2B. Bolster Retirement Security for All

Box 1 contains the section on retirement security from the *Prescription for Prosperity: An Economic Agenda for Pennsylvania's Future*. This section elaborates the rationale for the recommendations in the retirement security section of the agenda. We also provide more detail on how agenda recommendations might be implemented. As with all sections of this "discussion draft," we welcome feedback. (Comments may be submitted to agenda@keystoneresearch.org.)

Even more than the weekend and the 40-hour week, retirement security for the middle class is an innovation of relatively recent vintage. After World War II, with the expansion of industrial unions in the nation's core manufacturing industries and then with the spread of "30-and-out" plans in the 1950s and 1960s, working families for the first time began to enjoy extended retirements without a decline in their standard of living. Retirement security was built on a three-legged stool: social security, personal savings, and pensions.

Box 1. *The Prescription for Prosperity Excerpt on Retirement Secuirty*

Bolster Retirement Security for All

i. Where state government has authority, support traditional guaranteed pensions that help employers retain experienced workers and that are one of the few remaining sources of retirement security for workers without a college education

ii. Make it easy, through establishment of Pennsylvania Voluntary Accounts, for small businesses to offer workers a savings plan plus a low-cost way to convert savings into a guaranteed monthly payment when workers retire

Now retirement security for the middle class is threatened. Renewed uncertainty about retirement security contributes to the economic anxiety of Pennsylvanians. This uncertainty stems, in part, from concern about the future of Social Security. It stems in part from the decline of U.S. savings rates. Many middle- and lower-income families have little or no third leg to on which to stand.

The erosion of retirement security stems also from a decline in the number of workers who receive a good pension through their job. Today, half of Pennsylvania's private sector employees get no retirement savings through their employers. Moreover, there has been a sharp decline—to less than one in five workers—in the share of private sector workers who have so-called guaranteed or "defined benefit" (DB) pensions. These pensions provide workers with a fixed monthly pension based on their years of service and on their salary during its peak years. Instead, more private sector workers with a pension have so-called "defined contribution" (DC) plans, which pay out upon retirement based on how much employers and workers contribute to a retirement fund that's invested in stocks and bonds. Employers, in many cases, contribute little to DC plans, reducing the size of the fund available upon retirement.

As with wages, except even more so, there has been a polarization in the distribution of pension benefits. Chief Executive Officers and other high-level managers enjoy lucrative annuities and lump-sum bonuses when they leave a job. Lower-income and less educated workers get little or nothing.

The trends that exist in private sector pension and in savings in the United States have prompted pension expert Teresa Ghilarducci to raise the possibility of "The End of Retirement" and a return to the days when many or most working people have to work until the end of their life to maintain a decent standard of living.

Particular in the private sector, primary responsibility for pension policy lies at the federal level and federal "pre-emption" limits what state's can do to strengthen retirement security. Nonetheless, the commonwealth can, and should, take action to shore up retirement security in both the public and the private sector. The state should do this via a two-pronged strategy.

<u>Shoring up public sector employees' traditional defined benefit (DB) pensions</u>.[1] Stronger public sector DB pensions can be funded responsibly through sensible reforms that in turn would strengthen Pennsylvania's economic competitiveness. State government has the authority to strengthen DB pensions for workers in Pennsylvania's public sector and can do so without massive new fiscal outlays. Sharp drops in the stock market after 2000 created a misperception that public sector DB pensions will be an unsustainable drain on public dollars, but sensible reforms would enable state governments to maintain DB pensions for state and local government employees.

These reforms would guarantee regular contributions, thereby reducing the pressure on the state to increase pension contributions when economic times are bad and encouraging the state to raise contributions when times are good. These reforms would be good for retirees, employers, and the state economy because they would:

- Give a typical public sector worker in Pennsylvania an adequate, although not generous, retirement income equal to about 75 percent to 80 percent of their pre-retirement income. According to professional advisors and economists,

[1] For detailed recommendations on how to accomplish this, see Christian E. Weller, Mark A. Price, and David M. Margolis, *Rewarding Hard Work: Give Pennsylvania Families a Shot at Middle Class Retirement* (Washington, D.C. and Harrisburg, PA: the Center for American Progress and Keystone Research Center, October 2006), online at www.keystoneresearch.org.

this is typically adequate to maintain approximately the same standard of living after retirement.

- Maintain the ability of state and local governments to attract and retain talented professionals, who would otherwise be drawn to higher paying jobs in the private sector if public sector DB pension benefits are allowed to deteriorate.

- Require regular, manageable contributions from state government and school districts so that stock market booms, such as in the late 1990s, do not lead to periods when employers contribute little or no money to public sector pension plans and leave them vulnerable when financial markets weaken again.

- Allow DB plans to retain their valuable role in the economy. Well funded pension plans invest in many assets and they are a particularly important source of financing for venture capital firms. Venture capital firms finance small privately held startup companies in exchange for an equity stake in the companies. Pennsylvania venture capital firms in 2005 received 20 percent of their resources from the DB pension plans for state government employees.

Defined-benefit public sector pensions are the *one* place in our economy today where workers who have a high-school degree or less have a good chance at a secure retirement. Shifting away from DB plans to DC plans that have higher administrative costs, more risk, and lower employer contributions would take is a step closer towards the end of retirement for more of Pennsylvania's middle class.

<u>Have state government give employees at all businesses the ability to save via Pennsylvania Voluntary Accounts</u> (PVAs). Following a model developed in Washington state, PVAs could give employees at all private sector businesses access at least to a well-managed savings vehicle with low administrative costs and a low-cost option to convert savings, upon retirement, into an annuity that pays out a fixed amount per year. Options could be established that allow for an employer match or just for employees to contribute. Employee contributions could be made the "default" option, so that employees would accumulate savings unless they specifically elect not to do so. (Research shows that making the default option to save instead of not to save raises participation rates in such plans substantially.) At the outset or in the future, the state government could also match contributions for low-income workers.

PVAs would benefit small businesses by removing many of the headaches associated with researching and managing retirement savings vehicles. Opinion research in Washington state by the Economic Opportunity Institute shows that small businesses are very supportive of these types of accounts and recognize that the accounts can help them attract and retain good workers.