2000, that had risen to 31.3 percent. For women, it rose from 22.1 percent in 1970 to 25.1 percent in 2000.<sup>61</sup> This group includes couples cohabiting, people living with roommates or people other than spouses.

The number of separated and divorced men and women rose sharply, but has remained a fairly small portion of the overall population. For men, it grew from 3.5 percent in 1970 to 10.1 percent in 2000, while for women it jumped from 5.7 percent to 12.6 percent.<sup>62</sup> In 2000, there were about 3.8 million cohabiting households or 2.7 percent of households, although the actual number may be higher.<sup>63</sup>

## Fertility

Women are also having children at later ages. For example, the fertility rate per 1,000 women aged 30 to 34 increased from 61.9 in 1980 to 89.6 in 1999. Similar increases occurred for women aged 35 and older while fertility rates for younger women remained flat or declined.<sup>64</sup> Additionally, 31 percent of births in the year 2000 were to unwed mothers.<sup>65</sup>

# **Implications of Family** and Social Trends

The changing racial and ethnic composition of the United States will not, *per se*, change the desire or need for retirement income and health care coverage. Nor will it necessarily change the type of benefit plans employers

might provide to employees (even though other trends, such as aging and rising health care costs, are likely to change the type of benefit plans). However, linguistic differences may present newer communications challenges for employers and the government in the provision of benefit plan coverage.

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Continuing social and family trends such as single parent families, later marriages, fewer children per family unit and children being born to parents at later ages all will have an impact on the provision of benefits and the nature of the shared effort by individuals,

employers and public plans. For example, just as the general need for long-term care should be expected to increase as the population ages, it may exacerbated as women have fewer children and bear them later in life. The change in family composition may lead more workers to question the value of some benefit arrangements (e.g., family health coverage) at different stages of employment. All in all, changing family structures will underscore the importance of flexible benefit arrangements.

#### **Workforce Trends**

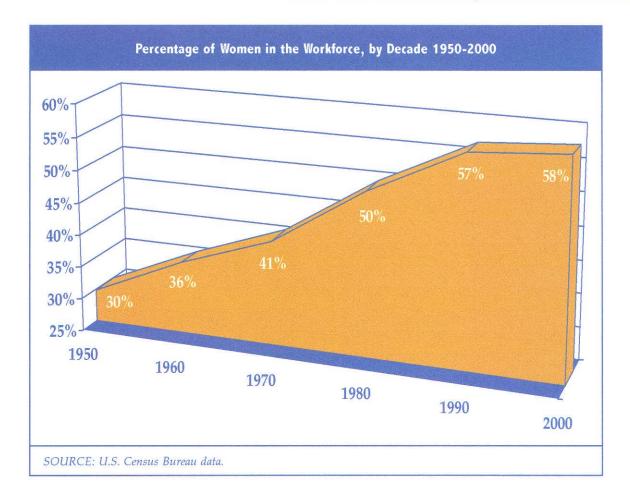
For the most part, the broad changes that have been underway in the American workforce will continue for some time. In the future there will be a higher proportion of women in the workforce and more jobs overall than those seeking those jobs. The types of jobs in demand will change as technology expands in the workplace and employers require higher levels of education. However, as is the case today, employers in the future are also likely to continue to offer long-tenured jobs.<sup>66</sup>

## Female Participation

The increasing participation of women in the workforce is probably the most significant labor trend in the last 50 years. Only one woman in four was in the paid labor force in 1940, but women's participation reached 58 percent in 2000.67 Instead of the old household division of labor with one spouse working and the other staying home, increasingly men and women must now balance marriage and family and employment. Over 70 percent of married women with children under the age of 18 worked in 2000, and nearly two-thirds of married couple families with children have both parents employed.<sup>68</sup> Almost 74 percent of single women with children were working in 2000, a significant increase over the 52 percent of single women working in 1980.<sup>69</sup>

#### **Tightening Labor Market**

In the future a shortage of workers in the face of rising job opportunities will likely continue the recent trend toward tighter labor markets. The labor market will tighten because younger workers will be entering the labor force at levels roughly equal to the number leaving work, a change from the recent decades when there were far more entering the workforce than leaving it.



Estimates of labor force growth in the current decade are 75 percent of that experienced in the 1990s with much lower employment growth forecast for the 2010s.<sup>70</sup>

## Shift in Types of Jobs

For more than a century, there have been dramatic shifts in the types of jobs that are available in the workplace. In 1900, most Americans lived in rural areas, and two-fifths of the working population engaged in farm-related occupations. Today, the proportion of Americans in agricultural jobs is two percent.<sup>71</sup> In 1930 about 29 percent of the working-age population held white-collar jobs, but today nearly three in five Americans work in managerial, professional, technical or administrative jobs. Service jobs account for an additional 14 percent of U.S. workers.<sup>72</sup>

In the future there will be yet more shifts in the types of jobs available. By 2010, there will be over 167 million jobs, an increase of 22.2 million over the prior decade. Professional and service occupations are expected to provide more than half the total job growth during this period.

#### Technology and Job Opportunity

Technology is a dominant influence in work and society. In 2001, 56.5 percent of U.S. households had a personal computer, up from 42 percent in 1998.<sup>73</sup> The proportion of households with Internet access more than doubled from 18 percent in 1998 to 50.5 percent four years later.<sup>74</sup> According to the National Telecommunications and Information Administration, computer and Internet access are positively correlated with

income. Even so, both computer and Internet use have increased steadily across all income categories over time. For example, among the lowest income households, those earning less than \$15,000 a year, Internet use increased from 9.2 percent in 1997 to 25 percent in 2001. Among employed people, computer use at any location is higher at 73.2 percent than for non-employed people, 40.8 percent. Similarly, 65.4 percent of employed people use the Internet, compared to 36.9 percent of the non-employed. According to the Bureau of Labor Statistics, 53.5 percent of the workers used a computer a work and nearly all of these have access to the Internet.

Computer and Internet use vary by occupation. The highest use is among managerial and professional specialty occupations, where 79.6 percent used a computer at work in 2001 and 65.8 percent used the Internet. 79 Technicians and related support occupations, including computer programmers, and administrative support occupations also had high rates of computer use (75 percent) and Internet use (52.8 percent) at work in 2001. Women are also more likely to use a computer at work than men, 59.9 percent and 47.9 percent respectively. Similarly while 41.2 percent of women at work used the Internet in 2001, 36.0 percent of men used the Internet.

Young and older workers were less likely to use a computer or Internet on the job. Among workers ages 16 to 24 years and ages 65 years and over, about one-third used a computer only at work in 2001, while about 1 in 5 used the Internet. 80 In contrast, over half of the workers ages 25 to 64 used a computer at work and about 2 out of 5 used the Internet.

The likelihood of using a computer or accessing the Internet was highest among workers ages 25 to 64. Nearly 3 out of 5 of these workers used a computer at work in 2001 while over 2 out of 5 used the Internet.

Computer use at work was greater in 2001 among white workers (54.9 percent) than African-Americans (42.3 percent) or Hispanic workers (32.0 percent).<sup>81</sup> Similarly, Internet use at work was greater among whites (39.6 percent) than African-Americans (28.8 percent) or Hispanics (19.8 percent.)

## **Telecommuting**

The increasing use of technology led to an increase in telecommuting, when employees work from home or an alternate worksite closer to home than the office. While there is no official statistic for telecommuters, more than 3.6 million Americans received pay for work done at home in 1997, but this figure does not include those who worked at an alternate worksite other than the home.<sup>82</sup> In addition, 6.5 million self-employed did some work at home.<sup>83</sup>

#### Technology and Older Workers

In a knowledge-based economy, workers will need proper training to handle information systems and technologies. This is an area in which an aging workforce may face both advantage and disadvantage. In a survey of human resource managers, older workers were rated lower for skill-related qualities, such as trying new approaches, learning new technologies, and having upto-date job skills. However, the less physically demanding nature of a knowledge-based economy can work to the advantage of older workers, who appear to

be adapting. The number of workers aged 55 to 64 using a computer at work was 53.7 percent in 2001, not much lower than peak usage of 58.6 percent rate among workers aged 45 to 54.85

## **Education and Job Opportunity**

Increased educational attainment translates into greater economic success. The average annual earnings in 1999 for those aged 18 and older who had completed high school only was \$24,572; for those with a bachelor's degree it was \$45,678.86

#### **Job Tenure Trends**

Because benefits are often conditioned on length of service with an employer, tenure trends are important. According to the Labor Department, about 25 percent of workers surveyed in January 2002 had been with their employer 12 months or less. <sup>87</sup> However, median years of tenure tend to increase with age. For example, the median tenure of workers aged 45 to 54 (8.6 years) was more than three times that of workers aged 25 to 34 (2.7 years). <sup>88</sup> The median tenure for all workers age 16 and over was 3.7 years in 2002. <sup>89</sup>

The media has made much about high turnover in employment and the decline in long-tenure jobs, but there is little or no evidence to support claims of higher turnover. Long-term jobs are distributed differently today, based on age, gender and educational attainment. Generally, turnover tends to decrease with age. Further, long-term jobs have become scarce for the least educated, particularly for men. Meanwhile, more women enjoy employment positions of long duration. 90

## Skilled Worker Gap

Changing demographics will also increase demand for workers, especially skilled workers. <sup>91</sup> In 10 years, according to an analysis by the Employment Policy Foundation, available jobs could outnumber workers by 6.7 million. <sup>92</sup> The demand will be even greater for skilled labor. According to the analysis of data for 1980 to 2002 from the Census Bureau, Bureau of Labor Statistics

and Bureau of
Economic Analysis,
there will be an
increase of 30.7 million
jobs openings for
people with at least a
two-year college degree.
But, only 23.3 million
people are expected to
have earned at least a
two-year degree and
enter the work force.

In a knowledge-based economy, workers will need proper training to handle information systems and technologies.

The expected shortfall in skilled workers may be tempered to some extent by older workers delaying retirement. However, this will not be sufficient to close the gap. To fully provide all the needed skilled workers would require some combination or all of the following factors: productivity growth, higher immigration or guest worker levels, higher labor force participation, and more training and education.<sup>93</sup>

#### Flexible Workers

According to the Bureau of Labor Statistics, 9.4 percent of American workers in 2001 were in alternative work arrangements that do not fit into the traditional employer-employee pattern. This group includes independent contractors (6.4 percent), on call workers

(1.6 percent), temporary help agency workers (0.9 percent) and workers provided through contract firms (0.5 percent). A 2003 survey by the International Telework Association Council found that the number of those working at home during business hours at least one day a week rose to 23.5 million, or 17.4 percent of the workforce. Another 23.4 million self-employed workers representing 17.3 percent of the workforce, also reported working at home at least one day a week.

#### Flexible Work Schedules

A far larger group of workers – 29 percent of full-time wage and salary workers – had flexible work schedules in 2001, that is, they worked at different hours than those regularly scheduled for the office or shift. <sup>96</sup> Twenty-six percent of workers between the ages of 55 and 64 had flexibility in setting work hours. Among those age 65 and older, 31 percent had flexible work hours. There is a significant gender difference within this older age group as 37 percent of men aged 65 and older have flexible work schedules compared to 22 percent of women. <sup>97</sup>

#### **Phased Retirement**

New patterns of mixing work and leisure are also emerging, as phased retirement programs illustrate. One survey of private sector employers found that 16 percent provide a formal phased retirement program with an additional 40 percent interested in initiating a program.<sup>98</sup>

Nonetheless, while a number of employees may wish phase in their retirement, there are employees who may not want to work past the time they are eligible for retirement and some may not be able to do so. As such, employers should have freedom to design

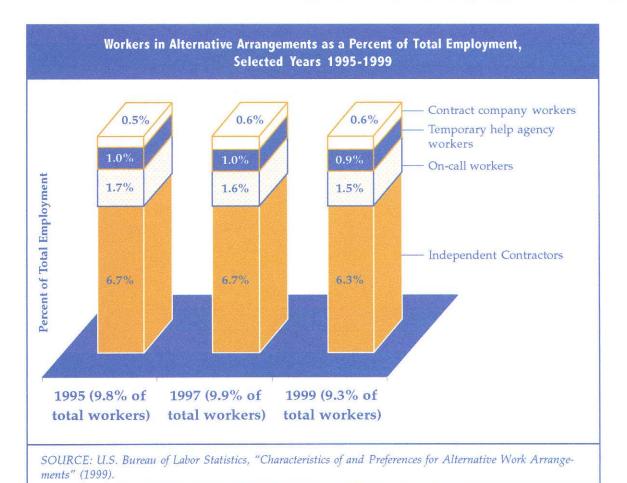
and meet the needs of a diverse workforce, including the ability to offer employees the opportunity for individual customization and choice.

## **Implications of Workforce Trends**

Slower labor force growth rates and tighter labor markets should result in a greater emphasis on benefits, as employers compete in a labor market where skilled job growth outpaces the availability of skilled workers. As employers compete for employee services, workers will demand not just higher wages but improved benefits and working conditions. The demand for workers will likely increase labor force participation by the elderly.

Studies cited in the discussion of labor market trends above<sup>99</sup> do not show a big shift in the overall percentage of workers who will have shorter tenure in their jobs. Data do, however, show that overall, workers will have many jobs throughout their careers, with tenure increasing in later years. Thus, it will still be a challenge for workers to acquire satisfactory retirement income.

An increase in personal ownership of computers and the use of computers in the workplace improve access to benefits information and even health care services and retirement investment choices. However, because neither computer ownership nor the ability to use up-to-date technology will be universal, there are likely to continue to be disparities between and among employees of particular companies in their ability to access that information. Similarly, companies themselves will differ in terms of the ability to provide benefits information using the most up-to-date technology.



The continued increase in the proportion of women in the workplace, and the corresponding growth in two-income families (with both the husband and wife working) may lead to changes in the types of benefits package employees request or prefer. For example, one working spouse might be interested in family health coverage from his or her employer while the other spouse may be more interested in other types of benefits. Thus, the family composition of workforce changes will likely accelerate the drive toward more flexibility in plan design.

Overall improvements in educational attainment levels will not be sufficient to serve an aging society unless it includes education that helps Americans attain higher levels of financial and employee benefit

literacy. Such literacy will be especially essential as individuals are increasingly required to take greater responsibility for their personal financial security.

## **Economic Trends and Implications**

Economic cycles in such indicators as unemployment, inflation, interest rates, and savings rates, along with unpredictable market responses to external factors, pose a challenge in the design of employee benefits. Future benefits systems should be flexible enough in design to handle these cyclical changes and be adjusted when necessary.

Some of the key factors that affect employee benefits have been highly volatile over the last decade and a half. The stock market, for example, experienced an upward march throughout the 1990s with the Dow Jones Industrial Average going from 2,753 at the start of the 1990s to 11,723 on January 14, 2000. From its high in January 2000 to its bottom of 7,524 on March 11, 2003, the Dow Jones Industrial Average lost almost 36 percent of its value. After March 11, 2003, the market began a rebound that gained strength in the second half of the year. By March 1, 2004, the market had risen 40 percent to 10,678 from its low of March 11, 2003. During the years of losses, many older Americans were forced to retrench their expectations about retirement and financial security.

Market fluctuations have a substantial effect on pension plan funding (both overfunding and underfunding) and individual financial decisions, including the financial security of 401(k) plan accounts. These trends highlight the importance of providing financial and benefits education for individuals.

Health care costs have dramatically increased for the average American. In 1950, an individual's medical care costs made up just 3.7 percent of consumer expenditures. In the year 2000, medical care expenditures were almost 15 percent of personal consumption. Demployers likewise have been experiencing rising health care cost pressures. Employer costs for health plans, for example, rose 10.1 percent in 2003, after rising 14.7 percent in 2002. In 2004 employers expect costs to jump another 14 percent.

Small businesses may be especially vulnerable to market and price trends. For example, a declining economy may force small employers to eliminate health care coverage or make them less willing to adopt

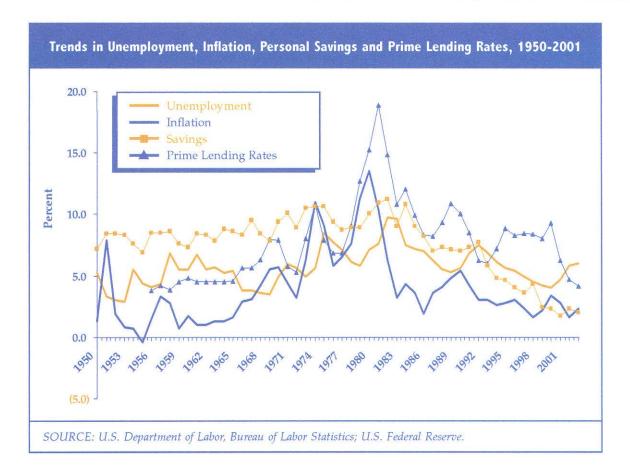
retirement plans, thereby expanding the population of workers with reduced or no benefits.

Finally, another recent trend is increasing equity ownership by Americans. The Federal Reserve reports that in 2001, 51.9 percent of all households held stock either directly or indirectly, <sup>102</sup> an increase from 48.9 percent 1998 and up dramatically from 31.6 percent in 1989. <sup>103</sup>

Some of the expansion in the equity culture has been driven by employer-sponsored stock ownership programs, including employee stock purchase plans that provide stock options to rank-and-file workers. For example, a 2000 survey by the National Association of Stock Plan Professionals and PricewaterhouseCoopers reported that 44 percent of 345 large domestic companies with stock option plans made grants to *all* employees, including hourly employees.<sup>104</sup>

#### Conclusion

Demography shapes our national and individual destinies. Increases in the proportion of the elderly in the population will put enormous financial strains on the employee benefits system and on individuals preparing for retirement. In addition these trends have ominous implications for the future of Social Security and Medicare, which face a future where there will be fewer workers to finance the benefits for the growing ranks of retirees. The strains on publicly-funded benefits will make it all the more important that individuals are prepared to shoulder the costs associated with retirement. More workers in the future will depend on retirement income from a defined



contribution plan, where more of the burden of determining how much to save and even how to invest falls on the individual.

In addition, longer life spans mean that workers will have to accumulate more assets for retirement than may have been required in the past. They will also need to be able to afford supplemental retiree health insurance, out-of-pocket medical expenses, and pay for long-term care.

Employers help individuals achieve their goals by providing attractive plans, offering matches for employee contributions and structuring investment options. Indeed, employer contributions to all types of pension plans and insurance funds, including health care, totaled \$723.4 billion in 2003.<sup>105</sup> Together with changes in employee benefits and business trends, rising health care costs

put strains on the ability of employers to provide a full range of benefits. At the same time, employers face the task of closing shortfalls in pension funding that have appeared as a result of lower interest rates and sustained declines in asset values, as well as funding rules that increase the volatility of the funding obligation.

The employee benefits system must meet the challenge posed by an aging population, labor force trends, changing family structures, volatile financial markets, health care trends, and changing regulatory regimes that will reshape society, business and the life of America's workers. Otherwise, these trends could overwhelm and weaken the employee benefits system and thereby undermine their vital role in helping individuals build and maintain personal financial security.

## Notes, Appendix A

<sup>1</sup> Personal financial security, as used in this document, is a broad term that describes a state of being secure in the expectation one will be able to sustain one's living conditions and general welfare throughout retirement and in the face of potential adverse events. This is usually achieved by working and saving for the future and taking appropriate steps and precautions against potential adverse events and developments. Personal financial security for working age people is most often associated with having a good job with good prospects and owning a home, although the definition of personal financial security would likely vary from person to person. Beyond that foundation, both insurance and employee benefits play a vital role in protecting what one has achieved. The risks that might undermine personal financial security include the following: (1) employment: the financial risk of lost income that employees face when they lose their jobs; (2) health: the financial risk employees face when they or their family members are sick or injured on or off the job, including unexpected expenses and/or loss of income; (3) longevity: the financial risk that individuals face in their retirement years if they should outlive their assets; and (4) death: the financial risk employees and their families' face from premature death; (5) liability: the financial risk employees and their families' face due to their personal actions or those of their family members.

<sup>2</sup> The Boards of Trustees, Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, *The 2004 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds* (Washington, D.C.: Social Security Administration, 2004), p. 2.

<sup>3</sup> Ibid.

<sup>4</sup> U.S. Census Bureau 2000a.

<sup>5</sup> World Population Ageing, 1950 to 2050 (New York: United Nations, 2002), p. 462.

<sup>6</sup> U.S. Census Bureau 2000a.

<sup>7</sup> Social Security Administration, 2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, Table V.A2.

<sup>8</sup> Shripad Tuljapurkar, Nan Li, and Michael Anderson, "Stochastic Population Forecasts for the G-7 Countries," Appendix in Robert Stowe England, *The Fiscal Challenge of an Aging Industrial World* (Washington, D.C.: Center for Strategic and International Studies, 2002), pp. 116-140.

<sup>9</sup> Ibid, Table 3.3, p. 50.

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<sup>&</sup>lt;sup>23</sup> Panis, p. 8.

<sup>&</sup>lt;sup>24</sup> Centers for Medicare and Medicaid Services, National Health Care Expenditure Tables, "Table 1: National Health Expenditures Aggregate and per Capita Amounts, Percent Distribution, and Average Annual Percent Growth, by Source of Funds: Selected Calendar Years 1980-2002," from Web site at: <a href="http://www.cms.hhs.gov/statistics/nhe/historical/t1.asp">http://www.cms.hhs.gov/statistics/nhe/historical/t1.asp</a>.

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- <sup>60</sup> Ibid, p. 10.
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# **APPENDIX B:**

#### OTHER STAKEHOLDERS

Below, in alphabetical order, are the "other" stakeholders and their respective roles in helping individuals achieve and sustain personal financial security. One obligation universal to all these stakeholders is to charge reasonable prices and fees. The identities and roles of the stakeholders are by no means limited to the descriptions that follow.

Other Stakeholders	Roles
Actuaries, consultants and insurance brokers	<ul> <li>Use intellectual capital to provide innovative solutions related to plan formation, plan costs, and plan administration</li> <li>Develop and promote products that maximize value to plan participants and plan sponsors</li> <li>Inform plan sponsors about and respond to emerging issues and opportunities</li> <li>Develop and promote public policy proposals that: <ul> <li>Encourage personal financial security</li> <li>Encourage plan sponsorship</li> <li>Expand coverage</li> <li>Simplify plan administration</li> <li>Increase quality</li> <li>Improve cost effectiveness</li> <li>Support and enhance the employer-based benefits system</li> </ul> </li> <li>Provide data for and support research that: <ul> <li>Promotes informed decisions</li> <li>Enhances the quality of the benefits system</li> <li>Improves the cost-effectiveness of the benefits system</li> </ul> </li> </ul>

Other Stakeholders	Roles
Attorneys: (Including lawyers, the American Bar Association and state bar associations)	<ul> <li>Represent stakeholders to ensure their needs are met under the benefits system and related legislation and regulations</li> <li>Develop and promote public policy proposals that: <ul> <li>Balance the good of the benefits system with the rights of individuals for compensation if wronged</li> <li>Encourage personal financial security</li> <li>Encourage plan sponsorship</li> <li>Expand coverage</li> <li>Simplify plan administration</li> <li>Increase quality</li> <li>Improve cost effectiveness</li> </ul> </li> </ul>
Educators and Education Systems: (Including primary, secondary and higher education)	<ul> <li>Use intellectual capital to develop educational programs and materials that foster personal financial security</li> <li>Promote the integration of such programs and materials into primary, secondary, and higher education curricula</li> <li>Promote community outreach programs based on similar programs and materials</li> <li>Promote public policy proposals that: <ul> <li>Encourage personal financial security</li> <li>Encourage plan sponsorship</li> <li>Expand coverage</li> <li>Simplify plan administration</li> <li>Increase quality</li> <li>Improve cost effectiveness</li> </ul> </li> </ul>

Other Stakeholders	Roles
Health Care Givers: (Including physicians/doctors, hospitals and other medical service providers)	<ul> <li>Practice evidence-based medicine that:</li> <li>Continually improves outcomes</li> <li>Fosters innovation in health and wellness</li> <li>Improves cost-effectiveness</li> <li>Educate patients on health and wellness issues</li> <li>Share in the "cost" of care for the disenfranchised</li> <li>Provide data for and support research that: <ul> <li>Promotes informed decisions</li> <li>Enhances the quality of the benefits system</li> <li>Improves the cost-effectiveness of the benefits system</li> </ul> </li> <li>Promote public policy proposals that: <ul> <li>Encourage personal financial security</li> <li>Encourage plan sponsorship</li> <li>Expand coverage</li> <li>Simplify plan administration</li> <li>Increase quality</li> <li>Improve cost effectiveness</li> </ul> </li> </ul>
Health Care Plans: (Including health insurance providers)	<ul> <li>Promote the practice of evidence-based medicine that: <ul> <li>Continually improves outcomes</li> <li>Fosters innovation in health and wellness</li> <li>Improves cost-effectiveness</li> </ul> </li> <li>Use intellectual capital to develop and disseminate programs and materials designed to educate stakeholders on health and wellness issues and evidence-based medicine</li> <li>Share in the "cost" of care for the disenfranchised</li> <li>Provide data for and support research that: <ul> <li>Promotes informed decisions</li> <li>Enhances the quality of the benefits system</li> <li>Improves the cost-effectiveness of the benefits system</li> </ul> </li> </ul>

Other Stakeholders	Roles
Health Care Plans: (Including health insurance providers) continued	<ul> <li>Promote public policy proposals that:</li> <li>Encourage personal financial security</li> <li>Encourage plan sponsorship</li> <li>Expand coverage</li> <li>Simplify plan administration</li> <li>Increase quality</li> <li>Improve cost effectiveness</li> <li>Support and enhance the employer-based benefits system</li> </ul>
Investment Managers: (Including mutual funds, insurance companies and trust companies)	<ul> <li>Develop and promote appropriate and cost-effective products and services for plan participants, plan sponsors and related stakeholders</li> <li>Use intellectual capital to develop and disseminate programs and materials designed to educate stakeholders on: <ul> <li>Personal financial planning</li> <li>Retirement planning</li> <li>Investment planning</li> </ul> </li> <li>Provide data for and support research that: <ul> <li>Promotes informed decisions</li> <li>Enhances the quality of the benefits system</li> <li>Improves the cost-effectiveness of the benefits system</li> </ul> </li> <li>Promote public policy proposals that: <ul> <li>Encourage personal financial security</li> <li>Encourage plan sponsorship</li> <li>Expand coverage</li> <li>Simplify plan administration</li> <li>Increase quality</li> <li>Improve cost effectiveness</li> <li>Support and enhance the employer-based benefits system</li> </ul> </li> </ul>

Other Stakeholders	Roles
Quasi-Governmental Bodies: (Including FASB, IASB, NYSE, NASDAQ)	<ul> <li>Use intellectual capital to develop and disseminate programs and materials designed to educate stakeholders on: <ul> <li>Personal financial planning</li> <li>Retirement planning</li> <li>Investment concepts</li> </ul> </li> <li>Promote public policy proposals that: <ul> <li>Encourage personal financial security</li> <li>Encourage plan sponsorship</li> <li>Expand coverage</li> <li>Simplify plan administration</li> <li>Increase quality</li> <li>Improve cost effectiveness</li> </ul> </li> <li>Provide data for and support research that: <ul> <li>Promotes informed decisions</li> <li>Enhances the quality of the benefits system</li> <li>Improves the cost-effectiveness of the benefits system</li> </ul> </li> </ul>
Researchers, developers and producers: (Including drug companies, producers of technologies and machines, and researchers)	<ul> <li>Use intellectual capital to complete research and develop reports that assist all stakeholders to: <ul> <li>Promote informed decisions</li> <li>Enhance the quality of the benefits system</li> <li>Improve the cost-effectiveness of the benefits system</li> </ul> </li> <li>Use intellectual capital to measure results and outcomes of processes and procedures and recommend improvement strategies</li> <li>Promote public policy proposals that: <ul> <li>Encourage personal financial security</li> <li>Encourage plan sponsorship</li> <li>Expand coverage</li> <li>Simplify plan administration</li> <li>Increase quality</li> <li>Improve cost effectiveness</li> </ul> </li> </ul>

Other Stakeholders	Roles
Third Party Administrators:	Use intellectual capital to develop and promote the use of products, services, innovative methods and technologies that:  Promote informed decisions  Enhance the quality of the benefits system  Improve the cost-effectiveness of the benefits system  Provide data for and support research that:  Promotes informed decisions  Enhances the quality of the benefits system  Improves the cost-effectiveness of the benefits system  Promote public policy proposals that:  Encourage personal financial security  Encourage plan sponsorship  Expand coverage  Simplify plan administration  Increase quality  Improve cost effectiveness  Support and enhance the employer-based benefits system

## **APPENDIX C:**

#### AMERICAN BENEFITS COUNCIL PUBLICATIONS BIBLIOGRAPHY

All of the following documents produced by the American Benefits Council contain policy recommendations covering retirement, health care, retiree health care, and stock option issues. Copies of these items may be obtained by contacting the Council. Please note that documents produced prior to September 2000 were done so under the Council's previous name: Association of Private Pension and Welfare Plans (APPWP) and also known as the Benefits Association.

Pensions at the Precipice: The Multiple Threats Facing our Nation's Defined Benefit Pension System (May 2004)

Statement of Principles for Medicare Reform and Prescription Drug Coverage (February 2003)

A Flexible Workforce: The Changing Face and the Changing Pace of Today's Worker – An Employer Perspective (March 11, 2002)

Taking Stock in Employee Benefits: The Democratization of Broad-Based Stock Plans – An Employer Perspective (February 26, 2001)

Looking to the Future: A New Perspective on the Social Security Problem (April 6, 2000)

Stretching the Pension Dollar: Improving U.S. Retirement Security and National Saving by Enhancing Employer-Based Pension Plans (August 1999)

Preparing Americans for the Future: The Road to an Improved Employment-Based Retirement System (March 1997)

Provider Cost Shifting: A Burden for Employee Health Plans (August 1992)

Return on Investment: Pensions Are How America Saves (September 1991)

Gridlock Revisited: On the Road Toward Pension Simplification (September 1991)

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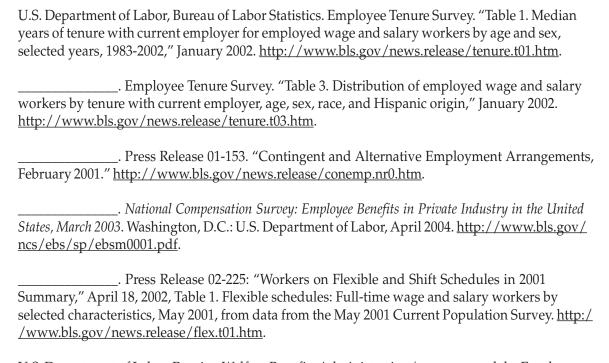
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