Statement before the Committee on Ways and Means
United States House of Representatives

The Real Retirement Crisis: It's Not Where You Think

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February 6, 2019

Chairman Neal, Ranking Member Brady, and Members of the Committee. Thank you for the opportunity to discuss developments in retirement income policy in the United States.

Today I wish to make three main points:

1. There simply is no retirement crisis. Retirement incomes have been rising rapidly and the vast majority of retirees state they have sufficient money to live comfortably. Retirement savings have risen seven-fold since participation in traditional defined benefit pensions peaked in 1975 and retirement plan participation has increased. No system is perfect, but the notion that retirement income provision needs a wholesale redesign is entirely unjustified by the data.
2. Congress has enacted a number of policies to increase 401(k) participation and improve 401(k) investments. Further bipartisan improvements have been suggested. However, Congress has over 30 years failed to reform Social Security and many Americans have little faith in the program. If there is a retirement crisis, it is in retirement plans run by federal, state and local governments, whose unfunded liabilities exceed even the most pessimistic estimates of shortfalls in retirement saving by U.S. households.
3. Because there is no retirement crisis, proposals such as to expand Social Security should be considered with caution. Expanding benefits could help low-income retirees, but middle and high-income workers would likely reduce their personal saving in response to higher expected Social Security benefits. Likewise, while tax increases would help address Social Security's funding shortfalls, those same tax increases could increase borrowing and debt by low-income workers and reduce work and encourage tax evasion by high high-wage employees.
4. Even if there is no broad retirement crisis, severely inadequate retirement incomes are always a crisis to the retiree who suffers from one. Congress should not ignore gaps in retirement income security. Instead, we need to address problems where they occur while being aware of unintended consequences. In some cases such reforms would be targeted; in others, a broader rethinking of retirement income policy may be necessary.

In the remainder of this testimony I review data regarding the adequacy of U.S. households' retirement saving and incomes; insights into Social Security reform; recent Congressional accomplishments on retirement policy; the challenge facing multi-employer pensions; and unintended consequences of state-sponsored auto-IRA savings plans.

Many of these facts and figures may be new and sometimes surprising. It is my hope to present retirement-related data and research that may be new to Members of the Committee, providing greater context to our nation's retirement savings success and challenges.

What Would a Retirement Crisis *Look* Like?

There will be many Members of the Committee, likely of both parties, who believe America faces a retirement crisis of inadequate savings, such that majorities of retirees face significant income shortfalls once they stop working.

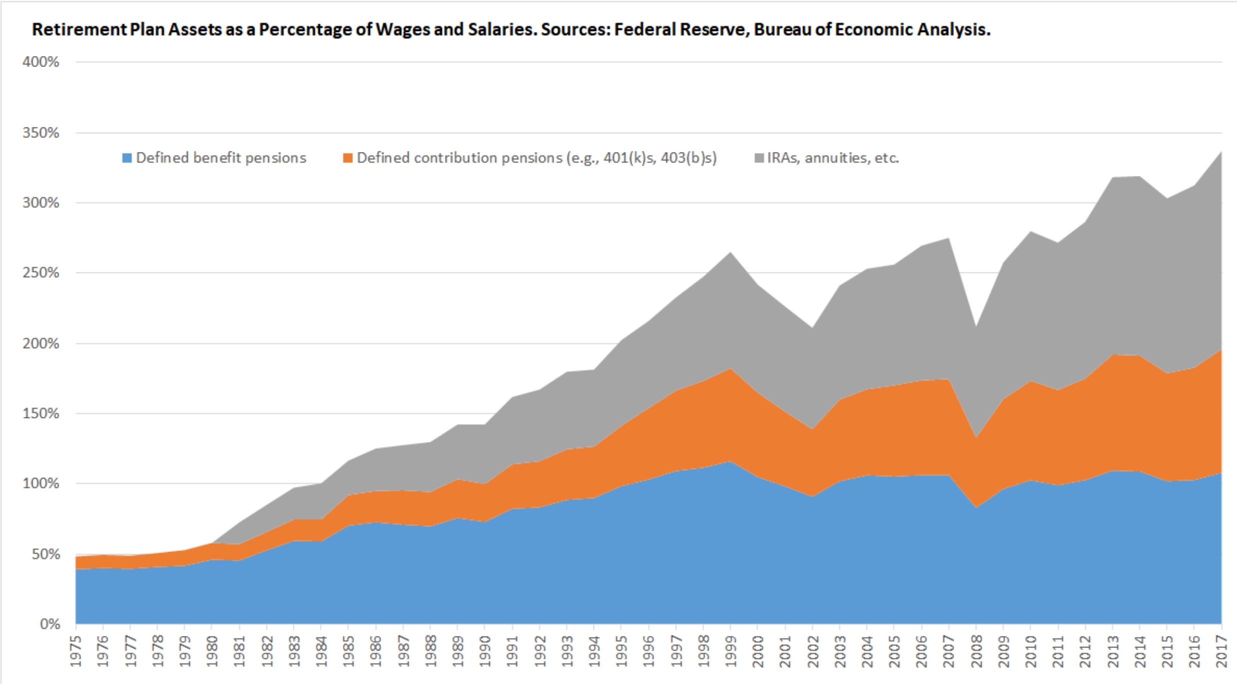
If America truly faced a retirement crisis, what might we expect to see around us today? I suggest that we would see many of the following:

- Stagnant or declining contributions to retirement savings plans.
- Falling participation in retirement plans.
- Falling retirement savings.
- Declining retirement incomes.
- Retirees spending down their savings too quickly.
- Rising poverty among retirees.
- Failure of retirees to maintain their previous standards of living.
- Retiree saying that they feel financially insecure.
- Low levels of retirement savings or incomes compared to other developed countries.
- High levels of dependency on Social Security benefits in retirement.

In fact, *none* of those indicators of a retirement crisis exist, as the date I present should amply demonstrate. In most cases prospects for a secure retirement are moving in the right direction.

Consider these facts:

- **Americans' contributions to retirement plans have increased,** from 5.8 percent of total wages and salaries when traditional pension participation peaked in 1975 to 8.7 percent of pay in 2015. (Sources: Department of Labor; Bureau of Economic Analysis.)
    - This increase occurred for three reasons: First, employees are contributing more, because 401(k)s have an employer contribution while most traditional pensions did not; second, employer retirement plan contributions have increased (Source: BLS National Compensation Survey); and third, more Americans are participating in employer-sponsored retirement plans.
- **Total retirement savings have skyrocketed.** In 1975, at the peak of worker coverage in traditional pension plans, total retirement savings were equal to 48 percent of total employee wages. By 1995 retirement assets rose to 202 percent of employee wages. 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. (Sources: Federal Reserve; Bureau of Economic Analysis.)



- **Retirement plan participation has increased**. In 1975, only about 45 percent of U.S. private sector workers participated in a retirement plan. By 2012, according to a Social Security Administration analysis of income tax records, 61 percent of workers were accruing benefits in an employer-sponsored retirement plan.[1]
- **The retirement plan coverage gap is smaller than you think**. According to Bureau of Labor Statistics data, in 2017 70 percent of U.S. workers were offered a retirement plan by their employer, with 54 percent choosing to participate.
  - Moreover, most couples could save adequately even if only one spouse was offered a retirement plan at work. Among households with total earnings above $25,000, 95 percent have access to an employer-sponsored retirement plan.[2]
  - Likewise, IRS data show that in 2014, 80 percent of married households actively participated in a retirement plan.[3] The 401(k) contribution limit of $19,000 would allow the vast majority of households to adequately save for retirement to provide for both spouses even if only one spouse had a plan.
- **More retirees are collecting larger benefits from private retirement plans**. Census Bureau research finds that in 1984, only 23 percent of new retirees received benefits from a private retirement plan. By 2007, that figure had nearly doubled to 45 percent. Over that period, the

[1] Dushi, Irena, Howard M. Iams, and Jules Lichtenstein. "Retirement Plan Coverage by Firm Size: An Update." Social Security Bulletin, Vol. 75, No. 2, 2015
[2] Source: Current Population Survey.
[3] Source: IRS Statistics of Income.

median private retirement plan benefit contingent upon receipt rose by 141 percent above inflation.[4]

- **Retiree incomes are growing significantly faster than incomes for working-age households**. This trend indicates that retirees' ability to maintain their pre-retirement standard of living is increasing, not declining.

Growth of Real Household Incomes by Age Group, 1988 to 2016			
	25th	Median	75th
55 to 64	18%	25%	36%
65 to 74	44%	62%	75%
Source: Survey of Consumer Finances			

  - 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. Similar trends exists throughout the income distribution. In fact, incomes for low-income retirees at the 25th percentile of the income distribution have grown faster than incomes for higher-income workers at the 75th percentile.
- **Poverty in Old Age Has Fallen Dramatically** and Is Far Below Poverty for Younger Americans. A 2017 Census Bureau analysis which relied upon IRS data to more accurately measure retirees' incomes shows a low and declined elderly poverty rate. From 1990 to 2012, the share of retirees with incomes below the poverty threshold fell from 9.7 to just 6.7 percent.[5]
  - The poverty rate in retirement is far lower than among working-age families. It is very hard to draw the conclusion from this that low-income worker-age households should be saving more for retirement.
- **The vast majority of retirees say they're doing fine**. According to Gallup, 78% of current retirees say they "have enough money to live comfortably." The share of working-age families who say they have enough money to live comfortably is about 15 percentage points lower. This does not point to insufficient savings or retirement incomes.
  - In 1992, only 61% of Americans over 65 reported in the Survey of Consumer Finances that their retirement income was "At least enough to maintain your standard of living." By 2016, that had risen to 75 percent. The share describing their retirement income as "totally inadequate" had fallen by almost half, while those calling their retirement incomes "very satisfactory" nearly tripled.
- **Health costs are not eating away at retirees' incomes**. In the Survey of Consumer Finances, out of pocket health costs have stayed roughly stable at about 10 percent of over-65 households' total incomes since data collecting began in 1984. Health costs have risen, but retirees' incomes have increased just as quickly.

[4] Bee, C. Adam, and Joshua Mitchell. "The Hidden Resources of Women Working Longer: Evidence from Linked Survey-Administrative Data." In Women Working Longer: Increased Employment at Older Ages, pp. 269-296. University of Chicago Press, 2017.
[5] Bee, Charles Adam, and Joshua Mitchell. "Do Older Americans Have More Income Than We Think?" U.S. Census Bureau Working Paper. 2017.

- **Many retirees aren't even consuming their whole incomes, much less drawing down their savings**. In the Federal Reserve's Survey of Consumer Finances, over half of retiree households state that they spend less than their incomes; about one-third spend about equal to their incomes, while less than 15 percent state that their spending exceeds their incomes. Several other studies finds that retiree households' net worths tend to *rise* as they get older, disproving the claim that underfunded retirees are running out of money.[6]
- **Retirees are far less dependent on Social Security than you think**. For years, the Social Security Administration has issued statistics claiming that roughly two-thirds of retirees receive the majority of their income from Social Security while one-third depend on Social Security for 90 percent or more of their incomes. In a 2014 article with pension expert Sylvester Schieber, we argued that these figures overstate reliance on Social Security because they use survey data that are very poor at measuring benefits paid by private retirement plans.[7] At the time, our claim was called "eye-popping." Today, Census Bureau confirms that we were correct: IRS data that better capture benefits from private retirement plans show that only 42 percent of retirees rely on Social Security for the majority of their income. Only 12 percent of retirees – one third the share claimed by the SSA figures – receive 90 percent or more of their income from Social Security benefits.[8]
- **Most retirees far exceed financial planners' 70 percent target "replacement rate."** Recent research has examined individuals and households' incomes both before and after retirement. Census Bureau economists Adam Bee and Joshua Mitchell have used IRS data to more accurately measure retirees' incomes. They found in a 2016 analysis that new retirees of varying educational and marital statuses had median replacement rates 26 to 30 percentage points higher than financial planner's 70 percent target replacement rate.

Median Household Incomes Prior to and Following Retirement			
Educational attainment/ marital status	*One Year Before Retirement*	*Five Years After Retirement*	*Replacement Rate*
College Educated	$77,800	$74,500	96%
Non-College Educated	$40,500	$41,700	103%
Married	$59,200	$57,500	97%
Unmarried	$28,800	$29,400	102%
All (median)	$48,600	$48,600	100%
Source: Bee and Mitchell (2016)			

  - In a 2017 follow-up analysis, Bee and Mitchell calculated pseudo-replacement rates based on income levels. The replacement rate presented here is calculated as total income in the fifth year following retirement as a percentage of average earnings in

[6] See Browning, Chris, Tao Guo, Yuanshan Cheng and Michael S. Finke. "Spending in Retirement: Determining the Consumption Gap." Journal of Financial Planning. March, 2016.
[7] Schieber, Sylvester J. and Andrew G. Biggs. "Retirees Aren't Headed for the Poor House. The most commonly cited measure of retirement income ignores at least 60% of the money that seniors receive." The Wall Street Journal, Jan. 23, 2014.
[8] Bee, Charles Adam, and Joshua Mitchell. "Do Older Americans Have More Income Than We Think?" U.S. Census Bureau Working Paper. 2017.

- the 15 years prior to retirement. Again, at all income levels typical replacement rates are far above the 70 percent that financial planners consider to provide an adequate retirement income.
- A 2017 study by economists at the Internal Revenue Service and the Investment Company Institute also found that recent retirees at all income levels have typical replacement rates far above recommended levels.[9]

Retirement Income Replacement Rates by Income Level, 2012			
Income Percentile	25th	Median	75th
Replacement Rate	93%	94%	96%
Source: Bee and Mitchell (2017), using IRS administrative data. The replacement rate is calculated as total income in the fifth year following retirement as a percentage of inflation-adjusted average earnings in the 15 years prior to retirement.			

- **One reason retirement saving has improved is that traditional pensions weren't very good.** Some people look back fondly on the days of traditional defined benefit pensions. But even at their peak, only 39 percent of private sector employees participated in a defined benefit pension.[10] And even when a worker participated, that doesn't mean he'd receive a meaningful benefit at retirement, due to strict vesting rules that required long service before qualifying. 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.[11] SSA data show that, among new retirees in 1980-1981, only 9 percent of 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.[12] Once federal regulations required employers to loosen vesting requirements and better-fund promised benefits, employers stopped offering traditional pensions.
- **Americans are good retirement savers.** According to the OECD, the U.S. has total public and private sector pension funds equal to 150 percent of GDP. The average among other developed countries is only 53 percent, one third of U.S. levels. U.S. retirees have incomes equal to 94 percent of the population-wide average income, above the OECD average of 84 percent. Other countries might have more generous Social Security-type programs, but their citizens don't save as much as Americans do. The median disposal income of Americans over age 65 is second only to Norway and Luxembourg.

The Most-Rigorous Studies Show a Small Retirement Savings Gap

The media enjoy reporting on studies claiming to show a massive "retirement savings gap" facing working-age Americans. But these popular studies are not peer-reviewed and often have glaring methodological weaknesses. The more rigorous studies conducted by academic

[9] Brady, Peter J., Steven Bass, Jessica Holland, and Kevin Pierce. "Using Panel Tax Data to Examine the Transition to Retirement." 2017.
[10] Source: Joshua Gotbaum, former PBGC director.
[11] Senate Labor Subcommittee. "Statistical Analysis of Major Characteristics of Private Pension Plans." 1972.
[12] Irick, Christine. "Income of New Retired Workers by Social Security Benefit Levels: Findings From the New Beneficiary Survey." Soc. Sec. Bull. 48 (1985): 7

economists find a much smaller gap between what Americans need to save and what they've actually put away.

In a 2017 study, I reviewed the research on retirement savings adequacy.[13]

For instance, the National Institute for Retirement Security, which is the research arm of the public sector pensions industry, argues that from 65 to 92 percent of households are undersaving and the total "retirement savings gap" ranges from $7 to $14 trillion.[14] For context, total retirement savings – equal to the balances of employer sponsored-retirement plans, household retirement savings such as IRAs, and accrued Social Security benefits – are equal to about $94 trillion. But the NIRS study:

- Overstates the amount that workers need to save for retirement, assuming an 85% target replacement rate vs. the 70 percent rate the Social Security Administration says most financial advisors support;
- Counts workers as "undersaving" if they don't begin saving immediately at age 25, even if they end up with the appropriate amount of money by retirement. Most employees don't start saving for retirement until their 30s and textbook economics supports this decision.
- Fails to account for Social Security's progressive benefit formula, by assuming that every retiree receives the same "replacement rate."
- Assumes that multi-trillion dollar shortfalls in state and local government pension systems will be solved entirely by cutting benefits. In reality, for both legal and political reasons nearly all of those benefits will be paid.

Big numbers make headlines, but they don't stand up to scrutiny.

By contrast, a 2009 study by three economists – William Gale of the Brookings Institution and Karl Scholz and Ananth Seshadri of the University of Wisconsin – found that 75 percent of working-age households were adequately preparing for retirement.[15] Perhaps more importantly, my own analysis of their study estimated that among those households who were not adequately prepared, the shortfall in total household assets was less than 10 percent. In other words, even among the proportion of Americans who are undersaving, the typical household does not face a "retirement crisis." An earlier version of this study won TIAA-CREF's Paul A. Samuelson Award for Outstanding Scholarly Writing on Lifelong Financial Security and was published in the peer-reviewed and highly-respected *Journal of Political Economy*.

Similarly, a 2011 study authored by Michael Hurd and Susanne Rohwedder of the RAND Corporation and published by the National Bureau of Economic Research found that 71 percent of working age households are adequately prepared for retirement, a result the authors described as showing that "More Americans may be adequately prepared for retirement than previously

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[13] Biggs, Andrew G. "Is There a Retirement Crisis? Examining Retirement Planning in the Household and Government Sectors." September 21, 2017.

[14] Rhee, Nari. "The retirement savings crisis." Washington DC: National Institute on Retirement Security (2013).

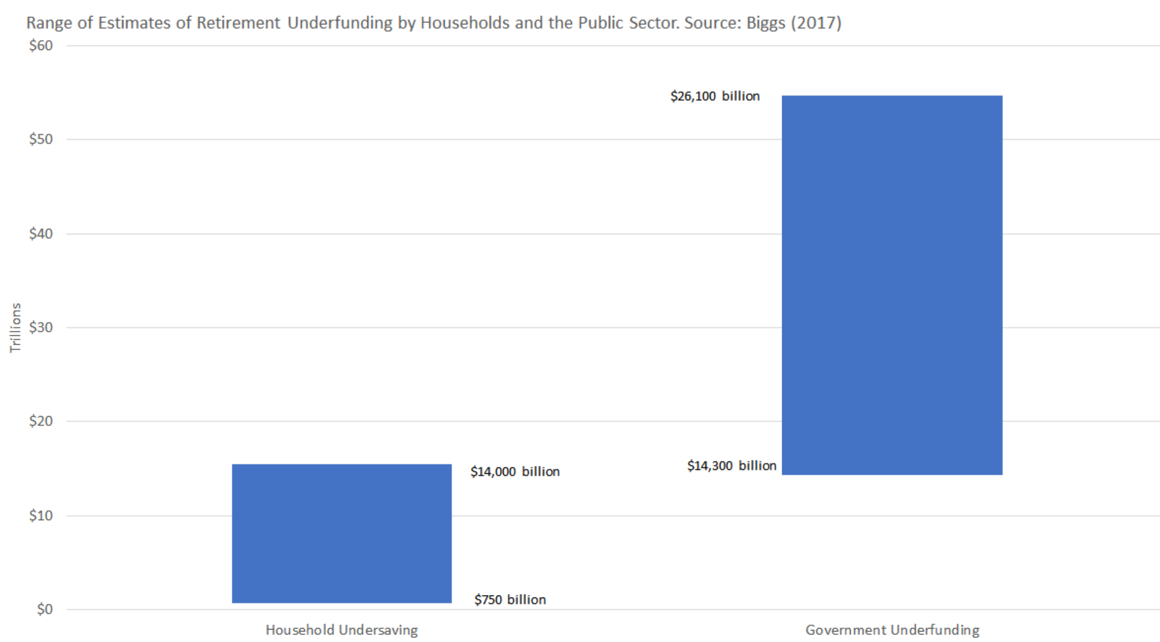
[15] Gale, William, John Karl Scholz, and Ananth Seshadri. "Are all Americans saving 'optimally' for retirement?." Michigan Retirement Research Center Working Paper wp189 (2009).

thought." Hurd and Rohwedder do not find widespread undersaving. For instance, among college educated married couples, roughly nine-in-ten are saving enough for retirement. However, among single women without a high school diploma, only 27 percent were prepared. This points toward targeted solutions, not a broad Social Security expansion in which the majority of extra benefit dollars are paid to middle and upper-income retirees.[16]

The Real Crisis is in Underfunded Government Plans

In a 2017 study I reviewed both the range of estimates of household retirement undersaving and estimates of how much government retirement plans are underfunded at the federal, state and local level.[17] These government retirement plans range from Social Security, to federal employee and military pensions, to state and local government retirement plans.

These studies produce a range of estimates. However, even the *largest* estimates of the retirement savings gap by households – the $14 trillion figure claimed by the National Institute for Retirement Security – falls short of the *smallest* estimate of government retirement plan undersaving at $14.3 trillion. The most credible estimates of household undersaving – those that are published by academic economists in peer-reviewed studies – are as low as $750 billion, out of more than $94 *trillion* in combined employer retirement plan assets, household retirement savings and accrued Social Security benefits. Likewise, if one accepts figures for state and local pension underfunding published by the Federal Reserve along with the Congressional Budget Office's more pessimistic projections for Social Security, total underfunding in government-run retirement plans is as high as $26.1 trillion.



[16] Hurd, Michael D., and Susann Rohwedder. Economic Preparation for Retirement. No. w17203. National Bureau of Economic Research, 2011.

[17] Biggs, Andrew G. "Is There a Retirement Crisis? Examining Retirement Planning in the Household and Government Sectors." September 21, 2017.

A 2017 study on retirement saving around the world published by the World Economic Forum concurs.[18] It concluded that 75 percent of the retirement savings gap in the United States is in public sector plans, with only 25 percent of undersaving coming from households or corporate pension underfunding. The same holds true across nearly all of the countries analyzed. Governments must be very wary of the temptation to promise retirement benefits without fully funding them.

These figures should cause one to question whether more responsibility for retirement income provision should be transferred from households participating in private sector plans to government-run programs.

How Adequate are Social Security Benefits?

Policymakers considering how to reform Social Security should first look at the adequacy of benefits currently paid by the program, in particular for lower-income retirees.

According to the Social Security Administration, most financial advisors state that a retiree can maintain their pre-retirement standard of living with a 70 percent "replacement rate" – that is, a retirement income equal to 70 percent of their pre-retirement earnings.[19] The Congressional Budget Office uses its Long Term Model to project Social Security replacement rates for individuals of different earnings levels and birth years. The replacement rate is calculated as the Social Security benefit at age 65 as a percentage of the retiree's career-average earnings, adjusted for inflation. These figures represent the degree to which Social Security benefits replace the average buying power the retiree had during his working years.

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

	Lifetime Income Quintile				
Year of Birth	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."

For middle-income workers, Social Security replaces between 54 and 60 percent of inflation-adjusted career-average earnings. These workers need to save modestly on top of Social Security to reach a 70 percent replacement rate.

For a low-income individual in the bottom fifth of the earnings distribution, Social Security replaces between 83 and 96 percent career-average earnings. Even assuming that low earners require a higher replacement rate, these figures explain that it is rational for many low earners not to save for retirement above what Social Security provides. This does not mean low earners are perfectly provided for by Social Security. Due to quirks in Social Security's benefit

[18] World Economic Forum. "Global Pension Timebomb: Funding Gap Set to Dwarf World GDP." 26 May 2017
[19] Social Security Administration website; "Social Security Retirement Planner: Decide When to Retire," http://www.ssa.gov/retire2/ ; see also Social Security Administration (2005).

formula, some low earners receive very high replacement rates while others receive lower ones. But these are problems that a properly-designed Social Security reform proposal could fix.

Congress Has Made Progress, But Also Fallen Short

One reason private sector retirement plan participation, contributions and savings have increased is that Congress has empowered these plans to improve.

The Pension Protection Act of 2006 made it easier for employers to automatically enroll employees in 401(k)s and 403(b)s. Auto-enrollment can dramatically increase retirement plan participation. At the time, only around 10 percent of plan sponsors used automatic enrollment, according to Vanguard. Today, nearly half do.[20]

Likewise, Congress made it easier for employers to default employees into low-cost target date funds, which automatically shift investments from stocks to bonds as a worker nears retirement. Today, nearly 60 percent of 401(k) participants hold their savings in a target date or other professionally-managed fund, up from only 1 in 10 in 2003. As a result, defined contribution participants today receive investment returns that are nearly identical to those received by professionally-managed, high-cost defined benefit plans.[21]

More recently, the House passed legislation to facilitate the expansion of Open Multiple Employer Plans, which are defined contribution plans run by a single administrator that are open to employees of multiple firms. Open MEPS would help overcome the high fixed costs of running a 401(k), which can make offering a retirement plan cost-prohibitive for smaller employers. These costs help explain why only 45 percent of establishments with fewer than 100 employees offer retirement plans but 90 percent of establishments with 100 or more employees offer a plan.[22]

Members of Congress are considering further retirement policy changes, some of which have bipartisan support while others are more controversial. Proposals include changes such as eliminating required minimum distributions from retirement plans for retirees with relatively low account balances, allowing them to maintain their account balances; eliminating the current 70 ½ age limit on IRA contributions; allowing new parents to make modest penalty-free withdrawals from retirement accounts; and establishing universal, all-purpose savings plans.

Progress has been made on a bipartisan basis and further progress is possible.

At the same time, Congress has failed with regard to the single program over which is has principle jurisdiction: Social Security. Congress has known for three decades of the need to reform Social Security; the cause of the program's funding shortfall; and the steps available to address it. And yet to date, no action has occurred.

Congressional inaction has led to lost confidence in Social Security. While only 35 percent of workers are very or somewhat confident that Social Security will continue to provide benefits of

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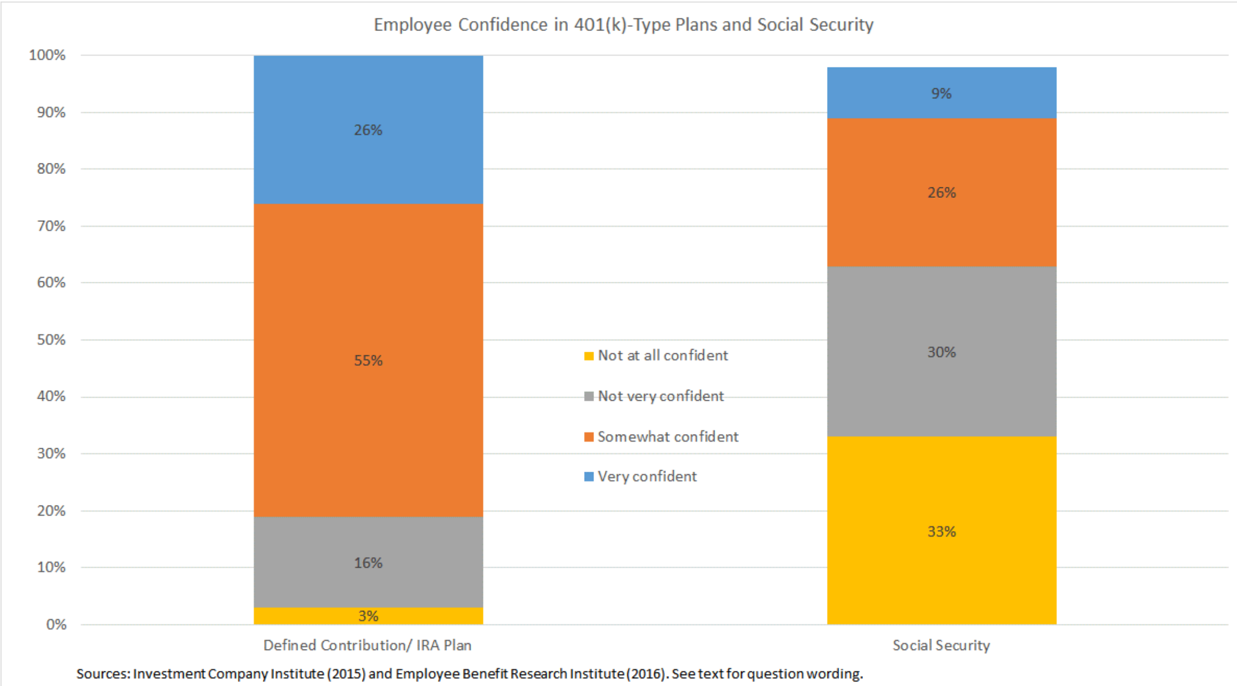
[20] Vanguard. "How America Saves, 2018." June, 2018.
[21] McGee, Josh B. "Defined-Contribution Pensions Are Cost-Effective." Manhattan Institute. August 12, 2015.
[22] Bureau of Labor Statistics. Employee Benefits Survey.
https://www.bls.gov/ncs/ebs/benefits/2018/ownership/private/table01a.htm

at least equal value to benefits received today (Source: EBRI, 2016), 81 percent of 401(k) and IRA holders are very or somewhat confident that these accounts can help individuals meet their retirement goals. (Source: Investment Company Institute, 2015.)



If Congress applied the same innovative, bipartisan instincts it has applied to private sector retirement plans to Social Security, Americans' confidence in this most important retirement program could be restored.

Social Security Expansion Has Benefits and Downsides

In the last 1990s, a bipartisan, centrist coalition in Congress favored Social Security reforms that combined increased revenues, reductions in the growth of benefits, and individual savings components to make up for lost benefits. Today, the spectrum of opinion has shifted more toward maintaining or even improving on scheduled Social Security benefits. For instance, the Social Security 2100 Act, introduced into the House with 200 original co-sponsors, would increase benefits to varying degrees for nearly every retirees.

The Social Security 2100 Act stands out from previous expansion plans in that it would make Social Security solvent not merely for 75 years, but also leave the program in strong financial shape at the close of the 75 year period. Rep. John Larson (D-CT) deserves significant credit for taking on that challenge and his co-sponsors deserve credit for putting their names to a proposal that would put Social Security's finances back on track. Many Members of Congress over the years have never put their name to legislation to fix the federal government's largest program.

In that spirit, however, proponents of approach to Social Security reform should be open to reasonable criticisms of such plans. In the following subsection I note several of the costs or disadvantages of a Social Security proposals that aim to fully maintain or to expand current law benefits.

Reduced Personal Saving

A range of academic research finds that middle and high-income workers balance their personal retirement saving decisions against what they expect to receive from Social Security.[23] If Social Security benefits are increased, middle and high-earning households will save less for retirement on their own, usually by 70 to 100 cents on the dollar. The table below reviews some of this literature. This research implies that for middle and upper-income workers, Social Security expansion would substitute tax-financed Social Security benefits for income derived from personal saving.

Review of Economic Research on How Personal Saving Responds to Changes in Pension Benefits

Authors	*Degree to Which Personal Savings Are Adjusted in Response to Changes in Pension Benefits*
Attanasio and Rohwedder (2003)	70% (for households over age 31)
Lachowska and Myck (2015)	~100%
Attanasio and Brugiavini (2003)	~100% (among middle-aged households of all income levels)
Englehardt and Kumar (2011)	70-100% (among college educated households)
Alessie, Angelini and Van Santen	Nearly 100% (among better-educated workers)
Gale (1998)	~70% (for more educated individuals and those who hold retirement accounts; response is measured against value of traditional defined benefit pension benefits)

This isn't a trivial point, because a large proportion of the total benefit increase under Social Security expansion proposals may flow to middle and upper-income households. In 2016 I analyzed Sen. Bernie Sanders' Social Security expansion legislation, finding that two-thirds of benefit increases flowed to households in the top three income quintiles, with only 9 percent of benefit increases received by the poorest income quintile.[24] I have not conducted a similar analysis for the Secure 2100 Act, but a back-of-the-envelope calculation produces similar results.

Share of Lifetime Benefit Increases Under Bernie Sanders Reform Plan

Career Earnings Quintile				
Lowest	Second	Middle	Fourth	Highest
9%	26%	21%	21%	22%

Source: Andrew Biggs, AEI, using Policy Simulation Group models. Analyzes individuals born in 2000.

[23] Among these studies are: Gale, William G. "The effects of pensions on household wealth: A reevaluation of theory and evidence." Journal of Political Economy 106.4 (1998): 706-723; Alessie, Rob, Viola Angelini, and Peter Van Santen. "Pension wealth and household savings in Europe: Evidence from SHARELIFE." European Economic Review 63 (2013): 308-328; Gary V. Engelhardt and Anil Kumar. "Pensions and Household Wealth Accumulation." Journal of Human Resources January 1, 2011 vol. 46 no. 1 203-236; Lachowska, Marta and Myck, Michal, The Effect of Public Pension Wealth on Saving and Expenditure (February 1, 2015). Upjohn Institute Working Paper No. 15-223; Attanasio, Orazio P., and Agar Brugiavini. "Social security and households' saving." the Quarterly Journal of economics (2003): 1075-1119; Attanasio, O., and S. Rohwedder. 2003. "Pension Wealth and Household Saving: Evidence from Pension Reforms in the United Kingdom." American Economic Review 93(5): 1499–1521.

[24] Biggs, Andrew G. "Hillary's and Bernie's Pie-in-the-Sky Social Security Proposals." The Wall Street Journal, March 17, 2016

The tilt of Social Security expansion plans away from the poor occurs for three main reasons.

- Many low earners already receive a supplement to their Social Security benefit based upon their spouse's earnings. Under current law, expansion of a low earner's base Social Security benefit would result in a reduced spousal supplement, such that total benefits to that low-income retiree would not change. Total benefits would increase only to the degree that the expansion to the base benefit were larger than the spousal supplement currently being received.[25]
- While low earners may receive larger benefit increases in percentage terms, in dollar terms middle and high earners often receive more. For instance, in the Social Security 2100 Act an individual earning $132,000 every year of his career receives an annual benefit increase that is twice as large in dollar terms as a very low wage worker earning only around $13,000.
- High-wage earner is likely to live longer and collect benefit increases for more years. A Congressional Budget Office analysis found that the highest-income Americans tend to live about six years longer past retirement than the lowest-income retirees.[26]

Due to these factors, the dollar value of the Social Security 2100 Act's benefit increase for a worker earning the maximum taxable wage will be several times higher than is paid to a very low-wage worker, who obviously is at much greater risk of poverty in old age.

Lower personal saving by middle and high-income workers reduces the capital stock, productivity and economic growth. Likewise, as discussed below, the higher taxes required to finance Social Security expansion will reduce labor supply, also lowering economic growth. The Congressional Budget Office is capable of analyzing Social Security reform proposals using models that account for these economic effects. In my view it is almost certain that these models would project that Social Security expansion proposals like the Social Security 2100 Act would reduce economic growth and the resources available to all future Americans, including retirees.

Effects of Raising Social Security Taxes

Paying full promised Social Security benefits, much less expanding Social Security, would require significant tax increases. Social Security payroll taxes are already the largest tax for most employees. Moreover, Social Security is underfunded by roughly one-fifth, according to SSA and CBO projections, which implies that a resolution of the Social Security funding problem that maintains full scheduled benefits requires a not-inconsequential tax increase.

I here point out three issues with raising Social Security taxes.

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[25] For instance, imagine a low-wage retiree entitled to a monthly benefit of $400 based upon her own earnings who has a spouse who receives a $1,000 monthly benefit based upon his own earnings. Under Social Security benefit rules, the low wage retiree is entitled to a spousal supplement of $100 to bring her total benefit up to $500, equal to half that of her spouse. If a Social Security expansion plan increased her basic benefit by $75 per month, to $475, her total benefit would still remain at $500. Only if her earnings-based benefit were increased by more than $100 would her total benefits increase, and then only to the degree that he new earnings-based benefit exceeded $500.

[26] Manchester, Joyce, and Julie Topoleski. "Growing disparities in life expectancy." Congressional Budget Office presentation. 2008.

First, raising payroll tax rates could cause lower-income Americans to increase their debt. For instance, the Social Security 2100 Act increases the payroll tax rate from 12.4 to 14.8 percent, which would reduce take-home pay by about 2.4 percent. Workers could either accept that reduction in their standard of living or they could seek to maintain their standard of living by taking on additional debt. Recent research examined the effect of automatic enrollment of Department of Defense employees not the federal Thrift Savings Plan, which has a default employee contribution rate of 3 percent of pay.[27] This research found that for less-educated employee, increases to mortgages, auto loans and credit card debt substantially exceeded the new employee contributions to the TSP, in all likelihood reducing their household net worth.

Second, raising employer payroll taxes would reduce other tax revenues. The standard view among economists, which SSA and CBO incorporate into their valuations, is that employer fund a payroll tax increase by holding back on employee wages. When this occurs, those lost wages would no longer be subject to Social Security or Medicare payroll taxes and federal or state income taxes. The Joint Committee on Taxation estimates that the loss to federal tax revenues would range from about 10 percent (for a worker earning $10,000 annually) to 21 percent for an individual earnings $1 million. Losses to state tax revenues would be several percentage points more.

Third, higher Social Security taxes would reduce labor supply, further reducing the net revenue received as part of a Social Security expansion plan. A plan such as the Social Security 2100 Act would increase the effective top marginal tax rate by roughly 15 percentage points. Social Security Administration actuarial estimates do not assume any labor supply response to higher marginal tax rates. However, a 2006 analysis by economists Emmanuel Saez and Jeffrey Liebman – the former famed for his analysis of income and wealth inequality, the latter a Harvard economist who served as head of the Office of Management and budget under President Obama – found that even a modest adjustment of high earners' labor could, in conjunction with employer responses to higher payroll taxes, cut the net amount of new revenues received in half.[28]

Multiemployer Pensions

A multiemployer pension is jointly run by a labor union and multiple employers, typically within the same industry or geographic area. Multiemployer pensions are on average heavily underfunded, with a funding ratio for 2015 of just 43% and total underfunding of $638 billion, according to the latest PBGC data.[29] Plans covering about ten percent of participants will run out of money within the next ten years, which would result in either significant benefit cuts to retirees or a taxpayer-financed bailout.

Multiemployer pension funds are in trouble today because Congress acceded to the requests of multiemployer plans and their union and employer sponsors to subject them to far less stringent

[27] Beshears, John, James J. Choi, David Laibson, Brigitte C. Madrian, and William L. Skimmyhorn. "Does Borrowing Undo Automatic Enrollment's Effect on Savings?" Working paper, 2016.
[28] Liebman, Jeffrey, and Emmanuel Saez. "Earning responses to increases in payroll taxes." National Bureau of Economic Research, 2006.
[29] https://www.pbgc.gov/sites/default/files/2016_pension_data_tables.pdf, table M9.

rules than are applied to single employer plans and instead give the plan trustees very wide discretion as to how to run the plans. The trustees of multiemployer plans generally chose to make irresponsible decisions in order to make relatively generous pension promises without having to collect contributions to properly fund those promises.

We are not here to assign blame, particularly not to retirees who face benefit cuts. But if we are to avoid future pension funding crises, it is essential to understand how the current crisis came about.

There are several problems that have caused multiemployer plans to become so underfunded:

- First, multiemployer plans were allowed to use reasonable assumptions to measure liabilities instead of specific discount rates that Congress requires single-employer plans to use. Multiemployer plan trustees have used expected rates of return on risky assets to discount the value of guaranteed future benefits, an approach that is disconnected with the value of those liabilities and is rejected by nearly all professional economists. A multiemployer plan that funded using a 7 to 8 percent discount rate to measure liabilities would contribute roughly half as much as single employer plan that is required to use a corporate bond yield in the range of 3 to 4 percent.
- Second, multiemployer plans were given up to 15 years or more to address unfunded liabilities, whereas a single-employer plan must address shortfalls in only 7 years. Again, this implies substantially lower contributions for multiemployer plans.
- Third, single employer plans must terminate if they cannot meet required contributions, a requirement designed to prevent underfunded plans from digging a deeper financial hole that endangers participants, the PBGC and taxpayers. In contrast, multiemployer plans who claim that they will not be able to meet required contributions in the next several years are exempt from the required contribution rules.
- Fourth, an employer sponsoring a single employer plan is generally fully responsible for any plan underfunding. Multiemployer plans divide this responsibility among many employers. But due to rules that are extremely complex and have uneven application, no employer is actually responsible for making up underfunding.
- Fifth, despite these higher financial risks, multiemployer plans pay much lower premiums to the PBGC than single-employer plans.

Unions and corporations liked these funding rules because they reduced the contributions required for the plan and allowed for higher promised benefits. However, these funding rules resulted in much more poorly-funded pensions and a PBGC backstop with far fewer resources to call upon if needed.

The justification for looser rules for multiemployer pension were twofold: first, that labor unions, who make up half the trustees of each plan, would ensure that plans were funded; and second, that every employer in the plan would be jointly and severally responsible for plan underfunding, thus relying on each other to bail out the plan rather than turning to the federal government. With several large multiemployer plans likely to run out of money and plan sponsors and participants lobbying for a federal bailout, that justification is today obviously no longer applies.

But looser regulation of multiemployer pensions was flawed from the start. A pension that relies upon multiple employers in the same industry or region is no more diversified than an investor who purchases stock in multiple companies in the same industry. History shows that entire industries rise and fall just as individuals companies do.

Today, there is no further justification for using high discount rates to value multiemployer pension liabilities. If those plans were analyzed using the same corporate bond yield curves that are applied to single employer pensions, the vast majority of multiemployer plans would be considered heavily underfunded. Those findings would reflect financial reality and Congressional policy should respond to that reality.

Congress might model its response to the multiemployer pensions crisis as it did to the financial sector crisis following the Great Recession. Congress chose to bail out ailing financial firms in order to prevent a wider financial collapse and further economic suffering. But Congress also implemented legislation and regulations designed to prevent a repeat of the financial crisis.

Congress should do the same with regard to multiemployer pensions. If a multiemployer pension can remain healthy and well-funded under the stricter funding rules that are applied to single employer plans, then it should continue to operate. But if a multiemployer plan cannot meet minimum required contributions under the higher single-employer funding standards, the plan should be prohibited from continuing to accrue new benefit liabilities that it cannot afford to pay. The plan should be frozen, meaning it would not accrue new benefit liabilities, and employees should shift to 401(k)-type plans to which both employers and employees would contribute. Freezing future benefit accruals in an underfunded multiemployer plan would free up company resources that could be used to help pay the full benefits owed to current retirees.

Some proposals, such as the Butch Lewis Act, would attempt to prop up multiemployer pensions using federal government loans. The proceeds of these loans, if invested and earning high returns, would in theory allow plans to pay full benefits while repaying the loan in a lump sum in 30 years' time. This strategy is a slightly more complex version of what is known in state and local finance as a "pension obligation bond," in which a pension plan borrows money and then reinvests it in hopes of earning a higher return. Any federal legislator contemplating support of a loan-and-invest strategy should understand the experience at the state and local level, where pension obligation bonds are often viewed as a desperation move that can easily backfire. It would be alarming to import this dubious state-and-local pension strategy to the federal level. If borrowing using low discount rates in order to earn high investment returns were an appropriate strategy, the Congress should eliminate taxes and instead invest in the markets.

The Butch Lewis Act also would allow insolvent multiemployer pensions to continue offering new benefits to current employees even as those plans turn to the federal government for assistance in paying current retirees.

The Central States Plan, for instance, offers current employees benefits that remain several times more generous than what a typical private sector employee can expect to receive via his 401(k). Moreover, when those future promised benefits are measured using an appropriate discount rate, the new benefits promised by Central States each year will exceed the total contributions made to the plan, pushing Central States even deeper into a financial hole. Providing federal assistance to an underfunded plan even as it continues to accrue generous new benefit liabilities seems unwise.

The first rule of holes, it is said, is to stop digging. Multiemployer pensions are in a deep financial hole. While assistance to retirees is worthy of Congressional consideration, any reform proposal needs to discard junk accounting and stop the hole from becoming deeper.

State Auto-IRA Plans

A number of states have established so-called "auto-IRA" programs, in which employees who are not offered a 401(k) or other retirement plan at work would be automatically enrolled in an Individual Retirement Account with contributions automatically deducted from the worker's paycheck.

State auto-IRA plans can fill a gap in retirement plan coverage. However, state auto-IRA plans also raise a number of issues that federal policymakers should be aware of.

First, employees enrolled in auto-IRA plans could within a few years accumulate sufficient savings to become ineligible for a range of means-test federal transfer programs, such as food stamps, Temporary Assistance for Needy Families, Supplemental Security Income, housing subsidies and Medicaid, which have asset and income tests that can be triggered by as little as $1,000 in savings. Poor households would be forced to spend down their savings, perhaps paying a penalty for early withdrawals, before regaining eligibility for benefits. It would be a cruel and politically unsustainable irony if low-income workers were signed up for retirement accounts, with contributions deducted from their paychecks, only to find that the true beneficiaries of those savings were the state and federal programs that disqualified the workers for benefits.

Second, we cannot simply take it for granted that states will be good stewards of private sector employees' retirement savings. For instance, state-run 529 college savings plans charge widely varying fees, which can eat away at workers' savings. Likewise, in states such as New York and California public officials have been jailed for corruption with regard to the choice of public pension investments. It is too early to see any abuses with state auto-IRA plans, and we hope such abuses never occur. Nevertheless, Congress should bear in mind that things happen at the state level which would not occur in the federal government. If a supplementary non-employer-based savings plan is deemed necessary, it may make sense to enact such a plan at the federal level.

Third, I would be very concerned with any state that went beyond a simple IRA plan and instead established a so-called "Secure Choice" plan in which worker contributions were merged into a single pool and benefits paid out according to a formula. A number of the original proponents of state-run retirement plans, such as prominent retirement economist Teresa Ghilarducci and the National Council of Public Employee Retirement Systems (NCPERS), favor such an approach. State and local governments have not been good managers of their own pension plans, underfunding those plans much as multiemployer pensions have been underfunded, and today facing multitrillion dollar unfunded liabilities. The Commonwealth of Puerto Rico, with which I have involvement via my membership in the federal Financial Oversight and Management Board for the island, ran such a plan for public sector workers beginning in the early 2000s. While government employees believed they had designated accounts holding their contributions, those employee contributions were in fact pooled and spent down to pay retirees in previous defined benefit pension plan. Today, employees and retirees face cuts to their pension benefits as the Puerto Rico government undergoes a restructuring of its debt obligations. That is not a model to emulate.