The Solution to the *Pension Crisis* Is **More** Pensions

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The hallmark of civilized societies and rich economies is that not only do the rich live longer and are entitled to leisure at the end of their working lives, but the poor are entitled too. For most of the post-World War II period, as Social Security and Medicare expanded and union-negotiated pensions set standards for most employers, social progress in America included democratized retirement and longevity. Yet, as the current financial collapse reduces assets in retirement funds, and pensions predictably become more expensive in wealthy countries, some analysts call for pensions to be cut and for people to work longer and take more risks with financial markets.

There are two misguided categories of beliefs that support this view:

- All people are living longer so they should and could work longer.
- Nations cannot afford pensions because the population is aging.

These beliefs are wrong.

The truth is that most older people say they had to retire at an earlier age than they intended to. Often they retire early not as something they decide, but because of health reasons, their spouse's health or, more likely, they lose their jobs. Age discrimination, layoffs, and plant shutdowns adversely affect older people's ability to work.

Working More Is a Not Retirement Policy

Raising the retirement age and cutting benefits is not the solution to funding aging societies. Work is not a substitute for safe and reliable pensions. Some in the United States have called for age seventy to be the American new norm because the ratio of working to older Americans is getting smaller.[1] Americans have been working more than others for decades. The American work week used to be shorter than Germany's and France's before 1980, but now only the Japanese work longer hours than Americans. Also, the United States is the only Organization for Economic Cooperation and Development (OECD) nation that bans forced retirement, pays full Social Security benefits to people who have not retired (this does not help the system's finances), and has raised the normal retirement age to 67.

There are winners when older people stay employed or enter the labor force to look for work: educated professionals (many who make and influence retirement policy), who began working full-time in their mid-twenties, not their teens, and who, by age 65, have worked fewer years than non-college-educated workers, and who are more likely to enjoy and control their work pace and work tasks, win. Workers with high socioeconomic stature lose the least when working longer because they already work at older ages than people at lower socioeconomic positions. If the lower-positioned workers are forced to work longer, the jobs they get often have less status and pay than they are used to. Jobs for people over 65 are less likely to be "executive," "professional," or "technician" and more likely to be in "sales" and "service" occupations.[2]

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Add to this the fact that longevity improvements are not distributed equally: white-collar male workers have gained the most. Older American white women's longevity growth is a flat line: virtually no improvement. Nonwhites have shown moderate improvement. Living longer says nothing about the ability to work longer. The percentage of people over 50 saying they have mental and physical limitations to work has not changed since the 1980s.

It is not just the workers' choice about whether they work or not. The supply and the demand in the market determine the ability to work. Older people want jobs when their wealth is down, which typically happens during a recession and when pension income is financialized—tied to financial markets in 401(k) type plans—but, of course, at that point, jobs are scarce. The unemployment rate for people over 65 reached its highest point in 2010 than any time since the Great Depression. Older workers want jobs when wealth declines, but cannot find them.

We Can Afford Better Pensions

This nation spends over $100 billion a year on tax breaks for pensions that go to people who need it least. That $100 billion can be redistributed to cover 65 million people without pensions, improve retirement security for everyone, and do so with no extra taxpayer costs.[3]

Congress, year after year, has raised contribution limits for 401(k)s while it imposed more stringent regulations on Defined Benefit (DB) plans. In 2010, for people 50 years of age or older, this limit was $20,500, and for people younger than age 50, the limit was $15,500. The total amount that can be contributed between employee and employer contributions is the smaller amount of 100 percent of the employee's compensation or $49,000 for 2010 (which is near the average wage for an American worker). Because they get the larger tax benefits, higher-income people contribute more and more often to 401(k)-type plans (defined contribution plans).

According to the Urban and Brookings Tax Policy Center, 79.8 percent of government subsidies for retirement accounts go to the top 20 percent of earners—those earning over $60,000 per year—and 50 percent of the tax expenditures go to the 6 percent of workers earning over $100,000 per year for contributions up to $20,000 per person per year.[4] For over 52 percent of Americans, tax units have earnings less than $40,000. This is the way the current deduction works now. A lawyer earning $200,000 makes a $1,000 contribution to his 401(k) plan and reduces income tax by $350. His receptionist, earning $20,000, makes the same $1,000 contribution (which is much less likely) and saves only $150 in taxes. This is not effective public policy: for all this monetary effort, the U.S. savings rates did not improve, and pension coverage did not expand.

The lopsided distribution of tax breaks for pensions could have been predicted from the system's origins. The 401(k) plan is named after the section of the tax code passed in 1978, which intended to help high-income management employees save on a tax-favored basis. In the United States, provisions in the tax code that favor certain kinds of activities are significant sources of government subsidies to an activity—or in this case, the 401(k) system. Taxes not collected on pension contributions and earnings equal a fourth of annual Social Security contributions and, at over $114 billion, are perversely larger than household savings, totaling just over $102 billion.[5]

Guaranteed Retirement Accounts: A Pension Public Option

How to produce safe and secure pensions for all Americans? A new coalition of scholars, policymakers, and retirement advocates called Retirement USA has called for twelve principles of pension reform that will secure pensions. My proposal, Guaranteed Retirement Accounts (GRAs) meets all twelve criteria.[6]

Guaranteed Retirement Accounts eliminate all the risks associated with the "financialization"of pensions. 401(k) type plans create a direct link from people to financial markets By placing retirement savings in individual accounts sold by the banks and other for-profit financial institutions people face risks that could be avoided. They are: the risks that people will make poor investment choices; that markets will slump for substantial periods of time—for the ten years between May 2000—2010 the stock market (index Russell 3000) was negative .9 percent—; the accounts' high fees drain assets; that employees and employers will not save enough on a voluntary basis; that people will make the wrong decisions about how to spend the money at retirement; that inflation will erode assets, and, last that people may live longer than their money.

Without change, boomers will replace less income in retirement than their grandparents and parents did: Boston College's National Income Security Index, which forecasts the likelihood that retirees will have available 70 percent of their preretirement income—the minimum standard used for adequacy in retirement—shows that 45 percent of Americans about to retire would not reach that goal, whereas, in 1992, only 32 percent were at risk of not reaching that standard.[7]

Guaranteed Retirement Accounts will compete with 401(k)-type plans and IRAs and other employer plans. Every worker will need to demonstrate they are participating in a pension plan that meets federal standards (standards associated with the GRAs.) GRAs are a government/private sector partnership. Contributions in a GRA come from three parties: the employee, employer (each contribute at least 2.5 percent of pay each) and the government. The government provides a $600 tax credit each year (indexed for inflation) to defray the employee's contributions. An independent government agency collects all these contributions and pays a guaranteed rate of something close to the growth rate of GDP (long term rate of 3%), plus inflation rate. An independent agency would collect the contributions and an independent and government-appointed board of trustees will contract with professional investors to invest the funds in a prudent diversified portfolio, not unlike pension funds do now, for instance, like that for the Federal Reserve Bank employees. Only the U.S. government is large enough to be able to invest worldwide in a diversified fund that pays close to a 3 percent real return for the long term with minimal fees. In order to ensure the accumulations are used for retirement, the money is withdrawn only at retirement as an annuity. GRAs are a safe, low cost financial institution retirement savings. They are fashioned after plans that are available for federal employees including Congress, employees of large corporprations, and are very similar to the college professors plan, the Teacher's Insurance and Annuity Association (TIAA).

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The GRA is a one of four pension reform plans examined by the Government Accountability Office (GAO).[8] It has detractors; the subsidy of $600 per person, indexed to inflation, would be financed by ending the current practice of tax deductions. The deductions could be kept, but the proposal would not be revenue-neutral. There is concern that the GRA would give a larger share of income to the poor; the subsidy would pay for most of the contributions of the bottom 40 percent. Gene Sperling, Peter Orszag, and the Center for American Progress have advocated for a flat credit that is proportional to an employee's contributions, typically 20–30 percent of contributions.[9] Another concern with GRA is that it is a mandate and thus may undermine the existing employer-based system of retirement savings. This argument is easily dealt with because 64 million Americans have no plan. The GRA is a new government program that gives people choice in where to put their retirement money if they do not have a DB or Defined Contribution (DC) plan at work. This is a non-commercial alternative with stellar investment managers. The government must guarantee 3 percent real return (or the rate pegged to real growth in GDP) for the investments so it will invest in a diversified portfolio. If the federal government only invests GRA money in treasuries, it would not earn the growth rate of the economy.

Conclusion

Definancializing pensions will help the macro economy. Converting to guaranteed accounts from 401(k) plans would diminish financial anxiety, improve elders' states of mind, and perhaps modulate swings in consumer spending. Also, workers could retire with GRAs in a recession, while now, older workers are forced to compete with the young for scarce jobs.

Just as the last great Depression reordered the financial institutions that secured pensions, the 2009 financial crisis eroded the non-Social-Security layers of the pension system. Therefore, the crisis may provide the opportunity to create a supplement to Social Security. This new layer of pension income could come from an advanced-funded, professionally managed system—the Guaranteed Retirement Accounts.

Notes

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