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SCHWARTZ CENTER FOR ECONOMIC POLICY ANALYSIS

POLICY NOTE

INADEQUATE RETIREMENT SAVINGS FOR WORKERS NEARING RETIREMENT

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ELEVATOR PITCH

Without a universal supplement to Social Security, many of the 24 million workers ages 55-64 will face declining living standards or poverty in just 10 years. One-third of older workers have neither retirement savings through a 401(k) or IRA, or a defined benefit (DB) pension. Overall, the median account balance of workers approaching retirement is just $15,000. The median account balance for those with retirement savings is just $92,000.

KEY FINDINGS

- 35% of all workers ages 55-64 have neither retirement savings in defined contribution (DC) or IRA accounts or defined benefit (DB) pension coverage from a current or past job.
- Because a third of older workers have no retirement savings, the median account balance of workers approaching retirement is just $15,000.
- 50% of low-income older workers (earning less than $40,000 annually), 20% of the middle class (between $40,000 and $115,000), and 15% of high-income workers ($115,000 plus) have neither retirement savings or a DB pension.

MEDIAN DEFINED CONTRIBUTION AND IRA ACCOUNT BALANCES OF WORKERS AGES 55-64

Older Workers	Median Account Balances, DC Plans and IRAs
All workers ages 55-64 (35% have neither retirement savings nor DB coverage)	$15,000
Workers ages 55-64 who have any retirement savings	$92,000

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

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- The median account balance of those with retirement savings is $92,000. Among account holders in the top 10% of earners, the median balance is just $250,000.
- Income from retirement savings will replace a median 14% of pre-retirement income of workers with accounts, which is insufficient to maintain pre-retirement living standards. The small minority that also has DB pension coverage is better prepared with a median 20% replacement rate from their retirement savings, plus DB income.

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MEASURING RETIREMENT SAVINGS

This policy brief analyzes the distribution and inadequacy of retirement wealth among workers nearing retirement. We report the share with retirement accounts, and median retirement savings and replacement rates by income (the bottom 50 percent of older earners making $40,000/year or less, the middle 40 percent making between $40,000 and $115,000, and those in the top 10 percent earning over $115,000).[1]

We classify workers as having a retirement plan if they report having retirement savings in an IRA or defined contribution (DC) account such as a 401(k), 403(b), or equivalent, or report DB pension coverage from a current or past job.[2] A worker's retirement savings is the sum of his or her IRA and DC account balances. We report medians rather than averages because averages are skewed by a small number of workers with very large balances (see Appendix for means).

Most of the wealth accumulated in DC plans is held in IRA accounts. While workers can make direct contributions to IRAs (and the self-employed can contribute to SEP-IRAs), the majority of savings held in IRA accounts have been rolled over from employer-sponsored 401(k) accounts following a job change. We therefore include IRA balances in our DC totals.

While previous studies use data from the 2013 Survey of Consumer Finances (SCF), this brief uses data from the recently released 2014 Survey of Income and Program Participation (SIPP). The SIPP's larger sample size compared to the SCF (5,621 vs. 522 workers ages 55-64) allows for cross tabulation by income and plan ownership that the SCF sample size does not permit.[3] The two studies yield similar estimates of aggregate DC and IRA wealth for workers ages 55-64: $2.405 trillion for the SIPP and $2.513 trillion for the SCF.

Although poverty is measured at the household level, this analysis is conducted at the individual level since retirement accounts are owned and controlled by individuals rather than households. This brief shows that most older workers do not have adequate savings for themselves, much less enough to share with a partner (see Appendix for household-level statistics).

MOST WORKERS EARNING INCOMES BELOW THE MEDIAN DO NOT HAVE RETIREMENT SAVINGS

Half of near-retirees earning below the median income of $40,000 have no pension plan – they have neither retirement savings nor a DB pension. Just 41 percent report having only a DC account or IRA, 4 percent only a DB pension, and 5 percent both. Smaller shares of earners in the middle 40 percent and the top 10 percent (earning over $115,000 per year) lack any pension plan (20 and 15 percent respectively). Most workers earning above the median of $40,000 a year have only a DC account or IRA, while a smaller group reports having a DB pension as well (see Table 1). Plan ownership rates are almost identical for men and women (see Appendix for rates by gender).

WORKERS AT ALL INCOME LEVELS HAVE INADEQUATE RETIREMENT SAVINGS

More than half of workers earning below median income ($40,000) have no retirement savings. Median retirement savings for this income group is zero. Workers earning less than median income who own an IRA or DC plan, but with no DB entitlement, have a median account balance of $32,000, the middle 40 percent of earners have $100,000, and the top 10 percent have $230,000. The median retirement savings of workers earning less than $40,000 with any retirement savings amount to about a year's earnings.

TABLE 1: SHARE OF WORKERS WITH RETIREMENT PLANS BY INCOME AND PLAN TYPE, AGED 55-64

Income Group (Annual Income)	No Plan	DB Only	DC or IRA Only	DC or IRA, w/ DB
Bottom 50% (< $40,000)	50%	4%	41%	5%
Middle 40%	20%	5%	59%	16%
Top 10% (> $115,000)	15%	2%	63%	20%
All Older Workers	35%	4%	50%	11%

Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data

TABLE 2: MEDIAN DC PLAN 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.					

The small minority of workers with both retirement savings and a DB pension has somewhat more retirement savings than workers with only DC savings, regardless of income level (DB participants are often unionized and paid more than similar workers). Workers with DB and DC accounts for the three income groups have a median DC and IRA account balance of $60,000, $150,000, and $315,000 (see Table 2). Regardless of income level, workers with both a DB and DC plan are better positioned to maintain living standards in retirement, in part because they have larger account balances, but mainly because they can also look forward to income from their DB pension (the value of which is not calculated in this brief).

MOST WORKERS FACE DECLINING LIVING STANDARDS OR POVERTY IN RETIREMENT

This study determines the adequacy of retirement savings by comparing projected replacement rates (projected post-retirement income from retirement savings and Social Security divided by pre-retirement income) with targets that permit workers to maintain their standard of living in retirement.[4] We project income post-retirement from retirement savings with generous assumptions: (1) workers earn a 4.5 percent real return on investments (net of fees); (2) workers contribute 6 percent of pay to their 401(k) with an employer match of 3 percent; and (3) workers purchase an inflation-indexed annuity at age 65.[5] Income targets post-retirement are less than 100 percent of pre-retirement pay because retirees no longer pay Social Security taxes or need to save for retirement, often have lower taxes, and may face lower living expenses. Targets are typically lower for higher earners, because Social Security replaces less of their pre-retirement earnings.

The study assumes a replacement rate target of 85 percent for workers earning below $40,000, a 75 percent target for workers earning between $40,000 and $115,000, and a 65 percent target for workers earning more than $115,000.[6]

Assuming that Social Security will replace 43 percent of the pre-retirement income of workers earning less than median income, they would need to replace 42 percent of their earnings with income from retirement savings.[7] As the median retirement savings of this group is zero, their median replacement rate from retirement savings is zero percent. Without retirement savings, workers below median income will be almost entirely dependent on Social Security and will be at high risk of not only downward mobility in retirement, but also falling into poverty. The picture is not much different for the small minority that has retirement savings.

Bottom line: Retirement savings will replace 14 percent of pre-retirement income for workers with incomes below the median, leaving lower-income older workers 28 percentage points short. Likely to outlive their savings, these retirees are at a high risk of poverty.

For middle-income workers, Social Security replaces 29 percent of income, requiring they have enough retirement wealth to replace 46 percent of their pre-retirement income. However, the median replacement rate for middle-income older workers is 10 percent overall and 15 percent among those with retirement savings. Finally, Social Security replaces just 24 percent of income for those in the top 10 percent. These workers need a replacement rate of 41 percent from retirement savings, but the median replacement rate for this group is 11 percent overall and 12 percent among those with retirement savings (see Table 3). Thus, even the median high earner with retirement savings will face downward mobility in retirement.

TABLE 3: MEDIAN PROJECTED REPLACEMENT RATE FROM DC/IRA SAVINGS 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%	14%	24%	15%	0%
Middle 40%	0%	15%	20%	16%	10%
Top 10% (> $115,000)	0%	12%	20%	14%	11%
All Older Workers	0%	14%	20%	13%	4%
Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data					

SYSTEMIC ISSUES CAUSE DEFINED CONTRIBUTION SAVING PLANS TO FAIL

Social Security provides the largest share of retirement income for most retirees, and the progressivity of the benefit formula ensures that Social Security replacement rates (Social Security benefits as a percent of preretirement income) are largest for low- to moderate-income workers. But Social Security alone is insufficient to allow any but the lowest paid workers to maintain their pre-retirement standards of living. Further, due to rising Medicare premiums and an increase in Social Security's Full Retirement Age from 65 to 67 – the equivalent of a 13.3 percent cut in benefits – Social Security replacement rates will fall for everyone.

Employer-sponsored retirement plans are intended to bridge the gap between Social Security and targeted retirement income. Unfortunately, at any point in time, less than half of all private sector workers have a workplace retirement plan, a share that has declined over the last 30 years.[8] Many of those who move in and out of covered employment cash out their benefits on job-change or quit before their benefits vest.

401(k) plans became widespread in the 1980s, and for most workers in the private sector they replaced rather than supplemented DB plans. Only a small number of workers participate in both a DB pension and a DC plan, and they are the only group prepared for retirement regardless of income level.[9]

In theory, DC plans could enable participants to accumulate adequate wealth by the time they retire. But in practice, account balances fall short, reflecting spotty eligibility histories, non-participation, inadequate contributions and employer matches, pre-retirement withdrawals, high fees, and subpar investment returns. These faults are inherent to the DC system and cannot be fixed by regulation.

POLICY RECOMMENDATIONS

The combined effects of cuts to Social Security benefits and the consequences of a broken DC-centric savings system has created a retirement crisis. Few workers without workplace retirement plans save for retirement. Without significant reform to the retirement system, many workers who reach retirement age will be forced to choose between working longer and suffering severe drops in their living standards in retirement. The far-reaching effects of an increase in downward mobility and old-age poverty include pressure on the social safety net and economic stagnation due to weaker consumer spending. Working longer is not a solution. Many older workers cannot work longer due to physical or mental impairment, and those that are capable of working face a labor market unfriendly to older workers.

Rather than worsening the retirement crisis by cutting Social Security benefits, policymakers should both strengthen Social Security and expand retirement plan coverage. Guaranteed Retirement Accounts (GRAs) are individual accounts requiring employers and employees to contribute with a fair and effective refundable tax credit provided by the government. GRAs provide a safe, effective vehicle for workers to accumulate personal retirement savings over their working lives.[10]

ENDNOTES

1. The 50/40/10 split follows the framework of Piketty (2014).

2. The SIPP data do not permit estimation of expected DB benefits or their expected present value.

3. The 522 exclude the SCF high wealth supplement. Including the high-income supplement, the 50/40/10 split is 2,993, 2,106, and 522 in the SIPP, compared with 313, 301 and 307 in the SCF.

4. Our preference for current rather than lifetime earnings as a replacement rate denominator reflects the Social Security Administration (2015) Technical Panel endorsement of a comparison of retirement income to the average of a person's last five years' significant earnings. This study uses current earnings as a proxy for the five-year average because SIPP lacks a full salary history. Many of these issues are discussed in Goss, et al. (2014).

5. We assume August 2017 annuity rates. Although people rarely purchase an inflation-indexed annuity, it provides a higher income than commonly used drawdown strategies and is the only financial product that provides an inflation-indexed lifetime income. Thus, the assumption yields a conservative estimate of the share of households financially unprepared for retirement.

6. The recommendations of financial planners and academic studies of financial preparedness for retirement are typically based on simplified versions of what economists call the "life cycle model." This model of household consumption over the life course assumes people want to smooth the satisfaction they obtain from consumption. But households differ in their circumstances, preferences, and attitudes towards risk. The amount a household should save to finance future consumption depends on age, planned retirement age, feelings about downsizing, plans to substitute home production for purchases of goods and services, the extent to which work- and child-related expenses will decline after retirement, anticipated health care costs, and other factors. Households also face the risks of job loss and worse than expected investment returns and may desire additional reserves as a precaution. The financial planner or economist cannot observe many of these parameters and must also make simplifying assumptions. Even in a simplified model, different assumptions can yield widely different wealth targets (see Skinner 2007). Relative to earnings immediately prior to retirement, targets will also be lower for those whose earnings peak at older ages. While recognizing this is an uncertain and sometimes controversial issue, our assessment of the academic and practitioner literature leads us to conclude that plausible replacement rate targets for the bottom 50 percent, middle 40 percent, and top 10 percent are 85 percent, 75 percent, and 65 percent, respectively.

7. Our estimates of Social Security replacement rates use data from Clingman and Burkhalter (2016) and Clingman, Burkhalter, and Chaplain (2017). We interpolate their numbers to obtain estimates of replacement rates at the 25th, 70th, and 95th percentile of the earnings distribution, but do not adjust for lower labor force participation rates of low earners at older ages. We adjust the denominator to reflect the earnings at age 60 of those still in the labor force at that age.

8. Munnell and Bleckman (2014).

9. Having two types of plan may indicate that the worker desires to save for retirement more than others in like circumstances or DB and DC dual coverage may indicate that an employer competes on the basis of secure retirement plans – identifying the reasons is beyond the scope of this brief.

10. Ghilarducci and James (forthcoming).

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APPENDIX

APPENDIX TABLE 1: SHARE OF MALE WORKERS WITH RETIREMENT PLANS BY INCOME AND PLAN TYPE, AGED 55-64				
Annual Income (Income Group)	No Plan	DB Only	DC or IRA Only	DC or IRA, w/DB
< $40,000 (34% of men)	55%	3%	37%	5%
$40,000-$115,000 (46% of men)	23%	5%	56%	16%
> $115,000 (20% of men)	15%	3%	62%	20%
All Older Men	35%	4%	49%	12%
Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data				

APPENDIX TABLE 2: SHARE OF FEMALE WORKERS WITH RETIREMENT PLANS BY INCOME AND PLAN TYPE, AGED 55-64				
Annual Income (Income Group)	No Plan	DB Only	DC or IRA Only	DC or IRA, w/DB
< $40,000 (61% of women)	47%	4%	43%	6%
$40,000-$115,000 (35% of women)	17%	5%	62%	16%
> $115,000 (4% of women)	13%	4%	65%	18%
All Older Women	35%	4%	51%	10%
Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data				

APPENDIX TABLE 3: MEAN DC PLAN BALANCES (INCLUDING IRAS) OF WORKERS BY INCOME AND PLAN TYPE, 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)	$-	$71,000	$114,000	$76,000	$35,000
Middle 40%	$-	$159,000	$206,000	$169,000	$126,000
Top 10% (> $115,000)	$-	$335,000	$433,000	$359,000	$296,000
All Older Workers	$-	$146,000	$226,000	$161,000	$99,000
Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data					

APPENDIX TABLE 4: MEDIAN DC PLAN BALANCES (INCLUDING IRAS) MARRIED HOUSEHOLDS BY INCOME AND PLAN TYPE, AGED 55-64					
Income Group (Annual Income)	No Plan	DC or IRA Only	DC or IRA, w/DB	All with DC	All
Bottom 50% (< $78,000)	$-	$76,000	$180,000	$100,000	$15,000
Middle 40%	$-	$166,000	$200,000	$188,000	$130,000
Top 10% (> $193,000)	$-	$260,000	$567,000	$324,000	$250,000
All Older Households	$-	$140,000	$230,000	$168,000	$80,000
Source: Authors' calculations using 2014 Survey of Income and Program Participation (SIPP) data					

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