



Statement before the House Committee on the Budget
On “Keeping Our Promise to America’s Seniors: Retirement Security in the 21st Century”

13 Things You (Probably) Didn’t Know About Retirement Savings

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May 15, 2019

Chairman Yarmuth, Ranking Member Womack, and Members of the Committee. Thank you for inviting me to speak on retirement security in the 21st Century.

Retirement saving is an exceedingly important topic for households, for policymakers and for the U.S. economy. Unfortunately, there is a great deal of ignorance with regard to the adequacy of Americans' retirement savings. I mean ignorance literally: there are a great many facts and datapoints on U.S. retirement savings and retirement incomes of which many elected officials are unaware, in part because the news media receive a higher click count for stories on a supposedly looming "retirement crisis" than for articles acknowledging that, in fact, things are going fairly well.

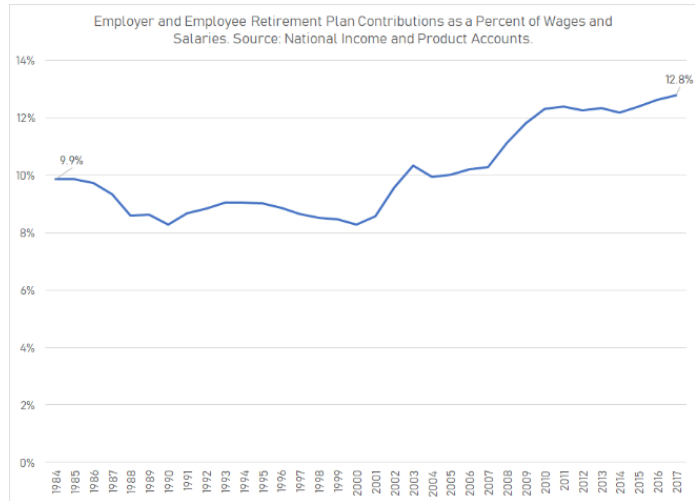
For that reason, my testimony will consist of facts, figures and ideas with which Members of Congress may not be familiar. Some of these will be surprising and contrary to what you believe or have read. I assure you that the claims I make herein are well-backed by data and evidence. Even then, I welcome questions and further discussions. Until elected officials build a common baseline of understanding regarding retirement saving and retirement programs, it will be difficult to form policies to ensure that Americans enjoy retirement security in the 21st Century.

Thirteen things you (probably) didn't know about retirement savings.

1. We're saving more for retirement than ever.
2. Total retirement savings have never been higher.
3. Just ask them: Retirees will tell you they're doing okay.
4. Retirement incomes are rising; poverty in old age is falling.
5. The golden age of traditional pensions really wasn't that hot.
6. Social Security benefits are more adequate than you think.
7. Financial planners recommend a 70 percent "replacement rate." The typical retiree does far better than that.
8. U.S. retirement plan assets dwarf other countries.
9. How we fix Social Security can have a big effect on the economy.
10. Out-of-pocket health spending has barely grown as a percent of seniors' incomes.
11. Most traditional pensions aren't going away.
12. The shift from traditional pensions to 401(k)s hasn't increased retirement inequality.
13. The real "retirement savings gap" is in government.

1. We're saving more for retirement than ever.

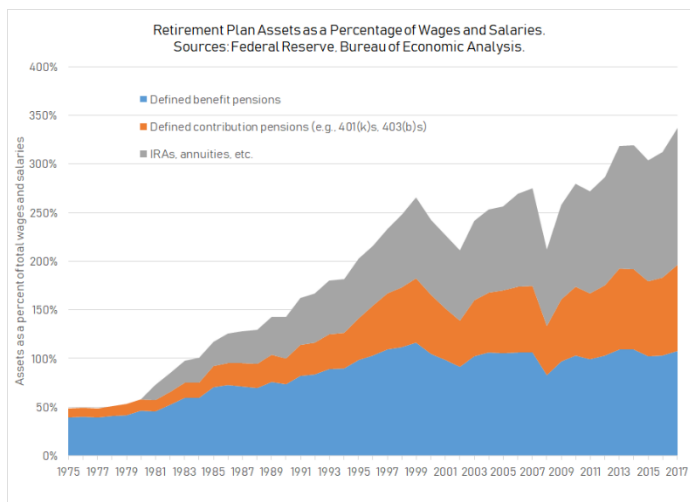
The news media rarely mention it, but Americans today are putting aside a substantially larger share of their paychecks toward retirement than ever before. Data from the National Income and Product Accounts show that combined employer and employee contributions to workplace retirement plans have risen from 9.9 percent of employee wages and salaries in 1984 to 12.8 percent in 2017, a nearly one-third increase in retirement plan contributions.¹



There are two main reasons Americans are saving more for retirement. First, 401(k)s are more widespread than traditional pensions ever were. Second, while traditional pensions were funded only by employers, who often failed to fully fund these plans, both employers and employees contribute to 401(k)s. More plans and more contributors equals more money set aside for retirement.

2. Total retirement savings have never been higher.

In 1975, at the peak of worker coverage in traditional pension plans, total retirement savings were equal to 48 percent of total employee wages, according to Federal Reserve Board data. In 2017, retirement assets topped 337 percent of employee wages, a seven-fold increase from the supposed “Golden Age” of retirement when traditional pensions were dominant.



3. Just ask them: Retirees will tell you they're doing okay.

Multiple surveys show that retirees are the most financially secure segment of the U.S. population. According to Gallup, nearly 8-in-10 retirees say they have enough money, not merely to survive, but to “live comfortably.” Barely over 6-in-10 working age households say the same. In the Federal Reserve’s Survey of Household Economics and Decisionmaking, only 6 percent of current retirees rate their retirement in the lowest of four categories, denoting “Finding

¹ While the NIPA data run only through 1984, a separate dataset on private sector plans from the Department of Labor shows a roughly constant rate of retirement plan contributions from 1975 through 1984.

it hard to get by.” Even among retirees who never finished high school, only 14 percent say they are having difficulty getting by.

In the Health and Retirement Study, 78 percent of retirees describe their retirement as either the same or better than their pre-retirement years, up from only 65 percent in 1992. Likewise, in the Federal Reserve’s Survey of Consumer Finances, 75 percent of age 65+ Americans in 2016 reported having an income sufficient to at least enough to maintain their standard of living, versus only 61 percent of retirees in 1992.

In a 2017 Vanguard survey, 54 percent of retirees said they thought America as a whole faced a “retirement crisis.” But only 4 percent of retirees described their own financial situation as a “crisis.”² Americans fear a retirement savings shortfall, but most judge their own retirement situation positively.

4. Retirement incomes are rising; poverty in old age is falling.

Federal Reserve data show that from 1988 to 2016, the median household income for Americans aged 65 to 74 grew by 62 percent above inflation. Over that same period, the median income for near-retirees aged 55 to 64 grew by only 25 percent.³

And it is not merely the very rich whose incomes have increased. A 2017 Census Bureau analysis of IRS tax data found that from 1990 to 2012, the share of retirees with incomes below the poverty threshold fell from 9.7 to just 6.7 percent.⁴

Moreover, the Social Security Administration’s sophisticated Model of Income in the Near Term projects that poverty in old age will continue to decline. Between the later Baby Boomers retiring today and Gen-X Americans retiring in the 2030s, SSA projects that poverty in retirement will decline by nearly one-fifth.⁵

5. The “Golden Age” of traditional pensions really wasn’t that hot.

Traditional pensions had two main problems. Starting with the fact that most workers didn’t have more. Participation in traditional pension peaked at only 39 percent of private sector workers in 1973.⁶ To make matters worse, strict vesting rules often required up to 15 years in a job before qualifying for any benefits. A 1972 study by the Senate Labor Subcommittee found that between 70 and 92 percent of traditional pension participants failed to qualify for a benefit.⁷ That explains why a 1980 Social Security Administration survey of new retirees found that only 9 percent of

² Vanguard. “Retirement transitions in four countries.” February 7, 2017.

³ Source: Survey of Consumer Finances.

⁴ Bee, Charles Adam, and Joshua Mitchell. “Do Older Americans Have More Income Than We Think?” U.S. Census Bureau Working Paper. 2017.

⁵ Butrica, Barbara A., Karen E. Smith, and Howard M. Iams. “This is not your parents’ retirement: comparing retirement income across generations.” Soc. Sec. Bull. 72 (2012): 37.

⁶ Source: Joshua Gotbaum, former PBGC director.

⁷ Senate Labor Subcommittee. “Statistical Analysis of Major Characteristics of Private Pension Plans.” 1972.

retirees in the bottom half of the income distribution received *any* benefit from a private pension plan. Even among the richest quarter of retirees, barely half received a private pension benefit.⁸

6. Social Security benefits are more adequate than you think.

Financial advisors believe a retirement income equal to 70 percent of pre-retirement earnings is sufficient for typical retirees to maintain their pre-retirement standard of living. Social Security, many believe, replaces only 40 percent of pre-retirement earnings. But this 40 percent Social Security replacement rate is artificially low, because it effectively compares the average benefit paid to a new retiree today to the average wages of *workers today*, not to the generally lower wages that today’s retirees earned over their past careers.

The Congressional Budget Office publishes figures comparing Social Security benefits to retirees’ *own* career-average earnings, adjusted for inflation.⁹ For middle-income retirees, Social Security replaces between 54 and 60 percent of career-average earnings, depending upon the birth cohort. For the poorest fifth of retirees, Social Security replaces between 84 and 96 percent of pre-retirement earnings.

CBO Measurement of Social Security Replacement Rates, Compared to Career-Average Earnings Adjusted for Inflation

Year of Birth	Lifetime Income Quintile				
	Lowest	Second	Middle	Fourth	Highest
1940s	94%	70%	60%	52%	39%
1950s	84%	63%	54%	46%	34%
1960s	83%	64%	54%	46%	33%
1970s	89%	67%	56%	47%	33%
1980s	94%	71%	58%	49%	36%
1990s	96%	72%	60%	50%	36%
2000s	94%	70%	58%	49%	36%

Source: Congressional Budget Office. "CBO's 2017 Long-Term Projections for Social Security: Additional Information October 27, 2017."

7. Financial planners recommend a 70 percent “replacement rate.” The typical retiree does far better than that.

Recent research using IRS data has shown that today’s retirees typically have incomes equal to 90 percent of their average pre-retirement earnings, far above the 70 percent replacement rate that financial planners believe allows retirees to maintain their pre-retirement standard of living. 2017 research co-authored by economists at the Internal Revenue Service and the Investment Company Institute found that the average middle income retiree household had an income equal to 113 percent of its spendable income just prior to retirement income. The poorest-fifth of households had an average total replacement rate of 112 percent.¹⁰

In other 2017 research, two Census Bureau economists compared retirees’ incomes five years following retirement to their earnings in various periods leading up to retirement. The median (or typical) household had a replacement rate of 94 percent of earnings in the 15 years prior to

Retirement Income Replacement Rates by Income Level, 2012. Income five years following retirement as percent of real earnings in the 15 years prior to retirement.

Income Percentile	25th	Median	75th
Replacement Rate	93%	94%	96%

Source: Bee and Mitchell (2017), using IRS administrative data.

⁸ Irick, Christine. “Income of New Retired Workers by Social Security Benefit Levels: Findings From the New Beneficiary Survey.” Soc. Sec. Bull. 48 (1985): 7

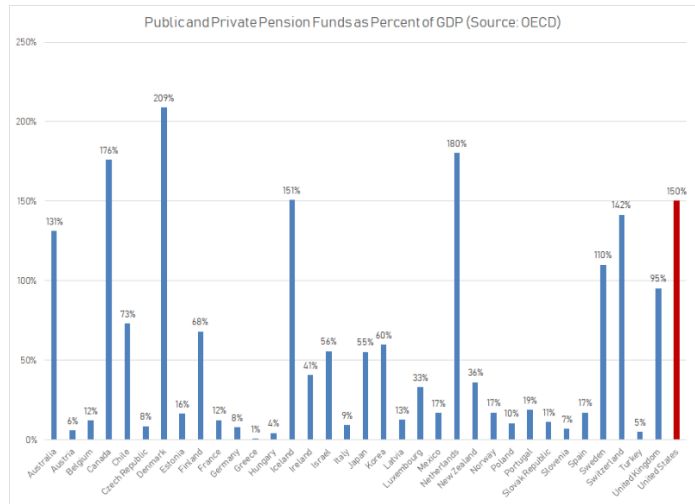
⁹ Source: Congressional Budget Office. “CBO’s 2017 Long-Term Projections for Social Security: Additional Information October 27, 2017.”

¹⁰ Brady, Peter J., Steven Bass, Jessica Holland, and Kevin Pierce. “Using Panel Tax Data to Examine the Transition to Retirement.” (2017).

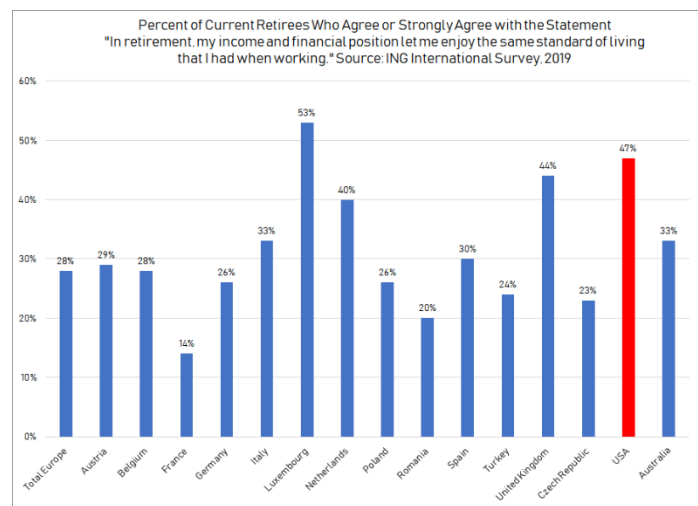
retirement, versus replacement rates of 93 percent for lower-income households and 96 percent for upper-middle class households.

8. U.S. retirement plan assets dwarf other countries.

According to OECD data, the median developed country has total public and private retirement funds equal to 19 percent of gross domestic product. In the U.S., savings in public pensions, employer sponsored retirement plans and IRAs totals 150 percent of Gross Domestic Product, a level over seven times the typical OECD country and exceeded by only four of 35 OECD countries.¹¹ The U.S. also have more favorable demographics for Social Security than other countries have for their pay-as-you-go retirement plans.



U.S. retirees are also far more financially secure than elsewhere. A 2019 ING International survey found that in only two countries – the United Kingdom and Luxembourg – did retirees report a better ability to maintain their pre-retirement standard of living and a lower chance of experiencing severe shortfalls. Countries such as France and Germany fell far short of U.S. levels of reported retirement income adequacy.



9. How we fix Social Security can have a big effect on the economy.

Social Security is *big*: the biggest federal program, the biggest tax most workers pay, and the biggest source of income for most retirees. And since Social Security’s trust funds will run out in 2035, triggering automatic across-the-board benefits, Social Security reform is inevitable. Given its size, it’s not surprising that changes to Social Security can affect the economy. In general, proposals to expand Social Security will encourage middle- and higher-income households to work less (due to higher taxes) and save less (due to the higher benefits those households will receive once they retire).¹² Plans that would fix Social Security by reducing the growth of benefits for middle- and high-earning workers would encourage both work and saving.

¹¹ These include Canada, Denmark, Iceland and the Netherlands.

¹² Most research finds that lower-income workers are less responsive to these incentives.

The University of Pennsylvania Wharton School's Penn Wharton Budget Model projects that the Social Security 2100 Act, the most prominent Social Security expansion plan, would reduce gross domestic product in 2049 by 2.0 percent relative to a baseline in which the federal government simply borrowed to pay Social Security benefit after the trust fund ran out in 2035. By contrast, a plan that raised the retirement age, reduced benefits progressively and used the chain-weighted CPI to calculate COLAs would increase GDP by 5.3 percent. The 7.3 percent of GDP difference in 2049 between a Social Security benefits expansion plan and a benefits restraint plan would be worth \$2.6 trillion in today's terms. Annual federal revenues would be over \$500 billion lower (in 2019 dollars) due to lower GDP. Thus, how we fix Social Security can have a dramatic effect on Americans' future incomes and the resource available to the federal government to address healthcare, debt and other priorities.

10. Out-of-pocket health spending has barely grown as a percent of seniors' incomes

Everyone knows that out-of-pocket health spending has grown, for seniors and for younger Americans. On average, each retiree spent an average of \$2,740 out of pocket in 2010, equal to 9.7 percent of their incomes.¹³ But retirees have a key advantage: their incomes have grown more rapidly than those of working-age households, and so data from the Consumer Expenditure Survey show that out-of-pocket health spending as a share of retirees' incomes exhibit only a very modest upward trend over time. This doesn't mean that retirees have no problems funding health care expenses: health costs can be highly variable, meaning that simple averages don't tell the whole story. But the fact that average incomes have risen as quickly as the average retiree's health expenses says that the retirement saving system is doing its job well. The second step – helping retirees insure against the risk of very high health costs – depends upon financial planners and government.

11. Most traditional pensions aren't going away

When it is pointed out that current retirees have high incomes and low levels of poverty, a common response is that the true retirement crisis will kick in once traditional defined benefit pensions truly disappear. The data show that is unlikely. Currently, about two-thirds of total defined benefit pension benefits are paid out of public sector plans: retired federal employees and members of the military and retired state and local government employees. Those benefits aren't going away anytime soon. Only one-third of traditional pension benefits being received by America's seniors are paid from private sector plans.¹⁴

And those disappearing private pension benefits won't be difficult to replace. Assets in private sector defined benefit plans have never exceeded 20 percent of gross domestic product. By contrast, assets in 401(k) plans today are equal to 29 percent of GDP. And IRA account balances,

¹³ De Nardi, Mariacristina, Eric French, John Bailey Jones, and Jeremy McCauley. "Medical spending of the US elderly." *Fiscal Studies* 37, no. 3-4 (2016): 717-747. These figures include retiree spending on long-term care.

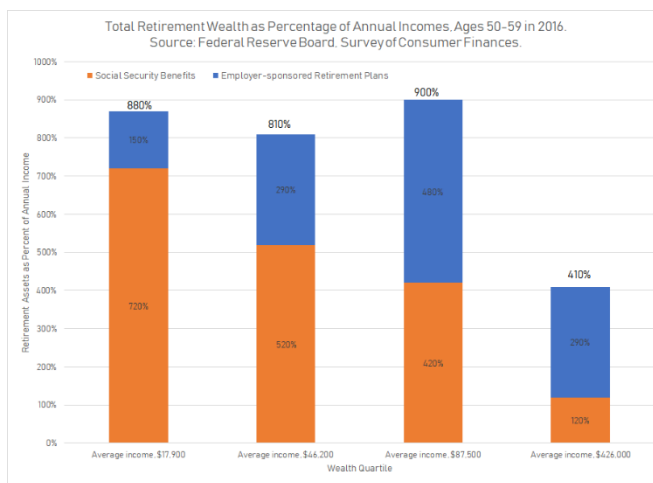
¹⁴ As an aside, this shows how small private sector defined benefit pensions were and are relative to the public sector, where coverage is nearly universal and employee longevity is generally long enough to vest in benefit. The public sector generally employs about one-fifth of the population while the private (and non-profit) sectors employ the other four-fifths. The fact that public sector pensions pay out two-thirds of total benefits implies that, per employee, public sector pensions pay out eight times as much benefits as private sector pensions.

much of which were rolled over from 401(k)s, are equal to 47 percent of GDP. Private sector DB pension benefits are much smaller than people supposed and private sector 401(k)/IRA savings are much larger.

12. The shift from traditional pensions to 401(k)s hasn't increased retirement inequality

It's sometimes claimed that the shift from defined benefit pensions to 401(k)s has made retirement savings more unequal. However, Federal Reserve research published in 2019 show that the distribution of retirement plan savings are very similar today to when traditional pensions were predominant.¹⁵

Moreover, that same Federal Reserve study showed that total retirement preparation is remarkably equal across income levels once Social Security is included. The Fed economists calculated the sum of a household's expected Social Security benefits and personal retirement savings, then expressed this amount as a percentage of the household's annual income. Average total retirement savings were very similar between the bottom three wealth quartiles, even if lower income household depended more on Social Security and higher income



households more on personal retirement savings. The ratio of total retirement savings to incomes was lower in the richest wealth quartile. This is due to the Social Security taxable maximum, which limits the accrual of future Social Security benefits, and limits on tax-preferences contribution to private retirement plans, which apply mostly to high-income households.

The shift from traditional pensions to 401(k)s increased the *level* of retirement savings, but didn't markedly change the *distribution* of retirement savings. *This implies that 401(k)s have resulted in greater retirement savings for low- and middle-income Americans than the previous system of defined benefit pensions.*

13. The real “retirement savings gap” is in government

The news media love to write about a supposed “retirement savings gap,” even though the best academic studies find that most Americans are saving adequately and, for those who are not, shortfalls tend to be modest.¹⁶ And yet, there is a massive retirement savings gap in government plans, from Social Security to federal employee and military pensions to state and local

¹⁵ Sabelhaus, John and Alice Henriques Volz. “Are Disappearing Employer Pensions Contributing to Rising Wealth Inequality?” FEDS Notes. February 01, 2019.

¹⁶ For instance, see Gale, William, John Karl Scholz, and Ananth Seshadri. “Are all Americans saving ‘optimally’ for retirement?” Michigan Retirement Research Center Working Paper wp189 (2009); and Hurd, Michael D., and Susann Rohwedder. “Economic preparation for retirement.” In *Investigations in the Economics of Aging*, pp. 77-113. University of Chicago Press, 2011.

government plans. In fact, while peer-reviewed studies of household retirement savings find a household saving gap of about \$1 trillion, out of over \$90 trillion in total retirement plan assets and accrued Social Security benefits, estimates of government plan underfunding range from \$14 trillion to \$26 trillion. In a separate study, the World Economic Forum found that 83 percent of retirement underfunding in the U.S. is in government plans, a pattern that is consistent across countries.¹⁷

¹⁷ World Economic Forum. “Global Pension Timebomb: Funding Gap Set to Dwarf World GDP.” 26 May 2017