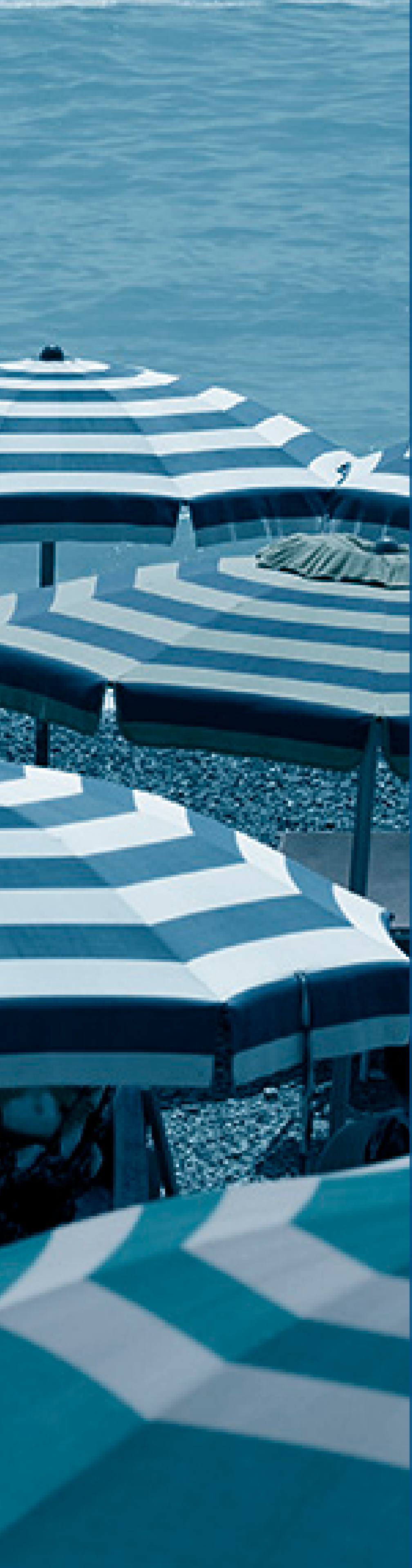


CHAPTER 7

Retirement

By David Madland and Alex Rowell

Retirement

The promise of a secure, comfortable retirement is a crucial tenet of middle-class security. After decades on the job, workers should be able to retire without facing a decline in their standard of living. Weak income growth and rising costs, however, have made it difficult for workers to save for retirement, putting the futures of many middle-class Americans in jeopardy.

In 2015, 46 percent of households reported that they could not afford an emergency expense of $400 or would have to pay for it by selling something or borrowing money.[1] Three in ten nonretired households reported not saving at all.[2] And households who do save often have other more urgent priorities: When households were asked what they saved for, only 57 percent of savers reported putting money away for retirement.[3]

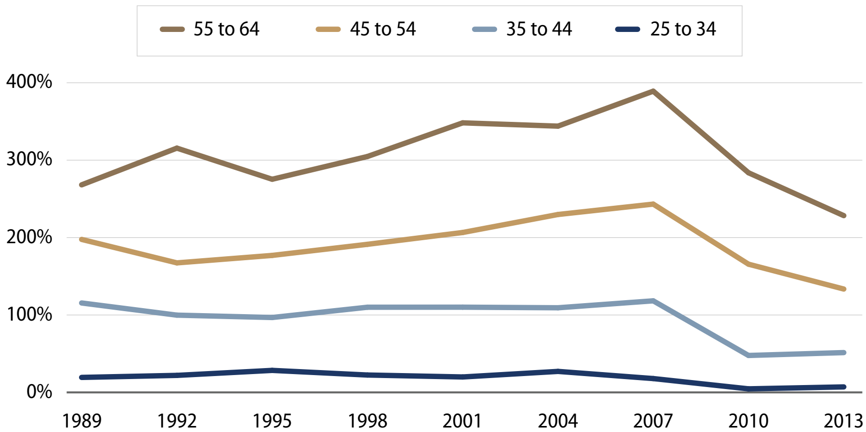
Data show that a large number of households simply lack the financial means to set money aside for retirement. Households are building up fewer assets relative to their incomes than they did in the past, as measured by the Federal Reserve's Survey of Consumer Finances, or SCF.[4] This is especially concerning for several reasons. Today's households will need more in savings in order to maintain their standard of living in retirement as a result of increased life expectancy; a Social Security full retirement age of 67 for those born after 1960; rising health-care costs; and low real interest rates.[5] Additionally, measured assets for families should actually be rising since companies are moving from defined-benefit, or DB, pensions, which are not counted as assets by the SCF, to defined-contribution, or DC, pensions, which are.[6]

Academics and policy experts disagree on how to precisely measure Americans' readiness for retirement.[7] No matter which metric is used, however, too many Americans risk facing a lower standard of living upon exiting the labor force. According to the Center for Retirement Research's highly regarded National Retirement Risk Index, or NRRI, more than half of U.S. households have insufficient assets to maintain their standard of living in retirement.[8] The number of at-risk households has grown dramatically over time: 30 years ago, only 31 percent were unprepared.[9]

FIGURE 7.1

Households are not building up additional assets relative to their incomes, even as retirement needs increase

Median wealth-to-income ratios, by age and year



Note: The sample includes all households younger than age 65 who indicate they are not yet retired. The sample does not include vehicle wealth.

Source: CAP's calculations based on several years of data from Board of Governors of the Federal Reserve System, "2013 Survey of Consumer Finances," available at http://www.federalreserve.gov/econresdata/scf/scfindex.htm (last accessed November 2014); Keith Miller, David Madland, Christian E. Weller, "The Reality of the Retirement Crisis" (Washington: Center for American Progress, 2015), available at https://www.americanprogress.org/issues/economy/report/2015/01/26/105394/the-reality-of-the-retirement-crisis/.

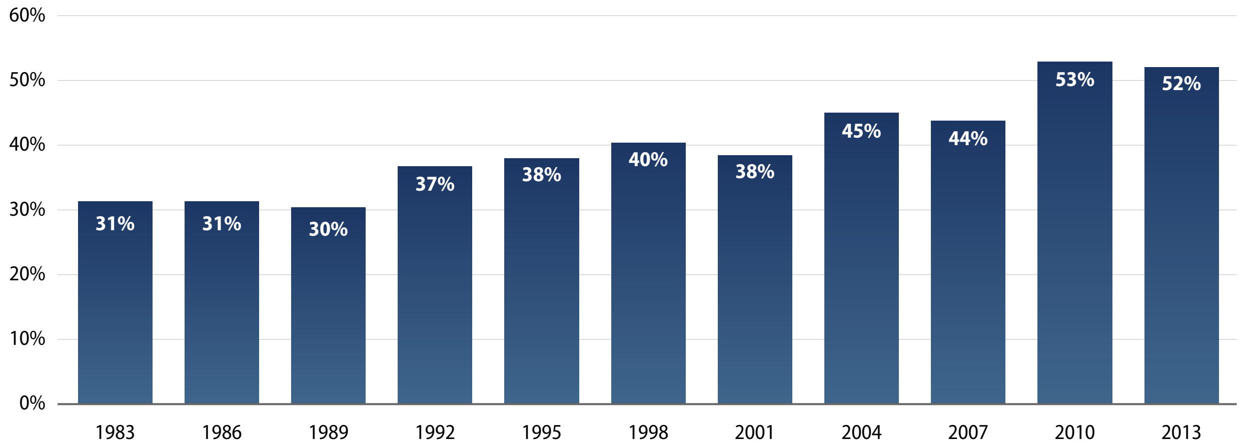
Although estimates vary, even optimistic studies show that approximately 1 in 4 retired Americans in 2004 did not have enough retirement income to maintain their standard of living, with each generation of retirees faring worse.[10] Even under this best-case estimate, far too many Americans will struggle to maintain a secure retirement.

That such a large percentage of households are at risk is not surprising considering that millions of Americans lack access to retirement plans at work,[11] which—alongside Social Security benefits—can provide a major source of retirement income. Having a workplace retirement account is crucially important to saving for retirement: Payroll deductions make it easy to save, and plan features, such as auto-enrollment and employer contributions, boost savings.[12] More than 30 percent of American workers lack access to a retirement plan at work, and only just more than half of all civilian workers participate in a workplace retirement plan, according to the National Compensation Survey.[13]

FIGURE 7.2

The increasing risk of having insufficient money during retirement

Share of working-age households at risk of not having enough money to maintain their standard of living over time



Source: Alicia H. Munnell, Wenliang Hou, and Anthony Webb, "NRRI Update Shows Half Still Falling Short" (Chestnut Hill, MA: Center for Retirement Research at Boston College, 2014), available at http://crr.bc.edu/briefs/nrri-update-shows-half-still-falling-short/.

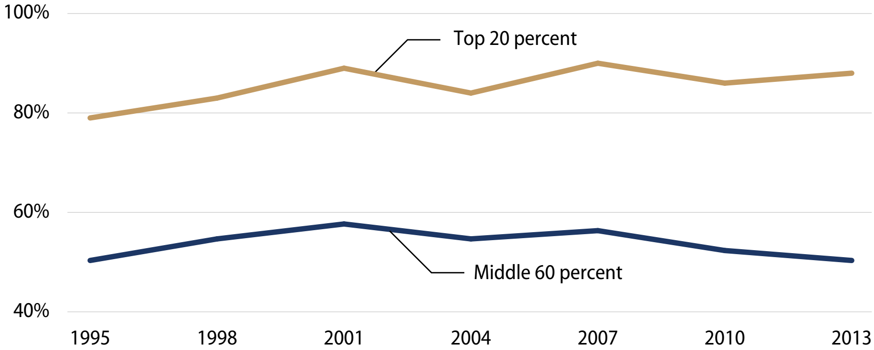
Participation in workplace retirement plans has fallen since 2001, making it even harder for workers to build up the assets necessary to maintain their standard of living in retirement.[14] And too many Americans who do have the resources to save face high fees in their retirement accounts that make it difficult to build up assets.[15] While fees may look small on paper—if savers notice them at all—previous CAP research has shown that even a 0.75 percentage point difference in annual fees can cost a typical worker almost $100,000 in his or her lifetime.[16] Until recently, many workers risked paying high fees because not all retirement advisers were required to act in their clients' best interest.[17] Instead, advisers could direct savers to more expensive funds that padded their profit margins, which led to savers losing an estimated $17 billion each year.[18]

While those without an employer-provided account have the option of seeking out and saving in an individual retirement account, or IRA, the vast majority do not.[19] As a result, the overall picture is bleak: Nearly one-third of nonretired Americans have no retirement savings or pension at all.[20] The median household nearing retirement, or age 55 to 64, with retirement savings has saved just $104,000—only enough to afford a $400 monthly payment from a lifetime annuity and well below what a typical household would need in retirement.[21] Factoring in households who lack accounts altogether, the median near-retirement household has only $14,500 saved for retirement.[22]

FIGURE 7.3

Middle class households are far less likely to have retirement savings than wealthy households

Share of families ages 32 to 61 with savings in retirement accounts, by income group



Note: Retirement accounts include 401(k)s, individual retirement accounts, and Keogh plans; Families include single/no kids households. Ages for families are based on the male in a mixed-sex couple or the older spouse in same-sex couple.

Source: Author's calculations based on Monique Morrissey, "The State of American Retirement: How 401(k)s have failed most American workers" (Washington: Economic Policy Institute, 2016), available at http://www.epi.org/publication/retirement-in-america/.

These figures reflect the reality that, too often, middle-class Americans are not able to save for retirement in the same way as their wealthier peers. Eighty-eight percent of households age 32 to 61 in the top income quintile had a retirement account in 2013—virtually unchanged from 89 percent in 2001—compared to only 52 percent of middle-class households, down from 56 percent in 2001.[23] And wealthy households have by far the most assets in these accounts: The top 20 percent of households hold 74 percent of total retirement account savings, while the middle 60 percent hold the other 26 percent.[24]

Younger Americans are faring worse than their older counterparts. In 2014, a majority of American households age 18 to 29 had no retirement savings or pensions. Among households age 30 to 44, about 3 out of 10 have no retirement savings or pension.[25] The Center for Retirement Research's estimates that 45 percent of households age 50 to 59 are at risk of failing to meet their living standard in retirement; among younger households age 30 to 39, an even higher proportion—59 percent—are already at risk. There is also reason to believe that rising student debt levels may crowd out retirement savings and harm retirement readiness among younger generations. If today's households had the same amount of debt as do new college graduates, an additional 4.6 percent of households would be at risk.[26]

Absent changes in policy, millions of families will be unable to retire and maintain the standard of living they enjoyed during their working life. The human costs will be real: Americans will have to work longer than planned or cut back in an unexpected fashion after a lifetime of work. And the costs to the economy at large are also daunting: Struggling retirees will rely more heavily on government programs, and reduced personal spending from retirees could contribute to slower overall economic growth.[27]

How current policies fail retirees

When President Franklin D. Roosevelt signed the Social Security Act in 1935, he congratulated Congress for passing a law that "will give some measure of protection to the average citizen and to his family … against poverty-ridden old age."[28] Social Security was not designed to be the only source of income for retirees; private savings and pensions were intended to sustain workers after they left the labor force.[29] But as workplace retirement plans have become scarcer and labor, financial, and housing markets have become less stable,[30] Americans' retirement readiness has declined.[31]

In today's system, Americans who work at small- and medium-sized businesses are less likely to have access to workplace plans than those at large companies.[32] This is because small business owners lack a broad base of employees over which to spread fixed costs, making it more difficult and costly to start a company retirement plan. Unlike the increasingly rare DB pension plans, which are available to fewer than 1 in 5 private sector workers,[33] today's more common DC plans place individuals at risk during market downturns. Furthermore, under DC plans, workers bear the burden of choosing the proper portfolio and determining the appropriate amount to save. Smart plan design can help solve these problems: Auto-enrollment and escalation—as well as simple, low-fee plan investment options that automatically adjust based on one's expected retirement date—are very beneficial to savers. But building up sufficient assets is not the only challenge: Once individuals decide to retire, they face various risks, including longevity risk, or the risk of outliving their savings. To avoid this, individuals can purchase an annuity to convert their lump-sum savings into a lifetime stream of income. CAP's previous analysis has shown that low-cost annuities make it much easier for individuals to achieve a successful retirement, but unfortunately, in-plan annuity options are rarely available in the DC plan market.[34]

The federal government plays a large role in subsidizing private savings for retirement, forgoing more than $100 billion in tax revenue each year due to retirement savings incentives.[35] But these incentives are needlessly complicated, making it very difficult for a saver to maximize their tax benefit. More importantly, they are regressive, disproportionally helping the wealthy while leaving many lower-income Americans behind: The top 20 percent of households by income receive 66 percent of the benefits from the federal government's retirement tax expenditures.[36]

The Saver's Credit, introduced in 2001, is a tax credit designed to help low- and moderate-income Americans save for retirement. However, the credit falls short due to its size and structure. The $1.3 billion spent annually on the Saver's Credit pales in comparison to retirement tax incentives in total.[37] Also, the credit is non-refundable, which means that many working families with low or no tax liability receive little to no benefit from the credit.[38]

While President Barack Obama and many members of Congress have pushed for various proposals to help working Americans save for retirement—including an automatic IRA program to increase access to workplace retirement accounts and an expanded, refundable Saver's Credit[39]—Congress has not enacted these proposals into law. The Obama administration, however, has used executive action to establish myRA, a portable, starter retirement account with no fees and no minimum balance.[40]

Meanwhile, states such as California, Connecticut, Illinois, and Oregon are working to increase access to retirement savings accounts by automatically enrolling those without employer-sponsored retirement accounts into retirement plans.[41] While these state initiatives are worthwhile and will improve retirement readiness, many workers in states that do not offer these savings options will continue to fall behind. Solving our national retirement crisis will require national solutions.

Policy recommendations

In order solve today's retirement crisis, policymakers need to protect and strengthen the backbone of our retirement system, Social Security, and expand access to high-quality retirement savings options for workers—no matter their employer.

Social Security

Social Security was not designed to be the sole source of income for workers in retirement. But, today, 64 percent of households 65 or older receive more than half of their income from Social Security, and about one-third receive more than 90 percent of their income from Social Security.[42] Nonmarried beneficiaries are even more reliant on Social Security: Nearly half receive 90 percent of their income from the program.[43] Previous CAP research has demonstrated that while there is no fiscal imperative to cut Social Security,[44] there is a moral imperative to protect it from cuts that would harm the middle-class and low-income families that rely upon it.

Congress should expand Social Security benefits for those in need and modernize key benefits.

Increase the special minimum benefit

Social Security is an effective anti-poverty program, lifting nearly 15 million Americans age 65 and older out of poverty in 2013.[45] Because many seniors and disabled Americans remain in poverty,[46] the minimum benefit provided by Social Security and Supplemental Security Income should increase so that a worker with 30 years of covered Social Security earnings would receive a benefit of 125 percent of the monthly poverty level.

Modernize survivorship and divorce benefits

Survivorship and divorce benefits should also be updated. In today's Social Security system, dual-earner couples earn lower survivorship benefits than single-earner couples who paid the same combined Social Security taxes over their working lives.[47] For example, a dual-earner couple each earning $50,000 annually would pay the same payroll taxes as a single-earner couple with the working spouse earning $100,000 annually. However, the dual-earner couple would receive a lower survivorship benefit upon the death of their spouse. This disparity should be eliminated, and survivorship benefits should be improved to limit the benefit cut that survivors face upon the death of their spouse. In addition, today's divorce benefits for Social Security are only available for marriages lasting 10 years or longer, leaving many divorcees without benefits. Instead, divorce benefits should phase in over several years for those married at least five years.[48]

Institute a caregiver credit

Policymakers should also recognize the value of unpaid caregiving and help these workers in retirement by instituting a caregiver credit. Currently, workers who take time out of the labor force to care for their children or elderly relatives not only give up earnings but also may face reduced Social Security benefits in the future. With this credit, workers who leave the labor market or significantly reduce their paid work hours for caregiving would receive credit toward their Social Security benefits at half of national average earnings for up to five years.[49] Such a credit would be especially beneficial to women, who are both more likely to take time off for caregiving, as well as more likely to live in elderly poverty.[50]

Private savings

Strengthening Social Security is critical to shoring up retirement, but policymakers cannot stop there. Action must be taken to help workers privately save for retirement as well. This means both making sure that workers earn enough so that they are able to put money aside for the future and increasing access to high-quality retirement savings options.

Create a National Savings Plan to ensure all workers are able to save at work

All workers should be able to save for retirement at work, no matter their employer. To that end, policymakers should create to a high-quality, low-fee portable retirement plan such as CAP's proposed National Savings Plan, or NSP, which is based on the Thrift Savings Plan currently available to federal employees.[51] Workers without employer-provided retirement plans would be automatically enrolled in this plan by their employers; independent contractors and the self-employed would be also be eligible to join.

CAP analysis has found that a worker saving in the NSP would be more than twice as likely to have a secure retirement than a worker contributing the same amount to a typical 401(k) plan. And NSP savers would be more than five times as likely to have a secure retirement as workers saving in a high-fee 401(k) plan, such as those often offered to small businesses. The NSP would also be the ideal next step for savers currently saving in the Treasury Department's myRA program after they reach the myRA account maximum.[52]

Better protect savers from market risk through collective defined-contribution plans

Policymakers should also consider new ways to protect workers near retirement from the risk of market downturns that would dramatically lower their retirement income. States and the federal government should create plans such as CAP's Secure, Accessible, Flexible, and Efficient, or SAFE, Retirement Plan,[53] a collective DC plan that combines the benefits of DB pensions with 401(k)-type plans.

While employers would not have to guarantee returns with such a plan, the pooled, professionally managed investments would reduce risks for savers. This risk-pooling would smooth investment returns over time and keep market crashes from decimating savers. And elements of this plan could be instituted in the payout phase of the NSP, allowing workers to reduce their individual investment risk later in life.

Fully implement the conflict of interest rule

Even without creating new forms of retirement accounts, policymakers can take action to help savers in today's 401(k) and IRA market. Thanks to a newly finalized rule from the U.S. Department of Labor, Americans saving for retirement today are now better protected from advisers' conflicts of interest, which costs savers an estimated $17 billion per year through higher fees, lower returns, and inappropriate advice.[54] The rule updates a 40-year-old standard to protect savers in today's retirement market and ensures that retirement advisers put their clients' best interests before their own profits.

Special interest groups, however, are still fighting in Congress and the courts to have the rule overturned, claiming that it will reduce access to retirement advice.[55] These critiques are unfounded: The success of many current firms shows that it is possible to offer independent, nonconflicted retirement advice.[56] It is crucial that the conflict of interest rule is fully implemented, and lawmakers should stand on the side of savers and firmly against efforts to weaken or eliminate the rule.

Reform retirement tax incentives to help those who need it most

Finally, Congress should revamp retirement tax incentives to better target those who need the most assistance. Today's confusing and regressive mix of tax deductions results in most benefits flowing to the wealthy while failing to substantially incent retirement savings.[57] Policymakers should convert the Saver's Credit—which currently fails to reach many families—into a refundable tax credit that is deposited directly into savers' personal accounts, acting more directly as a government match.[58] This would help lower-income savers build the assets they need to make it to the middle class.

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