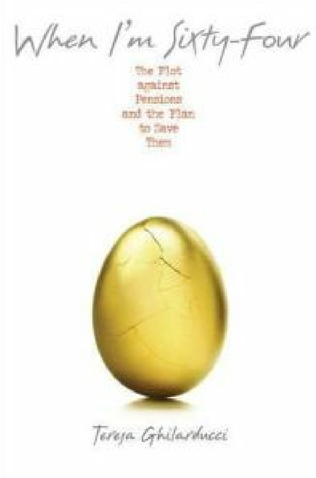

Book When I'm Sixty-Four

The Plot against Pensions and the Plan to Save Them

Teresa Ghilarducci
Princeton UP, 2008
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Recommendation

For many Americans, the dream of a safe, secure retirement has become a cruel joke. Elderly people without pensions find themselves trying to squeeze by on Social Security as they work part time for minimum wage serving hamburgers or greeting customers at discount stores. Some have money saved, but the overall U.S. savings rate is way down. For most workers, reliable pensions are becoming a thing of the past, just as costs are rising. Pension expert Teresa Ghilarducci explains that Social Security is under threat, even though many retirees have no other source of income. What is to be done? At this point, Ghilarducci stops analyzing and starts recommending. Americans need a bold, new government program offering “Guaranteed Retirement Accounts” (GRAs). She asserts that – given a burst of radical change – this idea can provide safe, secure incomes for U.S. elders. *BooksInShort* finds that even though some readers might dispute her political conclusions and the fine points of her alternative plan, Ghilarducci cares passionately about retirement policy and provokes a meaningful conversation for those who hope for a dignified retirement.

Take-Aways

- In humane societies, the elderly can retire with dignity, but now retirement is under siege in the U.S.
- Many conservatives oppose the nation’s retirement system and would like to end it.
- Companies used to offer traditional “defined benefit” pension plans.
- Now, most companies offer “defined contribution” pension plans, like 401(k)s, instead.
- Defined contribution plans are cheaper for the company and help negate its risk.
- However, they are also less effective in terms of guaranteeing a secure retirement.
- For retirement, the average worker will require 100% of his or her preretirement income. Low-wage workers will need an even higher percentage of what they earned.
- Forecasters say that one out of five U.S. retirees may live in poverty in the future.
- Today, most Americans have exceedingly weak “retirement wealth portfolios.”
- “Guaranteed Retirement Accounts,” featuring mandated savings and government guarantees, could help safeguard retirement for U.S. workers.

Summary

Retirement Under Attack

Although Americans are living longer, many are enjoying old age less. Those who turn 65 in 2010 are likely to survive for more years than any 65-year-old people in history, but they will spend 14% fewer months being retired. This is due to a prevailing school of thought that believes if people are living longer, they ought to work longer as well, particularly if they are not prosperous. With this in mind, ask yourself just who would come out ahead if "pension income" – such as Social Security – became less available and less reliable.

> "Giving people more free time near the end of their lives is a good reason to celebrate, defend and even expand particular aspects of the American pension and Social Security system."

Clearly, less well-off elderly people would suffer the most because they would be forced to work into senescence instead of retiring. Employers would benefit because they could reduce the wages of elderly workers forced to compete with younger people for available jobs. The other winners would be the financial managers who set up and supervise 401(k) and similar voluntary retirement savings plans, including the types of plans needed if the U.S. government ever privatizes Social Security.

> "Making retirement available to almost all workers, that is, 'democratizing retirement,' is one of the greatest achievements of robust market economies."

Advanced, humane societies provide safe, reliable retirement systems. With the introduction of Social Security in 1935, the U.S. led the way toward providing older people with a secure, dignified retirement. Under Social Security's original terms, everyone could have some semblance of a secure retirement. Organizational pension plans began with a similar intent – to give members of a group or the people in a corporation's workforce reasonable retirement benefits after decades of hard work.

The Death of Defined Benefit Plans

In recent years, the emphasis in the U.S. has shifted away from set benefits and toward do-it-yourself plans, like Individual Retirement Accounts (IRAs), including 401(k) set-asides. Some policy makers have even discussed creating "personal savings accounts" to fund individual Social Security payments. Emphasis on such build-your-own-retirement plans ignores how well Social Security works and what it has accomplished for millions of older Americans.

> "Until the 1950s, only the wealthy could expect to retire."

At one time, two out of three full-time workers in the U.S. had a defined benefits (DB) pension plan. Now, many U.S. companies have eliminated their DB pensions, and replaced them with "defined contribution" (DC) plans, providing 401(k)-type savings accounts with penalties for early withdrawal. Government workers continue to receive DB plans. Using DC plans saves companies money and transfers the risk of investing retirement funds to the individual workers. Younger people with low wages almost always fail to maintain their IRAs. When emergencies arise, dipping into savings is the quickest, most tempting way to cope, but defined benefit pension plans lock away savings, thus prohibiting early spending.

> "Compared to what retirees actually experience, workers overrate what they can do for themselves."

The demise of DB plans is unfortunate. They usually provide far better pension coverage than DC plans: The Pension Benefit Guaranty Corporation guarantees them, they earn better returns, charge lower fees and perform as well as annuities. DB plans have smaller administrative costs and provide "more retirement income with less risk." However, now such plans are rare, except for government workers and special provisions some firms make for high-ranking executives.

> "Older people are working more hours, postponing retirement and going back to work after being retired, mainly because of the collapse of the pension system."

For many workers, particularly those with limited means, "self-directed and voluntary" defined contribution plans are unreliable sources of retirement funding. Even if a retiring worker has money left in a DC plan, he or she typically gets a lump sum payout, not an annuity. That is not conducive to a secure retirement. Of course, higher income workers do well with 401(k) accounts, which are savings accounts, not pension plans. These workers can afford to sock away substantial sums each year. Unlike poorer workers, they do not tend to pull money out to meet emergencies. Employers love 401(k) plans, because they do not need to contribute to them on behalf of their workers, who use them to save money being withheld from their paychecks.

Common Retirement Misconceptions

Many Americans believe three incorrect ideas about retirement: that people are living longer so they should work more; that U.S. labor shortages will develop as more Americans age; and that pensions are not economically sustainable. Because of these misconceptions, a strong movement is afoot to attack the current pension system, even though it has performed well over the years.

> "The elderly are increasing their work effort more than at any other time since World War II."

One school of thought believes in privatizing Social Security, thus changing pensions from safe annuities into unsafe "financial market assets." Many conservatives want to reduce Social Security benefits by increasing the retirement age. They urge private retirement savings accounts, and advocate replacing defined benefit plans with defined contribution plans. Such moves would make retirement even more of a gamble.

> "The political history of Social Security demonstrates the effectiveness of expertise and bold ideas."

Retirement is also far less democratic than in the past. Gender, class and income issues now determine who enjoys a secure retirement much more than they did previously. Many "minority, female and low-income workers" cannot afford to participate in existing pension plans, though attractive pensions often are available for higher-paid employees.

What You Need for a Secure Retirement

Economists and financial planners used to say that retirees need 60% to 85% of their preretirement earnings to live comfortably. This is no longer accurate. Because of inflation, increased healthcare costs and rising taxes, retirees actually need close to 100% of their preretirement income to get by. Low-wage workers need more than

100% of their prior incomes.

> "Defined benefit pensions served their purpose, but their purpose was no longer needed – labor relations and managers no longer cared about employee loyalty."

For example, take an American who earns $45,000 annually. Let's say this person starts saving money at age 40 and earns "3% per year above inflation" (very optimistic) on any investments. For a safe, comfortable retirement, this individual must save some $27,000 annually. This unlikely achievement – which means accumulating savings and interest of nearly $1 million – would enable him or her, upon retirement, to buy an annuity that pays $45,000 annually (thus furnishing the needed 100% of preretirement income). Of course, this person would also have Social Security payments, so he or she would not need a full $45,000 annuity payment. And if this individual has no debt and could tap into the value of a home, things would be even better. Unfortunately, people often make such faulty assumptions about their ability to save, earn and stay out of debt when they plan retirement. Many experts think that Baby Boomers, overall, have not saved sufficient funds to retire at their accustomed "standard of living."

The Standard "Retirement Wealth Portfolio" is in Big Trouble

For most Americans, a comfortable retirement depends on "Social Security, pensions, personal wealth, earnings, and kinship and community." Unfortunately, the first four of these five areas are now weakened and even under threat. Social Security and pensions are not as robust as they once were. You now must be older to start collecting Social Security benefits. Current trends in the U.S. radically skew asset distribution in favor of the wealthy. Each year, the disparity between rich and poor becomes more pronounced. More elderly "retirees" now must work to survive. Thus, earnings now play a larger role in the retirement wealth portfolio, although many older people are limited in how much they are able to work, and their potential salaries or hourly fees are much lower than the incomes younger people potentially can earn.

> "The less workers earn, the less likely they are to be covered by their employer's defined benefit pension, and it is just as unlikely that they will participate...in their firm's 401(k) pension plan."

Americans face constant political pressure to extend the standard retirement age. Older people work more years than the elderly did in the 1980s. Before then, people retired much earlier. The "so-called Greatest Generation" – people born between 1920 and 1935 – has benefited nicely from retirement. Its members receive Medicare and many have annuity-type pensions. Those who owned stocks were able to sell them at high prices during the boom years of the 1990s to pay for their retirements.

> "Employer risk is high in a DB plan because an employer's financial health greatly determines the pension's value over time."

Social scientists estimate that 20% of all future retirees could be poor. Those born between 1946 and 1962 are likely to be the last generation that will enjoy a more affluent retirement than previous generations. After that, things will slide downhill fast for future retirees. "Divorced women, low-wage workers and retirees with long-term care needs and medical expenses" will suffer most.

> "The GRAs eliminate the bias toward 401(k) plans and the tax subsidy for a system that does not work – this situation is the very definition of inefficiency."

Retirement has become a huge risk. The only bright spot, ironically, is that the "share of retirement income from work" is increasing and will continue to grow, probably exponentially. Older people have only a bit more than half of the earnings of average households, so many older people simply must stay employed. A 2002 Gallup poll found that 45% of working Americans older than 50 anticipated not having sufficient funds to live "comfortably when retired."

The Assault on Social Security

Social Security is under constant political assault. In recent decades, many conservative and libertarians have worked to change it so, they say, it can avoid bankruptcy. Soon the U.S. will have too many retirees subsisting on the incomes of too few workers. Many conservatives want to "privatize" (although they now avoid using this word) Social Security by adopting personal savings accounts. Many Republicans hope that personal savings accounts will be the future of Social Security, but such accounts present numerous questions and problems. Will people be able to manage their own accounts effectively? Will implementing savings accounts require cutting benefits? What about the costs of money management or the heavy expenses of changing over from the current system? Opponents raise other issues concerning the privatization of Social Security – which would become, in effect, a "pay-as-you-go" retirement funding system.

> "The diminishment of Social Security is part of the attack on retirement entitlement."

In 2003, Social Security trustees began using an "infinite time horizon" to forecast the program's financial strengths and liabilities into an unending future. This replaced the previous 75-year time horizon, already an unusually long extension. Canada is the only other country that uses a window as long as 75 years to estimate future "social insurance projections."

> "More young people believed in UFOs, Unidentified Flying Objects, than believed that Social Security would be there for them when they retire."

If you extend Social Security's liabilities into infinity, as a mathematical approach, its projected financial shortfalls nearly double. Its costs rise from 0.68% of gross domestic product to 2.3%. Of course, conservatives believe that Social Security is always in a severe crisis. In 1982, they claimed the program would be unable to pay benefits within a two-year period.

A New Approach: "Guaranteed Retirement Accounts"

Social Security is not supposed to be the sole provider of a solid retirement for American workers. Pensions and savings also have a crucial role, but the U.S. savings rate is very low and the pension system clearly is crippled. Unless changes are made quickly, many people will not be able to afford to retire. To solve this problem, the U.S. government should mandate "Guaranteed Retirement Accounts" (GRAs) and guarantee a 3% minimum rate of return, adjusted for inflation. The accounts would be administered by an agency of the government, not commercial, profit-seeking financial managers. People would have to save 5% of their earnings. They would get a $600 annual tax credit, but would not be allowed to withdraw money before retirement or age 65. They would receive their payouts as "inflation-indexed annuities."

Combined with a strengthened Social Security system and standard defined benefit pension plans, GRAs could assure most workers a serene retirement. GRAs would not involve "unfunded liabilities." They would promote savings and benefit all workers (not just the well-paid). The program would exempt people with defined benefit plans "where the pension contribution is at least 5% of earnings." The government would set the GRA retirement age just as Social Security sets its retirement age. With Social Security, GRAs would enable older people to retire with dignity.

About the Author

Teresa Ghilarducci is director of the Schwartz Center for Economic Policy Analysis at The New School for Social Research. She is an expert on retirement reform.