SCHWARTZ CENTER FOR
ECONOMIC POLICY ANALYSIS
THE NEW SCHOOL

A Safe and Secure Retirement for All Americans
Pension Reform in the United States

Why We Need Pension Reform

American workers face a retirement crisis. The extreme fragility of financial markets reveals that asset-based sources for retirement income are increasingly unstable and unsuitable for basic retirement needs. People increasingly have to withdraw money from their individual retirement accounts to meet immediate needs. And many older people have had to postpone retirement or look for work at a time when unemployment is rising and wages are stagnating.

Good pensions require effective pension institutions. The role of these institutions is to allow people to accumulate assets and invest them efficiently, including avoiding excessive fees. Pension savings need to be distributed to guarantee individuals a decent standard of living for the rest of their lives.

Over half of the American workforce does not have a pension. Yet the government spends hundreds of billions of dollars through tax breaks in an effort to expand pension coverage and security.

Reform is needed.

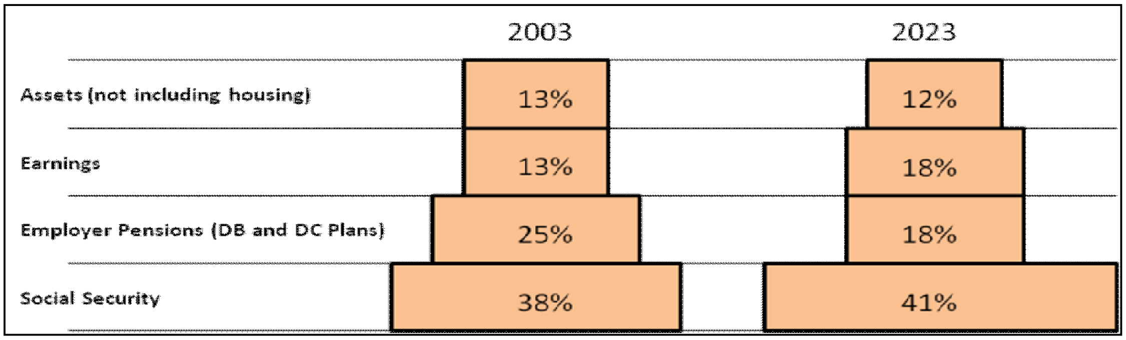
The following four principles, synthesized from *Retirement USA's Twelve Principles for a New Retirement System*[1], provide a roadmap to assess effective pension reform plans.

The *Beyond 401(k) Project* at The New School's Schwartz Center for Economic Policy Analysis (SCEPA), sponsored by the Rockefeller Foundation and in collaboration with Demos and the Economic Policy Institute, has developed a plan to guarantee safe and secure retirement income for all Americans. This plan, known as Guaranteed Retirement Accounts (GRAs), meets the five overarching principles necessary for adequate pension reform.

In a GRA system, workers and their employers would each contribute 2.5% of pay, and the government would provide an annual $600 (indexed for inflation) to offset worker contributions. These contributions would be professionally invested in financial markets, but earn a rate of return guaranteed by the government. At all times, workers would be able to track the dollar value of their accumulations. When individuals are eligible to collect Social Security, the value of their GRA assets would be distributed back in the form of an annuitized pension.

Principle 1: All American workers must accumulate enough income to guarantee a decent retirement.

Retirees are increasingly relying on income and Social Security to meet their needs, while their asset and pension wealth contracts[2]. This means seniors continue working in old age, and work for the elderly is increasingly scarce during trying times.



For this reason, any retirement proposal must provide universal coverage.

Retirement experts estimate retirees need 70% of their pre-retirement income to maintain a decent standard of living, depending on the individual's household unit, income history and gender. This minimum includes all retirement income sources, such as Social Security benefits.

Low levels of financial literacy and savings make this target a hit-and-miss for many Americans[3]. GRAs would help American workers shore up savings to meet basic retirement needs. The plan would provide a yearly payout to the individual, adjusted for inflation and based on the accrued mandatory contributions paid by both worker and employer.

Principle 2: Government, employers and employees must share the responsibility of paying for retirement, and, beyond a certain threshold, allow workers to contribute as much as they deem necessary.

Retirement is an individual decision as well as a social good. In fact, 62% of Americans say that having a secure retirement is an integral part of the American dream[4]. No society can afford to have large swaths of its elderly populations marred in poverty and destitution.

Social Security has been successful in fulfilling its mandate to keep American families out of poverty. According to the Center on Budget and Policy Priorities,[5] 19.8 million Americans would be poor without Social Security. In addition to helping adults over 65, the program also keeps 1.1 million children out of poverty.

Social Security represents the social contract between the government and the people. As such, it should be strengthened to meet these demands and responsibilities. Social Security must remain a social insurance program that is adequately and fairly funded to provide a minimum floor of protection from poverty.

But Social Security needs help. The average retiree receives about 37% of his or her pre-retirement income through Social Security, but this number is likely to decline in the future[6]. As mentioned earlier, even this amount is inadequate, providing only half the replacement income a typical beneficiary needs. Given these circumstances, it will become harder for people to remain middle-class in old age. Instead, they will be forced to delay retirement or face poverty.

Moreover, 20% of workers have employer-provided pension plans known as defined-benefit (DB) plans. DB plans serve to close the gap between Social Security and the total a retiree needs to live. By providing a guaranteed income, these plans are far superior to 401(k) plans. Unfortunately, despite five years of record corporate profits, too many pension plans in the private sector are under-funded. Many have been eliminated entirely. The federal government needs to hold corporations accountable for the promises made to workers.

For this reason, government, employers and employees must share the responsibility to pay for a safe and secure retirement. Beyond a certain threshold -enough to maintain the living standards they have worked so hard to attain- workers should be allowed to contribute as much as they deem fit to allow for retirement.

GRAs fulfill these requirements, with 5% of pay split evenly between workers and employers and the government providing a $600 tax credit adjusted for inflation.

Principle 3: Payouts should occur only at retirement and must cover the recipient's retired life, with portable benefits between jobs.

In hard times, people are tempted to erode their nest egg. Indeed, Fidelity Investments[7] recognized that during the Great Recession, hardship withdrawals from 401(k)s reached a ten-year high. Additionally, when workers are fired or leave a job, they cash out their pensions automatically instead of transferring their accrued savings elsewhere. These leakages make retirement incomes substantially smaller.

GRA funds cannot be withdrawn before retirement, minimizing leakages for retirees. They would also be fully portable between jobs. This will not increase administration costs, as contributions would be exacted by a payroll contribution from the employee's check similar to FICA taxes paid to Social Security and Medicare. These automatic payroll deductions will ensure efficient and consistent payments in the system's accounts.

Principle 4: Assets must be pooled under effective, efficient and transparent regulatory oversight and administration.

Private investment companies charge dearly to administer individual accounts. In 1997, the Advisory Council on Social Security[8] estimated that costs for individually managed plans –which permit people to invest freely in stocks, bonds, or mutual funds, and other investment vehicles offered by other insurance or brokerage companies- would average 1% per year or an accrued 20% total cost when assets are redeemed at retirement. In stark contrast, Social Security administrative costs charged as a percentage of total expenditures averaged only about 0.7% of benefit payments[9].

Using Social Security as a management template, assets in a GRA would be pooled under effective, efficient and transparent regulatory oversight. A professional board would invest the money in private markets managed by a Guaranteed Retirement Fund (very similar to the TIAA-CREF, the pension fund for university professors).

A public option for retirement is critical for controlling costs. Allowing prospective retirees the choice of a public retirement plan will serve to keep private plans honest. This will harbor competitive pressures into private plans to lower administration costs and loading charges. As a result, competitors will have to figure out how to lower costs and increase efficiency.

Principle 5: Government subsidies for retirement must be effective and targeted.

The current system is broken. Six percent of all taxpayers receive half of all subsidies[10]. Even more disturbing, 401(k) tax subsidies exceed savings in these programs. As tax subsidies to 401(k) retirement plans increased 28% from 2005 to 2009, contributions went up a meager 9% for the same period[11].

In addition to depressed asset values during times of economic distress and the possibility of higher administration fees, 401(k)s are not the best investment vehicle to provide retirement income for working and middle-class Americans.

Under a GRA system, a $600 refundable tax credit will be given to all workers, regardless of income. These credits would replace the costly 401(k) tax breaks which overwhelmingly accrue to high-income households and the financial industry.

A Safe and Secure Retirement for All

Privately-run, individually-directed voluntary accounts supported by tax deductions do not work. Expensive to maintain, these are subject to financial risks and leakages, and provide meager incentives to save at a huge loss to the taxpayer. In the end, 401(k) plans make it difficult for America's working and middle-class families to save enough for a safe and secure retirement.

All workers without a guaranteed pension need to close the gap between how much a retiree needs to live and the amount Social Security provides. Retirement plans should be portable and funded by stable employer contributions to ensure workers accumulate the benefits needed without creating uncertainty for employers. Investments should be pooled to reduce the costs of professional management, and workers should have a voice in plan governance to ensure accountability.

Characteristics of a Good Pension System	401(k)'s	Obama's Auto IRA	GRA's
Universal coverage	No	Almost	Yes
Portable	Yes	Yes	Yes
Pooled assets, efficiently administered	No	No	Yes
Shared responsibility	No	No	Yes
Adequate pensions	No	No	Yes
Targeted government aid	No	Almost	Yes
Annuities	No	No	Yes
Payout at retirement	No	No	Yes

In this sense, GRA's can provide a series of benefits for retirees. Creation of such a system would guarantee retirees a safe and secure retirement to preserve their quality of life in old age. GRAs combine the versatility of individual, defined contribution plans with the security of defined benefit programs to ensure better retirement prospects to all American families.

Retirement insecurity hurts business plans, worker's lives and retiree well-being. It is the next immediate social and economic problem requiring a solution.

Guaranteed Retirement Accounts, as mandatory add-on accounts to Social Security, will cover 63 million workers without pensions. It will also boost savings rates, increase investment, stabilize labor force participation among older workers and increase efficiency and security in investment returns. Individually directed accounts like 401(k) plans have failed the American worker; professionally-managed GRA accounts with guaranteed returns will get the most out of every dollar to help American families achieve a safe and secure retirement.

Notes

1 Retirement USA, Principles for a New Retirement System" http://www.retirement-usa.org/the-principles/

2 Butrica, Barbara; Iams, Howard & Smith, Karen (2003/2004) "The Changing Impact of Social Security on Retirement Income in the United States" Social Security Bulletin. Washington: Vol. 65, Iss. 3; p. 1-13.

3 Lake Research Partners (2009) Survey Memorandum. http://www.changetowin.org/fileadmin/pdf/american-dream-jun-2009/pubmemo_CTW_AmericanDream_f_060109.pdf

4 MetLife & Mature Market Institute (2003) "The MetLife Retirement Income IQ Test: Findings from the 2003 Survey of American Pre-Retirees" http://www.instituteforpr.org/files/uploads/MetLife_IQTest.pdf

5 Van de Water, Paul & Sherman, Arloc (2010) "Social Security Keeps 20 Million Americans Out Of Poverty: A State-by-State Analysis". Center for Budget and Policy Priorities: http://www.cbpp.org/files/8-11-10socsec.pdf

6 Government Accountability Office (2009) "Private Pensions: Alternative Approaches Could Address Retirement Risks Faced by Workers but Pose Trade-offs" http://www.gao.gov/new.items/d09642.pdf

7 Fidelity Investments (2010) "Fidelity's 401(K) Data Show Steady Savings Pattern By Majority, But Loans and Hardship Withdrawals on The Rise". News Release Archive: http://www.fidelity.com/inside-fidelity/employer-services/fidelity-q2-401k-data

8 Report of the 1994-1996 Advisory Council on Social Security (1997) "Appendix II: Financial Data on the Plans" http://www.ssa.gov/history/reports/adcouncil/report/append2.htm

9 Social Security and Medicare Boards of Trustees (2010) "Executive Summary: Status of the Social Security and Medicare Programs" http://www.ssa.gov/OACT/TRSUM/index.html

10 Toder, Eric; Harris, Benjamin & Lim, Katherine (2009) "Distributional Effects of Tax Expenditures" Schwartz Center for Economic Policy Analysis & The Tax Policy Center: http://www.newschool.edu/scepa/publications/Distributional%20effects%20of%20tax%20expenditures%20final.pdf

11 Ghilarducci, Teresa & Arias, Daniela (2009) "The High Cost of Nudge Economics and the Efficiency of Mandatory Retirement Accounts" Schwartz Center for Economic Policy Analysis Project Paper: http://www.newschool.edu/scepa/Making_Retirement_Work/Papers/The%20High%20Cost%20of%20Nudge%20Final.pdf

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