IN BRIEF: Pension Portability --- Is this Europe's Future?
An Analysis of the United States as a Test Case

Introduction

Pension losses suffered by workers who change jobs result in reduced retirement income and can impede job change, raising concerns both for labor market equity and efficiency. Because of penalties for workers who leave a job before retirement, employer-based pensions can inhibit workers from making job changes that would otherwise be desirable for them and for the efficient functioning of the labor market.

Pension portability is the ability of workers to change jobs without losing future pension benefits. The extent to which this feature is part of a pension system depends on the particular design of the pension plans in the system, which may be affected by government regulations establishing minimum standards.

Purpose

This report describes ways that pension portability for job changers has been achieved in the United States. It describes both the minimum standards mandated by law and the arrangements that some employers have made that exceed those requirements. While it indicates the most commonly used methods to achieve portability, it discusses a number of other, less commonly used methods because they are possible models for extending portability to more workers. It discusses portability for both private sector plans and plans covering government sector employees. Plans for government sector employees are subject to different pension laws from those affecting private sector plans and consequently have been able to develop different methods for achieving portability.

Methodology

The report describes pension portability law and the portability arrangements that have been developed in both the private and public sectors. It analyzes the sources of portability loss and policies that can reduce that loss. While primarily focusing on the United States, the paper also compares US portability arrangements with those in Europe.

Main Findings

Two factors have made pension portability an important policy issue in the United States. The first is the relatively high level of job change by US workers. The second is the relatively modest level of their Social Security benefits, which has led US workers to rely more on employer-provided pensions than workers in most other countries.

The report finds that defined contribution plans are the main way that portability is provided in the United States. While it is more difficult to provide portability with defined benefit plans, there are several important exceptions. Portability can be provided through cash balance plans and through multiemployer plans. Single employer defined benefit plans pose the greatest challenges for providing portability. Portability losses in single employer defined benefit plans are limited in the United Kingdom and Ireland by mandatory inflation adjustments for deferred vested benefits. That policy, however, is expensive for employers, and may discourage some employers from providing defined benefit pension plans.

In Europe, the importance of pension portability within national labor markets varies across countries. The Netherlands is an example of a European country where portability issues have been addressed, presumably because that country's Social Security provides only a flat rate benefit and occupational pensions are relatively important. France is another example. Occupational pensions there are compulsory. It would be contradictory to the idea of a compulsory pension system to have workers who change jobs suffer pension benefit losses. In some European countries, such as Italy, occupational pensions are relatively unimportant and pension portability is not an issue because Social Security is so generous.

Conclusions

In some respects, the United States may provide a relevant case study for European pension portability. European Union members' desire to facilitate labor movement between and within member states resembles the US's discussion on how to facilitate pension portability within and between the 50 states.

Pension portability is achieved most easily through defined contribution plans. It is generally difficult to achieve with traditional single employer defined benefit plans. Cash balance plans, however, provide better portability than do other single employer defined benefit plans. Multiemployer defined benefit plans allow workers to change jobs among participating firms and suffer no portability loss. Portability for single employer defined benefit plans could be improved by requiring price or wage indexing of wages used in calculating pension benefits at retirement, but that would be expensive for employers and probably would cause some employers to stop offering defined benefit plans.

Portability losses are only one aspect of the risks facing workers who participate in pensions. While portability is achieved more readily in defined contribution plans than in defined benefit plans, risks occur in defined contribution plans that do not occur in defined benefit plans with respect to investment in financial markets and conversion of account balances to annuities. A full evaluation of a pension system would consider all aspects of risk.

Source: John Turner, Pension Portability – Is This Europe's Future? An Analysis of the United States as a Test Case. For a copy of the 27-page Issue Paper, write for PPI Issue Paper #2003-03, Public Policy Institute, AARP, 601 E Street, NW, Washington, DC 20049. Or see www.aarp.org/ppi .