Testimony by Monique Morrissey on “Restoring the Trust for Americans at or Near Retirement” before the U.S. House Committee on the Budget, July 13, 2016.

Thank you, Chairman Price and Ranking Member Van Hollen for inviting me to testify today.

My name is Monique Morrissey. I am an economist at the Economic Policy Institute and author of *The State of American Retirement: How 401(k)s Have Failed Most American Workers*. The Economic Policy Institute is a nonprofit, nonpartisan think tank created in 1986 to include the needs of low- and middle-income workers in economic policy discussions.

We face a looming retirement crisis. For the first time in modern American history, future generations will face a sharper drop in income at retirement than current retirees. This historic reversal is not because Social Security is broken, but because it has shrunk. It is also because we embarked on a failed policy experiment, relying on upside-down tax breaks to encourage people to save for retirement while traditional employer-provided pensions declined.

The National Academy of Social Insurance has estimated that Social Security cuts implemented in 1983 reduced benefits by 19 percent for Americans born in 1960 compared with those born in 1936. These cuts include an across-the-board increase in the normal retirement age (equivalent to a 13 percent across-the-board reduction in benefits), as well as the taxation of Social Security income. The latter will have an even greater effect over time as limits on untaxed benefits are not indexed to inflation (Reno, Bethell, and Walker 2011).

In 1983, unlike today, Social Security faced an imminent shortfall. Congress responded with benefit cuts and by accelerating scheduled increases in the payroll tax rate. This seemed like a balanced response at the time, but Congress could not have anticipated that another leg of the proverbial retirement stool—employer pensions—was about to be knocked out from under working Americans, nor how slow and unequal wage growth would affect household and Social Security finances.

The previous year—1982—a few large employers had begun offering a new type of savings plan named after a section of the tax code that clarified the treatment of deferred compensation (EBRI 2005). These plans were initially seen as supplements to, not replacements for, traditional pensions, though this is what they quickly became.

Congress did not change the tax code with the intention of creating a new type of retirement plan. In fact, the bank for which the first 401(k) was designed turned it down, believing Congress would reverse course once it had realized how the new rules could be interpreted (Benna 2016; Olshan 2011 and 2016; Tong 2013). Yet seemingly overnight, 401(k)s dominated the retirement landscape. As early as 1984, there were more private-sector workers in 401(k)-style defined-contribution plans than in traditional defined-benefit pensions, though many of these were likely supplemental plans (DOL 2015)). By 1992, the number of families in all sectors where at least one spouse participated in a DC plan exceeded the number with DB pensions (author's analysis of Survey of Consumer Finances microdata).

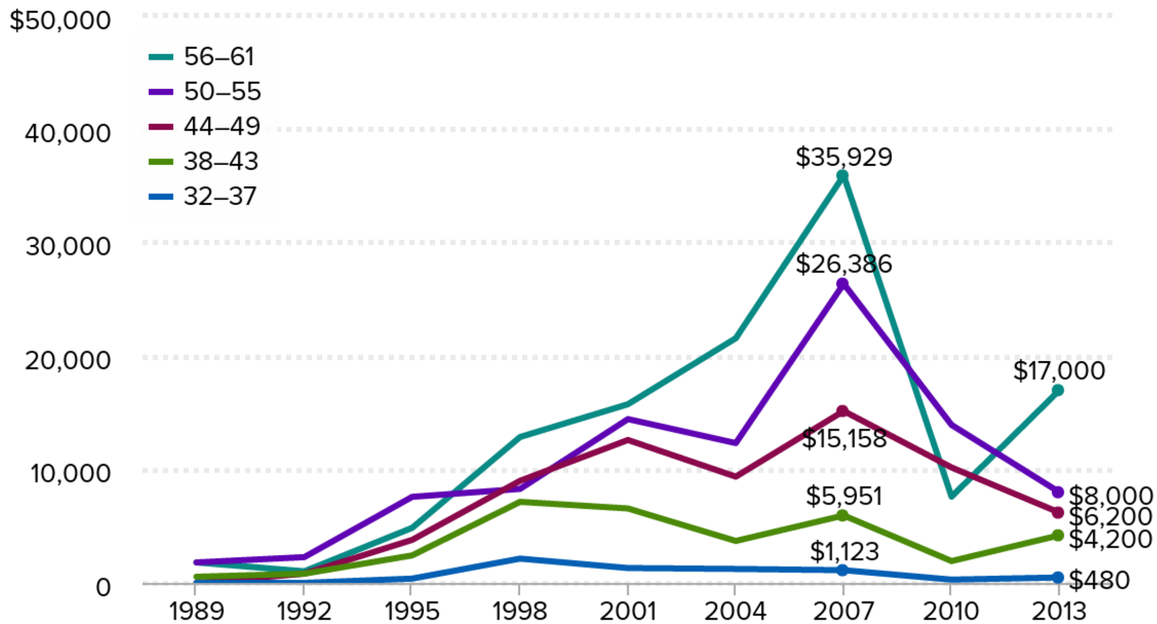
The plans were popular with employers for obvious reasons. They shifted most of the cost and all the risk of retirement onto workers. Meanwhile, some participants were lulled by rising stock prices, at least until the dot-com bubble burst. This was followed seven years later by the financial crisis and Great Recession, which caused the net worth of the typical family approaching retirement to fall by half. (Unless otherwise noted, all statistics and figures are from *The State of American Retirement* and based on wealth data from the Survey of Consumer Finances and income data from the Current Population Survey.)

However, we are not just facing a temporary problem caused by a once-in-a-lifetime downturn. Americans' retirement prospects were dimming even before the Great Recession, and they have not brightened in the recovery. Researchers at the Boston College Center for Retirement Research have long warned that wealth-to-income ratios were not rising. This is bad news because people should be saving more to make up for declining pension and Social Security benefits, support themselves over longer lifespans, and offset rising health care costs, among other reasons (Delorme, Munnell and Webb 2006; Munnell, Hou and Webb 2014; Munnell, Rutledge and Webb 2014). It also does not take into account the increasingly unequal distribution of income and wealth.

Wealth measures are affected by factors that may have little impact on retirees' standard of living, such as fluctuating home prices. However, retirement accounts are part of—not an exception to—the wealth problem, as most families have little or nothing saved in these accounts. The typical family approaching retirement had accumulated just $17,000 in a retirement account in 2013, not enough to make an appreciable difference to their standard of living in retirement. A quarter century after participation in 401(k)-style plans surpassed that in traditional pensions, pension benefits remain six times as important to seniors as retirement account distributions.

Most families—even those approaching retirement—have little or no retirement savings

Median retirement account savings of families by age, 1989–2013 (2013 dollars)



Note: Scale changed for visibility. Retirement account savings include 401(k)s, IRAs, and Keogh plans.

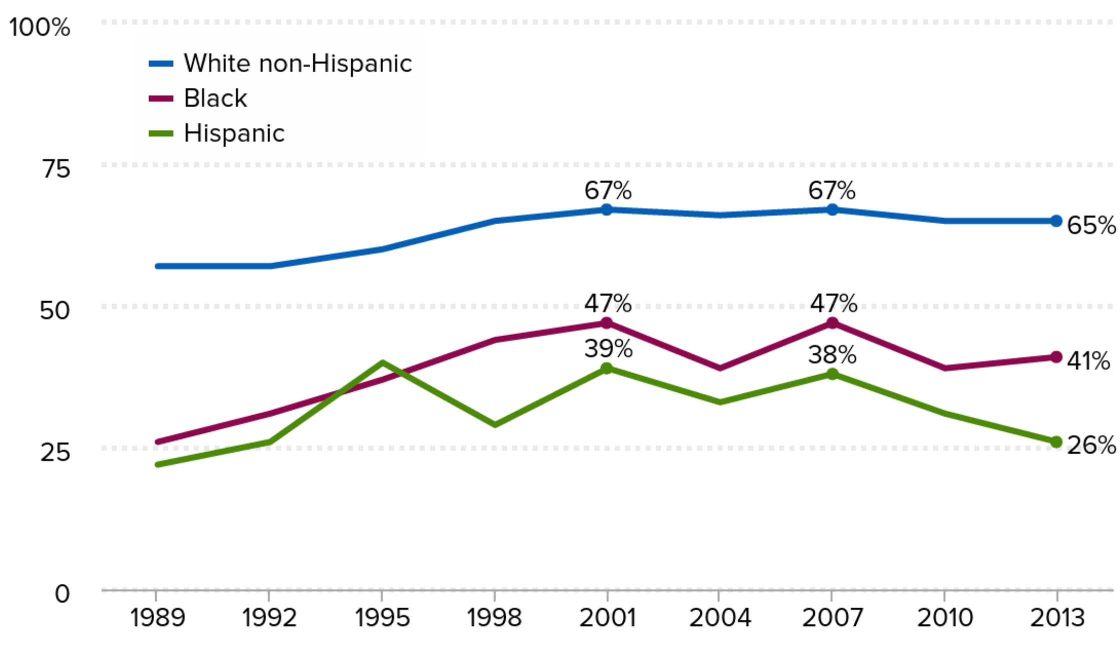
Source: EPI analysis of Survey of Consumer Finance data, 2013.

Economic Policy Institute

Despite rules intended to limit the share of the tax benefit received by high earners, one fifth of population holds three-fourths of the wealth in tax-qualified plans. This inequality is not random—some groups have fared worse than others. Most working-age black and Hispanic families as well as families headed by someone with a high-school education have no retirement account savings at all, and the same is true of unmarried people. Among all working-age families, 70 percent have $50,000 or less saved in a retirement account, including 43 percent who have nothing at all. Meanwhile, the top 10 percent have a quarter million dollars or more and the top 1 percent have over a million.

Most black and Hispanic families have no retirement account savings

Share of families age 32–61 with retirement account savings by race, 1989–2013



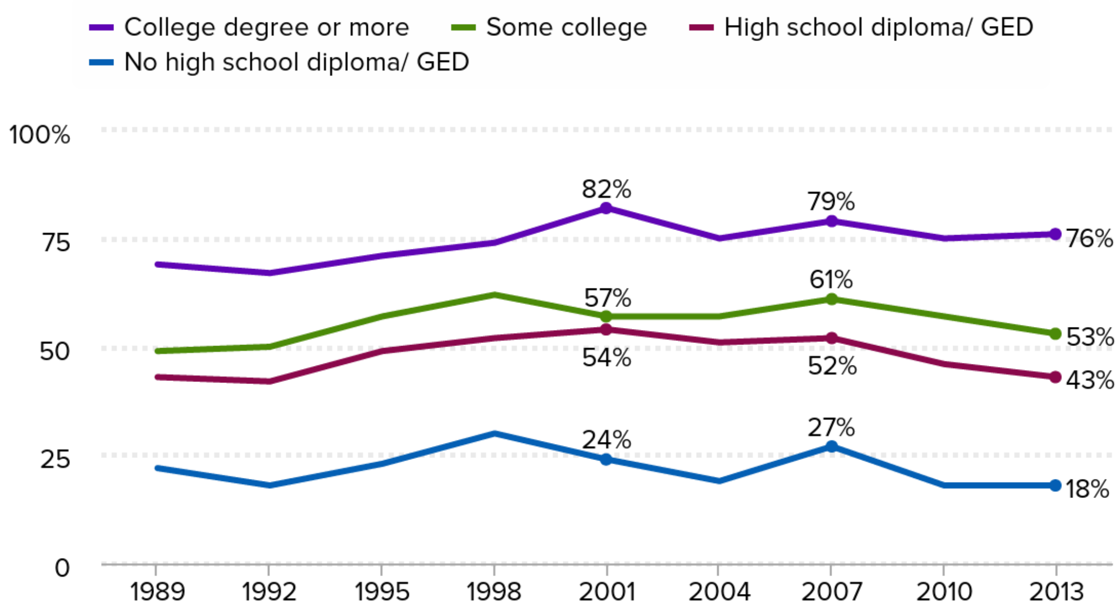
Note: Retirement account savings include 401(k)s, IRAs, and Keogh plans.

Source: EPI analysis of Survey of Consumer Finance data, 2013.

Economic Policy Institute

College-educated families are much more likely to have retirement savings

Share of families age 32–61 with retirement account savings by education, 1989–2013



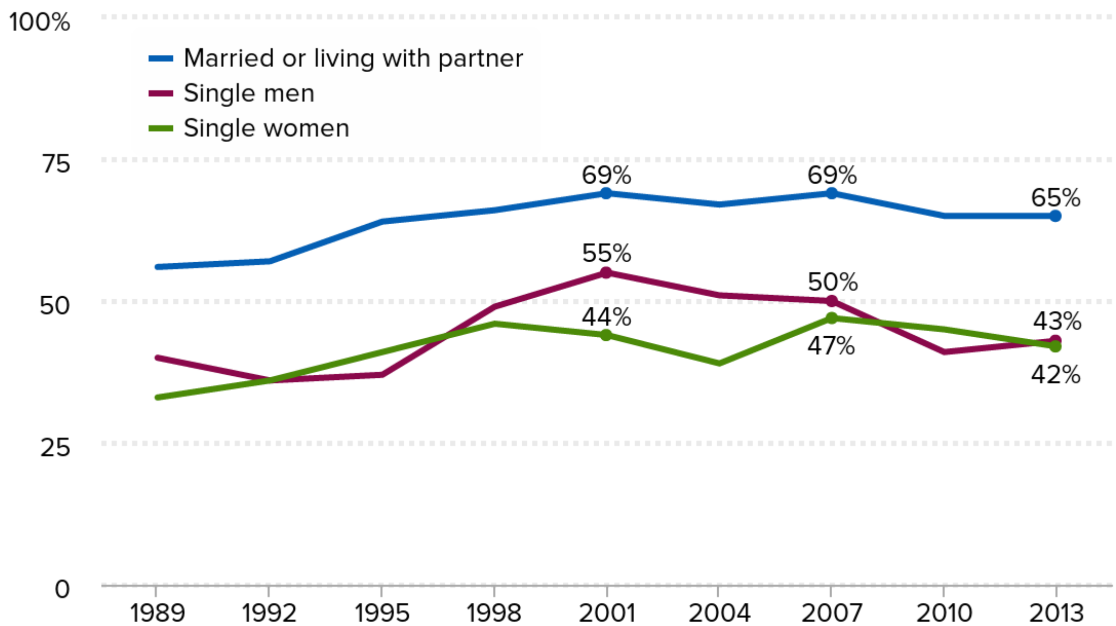
Note: Retirement account savings include 401(k)s, IRAs, and Keogh plans. "College degree" includes associate degrees.

Source: EPI analysis of Survey of Consumer Finance data, 2013.

Economic Policy Institute

Single people are less likely to have retirement savings

Share of families age 32–61 with retirement account savings by gender and marital status, 1989–2013



Note: Retirement account savings include 401(k)s, IRAs, and Keogh plans.

Source: EPI analysis of Survey of Consumer Finance data, 2013.

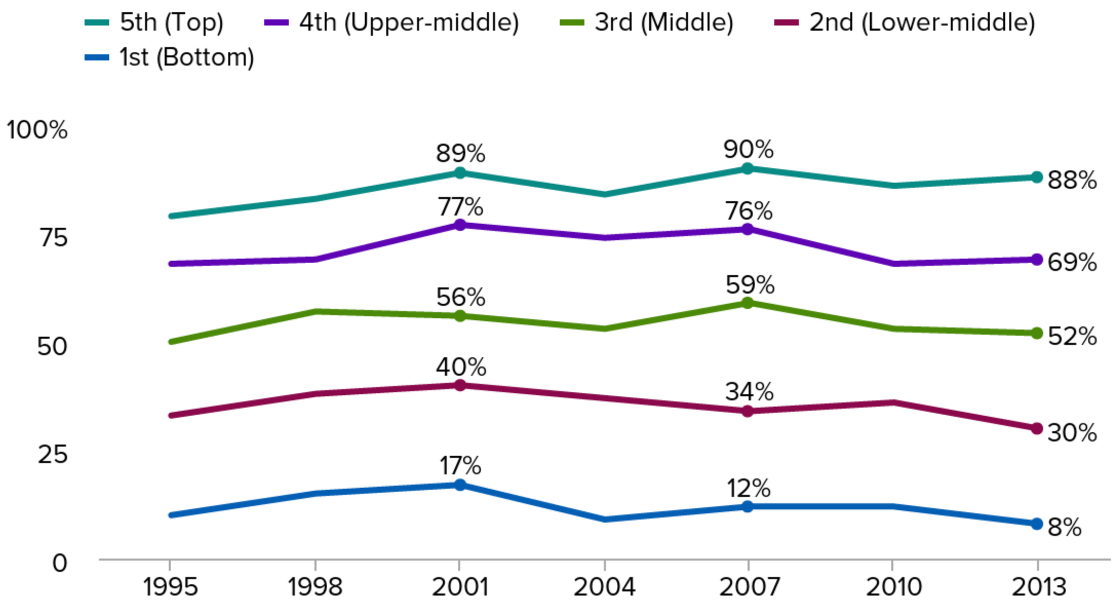
Economic Policy Institute

It was not always this way. We have gone from a retirement system that reduces inequality to one that magnifies it. Social Security has a progressive benefit structure, with a higher replacement rate for lower-income workers. Meanwhile, traditional pensions at least did not exacerbate inequality. Before the 401(k) revolution, black workers were almost as likely to participate in pensions as white workers, and high-school educated workers were almost as likely to participate as college-educated workers.

However, there are now more than twice as many workers in 401(k)-style plans as traditional pensions, and participation in 401(k) plans is very unequal. High-income families are 10 times as likely to have retirement accounts as low-income families. Moreover, retirement inequality is growing, as the top fifth of households have seen gains in the New Millennium while the bottom four fifths have lost ground.

High-income families are 10 times as likely to have retirement accounts as low-income families

Share of families age 32–61 with retirement account savings by income quintile, 1995–2013



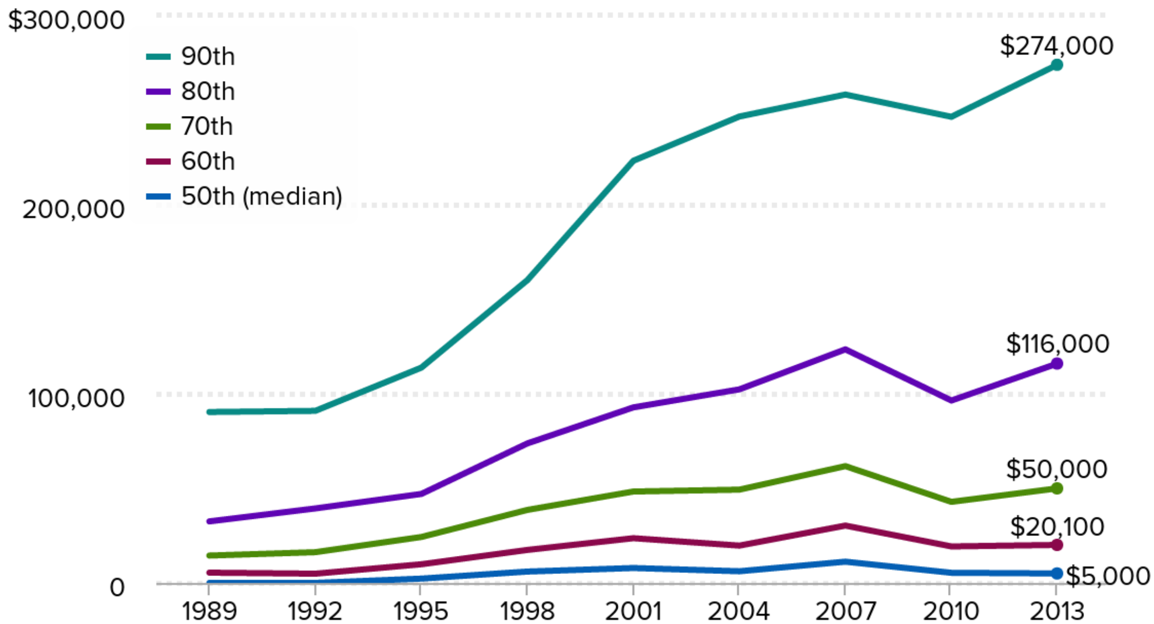
Note: Retirement account savings include 401(k)s, IRAs, and Keogh plans. Family-income quintiles are based on "normal income," a measure that ignores temporary fluctuations and is not available for years prior to 1995.

Source: EPI analysis of Survey of Consumer Finance data, 2013.

Economic Policy Institute

The gap between the retirement ‘haves’ and ‘have-nots’ has grown since the recession

Retirement account savings of families age 32–61 by savings percentile, 1989–2013 (2013 dollars)



Note: Retirement account savings include 401(k)s, IRAs, and Keogh plans. Scale changed to accommodate larger values.

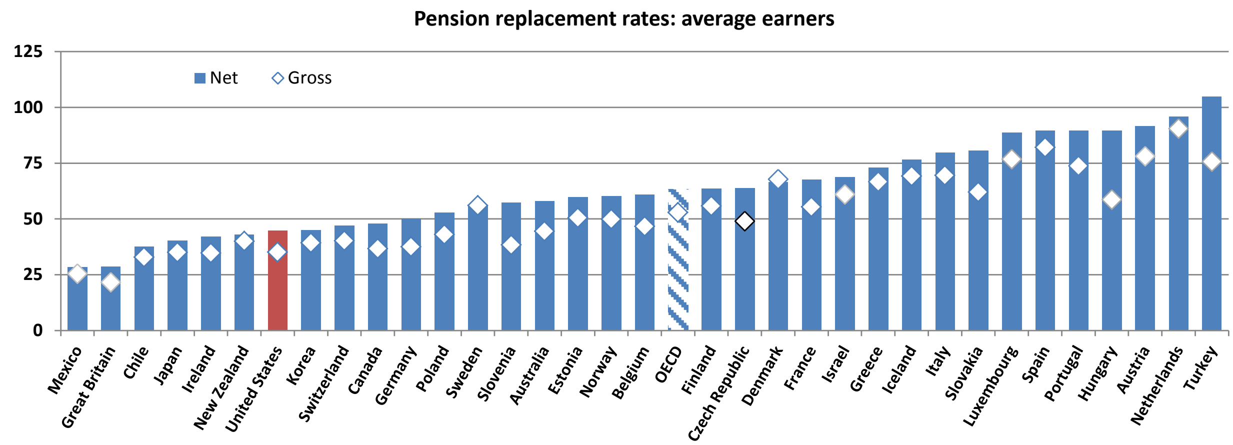
Source: EPI analysis of Survey of Consumer Finance data, 2013.

Economic Policy Institute

The problem is often defined as people not saving enough. However, more than half of households in the bottom half of the income distribution—65 percent of those in the lowest income quartile and 42 percent of those in the lower-middle quartile—do not have access to an employer-based retirement savings plan (GAO 2016). Others may have good reasons for avoiding a high-cost, high-risk system. Tax incentives for retirement saving are based on taxes that would otherwise be owed on investment earnings and are worth much more to taxpayers in upper tax brackets who can afford to take on more investment risk.

What needs to be done? First and foremost, we need to reverse Social Security cuts and expand benefits across the board. To do this, we need to raise revenues by lifting the cap on taxable earnings and adopting other measures to expand the revenue base. I am also in favor of very slowly increasing the contribution rate to offset any increases in life expectancy. This can easily be accommodated by rising living standards, though care must be taken to maintain the progressivity of the system in the face of growing gaps in life expectancy.

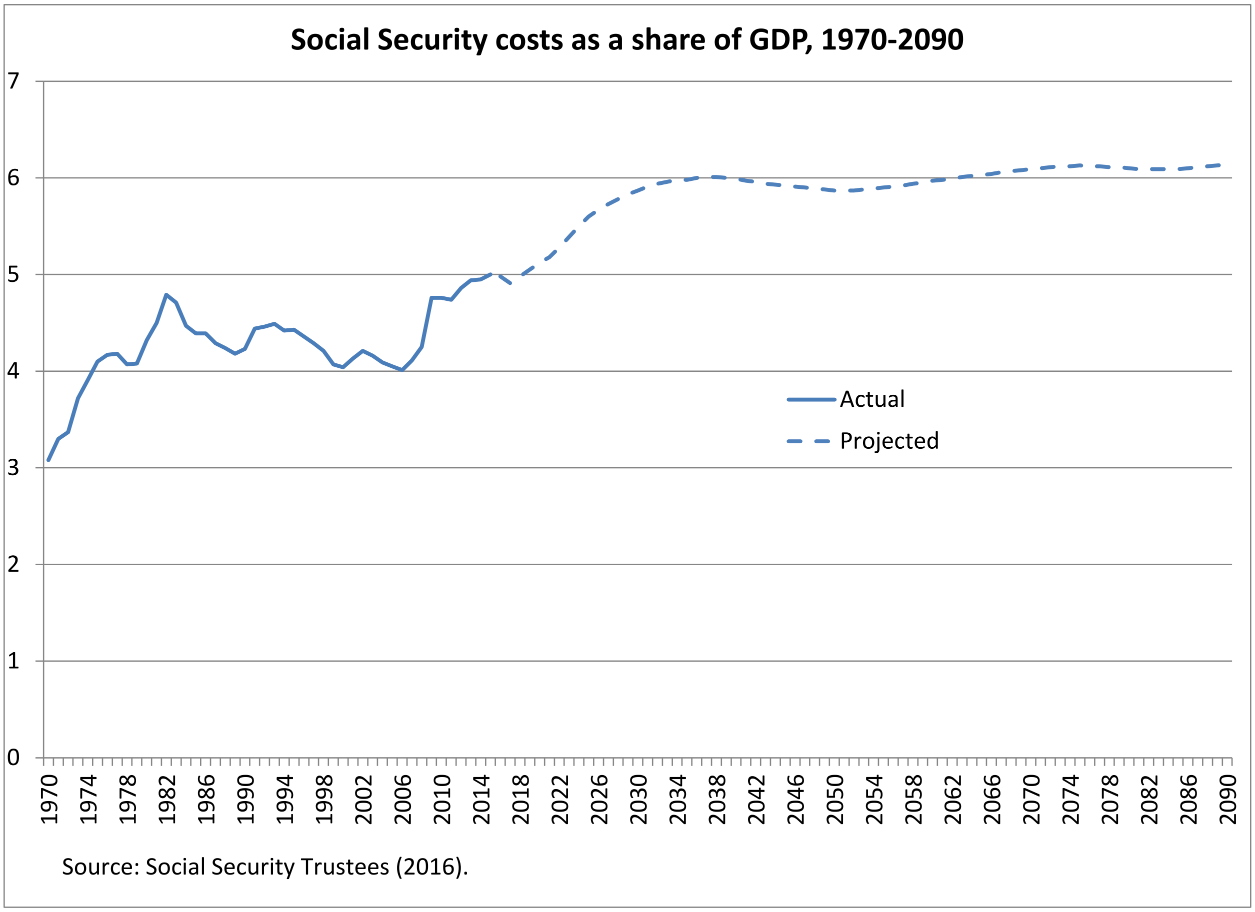
There are no economic impediments to expanding Social Security, which provides modest retirement benefits compared to public pension systems in other advanced economies. Social Security replaces a lower-than-average share of earnings despite a higher-than-average retirement age than systems in other countries in the Organisation for Economic Co-operation and Development (OECD)—35 percent in the United States versus 53 percent for the OECD countries as a group.



Source: OECD Pensions at a Glance 2015.

Most experts recommend that families should aim to replace at least 70 percent of pre-retirement income (more for low-wage workers and less for high-wage workers). Thus, Social Security provides roughly half of what people need to maintain their standard of living in retirement, with the rest left to employer pensions and private savings. However, the Center for Retirement Research conservatively estimates that fewer than half of working-age households are on track to accumulate enough savings and benefits to maintain their pre-retirement standard of living, and the share at risk is even higher for younger households (Munnell, Hou and Webb 2014).

It is often suggested that we cannot afford to expand Social Security because of an aging population. It is true that the aged dependency ratio is rising due to the Baby Boomer retirement, a lower birthrate, and longer life expectancy. However, the dependency ratio is lower, and rising more slowly, than in most OECD countries and there have been offsetting factors, including immigration and an increase in women's labor force participation (OECD 2015; Ballantyne, Mishel and Morrissey 2010). As a result, the United States does not face escalating Social Security costs as a share of GDP. Instead, benefit outlays are projected to stabilize at around six percent of GDP, one percentage point higher than today (Social Security Trustees 2016).



Social Security is still running a surplus, though this will change in a few years as the bulk of the Baby Boomers enter retirement. Social Security will be able to pay full benefits for longer—through 2034—as it taps trust fund savings. The need to build up and then spend down the trust fund to accommodate a bulge in the beneficiary population was anticipated by Social Security actuaries and Congress in 1983.

What the actuaries did not foresee was how slower wage growth, rising inequality and rising health costs would erode the system's revenue base (Ballantyne, Mishel and Morrissey 2010). The Advisory Council on Social Security noted in 1997 that such adverse economic factors, *not* an unanticipated increase in the beneficiary-to-worker ratio ("the usual popular explanation"), were contributing to Social Security's worsening outlook. These ongoing problems were exacerbated a decade later by the Great Recession, which decimated payroll tax revenues during the Baby Boomers' peak earning years and reduced the interest earned on trust fund assets.

These economic challenges can be addressed through policy interventions within and outside Social Security. The Affordable Care Act directly addressed the most daunting fiscal challenge we face—rising health costs—though we have much further to go to get health costs in line with those in other advanced economies. Bending the cost curve has an obvious beneficial impact on Medicare, but also improves Social Security's finances by increasing the share of employee compensation subject to payroll taxes. The Affordable Care Act also helps older Americans directly because they face higher out-of-pocket costs than younger Americans both before and after becoming eligible for Medicare. Because government programs do a better job of restraining costs than private insurers or individual consumers, the economic burden of rising health costs would only be exacerbated by shifting more of these costs onto the private sector.

Congress also needs to address the problem of slow and unequal wage growth due to a widening gap between pay and productivity (Bivens et al. 2014). This will directly raise the standard of living of most Americans while also improving Social Security's finances because a growing share of earnings is above the cap on taxable earnings. The taxable share of earnings in covered employment declined from 90 percent in 1983 to less than 83 percent in 2014—a cumulative loss of $1.2 trillion including interest (author's estimate based on Social Security Administration 2016 and Social Security Trustees 2016). In addition to lifting the cap, policies that would increase taxable earnings include raising the minimum wage, strengthening the right to collective bargaining, and prioritizing full employment in the conduct of monetary policy (Mishel and Eisenbrey 2015; Economic Policy Institute n.d.).

In short, we face a looming retirement income crisis brought on by ill-timed Social Security cuts and a shift from secure pensions to risky, high-cost, and highly unequal 401(k) plans. The good news is that the situation is not a zero-sum game pitting seniors against younger families. As economist Dean Baker has pointed out, countries that devote more social spending to seniors also spend more on children (Baker 2013). The most important policies for raising the living standard of working Americans would also help seniors and improve Social Security and Medicare's finances. Likewise, a progressive benefit expansion would have positive macroeconomic implications. Conversely, proposals to address the Social Security shortfall by further cutting benefits would fall hardest on younger generations who are already at greater risk due to declining Social Security and pension benefits.

Americans across the political spectrum understand this and are willing to pay more to preserve and expand Social Security (Walker, Reno and Bethell 2014; Tucker, Reno and Bethell 2013). Policymakers are starting to catch up to their constituents. Thus, the draft 2016 Democratic Party Platform calls for Social Security expansion, an idea supported by both Democratic presidential candidates. The presumed Republican candidate has at least said he will not cut benefits, though he appears to be under pressure to reverse this position. This is a sea change from a decade ago when the question was not whether to expand Social Security or leave it alone, but rather how much to cut benefits.

In addition to expanding Social Security, we need to preserve pensions for those who have them, including most public-sector workers. We also need new solutions for workers whose employers are not in a position to provide pensions. State and local governments are experimenting with hybrid plans that could provide workers with some of the advantages of pensions without requiring employers to take on long-term liabilities. What we do *not* need is to cut proven, cost-effective social insurance programs like Social Security and Medicare and shift the burden to individuals who face much higher costs and higher risks in a do-it-yourself system.

Advisory Council on Social Security. 1997. Report of the 1994-96 Advisory Council on Social Security, Volume I: Findings and Recommendations, Appendix 1, Developments Since 1983 (Washington, D.C., January 1997).

Baker, Dean. 2013. “The Kids versus Seniors Line Doesn't Fit the Facts,” Center for Economic and Policy Research Blog, September 2013.

Ballantyne, Harry C., Lawrence Mishel and Monique Morrissey. 2010. “Social Security and the Federal Deficit: Not cause and effect,” Economic Policy Institute Briefing Paper, August 6.

Benna, Ted. 2016. “The Day I Designed The First 401(K) Savings Plan,”

Delorme, Luke, Alicia H. Munnell, and Anthony Webb. 2006. “Empirical Regularity Suggests Retirement Risk,” Boston College Center for Retirement Research *Issue in Brief*, January.

Economic Policy Institute. n.d. “The Agenda to Raise America’s Pay.”

Employee Benefit Research Institute (EBRI). 2005. History of 401(k) Plans: An Update.

Mishel, Lawrence and Ross Eisenbrey. 2015. “How to Raise Wages: Policies That Work and Policies That Don’t,” Economic Policy Institute Report, March 19.

Munnell, Alicia H., Wenliang Hou, and Anthony Webb. 2014. “NRRI Update Shows Half Still Falling Short,” Boston College Center for Retirement Research Issue Brief #14-20, December.

Munnell, Alicia H., Matthew S. Rutledge, and Anthony Webb. 2014. “Are Retirees Falling Short? Reconciling the Conflicting Evidence,” Boston College Center for Retirement Research Working Paper, September.

Morrissey, Monique. 2016. *The State of American Retirement: How 401(k)s Have Failed Most American Workers*, Economic Policy Institute, March 3.

Olshan, Jeremy. 2011. “‘Father’ of the 401(k)’s Tough Love,” *MarketWatch*, November 22.

Olshan, Jeremy. 2016. "The inventor of the 401(k) says he created a 'monster,'" *MarketWatch*, June 18.

Reno, Virginia P., Thomas N. Bethell, and Elisa A. Walker. 2011. "Social Security Beneficiaries Face 19% Cut; New Revenue Can Restore Balance." National Academy of Social Insurance.

Social Security Administration. 2016. *Annual Statistical Supplement, 2015*.

Social Security Trustees. 2016. "The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds."

Tong, Scott. 2013. "Father of modern 401(k) says it fails many Americans," *Marketplace*, June 13.

Tucker, Jasmine V., Virginia P. Reno, Thomas N. Bethell. 2013. "Strengthening Social Security: What Do Americans Want?" National Academy of Social Insurance, January 2013.

United States Department of Labor (DOL). 2015. "Private Pension Plan Bulletin Historical Tables and Graphs, 1975-2013."

United States Government Accountability Office (GAO). 2016. "RETIREMENT SECURITY: Low Defined Contribution Savings May Pose Challenges," May 5.

Walker, Elisa A., Virginia P. Reno and Thomas N. Bethell. 2014. "Americans Make Hard Choices on Social Security: A Survey with Trade-Off Analysis," National Academy of Social Insurance, October.