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Report to the Ranking Minority Member, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

September 2001

# PRIVATE PENSIONS

# Issues of Coverage and Increasing Contribution Limits for Defined Contribution Plans


GAO-01-846

# Contents

**Abbreviations**

| | |
|---|---|
| CPS | Current Population Survey |
| DB | defined benefit |
| DC | defined contribution |
| SCF | Survey of Consumer Finances |
| SIMPLE | Savings Incentive Match Plan for Employees |

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**United States General Accounting Office**
**Washington, DC 20548**

September 17, 2001

The Honorable William J. Coyne
Ranking Minority Member
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Coyne:

At $85 billion this year, tax preferences for public and private employer-sponsored pension plans represent the largest tax expenditure, exceeding those for either home mortgages or health benefits.[1] The purpose of these pension tax preferences is to raise private savings for workers' retirement. Greater private savings for retirement can enhance income security in retirement by supplementing Social Security benefits as well as reduce the need for public assistance. Pension tax preferences are structured to strike a balance between providing incentives for employers to start and maintain voluntary, tax-qualified pension plans and ensuring that participants receive an equitable share of the tax-subsidized benefits. The Internal Revenue Code places limits on the amounts that workers and employers can contribute to tax-deferred retirement plans. These limits exist to prevent partial public subsidies of excessively large retirement benefits through tax preferences.

Proposals intended to expand pension coverage and promote pension savings have recently received much attention. In the Economic Growth and Tax Relief Reconciliation Act of 2001, for example, Congress raised statutory limits on tax-deferred pension contributions and benefits and made other changes to the law governing qualified pension plans. Some assert that increasing these limits will enhance employer incentives to start new plans and improve existing plan coverage, especially for employees of small businesses. Others contend that these measures will primarily benefit higher paid individuals and may not improve pension

[1]Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 2001-2005" (JCS-1-01), April 6, 2001. "Tax expenditures" are revenue losses attributable to provisions of federal tax laws and include reductions in income tax liabilities that result from special tax provisions or regulations that provide tax benefits to particular taxpayers. Pension contributions that fall within statutory limits, as well as investment earnings on pension assets, are not taxed until benefits are paid to plan participants. As a result, these tax preferences largely represent timing versus permanent differences in tax revenue generation.

coverage for low- or moderate-income workers. In this report, we consider increases in limits on contributions to defined contribution (DC) plans,[2] the type of pension plan that covers most pension participants.[3] You asked us to describe: (1) the extent to which workers participate in all pension plans, the extent to which workers participate in DC plans, and the earnings and genders of these DC participants; (2) the number, earnings, and genders of DC participants likely to benefit directly from an increase in limits on contributions to qualified DC plans; and (3) the number, earnings, and genders of DC participants likely to benefit directly from allowing participants aged 50 or older in certain DC plans to make "catch-up" contributions in excess of other statutory limits.

To address your questions, we used the 1998 Survey of Consumer Finances (SCF) to estimate the number, percentage, earnings, and genders of all workers who participated in pension plans and, separately, in DC plans.[4] We also used the 1998 SCF to estimate the number, percentage, earnings, and genders of certain DC participants (referred to below as likely direct beneficiaries) who may benefit from the increases in statutory limits on contributions to qualified DC plans we analyzed.[5] We analyzed increases in contribution limits in isolation from any other enacted or

[2]In a DC plan, pension benefits are based on the contributions to and investment returns on individual accounts. Our analysis of all pension plan participants includes participants in both DC and defined benefit (DB) plans. Because most workers who participate in pension plans are in DC plans, and because data limitations prevent us from analyzing the maximum DB benefit, this report deals only with DC plan contribution limits. Subject to data limitations, our analysis of contribution limits is based on all DC plans, regardless of whether or not they permit employees to make tax-deferred contributions. For additional information about the scope and methodology of our analysis, see the appendix.

[3]We define pension participants as persons aged 18 or older who were working at the time of the survey, whose earnings could be expressed as an annual amount, and who were included in a pension plan through their job. Pension participants, under this definition, exclude workers whose employers offered pension plans but who were not included in those plans because they were not eligible to be included or chose not to be included.

[4]The 1998 Survey of Consumer Finances (SCF) was the most recent triennial survey of household finances sponsored by the Board of Governors of the Federal Reserve System. For more information on the SCF—including data availability, survey and sample design methodology, data documentation, and applications—visit the SCF Web site at http://www.federalreserve.gov/pubs/oss/oss2/scfindex.html.

[5]Our analysis describes who was likely to benefit directly from contribution limit increases at the time the SCF was conducted in 1998. Individuals we did not classify as likely to benefit directly from increased contribution limits may benefit in subsequent years if they are able to contribute at higher levels. Our analysis did not permit us to estimate how many workers would likely benefit directly from higher contribution limits at any point in their working life.

proposed statutory changes and did not analyze the specific contribution limit increases in any specific enacted or proposed legislation. We defined likely direct beneficiaries of an increase in DC plan contribution limits as employed DC participants whose employer and/or employee contributions were equal to or above the contribution limits we analyzed.[6] (Individuals can make contributions in excess of the specified limits, but these additional contributions do not receive favorable tax treatment.)

In addition to analyzing SCF data, we analyzed a small sample of plan-specific data and obtained analyses conducted by the Department of the Treasury and by a large financial services firm. We also interviewed federal agency officials, pension experts, and representatives of nongovernmental organizations to obtain their views on the effects of raising various contribution limits. We conducted our work between January and August 2001 in accordance with generally accepted government auditing standards.

## Results in Brief

According to data from the most recent (1998) SCF, 47 percent of all workers participated in a pension plan, and 36 percent of all workers participated in a DC plan. ("All workers" includes both full-time and part-time workers.) More than half of pension plan participants, like more than half of all workers, had low or moderate earnings (less than $40,000 per year) and were men. When we categorized pension participants by their earnings, we found that more than half of pension participants had low or moderate earnings. For example, 57 percent of all pension participants earned less than $40,000 per year. However, when we examined the percentages of workers at different earnings levels that participated in pension plans, we found that workers with low or moderate earnings were less likely than higher earners to participate in a pension plan. For example, 38 percent of workers who earned less than $40,000 per year participated in a pension plan, while 70 percent of workers who earned between $40,000 and $74,999 per year participated in a plan.[7] In addition, when we characterized pension participants by their gender, we found that

[6]The appendix provides a more detailed explanation of this definition. Likely direct beneficiaries, defined in this way, are in a position to increase their contributions (or their employers are in a position to increase employer contributions) if contribution limits are raised. However, this does not mean that all likely direct beneficiaries (or their employers) will actually increase their contributions if contribution limits are raised.

[7]Similarly, workers who earned under $40,000 per year were less likely to participate in pension plans than higher earning workers whose annual earnings were $75,000-$149,999 or $150,000 or higher.

more than half of pension participants were men. When we examined the percentages of male and female workers participating in pension plans, we found that men were more likely than women to be plan participants. In most cases, the earnings and gender characteristics of DC participants resembled those of all (DC and DB) pension plan participants.

About 8 percent of all DC participants, or 3.1 million people, were likely direct beneficiaries of an increase in all the statutory contribution limits we analyzed. Higher earners were more likely than low and moderate earners, and men were more likely than women, to benefit directly from such an increase. When we analyzed increases in each of the three contribution limits sequentially, we found that increasing the percentage limit on combined employer and employee contributions first accounts for half of the 3.1 million likely direct beneficiaries of an increase in all three contribution limits. Increasing DC plan contribution limits could also indirectly benefit some additional low- and moderate-earning workers. Those workers could benefit indirectly if employers found higher limits attractive enough to form new plans that would extend pension coverage to more employees, expand pension coverage in existing plans, and/or increase their contributions for low- and moderate-earning participants in existing plans. These expansions of coverage or increases in contributions for low and moderate earners are very difficult to measure. They occur at the individual, employer, and pension plan levels, and how widespread they would be is unknown.

About 721,000 DC participants, or 11 percent of eligible DC participants, were likely to benefit directly from a so-called "catch-up" provision allowing persons aged 50 or older to make additional contributions to certain DC plans. Higher earners were more likely to benefit directly from this option than low and moderate earners. However, there is no significant difference between the percentage of eligible male DC participants likely to benefit directly and the percentage of eligible female DC participants likely to benefit directly.

## Background

Total retirement income comes from Social Security, pensions, personal savings and other assets, and postretirement earnings. Depending on the individual, an adequate retirement income may be achieved with different combinations of these sources. For example, Social Security provides near-universal coverage and provides proportionally larger benefits for lower earning participants. That is, Social Security replaces a higher percentage of preretirement income for lower earning workers than for higher earners. In contrast, the U.S. employer-sponsored pension system is voluntary and tax-subsidized and provides proportionally larger benefits

for higher earning participants. To the extent that it is deemed desirable that the total percentage of preretirement income replaced by Social Security and employer-sponsored pensions together is reasonably constant, private pensions would tend to play a larger role in the retirement income of higher earning workers.

The two types of employer-sponsored pension plans are defined benefit (DB) and defined contribution (DC). DB plans promise to provide a level of retirement income that is generally based on salary and years of service. The employer, as the plan sponsor, is responsible for funding the promised benefit, investing and managing the plan assets, and bearing the investment risk. Under DC plans, employees have individual accounts to which employers, employees, or both make periodic contributions. DC plan benefits are based on the contributions to and investment returns on the individual accounts. The employee bears the investment risk. In some types of DC plans, including 401(k), 403(b), 457, and Savings Incentive Match Plan for Employees (SIMPLE) plans, employees may choose to make tax-deferred contributions instead of receiving the same amount as taxable salary.[8]

A fundamental requirement for tax-qualified pension plans of taxable private employers is that contributions or benefits be apportioned in a nondiscriminatory manner between a top group of highly paid employees and owner-employees and workers outside the top group. There are standard plan designs that allow employers to comply with this requirement. Alternatively, employers can develop a custom-tailored plan design and apply general testing methods (as required by law) to a plan's apportionment of contributions or benefit accruals each year. These methods for custom-tailored plan designs are complex, but they generally require the employer to provide both coverage and contributions (or benefits) for workers outside the top group at rates that do not differ too greatly from the rates at which the employer provides coverage and contributions (or benefits) for members of the top group.

Tax-deferred contributions to defined contribution plans by employers and employees are constrained by legal limits. The purpose of these limits

[8]A private employer may establish a 401(k) plan (26 U.S.C. 401(k)). A tax-exempt employer or public educational organization may establish a 403(b) plan (26 U.S.C. 403(b)). A state or local government employer may establish a funded 457 plan (26 U.S.C. 457(g)). A tax-exempt employer may establish an unfunded 457 plan (26 U.S.C. 457 (b)(6)). An employer with 100 or fewer employees may establish a SIMPLE plan (26 U.S.C. 408(p)). A SIMPLE plan is a simplified retirement plan for small employers that is not subject to some of the requirements that the Internal Revenue Code imposes on qualified pension plans.

is to prevent tax preferences from being used to subsidize excessively large pension benefits. The Employee Retirement Income Security Act of 1974 imposed dollar and percentage-of-compensation limitations on combined employer and employee tax-deferred contributions.[9] The Tax Reform Act of 1986 introduced a dollar limitation (i.e., a maximum dollar contribution) on employees' tax-deferred contributions to DC plans.[10] The Economic Growth and Tax Relief Reconciliation Act of 2001 increases all three of these limits beginning in 2002; the scheduled increases are to be fully implemented by 2006. The same law also allows a so-called "catch-up" provision, where persons aged 50 or older are permitted to make additional tax-deferred contributions, in excess of other applicable statutory limits, to 401(k) and similar DC plans. Such a provision permits older workers to make larger contributions and may help those who had not previously been able to save sufficiently to "catch up" to more adequate levels of retirement savings. (See table 1 for a summary of these limits.)

Tax-deferred pension contributions may also be limited by the application of other statutory limits that we do not analyze in this report because of data limitations.[11] In addition to the legal limits, some plans set their own limits on contributions. In DC plans with plan-specific contribution limits, tax-deferred contributions are limited to the statutory limit or the plan-specific limit, whichever is smaller. Employers set plan-specific limits, in part, to ensure that the plans they sponsor pass statutory and regulatory requirements such as the requirement that contributions or benefits not be skewed too heavily in favor of highly paid employees or owner-employees.

[9]26 U.S.C. 415(c)(1). The dollar limit was initially indexed for inflation but was reduced during the early 1980s and did not increase again until 2001. The percentage limit had not changed since it was first enacted, but an increase is scheduled to take effect in 2002.

[10]26 U.S.C. 402(g)(1). The Tax Reform Act of 1986 limited employees' tax-deferred contributions to a dollar amount that is indexed for inflation.

[11]There is a statutory limit on the amount of compensation that can be taken into account in determining qualified pension plan contributions or benefits (26 U.S.C. 401(a)(17)). There is also a statutory limit on the total amount of tax-deductible contributions that an employer may make to certain types of plans (26 U.S.C. 404(a)(3)).

**Table 1: Changes in Various DC Plan Contribution Limits, 1998-2006**

| **Limit on tax-deferred contributions** | **Level of limit in 1998** *(in 1998 dollars)* | **Level of limit in 2001** *(in 2001 dollars)* | **Level of limit in 2006** *(in 2006 dollars)* |
|---|---|---|---|
| Dollar limit on employee contributions[a] | $10,000 | $10,500 | $15,000, indexed for inflation after 2006[b] |
| Dollar limit on combined employer and employee contributions[c] | $30,000 | $35,000 | $40,000, indexed for inflation currently and to continue to be indexed |
| Percentage limit on combined employer and employee contributions[c] | 25% of compensation | 25% of compensation | 100% of compensation |
| Persons aged 50 or older allowed to make "catch-up" contributions[a] | Provision did not exist[d] | Provision did not exist[d] | $5,000 additional contribution in excess of other applicable statutory limits, indexed for inflation after 2006 |

Note: This table includes recent changes in each of the DC plan contribution limits analyzed in this report. We include the level of each limit in 1998, the year to which our analysis pertains, as well as the levels in 2000 and 2001 and the scheduled level in 2006.

[a]These limit increases are scheduled to be phased in between 2002 and 2006, as provided in the Economic Growth and Tax Relief Reconciliation Act of 2001.

[b]The dollar limit on employee contributions is the same for 401(k) and 403(b) plans. In 2001, this limit is $8,500 for 457 plans and $6,500 for SIMPLE plans. Beginning in 2002, the dollar limit on employee contributions for 457 plans will be the same as the limit for 401(k) and 403(b) plans. For SIMPLE plans, this limit will increase to $10,000 by 2005 and will be indexed for inflation thereafter.

[c]Under section 415(c) of the Internal Revenue Code, combined employer and employee contributions are limited to the lesser of $35,000 or 25 percent of compensation in 2001. Increases in the dollar and percentage limits on combined employer and employee contributions are not phased in. The increases take effect in 2002. The value of the percentage limit is not scheduled to change after 2002. Beginning in 2006, combined employer and employee contributions will be limited to the lesser of $40,000 or 100 percent of compensation.

[d]Catch-up provisions more restrictive than the one enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 already exist for 403(b) and 457 plans.

## The Majority of Pension Participants Had Low or Moderate Earnings, but More Than Half of Low and Moderate Earners in the Workforce Did Not Participate in a Pension Plan

About 51 million workers, or 47 percent of all workers, participated in a pension plan in 1998. ("All workers" includes both full-time and part-time workers.) When we categorized pension participants by their earnings, we found that more than half of pension participants, like more than half of all workers, had low or moderate earnings. However, when we examined the percentages of workers in various earnings groups that participated in pension plans, we found that participation rates were lower for low and moderate earners than for higher earners. When we categorized pension participants by their gender, we found that more than half of pension participants, like more than half of all workers, were men. When we examined the percentages of male workers and of female workers that participated in pension plans, we found that participation rates were lower for women than for men. The patterns of participation by earnings and gender for DC plans were generally similar to those for all pension plans.

## Fewer Than Half of All Workers Participated in Pension Plans

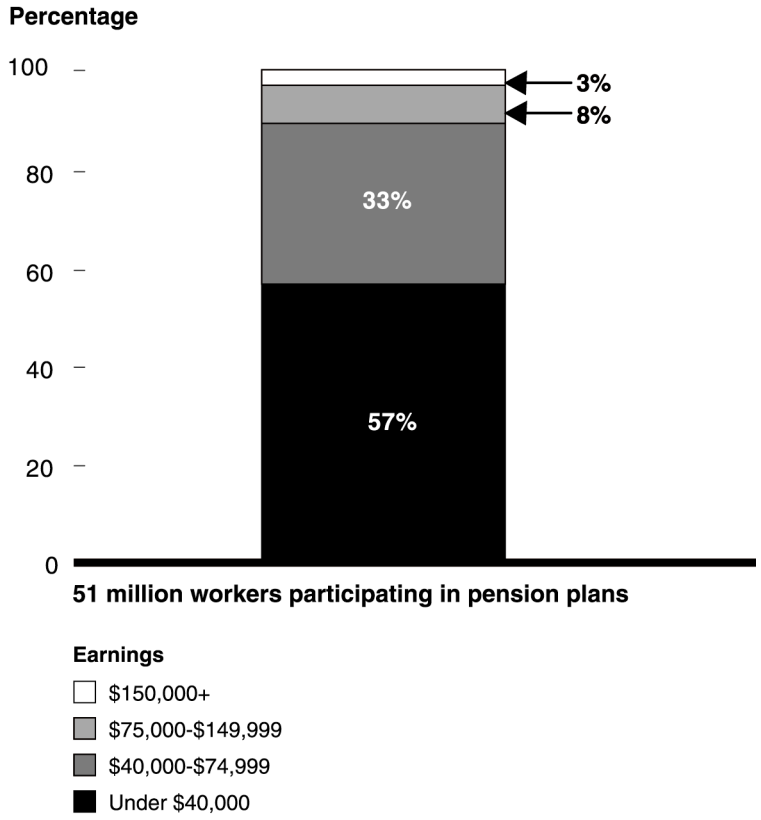
In 1998, about 51 million workers, or 47 percent of all workers, participated in a pension plan. Workers who did not participate either worked for employers that did not offer pension plans, were not eligible to participate in their employers' plans, or chose not to participate in their employers' plans.[12]

When we estimated the percentages of pension participants that were in different earnings groups, we found that more than half of pension participants, like more than half of all workers, had low or moderate earnings.[13] Of the 51 million workers who participated in a pension plan, 57 percent had annual earnings of less than $40,000. (See fig. 1.) Our analysis of pension participation by household income detected a similar pattern. About 28 percent of pension participants had household incomes of less than $40,000 per year, while another 41 percent had annual household incomes above $40,000 but below $75,000.

[12]According to our prior work, 14 percent of the employed labor force did not participate in pension plans offered by their employers because they were not eligible to participate or chose not to participate. Also, 39 percent of the employed labor force did not participate because their employers did not offer pension plans. *Pension Plans: Characteristics of Persons in the Labor Force Without Pension Coverage* (GAO/HEHS-00-131, Aug. 22, 2000).

[13]According to our analysis of 1998 SCF data and Current Population Survey data from the March 1999 Annual Demographic Supplement, at least 70 percent of all workers earned less than $40,000 in 1998.

**Figure 1: Earnings of Pension Plan Participants**

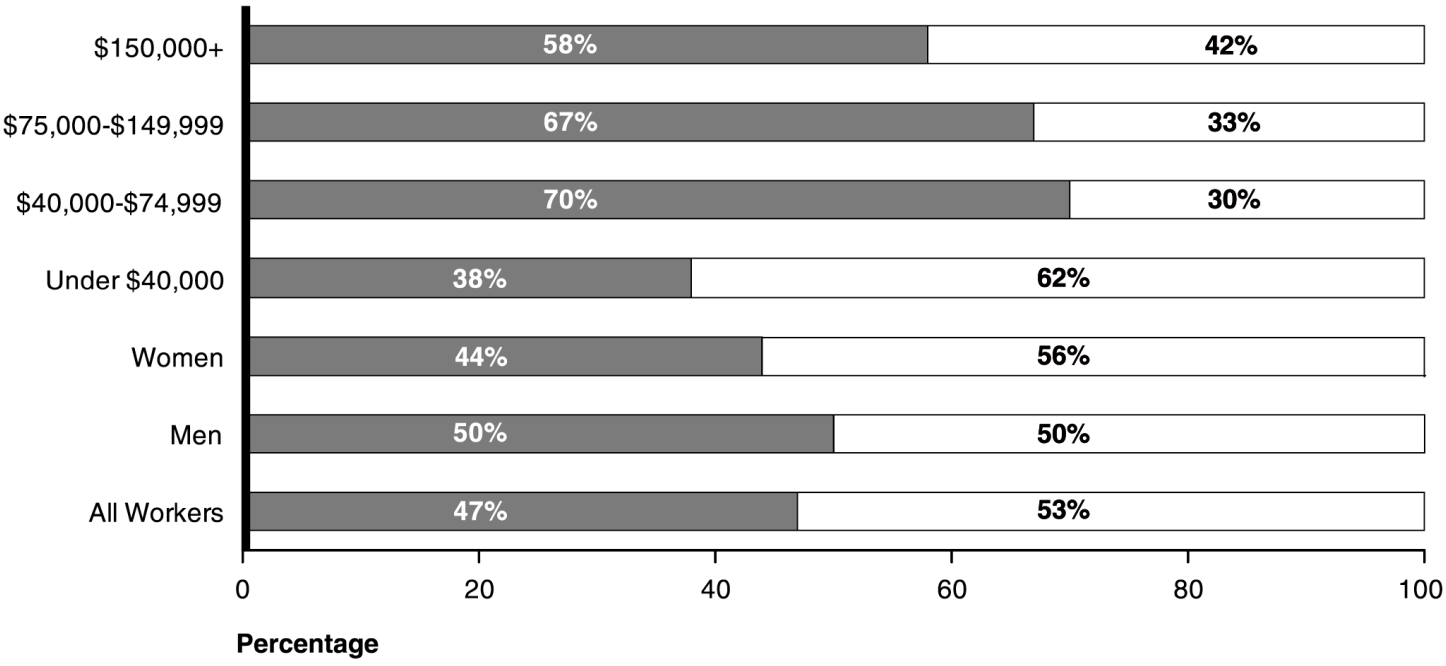



Note: "Workers participating in pension plans" includes both full-time and part-time employees. Percentages do not total 100 percent because of rounding.

Source: GAO tabulations of 1998 SCF data.

However, higher earners were more likely to participate in pension plans than low and moderate earners. Specifically, 38 percent of workers who earned less than $40,000 per year participated in a pension plan, while 70 percent of workers who earned between $40,000 and $74,999 per year participated in a plan. (See fig. 2.)

**Figure 2: Pension Plan Participation by Earnings and Gender**




Note: There are no statistically significant differences at the 0.05 level among the percentages of workers that participated in pension plans in the $40,000-$74,999, $75,000-$149,999, and $150,000+ earnings categories. Categories include both full-time and part-time employees. Our sample includes persons 18 years of age and older who work, including persons who may be self-employed. We did not include contributions to IRAs for any person in our sample, including the self-employed nor did we consider Keogh plans in our analysis. See appendix.

Source: GAO tabulations of 1998 SCF data.

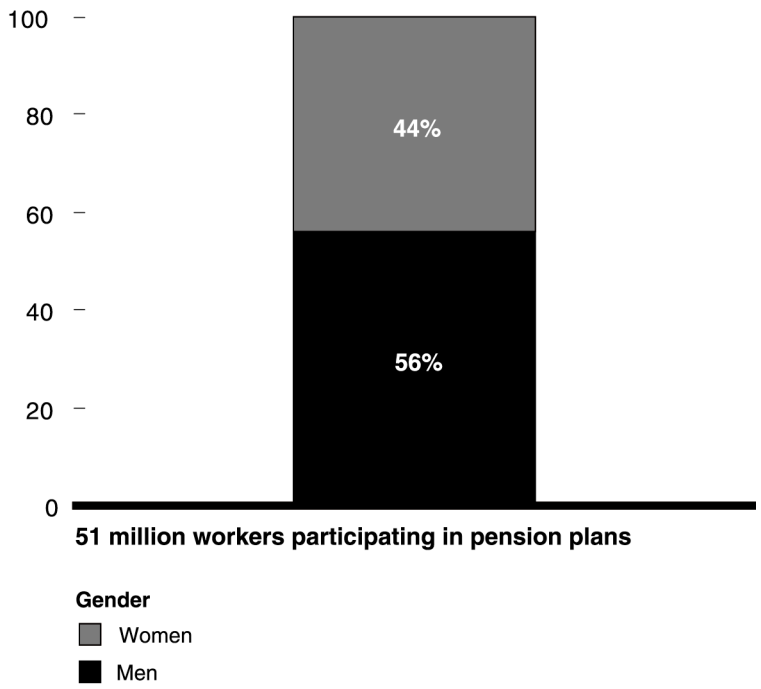
A similar pattern of lower participation rates for low- and moderate-income workers exists when individual workers are classified by their household incomes rather than by their individual earnings. Of workers with household incomes of less than $40,000 per year, 30 percent participated in a pension plan. Of workers with annual household incomes between $40,000 and $75,000 per year, 57 percent participated. Among the reasons for low-income workers' lower pension plan participation rates are that low-income workers are more likely to work for small employers (who are less likely to offer pension plans than larger employers), are more likely to work in part-time positions (which are less likely to be

covered by pension plans than full-time positions), are less likely to be able to afford to save for retirement through employer-sponsored plans, and depend more heavily on Social Security as a source of retirement income.

## Women Were Less Likely to Participate in Pension Plans Than Men

When we estimated the percentages of pension participants that were male and female, we found that more than half of pension participants, like more than half of all workers, were men. Of the 51 million workers who participated in a pension plan, 56 percent were men. (See fig. 3.) In 1998, about 53 percent of all workers were men.

**Figure 3: Gender of Pension Plan Participants**




Note: "Workers participating in pension plans" includes both full-time and part-time employees.

Source: GAO tabulations of 1998 SCF data.

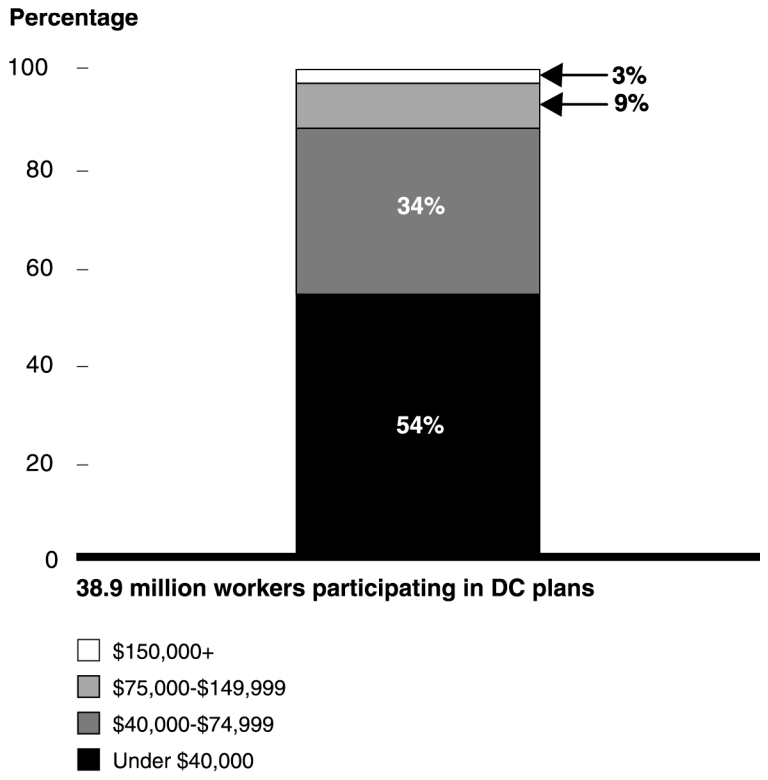
As in our earnings analysis, we tested the possibility that even though most pension participants were men, there could be many men who did not participate in pension plans and many women who did participate. To test this possibility, we examined the percentages of female and male workers who participated in pension plans. We found that women were

less likely than men to participate in a pension plan. Specifically, half of all male workers and 44 percent of all female workers participated in a plan. (See fig. 2.) Women workers' lower wages, greater concentration in part-time jobs, and greater concentration in industries where few employers offer pension plans may be among the reasons why women were less likely than men to participate in plans.

## DC Plan Participation Patterns Were Generally Similar to Those of All Pension Plans

The earnings and gender patterns of DC plan participation resembled those of participation in all pension plans. About 38.9 million workers, or 36 percent of all workers, participated in DC plans. Of these 38.9 million workers, 54 percent had annual earnings of less than $40,000, and 57 percent were men. (See fig. 4 and fig. 5.)

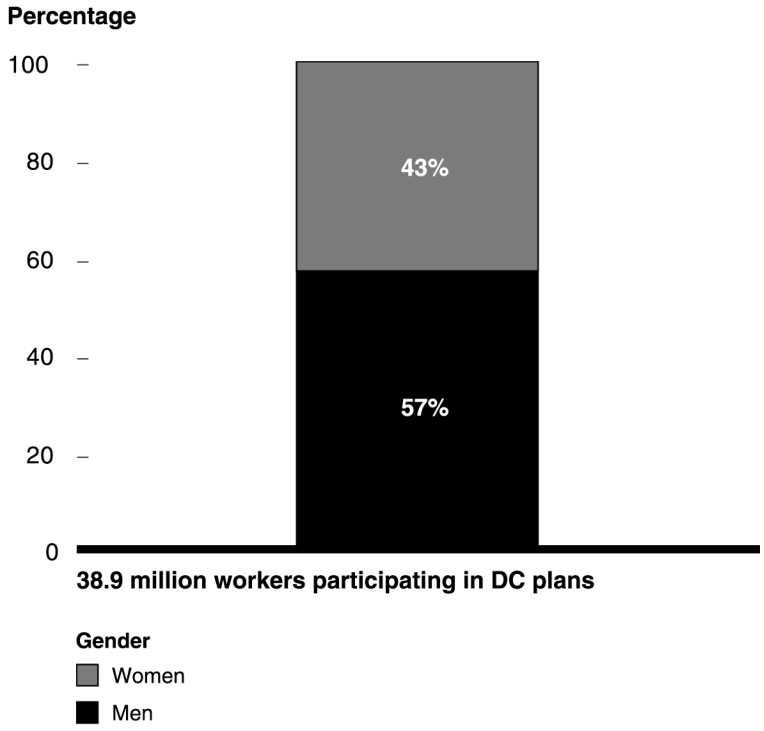
**Figure 4: Earnings of Participants in DC Plans**




Note: "Workers participating in pension plans" includes both full-time and part-time employees.

Source: GAO tabulations of 1998 SCF data.

**Figure 5: Gender of Participants in DC Plans**

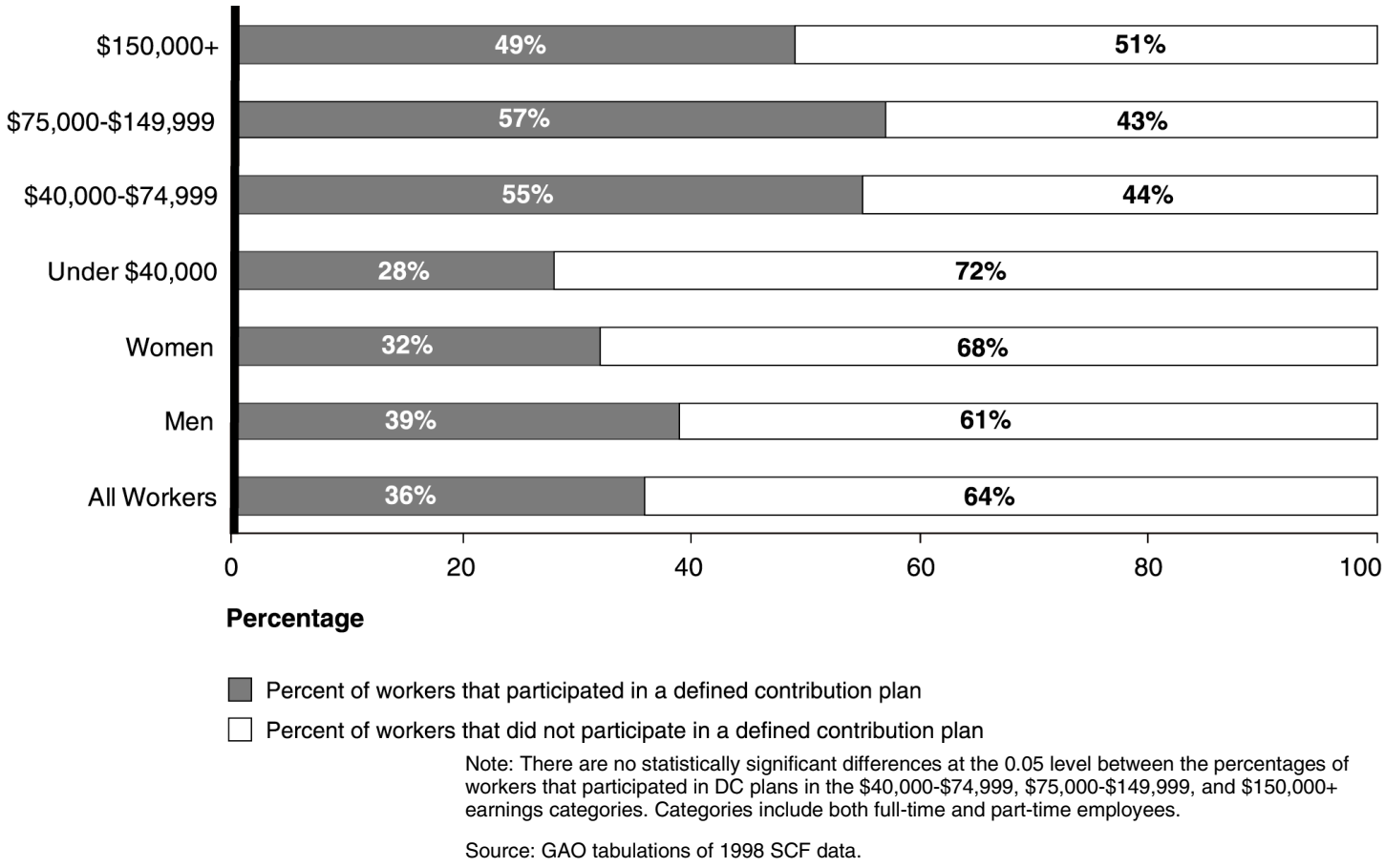



Note: "Workers participating in pension plans" includes both full-time and part-time employees.

Source: GAO tabulations of 1998 SCF data.

When we estimated the percentage of workers in each earnings group that participated in DC plans, we found that low and moderate earners were less likely to participate than higher earners. Of all workers who earned less than $40,000 per year, 28 percent participated in DC plans; of those who earned between $40,000 and $75,000 per year, 55 percent participated in DC plans. (See fig. 6.) Likewise, workers with low or moderate household incomes were less likely to participate than those with higher household incomes. When we estimated the percentages of men and women workers that participated in DC plans, we found that a higher percentage of male (39 percent) than female workers (32 percent) participated in DC plans.

**Figure 6: DC Plan Participation by Earnings and Gender**




Note: There are no statistically significant differences at the 0.05 level between the percentages of workers that participated in DC plans in the $40,000-$74,999, $75,000-$149,999, and $150,000+ earnings categories. Categories include both full-time and part-time employees.

Source: GAO tabulations of 1998 SCF data.

## Increase in DC Plan Contribution Limits Would Likely Benefit About 3.1 Million DC Participants Directly

About 8 percent of all DC participants were likely to benefit directly if all three DC plan contribution limits discussed in this report increased at the same time. The 3.1 million DC participants who were likely to benefit directly from these limit increases generally had higher earnings than the 35.7 million who were not likely to benefit directly. When we examined the percentages of workers in various earnings categories that were likely to benefit directly from these limit increases, we found that higher earners were more likely than low and moderate earners to benefit directly. When we compared the gender of likely direct beneficiaries with that of DC participants not likely to benefit directly, we found that men made up a higher percentage of likely direct beneficiaries than of DC participants not likely to benefit directly. When we examined the percentages of male and female DC participants that were likely to benefit directly, we found that a

higher percentage of men than women were likely to benefit directly. When we analyzed the effects of increases in each of the three contribution limits sequentially, we found that increasing the percentage limit on combined employer and employee contributions first accounts for half of the 3.1 million likely direct beneficiaries of an increase in all three contribution limits. In addition to likely direct beneficiaries, some low and moderate earners might benefit indirectly from increases in DC plan contribution limits if they resulted in extra pension coverage or contributions for those workers, but the number of workers who might benefit in this way is unknown.

## Few Workers Were Likely to Benefit Directly If All DC Plan Contribution Limits Increased

Few DC participants were likely to benefit directly from increasing all three DC plan limits we analyzed.[14] We define likely direct beneficiaries as employed DC participants whose employer and/or employee contributions were equal to or above the statutory limits we analyzed.[15] About 8 percent of all DC participants, or 3.1 million people, were likely to have benefited directly if all the contribution limits analyzed in this report had been increased.

The results of our analysis of the SCF are consistent with plan-specific data we analyzed. A New York state law firm that administers DC plans provided us with data on a sample of 1,831 participants in 15 DC plans.[16] About 6 percent of these 1,831 participants had employer and/or employee contributions at or above one or more of the three contribution limits we analyzed. An additional 4 percent of these participants made the maximum contributions allowable under plan-specific contribution limits or

[14]In addition to likely direct beneficiaries, some workers could benefit indirectly from DC plan contribution limit increases. We were unable to estimate the number of indirect beneficiaries, including DC participants who could benefit from additional employee or employer contributions, nonparticipants who could be included in existing DC plans if they expanded their coverage, and nonparticipants who could be included in new DC plans.

[15]The appendix provides a more detailed explanation of this definition. Note that participants whose contributions exceed statutory limits on tax-deferred contributions are subject to tax on amounts contributed in excess of the limits.

[16]This sample of DC participants is not nationally representative and covers the year 2000 rather than 1998. We analyzed it because we were not able to obtain nationally representative plan-specific data.

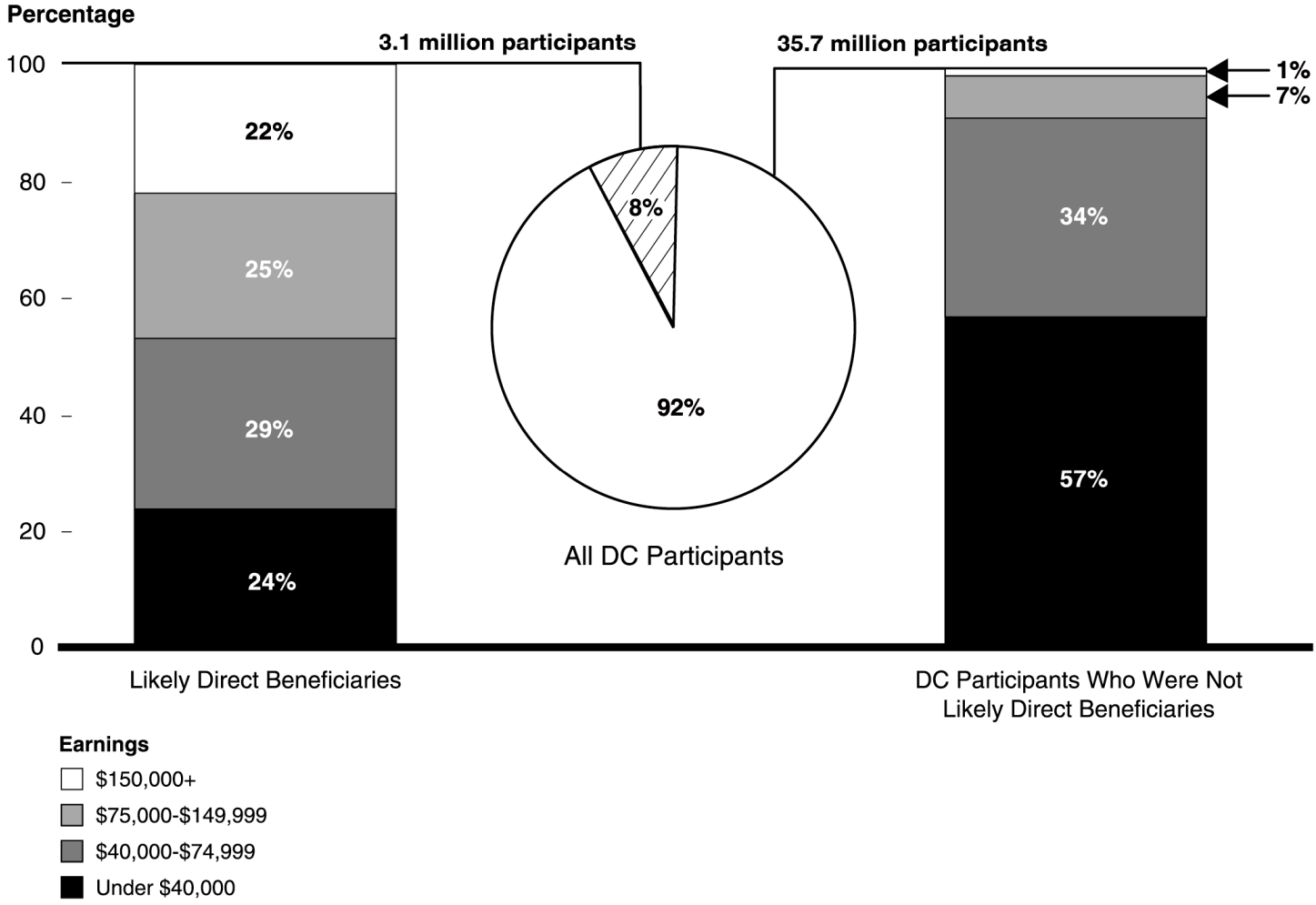
nondiscrimination rules.[17] Therefore, between 6 and 10 percent of these participants would likely have benefited directly if all three contribution limits we analyzed had been increased. This is generally consistent with our finding that 8 percent of DC participants were likely direct beneficiaries of an increase in all three contribution limits we analyzed.

## Likely Direct Beneficiaries of Increasing All Contribution Limits Generally Had Higher Earnings Than DC Participants Not Likely to Benefit Directly

Likely direct beneficiaries of an increase in all three contribution limits generally had higher earnings than DC participants who were not likely to benefit directly from such an increase. Of the 3.1 million likely direct beneficiaries, 24 percent earned less than $40,000 per year, while 22 percent earned more than $150,000 per year. Of the 35.7 million DC participants who were not likely direct beneficiaries of limit increases, 57 percent earned less than $40,000 per year, and 1 percent earned more than $150,000 per year. (See fig. 7.) We found a similar pattern when we analyzed individual DC participants by their household incomes rather than by their individual earnings. Likely direct beneficiaries of an increase in all limits analyzed in this report generally had higher household incomes than DC participants who were not likely direct beneficiaries.

[17]DC participants who made the maximum contribution allowable under plan-specific contribution limits should be considered likely direct beneficiaries of increases in statutory contribution limits only if their plan limits increased to enable participants to take advantage of at least some of the extra contributions allowed by law. Participants who made the maximum contribution allowable under nondiscrimination rules should be considered likely direct beneficiaries of increases in statutory contribution limits only if their plans would still satisfy nondiscrimination rules when those participants made additional contributions. Our analyses of 1998 SCF data do not include participants who made the maximum contribution allowable under plan-specific contribution limits or nondiscrimination rules as likely direct beneficiaries of limit increases because the 1998 SCF does not contain the plan-specific information that would be necessary to identify such participants.

**Figure 7: Increasing All Contribution Limits: Earnings of Likely Direct Beneficiaries and of DC Participants Who Were Not Likely Direct Beneficiaries**



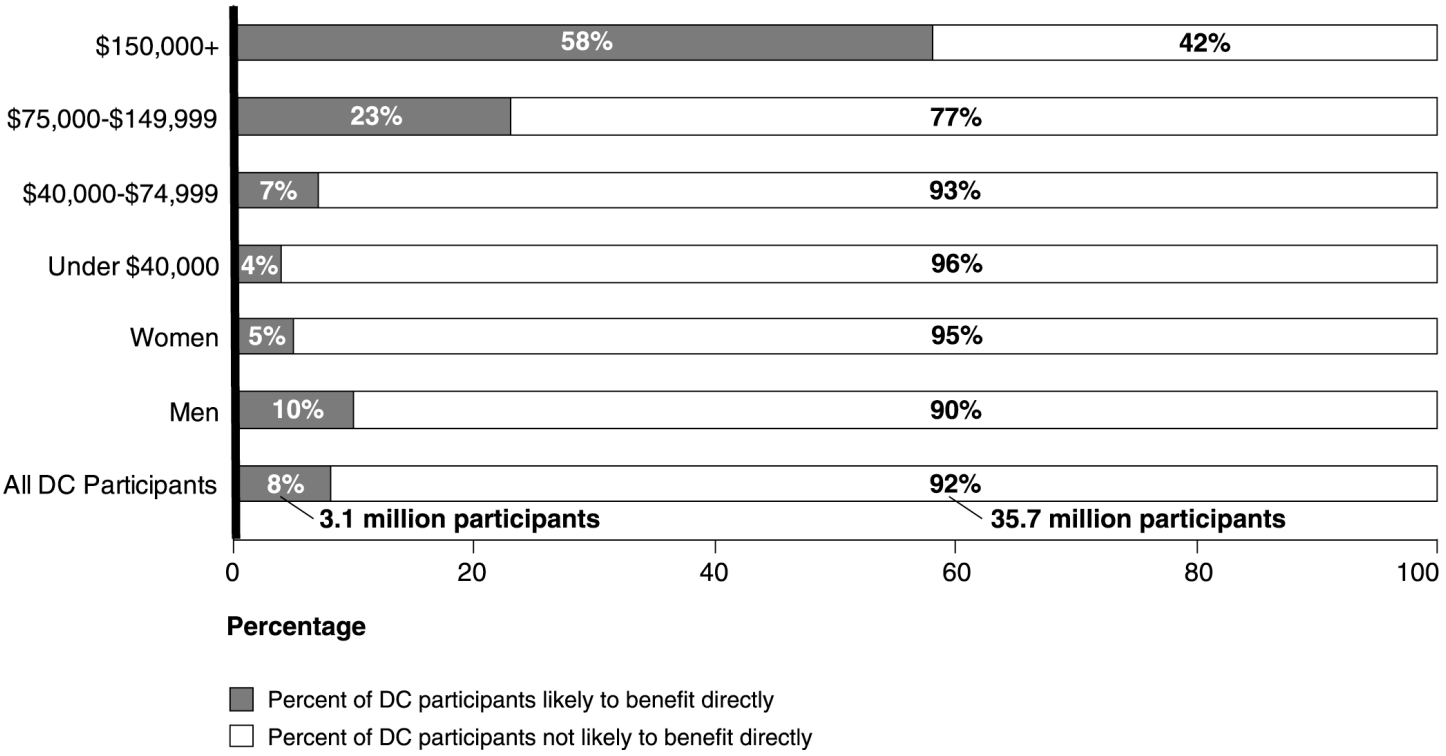

Note: Analysis based on 402(g) limit and 415(c)(1) dollar and percentage limits. The difference in percent with earnings of $40,000-$74,999 between likely direct beneficiaries and DC participants who were not likely to benefit directly is not statistically significant at the 0.05 level. Categories include both full-time and part-time employees.

Source: GAO tabulations of 1998 SCF data.

We also estimated the percentage of DC participants, within each earnings category, who were likely to benefit directly from increasing all three contribution limits. We found that higher earning DC participants were more likely than low- or moderate-earning DC participants to benefit directly from an increase in all three DC plan contribution limits. Specifically, among DC participants with annual earnings over $150,000, 58

percent were likely to benefit directly. In contrast, 4 percent of DC participants with annual earnings of less than $40,000 were likely to benefit directly. (See fig. 8.)

**Figure 8: Percent of DC Participants Likely to Benefit Directly From Increasing All Contribution Limits**



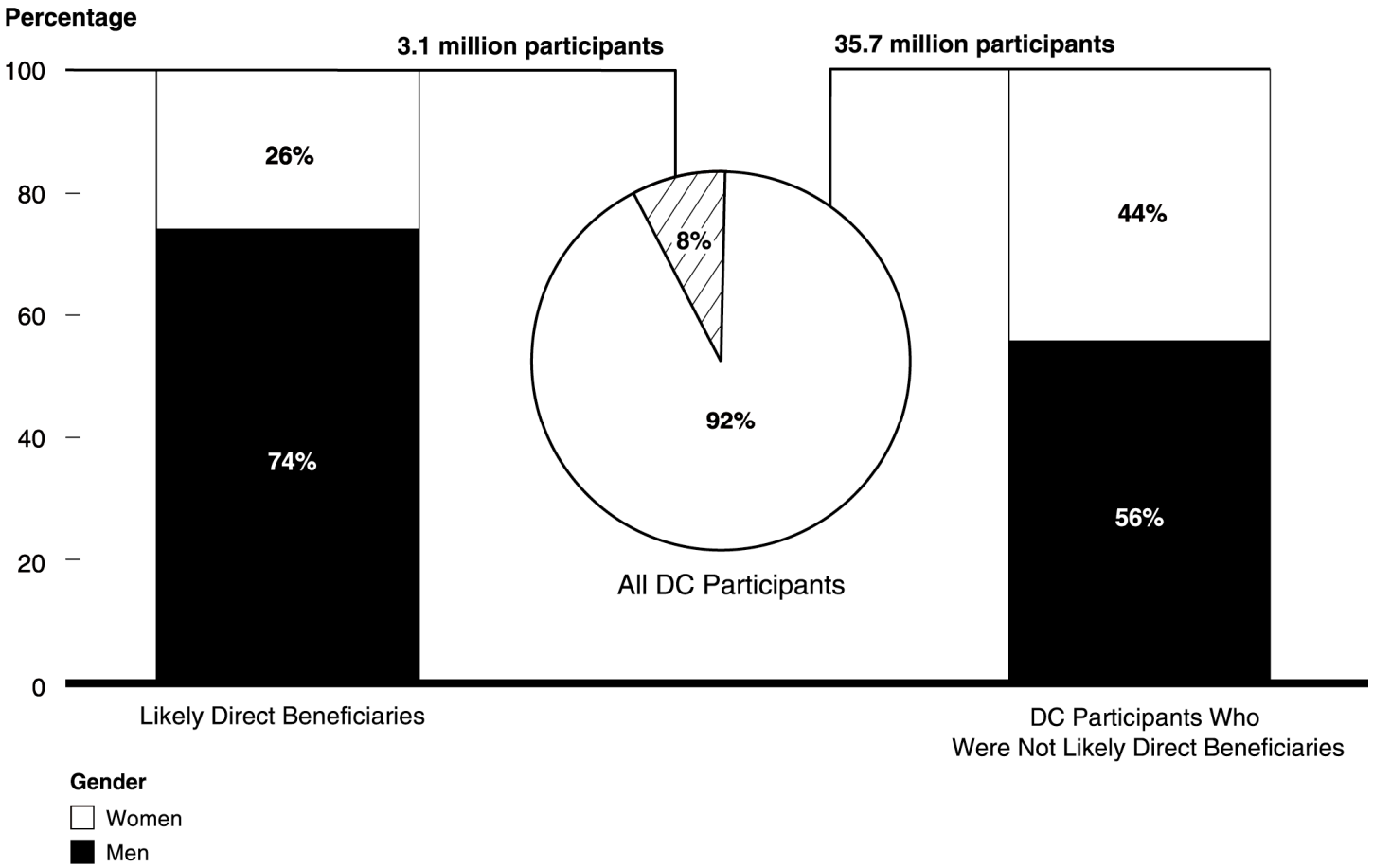

Note: Analysis based on 402(g) limit and 415(c)(1) dollar and percentage limits. Categories include both full-time and part-time employees.

Source: GAO tabulations of 1998 SCF data

## If All DC Plan Contribution Limits Increased, Male DC Participants Were More Likely to Benefit Directly Than Female Participants

When we compared the gender of likely direct beneficiaries of an increase in all three limits with the gender of DC participants who were not likely to benefit directly from such an increase, we found that likely direct beneficiaries were more likely to be men. About 74 percent of the 3.1 million likely direct beneficiaries were men, and 56 percent of the 35.7 million DC participants who were not likely to benefit directly were men. (See fig. 9.)

**Figure 9: Increasing All Contribution Limits: Gender of Likely Direct Beneficiaries and of DC Participants Who Were Not Likely Direct Beneficiaries**




Note: Analysis based on 402(g) limit and 415(c)(1) dollar and percentage limits. Categories include both full-time and part-time employees.

Source: GAO tabulations of 1998 SCF data.

As we did for earnings, we also did a second set of analyses for gender, in which we examined the percentages of male and female DC participants who were likely direct beneficiaries of an increase in all three contribution limits. In doing so, we found that 10 percent of male and 5 percent of female DC participants were likely direct beneficiaries of an increase in all these limits. (See fig. 8.) Women workers' lower earnings might be a reason why women were less likely to benefit directly from these limit increases.[18]

## Different Earnings and Gender Groups Were Likely to Benefit from Increasing Percentage and Dollar Contribution Limits

Although 3.1 million DC participants were likely direct beneficiaries of increasing the three contribution limits, many of the 3.1 million likely direct beneficiaries could have benefited because only one of the three limits was increased. Other likely direct beneficiaries could have benefited only from increasing at least two of the contribution limits.

To determine how each of the three limits contributes to the total number of likely direct beneficiaries, we analyzed the effects of increasing the three contribution limits sequentially. Because the effects of the three separate limit increases interact, this sequential analysis is preferable to an analysis in which each limit is increased while the other two are held fixed.[19] First, we increased the percentage limit on combined employer and employee contributions, while holding the other dollar contribution limits fixed. Next, we increased the dollar limit on employee contributions, while holding the dollar limit on combined employer and employee contributions fixed. Finally, we increased the dollar limit on combined employer and employee contributions. For each stage in the analysis, we asked two questions: (1) how many DC participants were likely to benefit directly at this stage and (2) what were their earnings and gender.

Increasing the percentage limit first accounts for half of all the 3.1 million likely direct beneficiaries of increasing all three contribution limits. Also, likely direct beneficiaries of increasing the percentage limit generally had lower earnings and were more likely to be female than likely direct beneficiaries of increasing the dollar limits. Specifically, we found that

[18]According to the 1998 SCF, women who participated in DC plans had median earnings of $29,000; i.e., half earned more than $29,000 and half earned less. Male DC participants had median earnings of $43,193.

[19]The sequence in which the limits were increased did not substantially affect the results of our sequential analysis. See the appendix for more information on the methodology for this analysis.

- Increasing the percentage limit on combined employer and employee contributions first accounts for 1.5 million of the 3.1 million DC participants who were likely direct beneficiaries of increasing all three contribution limits. (See table 2.) Forty-eight percent of these 1.5 million likely direct beneficiaries earned less than $40,000 per year and 44 percent earned between $40,000 and $75,000 per year. (See table 3.) Forty-four percent of these 1.5 million likely direct beneficiaries were female. (See table 4.)
- Increasing the dollar limit on employee contributions second accounts for 1.1 million of the 3.1 million likely direct beneficiaries of increasing all three contribution limits. Fifty-four percent of these 1.1 million likely direct beneficiaries earned between $75,000 and $150,000 per year and 91 percent were male.
- Increasing the dollar limit on combined employer and employee contributions third accounts for 519,000 of the 3.1 million likely direct beneficiaries of increasing all three contribution limits. Seventy-four percent of these likely direct beneficiaries earned $150,000 or more per year and 92 percent were male.

**Table 2: Likely Direct Beneficiaries of Increasing the Three Contribution Limits in Stages**

| Sequence of contribution limit increases | Number of likely direct beneficiaries | Percent of total |
|---|---|---|
| Stage #1–Percentage limit on combined employer and employee contributions | 1.5 million | 50 |
| Stage #2–Dollar limit on employee contributions | 1.1 million | 34 |
| Stage #3–Dollar limit on combined employer and employee contributions | 519,000 | 17 |
| **Total number of likely direct beneficiaries** | **3.1 million** | **100** |

Note: Percentages do not total 100 percent because of rounding.

**Table 3: Earnings of Likely Direct Beneficiaries of Increasing the Three Contribution Limits in Stages**

| | Percent of likely direct beneficiaries in each earnings category | | | | | |
|---|---|---|---|---|---|---|
| Sequence of contribution limit increases | Under $40,000 | $40,000-$74,999 | $75,000-$149,999 | $150,000+ | All earnings categories | Number of likely direct beneficiaries |
| Stage #1–Percentage limit on combined employer and employee contributions | 48 | 44 | 7 | 0 | 100 | 1.5 million |
| Stage #2–Dollar limit on employee contributions | 0 | 16 | 54 | 30 | 100 | 1.1 million |
| Stage #3–Dollar limit on combined employer and employee contributions | 0 | 7 | 19 | 74 | 100 | 519,000 |

Note: Percentages may not total 100 percent because of rounding.

**Table 4: Gender of Likely Direct Beneficiaries of Increasing the Three Contribution Limits in Stages**

| Sequence of contribution limit increases | Percent of likely direct beneficiaries in each gender category | | | Number of likely direct beneficiaries |
|---|---|---|---|---|
| | Male | Female | Both genders | |
| Stage #1–Percentage limit on combined employer and employee contributions | 56 | 44 | 100 | 1.5 million |
| Stage #2–Dollar limit on employee contributions | 91 | 9 | 100 | 1.1 million |
| Stage #3–Dollar limit on combined employer and employee contributions | 92 | 8 | 100 | 519,000 |

## Low and Moderate Earners Could Benefit Indirectly From DC Plan Limit Increases

In addition to participants who would likely benefit directly from raising DC plan limits, some low and moderate earners who do not now participate in DC plans might benefit indirectly from increases in those limits. Some industry groups told us that some employers, especially small employers, could find higher limits attractive enough to form new DC plans that would extend pension coverage to employees not previously covered. Other employers, these groups told us, could find higher limits attractive enough to expand coverage and/or increase their contributions for low- and moderate-earning participants in their existing DC plans. These groups told us that many of those who could take advantage of increased contribution limits were key business decisionmakers who determine pension plan formation and coverage for their firms. One way that these key decisionmakers could take advantage of higher contribution limits would be to start new qualified DC plans. If they chose to do this, then nondiscrimination rules would require them to include some low- and moderate-earning employees in those new plans.

We were unable to measure the number or characteristics of workers who might benefit indirectly from increases in DC plan contribution limits, including workers who might be included in new DC plans. Whether or not these indirect effects would occur is specific to the individual, employer, and plan. How widespread these effects would be is unknown; the effects are very difficult to measure.

Survey data suggest that limits on tax-deferred pension contributions may not be among the most important reasons why some small employers do not offer pension plans. According to the Employee Benefit Research Institute's 2001 Small Employer Retirement Survey, insufficient tax benefits for the firm's owner ranked 9th out of 12 major reasons that small

employers who did not offer pension plans gave for their decision not to offer a plan.[20] In that survey, 48 percent of employers who had 5 to 100 employees and who did not offer a plan cited uncertain revenue as a major reason for not offering a plan, and 18 percent of those employers cited this as the most important reason. In contrast, 16 percent of employers surveyed said that "tax benefits for the owner are too small" was a major reason why they did not offer a plan, while 1 percent said that it was the most important reason. However, it is difficult to isolate the effects of one of these explanations in light of the many competing factors small employers must consider when deciding whether to offer a pension plan.

Some key business decisionmakers may have to expand pension coverage or contributions in their companies' existing qualified DC plans in order to take advantage of increased contribution limits. To enable highly paid employees to take advantage of the higher limits and still have their plans pass the nondiscrimination tests, some companies may have to include more low- and moderate-earning workers in their plans, increase their contributions for low and moderate earners, or both.

## "Catch-Up" Provision Was Likely to Benefit Few Participants Directly

Allowing a "catch-up" provision—permitting persons aged 50 or older to make additional contributions to DC plans in excess of the statutory limits we analyzed—would likely have directly benefited 11 percent of all eligible DC participants, or 721,000 participants. The 721,000 DC participants who were likely to benefit directly from this option generally had higher earnings than the 5.9 million eligible DC participants who were not likely to benefit directly. In addition, when likely direct beneficiaries are considered as a percentage of all eligible DC participants in various earnings categories, a larger percentage of participants earning $75,000 per year or more than of those earning less than $75,000 per year was likely to benefit directly from this provision. The likely direct beneficiaries of this provision did not differ significantly in gender from eligible DC participants who were not likely direct beneficiaries. When likely direct beneficiaries are considered as a percentage of all eligible male DC participants and of all eligible female DC participants, there is no significant difference between the percentage of eligible male DC participants likely to benefit directly and the percentage of eligible female DC participants likely to benefit directly.

[20]Employee Benefit Research Institute, *The 2001 Small Employer Retirement Survey (SERS) Summary of Findings* (n.d.), available at www.ebri.org/sers/2001/01serses.pdf.

## Few Eligible DC Participants Were Likely to Benefit Directly From "Catch-Up" Provision

Few eligible DC participants were likely to benefit directly if employees aged 50 or older were allowed to make additional contributions in excess of other statutory limits. In analyzing this option, we defined eligible DC participants as workers aged 50 or older who contributed to 401(k) or similar DC plans. About 11 percent of eligible DC participants, or 721,000 people, were likely direct beneficiaries of this option.

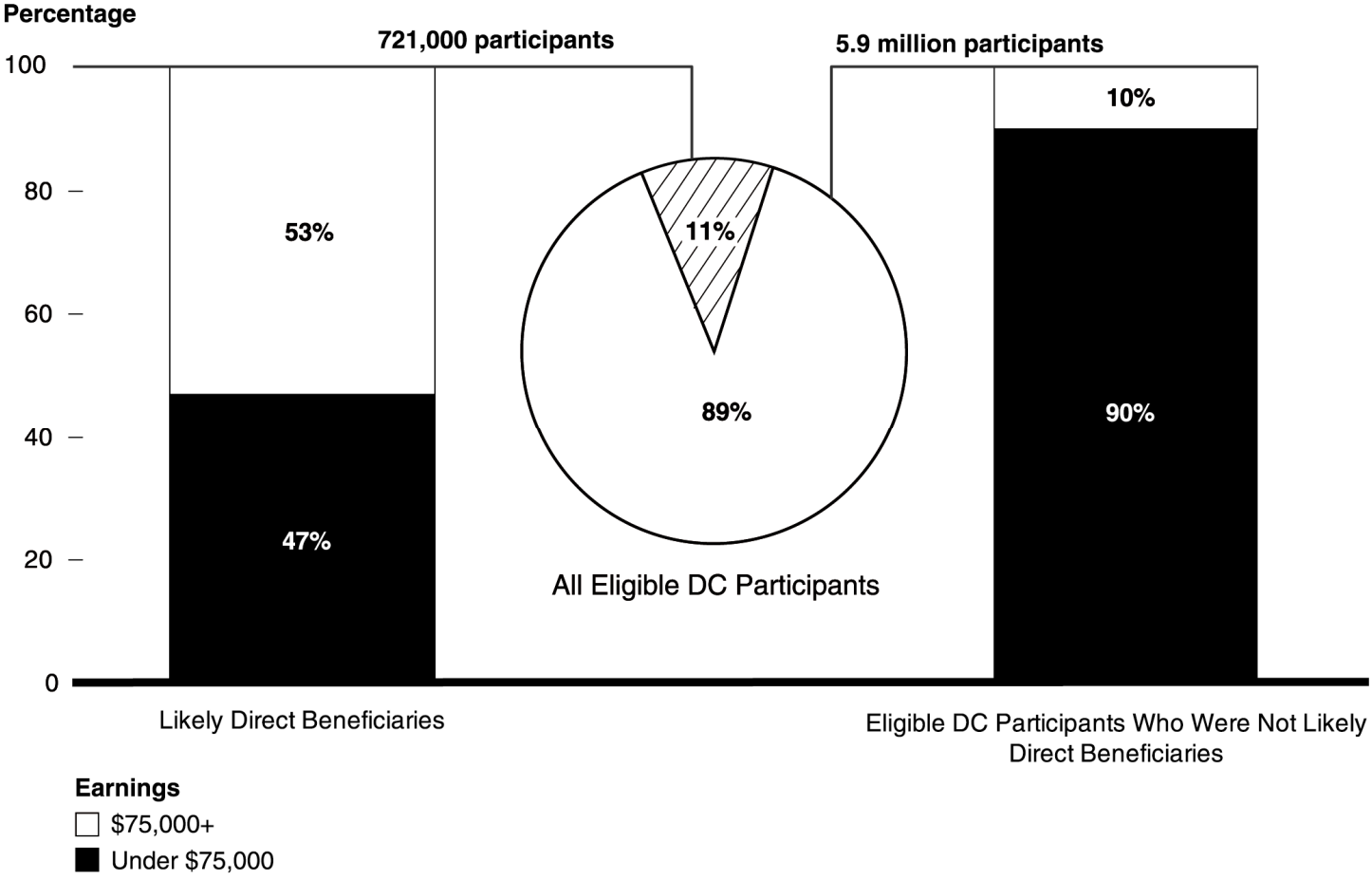
This finding is consistent with other efforts to analyze the effects of allowing older workers to make additional contributions to DC plans. Treasury's analysis of 1998 federal income tax data showed that 8 percent of workers aged 50 or older who contributed to DC plans made contributions equal to the employee dollar contribution limit. This is comparable to our finding of 11 percent of eligible DC participants aged 50 or older who would be likely direct beneficiaries of a "catch-up" provision. Our finding is also generally consistent with the result of our analysis of data on a nonrepresentative sample of 367 participants aged 50 or older in 11 401(k) plans administered by a New York state law firm. In that sample, about 15 percent of participants aged 50 or older made employer and/or employee contributions at or above one of the three limits we analyzed, and an additional 8 percent made the maximum contributions allowable under plan-specific contribution limits or nondiscrimination rules.

## Likely Direct Beneficiaries of "Catch-Up" Provision Generally Had Higher Earnings Than Other Eligible DC Participants

Those likely to benefit directly if older workers were permitted to make additional contributions to DC plans generally had higher earnings than eligible DC participants not likely to benefit directly. We divided eligible DC participants into two earnings categories: those who earned less than $75,000 per year and those who earned $75,000 per year or more.[21] About 47 percent of these 721,000 likely direct beneficiaries of this option earned less than $75,000 per year, while 53 percent earned more than $75,000 per year. Of the 5.9 million DC participants who were not likely to benefit directly, 90 percent earned less than $75,000 per year, and 10 percent earned more than $75,000 per year. (See fig. 10.) We found a similar pattern when we analyzed individual DC participants by their household incomes rather than by their individual earnings. Employees who were likely to benefit directly if older workers were allowed to make extra contributions to DC plans had higher household incomes than eligible DC participants who were not likely direct beneficiaries.

[21]For the analysis of this option, we used only two categories for earnings and household income, under $75,000 per year and $75,000 per year and up, rather than the four categories we used for the analyses of other limit increases. The reason for this difference is that the use of four categories for earnings and for household income did not produce statistically reliable results in the analysis of additional contributions by older workers.

**Figure 10: Permitting Additional Employee Contributions for Participants Aged 50 and Older: Earnings of Likely Direct Beneficiaries and of Eligible DC Participants Who Were Not Likely Direct Beneficiaries**

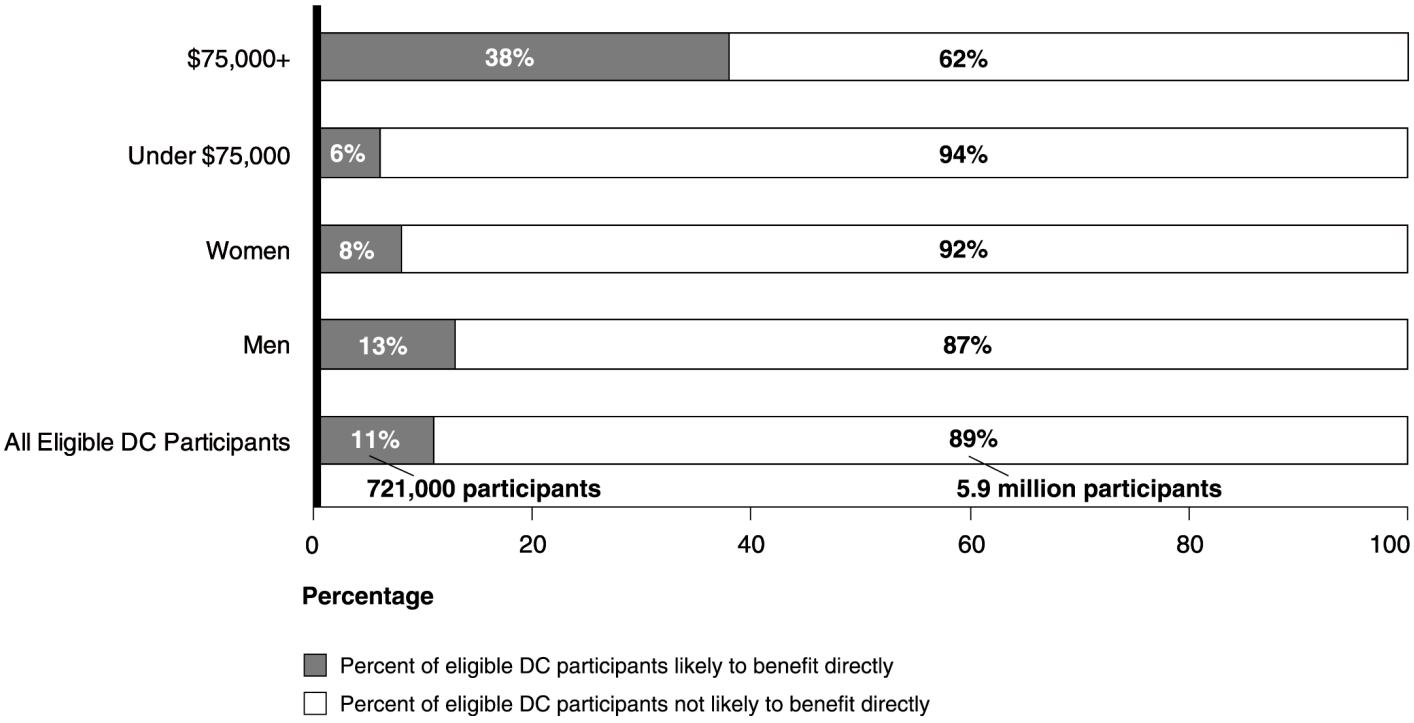



Note: Eligible DC participants are those aged 50 and older who contributed to 401(k) and similar plans. Likely direct beneficiaries are eligible DC participants who contributed or received contributions at or above the 402(g) limit and/or 415(c)(1) dollar or percentage limit. Categories include both full-time and part-time employees.

Source: GAO tabulations of 1998 SCF data.

We also estimated the percentage of eligible DC participants within each earnings category who were likely to benefit directly from allowing persons aged 50 or older to make additional contributions. We found that 6 percent of eligible DC participants who earned less than $75,000 per year were likely to benefit directly from this option, while 38 percent of eligible DC participants with annual earnings of $75,000 or more were likely to benefit directly from it. (See fig. 11.)

**Figure 11: Percent of Eligible DC Participants Likely to Benefit Directly From Permitting Additional Employee Contributions for Participants Aged 50 and Older**




Note: Eligible DC participants are those aged 50 and older who contributed to 401(k) and similar plans. Likely direct beneficiaries are eligible DC participants who contributed or received contributions at or above the 402(g) limit and/or 415(c)(1) dollar or percentage limit. There is no statistically significant difference at the 0.05 level between the percent of male DC participants who were likely to benefit directly and the percent of female DC participants who were likely to benefit directly. Categories include both full-time and part-time employees.

Source: GAO tabulations of 1998 SCF data.

## "Catch-Up" Provision Would Not Likely Have Directly Benefited Men or Women Significantly More

The gender of DC participants who were likely to benefit directly from a "catch-up" contribution provision did not differ significantly from that of eligible DC participants who were not likely to benefit directly. About 73 percent of the 721,000 likely direct beneficiaries of allowing workers aged 50 or older to make extra contributions to DC plans were men. Of the 5.9 million eligible DC participants who were not likely to benefit directly, 60 percent were men. This percentage did not differ significantly from 73 percent.

As we did for earnings, we also analyzed the percentages of eligible male and female DC participants that were likely to benefit directly from the

"catch-up" provision. In doing so, we found that among eligible DC participants, there is no significant difference between the percentage of men likely to benefit directly and the percentage of women likely to benefit directly.

## Agency Comments

The Department of Labor had no comment on the report. The Department of the Treasury provided us with technical comments, which we incorporated as appropriate.

We are sending copies of this report to the Secretary of the Treasury, the Secretary of Labor, and interested congressional committees. Copies will also be made available to others on request. Please call me or Charles A. Jeszeck at (202) 512-7215 if you or your staff have any questions. Other major contributors to the report include Howard Wial, Jeremy Citro, Gene Kuehneman, Edward Nannenhorn, Donald J. Porteous, and Andrew Davenport.

Sincerely yours,

Barbara D. Bovbjerg
Director, Education, Workforce,
and Income Security Issues

# Appendix: Scope and Methodology

We used survey data from the 1998 Survey of Consumer Finances (SCF), sponsored by the Board of Governors of the Federal Reserve System, to estimate

- the number and percentage of workers that participated in pension plans and the number and percentage of workers that participated in DC plans, by earnings and gender;
- the earnings and gender distributions of pension plan participants and DC participants;
- the number and percentage of DC participants who would and would not likely have benefited directly from increasing the three contribution limits, by earnings and gender;
- the number and percentage of likely direct beneficiaries of increasing each of the contribution limits sequentially, by earnings and gender; and
- the number and percentage of participants in certain DC plans aged 50 or older who would and would not likely have benefited directly from allowing "catch-up" contributions in excess of the three contribution limits, by earnings and gender.

We also interviewed federal agency officials, pension experts, and representatives of nongovernmental organizations to obtain their views on the effects of raising DC plan contribution limits.

## 1998 Survey of Consumer Finances

The SCF is a triennial, nationally representative survey that provides extensive information on the financial characteristics of households. We used the 1998 SCF because it is the most recent, nationally representative data source with information for all age groups on pension plan participation, DC plan participation, and employer and employee contributions to DC plans. Data on overall pension participation and characteristics of pension plan participants obtained from the 1998 SCF are generally comparable to those obtained for 1998 from the 1999 Current Population Survey (CPS), a much larger, nationally representative data set that does not contain as much detail on pensions as the SCF.[1] The SCF asked a representative sample of 4,309 households questions about their pensions, incomes, labor force participation, asset holdings and debts, use

[1]A comparison of SCF and CPS data on participation in pension plans shows a 1 percentage point difference between the two surveys regarding the pension participation rates of all workers, male workers, and female workers in 1998. The percentage of pension participants who were male differs by 2 percentage points between the two surveys. However, the estimated numbers of workers and pension participants derived from the SCF are smaller than the corresponding numbers derived from the CPS, in part because the SCF does not include data on more than two workers in each household.

of financial services, and demographic information. From the SCF, we created a sample containing information on 4,776 individual respondents and spouses (or partners) who were at least 18 years old and working at the time of the survey and whose earnings could be expressed as an annual dollar amount. We used sample weights throughout our analysis.

There is a wide range of sampling errors for the estimated percentages used in this report. All estimated percentages for which the base (i.e., the denominator) is "all workers" have sampling errors less than plus or minus 3 percentage points at the 95-percent confidence level. All estimated percentages for which the base is "all pension plan participants" have sampling errors less than plus or minus 4 percentage points at that confidence level. All estimated percentages for which the base is "all DC participants" have sampling errors less than plus or minus 5 percentage points at that confidence level. Except as shown in table 5, all estimated percentages cited or relied on in this report had sampling errors less than plus or minus 12 percentage points at that confidence level.

**Table 5: Sampling Errors of 12 Percentage Points or More**

| Percentage of | Sampling error[a] (percentage points) |
|---|---|
| Likely direct beneficiaries of an increase in all three limits analyzed in this report that were likely direct beneficiaries of an increase in the percentage limit on combined employer and employee contributions[b] | 12 |
| Workers with household incomes of $150,000+ that participated in a pension plan | 12 |
| Likely direct beneficiaries of an increase in all three limits analyzed in this report that were male | 12 |
| Likely direct beneficiaries of an increase in the dollar limit on employee contributions[c] with earnings of $150,000+ | 13 |
| Likely direct beneficiaries of an increase in the percentage limit on combined employer and employee contributions[b] with earnings of $40,000-$74,999 | 13 |
| Workers with earnings of $150,000+ that participated in a DC plan | 13 |
| Workers with earnings of $150,000+ that participated in a pension plan | 14 |
| Likely direct beneficiaries of allowing extra contributions by workers aged 50+ with earnings of $75,000+ | 15 |
| Likely direct beneficiaries of an increase in the percentage limit on combined employer and employee contributions[b] that were male | 16 |
| Likely direct beneficiaries of an increase in the percentage limit on combined employer and employee contributions[b] that were female | 16 |
| DC participants with earnings of $150,000+ who were likely direct beneficiaries of an increase in all three limits analyzed in this report | 17 |
| Likely direct beneficiaries of an increase in the percentage limit on combined employer and employee contributions[b] with earnings under $40,000 | 17 |
| Likely direct beneficiaries of allowing extra contributions by workers aged 50+ with household incomes under $75,000 | 22 |
| Likely direct beneficiaries of an increase in the dollar limit on combined employer and employee contributions[d] with earnings of $75,000-$149,999 | 22 |
| Likely direct beneficiaries of an increase in the dollar limit on combined employer and employee contributions[d] with earnings of $150,000+ | 25 |

| Percentage of | Sampling error[a] (percentage points) |
|---|---|
| Likely direct beneficiaries of an increase in the dollar limit on employee contributions[c] that were male | 26 |
| Likely direct beneficiaries of an increase in the dollar limit on employee contributions[c] with earnings of $75,000-$149,999 | 27 |
| Likely direct beneficiaries of allowing extra contributions by workers aged 50+ with earnings under $75,000 | 31 |
| Likely direct beneficiaries of allowing extra contributions by workers aged 50+ that were male | 33 |
| Likely direct beneficiaries of an increase in the dollar limit on combined employer and employee contributions[d] that were male | 34 |

[a]At the 95-percent confidence level.

[b]First stage of sequential analysis.

[c]Second stage of sequential analysis

[d]Third stage of sequential analysis.

The SCF uses multiple imputation to estimate responses to most survey questions to which respondents did not provide answers. The error due to this imputation procedure is included in the sampling errors described above.

The SCF and other surveys that are based on self-reported data are subject to several other sources of nonsampling error, including the inability to get information about all sample cases; difficulties of definition; differences in the interpretation of questions; respondents' inability or unwillingness to provide correct information; and errors made in collecting, recording, coding, and processing data. These nonsampling errors can influence the accuracy of information presented in the report, although the magnitude of their effect is not known.

## Definitions of Concepts Used in Our Analysis of the SCF

In estimating the percentage and characteristics of workers that participated in pension plans and in DC plans, we defined workers as all persons aged 18 or older who were working at the time of the survey and whose earnings could be expressed as an annual amount. This definition included both public- and private-sector workers and included self-employed workers. We defined pension plan participants as workers who were included in any type of pension plan through their job. We defined DC participants as workers who participated in a plan in which money is accumulated in an account. We did not include personal contributions to IRAs for any person in our sample, including persons who may be self-employed nor did we consider Keogh plans in our analysis because of both the report's objectives and limitations in the SCF data. This is relevant for figures 1, 2, and 3 in the text, where considering IRA contributions and

participation in Keogh plans by self-employed persons would likely raise pension participation rates, particularly for the higher income categories.

We defined likely direct beneficiaries of an increase in all three DC plan contribution limits we analyzed as employed DC participants whose employer and/or employee contributions were equal to or above one or more of the three statutory limits.[2] We defined likely direct beneficiaries in this manner because participants with contributions at the current statutory limits (or their employers) are in a position to increase their contributions if the limits are raised. This definition does not imply that all likely direct beneficiaries (or their employers) will actually increase their contributions if the limits are raised, only that they are in a position to do so.

On the other hand, it is not likely that participants with contributions below the current statutory limits would respond to an increase in the statutory limits by contributing more than the current limits. We included participants with contributions above the statutory limits in our definition of likely direct beneficiaries because the SCF does not distinguish between tax-deferred and nontax-deferred contributions or between qualified and nonqualified plans. Therefore, we were unable to identify DC participants whose tax-deferred contributions were exactly equal to the statutory limits. The general patterns described in the report were not sensitive to several alternative definitions of likely direct beneficiaries. In analyzing the option of allowing workers aged 50 or older to make extra contributions to DC plans, we limited our analysis to eligible DC participants. We defined eligible DC participants as workers aged 50 or older who contributed to 401(k) and similar DC plans. The SCF enabled us approximately to identify participants in plans of this general type, but did not enable us to distinguish between particular types of plans within this category, such as 401(k), 403(b), 457, and SIMPLE plans.

We classified individuals by their gender, individual earnings, and household income. We defined earnings as the sum of wage and salary income from a worker's main job and business income (if any) from that job. For workers who did not report their earnings as annual amounts, we used information about hours worked per week and weeks worked per

[2]Our analyses of SCF data do not include participants who made the maximum contribution allowable under plan-specific contribution limits or nondiscrimination rules as likely direct beneficiaries of limit increases because the 1998 SCF does not contain the plan-specific information that would be necessary to identify such participants.

year to express earnings as an annual amount. Our analyses excluded individuals whose earnings could not be expressed as an annual amount. For all analyses except that of allowing older workers to make extra contributions, we used four earnings categories: under $40,000 per year, $40,000-$74,999 per year, $75,000-$149,999 per year, and $150,000 per year or more. We chose the $40,000 cutoff because $40,000 was slightly higher than the $36,000 median annual earnings of all pension participants in 1998. We chose the $75,000 cutoff because 90 percent of all pension participants earned less than $75,000 per year in 1998. We chose the $150,000 cutoff because more than 95 percent of all pension participants earned less than $150,000 per year in 1998. For the analysis of allowing older workers to make extra contributions, we used two earnings categories (under $75,000 per year and $75,000 per year or more) because the use of four categories did not produce statistically reliable results in this analysis.

We used the same dollar cutoffs for household income as for earnings. Because the 1998 SCF asked respondents about their 1997 household income, we converted reported household income to 1998 dollars using the Consumer Price Index.

## Sequential Analysis of Likely Direct Beneficiaries

To understand how each of the three limits contributes to the total number of likely direct beneficiaries, we analyzed the effects of increasing the three limits sequentially in a three-stage process. First, we increased the percentage limit on combined employer and employee contributions, while holding the dollar contribution limits fixed. Likely direct beneficiaries at this stage of the analysis are those DC participants whose contributions are limited only by the percentage limit on combined employer and employee contributions and those DC participants whose contributions are limited by both the percentage limit on combined employer and employee contributions and the dollar limit on employee contributions. This stage contributes half of the likely direct beneficiaries of increasing all three contribution limits. Next, we increased the dollar limit on employee contributions, while holding the dollar limit on combined employer and employee contributions fixed. Likely direct beneficiaries at this stage are those DC participants whose contributions are limited only by the dollar limit on employee contributions. This stage contributes about an additional third of the likely direct beneficiaries of increasing all three contribution limits. Finally, we increased the dollar limit on combined employer and employee contributions. Likely direct beneficiaries at this final stage are those DC participants whose contributions are limited by the dollar limit on combined employer and employee contributions (including those whose contributions are limited

by one or both of the other two limits in addition to the percentage limit on combined employer and employee contributions). The sequence in which the limits are raised does not substantially affect the results of the sequential analysis.

## Other Methodological Issues in the SCF Analysis

We examined contributions to DC plans as of the time the SCF was conducted in 1998. Individuals we did not classify as likely to benefit directly from increased contribution limits may benefit in future years if they are able to contribute at higher levels. Our single-year analysis did not permit us to estimate how many workers would likely benefit directly from higher contribution limits at any point in their working life. Similarly, because we did not have data on earnings or income for more than 1 year, we were unable to classify individuals by their lifetime earnings or income.

We conducted our analyses of the effects of increasing DC plan contribution limits with the individual, rather than the household, as our primary unit of analysis. Conducting an analysis based exclusively on household-level data could yield different results. For example, some households may include two DC participants, in which one is contributing or receiving contributions at one or more of the limits we analyzed, while the other has room under these limits for additional contributions. At the individual level, the contributor constrained by the limit would be included as a likely direct beneficiary, while the spousal participant not contributing at the limit would not be included. From a household-level perspective, such a household might or might not be classified as benefiting directly from one or more of the limit increases we analyzed. Depending on how such households would be classified, the results could differ from an individual-level analysis. We note that our methodology is consistent with that used by the Department of the Treasury in analyzing the effects of increasing DC plan contribution limits.

## Interviews

We conducted interviews to obtain the views of federal agency officials, pension experts, and representatives of nongovernmental organizations on the effects of raising various DC plan contribution limits. The federal agencies whose officials we interviewed were the Departments of Labor and Treasury. Pension experts we interviewed had expertise in pension tax law and/or pension policy. Nongovernmental organizations whose views we obtained included pension actuaries and industry associations.

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