Pressures on Pensions

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Debate about the pension crises has centered on certain questions such as: Are greedy government workers bankrupting states? Are pension-slashing politicians backed by big moneysaving the day? Or do the budget problems of state and local governments have more to do with wasteful corporate subsidies than pensions? What are the real policy solutions to the pressures placed on pensions?" I will address the first question, are greedy government workers bankrupting states? And I will quickly review the direction public policy needs to go in order to forestall a large drop of retirement income for American workers.

The Moderate Level of Public Employee Pensions

Effective solutions to the pressures on pensions are a combination of straightforward policies of what I call good pension hygiene (see for example the Society of Actuaries Blue Ribbon Report[1]). The various policy proposals call for a combination of aligning pension benefits when they far exceed pension norms by continuing to "roll back" benefit increases made, for instance for California safety employees, in the 1990s (however, most of these rare benefit increases have been rolled back), eliminate pension spiking and so forth; improve pension funding by smoothing out pension contributions; increase employer and employee contributions; ensure state and local governments fund the annual required contribution (ARC) -- legislation or constitutional changes may be necessary; and use actuaries and actuarial methods that realistically forecast future earnings – this brings attention to the actuary professional practices -- to stabilize annual contributions.

There is no evidence of any particular "greed" by government workers or unions. Unions have little effect on pension benefits – benefits are set by legislators. Pension benefits in the public sector have increased 2.5% annually since 1993, which has not exceeded inflation or wage increases. Pension benefits in the government sector are not exceedingly large. The average annual benefit in 2008 was $23,000 – which is what a middle class worker would need to

[1] http://www.soa.org/blueribbonpanel/

supplement Social Security to achieve adequate retirement standards. The most recent period, 2004 – 2008, was a period of relative pension growth stability (pensions in the public sector grew more in the 1990s). Multivariate analysis by the Center for Retirement Research at Boston College showed the growth of funded status was the main impetus to any increase in benefits and a state's indebtnesses and closing the DB plan to new entrants were the main factors slowing down or cutting pension benefits. Unionization had hardly any effect. [2] The largest factor affecting a legislature's likelihood of increasing pension benefits is the state's debt load (scaled to the state GDP). Therefore, the budget problems of state and local governments have more to do with losses in revenue, rather than spending, and the solution to balance budgets almost always lie in expanding the tax base or raising rates.

Eroding Retirement Income

The political pressure on state and local pension plans come at a strange time because the pressure on all workers to secure retirement income has never been worse.

In just 10 years, from 2010 to 2020, the number of people over 65 years of age will have increased by more than 14 million, from 40.2 million to 54.8 million, and in another 10 years it will increase to 72 million. Older workers near retirement lost 25 percent of their assets in the financial crisis. They're coming into retirement with lots of debt — mortgages, credit cards, even student loans — and with lower-than-anticipated levels of income. Their ability to save has been diminished. The U.S. Census Bureau's Survey of Income and Program Participation forecasts that when current workers ages 50 to 64 reach age 65, over 48 percent will be poor or near-poor. And while many public-sector workers are seeing their pensions being cut back dramatically, about half of private-sector workers have no pension at all. Tens of thousands of older workers are taking Social Security early — foregoing a substantial portion of their maximum benefit — because they've lost their jobs and cannot find employment.

The net result of all this is a looming crisis for state and local governments, both because of the declines in tax revenue resulting from lower incomes as well as the fact that poor people put far more demands on government services than the non-poor. In addition, the creation of a vast new class of formerly middle-class, now poor, elderly will bring with it significant political and social instability.

People do not have enough in their retirement accounts to retire on and maintain their standard of preretirement living; but, it is cruel and impractical to propose solving the retirement crisis by having people work longer. The average older worker – a near retiree -- has a retirement account balance of less than $30,000, over half have nothing.

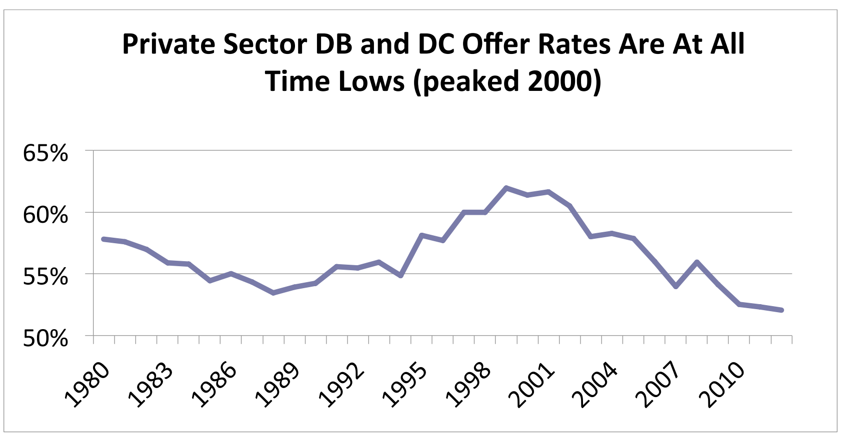
[2] http://crr.bc.edu/wp-content/uploads/2011/07/slp_19-508.pdf

Table 1

Total Personal Income Quartiles	All Retirement Accounts
Bottom 25th (mean)	$ 16,034
Bottom 25th (median)	$ 0
25-50th (mean)	$ 21,606
25-50th (median)	$ 0
50-75th (mean)	$ 41,544
50-75th (median)	$ 6,500
75- up (mean)	$ 105,012
75- up (median)	$ 52,000

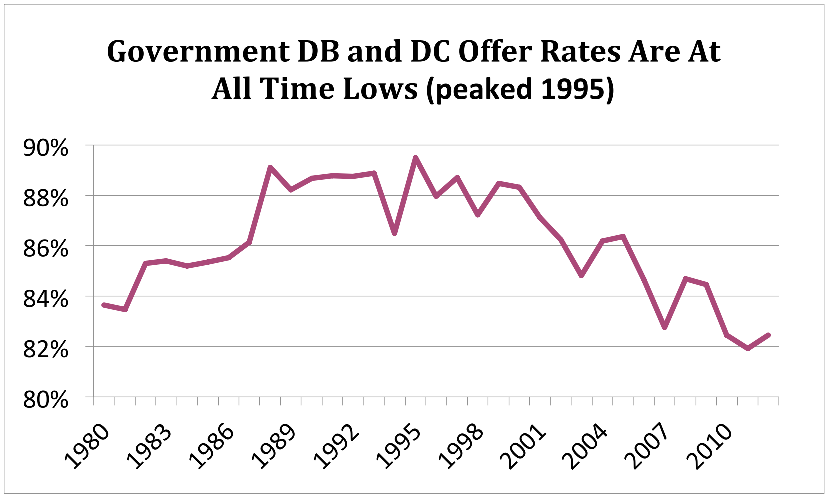
Coverage for public and private sector workers is on a downward secular trend. For the private sector coverage has fallen from 63% in 2000 to 53% in 2012. See Graph 1. In the public sector coverage has fallen from a high of 89% in 1995 to 82% in 2012. Bargaining power needed for pressing for and being offered a retirement account at work has been eroded by declining unionization, import penetration, and chronically high unemployment since the 1990s. See Graph 2. [3]

Graph 1



Graph 2

[3] http://www.economicpolicyresearch.org/images/docs/SCEPA_blog/guaranteeing_retirement_income/Fact_Sheet_Retirement_Balances_july_2012_revised_FINAL.pdf



Also, the system is highly subsidized with taxpayer money. Policy makers exempted regular pension and 401(k) and IRA contributions from tax, hoping to ensure that all workers had enough savings for retirement. But because those tax advantages are tax deductions rather than refundable tax credits, the highest paid employees with the highest contributions and highest tax rates get the most subsidies. Eighty percent of the tax breaks for retirement accounts go to the wealthiest 20 percent of taxpayers.[4]

<u>What Not To Do to Reduce and Stabilize Pension Costs.</u>

Both the Republican response to the retirement crisis and President Obama's proposals are flawed.

There are two bad solutions to the increase costs of pensions. One is cutting pension benefits for state and local workers and the other is raising the retirement age. Cutting pension benefits may have a short term relief on state and local benefits; but, it may cause higher long terms costs as public sector workers join the private sector workers in being poor or near poor retirees. In almost all states we examined near retirees with DB plans had a very small chance or being poor and those with none or some DC plans had more than a 35% of being poor.[5] The number of elderly adults who have become homeless has increased around the county.

Cutting pension benefits would cause more social services spending in the future. Therefore, public finance issues should focus on preventing old age poverty and the costs associated with elderly poverty, including Medicaid costs.

[4] http://www.americanprogress.org/issues/open-
[5] http://www.reuters.com/article/2012/08/07/us-column-miller-poverty-idUSBRE8760VW20120807

The real policy solutions to the pressures placed on pensions lies in good pension funding hygiene and more funding from employers, workers, and sensible subsidies from the federal and state governments. Cutting public sector pension benefits and financializing them with 401(k) type arrangements will make the upcoming American retirement crisis worse. In the United States expanding Social Security and providing all workers with a safe and secure retirement plan at work will help solve the growing retirement crisis caused by the thirty-year failed experiment with 401(k)s and other do-it-yourself retirement planning systems. There is a state by state movement to create public option pensions for people who want a choice, a supplement and who have nothing at all.

Many propose to raise the normal retirement age on the premise that older people can work longer if they don't have enough saved for retirement and are not covered by pensions. But jobs older workers have are getting worse. And, since the 1990s, older workers have suffered chronic underemployment, unemployment, and age discrimination. The physical and mental demands of older workers' jobs have increased since 1992. Anthony Bonen, a graduate research assistant in our Schwartz Center for Economic Policy Analysis at The New School, analyzed the University of Michigan's Health and Retirement Study[6] to show that older workers (ages 62 and 65) reported an increase in jobs that require lifting heavy loads, that require 'good eyesight," that require 'stooping, kneeling or crouching and intense concentration.

Table 4

Workers aged 62-65 Have Worsening Conditions (1992 – 2008)

	1992	2009
lifting heavy loads	14%	17%
stooping, kneeling, crouching	0%	15%
require good eyesight	39%	70%
intense concentration	30%	56%

Raising the retirement age is a form of cutting pension benefits and putting more people in IRAs, as Obama proposes, ignores the reality that many people withdraw money from their IRAs before retirement and that the fees erode 20% of the balances unnecessarily.

Financializing pensions causes automatic destabilization – a subject of another panel – but an unforeseen but growing problem. As the first-ever comparative study of how large pension institutions impact the long-term business cycle, the Ghilarducci, Saad-Lesser, and

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http://www.economicpolicyresearch.org/images/docs/SCEPA_blog/guaranteeing_retirement_income/Bonen_Policy_Note_1.23.13.pdf

New York Times reporters Steve Greenhouse and Michael Barbaro revealed an embarrassing internal memo to Wal-Mart's board of directors in 2005 that revealed the corporation's motives and methods to make work harder for older workers. The leaked Wal-Mart memo "proposes numerous ways to hold down spending on health care and other benefits" by ensuring every job required physical tasks — stocking shelves, gathering carts — which should discourage unhealthy and older workers from obtaining and/or retaining employment at the retailer.

Fisher (2012) [7]compare the effects of Social Security against market-based retirement vehicles such as 401(k) plans. The size of both of these systems - 93% of American workers are covered by Social Security, and 63% possess 401(k)-type retirement plans - gives them a significant influence on the economy. Market-based retirement accounts increase the volatility of the business cycle, contributing to an overheating of the economy during expansive periods and exacerbating economic contraction during recessionary spells. On the other hand, Social Security helps to reign in the economy during periods of expansion, and stimulating it during recessions - a function known as an automatic stabilizer. The study finds that for every $1 increase in real GDP, 401(k) plans reduce government programs' automatic stabilizing impact by 15%.

This provides hard proof that Social Security and other old age programs are a win-win for both individuals and the economy.

The solution to the downward mobility of middle-class workers to poor or near poor retirees are the following:

1. Expand Social Security: Senator Harkin (D-IA) would link benefits to the consumer price index for elderly consumers, CPI-E, this is supported by Senators Brown (D-OH), Begich (D-AK), Schaltz (D-HI), Warren (D-MA). Congresswoman Sanchez introduced the House version of the Bill in September, which has since obtained 55 co-sponsors. The Congressional Progressive Caucus (CPC) -- Co-Chairs Reps. Raúl M. Grijalva (D-Ariz.) and Keith Ellison (D-Minn.) aims to expand jobs, repeal the sequestration, expand retirement and health benefits.

2. Give every workers access to an employment based retirement plan as proposed by many state legislatures and Sen. Harkin and Secure Choice Plans.

3. Regulate the 401(k) and IRA industry to prevent predatory high fees and conflict of interest, and

4. Protect government workers' pension plans and all other private-sector defined-benefit plans.

5. Turn the deduction into a refundable tax credit.

These approaches to the pressure on pensions would increase, not decrease, retirement plan availability, thereby countering the declining rates of sponsorship by employers and staving of the future retirement income shortfall. This approach toward putting more money in people's retirement accounts would help raise the amount of retirement savings people accumulate by shielding them from the high fees and poor investment choices they face when they are left to fend for themselves in the retail 401(k) and IRA market. If all American residents had access to government pension funds the stock market would be less volatile – current retiree income would

[7] Teresa Ghilarducci & Joelle Saad-Lessler & Eloy Fisher, 2012. "The macroeconomic stabilisation effects of Social Security and 401(k) plans," Cambridge Journal of Economics, Oxford University Press, vol. 36(1), pages 237-251.

be more stable, Americans would save more for retirement, and the tax code would be more efficient.

Our society has prepared for people retiring in deliberate and meaningful ways since the sensible construction of Social Security (even though Social Security was opposed by the insurance industry for fear Social Security would detract from their business, the opposite occurred.

Every worker needs a guaranteed pension to supplement their Social Security for the rest of their life. Every worker, rich or poor, needs to have some time to themselves, on their own terms, at the end of their working lives. Human beings may be bad at some things, but we’re good at others, like coming together to solve a looming old age poverty problem.