PROMOTING MIDDLE-CLASS RETIREMENT SECURITY:
THE IMPORTANCE OF ACCOUNTING FOR INEQUALITY IN RESOURCES, BURDENS, AND RISKS

Statement of
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before the
Budget Committee
United States House of Representatives

KEEPING OUR PROMISE TO AMERICA'S SENIORS: RETIREMENT SECURITY IN THE 21ST CENTURY

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* The views expressed are my own and should not be attributed to the Urban Institute, its trustees, or its funders.

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Chairman Yarmuth, Ranking Member Womack, and members of the committee, thank you for the opportunity to discuss the many challenges confronting the nation's current and future retirees. My name is Melissa Favreault, and I am a senior fellow at the Urban Institute, where I study US retirement and disability policy. The views I express today are my own and are not necessarily those of the Urban Institute, its board, or its funders.

Just over four weeks ago, the Social Security and Medicare Trustees released their annual reports on the programs' financial status (Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds 2019; Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds 2019). The trustees reported that both programs are underfunded. Although each report contained important new information, their conclusions echoed those of past reports: to put the programs on a sounder financial footing, Congress will need to increase program revenues, slow the growth in program costs, or combine these two approaches.

Because Social Security and Medicare are such large, fundamental parts of our economy and daily lives, such program changes must be carefully considered. For years, government and independent analysts have been examining reform proposals to help inform lawmakers and the public of various options and their fiscal and distributional consequences. The required trade-offs must be weighed and debated, with input from beneficiaries, service providers, and taxpayers. This hearing is a welcome step in this important process.

After I briefly describe the financial risks faced by today's workers and retirees, my testimony will emphasize five points about social insurance, retirement savings, and employment policies.

- Social Security is the bedrock of the US income security system. We must shore up its finances, and as we do this we must account for persistent disparities in retirement and disability and the effects of increasing inequality in earnings, wealth, and longevity in recent decades.
- For many, employer-sponsored retirement plans and Social Security complement one another, but access to such plans is not yet universal, and government subsidies to these plans now mostly go to those who need them least. They should be adjusted to better promote savings and retirement adequacy for less-advantaged workers. Employers and Congress should continue to consider evidence-based, innovative, progressive ways to encourage working-age people to save.
- Medicare is a vital support for older Americans. However, its protections are incomplete, so out-of-pocket health care spending can significantly burden many older adults. These burdens are expected to increase in coming decades. Adjustments to Medicare cost sharing could help.
- Americans face a significant, unpredictable risk of needing long-term services and supports (LTSS). For many, this is the largest financial risk in retirement. Millions of family caregivers step in to fill this gap each year, often putting their own retirement security at risk.
- Decades of income stagnation and high levels of inequality in health risks have compounded many of these challenges. Those with the highest risks are often those least able to save for their health and long-term care needs in old age. Working longer can help older adults who are

still able to work better manage their risk both by offering more opportunity to save and by reducing how long they need their savings to last.

Background

Before going into detail on these five points, I'll start with some brief background on risk, how risks differ for different segments of the population, and the motivation behind programs such as Social Security and Medicare. To guarantee a secure retirement, people need access to jobs with good wages and benefits that protect them when misfortune strikes (such as health insurance in case they need expensive medical treatment for an illness or injury) and help them to prepare for the future (such as a retirement plan). Along the way, they face a range of risks.

One risk is low lifetime earnings. Some people are never able to access good jobs either because they lack the skills employers in their communities need or because they have disabilities or extended care responsibilities that limit or prevent work. Figure 1 shows how lifetime earnings differed for a sample of older adults who were approaching age 62 early this decade (those who were born from 1950 to 1954). It compares men and women separately by education and race and compares women by the number of children they had. It reveals dramatically different lifetime earnings—and thus dramatically different capacities to save for retirement—across the groups. The large racial disparities reflect decades of discrimination in labor and housing markets (Favreault 2008), many of which persist to this day. Women's lower lifetime earnings often reflect that they spent time out of the labor force or worked part time in order to provide family care.

A second risk is being forced into an early retirement through job loss, health problems, or another reason. Some people may work for decades at the same employer and expect to retire from that company but then get laid off late in their careers. When these older workers reenter the job market, they may face diminished prospects and age discrimination (Neumark, Burn, and Button 2017). My colleague Richard Johnson and his coauthor Peter Gosselin found that as many as half of employed 50-year-olds in full-time, full-year jobs may face an involuntary job separation. When these workers are reemployed, Johnson and Gosselin (2018) find that their wages are on average lower than what they earned before the separation. Just 10 percent earn as much after the separation as they earned before. Others experience late-career health shocks and disabilities. Munnell, Rutledge, and Sanzenbacher (2019) report that 37 percent of workers retire earlier than planned and that health shocks are the largest factor in workers' choices to retire earlier than planned (followed by employment shocks and family changes—other risks).

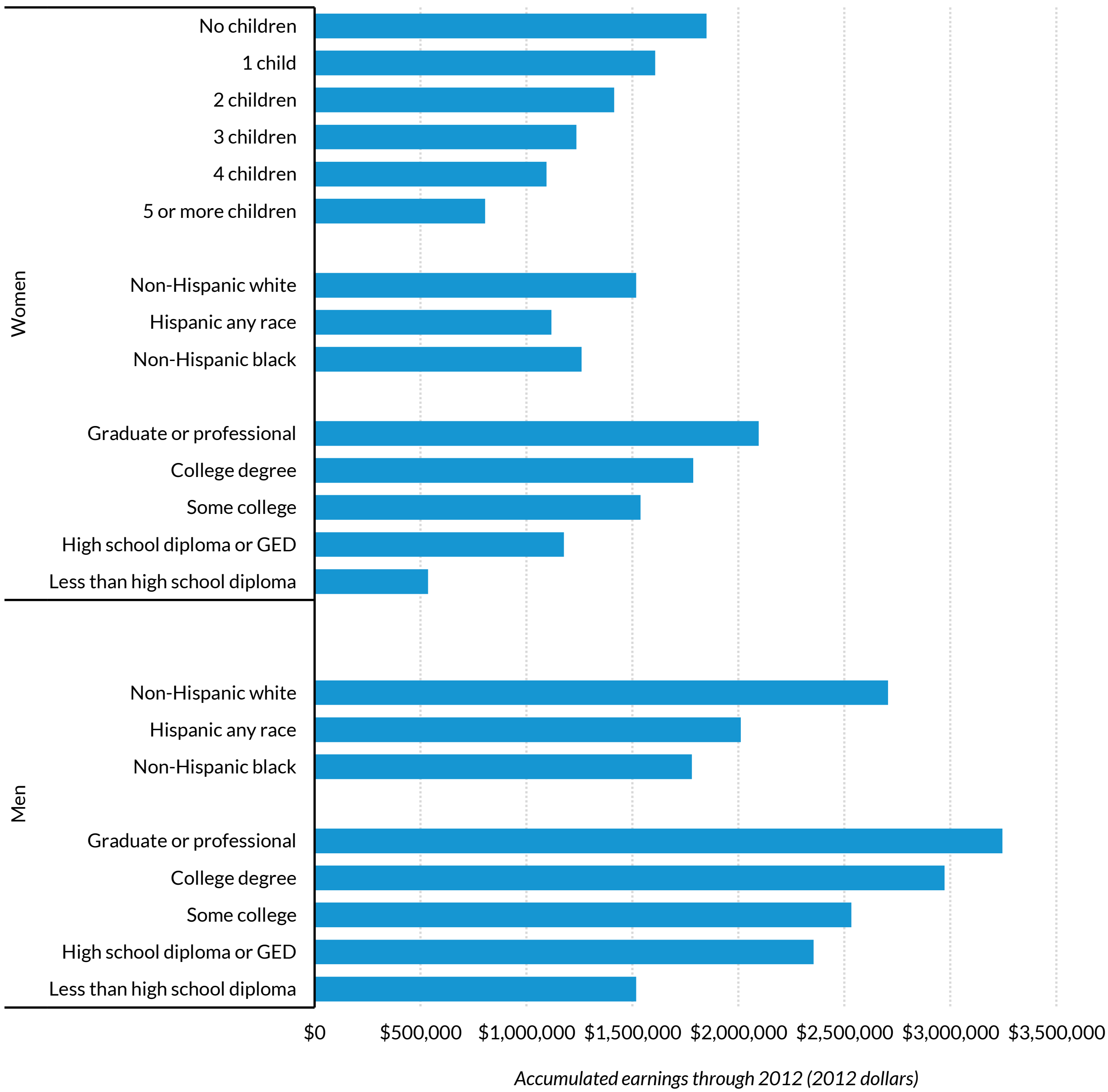
Workers also need to worry about investment risk. Some can see their retirement savings disappear because of an extended stock market bust just as they are approaching retirement. Other workers might find that their employer goes bankrupt, and the company stock they were counting on for retirement becomes worthless.

Others may face retirement in poor financial shape because of their own choices: they had a good job with a good salary but never made savings a priority.

FIGURE 1

Accumulated Lifetime Earnings by Gender and Race, for People Born 1950 to 1954 Who Survive until 2012

Men earn dramatically more than women over the course of a lifetime, and for both men and women, those with more education on average earn dramatically more than those with less education; disparities by race and ethnicity are also large



Source: Favreault (2018) based on 2008 Survey of Income and Program Participation matched to earnings records.
Notes: Accumulated values as of 2012 in 2012 dollars, without discounting.

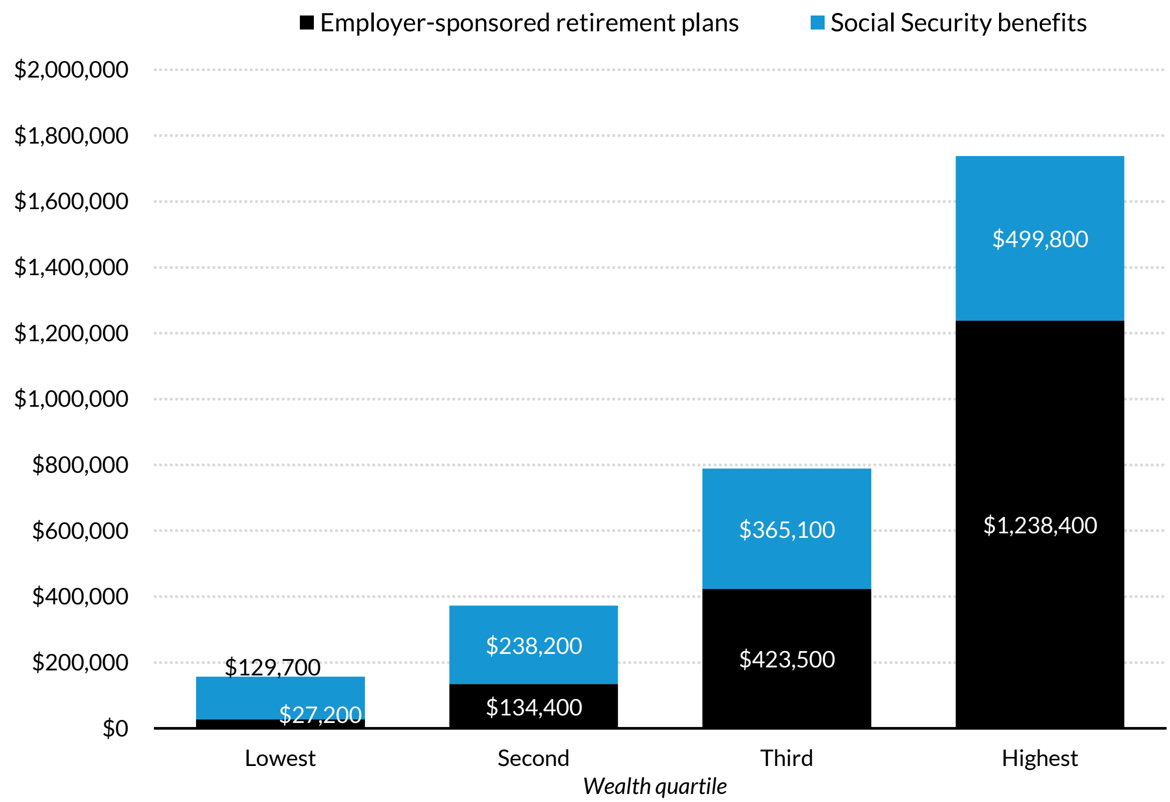
Once workers enter retirement, new challenges and risks can arise. Those who were fortunate and diligent enough to have saved need to a plan to spread their assets over their remaining lifetimes without knowing how long that will be. This means a longer life is not just a gift but also another risk to be managed. They also need to worry about inflation eating away at their resources. And one of the largest risks faced by those who live for a long time is the risk of becoming frail and needing full-time care, for example because of a debilitating disease such as Alzheimer's. The Society of Actuaries documents how workers plan for and cope with these risks after retirement.[1]

The government, employers, private insurance companies, and individuals all play different roles in managing these life-course risks. Individuals work and save to prepare for retirement and difficult times. Some employers provide workers with health insurance, disability insurance, and pension benefits. Insurance companies manage risks for health and disability insurance for employers and for workers who purchase health insurance or long-term care insurance directly.

FIGURE 2

Retirement Wealth for Working Families Approaching Retirement (Ages 50–59), by Wealth Quartile

Those in lower wealth quartiles hold comparatively little retirement plan wealth outside of Social Security



Source: Sabelhaus and Henriques Volz (2019) from Survey of Consumer Finances and Financial Accounts of the United States.
Notes: Reports averages of present values within groups.

[1] See "Understanding and Managing Post-Retirement Risks," Society of Actuaries, February 2019, https://www.soa.org/resources/research-reports/2017/post-retirement-needs-decisions/.

The federal government steps in where markets do not work or do not work well. For example, people are much more likely to buy a type of insurance if they know they are likely to need the benefits (adverse selection), and they might make socially damaging choices if it is financially advantageous to them (moral hazard). A further rationale for government intervention is that too many people are myopic: they simply won't save for retirement or for disability unless they are forced to, or they fully intend to save at some future point, but they procrastinate so long they do not have enough time to accrue the savings they will need.

Figure 2 gives us a sense of where those coming up on retirement—working families who are ages 50 to 59—stand today. The figure shows that for those lower in the wealth distribution, future Social Security benefits constitute the majority of family wealth.

This brings me to my first policy point: Social Security is the bedrock of the US income security system, protecting tens of millions of Americans every year with guaranteed, progressive, inflation-protected benefits. To keep our promise to America's seniors and today's workers, we must shore up Social Security's finances. As we do this, we must account for the effects of increases in inequality in earnings and longevity in recent decades.

With its guaranteed, nearly universal, progressive retirement benefits offered in the form of an inflation-protected annuity, Social Security is the central component of a secure retirement for most Americans. It provides a large share of many retirees' total incomes.[2] In addition to worker retirement benefits, the program also provides benefits in time of disability, for dependent family members, and for survivors after a worker's death. It thus addresses or reduces most of the risks and challenges I've just enumerated: progressivity reduces low lifetime earnings risk; annuitization and inflation protection reduce the challenges of making savings last;[3] mandatory participation addresses the risk of failing to save; and disability, spouse, and survivors' benefits address the risks associated with disability or the death of a family's primary earner.

The program has had tremendous success helping workers prepare for retirement and disability. It has allowed generations to live independently, securely, and with dignity. Social Security played a significant role in reducing poverty among older adults.[4] Old-age poverty rates fell from 35.2 percent in 1959 to 9.2 percent in 2017.[5,6] Meyer and Wu (2018) find that in recent years, Social Security reduced the pretransfer poverty

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[2] Using high-quality household survey data matched to administrative records, Bee and Mitchell (2017) estimate that more than two-fifths (42.2 percent) of people ages 65 and older in 2012 depended on Social Security for at least half of their income, and one-tenth (10.2 percent) depended on Social Security for 90 percent of their income. Dushi, Iams, and Trenkamp (2017) present similar estimates for a later period comparing data sources.

[3] These two aspects of Social Security—annuitization and inflation protection—could make it easier for workers to navigate the spend-down phase in retirement if they can wait to claim Social Security benefits until after they reach the full retirement age (Mahaney and Carlson 2008). Deferring benefits raises their Social Security income and their stream of inflation-protected benefits that last a lifetime.

[4] Using a strategy geared at estimating causal effects, Engelhardt and Gruber (2006) estimate that historically (from 1968 to 2001) every $1,000 increase in Social Security benefits reduces elderly poverty by 2 to 3 percentage points.

[5] Using the Supplemental Poverty Measure, which better accounts for seniors' health care costs, aged poverty is estimated much higher—14.1 percent—in 2017 (Fox 2018).

[6] Bee and Mitchell (2017) find that the official poverty measure may overstate poverty because certain types of income are poorly reported.

rate overall by about one-third and reduced it for those age 65 and older by three-quarters.[7] They report further that roughly two-thirds of total benefits go to people who were poor before accounting for transfers and that these transfers reduce the poverty gap about 45 percent. These statistics illustrate that government can accomplish great things. And this retirement security has been delivered very economically: although the program's rules are complex, Social Security's administrative costs are low relative to private insurance programs.

As the Social Security trustees reported in April, the program now faces a modest long-term shortfall, estimated at 2.78 percent of taxable payroll. Our aging population, contributed to in part by low birth rates, accounts for much of the program's 75-year shortfall. Increased earnings inequality has also exacerbated the problem. Social Security caps the earnings it counts for both payroll taxes and benefits at $132,900, adjusted annually for inflation. As the highest earners have garnered a greater share of total earnings, this cap starves Social Security of needed revenue and worsens the program's fiscal position.[8] Legacy debt also contributes to underfunding (Diamond and Orszag 2004; Leimer 2016; Munnell, Hou, and Sanzenbacher 2017): Early program participants who contributed little to support their benefits earned much higher returns on their contributions than subsequent generations.

Bolstering Social Security's long-term finances as soon as possible will help workers plan for their retirement and reduce their uncertainty about the future. It also will allow the costs of change to be more broadly shared across generations. It is thus heartening to see that members of the Congress and this committee are developing legislation designed to put Social Security on better financial footing.

Increasing program revenue needs to be a critical component of restoring the program's long-term financial balance. At least part of this new revenue should come from high-income adults who can best afford to make higher contributions. Nobel Laureate Peter Diamond and Emmanuel Saez have suggested that very high earners should be subjected to high and increasing tax rates that are higher than under current policy (Diamond and Saez 2011). Increasing the cap on earnings included in Social Security's wage and benefit base, so that it covers at least the same share of earnings it did in the early 1980s (figure 3),[9] could improve the program's fiscal balance and simultaneously help the program better account for recent increases in earnings inequality. Such a change is also popular: in public opinion polls, Americans consistently report that they would prefer to pay more to keep Social Security on a solid footing rather than reducing program benefits,

[7] Meyer and Wu use recent, high-quality data from the Survey of Income and Program Participation from 2008 to 2013 matched to administrative records and a careful accounting strategy. Such an approach does not integrate the potential for behavioral change that could occur if, say, Congress were to change Social Security or if Social Security never existed. It does, however, provide a powerful illustration of the effects of the program as it now exists. Romig (2018) provides similar estimates, including state-by-state estimates, using data from the Current Population Survey.

[8] My Urban Institute colleague Richard Johnson estimates that if the share of total earnings that were covered had remained roughly constant at the early 1980s levels, Social Security's 75-year actuarial deficit would be about a quarter smaller.

[9] According to estimates from Social Security's actuaries, if Congress raised the taxable maximum to $267,600 this year, 90 percent of total earnings would be covered, the same level as in the early 1980s. Such a change could extend the program's solvency by about five years and reduce the actuarial deficit about 28 percent (See option E3.1 in Social Security Administration, Office of the Chief Actuary 2018) if workers received additional credits toward benefits from the new taxes. If workers did not receive credit for the extra contributions, then the system would be fully solvent for about six more years and the actuarial deficit would fall about 35 percent (See option E3.2 in Social Security Administration, Office of the Chief Actuary 2018).

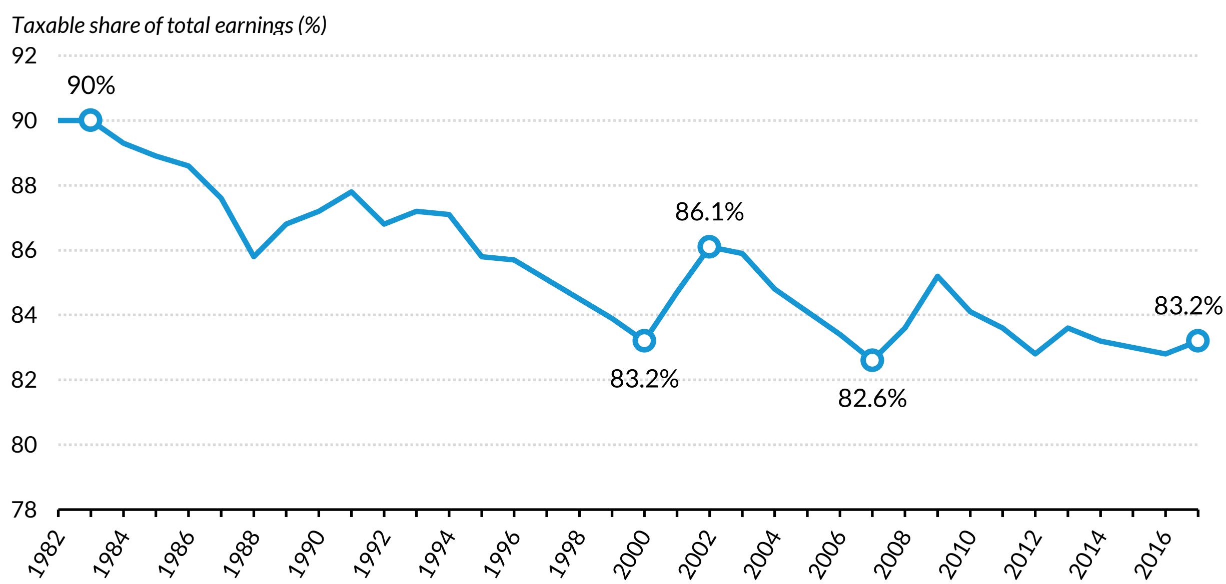
and they especially prefer when higher earners contribute the most (Tucker, Reno, Bethell 2013; Walker, Reno, and Bethell 2014).

Asking more from affluent workers could also help account for the fact that death rates are much lower, and so life expectancy is much longer, for higher lifetime earners than for lower lifetime earners (Bosley, Morris, and Glenn 2018; Bosworth, Burtless, and Zhang 2015; National Academies of Sciences, Engineering, and Medicine 2015; Waldron 2013). Estimates vary across these studies, but differences by education and lifetime earnings are often striking, in some cases over ten years difference in life expectancy at age 51 between the highest and lowest status groups. Death rates are also lower for women than men. Moreover, recent life expectancy gains have gone overwhelmingly to those with the most education and highest lifetime earnings (Bosworth, Burtless, and Zhang 2015; National Academies of Sciences, Engineering, and Medicine 2015; Olshansky et al. 2012; Waldron 2007) (figure 4). As a result, people with less education, especially less-educated men, are more likely to die before reaching Social Security's eligibility age or within a few years of beginning to collect benefits (figure 5). For men with less than a high school education, deaths are expected to be concentrated in their late 70s and throughout their 80s. Men with more than a college degree are expected to be more likely to die in their late 80s and throughout their 90s. For women, expected deaths for the most educated are largely concentrated in their 90s. These estimates also underscore how challenging it is for retirees to manage how long their retirement resources last, because their possible ages of death can vary greatly.

FIGURE 3

Share of Total Earnings Taxable by Social Security, 1982–2017

As earnings have increased more rapidly for the highest earners, the share of total earnings that Social Security taxes has fallen, reducing program revenues

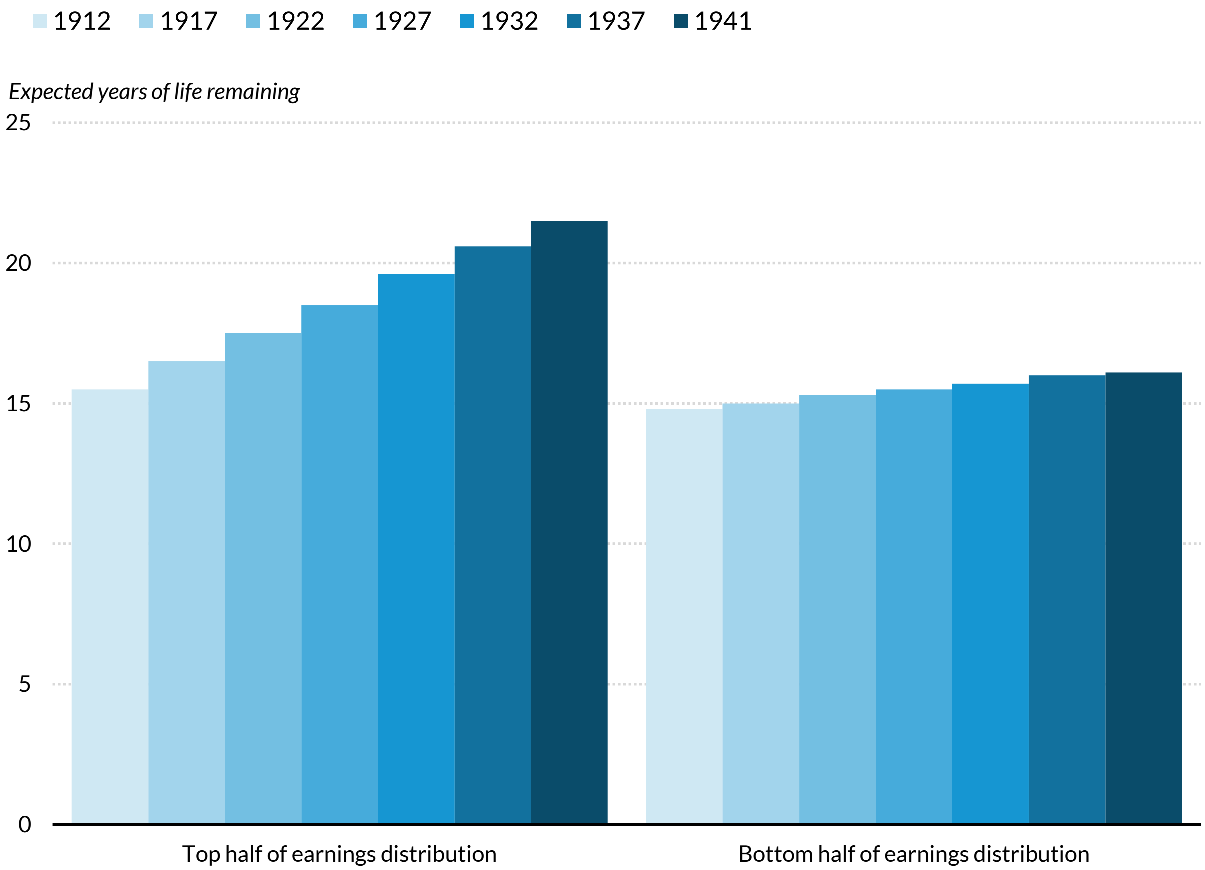


Source: Table 4.B1 *Annual Statistical Supplement to the Social Security Bulletin*.
Notes: Data for years 2013 through 2016 are preliminary; page 143 in the *2019 Trustees Report* reports a value of 83.2 percent for 2017. Vertical axis does not begin at zero.

FIGURE 4

Life Expectancy at Age 65 for Men by Birth Cohort and Lifetime Earnings

In recent decades, life expectancy grew for men in the top half of the distribution but stagnated for others



Source: Waldron (2007).

Social Security has enjoyed deep political support because workers participate over their lifetimes, first as contributors and later as beneficiaries; many workers thus consider it an earned right. Wilbur Cohen, who headed the Department of Health, Education, and Welfare in 1968 and was a strong Social Security supporter, opined that programs for the poor will end up being poor programs. Many Social Security analysts still echo that view today.

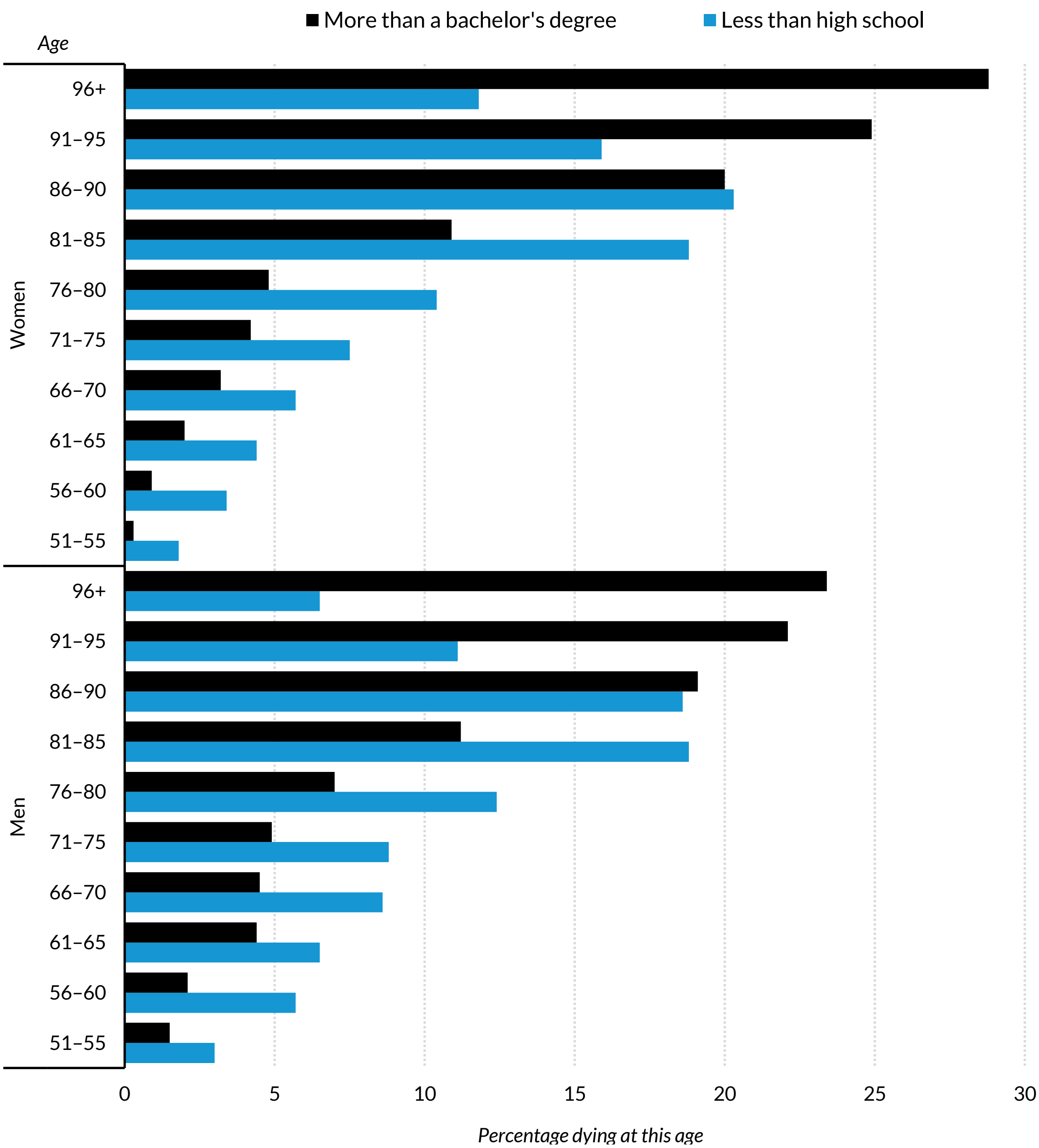
Raising the Social Security earnings cap alone and reducing higher-wage workers' returns on these contributions will probably not generate enough additional revenue to close the program's long-term shortfall. Even if doing so would raise enough revenue, many believe that solving the program's financing challenges solely through tax increases on the well-to-do would not be in its long-term best interests. Progressive policy sometimes requires choices that on some level appear regressive. Some other revenue-side options for improving Social Security solvency could include raising the payroll tax rate and expanding the contribution base, such as by including employee and employer contributions to employer-sponsored health insurance premiums or employee contributions to covered earnings.

Whatever the source, implementing revenue increases gradually—and particularly so that the new resources track the program's need for cash—could help limit potential work disincentives.

FIGURE 5

Projected Distribution of Age at Death by Education and Gender for People Born from 1965 to 1974 who Survive Until Age 51

Expected age of death differs greatly depending on education and gender



Source: Author' calculations from DYNASIM (runid 964, dated October 2018).

Too many older adults in the US are still poor or near poor. Recent studies estimate that between 3.0 and 7.2 million people age 65 and older live in poverty, depending on the data, time period, and measure used (Bee and Mitchell 2017; Fontenot, Semega, and Kollar 2018; Fox 2018). As we bolster the system's finances, we also should consider other program improvements, such as adding benefits targeted to the poor and near poor or adjusting rules to improve work incentives and increase fairness between different kinds of families.

Today, long-term low-wage workers are not guaranteed a Social Security benefit that can bring them out of poverty.[10] Women, especially those who are unmarried and long-term caregivers, are among those most likely to have low Social Security benefits (Favreault 2018), and their old-age poverty rates are nearly double those of men (Bee and Mitchell 2017). Poverty rates for older black and Hispanic Americans are estimated to be more than double those of the aged population as a whole (Bee and Mitchell 2017). Disabled workers, particularly those who become disabled at a young age, are also especially vulnerable, with much higher poverty rates and higher levels of material hardship (Brucker and Houtenville 2014; Favreault, Johnson, and Smith 2013; She and Livermore 2007, 2009; Wu and Hyde 2018), and high poverty rates of people with disabilities persist at age 65 and older, where they are more than double the rates of those without disabilities (Bee and Mitchell 2017).

Analysts and policymakers have proposed a wide range of Social Security adjustments that would narrow these gaps. In past work, colleagues and I have analyzed highly targeted minimum benefits that can be efficiently provided through the tax system, akin to an income tax credit for retirees (Herd et al. 2018). Congress should consider this type of adjustment.

Other ways to enhance the program for low-income retirees include redesigning and expanding minimum benefits and survivor benefits (sometimes financed through reductions in spousal benefits), granting earning credits to family caregivers who spend time outside of the paid workforce or working part time, adjusting the Social Security benefit formula to increase progressivity, and increasing benefits for the very old. Many such provisions have been integrated into past Congressional and commission proposals. Researchers at the Social Security Administration, Congressional Budget Office, and Urban Institute have documented the distributional effects of many alternative Social Security changes. In recent work, we have also tried to illustrate how different Social Security adjustments meet different goals (Favreault and Smith, forthcoming). Congress should ground in evidence policy adjustments aimed at increasing benefits for the most vulnerable. It should approach ideas to tap Social Security benefits to meet early life course needs with great caution.[11]

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[10] For example, a worker who earned the minimum wage for 40 hours per week and 52 weeks per year every year from age 20 to 59 and then claimed Social Security benefits at the early eligibility age of 62 would be eligible for a benefit of roughly 72 percent of the federal poverty level. If she deferred claiming until her full retirement age, she could receive a benefit of just about poverty. Part-time hours or fewer weeks in the year, common conditions for lower-wage workers, would yield lower benefits.

[11] Some policymakers and analysts have proposed allowing workers to borrow from their future Social Security retirement benefits to finance paid parental leave, pay off student loans, or meet other needs at younger ages. Although I applaud innovative solutions to address the needs of family caregivers and those with high student debt, Congress should recognize the downside of tapping Social Security benefits early in life. Diverting Social Security benefits for other purposes could undermine future retirement security (Johnson and Favreault 2018). Borrowing from future Social Security benefits would likely be most tempting to those with less education and lower lifetime

Our research has identified the risks of unintended consequences of certain changes in the program (Favreault 2018). For example, Congress needs to be aware of how raising benefits for lower lifetime earners interacts with eligibility for and benefits from Supplemental Security Income and Medicaid. The Supplemental Security Income program deserves attention in its own right. Its income and asset restrictions have not been updated in decades, so they are now about half what they were in inflation-adjusted dollars the last time Congress changed them.

Second, employer-sponsored retirement plans are a critical complement to Social Security. However, employees' access to these plans is uneven and many current-law federal retirement savings incentives to workers and employers—largely through the tax code—are regressive. Employers and Congress should continue to consider evidence-based, innovative, progressive ways to increase access to easy savings and encourage working age people to save. Congress should also redirect retirement savings subsidies so that they better stimulate savings among those for whom saving is most difficult.

Social Security was never intended to be workers' sole source of support in old age. In the 1940s, the analogy of a three-legged stool was famously applied to retirement security—with Social Security, employer pensions, and private savings and investment constituting the stool's three legs.[12]

The Bureau of Labor Statistics reports that in 2018, 55 percent of workers are covered by and participate in employer retirement plans (2018). The remaining 45 percent who are not offered a retirement plan by their employer or who are offered one but choose not to participate disproportionately hold low-wage or part-time jobs (figure 6). Less than half of those in jobs with wages in the lowest quarter are offered employer pensions, and only about a quarter of these workers participate. Participation and ultimate pension income in retirement also vary by race and ethnicity (Johnson, Mudrazija, and Wang 2016). Those with a retirement plan are now far more likely to be covered by a defined-contribution plan than by a more traditional defined-benefit pension. The US Department of Labor's Employee Benefit Security Administration estimated that in 2016, 85 percent of private-sector workers with retirement plan coverage were in defined-contribution plans compared with just under 15 percent in defined-benefit plans.[13] Public sector workers are more likely than private sector workers to be covered by defined-benefit plans.

Expanding access to low-cost savings vehicles for those not offered an employer retirement plan is a critical first step in boosting retirement adequacy. Several states have started to do this, and we should monitor these experiences and learn what works best from them.

The behavioral economics literature has emphasized the importance of features like automatic enrollment, compulsory choice, and automatic escalation in increasing participation and contributions

earnings, who face above-average risks of ending up sick and poor in retirement. In the case of paid leave benefits that are designed to pay for themselves, those who claim them could effectively be choosing to pay interest for 50 years on a loan of just a few thousand dollars.

[12] Social Security's historian claims that this metaphor did not begin in the Roosevelt administration, but rather with an insurance company actuary. See "Research Note #1: Origins of the Three-Legged Stool Metaphor for Social Security," Social Security Administration, accessed May 13, 2019, https://www.ssa.gov/history/stool.html.

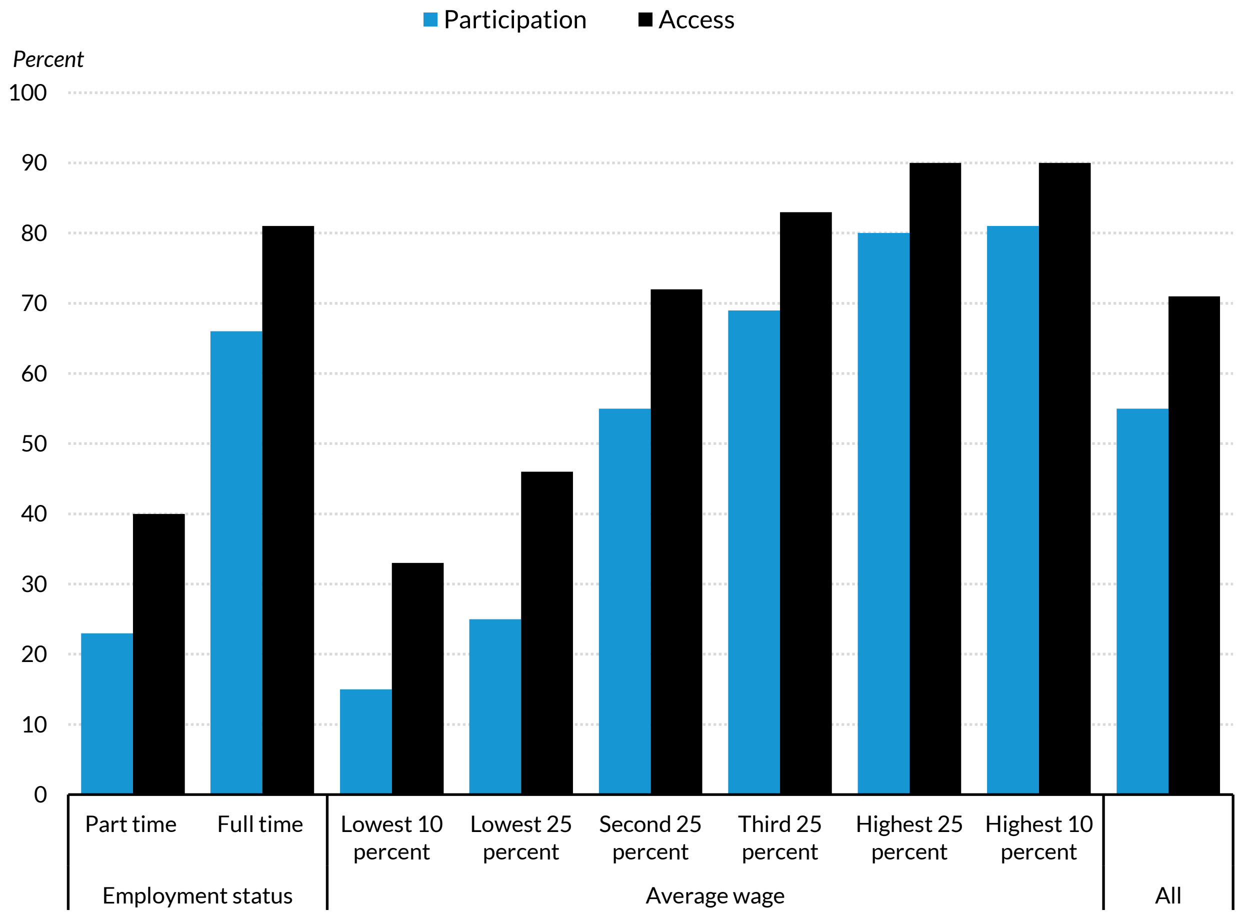
[13] Based on form 5500 filings for plan years ending in 2016. The population includes eligible nonparticipants. See table B7 of US Department of Labor, Employee Benefit Security Administration (2018).

in retirement savings vehicles (Carroll et al. 2009; Madrian and Shea 2001; Thaler and Benartzi 2004). The Pension Protection Act of 2006 made it easier for employers to offer automatic enrollment, and this has helped boost saving.

FIGURE 6

Access to and Participation in Retirement Benefits, by Average Wage Quantiles and Status, 2018

Higher-wage and full-time workers are most likely to be covered by and participate in pensions



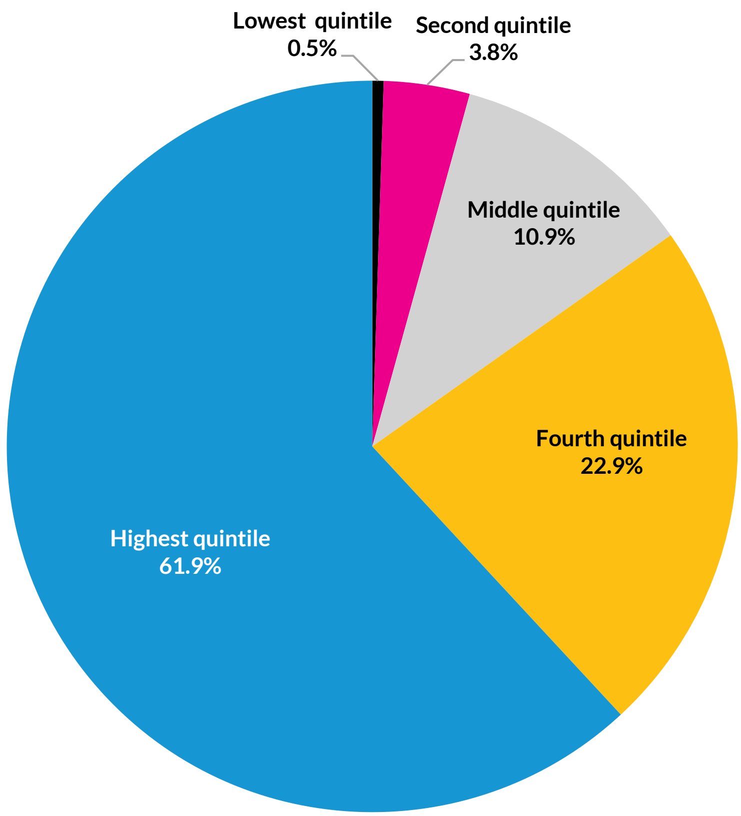
Source: Bureau of Labor Statistics (2018), table 2.
Notes: Population is civilian workers, March 2018.

The tax code subsidizes retirement savings by allowing people to deduct qualified savings from their taxable income. Because worker and employer contributions are generally larger for higher-income workers, and higher-income workers face higher marginal tax rates, it is more valuable for higher-income workers than lower-income workers to defer earnings. Federal tax incentives for retirement savings—and similar vehicles such as health savings accounts and college savings—are thus largest for those with the highest incomes (figure 7). My Tax Policy Center colleagues estimated that in 2017, more than three-fifths of these tax incentives for retirement went to those in the top one-fifth of the pretax income distribution; these incentives are thus directed to those who are most likely to save even absent large incentives. In 2017, these federal tax expenditures for retirement amounted to almost $230 billion. From 2018 to 2022, this is likely to reach nearly $1.4 trillion in lost revenue.[14]

FIGURE 7

Share of Tax Expenditures for Retirement Savings Incentives by Before-Tax Expanded Cash Income Quintile, 2017

Tax expenditures for retirement savings flow disproportionately to those with the highest incomes



Source: Urban Institute (2017), table T17-0130.
Notes: Estimates are for before the Tax Cuts and Jobs Act of 2017 was enacted.

Some analysts thus characterize retirement savings incentives in the tax code as "upside down" (Orszag 2004). Research by Chetty and colleagues (2012) suggests that savings incentives are most likely to generate new savings for lower-wage workers; at higher income levels, they are more likely to shift assets from taxable accounts into tax-preferred vehicles instead of increasing total saving

Retirement saving subsidies for defined contribution plans should better target those for whom saving is most difficult rather than rewarding those who often would have saved anyway. Several of my

[14] "How Large Are the Tax Expenditures for Retirement Saving?" Urban-Brookings Tax Policy Center Briefing Book, accessed May 13, 2019, https://www.taxpolicycenter.org/briefing-book/how-large-are-tax-expenditures-retirement-saving.

colleagues (Butrica et al. 2014; Gale 2011) have proposed and evaluated ideas about how to flip or flatten these upside-down incentives. These include, for example, replacing tax deductions with tax credits for retirement savings in defined contribution plans. Some suggest that directing such subsidies to Social Security instead of retirement plans might be prudent given how reliant most of the population is on the program (Sabelhaus and Henriques Volz 2019).

Third, like Social Security, Medicare is a vital support for older Americans. However, its protections are incomplete, so the risk of high health care spending is significant for many older adults. This risk is projected to increase dramatically in coming decades, especially for lower-middle- and middle-class families.

A discussion of future financing challenges for Medicare is beyond the scope of this hearing, so instead I focus narrowly on one important issue for middle class retirement security: cost sharing burdens.[15]

Although Medicare in total has a progressive financing system, premiums often eat up a significant share of Social Security benefits (Cubanski et al. 2018) and total income. Health care costs have typically grown faster than workers' incomes and retirees' Social Security benefits, pensions, and other retirement income. In coming decades, beneficiary premiums and cost shares are projected to increase faster than their incomes if current laws do not change, further increasing the already-significant share of retirees facing high health care spending burdens.

Medicare has some noteworthy coverage gaps that leave some beneficiaries responsible for substantial cost shares. Some services are not covered in traditional fee-for-service Medicare, most notably LTSS as well as vision, hearing, and dental care. Some Medicare Advantage plans cover some supplemental services.[16] Even for those services that Medicare does cover, the program's deductibles and copayments are organized by the type of service—such as hospital services, outpatient services, and prescriptions drugs—so that those using the same total amount of care but covered by different parts of the program can have higher cost-sharing requirements than those using services primarily from a single part of the program. Also, traditional Medicare has no cap on total out-of-pocket spending, though Medicare Advantage does have caps.

Beneficiaries in the middle class—and especially the lower middle class—are quite vulnerable. The ways that Medicare and Medicaid's cost-sharing provisions affect beneficiaries with the greatest health care needs deserve deeper consideration. As colleagues from Harvard Medical School and I showed in earlier work, the burden is likely to get much larger in coming decades (Hatfield et al. 2016) (figure 8). The share of retirees spending more than 20 percent of their income on premiums and cost shares for a

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[15] Many have argued that our nation's future fiscal health will depend critically on controlling health care cost growth, making this a fundamental challenge for government in coming decades. Although the Medicare program has contained costs per enrollee better than private insurers (Holahan and McMorrow 2019), careful analysis and monitoring, as by the Medicare Payment Advisory Commission, is required to pinpoint places where adjustments to service delivery and payment rates may be appropriate to improve and sustain this program

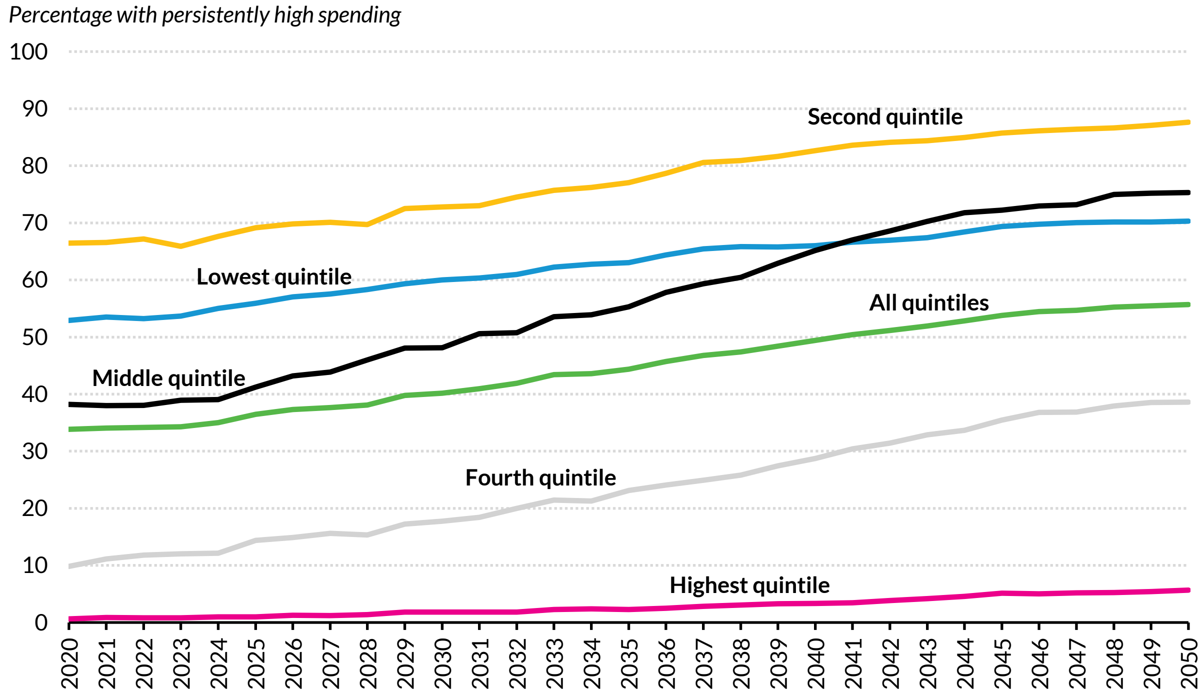
[16] For the first time, Medicare began allowing small LTSS benefits through the Medicare Advantage program in 2019. Any benefits must be primarily health related. Potential benefits include items such as in-home and caregiver support, palliative care, and adult day services. It will be worth monitoring this pilot year.

sustained period is expected to climb dramatically through 2050, especially for those in the second and middle income quintiles.

FIGURE 8

Percentage of Medicare Beneficiaries with Persistently High Out-of-Pocket Health Care Spending by Income Quintile, 2020–50

Medicare cost sharing burdens are expected to grow rapidly in coming decades, especially for those in the lower middle class and middle class



Source: Adapted from Hatfield et al. (2016), figure 3.
Notes: The lines show the percentage of people in the simulated population who spend at least 20 percent of per capita income on health care (in the index year plus or minus two years) in each year of the simulation. Results are shown separately for each income quintile and for the whole population.

The Medicare Payment Advisory Commission (2012) discusses and explores these issues, highlights the goal of balancing tradeoffs between protecting beneficiaries from high out-of-pocket costs and creating incentives for them to make good decisions about discretionary care, and makes recommendations about adjustments. My Urban Institute colleagues have documented how alternative Medicare policies—such as a unified annual deductible, alternative coinsurance rates, and a limit on out-of-pocket spending—could better protect high-need beneficiaries, sometimes without adding much to costs (Zuckerman, Shang, and Waidmann 2012). People who spend across different parts of the program would have cost-sharing requirements more comparable to those with spending in a single component of the program.

Changing eligibility for or increasing participation in, for example through targeted outreach, in Medicare Savings Programs,[17] which pay Medicare premiums for lower-income adults, and the Medicare Part D Low-Income Subsidy and other proposals could also help those who are spending large shares of their incomes on health care (Schoen, Buttorff, Andersen, and Davis 2015; Zuckerman, Shang, and Waidmann 2009, 2010, 2012).

Fourth, Americans face significant, unpredictable risk of needing long-term services and supports. For many, this is possibly the largest of all financial risks in retirement.

Between 50 and 70 percent of Americans face some long-term care risk from age 65 onward (Johnson 2019). However, awareness of this risk and potential costs is limited (Wiener et al. 2015; Associated Press-NORC Center for Public Affairs Research 2017). And these risks are felt very unevenly. Dementia, for example, one of the most feared diseases and biggest drivers of LTSS needs, affects women more than men. Those with less education are far more likely to succumb to dementia than those with a college degree or more (Choi et al. 2018; Crimmins et al. 2018; Freedman et al. 2018; Langa et al. 2016). And large disparities in dementia rates by race and ethnicity persist (Choi et al. 2018; Freedman et al. 2018; Matthews et al 2018; Mayeda et al. 2016). Dementia imposes large costs because of both the money and time required to provide care (Langa et al. 2001; Hurd et al. 2013, 2015). A long spell of dementia can lead to impoverishment.

Some people may require several years of care, and roughly 10 percent of those who survive to age 65 could require 10 or more years. A year of paid home care can run about $40,000 depending on the intensity of service provided; for those needing the most intensive services, the median cost for care in a semi-private room in a US nursing home is about $90,000 per year.[18] Costs this large fall far beyond the reach of the typical American retiree and could impoverish all but those at the very top of the wealth distribution. Many could be impoverished by a shorter-range disability spell. The LTSS system thus relies overwhelmingly on unpaid work from millions of family caregivers. My colleague Anne Tumlinson (2016) thus refers to the LTSS financing system as "about as underfinanced as any system can be."

LTSS generally are not covered by Medicare.[19] Currently, most spending for formal services is paid out of pocket by families or by Medicaid for those with low incomes. Access to Medicaid is uneven across the states because state eligibility requirements, generosity levels, and service delivery approaches vary widely (Houser, Fox-Grage, and Ujvari 2018; O'Malley Watts and Musumeci 2018).

A private long-term care insurance market serves a small set of mostly higher-income purchasers, and it has not reached deeply into the middle class. Moreover, the industry is clearly facing challenges. New policy sales are declining, and many carriers have exited the market after actual costs for the plans exceeded actuarial projections and premium increases were required (Schmitz and Giese 2019). These

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[17] Estimates from the literature suggest that many who are eligible to participate in Medicare Savings Programs do not currently enroll (Caswell and Waidmann 2017; Haber et al. 2003).

[18] "Cost of Care Survey, 2018," Genworth, March 13, 2019, https://www.genworth.com/aging-and-you/finances/cost-of-care.html.

[19] In the words of the Medicare website "Medicare doesn't cover long-term care also called (custodial care), if that's the only care you need. Most nursing home care is custodial care." (See "Long-Term Care Coverage," Medicare.gov, accessed May 13, 2019, https://www.medicare.gov/coverage/long-term-care.)

well-publicized premium increases for existing private insurance plans have likely further posed challenges for courting consumers, some of whom were already skeptical.

A resurgence of interest in LTSS policy in recent years has been building on lessons from earlier congressional efforts (Commission on Long Term Care 2013). Several policy groups and commissions have convened in recent years to address this problem (Bipartisan Policy Center 2014, Long-Term Care Financing Collaborative 2016, LeadingAge Pathways 2013, O'Leary 2014), highlighting the challenges and proposing various solutions.

There is no easy solution to this problem, so policymakers are considering a range of alternatives. Incremental proposals—such as respite care and caregiver credits—could help ease caregivers' burdens and families' exposure to large out-of-pocket costs (Favreault and Spillman 2018).

Social insurance holds promise as a large-scale solution to this problem. But developing a social insurance program requires many difficult choices about eligibility criteria, the benefit package, and financing (Tumlinson 2016). Financing may pose particular challenges in the current fiscal environment given the need to bolster Social Security and Medicare because of their current shortfalls.

States have been exploring a variety of ways to promote long-term care coverage, including raising consumer awareness, expediting product approval, offering tax incentives for purchasing long-term care insurance, and, more recently, considering state-based social insurance programs (Tell and Cohen 2019).

State initiatives may suggest a way forward on broader coverage improvements for LTSS needs. Washington State recently passed legislation creating a public insurance benefit of up to $36,500 financed by a 0.58 percentage point payroll tax on workers. State-level developments like this should be monitored carefully.

Because LTSS risks tend to be skewed toward those with less education and lower lifetime earnings, policies to institute social insurance will often have progressive effects if eligibility requirements are not highly restrictive. Policies could also integrate progressive benefit eligibility criteria, as my colleagues Marc Cohen and Judy Feder (2018) have proposed.

Finally, we are confronting these funding challenges for government social insurance programs and underinsurance for LTSS risks in a context in which workers have very different prospects of prefunding their retirement needs because of decades of wage and income stagnation. Social Security has remained one of few large sources of middle-class support in this period of increased concentration of economic resources. Working longer can help some reduce their risks.

In recent decades, workers' wages have fallen behind productivity growth (figure 9). Since the mid-1970s, wage growth from nonsupervisory workers in the private sector, a group constituting about 80 percent of private sector workers, has been much slower than the growth in total output per hour worked (less depreciation), according to calculations from analysts at the Economic Policy Institute.[20]

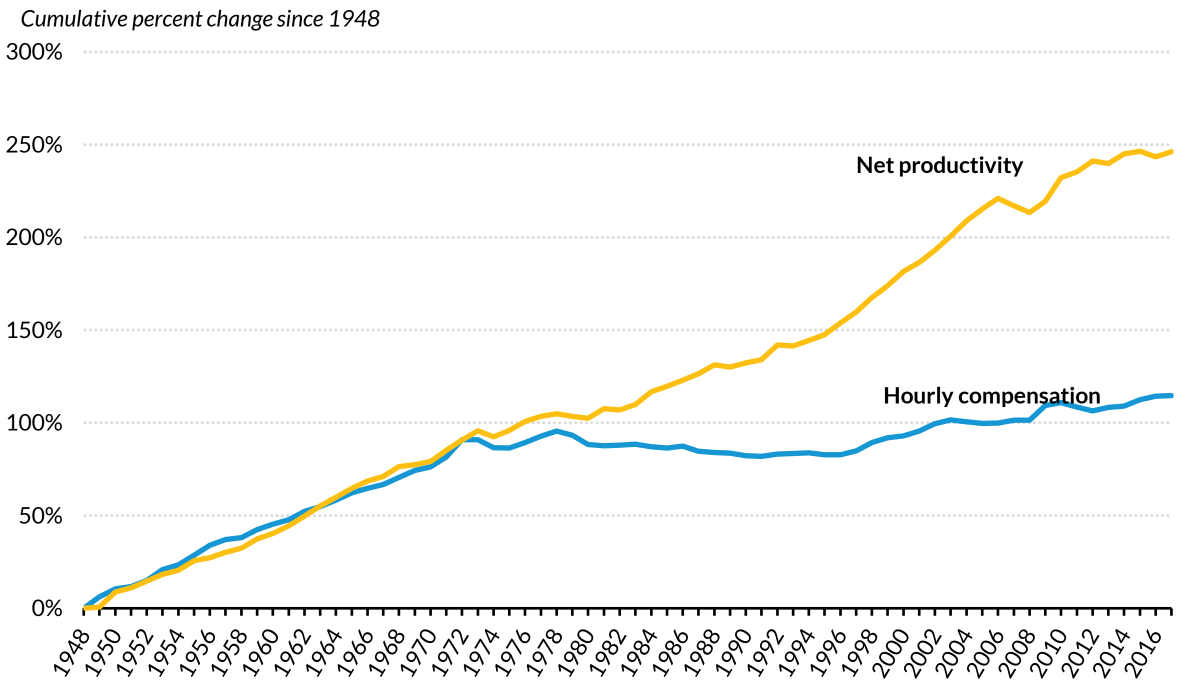
[20] See "The Productivity-Pay Gap," Economic Policy Institute, updated August 2018, https://www.epi.org/productivity-pay-gap/.

Workers and families at the top of the skills, earnings, and income distributions have done well over the past few decades. According to Congressional Budget Office estimates (2018), real (price-adjusted) incomes for those in the top fifth of the population have increased over 200 percent; incomes of those in the middle of the income distribution have increased just 26 percent (figure 10), reflecting the wage stagnation figure 9 reveals.[21]

FIGURE 9

Productivity Growth and Hourly Compensation Growth for Non-Supervisory/Production, Private-Sector Workers, 1948-2017

Since the mind-1970s typical workers' wages have lagged productivity gains



Source: "The Productivity-Pay Gap," Economic Policy Institute, updated August 2018, https://www.epi.org/productivity-pay-gap/, updated from Bivens et al. (2014), based on data from Bureau of Labor Statistics and Bureau of Economic Analysis.
Notes: Data are for compensation (wages and benefits) of production/nonsupervisory workers in the private sector and net productivity of the total economy. "Net productivity" is the growth of output of goods and services less depreciation per hour worked.

This increased concentration holds true for both retirement and nonretirement wealth (figure 11).[22] In 1989, the highest-wealth quarter held 80 percent of all wealth. By 2016, the highest-quarter's share had increased to 86 percent. The lowest quarter holds virtually no wealth, and the second quarter's share has dropped to 3 percent. Nonretirement wealth is a bit more skewed than retirement wealth, but all forms of wealth are overwhelmingly held by the highest quarter.

[21] Growth rates for the top 10 percent, and especially the top 1 percent, have been even higher.
[22] See also Batty et al. (2019).

As a result, many at the top will be able to enjoy long and very comfortable retirements, where they live as well or even better than they did when they were working. Those at the bottom, in contrast, often have very limited resources. Their retirements will on average be significantly shorter, and they will spend more time on average with health problems (figure 12),[23] many of which will be costly. Those in the lower middle class, roughly the second fifth of the income distribution, are likely to be especially squeezed and deserve special attention from policymakers.

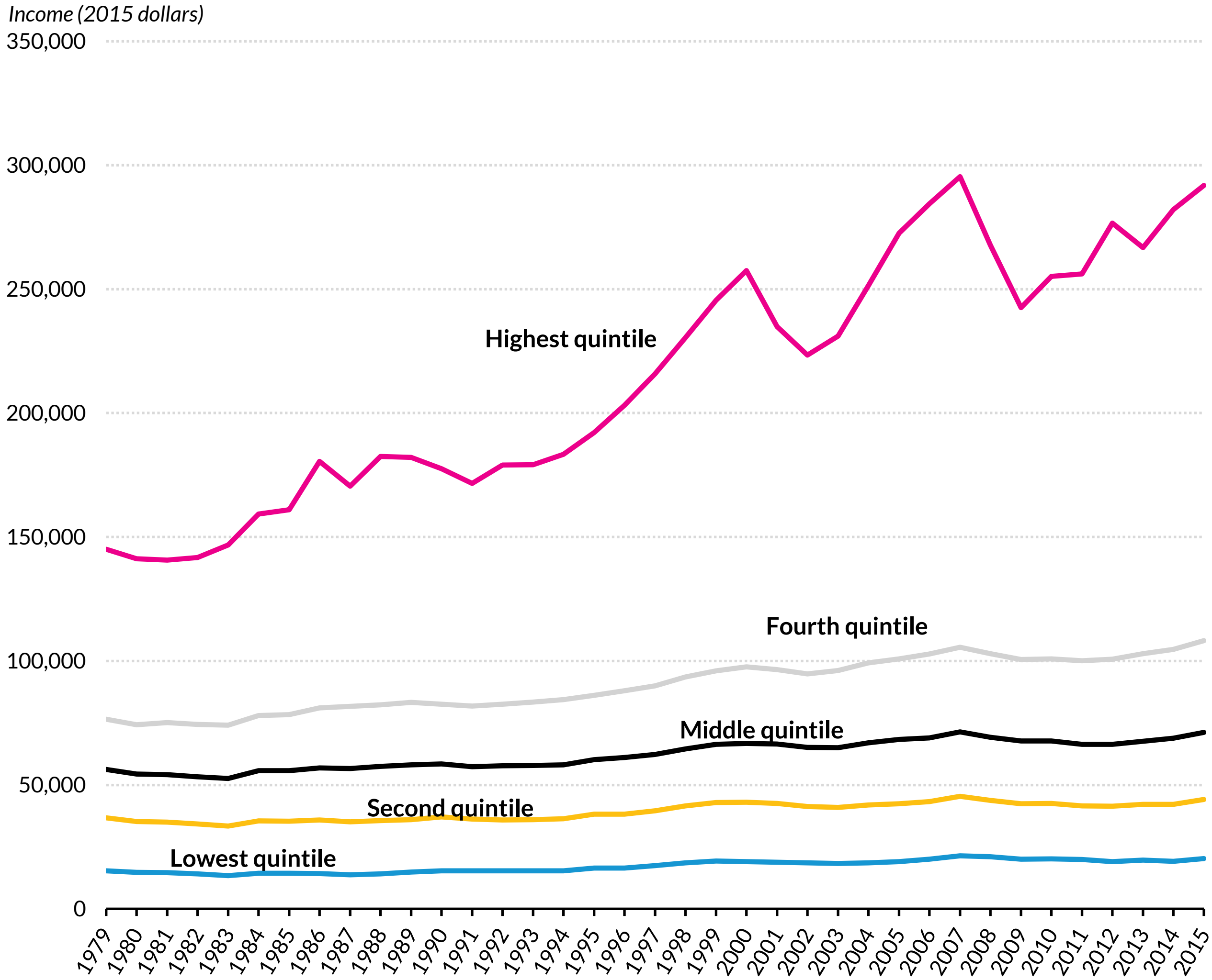
Longer, healthier lives bring with them the opportunity to contribute to our employers, our families, and our communities, and to improve our retirement prospects. Workers should be encouraged to stay on the job longer. For those who can work longer and defer claiming retirement benefits, a few extra years of work can provide powerful protection against the risk of outliving one's assets and provide additional cushion against unexpected health shocks (Butrica, Smith, and Steuerle 2006). Older adults also strengthen government balance sheets when they work longer and pay more taxes. In recent decades, both men and women have been working more at older ages, but some face late-career separations that may compromise their income security (Johnson and Gosselin 2018).

[23] Ghilarducci and Webb (2018) estimated the number of years workers can expect in retirement, including the number of years with limitations in activities of daily living, for those reaching retirement now. They report that the least educated women can expect to spend about 28 percent of retirement with disabilities; their counterparts with more education will spend 17 percent of a much longer retirement with disabilities. My own estimates of years collecting Social Security and Medicare benefits for later birth cohorts echo theirs (Favreault 2019).

FIGURE 10

Average Real Pre-Tax Incomes by Quintile, 1979–2015

Pre-tax incomes have stagnated except for the highest fifth of earners

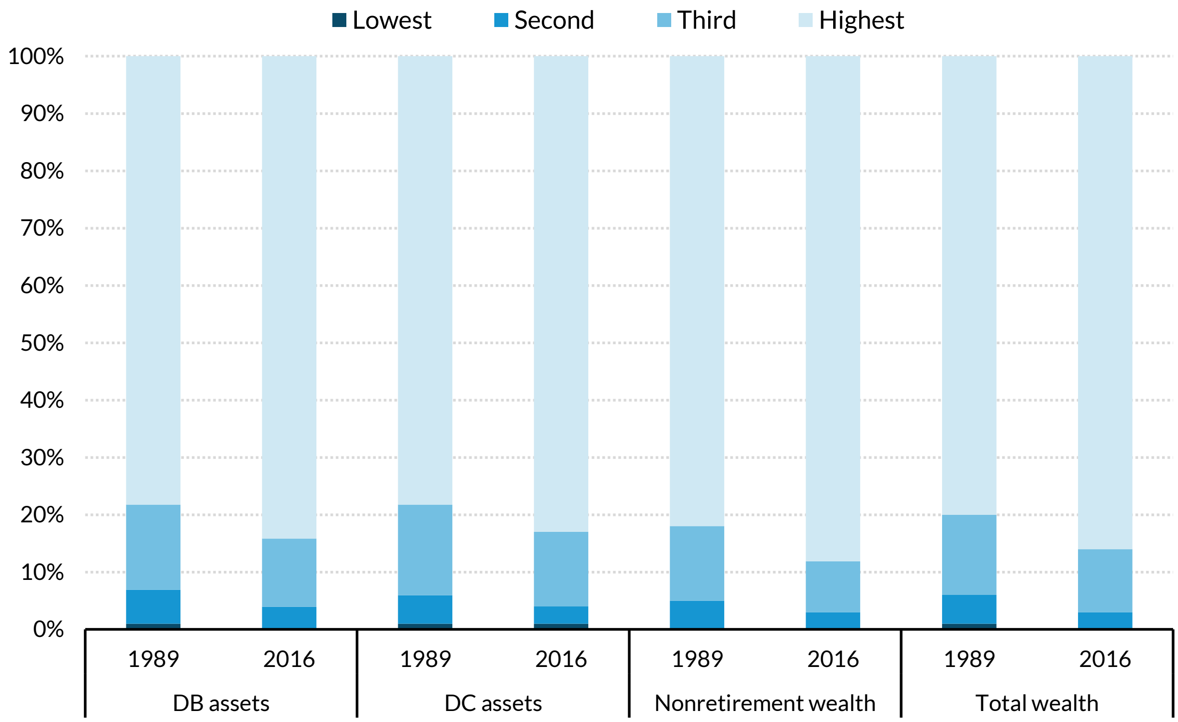


Source: Congressional Budget Office (2018).

FIGURE 11

Retirement, Nonretirement, and Total Wealth Concentration by Wealth Quartile, 1983 and 2016

Both retirement and nonretirement wealth became more concentrated from 1983 to 2016



Source: Sabelhaus and Henriques Volz (2019) from Survey of Consumer Finances and Financial Accounts of the United States.
Note: DB = defined-benefit; DC = defined-contribution.

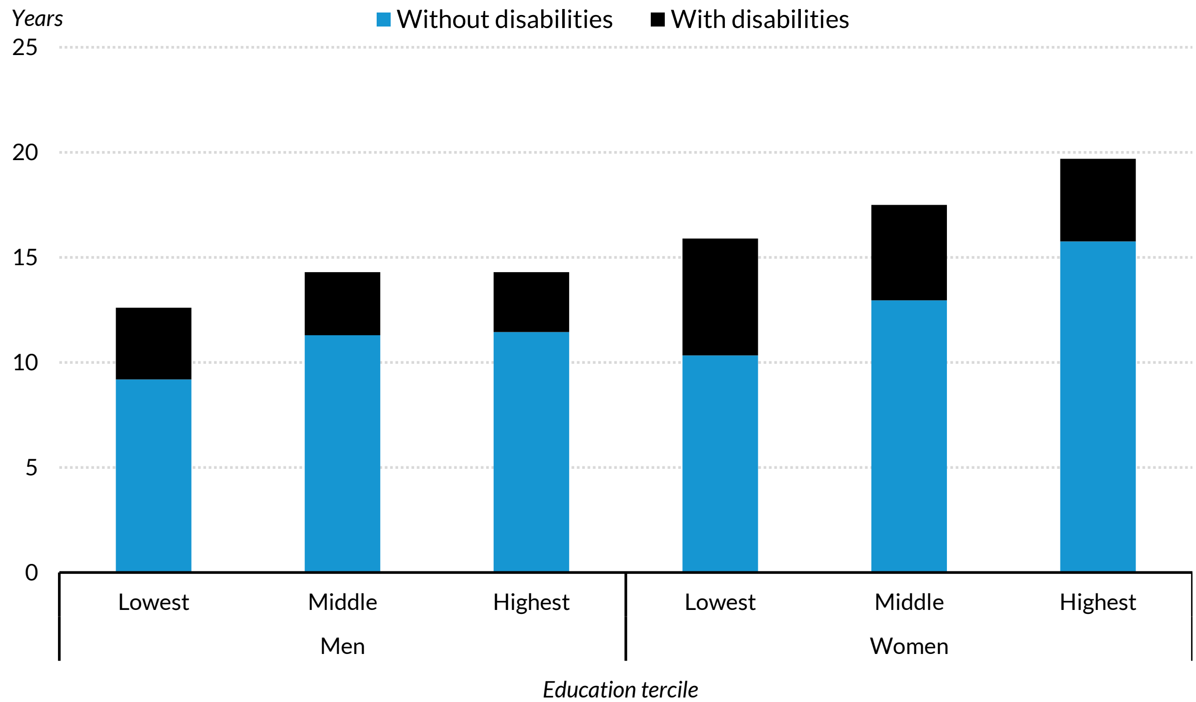
Policy changes need to recognize and account for these complex realities. Different people experience retirement very differently; studies of retirement risks show this. Although estimates of how many people are and are not prepared for retirement vary widely because of different assumptions across studies,[24] one robust finding from this literature is that certain groups are far more likely than others to be vulnerable, including unmarried people, especially unmarried women, people of color, people with less education, and people with low lifetime earnings. Policy needs to reflect this diversity, with incentives and supports tailored accordingly.

[24] Differences arise because analysts use different methods and include different risks. For example, those estimates that include the risk and potential costs of long-term services and supports tend to show much higher levels of risks than those that do not, and studies that use different replacement rate assumptions generate different results. For a discussion of how and why these studies differ, see Bajtelsmit and Rappaport (2018) and Munnell, Rutledge, and Webb (2014).

FIGURE 12

Average Years in Retirement with Disabilities, by Education and Gender

Those with less education will spend a longer share of their shorter retirement disabled



Source: Ghilarducci and Webb (2018).
Notes: Disability is defined based on reported limitations in activities of daily living.

Retirement Security Depends on More than Social Insurance and Retirement Savings Policies

Retirement preparedness is cumulative, reflecting choices made over a lifetime and the successes and setbacks experienced over a career. Many policies not traditionally associated with retirement indelibly shape it. As we reflect on ways to keep our promises to seniors, we should remember to recognize that today's children and young adults are the workers of tomorrow and will be the next generations of retirees. As figure 1 suggests, investments in education increase lifetime earnings. Those with more education will be more productive and thus better able to contribute more to Social Security and to securing their own retirements. The earlier we intervene to enable workers to have long, satisfying, productive careers, the more people will enter retirement on a solid footing in coming decades. Strong public policies can and should encourage people to save and work more when they can.

Similarly, immigrants are a vital part of our economic strength, accounting for much of our labor force growth (National Academies 2017) and a large share of scientists and business innovators (Brown et al 2019; Sana 2010).[25] They are also an important source of support to current and future Social

[25] See also Jeffery Passel and D'Vera Cohn, "Immigration Projected to Drive Growth in U.S. Working-Age Population through at Least 2035," *FactTank* (blog), March 8, 2017.

Security beneficiaries. Restrictive immigration policies could further compromise Social Security's economic health, as my Urban Institute colleagues have shown (Cosic and Johnson 2017).

Conclusions

The coming decades will require that we make many difficult choices. Here are a few suggestions of ways to keep our promises to America's seniors and improve retirement security in the 21st century:

- Restore Social Security's long-range fiscal balance, bearing in mind increased disparities in earnings and longevity. Tapping a combination of revenue sources, including increased contributions from higher earners, will be an integral component of this. Although it would be preferable to solve as much of Social Security's underfunding problem as quickly as possible, and ideal to achieve a 75-year solution, we should be open to interim alternatives. Increasing revenue to the program now would allow some from the generations now in their late careers to contribute to the solution; waiting to achieve a comprehensive agreement could limit our ability to take advantage of this opportunity.
- Social Security draws strength from its broad support as an earned right where all workers receive returns on their contributions.
- Address gaps in Social Security adequacy through targeted relief to those who most need it, using distributional analysis to confirm that the intended groups are reached and that program interactions are understood. Consider changes both to Social Security and Supplemental Security Income, and be mindful of program interactions.
- Convert our current regressive and inefficient tax expenditures for retirement savings in defined contribution plans into more targeted incentives. If tax deductions were replaced with credits, they would reach those more in need and generate more new retirement savings and reduce the preparedness gap.
- Learn from the best social science, including behavioral economics, about how to set retirement plan defaults so that they can cost-effectively increase saving and improve retirement outcomes (Benartzi et al. 2017).
- Adjust Medicare cost-sharing and eligibility for Medicare Savings Programs and the Medicare Low-Income Subsidy to reduce the share of moderate-income retirees with very high health care spending burdens.
- Carefully monitor new state efforts to bolster coverage for LTSS and consider federal solutions.
- Encourage work and savings.
- Recognize that Social Security and Medicare are two of the most important sources of middle-class support in a period of increased concentration of economic resources and power in the hands of a small share of the population. Maintaining their role in providing economic security is a critical task for the coming years.

Thank you again for giving me this opportunity to discuss retirement risks and policies that might reduce them.

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