ARE AMERICANS LOSING THE CHANCE TO RETIRE COMFORTABLY?

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Americans employed by businesses and nonprofit organizations are increasingly unprepared to live as comfortably in retirement as golden-agers have done in the past. The National Retirement Risk Index indicates the percent of working-age U.S. households at risk of being financially unprepared for retirement. According to this index, the households whose members face the prospect of a reduced standard of living in retirement grew from 30 percent at risk in 1989 to 51 percent at risk in 2009. Prospects are especially dire for Americans of color.

The income retired Americans have to spend comes from three sources: Social Security, individual earnings and savings, and pension benefits from employer-sponsored retirement plans. Private-employer retirement plans include 130 million Americans, three of every five people in the active workforce. But employer plans are falling down on the job of assuring adequate income flows for retired employees – leaving millions reliant on meager personal savings and overly dependent on Social Security at a time when politicians are advocating cuts in benefits.

The Rise of Employer Plans that Shift Risks to Workers

Employer-sponsored retirement plans come in two basic types. *Defined benefit* plans are funded completely by employers, and promise a specified benefit to retired employees at a specified age. *Defined contribution* plans work differently. Employees regularly contribute through deductions from paychecks, and some employers add contributions, but the retirement benefit that eventually results depends entirely on how much is put in and on returns on market investments.

Neither type of plan is risk-free, but who bears the risk is a key difference. In defined contribution plans, employees shoulder all the risks. Their invested funds may earn sub-par returns, and they are not guaranteed any fixed pension. In contrast, workers and employers shared the risks in defined contribution plans. Businesses may build up commitments they cannot meet or that burden future profits. For workers, inflation may eat into the annuity from the defined pension, unless there is a cost of living adjustment built in. And the sponsoring firm may fail, leaving workers with reduced pensions.

Despite the much greater risk to employees, since the 1970s, defined contribution plans have become the dominant form of employer-sponsored retirement plan. In 1980, defined benefit plans covered 38 percent of the active workforce, but that percentage declined to just 13 percent in 2008. Over the same period, defined contribution plans that place more risk on employees went from covering 14 percent of the workforce to including 46 percent, nearly half.

The dominant form of workplace retirement savings occurs in a type of defined contribution plan known as the 401(k), which permits pre-tax deductions from paychecks to grow tax-free until the money is withdrawn. By the end of 2009, the *average* balance in a 401(k) plan was $58,351 – and the median balance – that is, the balance for a typical worker right in the middle between top and bottom – was merely $17,794. If we add together all kinds of defined contribution retirement savings accounts, the typical total balance for people between the ages of 55 and 64 is approximately $100,000. But given that the typical household income for Americans that age is $56,575, the savings on hand are far from the ten times the amount of desired yearly income that financial experts say a person near retirement should possess.

How Did It Happen?

From 1950 to about 1980, U.S. laws and employment practices encouraged workers, employers, and the financial industry to cooperate to build secure retirement income. The U.S. government expanded Social Security to provide a solid foundation for low and middle-income retirees, and tax incentives to encourage employers to maintain pension plans. Millions of workers responded by saving their money, remaining loyal to the firm, and helping to make the firm productive. Financial service firms offered products to generate investment returns and spread risk of loss.

But since 1980, mutual cooperation has broken down:

- Employers are no longer concerned about retaining workers for the long-term, and have come to see defined benefit plans as a drag on balance sheets. Soaring executive compensation is now largely sheltered outside of traditional retirement plans.
- The growth of defined-contribution assets has fueled the mutual fund industry, which went from holding eight percent of the assets of defined contribution plans in 1990 to 51 percent in 2009. As of 2010, retirement contributions made up 40% of mutual fund assets. In recent times, financial firms and trade associations have lobbied for laws that lock in their stake. For example, despite the obvious conflict of interest involved, the Pension Protection Act of 2006 allows financial firms to both offer investment vehicles and give workers advice about where to invest. Employers rarely object, because they have shifted risks to workers.
- Finally, in an era of union decline, workers have little collective clout, and research shows that individual employees left on their own often make unwise financial decisions.

What Should be Done?

Many experts focus only on workers, asking how we can get people to save more. Another "solution" is for people to just work longer – and the reduction of leisure time in old age is very likely to be what happens for many, as the prospect of insufficient retirement income hits home. But the focus should not be solely on workers. Why not also change policies for powerful stakeholders like employers and financial firms?

Employers could structure contracts with financial service firms so that fees are based on the ability of workers to retire with adequate income. And elected officials could revise the tax code to link deductions for corporate retirement contributions to more adequate worker pensions. Tax deductions for executive compensation could even be linked to better pensions for the rank-and-file – a step certain to grab attention in CEO suites! These are just examples, but the key point is to redesign policy incentives to give less sway to changes that shift all risks onto workers, and more encouragement for the development of arrangements that spread and share risks.

Read more in John C. Scott, "The Problem of Private Pensions: Risk, Institutions, and Politics in the Hidden Welfare State," presented at "Critical Perspectives on Tax Policy," Emory University Law School, Atlanta, GA, September 16-17, 2011.