The Problem with Pension Portability

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I. INTRODUCTION

Pensions are a very important type of employee benefit, but some of the problems with them arise precisely because they are employee benefits. This Article discusses one of those problems: portability. When employees change jobs, they often lose pension benefits. Sometimes employees may not be fully “vested” in their pensions, and so they lose all or a part of their benefits when they change jobs. Other employees may be in plans that implicitly impose penalties for changing jobs, even if the employees are vested. Portability refers to the ability of employees to carry their pension benefits with them as they change jobs.

Concern about limited portability is a current\(^1\) and recurrent\(^2\) topic of public policy debate. This article will not resolve much in that de-
bate. Indeed, its message is quite the opposite: the portability debate will be very difficult to resolve for two interrelated reasons. First, the debate involves very difficult questions about the costs and distributional effects of changes in the rules relating to portability. Pension portability sounds good in general, as a soundbite or one-line campaign theme. After all, who could be against workers carrying their pension benefits with them as they change jobs? But pension portability will have costs that will be distributed across workers and employers in a particular way. Those costs and distributional effects pose an empirical challenge: it is difficult to determine what they are with an acceptable degree of precision. And they pose a normative challenge: with its costs and distributional effects, does portability provide a net benefit? The status quo, which is quite powerful in any event, becomes an even more formidable opponent when the consequences of every alternative are clouded with uncertainty.

Second, the portability debate is difficult because any changes affect, not only the ability of employees to transfer benefits, but also the calculus employers make when they decide whether to offer pensions as an employee benefit. Employers offer pensions, not out of the goodness of their hearts, but because pensions serve certain functions, such as retaining good employees, motivating them, and regulating retirement flows. Portability would interfere with the ability of pensions to perform these functions both directly (by making it more difficult to use pensions to serve those functions) and indirectly (by making it more expensive to use pensions for those purposes). Employers have an option when portability interferes with their ability to use pensions to pursue their employment objectives: offer fewer and less generous pensions.

This Article is about pension portability, but the problems addressed are important and general ones affecting all types of employee benefits. All employee benefits are part of the compensation package and, as such, all are designed to pursue certain employment-related goals. Portability of health care benefits, for example, poses issues similar to those posed by pension portability. Regulation on that is-


3. The issues are similar on both counts discussed in the text. First, health insurance portability will impose costs and have distributional effects that are important, significant and difficult to assess. See AMERICAN ACADEMY OF ACTUARIES, PROVIDING UNIVERSAL ACCESS IN A VOLUNTARY PRIVATE-SECTOR MARKET
sue, and indeed regulation of all employee benefits, occurs in the context of uncertainty about the costs of regulation and its distributional effects and about its effect on the continued willingness of employers to offer the benefit. This Article is intended both as an exploration of the issue of pension portability and as a case study of the challenges posed to lawmakers as they consider regulation of employee benefits generally.

II. PENSION PORTABILITY: THE LANDSCAPE

In general terms, portability refers to the ability of participants to transfer pension rights from one employer to another following a change in employment. For convenience, I am going to refer to the employer that the participant is leaving as the “old employer” and the employer that the participant is joining as the “new employer.”

The landscape of pension portability is complex and multifaceted. It involves issues of law, policy, and market dynamics. The ability of participants to transfer pension rights is often limited by the regulations and practices of both the old and new employers. This includes the rules governing the vesting of pension rights, the conditions under which participants can take their benefits with them, and the procedures for transferring benefits between employers.

Legal and regulatory frameworks play a crucial role in determining the feasibility of pension portability. In the United States, the Employee Retirement Income Security Act of 1974 (ERISA) sets the rules and regulations for private pension plans. ERISA requires employers to provide a statement of pension benefit portability to employees, and it establishes the conditions under which benefits can be transferred between employers.

The discussion of pension portability is deeply intertwined with issues of health insurance portability. Health insurance, like pensions, is closely tied to the labor market. As a result, evaluation of effects on the labor market must be a part of any evaluation of changes in the rules regulating portability of health insurance. See Jonathan Gruber & Brigitte C. Madrian, Health Insurance and Job Mobility: The Effects of Public Policy on Job-Lock, 48 INDUS. & LAB. REL. REV. 86 (1994); Alan C. Monheit & Philip F. Cooper, Health Insurance and Job Mobility: Theory and Evidence, 48 INDUS. & LAB. REL. REV. 68 (1994).

Having discussed the similarities, it is important to note that important differences also exist between pension and health care portability. In general terms, the main differences are in the type of cost-shifting that occurs under the two programs and in the nature of the benefits provided. For pensions, the principal cost-shifting is intrapersonal. Through pension plans, participants shift income from their working years to their retirement years; pension benefits tend to be linearly related to contributions into the plan. For health care, the principal cost-shifting is cross-participant. At any point in time, participants who need covered medical care are shifting their costs to other participants; benefits tend not to be linearly related to contributions. Similarly, pensions and health care are different in the type of benefit they provide. Health insurance provides a “merit good” which society tends to be unwilling or unable to limit, even if, particularly for emergency and critical care, the people needing the good are unable to pay.

For pensions, on the other hand, society is more willing and able to limit the amount provided for retirement income. Although discussion of pension portability may inform consideration of health insurance portability, because of these differences and others, the two issues require independent consideration.

A distinction exists between employers and pension plans. A plan may cover a large number of employers. See, e.g., Employee Retirement Income Security Program of 1974 (ERISA) § 3(37), 29 U.S.C. § 1002(37) (1994). Indeed, in the public sector, many of the major plans cover large numbers of employers. For example, in most states there is a single plan that covers all school teachers in the state. See Cynthia L. Moore, Public Pension Plans: The State Regulatory Framework (2d ed. 1998). This is obviously relevant to portability; a teacher moving from one school district employer to another within the same state often has com-

(1996)(discussing costs and distributional effects of providing for universal access to health care within a voluntary insurance market); Steven L. Willborn, et al., Employment Law: Cases and Materials 889 (2d ed. 1998)(citing evidence that recipients of COBRA continuation coverage receive approximately $3,500 in health care benefits for every $1,000 paid in premiums). Second, health insurance, like pensions, is closely tied to the labor market. As a result, evaluation of effects on the labor market must be a part of any evaluation of changes in the rules regulating portability of health insurance. See Jonathan Gruber & Brigitte C. Madrian, Health Insurance and Job Mobility: The Effects of Public Policy on Job-Lock, 48 INDUS. & LAB. REL. REV. 86 (1994); Alan C. Monheit & Philip F. Cooper, Health Insurance and Job Mobility: Theory and Evidence, 48 INDUS. & LAB. REL. REV. 68 (1994).

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Participants may be interested in transferring two distinct types of pension rights. First, participants may want to transfer service credit. In general terms, service credit means credit for the number of years participants have worked with the old employer. Second, participants may be interested in transferring assets held on their behalf in the old employer's fund.

The ability to transfer service credit may be important for participants in both defined-benefit and defined-contribution plans. Both types of plans may have "vesting" requirements that provide for all or part of service credit to vest over time. However, a teacher who wants to move to another state or even to another type of job within the state would face a portability problem.

At this point, however, I am not going to make a distinction between employers and plans. To simplify the discussion, I will be assuming single employer plans. As a result, the interests of the employer and the plan will be aligned, and I will be referring only to employers even though technically it may be plans that reallocate monies or take other actions.

5. In this introductory section, for convenience, I am going to talk only in terms of the participant's interests in portability. Employers, obviously, also have interests in the portability issue. I will discuss the relevant interests more completely later.

6. For our purposes, we need not examine difficulties in determining years of service. It should be noted, however, that the issue can be quite complex. See ERISA §§ 202(a)(3), 202(b), 203(b), 29 U.S.C. §§ 1052(a)(3), 1052(b), 1053(b) (1994) (defining rules for determining years of service for purposes of applying ERISA's vesting rules).

7. In defined benefit plans, employers promise employees a "defined benefit" at retirement. The amount of the benefit is determined by a formula specified in the plan which, in most plans, uses length of service and final salary as variables. For example, the formula may promise an annual benefit at retirement equal to .02 (the generosity factor) times years of service times the employee's average salary over her last three years of employment. Thus, if a thirty-year employee had an average salary of $50,000 over her last three years of employment, she would be entitled to an annual pension of $30,000 (.02 x 30 x $50,000). Employees do not have individual accounts established for them in defined-benefit plans. Instead, the employer is responsible for making contributions to a trust adequate to ensure that the promised pensions can be paid from the pooled fund. The amount of contributions required will depend on a complex actuarial analysis which takes into consideration factors such as the age, length of service, and expected attrition of employees, projections of future salary increases, and the rate of return on plan investments. In a defined-benefit plan, the employer bears the investment risk. If the pension fund's investments do poorly, or if the fund has too little money to pay the promised pensions for other reasons, the employer is liable for the shortfall.

8. In defined-contribution plans, employers promise only to make a "defined contribution" into an account established for each employee. The amount of the employee's benefit at retirement will depend entirely on the amounts contributed into her individual account and on her account's investment experience. Thus, in contrast to defined-benefit plans, employees bear the investment risk in defined-contribution plans. If the investment experience is poor, the amounts employees will receive at retirement will go down; if the investment experience is good, employees will receive more in retirement than initially expected.
some portion of an employee's pension benefits to be forfeited if she changes jobs too soon. Generally, employees become fully vested only after working five to seven years. The ability to transfer service credit would permit more employees to vest and, hence, to receive amounts that would otherwise remain unvested and thus be forfeited. For example, an employee who changed jobs every three years would never vest if all her employers had five-year cliff vesting rules. But if a portability scheme permitted service credit to be transferred, she could vest after two years with her second employer and with every later employer.

The ability to transfer service credit is important in defined-benefit plans even for participants who are vested with the old employer. One of the elements of the formula that defines an employee's pension in a defined-benefit plan is "final salary." As long as an employee continues to work for the same employer, this element serves to index the employee's pension to wage inflation. That is, as the employee's wages go up, so does the pension promised to the employee. But, in the absence of portability, when an employee leaves an employer, the final salary element of the pension formula is frozen at the amount of her final salary with that employer. If ten years elapse before she begins to receive the pension, it is quite likely that its value will be considerably diminished because of inflation. On the other hand, if the employee could transfer her years of service to her new employer and insert those years into the new employer's pension formula, the wage-indexing property of the final salary component of the pension formula would continue to work its magic. As will be detailed in a later section, this effect of portability—permitting employees to retain wage-indexed pensions—can be quite significant.

Participants may also be interested in the portability of assets held on their behalf by the old employer's fund. Participants may want as-

9. ERISA limits the vesting requirements of private plans. Plans governed by ERISA must have vesting schedules no longer than five or seven years. See ERISA § 203(a)(2), 29 U.S.C. § 1053(a)(2) (1994). Plans offered by public employers are not governed by ERISA and, as a result, may have longer vesting periods. The vesting period for public employees often extends to ten years and beyond. See FRANK V. AURIEMMA ET AL., GRAYING TEACHERS: A REPORT ON STATE PENSION SYSTEMS AND SCHOOL DISTRICT EARLY RETIREMENT INCENTIVES 38 (1992)(vesting periods for state retirement programs for teachers range from three to twenty years, with five and ten years being the most common periods).

10. "Final salary" itself, obviously, can be defined in ways that can significantly effect a participant's pension. For example, final salary defined as the participant's wages over the last year is generally more advantageous to a participant than final salary defined as the average of the participant's wages over the last three years. Regardless of how it is defined, however, as long as the employee keeps working for the same employer, the term serves to index a participant's pension to wage inflation.

sets transferred from the old to the new employer for a number of reasons. For example, the participant may think that the new employer's fund is more stable financially or has better investment advisors; the transfer may permit the participant to buy years of service credit in the new employer's plan; or the transfer may simply make it easier for the participant to keep track of her money by minimizing the number of accounts. As a general matter, in contrast to the portability of service credit, enhanced portability of assets would not be likely to have a significant financial effect. Employees would have greater control over who holds their money, but the amount of money held would be about the same.\footnote{12}

\textbf{III. EVALUATING THE COSTS AND BENEFITS OF ENHANCED PORTABILITY}

The portability debate is difficult, in part, because evaluating the costs and benefits of enhanced portability is quite difficult. A number of factors are relevant to the evaluation and not all of them cut in the same direction. Moreover, a number of the factors are quite difficult to assess because their impact depends on unknown information, for example, about how the labor market operates. This section will discuss these difficulties by surveying and assessing the relevant factors and by pointing out where roadblocks to full assessment exist. The section is divided into three major parts: the financial effects of enhanced portability, the labor market effects, and administrative and technical issues.

\footnote{12. Legislative efforts to enhance portability have focused on this type of portability by making it easier for participants to transfer monies between retirement accounts, especially between defined-contribution accounts. In 1992, Congress eased the "rollover" rules to clarify and expand the situations in which distributions from qualified plans could be rolled over into other retirement accounts, including Individual Retirement Accounts (IRAs). \textit{See Michael J. Canan, Qualified Retirement and Other Employee Benefit Plans} § 15.8 (Practitioner Ed. 1996). More recent proposals have also focused on the ability to transfer funds between defined-contribution accounts. \textit{See Retirement Account Portability Act of 1998, H.R. 3503, 104th Cong. (1998)(allowing participants in defined contribution plans to roll over account balances among Section 401(k), 403(b), and 457 plans); Pension Coverage and Portability Act, § 2329, 104th Cong. (1998)(same).}

The legislative focus on this type of portability is both understandable and ironic. It is understandable because it is relatively simple to accomplish and imposes few extra costs on plans and employers. It is ironic because, in contrast to the ability to transfer service credit, this type of enhanced portability provides only a very limited extra benefit to mobile workers.
A. Financial Effects

1. Sources of Increased Benefits and Costs

As indicated in Section I, enhanced portability of service credit would tend to increase costs and benefits in two primary ways. First, enhanced portability would ease vesting requirements indirectly. Without portability, workers lose their unvested benefits when they change employers. If workers could transfer their service credit to new employers, they could maintain their claim on unvested benefits and eventually work long enough for them to vest. To the extent workers eventually vest in benefits that would otherwise be forfeited, worker benefits have increased. To the same extent, employer costs have increased. Without portability, employers never incur the expense of making payments for forfeited unvested benefits; with portability, those benefits will eventually have to be paid to workers.

For defined-benefit plans, enhanced portability of service credit would also tend to increase costs and benefits for another reason: it would increase the ability of workers to take advantage of the wage-inflation index inherent in defined-benefit plans. Defined-benefit plans normally multiply three components to determine a worker's benefits:

13. For both worker benefits and employer costs, the analysis at this point assumes a static world in which employers do not react to changes in portability rules. I will discuss benefits and costs in a more dynamic world later. See infra Part III.A.2.

14. Vesting applies to both defined-contribution and defined-benefit plans. Thus, this type of increased benefits/costs would affect both types of plans.

Note that, although I have discussed this in the context of a transfer of service credit, this type of portability also entails assets. For defined-contribution plans, workers would be interested in the enhanced vesting primarily because the old employer transfers assets. Otherwise, the worker would vest sooner, but only in assets contributed by the new employer. The worker would likely acquire a vested right to those assets later anyway. The real enticement for workers is the opportunity to maintain their claim on the old employer's contributions. Obviously, those few employees who change jobs so often that they would not vest in the new employer's plan absent portability would benefit even if the old employer's contributions were not transferred.

For defined-benefit plans, new employers would be unlikely to be willing to accept the transfer of service credit if assets were not available to support the ultimate payments of benefits. A true portability scheme would require that old employers transfer to new employers the assets that had been accumulated on behalf of the worker. A quasi-portability scheme would permit the worker to transfer service credits, but only if the worker provided assets to support their ultimate payment.

15. This reason for increased costs and benefits does not exist for defined-contribution plans. After vesting, years of service do not affect benefits in defined-contribution plans; instead, after vesting, workers are merely entitled to the entire amount in their pension account. Thus, after vesting in defined-contribution plans, the ability to transfer years of service will not increase or decrease costs or benefits.
pension: a coefficient, years of service, and final salary. With that structure in mind, consider the experience of two workers with identical salary histories—each started with a salary of $20,000/year, received 6% annual salary increases, worked for thirty years, and thus ended with a salary of $108,370/year. The two worked for employers who made identical defined benefit promises—to pay a pension equal to 1.5% times years of service times final salary. The only difference between the workers is that Worker A spent her entire career with one employer, while Worker B split her career equally between two employers.

16. The coefficient is the percentage of the participant's final salary that accrues for each year of service. It is specified by the employer and generally falls somewhere between 1% and 2.5%. The coefficient is often given other names, such as "multiplier" or "generosity factor."

17. This example is adapted from Michael Falivena, Pension Portability: No Easy Solution, PENSIONS & INVESTMENTS 15 (February 5, 1990), cited in JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 85 (2d ed. 1995). Falivena's example considers other employees who split their careers between even more employers and who, therefore, suffer even greater pension losses.

18. Another way to see this is to calculate the extra pension that would be due Worker B if the final salary for Employer 1 had been indexed to wage inflation. The extra that would be due is equal to .015 times the years with that employer (15) times the difference between the indexed and unindexed salaries ($108,370 - $45,219 = $63,151). Making that calculation, the extra that would be due is $14,209, which equals the difference in the total pensions received by Workers A and B.


a. Table 1: The Wage-Indexing Effect of Portability

<table>
<thead>
<tr>
<th>Worker</th>
<th>Employer</th>
<th>Coefficient</th>
<th>Years of Service</th>
<th>Final Salary</th>
<th>Pension</th>
<th>Total Pension</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>1</td>
<td>.015</td>
<td>30</td>
<td>$108,370</td>
<td>$48,766</td>
<td>$48,766</td>
</tr>
<tr>
<td>B</td>
<td>1</td>
<td>.015</td>
<td>15</td>
<td>45,219</td>
<td>10,174</td>
<td>$24,383</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>.015</td>
<td>15</td>
<td>108,370</td>
<td>24,383</td>
<td>34,557</td>
</tr>
</tbody>
</table>

Worker B suffers a pension penalty of about $14,000 because of her job change. The penalty occurs because the "final salary" component of the pension formula indexes the pension to wage inflation, and B lost that index when she left her first job and her final salary was frozen at $45,219.
Portability of service credit would permit Worker B to avoid this loss. Portability would have permitted Worker B to transfer her 15 years of service to Employer 2 who then would have paid a pension equal to .015 times 30 years times $108,370 = $48,766. That is, Worker B would have received the same yearly pension as Worker A who did not change jobs. This increased benefit for Worker B, of course, would be an increased cost for Employers 1 and 2.19

As noted above,20 the ability of vested workers to transfer the assets of defined-contribution plans between employers when they change jobs does not generally entail increased costs or benefits. Without portability, vested workers would be entitled to the entire amount in their pension account with their old employer. The amount may be managed by their old employer, or workers may be able to roll it over into an account they manage themselves. With portability, vested workers would still be entitled to the entire amount in their pension account with their old employer. Portability would permit workers to transfer the account to their new employer, but it would not increase (or decrease) the amount in the account.21

2. Magnitude and Distribution of Increased Costs and Benefits

Assessing the magnitude and distribution of increased costs and benefits flowing from enhanced portability of service credit is difficult. This section begins by discussing portability in a static world where employers do not react to the change in portability by making other changes. Then the issue is discussed in a more dynamic world where employers react in various ways. The dynamic world, of course, is more realistic, but it is even more uncertain than the static world.

A Static World. Let's start with a very simple world. Assume that Employers 1 and 2 from Table 1 change from a system in which service credit cannot be transferred to one in which it can. No other changes are made. Employers 1 and 2 will want to assess both the magnitude of the increased costs to be expected from the change and the distribution of those costs between them.

The magnitude will depend on the number of workers that transfer between the two employers and their characteristics. Consider vest-

19. Under a quasi-portability scheme, Employer 2 would permit Worker B to purchase service credit for her years of service with Employer 1. Depending on the price, then, the increased cost could be borne entirely by Worker B, or shared by Employer 2 and Worker B. This type of quasi-portability scheme—that is, allowing workers to purchase years of service credit—is quite common in the public sector.
20. See supra note 12 and accompanying text.
21. In contrast to unvested workers and workers in defined-benefit plans, enhanced portability does not directly increase the benefits of vested workers in defined-contribution plans. Under certain circumstances, however, tax considerations may produce indirect benefits from enhanced portability.
ing effects first. The employers might try to estimate the expected cost of the change by looking to see how many unvested workers transferred between the two in the past and what the value of those unvested benefits were. With enhanced portability, those unvested benefits would no longer be forfeited. Their value would be an estimate of the extra cost of enhanced portability. But it would only be an estimate. With a non-portability rule, an unvested worker who is dissatisfied with his work at Employer 1 would be neutral (vis-à-vis his pension) between transferring to Employer 2 and any other employer; in either case, he would lose his unvested benefits. With a portability rule, the worker would prefer Employer 2 to all other employers. Thus, one would expect some workers with unvested benefits who transferred to other employers prior to the change in the portability rule to transfer to Employer 2 after the change. The value of the unvested benefits of those workers would also be extra costs caused by enhanced portability. But it would also be quite difficult to estimate the magnitude of this extra cost.

22. Or, at least, most of them would not be forfeited anymore. Some workers who transfer to Employer 2 may not stay there long enough to vest in the benefits, even with portability. To estimate this cost of enhanced portability, then, one would have to discount the value of forfeited benefits under a non-portability rule to account for these super-mobile workers.

23. Note that one would expect more workers to transfer between Employers 1 and 2 after the change in portability rules—one of the factors that inhibited movement between the employers (loss of unvested pension benefits)—has been removed. But workers who change employers because of the change in portability rules would not impose an extra cost on the employers. Without the change, those workers would stay with their original employers and vest in their benefits; they would receive the same amount of benefits under either a portability or non-portability rule, albeit from different employers. It is only those workers who would change jobs even without the change in portability rules who impose an extra cost; those workers would suffer a pension loss under a non-portability rule.

Although workers who change employers because of the change in portability rules would not impose an extra cost on employers, the increased ability of those workers to transfer to presumptively more desirable jobs would seem to be a benefit of enhanced portability. I discuss that point later in the section on labor market effects. See infra Part III.B.

24. This example assumes, of course, that some employers (Employers 1 and 2) would be covered by the portability rule and that other employers would not be. This will always be the case. If the portability rule were inserted into ERISA, for example, it would cover only employers covered by ERISA. See ERISA § 4(b), 29 U.S.C. § 1003(b) (1994)(ERISA does not cover plans offered by government employers or churches). Even if the portability rule had broader applicability, some workers who leave Employer 1 will enter self-employment or obtain employment with employers that do not offer a pension plan at all.

25. A range could be estimated. The minimum would be zero and the maximum would be the forfeited benefits of unvested workers who transferred to employers other than Employer 2. Determining what proportion of the maximum would constitute the cost is what would be difficult. Consider any individual worker. Presumptively, that worker preferred the other employer to Employer 2 (otherwise she would have transferred to Employer 2). But it would be difficult to de-
Estimating the magnitude of the extra costs from wage-inflation effects presents similar difficulties. The employers could make a rough estimate by looking at their past experience with workers who transferred between the two employers: What was the magnitude of the wage-inflation losses suffered by that class of workers? This estimate is likely to be less accurate than the comparable estimate for vesting effects. The wage-inflation estimate, as with the estimate for vesting effects, would also have to consider extra costs arising from the increased attractiveness of Employer 2 vis-à-vis all other employers. The wage-inflation effect of enhanced portability will encourage some workers who would leave Employer 1 and go to other employers otherwise, to go instead to Employer 2. That will contribute to the increased costs caused by enhanced portability, but estimating the number of workers whose decision will be tipped by this consideration would be quite difficult.

Estimations of the distribution of the extra costs between the two employers is also likely to be imprecise. The estimation would depend on two primary factors: 1) the allocation rules agreed to by the employers and 2) the experience of the employers. Consider vesting effects first. Assume that the portability arrangement specifies the following allocation rule: the old employer will transfer to the new employer the unvested assets of a transferring worker who later vests with the new employer. This rule tends to allocate the increased costs to the old employer. In the absence of enhanced portability, it

termine the strength of that preference. If the worker valued the preference at more than the value of the unvested benefits, she would transfer to the other employer even with enhanced portability, so no extra pension costs would occur. On the other hand, if the worker valued the preference at less than the value of the unvested benefits, she would transfer to Employer 2 instead, and there would be extra pension costs.

26. With the vesting effect, for example, one only needs to look at a relatively narrow class of transferring workers ("new" workers who have not yet vested), but the wage-inflation effect would apply to every worker who transfers between the two employers. Errors are more likely with the larger class of workers. Also, wage inflation itself plays a greater role in estimating the wage-inflation effect than in estimating the vesting effect. Thus, even if the wage-inflation prediction used to estimate costs is equally inaccurate, it would result in greater imprecision in the wage-inflation effect calculation than in the vesting effect calculation.

27. Although this seems to be the "natural" allocation rule, there is no reason in theory why the costs could not be allocated to the new employer. For example, the allocation rule could be that each new employer agrees to pay the unvested benefits of transferring workers, but that the old employer does not transfer the funds.

28. If the transferred assets precisely match the present value of the promised benefits from the years of service transferred, the costs will be completely and precisely allocated to the old employer. This would be the case with a defined-contribution plan because the promised benefit for the years of service transferred is equal to the amount of money transferred for those years. However, it may not be the case with defined-benefit plans. If, for example, a plan is systematically underfunded, the amount transferred would be less than the present
would be the old employer that recaptures the forfeited assets; now the employer has to forward them to the new employer for eventual distribution to the worker. But the actual distribution of the costs between Employer 1 and 2 will depend on their experience. If only one benefiting worker transfers, say from Employer 1 to Employer 2, Employer 1 would bear all of the vesting-effects costs of enhanced portability. If one worker goes each way (and each has equal unvested amounts), the costs would be distributed evenly between the two employers. The actual distribution, then, would depend on the allocation rule and the experience of the employers under the rule.29

This same basic analysis applies to the distribution of the extra costs caused by the wage-inflation effect. Any portability arrangement would have to set an allocation rule. For any individual transferring worker, the rule could impose the extra costs from the wage-inflation effect on either employer alone or share it between them.30 As before, however, the actual distribution of the costs would depend both on that rule and the experience of the employers. For example, if the rule is that new employers bear the extra costs caused by the wage-inflation effect and only one transferring employee benefits, the new employer receiving the worker would bear all of the costs of the new portability rule. Once again, estimates of distributional effects are likely to be more uncertain for wage-inflation effects than for vesting effects.

Workers would also be interested in the magnitude and distribution of the increased benefits flowing from enhanced portability. In our static world, the magnitude of the increased benefits for workers would be the same as the magnitude of the increased costs for employers, and subject to the same uncertainties. The increased benefits, however, would not be distributed uniformly across all workers. Obvi-

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29. An allocation rule could be devised that attempted to obviate the influence of actual experience on the distribution of costs. For example, the allocation rule could be that the vesting effects costs of Employers 1 and 2 will be totaled at the end of each year and divided equally.

30. As part of the portability agreement, the old employer could agree to use the worker's final salary with the new employer to calculate its pension obligation (which would allocate the increased costs to the old employer); the new employer could agree to use all of the worker's years of service to calculate its pension and offset the total by the amount the worker receives from the old employer (which would allocate the increased costs to the new employer); or the two employers could agree to share the increased costs in some way.

In this section, I am considering true portability. Under a quasi-portability scheme, the worker could purchase years of service credit from the new employer. The allocation of the increased costs under that type of scheme would be between the worker and the new employer and, obviously, would depend heavily on the purchase price.
ously, enhanced portability would benefit more mobile workers. Workers who never change jobs do not care about portability; only workers who change jobs would share in the increased benefits. Compared to the composition of the labor market overall, the group of more mobile workers who would receive a disproportionate share of the increased benefits would be likely to contain a higher proportion of women, the young, non-union members, low-income workers, less-educated workers, and workers without health insurance.\textsuperscript{31}

\textit{A Dynamic World.} In our static world, we assessed financial effects assuming that the only change made was the change in the portability rule. The world, however, is not static; it is dynamic. It is quite possible that a change in the portability rule would induce other changes in the pension system. This section will discuss financial effects in a more dynamic and uncertain world.

Consider our wage-inflation example again. In our static world, portability created an increased cost for the two employers (and benefit to Worker B) of about $14,000. If the employers had known about the portability rule in advance,\textsuperscript{32} how might they have reacted to minimize (or even eliminate) the increased cost? They have many options. In broad terms, they could have decreased the coefficient, changed the way in which years of service are calculated,\textsuperscript{33} changed the way in which final salary is calculated,\textsuperscript{34} or reduced the rate of salary increases.\textsuperscript{35} I do not have time or space to consider all these options.

\begin{itemize}
\item \textsuperscript{31} See Kenneth A. Swinnerton & Howard Wial, \textit{Is Job Stability Declining in the U.S. Economy?}, 48 INDUS. \& LAB. REL. REV. 293 (1995); Monheit \& Cooper, \textit{supra} note 3.
\item \textsuperscript{32} In the long run, of course, employers always know of changes "in advance" and, hence, can react to them. In the short run, the world is less dynamic. As a general matter, this means that the static world description of costs to employers and benefits to workers is more likely to be accurate in the short run and the dynamic world description of distributional effects between groups of workers is more likely to be accurate in the long run.
\item \textsuperscript{33} For example, they could have delayed the time when workers are permitted to begin accumulating years of service, increased the minimum number of hours worked necessary to get credit for a year of service, decreased the generosity of the break-in-service rules, or placed a cap on the maximum number of years of service a worker can accumulate. Some of these options may be limited by the rules for tax qualification.
\item \textsuperscript{34} For example, they could refuse to consider pension contributions as part of final salary or increase the length of time over which final salary is computed (e.g., using the average yearly salary over the past three or five years, instead of the final salary from the last year of work). Once again, tax qualification laws may impose some limits on the ability of employers to use these options.
\item \textsuperscript{35} Reducing the rate of salary increases is a different type of response than the others in a couple of respects. First, the other responses all operate to reduce pensions; reducing the rate of salary increases reduces both pensions and pre-retirement pay. Thus, the other responses tend to distribute the costs of enhanced portability across the group of workers receiving pensions, while this response tends to distribute the costs across all workers. Second, tax laws may
\end{itemize}
fully. But let me describe one of the possibilities — decreasing the coefficient — so that I can use it as an example of the general effects when employers react in these ways.

Assume the employers reacted to the change in the portability rule by reducing the coefficient from 1.5% to 1.28%. Let's look at the effects of the enhanced portability on the pensions received by Workers A and B in this more dynamic world:

b. Table 2: Effects of Enhanced Portability in a Dynamic World

<table>
<thead>
<tr>
<th>Static World Examples</th>
<th>Worker A</th>
<th>Worker B</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original Example:</td>
<td>$48,766</td>
<td>$34,557</td>
<td>$83,323</td>
</tr>
<tr>
<td>.015 x years x salary</td>
<td>Not portable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portability Example:</td>
<td>48,766</td>
<td>48,766</td>
<td>97,532</td>
</tr>
<tr>
<td>.015 x years x salary</td>
<td>Portable</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Dynamic World Example

<table>
<thead>
<tr>
<th>Reduced Coefficient</th>
<th>Worker A</th>
<th>Worker B</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>.0128 x years x salary</td>
<td>41,661</td>
<td>41,661</td>
<td>83,322</td>
</tr>
<tr>
<td>Portable</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In our original static world example, the enhanced portability created an increased benefit of about $14,000 for Worker B and an increased cost of that amount for the employers. The distributional issues were 1) how will the portability arrangement allocate the increased cost between the two employers and 2) what kinds of employ-

36. The actual generosity factor I used in the calculations below was .012814585. As you will see, this was not a randomly selected number. It is, however, within the range of generosity factors that are in use. Moreover, since the original generosity factor was 1.5%, the reduction of .22% is well within the range of reductions that might be possible. See Auricemma et al., supra note 9, at 40 (showing a range of 1.1% to 2.5% in the generosity factors used in the 50 states for teachers' systems in 1990).

It should be noted that this example assumes that the reduction in the generosity factor occurs before any pension benefits are earned by A or B. A retroactive reduction in the generosity factor would present problems. See ERISA § 204(g), 29 U.S.C. § 1054(g) (1994)(no retroactive reductions in accrued benefits).
ees are likely to be Worker B types\textsuperscript{37} who will receive the increased benefits?

In our dynamic world example, the increased benefit to workers as a group and cost to employers as a group have disappeared—the reduction in the coefficient has completely and precisely offset the overall effects of enhanced portability.\textsuperscript{38} As a result, the distributional issues are quite different and even more complex. In the static world, the change in the portability rule alone meant that employers as a group would lose and workers as a group would win. The only issue was to identify which employers were likely to bear the losses and which workers were likely to reap the gains. In the dynamic world, both employers and workers can be either winners or losers. Worker A, in our example, has suffered a loss from the changes in the portability rule and coefficient; enhanced portability did not help her and the reduced coefficient hurt her. Worker B enjoyed a gain; enhanced portability helped her more than she lost from the reduced coefficient.

This example illustrates the general principles in operation in a dynamic world. If employers react to enhanced portability by making precisely offsetting reductions elsewhere, there would be no net increase in costs to employers or benefits to workers. Instead of magnitude effects, enhanced portability would have only distributional effects. Some workers (and employers) would gain, others would lose. One's view of the desirability of portability would then depend on one's view of the propriety of the distributions between types of workers and between types of employers, rather than on any overall benefits flowing to workers from employers.

Not all employers, of course, would be able to make offsetting changes. Labor market or political factors may intervene. Similarly, even if offsetting changes are possible, employers are quite unlikely to be able to make precise estimates of the extent of offset necessary. The static world example illustrates an extreme under-offset (i.e., no offset); in that case, workers enjoy a net benefit and employers have increased costs. To the extent employers over-offset, workers suffer a net loss and employers have decreased costs.\textsuperscript{39}

\textsuperscript{37} Pun intended.

\textsuperscript{38} Note that the difference between the total pension benefits/costs in the original example (last column of the first row, $83,323) and the total pension benefits/costs in the dynamic world example (last column of the last row, $83,322) is due only to rounding error.

\textsuperscript{39} With respect to any particular portability arrangement, of course, employers would be likely to use actuaries to estimate the expected costs. Actuaries, however, are not much better at predicting the future than the rest of us. Estimating the costs of some type of general or all-purpose portability agreement would be very difficult even with the use of actuaries, and impossible to do precisely.
B. Labor Market Effects

The labor market effects of enhanced portability depend a great deal on contested notions about the nature of labor markets. Under an auction model of labor markets, enhanced portability would lead to greater efficiency. Under a life-cycle model, matters are not so clear. This section will present sketches of both models and discuss briefly their implications for portability.

Under the auction model of labor markets, a worker’s wages are equal to the value of the marginal product produced by the worker in each period. Workers sort into jobs which maximize the value of the marginal product they produce in each period and, by so doing, maximize their wages. Thus, any restrictions on mobility impede the efficient flow of workers to jobs in which they can produce the highest valued marginal product. Any restrictions on mobility are inefficient.

As the previous section illustrates, non-portability can impose significant financial penalties on workers when they change jobs. As a result, non-portability constitutes one type of restriction on mobility. Commentators adopting the auction view of the labor market have long argued that limits on the portability of pensions impede labor market efficiency. Conversely, enhanced portability would improve labor market efficiency by permitting workers to move more freely into higher-value jobs.

The life-cycle model views the employment relationship with a longer telescope: instead of maximizing productivity and wages in every period (as in the auction model), the worker is attempting to maximize life-time earnings. One consequence of the life-cycle model is that workers can be too mobile; in some situations, labor market efficiency can be enhanced through restrictions on mobility. Thus, pensions may serve functions (such as bonding workers to a firm, discouraging shirking, or regulating retirement flows) that enhance overall labor market efficiency.

40. See Pat Choate & J.K. Linger, The Hi-Flex Society 245 (1986) ("Weaknesses in pension availability, benefits, and portability are now impeding the mobility that is so essential during this period of economic and technological turbulence, as an aging work force avoids job changes to protect pension rights."); Arthur Ross, Do We Have a New Feudalism?, 48 Am. Econ. Rev. 903 (1958) (arguing that expanded pension coverage will tie workers to jobs so that they will not be able to respond to new opportunities).


42. Surveying these functions is beyond the scope of this article. For good surveys, see Dorsey et al., supra note 18; Stuart Dorsey, Pension Portability and Labor Market Efficiency: A Survey of the Literature, 48 Indus. & Lab. Rel. Rev. 276
Consider, as one example, the availability of on-the-job training. Under conditions of extreme mobility, employers would be reluctant to provide expensive on-the-job training. Workers would accept the training and then move on to other employers who are able to pay more because they do not undergo the expense of providing training. A restriction on mobility, such as the penalty that would be suffered if the worker had a non-portable pension, would permit employers to offer such training. The restriction would mean that they would be more likely to be able to recoup the expenses of the training. Thus, restrictions on mobility may enhance labor market efficiency because they may facilitate the provision of productivity-enhancing, on-the-job training.43

The life-cycle model is less dogmatic on the portability issue than the auction model. Under the auction model, limits on mobility are inefficient and ought to be discouraged. Under the life-cycle model, limits on mobility may be efficient or inefficient, depending on the circumstances.44

Considering labor market effects is very important in the portability debate. When the portability issue is raised, the simplistic solution often offered is to require defined-contribution plans with very short vesting periods.45 That solution does "solve" the portability problem, narrowly construed, because workers would generally be able to carry their pension benefits with them as they changed jobs. But the effectiveness of the solution as a public policy initiative is much less clear. Employers offer pensions as a part of the compensation package, not out of the goodness of their hearts, but because pensions serve certain functions. To the extent the simplistic solution interferes with the ability of employers to use pensions to achieve their employment


43. Once again, a complete survey of the employment-related functions served by pensions is beyond the scope of this article. For my purposes, it is sufficient to make the general point that pensions, and specifically non-portable pensions, serve certain productivity-enhancing functions, such as discouraging shirking (especially for jobs that are hard to monitor), minimizing the losses from excessive turnover in response to small or temporary economic shocks, and regulating retirement flows. As a result, enhanced portability may well mean that employers are less interested in offering pensions as a part of the compensation package. For a more detailed consideration of the functions served by non-portable pensions, see the articles cited supra note 42.

44. Note that simply because the life-cycle model implies that limits on mobility can sometimes be efficient, does not imply that limits on mobility are always efficient. Limits on mobility that do not create benefits (in such things as enhanced on-the-job training, reduced shirking, and better management of retirement flows) are inefficient for the reasons indicated by the auction model.

45. See, e.g., Stephen Glass, A Pension Deficit Disorder, 71 POL'Y REV. 71, 72 (1995)("There is a simple pension reform that would permit [completely portable pensions]. It is called a defined-contribution system.").
goals, employers will be less likely to include them in the compensation package. To the extent employers cannot use pensions to discourage workers from leaving until after the costs of on-the-job training have been recouped, or to regulate retirement flows, or to serve any other function, they will be less likely to offer a pension. The simplistic solution would guarantee more portable pensions, but at a cost. It may also mean that employers are less interested in offering pensions at all and, hence, that workers are less likely to have pensions.\footnote{Enhanced portability would adversely affect some, but not all, of the functions for which employers offer pensions. Enhanced portability would limit the ability of employers to use pensions to pursue the employment goals mentioned in the text, but it would not infringe on the pursuit of other goals, such as capturing tax benefits. For a brief review of the functions of employee benefits in the compensation package, see WILDBORN ET AL., supra note 3, at 758-65. As a result, it is important not to over-emphasize the extent to which enhanced portability would reduce pension availability. Some employers at the margin would not offer pensions because of their reduced usefulness, but others would continue to offer them because they fulfill other employment functions.}

It is that balance—between portability and the availability of pensions—that makes consideration of labor market effects critical in the portability debate.\footnote{Although critical, as this discussion makes clear, consideration of labor market effects is very difficult. Major disagreements are likely to arise both about how the labor market operates (for example, is the auction model or the life cycle model predominant) and about the actual effect enhanced portability might have on the extent and generosity of pensions within any model.}

C. Administrative and Technical Issues

Portability also raises several administrative and technical issues, especially for defined-benefit plans. One set of problems arises because plans have different contribution rates and benefit formulas. Portability creates a relationship between two (or more) plans and, as a result, requires that plans deal with some of these differences. This is a broad set of problems, and I do not intend to cover them all here. But consider, as an example, the pension systems for teachers in the neighboring states of Kansas and Missouri. In Kansas, employee and employer contributions into the retirement fund total about seven percent of employee compensation. In Missouri, the contributions total about twenty percent. In Kansas, the general benefit formula is \((1.4\%) \times (\text{years of service}) \times (\text{final average salary})\). In Missouri, the general benefit formula is \((2.1\%) \times (\text{years of service}) \times (\text{final average salary})\).\footnote{These figures are for 1990 and are from ARIEMMA ET AL., supra note 9, at 33, 40. Please note that I am making a general point here about the need to accommodate differences and not a specific point about the Kansas or Missouri systems. Overall, Kansas' level of benefits may well be higher than Missouri's. Kansas, for example, participates in the social security system, while Missouri does not (although, if anything, that tends to aggravate the accommodation problem be-}

Let's say Employee 1 transfers from a school in Kansas to
one in Missouri. If a portability agreement requires Kansas to transfer the money and Missouri to credit years of service, there is a problem. The money transferred is low because of the relatively low level of contributions in Kansas, but the value of the years of service is high because of the relatively high coefficient in Missouri. The incentive to move from Kansas to Missouri (considering only pension benefits) would be high; the incentive to move the other way low. Any portability arrangement would have to make some accommodation.

In general terms, differences in contribution rates and benefit formulas can have a significant influence on the cost of a portability arrangement and on the incentives it creates. As a result, portability arrangements must consider and accommodate these differences. This is a serious problem because pension plans can (and generally do) differ on a large number of parameters: level of contributions by participant, level of contributions by employer, eligibility for retirement rules, rules for determining number of years of service, the coefficient used in the benefit formula, how to calculate the final salary to be used in the benefit formula, and a multitude of other factors.

Portability would also raise administrative and technical issues relating to operation of plans overall. Generally, defined-benefit plans pay benefits over a period of time commencing at the worker's retirement, rather than in a lump sum paid at some earlier time. If portability required old employers to make lump sum payments to new employers at the time the worker transfers, plans could face cash flow problems. In extreme cases, plans could be forced to liquidate invest-

49. Note that this general type of problem can occur even if the contribution levels and benefit formulas are exactly the same. Assume that both Kansas and Missouri make Kansas' contributions and use Kansas' benefit formula, but that teacher salaries in Missouri are twenty percent higher. Consider again an employee who goes from Kansas to Missouri under a portability arrangement that requires Kansas to transfer the accumulated money and Missouri to credit the worker for years of service in Kansas. Once again, the amount of money transferred would be too low (7% of low Kansas salaries would be less than 7% of Missouri salaries) and the value of years of service would be too high (1.4% times years times the high Missouri salary would be more than the same formula times the low Kansas salary). The portability arrangement would need to account for the difference in salaries.

50. See generally AURIEMMA ET AL., supra note 9. On contribution rates and benefit formulas, Auriemma found that the combined employee and employer contribution rate in state teacher programs ranged from 6.6% (in Kansas) to 28.8% (in Rhode Island) and that the generosity factor portion of the benefit formula ranged from 1.1% (in Indiana) to 2.5% (in five states). See id. at 33, 40. This illustrates the problem but understates it because the divergence in state teacher programs is less than the divergence across all types of public and private plans.

Because social security benefits are transferable. The significant points from the example are that plans differ across the contribution and benefit formula parameters and that this difference in plans requires any portability arrangement to make certain accommodations to account for those differences.
ments at inopportune times. Moreover, to the extent the old employer's plan is underfunded, the early transfer of assets equal to 100 percent of the present value of the transferring worker's benefits would increase the level of the plan's underfunding and, hence, reduce the security of the plan's remaining participants and beneficiaries.51

The cost of setting up and administering a portability system would be another issue. The significance of the cost, or even whether there would be a net cost, is uncertain. On the one hand, developing and administering a portability arrangement would involve some cost. On the other hand, a portability arrangement would tend to ease the expense of administering small vested pensions for terminated workers. Those expenses (keeping track of the worker over the years, sending her annual reports, writing and mailing small checks) can be quite significant relative to the level of the benefit.

Finally, any portability arrangement would have to deal with the issue of incidental benefits. Some plans, but not others, provide benefits in addition to the pension. The most significant of these benefits is retiree health care. Any portability arrangement would have to resolve issues relating to the availability of incidental benefits.

IV. THE PROBLEM WITH PORTABILITY

The problem with portability is the problem with regulation of all employee benefits. First, employee benefit regulation occurs within complex systems so that it is difficult to assess the likely costs and distributional effects of changes. Although change may well be preferable, in the absence of reliable information about the effects of change, the status quo holds a powerful advantage.52 Second, employee benefits are not some sort of gift bestowed by employers on workers, but rather an integral part of the compensation package intended to fulfill certain employment goals. To the extent changes in the rules interfere with the ability of employers to use benefits to achieve those goals, employers will be less willing to offer employee benefits. The balance, then, is between enhancing the protections of employees who continue to receive benefits and attempting to ensure that benefits are available to as many employees as possible.53

52. This is not to criticize the advantage of the status quo in uncertain situations. Even though the status quo may not be perfect, at least we know what the current costs and distributional consequences are. With change, comes a journey into uncertainty, and the uncertainty itself is a cost that must be considered.
53. These problems cannot be avoided in any easy or obvious way. Certainly, divorcing pensions from employment could be done. In broad terms, the pension system could be socialized (along the lines of social security) or individualized (by
permitting expanded IRA-type accounts). Either system would permit greater portability since an individual's pension would not be connected to the individual's employment. But these types of grand solutions pose problems similar to, and as daunting as, any posed by tinkering with portability rules in the current employment-based system. Any grand solutions will also have costs and distributional effects that are difficult to specify in advance. Also any grand solution divorcing pensions from employment will mean that employers will no longer be able to use pensions to achieve their employment-related goals. As a result, any incentive employers currently have to subsidize the cost of pensions to achieve their goals will be gone.