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A UNIVERSAL RETIREMENT PLAN CAN REDUCE INEQUALITY AND PREVENT DOWNWARD MOBILITY IN RETIREMENT

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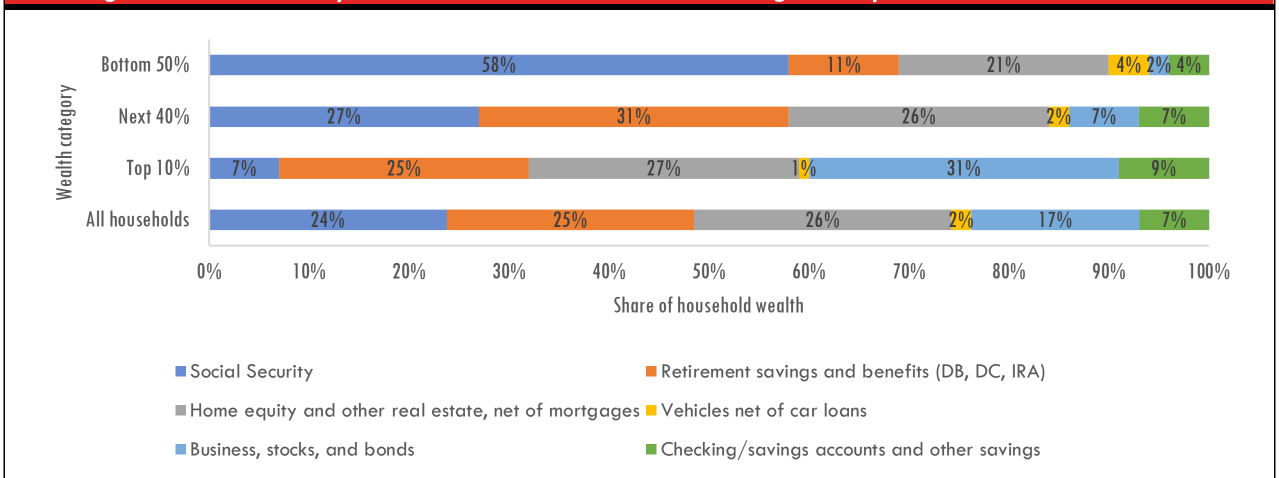
Elevator Pitch: Up to 40 percent of middle-income workers are at risk of downward mobility into poverty or near-poverty in retirement because of an inefficient retirement system that disproportionately benefits those with high incomes. Universal retirement accounts and providing workers with more equitable and better targeted tax incentives are among the best methods to supplement Social Security and prevent downward mobility in retirement.

As we write this in December 2022, Congress is deliberating various pieces of bipartisan legislation aimed at addressing the retirement crisis. The SECURE 2.0 act of 2022 and the Retirement Savings for Americans Act[1] are two of these initiatives. SECURE 2.0 is aimed at making saving for retirement more affordable and expanding access to retirement plans, two valuable goals that are unlikely to be achieved as construed in the bill. While the bill would help improve the retirement system, it will not address the fundamental inadequacies imbedded in it.

Other attempts such as the recent Retirement Savings for Americans Act would address the lack of access and savings incentives that fuel the retirement crisis by establishing a savings program for workers who do not have access to one and would support saving by providing matching contributions for low- and middle-income workers.

The retirement crisis is a real and growing threat. Social Security, retirement savings, and other private retirement assets represent the largest components of household wealth[2] and are among the most unequally distributed forms of wealth among households in the bottom 90 percent of wealth distribution (Figure 1).[3] Social Security plays a major role in reducing inequality in

Figure 1: Social Security and other retirement assets are the largest components of household wealth



Source: SCEPA calculation using the Health and Retirement Study 2016 wave.
Notes: Stock and bond categories represent direct ownership (i.e., outside of 401(k)-type plans). Amounts for defined benefit plans and Social Security benefits reflect the present value of expected benefits in retirement assuming retirement and claiming at Full Retirement Age. Values for real estate reflect net equity (value of home minus mortgage debt).

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retirement wealth and wealth in general. However, wealth inequality, driven by a lack of private savings, leaves many retirees unable to maintain their pre-retirement income, putting them at risk of a sharp decline in their living standards as they age.

As we estimate in this report, due to the systemic flaws of our retirement system, between 2019 and 2045 the number of poor or near-poor people over the age of 62 will increase by 22.3 percent, rising from 18 million to 21.3 million.

Serious legislative proposals to address this crisis should aim to fix the massive inefficiencies, inequities, and inadequacies embedded in our current retirement system.

Universal access to retirement savings may be one of the best complements for a reinforced Social Security system to supplement retirement income and ease the retirement crisis. Even under conservative assumptions, we find that universal access to retirement savings could reduce elder poverty by 26 percent by 2045 while reducing wealth inequality, which reflects the plight of low to moderate earners in contrast to the outsize accumulations of the wealthy few.

A broken system creates inequality and poverty in retirement

We pinpoint the lack of workplace retirement plan coverage as the main cause of inadequate and massively unequal retirement wealth.[4] Employers are not obligated to sponsor or contribute to their employees' retirement plans, which means most workers do not accumulate retirement savings. Worse, this voluntary system punishes employers who want to do the right thing by putting them at a disadvantage against those who choose not to support their employees. The current system also hurts self-employed workers and those with longer spells of not working in the formal economy, like people providing unpaid family care or those who are in gig employment.

Even the fortunate worker who is offered a commercial, self-directed, voluntary plan at work faces barriers likely to leave them with inadequate retirement savings. For workers who are eligible to contribute to an employer-provided plan, participation is voluntary. Many contribute sporadically, if at all, and many withdraw funds before retirement, eroding their future retirement security for short-term needs. Workers in 401(k)-type plans face higher fees, less access to diversified assets, and have suboptimal portfolio diversity compared with those in plans that are managed professionally; unlike workers with pension funds, workers in 401(k)-type plans do not have the bargaining power to negotiate with plan providers.

As a result of this flawed system, the typical older worker in the bottom 50 percent of the income distribution (earning less than $40,000 a year) has nothing saved for retirement. Median savings of workers in the middle 40 percent (earning between $40,000 and $115,000 a year) are only $60,000. Among workers in the top 10 percent of the income distribution (above $115,000 a year), the median amount saved is more than three times higher at $200,000 (See Table 1). Yet, such levels of savings, even when combined with Social Security benefits, are not sufficient for many workers to maintain their pre-retirement standard of living. Workers across the income distribution thus face an unacceptably high risk of not only downward mobility in retirement, but also poverty. Public policies must address this.

Table 1: Median defined contribution (DC) account balances (including IRAs) by income and plan type, workers aged 55-64

Income group (annual income)	No plan	DC or IRA only	DC or IRA, w/ DB	All with DC	All
Bottom 50% (< $40,000)	$0	$32,000	$60,000	$35,000	$0
Middle 40%	$0	$100,000	$150,000	$109,000	$60,000
Top 10% (> $115,000)	$0	$230,000	$315,000	$250,000	$200,000
All older workers	$0	$80,000	$150,000	$92,000	$15,000

Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data.
Notes: Account balances rounded to the nearest $1,000.

Universal access to retirement plans is a policy solution to help reduce the risk of poverty in retirement

If workers were able to save for retirement consistently throughout their careers, they would have more to supplement Social Security in retirement. They would also be able to use these savings to avoid claiming Social Security benefits before the full retirement age, avoiding a permanent reduction in monthly benefits. Social Security significantly reduces retirement wealth inequality and helps lift seniors out of poverty, but it does not replace enough pre-retirement income to suffice on its own. What's more, workers who claim Social Security benefits early, perhaps to supplement low wages, suffer from penalties that increase their risk of poverty when they eventually stop working. Using accumulated retirement savings, no matter how small they are, to postpone claiming Social Security would increase retirees' income throughout their lives and lower their risk of poverty.

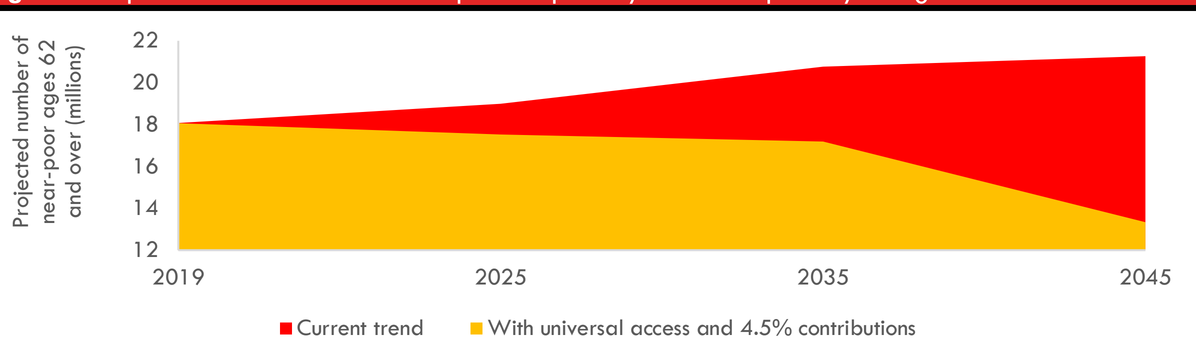
Using conservative assumptions (see below) we found that if all workers had access to a workplace retirement plan in 2019[5], 1.5 million seniors would have been diverted from poverty or near poverty by 2025 (Figure 2). By 2035, the number of seniors avoiding poverty would increase to 3.6 million. And by 2045, a universal pension system would have helped 7.9 million of these seniors avoid poverty in old age, a decrease of more than 26 percent. If we do nothing, we predict that over 12.3 million seniors will be poor in 2045 (see the technical appendix for more details about methodology).

We base our model on several assumptions about the features of a universal retirement plan: universal access, better targeted tax expenditures, and the option to use retirement savings to postpone claiming Social Security benefits. Based on these assumptions, in our simulation, we find: 1) workers who did not have access to a workplace retirement plan would contribute 3 percent of their pay to a universal retirement account; 2) to match those contributions, workers would receive a government match equal to 1.5 percent of their pay in the form of a refundable tax credit; and 3) the plan would provide workers with the option to either annuitize their savings at low cost or use their savings to postpone claiming Social Security and thus benefit from Delayed Retirement Credits (DRC).

We simulated the effect of the universal retirement plan with a consistent rate of return which is typical in a professionally managed account. Pooled investments in these accounts also help lower fees and improve portfolios (see the technical appendix for more information on annuitization and rate of return assumptions).

Reforming the retirement system will require other important elements. A good universal plan would ensure continuous access to retirement plans for all workers throughout their careers; make retirement plans easily portable; and help all workers who change jobs by eliminating the complications and costs associated with rolling over one account to another. These features also address a less visible

Figure 2. Impact of universal retirement plan on poverty and near-poverty at ages 62 and over



Note: Near-poverty is defined as having income lower than 200% of the Federal Poverty Level (FPL).

hindrance to saving, which is the lack of eligibility to participate in workplace retirement plans based on job tenure. Many employers require a probationary period — most commonly a year — before employees become eligible to participate in their retirement plans, which especially hurts employees in high-turnover industries.

Policy Recommendations

Establish a Universal Retirement Plan

To close the gap in access to retirement plans, we need a universal retirement plan similar to various plans that have been proposed. Examples include Guaranteed Retirement Accounts (GRAs)[6,7], the plan explained in a joint paper by Kevin Hassett and Teresa Ghilarducci[8]; Senator Marco Rubio's plan to open the federal Thrift Savings Plan to those without access[9]; the Dignity and Security in Retirement plan proposed by Pete Buttigieg's presidential campaign[10]; or the Retirement Savings for Americans Act proposed by Senators John Hickenlooper and Thom Tillis and Representatives Terri Sewell and Lloyd Smucker. While some of these plans may suffer from serious shortcomings, they all have the basic and vital feature of expanding access to retirement accounts.

Make Retirement Tax Expenditures More Equitable

The current structure of federal retirement tax benefits (which also affects state-level retirement tax benefits[11]) heavily favors those who have access to retirement accounts, those who can afford to save more, and who have higher marginal tax rates. These benefits provide little to no incentives for those who do not have access to retirement plans. people with low earnings and low tax rates, and those who may face severe budget constraints that prevent them from saving for retirement. Reforming retirement tax expenditures and making a Saver's Credit refundable would not only make retirement tax benefits more equitable but would also make them more effective and efficient.

Protect Retirement Savings

Early withdrawals from retirement accounts undermine workers' retirement security. Retirement funds must be protected from the urgency of short-term spending needs, whether withdrawals are due to a lack of emergency savings or for everyday consumption. Without safeguards, savings will either be significantly reduced or even drained before an individual reaches retirement, leaving them vulnerable to deprivation in old age despite their best efforts to save. This is especially true for those with lower incomes who are more likely to need the immediate cash and less likely to have the future disposable income to make up for the lost savings.

Retirement savings should also be protected by exempting them from asset tests that determine an individual's eligibility for public assistance benefits. Several public assistance programs have limits on the assets that can be held in savings accounts and most retirement accounts while remaining eligible for the program, which can discourage saving and has fueled a racial wealth gap. To support continued contributions to retirement accounts and not undermine the goal of these assistance programs, funds held in retirement accounts should not be taken into consideration when determining eligibility for these programs.

Strengthen and Expand Social Security

Any reforms in the retirement system should include strengthening and expanding Social Security as the bedrock of the American retirement system. All workers, regardless of their income level, rely on Social Security as a source of secure annuitized income in retirement. Social Security retirement and disability insurance ensure that workers will have a secure stream of income that keeps them out of poverty, no matter what happens to them. While the progressive design of Social Security keeps many low earners out of poverty at older ages, higher earners with longer life expectancies benefit from the efficient and affordable longevity insurance provided by Social Security.[12] Universal retirement plans and private savings would complement Social Security benefits and help workers maintain their standards of living in retirement.

Technical Appendix

Both retirement savings and employment of older workers were heavily affected by the Covid-19 pandemic and recession, as well as by various government programs implemented to counter these economic shocks and protect households. To avoid complications caused by the pandemic and emergency programs in the simulation, we use pre-pandemic data from 2019 and estimate the effects of universal retirement accounts using general assumptions applicable for typical years.

Projecting the impact of a Universal Retirement Plan on the number and share of near-poor ages 62+

The U.S. Census Bureau projects the size of the population for every age for the years 2025, 2035, and 2045. Separately, the Urban Institute, using the Dynamic Simulation of Income Model (DYNASIM) projects the near-poverty rate for people ages 62+ for these years in the future. We project the number of near-poor elders under current law by multiplying the Census Bureau projected population of each age group by the DYNASIM-projected near-poverty rates.

Next, we project near-poverty rates with a universal retirement plan implemented. That projection is done in four steps:

1. Using the March 2019 Current Population Survey (CPS), we calculate a base case, which is the poverty rate among people ages 62+ in 2025. We calculate the poverty rate by reweighting the 2019 sample based on projected changes in the age distribution of the elderly. We use the same procedure for the years 2035 and 2045.
2. For respondents who will be over 62 in 2025, we estimate an age earnings profile, assuming that their age-earnings profiles (average earnings by age) mirror those of Social Security Administration (SSA) scaled earners. The use of age-earnings profiles is important because average earnings decline at older ages. If we assumed continued growth in wages until people retired, we would overestimate earnings at older ages, and therefore overestimate contributions and account balances.
3. We assume that people who are younger than 65 in 2019 will contribute to the universal retirement plan until their retirement at age 65. For example, someone who is 60 in 2019 would contribute from 2019 to 2023, when they attained age 65 and were assumed to retire and claim Social Security and benefits (see below on projection of Social Security and benefits).
4. We add income from the new retirement savings to individuals' existing income and calculate the overall percentage reduction in poverty or near-poverty, then apply this percentage reduction to the DYNASIM-projected near-poverty rates. For example, if we find the poverty rate in the CPS would be reduced by 20% (e.g., from 10% to 8%), we apply the same reduction to the DYNASIM-projected rate. The CPS and DYNASIM-projected rates are close but differ because the latter incorporates economy-wide income growth.

Mortality and investment return assumptions

We assume retirement savings are converted into an inflation-adjusted single life annuity at a price that is actuarially fair to members of the 1943 birth cohort, assuming a 2.7% real rate of interest.

This assumed real rate is higher than the Treasury Inflation Protected Securities (TIPS) rate in March 2019, but it is appropriate because it is the long-term real interest rate assumed by the Social Security Trustees in 2019. The resulting annuity rate of 7.5% is two-thirds higher than spring 2019 rates in the individual annuity market, because insurers suffer from adverse selection and need to cover their cost of capital, including reserves for aggregate mortality risk (the risk that average annuitant mortality is lower than predicted).

A universal retirement plan would largely eliminate the cost drivers mentioned above by allowing partial self-annuitization and discouraging lump-sum withdrawals; although we recognize that some residual adverse selection may result from positive correlation between wages and contributions on one hand and socioeconomic status and mortality on the other hand. However, since the universal accounts are available only to those without employer-sponsored plans, high earners are not likely to have large amounts of savings in these accounts.

Alternatively, a plan could facilitate using retirement savings to postpone claiming Social Security, providing another form of annuitization at low cost which is especially helpful for low earners with relatively small savings. We assume that since Delayed Retirement Credits are actuarily fair, the lifetime income resulted from using this option will not be significantly different from annuitization at our assumed rate.

Our base case scenario assumes a 4.5% real return during the accumulation phase, consistent with a 40:40:20 split between stocks, bonds, and alternatives, with stocks returning 5.5%, bonds 2.25%, and alternatives 7.0%. Our analysis of 2015 Ibbotson data shows that over the period 1926-2012, the real geometric mean returns on large capitalization stocks and long-term corporate bonds averaged 6.8% and 3.6% respectively. Real returns on both stocks and bonds will likely be lower in the future[13], with the March 2019 forward PE ratio on the S&P 500 implying real stock returns of 6.3%. We assume the savings in the universal accounts will earn an illiquidity premium of 1.5% on the share of assets in alternative investments. We recognize that the illiquidity premium is imprecisely estimated, may vary across alternative asset classes, and may in part be a reward for bearing additional risk. However, our results are relatively insensitive to alternative estimates of the magnitude of the presumed illiquidity premium. Our conservative scenario assumes a 3% return, reflecting low current yields on Treasury Inflation Protected Securities and a high current cyclically adjusted price earnings ratio (Appendix Table 1).

Appendix Table 1: Effect of implementation on people ages 62+ living below 200% FPL, assuming 3% real return on investments

Year		2019	2025	2035	2045
Projected population		66,411,049	77,882,591	89,546,340	95,364,484
Current system	Near-poverty rate	27.2%	24.4%	23.2%	22.3%
	Near-poor people	18,063,805	19,003,352	20,774,751	21,266,280
	Increase in near-poverty	NA	5.2%	15.0%	17.7%
Reform	Near-poverty rate	27.2%	22.9%	19.7%	15.5%
	Near-poor people	18,063,805	17,835,113	17,640,629	14,781,495
	Increase in near-poverty	NA	-1.3%	-2.3%	-18.2%
Difference	Near-poverty rate	0.0%	-1.5%	-3.5%	-6.8%
	Near-poor people	NA	(1,168,239)	(3,134,122)	(6,484,785)

Endnotes

[1] https://www.hickenlooper.senate.gov/press_releases/hickenlooper-tillis-sewell-smucker-introduce-bill-to-expand-retirement-savings-for-working-americans/

[2] To calculate Social Security wealth, we impute a career earnings trajectory for each worker using two factors: (1) current earnings in the survey year (2016); and (2) scale factors from a Social Security Administration Actuarial Note published by Clingman and Burkhalter (2016). This career earnings trajectory is then used to calculate AIME and PIA, giving us the Social Security Retired Worker benefit. We assume all workers claim the Retired Worker benefit. We assume a worker collects benefits for 13 years, and we therefore multiply annual benefits by 13—the actuarial factor (Carlson 2020) —giving us an estimate for Social Security wealth.

[3] If we include the top 10% of the wealth distribution, other financial assets and business ownership would be the most unequal component.

[4] Ghilarducci, Teresa, Siavash Radpour, and Anthony Webb. 2020. "Retirement Plan Wealth Inequality: Measurement and Trends." *Journal of Pension Economics and Finance*. Cambridge University Press, 1–21. doi:10.1017/S1474747220000074.

[5] Both retirement savings and employment of older workers were heavily affected by the Covid-19 pandemic and recession, as well as by various government programs implemented to counter these economic shocks and protect households. To avoid complications caused by the pandemic and emergency programs in the simulation, we use pre-pandemic data from 2019 and estimate the effects of universal retirement accounts using general assumptions applicable for typical years.

[6] Economic Policy Institute, American Federation of Teachers, and Schwartz Center for Economic Policy Analysis. 2019. "Breathe Easy—How Guaranteed Retirement Accounts could change your life." https://www.economicpolicyresearch.org/retirement-tools/a-primer-ongras-and-how-they-work.

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[8] Ghilarducci, Teresa, and Kevin A. Hassett. 2021. "What If Low-Income American Workers Had Access to Wealth-Building Vehicles Like the Federal Employees' Thrift Savings Plan?" White Paper. Washington, DC: Economic Innovation Group. https://eig.org/wp-content/uploads/2021/03/Hassett-Ghilarducci-White-Paper-IWBI.pdf.

[9] Senator Marco Rubio. May 13, 2014. "Fact Sheet: Reforms To Ensure A Secure Retirement For 21st Century Seniors." https://www.rubio.senate.gov/public/index.cfm/2014/5/fact-sheet-reforms-to-ensure-a-secure-retirement-for-21st-century-seniors

[10] Abrams, Abigail. November 25, 2019. "Pete Buttigieg Releases His Plan for Securing Long-Term Care." Time.com. https://time.com/5738121/pete-buttigieg-long-term-care-retirement/.

[11] Ghilarducci, Teresa, Fisher, Bridget, Cid-Martinez, Ismail. (2015) "Retirement Savings Tax Expenditures: The Need for Refundable Tax Credits." Schwartz Center for Economic Policy Analysis and Department of Economics, The New School for Social Research, Policy Note Series.

[12] Radpour, Siavash, Ghilarducci, Teresa, and Webb, Anthony. (2020). "Expanding Social Security Benefits All Workers." Schwartz Center for Economic Policy Analysis and Department of Economics, The New School for Social Research, Policy Note Series.

[13] Diamond, P. A. (2000). "What stock market returns to expect for the future." Soc. Sec. Bull., 63, 38.