PREVENTING THE RETIREMENT CRISIS:

PROVIDING RETIREMENT SECURITY TO ALL WORKERS

Council 4 AFSCME
We Make Connecticut Happen

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Connecticut has a looming crisis – our current retirement system does not provide for economic self-sufficiency after a lifetime of work, resulting in increasing pressure on public assistance programs provided by the state and municipalities. According to the US Census' 2008 "American Community Survey," 16% of Connecticut older adults were estimated to have incomes at or below 150% of the FPL — and that is about to get a lot worse. Presently, in what is known as the golden age of retirement, many older households still have income from defined benefit pensions, but that is about to change. Connecticut's older adult population is expected to increase by 64% over the period from 2006 to 2030,[1] many of whom will have seen their pensions replaced with unstable tax deferred savings plans. This means we are likely to see a significant increase in the number of seniors living in poverty.

Our retirement system is commonly described as a "three-legged stool with Social Security, a defined-benefit pension, and personal savings each representing a leg. All three legs are currently under attack. Defined benefit pensions are the most beaten up. In 1975, 88% of private sector workers with a workplace retirement plan had pension coverage; by 2005 only 33% of private sector workers had pension coverage. By providing older households with a predictable monthly income, defined benefit pensions serve an important role in keeping older households out of poverty and off public assistance. According to a report by the National Institute for Retirement Security (NIRS) the pension income of 1.4 million older American households kept them off public assistance in 2006.[2]

By taking action now, the State of Connecticut has an opportunity to prevent this crisis. We can take advantage of the resources the state already has in place for its own employees to make the retirement marketplace more efficient, fair, and effective. A commission should be created to study how the state can develop an affordable retirement option using the experience and capability of its existing structure. This memo provides an overview of the crisis and identifies the principles that should be a part of a new state-based public option retirement plan.

The Crisis

Connecticut has the 7th oldest median age in the nation, according to the 2010 US Census. All levels of government are charged with providing some sort of financial assistance to older residents, whether its food stamps, heating assistance, health care, or property tax help. Without doubt the economic situation and the recent changes in retirement benefit coverage will force all of these forms of assistance to increase.

The deteriorating retirement system will lead to significant increases in public assistance to the elderly on the magnitude of a 40% increase.

The current economy has resulted in lower retirement funds. With costs for basic expenses increasing and incomes stagnating, the middle class has less resources for retirement. The Center for Retirement Research recently modeled that that the recession will result in a 4.3% reduction in average annual incomes when today's workers reach the age of 70.[3] Compounding the decrease in earnings, "leaky" 401(k) plans are being raided due to economic hardship. According to Fidelity Investments, the number of workers borrowing from their 401(k) accounts reached a 10-year high in 2010.[4] The result is families muddling through difficult times by significantly diminishing their retirement income.

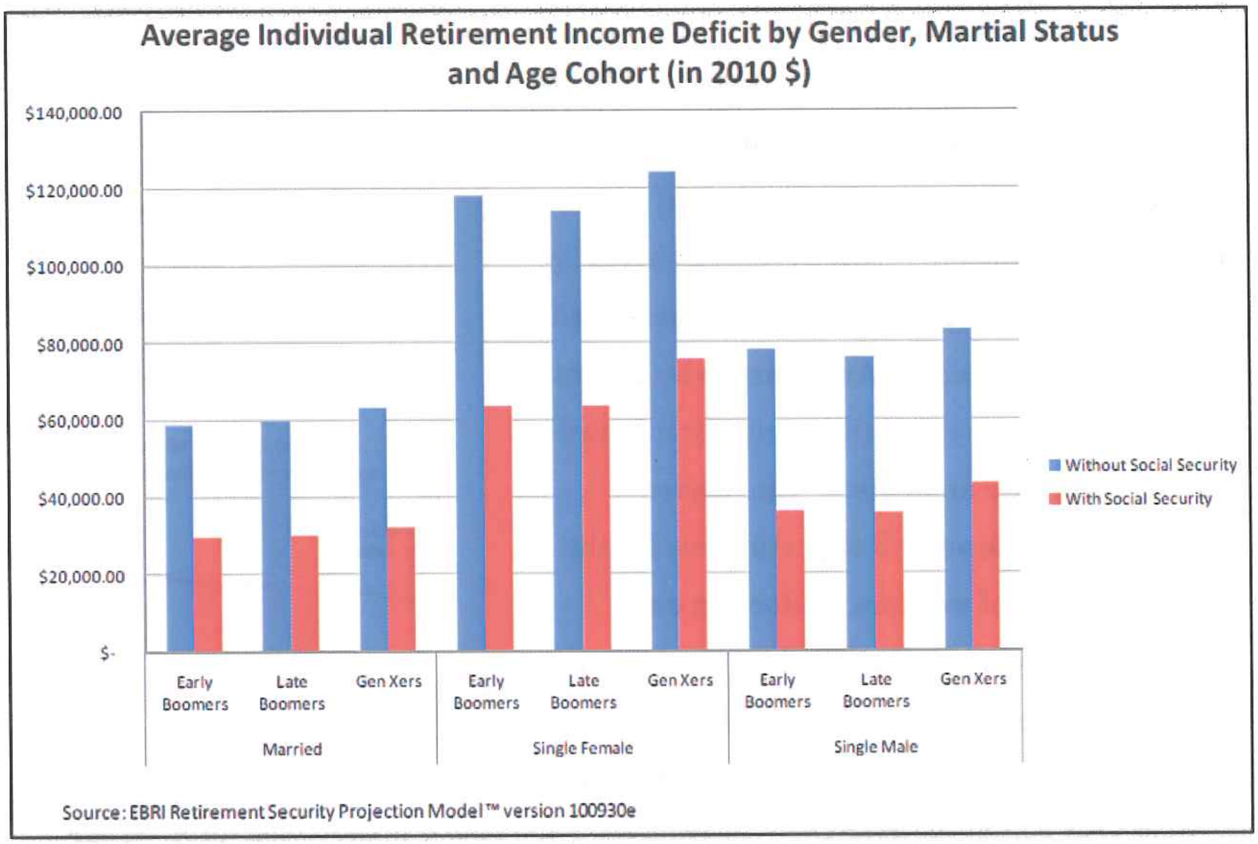
The "Elder Economic Security Standard Index" defines the amount of annual income a senior needs to live free of food, shelter or health care hardships. Income adequacy is based on characteristics and spending patterns of elder households. For a healthy, single Connecticut elder (65+) the Economic Security Standard Index is annual income of $21,383 for homeowners without a mortgage, and $24,408 for renters. The average Social Security benefit is $14,154 per year for an individual, which is 66% of the statewide index for homeowners and 58% of the statewide index for renters. For a healthy, married couple the Index is $32,039 for homeowners, without a mortgage, and $35,064 for renters. The average Social Security benefit is $23,022 per year for a couple, which is 72% of the statewide index for homeowners and 66% of the statewide index for renters.[5] In short, Social Security is simply not, nor was it intended to be enough to live on.

Unfortunately, Connecticut residents simply do not have access to *quality* retirement plans. According to the Employee Benefit Research Institute (EBRI), over the past 10 years in Connecticut, about 5% of workers have been dropped from participating in any type of retirement plan.[6] Social Security is the only source of income for one out of five older adults in Connecticut. Additionally, those who do have access to a retirement plan at work are most likely offered a 401(k) savings-type plan that requires individual workers to bear idiosyncratic risks and pay high administrative fees. According to the *Wall Street Journal* the median household income headed by a person aged 60 to 62 with a 401(k) account had less than one-quarter of what is needed to maintain their standard of living in retirement.[7]

The current retirement system exacerbates inequalities in our labor market, leading to unequal retirements for low-income workers, women, minorities and small business folks.

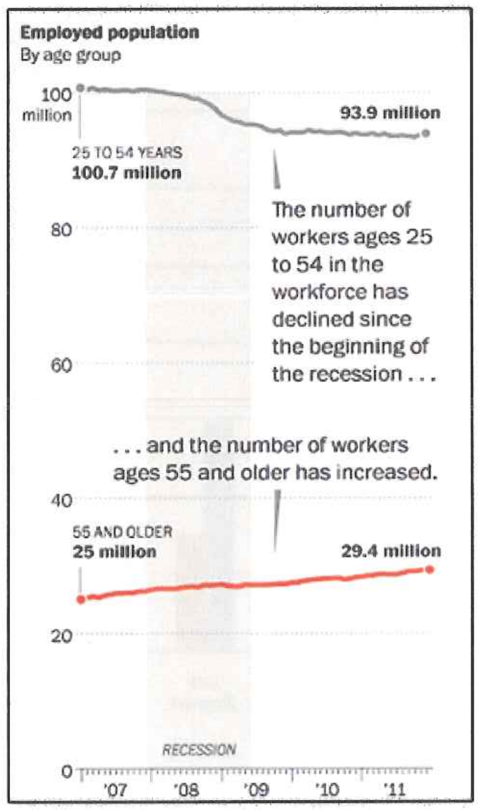
Not surprisingly workers in small businesses, low-income workers, women, and minorities are suffering the most under our current system. Only 38.4% of workers in private industry in the lowest 25 wage percentile have access to any retirement plan. Only 29.3% of workers in business with less than 25 workers have access. 36.8% of Hispanics have access.[8] 40% of older women rely solely on Social Security for retirement income.

The Employment Benefit Research Institute's modeling of the resources needed by different age groups to retire near their pre-retirement standard of living reveals the escalating nature of this crisis. The chart below looks at the expected deficit in retirement income that individuals in each age cohort are expected to face. In aggregate, the total deficit in retirement benefits is estimated to be $4.6 trillion (assuming current Social Security remain stagnant).[9]



The outcome of this shift away from sufficient retirement income for basic needs is the destruction of families and increased public assistance costs, both of which put a strain on our fragile economy. Senior citizens are the group most vulnerable to poverty. In most cases, they are in no position to just get a job. A national survey by McKinsey & Co. found that 40% of workers retired earlier than expected because of health problems or age discrimination.[10] In addition, being older frequently necessitates more money as help is usually needed for basic human needs such as mobility, nutrition, housekeeping and even personal hygiene. Moreover, workers forced to retire because of bad health or company downsizing, wind up on public assistance. According to a study by the NIRS, public assistance to older Americans would increase by $7.3 billion if the fortunate folks who are currently receiving pensions did not have them.

The lack of retirement income stalls our labor market, and worsens recessions. When workers are forced to stay working longer, they crowd out job opportunities for the younger generation. Since the 2008 stock market crash workers with 401(k) plans suddenly had insufficient savings to retire. A recent survey by Towers Watson found that 40% of workers plan to delay their retirement.[11] And many who did retire had to re-enter the job market (mostly in retail or fast-food) to make ends meet. This leaves businesses with fewer job opportunities for the next generation of workers, distorting our economy. Compiled by the Washington Post, the graph illustrates the way older workers are crowding out younger workers for the fewer jobs that are still available after the recession ended.[12] Our economy was built on the assumption that once workers reached a certain age, they retire and become full-time consumers, without adequate retirement income the entire system is at risk.



The Opportunity

The biggest opportunity we have is that unlike other types of public assistance, retirement savings can be advance funded in much the same way as the active state employee pension plans (Tiers II, IIa, and III). According to the Post-Employment Benefits Commission, it's this pre-funding that has resulted in these plans being properly funded and costing the state less than a 401(k)-type plan. If the state acts now, we can prevent the crisis. The longer we wait, the more it will cost.

8 in 10 Americans believe elected officials need to give a higher priority to ensuring workers can have a secure retirement.

Additionally, public opinion is on the side of the government providing businesses more opportunities to offer quality retirement plans. The public wants to know that they will be able to retire and they view the lack of retirement income as a significant problem. According to a Hart Research Poll, 72% of voters believe we should be working to ensure that more workers in our country have real retirement security, instead of taking away this benefit from public employees.[13] A NIRS poll found that more than 80% of Americans indicated that all workers should have access to a pension plan so they can be independent and self-reliant in retirement.[14] In this time of economic insecurity, the public wants their elected officials to be creative about finding ways to make the American Dream more accessible.

If the state takes this opportunity to provide a low-cost retirement plan option for small businesses, it would be creating a significant pro-business and pro-worker incentive for job growth. Businesses can offer employees access to a quality retirement plan without taking on significant costs or long-term risks. Additionally, talented and educated workers can come to Connecticut knowing it will provide an opportunity to reach the middle class.

In constructing a new retirement plan for Connecticut residents, we can draw on a wealth of knowledge about how different types of retirement plans effect older household income. For example, we know that defined benefit pensions are the great equalizer in resolving the racial and gender biases in our economy. We also know that there is an advantage for small businesses in defined contribution plans as they provide individual accounts which guarantee account holders their money even if the business' lifespan is short.

We also have successfully administered retirement plans for state employees that can be scaled up to provide for a public option plan for private sector workers. Reducing administrative fees is an easy and straight-forward example of what can be done. In 2004, the Congressional Budget Office estimated that administrative fees on 401(k) type-plans reduced assets at retirement by 23%.[15] It's not surprising then that Lieutenant Governor Nancy Wyman, as Comptroller, estimated that the state's defined contribution program had 50% lower administrative fees than what the average investor pays.[16] If workers were able to use the state's investment experts to administer their plans, they would be able to have those savings for their retirement.

Principles of a New Retirement Plan

In creating a fair, efficient and effective retirement plan for Connecticut workers and businesses, there are a certain principles that should be followed:

- Portability – 401(k) type plans are made for an economy where folks work for a limited number of years for multiple employers, however, too often employees simply cash out their plans rather than roll them over. Social Security is the model in that your retirement assets are based on total hours worked, not how long you work at any one employer.
- Universality – every worker should have access to participate in a retirement plan, the state's public option pension plan must be available for all businesses and workers to participate in, although plan design should be altered for different business sizes.
- Mutual Responsibility – we cannot deal with the oncoming crisis unless everyone does their fair share: workers, employers and government. Our current system pushes too much of the responsibility onto the worker.

- Shared Risks – pooled assets provide an opportunity to deal with financial and longevity risks. Government is far better suited for this than small employers or individual workers as it can take advantage of economies of scale to provide better rates of return.
- Resources Only Used for Retirement – to actually reduce senior poverty, workers should not be allowed to cash out retirement assets before they retire. Additionally, retirement assets should be paid out as an annuity, not a lump sum, to make sure older retirees do not run out of income.
- Transparent Administration – part of the failure of our current system of 401(k) plans is that there is limited oversight. Recent regulations promulgated by the Federal Department of Labor should increase the transparency of these plans, but workers still have limited ability to compare plans or hold administrators accountable.

Where Do We Go From Here

The Connecticut General Assembly should establish a study commission to gather additional information about the scope of workers who currently do not have access to a quality retirement plan or are close to retirement without adequate income. The commission should look at how incorporating the above principles, we can address the retirement crisis. The commission should be comprised of representatives from various offices charged with managing state resources as well as representatives of workers and small businesses. No one who has a significant financial stake in the current system should be a voting member of the commission. The commission should be charged with recommending to the legislature a detailed plan for addressing the impending retirement crisis that includes creating a new, publicly managed retirement plan. By acting now, we can put in place a framework that will prevent the crisis.

-**Matthew Brokman**, Council 4 AFSCME Political Field Representative. Jan. 2012.

Council 4 of the American Federation of State, County and Municipal Employees (AFSCME) represents approximately 35,000 employees in state and local government, boards of education and the private sector. Council 4 is affiliated with the 1.6 million member AFSCME International Union in Washington, D.C.

Endnotes

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