

# **Reorienting Retirement Risk Management**

EDITED BY

Robert L. Clark  
and Olivia S. Mitchell

**OXFORD**  
UNIVERSITY PRESS

**OXFORD**  
UNIVERSITY PRESS

Great Clarendon Street, Oxford OX2 6DP

Oxford University Press is a department of the University of Oxford.  
It furthers the University's objective of excellence in research, scholarship,  
and education by publishing worldwide in

Oxford New York

Auckland Cape Town Dar es Salaam Hong Kong Karachi  
Kuala Lumpur Madrid Melbourne Mexico City Nairobi  
New Delhi Shanghai Taipei Toronto

With offices in

Argentina Austria Brazil Chile Czech Republic France Greece  
Guatemala Hungary Italy Japan Poland Portugal Singapore  
South Korea Switzerland Thailand Turkey Ukraine Vietnam

Oxford is a registered trade mark of Oxford University Press  
in the UK and in certain other countries

Published in the United States  
by Oxford University Press Inc., New York

© Pension Research Council, The Wharton School, University of Pennsylvania, 2010

The moral rights of the author have been asserted  
Database right Oxford University Press (maker)

First published 2010

All rights reserved. No part of this publication may be reproduced,  
stored in a retrieval system, or transmitted, in any form or by any means,  
without the prior permission in writing of Oxford University Press,  
or as expressly permitted by law, or under terms agreed with the appropriate  
reprographics rights organization. Enquiries concerning reproduction  
outside the scope of the above should be sent to the Rights Department,  
Oxford University Press, at the address above

You must not circulate this book in any other binding or cover  
and you must impose the same condition on any acquirer

British Library Cataloguing in Publication Data  
Data available

Library of Congress Cataloging in Publication Data  
Data available

Typeset by SPI Publisher Services, Pondicherry, India  
Printed in Great Britain  
on acid-free paper by  
MPG Books Group, Bodmin and King's Lynn

ISBN 978-0-19-959260-9

1 3 5 7 9 10 8 6 4 2

## Contents

---

Preface	v
List of Figures	ix
List of Tables	xi
Notes on Contributors	xiii
List of Abbreviations	xix
1. The Evolution of Retirement Risk Management	1
<i>Robert L. Clark and Olivia S. Mitchell</i>	
<b>Part I: Revisiting Retirement Saving and Dissaving Advice</b>	
2. Retirement Saving Adequacy and Individual Investment Risk Management Using the Asset/Salary Ratio	13
<i>P. Brett Hammond and David P. Richardson</i>	
3. Employer-Provided Retirement Planning Programs	36
<i>Robert L. Clark, Melinda S. Morrill, and Steven G. Allen</i>	
4. How Does Retirement Planning Software Handle Postretirement Realities?	65
<i>Anna M. Rappaport and John A. Turner</i>	
5. Impact of the Pension Protection Act on Financial Advice: What Works and What Remains to Be Done?	86
<i>Lynn Pettus and R. Hall Kesmodel, Jr.</i>	
<b>Part II The Environment for Retirement Plan Redesign</b>	
6. The Effect of Uncertain Labor Income and Social Security on Life-Cycle Portfolios	107
<i>Raimond Maurer, Olivia S. Mitchell, and Ralph Rogalla</i>	
7. The Declining Role of Private Defined Benefit Pension Plans: Who Is Affected, and How	122
<i>Craig Copeland and Jack VanDerhei</i>	

**viii Contents**

8. Rebuilding Workers' Retirement Security: A Labor Perspective on  
Private Pension Reform 137  
*Damon Silvers*

9. Longevity Risk and Annuities in Singapore 156  
*Joelle H. Y. Fong, Olivia S. Mitchell, and Benedict S. K. Koh*

**Part III Innovations in Retirement Risk Financing**

10. Outsourcing Pension Longevity Protection 179  
*Igor Balevich*

11. Comparing Spending Approaches in Retirement 198  
*John Ameriks, Michael Hess, and Liqian Ren*

12. Risk Budgeting for the Canadian Pension Plan Investment  
Board 217  
*Sterling Gunn and Tracy Livingstone*

13. Can VEBA's Alleviate Retiree Health-Care Problems? 241  
*Aaron Bernstein*

*End Pages* 265

*Index* 269

## Chapter 8

# **Rebuilding Workers' Retirement Security: A Labor Perspective on Private Pension Reform**

---

*Damon Silvers*

This chapter looks at issues of risk, funding, and benefit design in the US private pension system, with particular attention to the labor movement's interest in obtaining retirement security for America's working families. The chapter seeks to address the question of how to best develop public policies that would encourage broad-based retirement provisions sufficient to provide most Americans with a comfortable retirement.

The labor movement created retirement in the United States. Prior to the rise of the labor movement in the 1930s and 1940s, old age meant poverty or economic dependence for most Americans (Epstein 1922; Altman 2005).<sup>1</sup> A privileged few received company or government pensions (Seburn 1991). A pension was seen as a special reward for loyal service, and was associated with the top echelon of white-collar workers. The wealthy lived in comfort in retirement off of their accumulated wealth, that is, their savings. Of course, the world of the early twentieth century was demographically different in two key ways – people died earlier and more people lived on farms.<sup>2</sup> Prior to the development of social insurance, workers often formed unions to directly provide health care, pensions, and life insurance (Ghilar-ducci 2008). Direct collective insurance rather than bargaining with employers was the primary function of many unions, making unions often hard to distinguish from insurance companies and mutual aid societies.<sup>3</sup>

Post-New Deal America was a world of large public and private sector employers, with rising living standards and relatively high levels of unionization.<sup>4</sup> Collective bargaining set the pattern for labor markets not only for the workers directly covered by union contracts, but also for large employers as a whole (Freeman and Medoff 1984). This period was characterized by rapidly rising wages and productivity, rising life expectancy, and shrinking farm employment (Price and Spriggs 2005; BLS 2009*a*). These were the years that produced the concept of retirement being founded on a three-legged stool – Social Security, a pension, and personal saving (Chao 2007).

**138 Damon Silvers**

Since 1980, the United States has become a different kind of economy, with different demographics. Industrial employment has declined dramatically, as have traditional employment relationships generally (Estreicher 1993).<sup>5</sup> While workers still tend to have longer job tenure in middle age, there has been an increase in job changes over a career since 1980 (Munnell, Haverstick, and Sanzenbacher 2006). Life expectancy has grown dramatically, as have health-care costs (Fronstin and Salisbury 2003; Feldstein 2008). And most importantly, from the perspective of retirement policy, the labor movement has weakened dramatically, particularly in the private sector.<sup>6</sup> While all of these developments have contributed to the fraying of the post-World War II retirement fabric, it is the decline of the labor movement that has ensured that, instead of responding to economic and demographic change, our retirement systems have crumbled. What remains – tax-favored saving accounts in the form of 401(k)s and the like – have proven to be poor substitutes for pensions because they lack key social insurance functions that the traditional pension provided.

The challenge we now face as a society is whether we want to perpetuate retirement as part of the life experience of most Americans, or instead return to a twenty-first century version of the state of affairs that existed at the beginning of the twentieth century. Unfortunately, we face this choice in the context of daunting circumstances. Our demographic history is with us in the form of the baby boomers. Even before the collapse of the capital markets in the fall of 2008, early baby boomers appeared to be the last cohort to enjoy better retirement prospects than their parents (Butrica and Uccello 2005). The fall in the equities markets and the residential real estate markets has likely made this situation far worse in recent times.

The implications for the US economy in the coming years are very serious. Low incomes for older Americans will mean less aggregate demand. They will also mean higher workforce participation, but often in less demanding and thus less productive jobs. Already, youth employment experts are pointing to the unusual persistence of baby boomers in the workforce in entry-level jobs, effectively diminishing entry-level opportunities for younger workers (Sum, Khatiwada, and Palma 2005).

While it is possible to envision ways of rebuilding America's private sector retirement system, it will be extraordinarily difficult to design and provide meaningful solutions for baby boomers in their 50s, simply because there is not enough time.

In this context, the labor movement faces the choice of whether to focus on defending what remains of the traditional retirement system, or to look to the creation of a more broad-based sustainable system of retirement provision. This choice is tied up with broader choices that all labor movements face at all times, between a narrow focus on improving the lives of current union members and broad efforts to improve the lives of all workers.

**Rebuilding Retirement Security 139**

In the aftermath of World War II, when the labor movement was strong and growing, a similar choice emerged around retirement security. Some advocated increasing Social Security to the point where it could function as a stand-alone retirement security system, but ultimately the labor movement focused on winning pensions through collective bargaining in organized workplaces (Lowenstein 2008). This strategy appeared, for a time, to have almost produced universal pension coverage in large workplaces – pension coverage peaked around 50 percent in the 1970s when private sector union density was less than 30 percent (Freeman 1997: 60–1). But this success did not endure. Now, a much weakened labor movement faces similar choices, as it concurrently confronts decisions about how much of its remaining resources to expend on policy relating to the right to organize and health care.

The remainder of this chapter will look at broad-based approaches to retirement security, designed both to address the disintegration of traditional pension plans, and the failure of corporate pseudo-individualism represented by the 401(k) plan. The discussion will sketch how the individualistic promise of the 401(k) plan – you determine whether to fund your plan, you determine how to invest your plan, and you can withdraw funds for other needs – all turn out to have perverse consequences. Ironically, these results are now known and acknowledged even by 401(k) advocates. The consequence is that companies and consultants now propose new plan designs consciously intended to counteract the flaws in the 401(k) model – with default contribution provisions, service providers offering customers customized guidance on how to invest their accounts, and employers seeking to persuade employees not to withdraw funds prematurely from their accounts.

Conversations about these issues take on a peculiar quality, as successively each supposed advantage of saving accounts is renounced by their advocates, along with the logic supporting them. In the end, the listener is left wondering: if employees are unable to make investment decisions on their own and, if purely voluntary contributions are ineffective, why do we not return to real (traditional) pensions?

**Problems in retirement security***Money*

The retirement security crisis is a problem of money. While there are inferior and superior ways of managing retirement assets, there is no way to provide retirement security without adequate funding. The history of retirement provision in the private sector since 1980 is the history of employers

**140 Damon Silvers**

replacing defined benefit (DB) pension plans, which were funded on average by employer contributions worth 8 percent of payroll, with voluntary saving plans such as 401(k)s, where average employer contributions are less than 3 percent of payroll (Munnell and Sundén 2006; Munnell, Aubry, and Muldoon 2008).

Of course, workers generally have the choice of putting more money in their 401(k) plans. Even before the recent steep increases in contribution limits, all but the highest-income workers could set aside 10 percent of their income on a pretax basis to their 401(k) plans. But in practice only a very few workers do so. The result is that median 401(k) account balances before the financial crisis were \$19,000, while median account balances for the typical household approaching retirement age were \$50,500 in a combination of 401(k) and individual retirement accounts (IRAs) in 2007 (VanDerhei et al. 2007; Munnell, Golub-Sass, and Muldoon 2009). The General Accounting Office has predicted that 401(k), IRA, and other retirement saving accounts will replace only 22 percent of annualized career earnings and 37 percent of workers will retire with a zero balance (USGAO 2007). By comparison, it costs about \$250,000 to buy a fixed life annuity sufficient to replace 40 percent of the median family income of \$48,000.<sup>7</sup>

This employer retreat from funding pensions was contagious. Once one employer in an industry had cut pension costs by moving to a 401(k), others followed suit. In industries where multiemployer pensions were predominant, the rise of non-pension providing employers was even more destructive, as it directly reduced the funding base of multiemployer plans (Traffic World 2007; Millonzi 2008; UPS 2009).

The lesson of this experience is that, like health care, pension coverage is sustainable when it is universal and involves a minimum percentage of payroll. There are really only two ways of achieving this goal – the reinvigoration of the collective bargaining process or a government mandate.

There are a number of international models for this type of approach, including, prominently, Australia, the Netherlands, and Switzerland (Harris 2000; Rix 2005; Ponds and van Riel 2007; Clare 2008). In each case, government mandated pension coverage and pension funding has emerged against the backdrop of strong labor movements.

Effective retirement systems aiming at income replacement ranges in the area of 30–40 percent need to be funded at no less than 8 percent of payroll.<sup>8</sup> Voluntary schemes relying on employee contributions will not reach these levels, nor have they done so historically or on a comparative international basis. Because of the regressive distribution of voluntary contributions – that is, high-income individuals voluntarily contribute not just higher dollar amounts, but much higher percentages of salary – tax-favored treatment of voluntary saving structures ends up being one of the most regressive and least effective tax expenditures (Ghilarducci 2008: 20–1).



**Rebuilding Retirement Security 141**

Naturally, the precise institutional form of mandatory pensions varies from country to country, and in some countries individual saving accounts are similar to elements of US 401(k) plan structures (Rix 2005; Ponds and van Riel 2007; Clare 2008). Adequate funding does not make the flaws of the 401(k) model go away, but it removes the most serious flaw – too little money.

*Investment management*

Investment management is about expertise and bargaining power. In a DB plan or a pooled investment plan, the pension beneficiary has expertise and some level of market power as a result of pooling the resources of many beneficiaries. Plans with individual accounts, unless modified, provide the beneficiary with neither expertise nor bargaining power. The result is substantially higher cost of money management and lower risk-adjusted returns across plan participants (Buck Consultants 2000; Levitz 2008).

The management of retirement assets is about two separate tasks: asset allocation and the management of funds within the allocation. With the exception of some individual IRAs, virtually all US retirement funds are professionally managed within a given asset allocation – in the case of 401(k) plans, by mutual fund managers. The issue in the area of picking individual investment assets is not whether the money is managed professionally, but how the fees and other terms are negotiated. Here we have a stark contrast between the bargaining power of collective trusts and that of individual employees. The combination of weak bargaining power and additional administrative costs of individual accounts leads the cost structure of money management for defined contribution (DC) plans to generally be far greater than the costs of DB plans.

In the area of asset allocation, however, the change from professional management to self-directed investment represents a loss of expertise in the management of retirement assets. Furthermore, as discussed later, the full exposure of individuals to market risk leads rational employees to make more conservative asset allocation decisions, because of a rational fear of exposure to volatility that a pooled approach to retirement security has a better ability to withstand.

*Market risk*

Of course, all funded plans are exposed to market risk. Like banks and other financial intermediaries, both DB and DC plans seek to receive compensation for taking investment risk. However, there is a fundamental difference between the nature of the exposure to market risk taken by DB and DC plans. In DB plans, the obligation to pay benefits is pooled among

**142 Damon Silvers**

beneficiaries through time. The obligation to pay benefits is fixed, and the fund holds, or should hold, enough assets to meet current obligations and invest to fund future obligations. By contrast, in DC plans with individual accounts, each person's account is a kind of mini-fund, with one set of payment obligations to one person during one fixed time frame.

Exposure to market risk creates the real possibility of DC participants reaching retirement age at a time when capital markets are depressed, particularly equity markets. This issue of market timing can expose DC participants to the risk of unacceptable losses, losses which can severely impact their standard of living in retirement (Weller 2005). Though this risk can be lessened by slowly converting equity holdings to debt holdings, prolonged bear markets limit the effectiveness of this strategy. The only way within the DC structure to address this problem is to maintain high fixed-income allocations – which some DC participants do – much to the dismay of academic and policy commentators who note the cost of this strategy in terms of returns (Mitchell and Utkus 2004; Munnell and Sundén 2004; Benartzi and Thaler 2007).

Ironically, there is an entire academic literature devoted to the proposition that DB plans should be invested entirely in bonds, while DC participants are underinvested in equities (JAAA/SA 2006). The opposite is true, assuming the DC participants' plans are their major retirement asset after Social Security, and assuming the DB plan is demographically healthy.

This issue of market timing is embedded within the larger issue of exposure to market losses. DB plans provide what their name suggests: a fixed benefit. At one level, this means no direct exposure to market risk. But DB plans still have to fund those obligations, which expose participants indirectly to market risk. Here, the risk is not that of short-term volatility, but rather of long-term secular decline in the capital markets of the kind that has not occurred in the developed world in modern times.

Nonetheless, regulatory and accounting regimes can undo much of the value of DB plans, as an absorber of market volatility, by requiring plans to behave as if they were facing liquidation at all times, or by punishing plan sponsors for market volatility that the plan can in fact absorb. The recent direction of both generally accepted accounting principles (GAAP) accounting and more importantly of Employee Retirement Income Security Act (ERISA) regulation has had this effect (United States Congress 2006a; FASB 2009).

*Employer credit risk*

The other side of the coin of market timing risk is employer credit risk, perhaps the most serious issue for US DB plans. This occurs because the

**Rebuilding Retirement Security 143**

single employer plan system allows solvent employers to withdraw from providing retirement security to their employees by freezing or terminating pension plans. The result for employees in terms of final average salary calculations and benefit accruals can be disastrous. In multiemployer plans, the failure of individual employers to honor commitments made to the fund, or their desire to withdraw from a fund, can destabilize the finances of the fund as a whole, affecting the benefits of employees of other firms. The Pension Benefit Guaranty Corporation (PBGC) has offered effective partial insurance against employer credit risk for a generation. However, there is no question that, as employers withdraw from providing retirement security for their employees, the number of private sector DB pension plans will shrink and the PBGC's insurance pool will become destabilized.

Employer credit risk in the context of employee benefits, more generally, has been a major issue in the auto industry crisis. Nevertheless, the real issue in this area has been unfunded retiree health benefit obligations, whose value was being driven by projections of infinitely increasing health-care costs. These retiree health benefit obligations ultimately led to the creation and funding of voluntary employee beneficiary associations (VEBAs; Eisenbrey 2009). In the recent GM and Chrysler bankruptcies, the VEBAs have ended up as large shareholders of both firms as a result of converting a large portion of those companies' obligations to their respective VEBAs into equity (Eisenbrey 2009). GM and Chrysler's pension plans, on the other hand, were funded and have continued through the bankruptcy of both companies (Gettelfinger, Holiefield, and Payne 2009; Gettelfinger, Rapson, and Payne 2009). While there is certainly continued employer credit risk through those plans, as with all single employer plans, neither of those plans has failed.

The case of Delphi, the auto parts maker spun off from GM, shows both the salience of funding issues in the context of employer credit risk and the dangers beneficiaries face when employers seek to escape benefit obligations. In contrast with GM's relatively well-funded plan, Delphi began cutting back on pension contributions almost from the moment of its spin-off from GM, leaving its plan unable to weather the market volatility of this decade (Walsh 2009). In July 2009, the PBGC took over the Delphi plan, causing its beneficiaries to have their benefits drop to PBGC guaranteed levels (Walsh 2009). The United Auto Workers (UAW) protected its members against this possibility by having GM guarantee pension benefits of Delphi employees represented by the UAW (Walsh 2009). Management participants in Delphi's plan were not thus protected.

Employer credit risk is also significant for DC plans in two ways, both of which could easily be fixed. It is a minor, if widespread, problem when financially weak employers refuse to pass on employee or employer

**144 Damon Silvers**

contributions to employee accounts (Burton 2005). On a much larger, and at times, catastrophic scale, employer credit risk presents itself when DC plans are invested in employer stock (Altman 2002; Feder 2002; Lim 2008). Employer stock is, of course, both volatile and junior in the capital structure to employer fixed obligations to DB plans. Ironically, ERISA limits the amount of employer stock that can be held in DB plans, where funding losses create a senior employer obligation, but are not limited in DC plans, where there is no further employer backup to employee losses (United States Congress 1974).

Employer credit risk in both its DB form and its DC form is the logical consequence of trying to design a system of retirement security that simultaneously seeks to be a finance tool for firms and an employee retention incentive. While any retirement plan can be a way for employers to attract and retain employees, non-portable plans with cliff vesting have a special retaining power. But along with that power comes an unavoidable exposure to employer credit risk. In DC plans, employer stock is an inexpensive way to finance retirement and provide capital to a firm. Of course, along with these financing advantages to the firm comes the firm-specific risk for the employee.

*Longevity risk*

A DB plan, like any other basic annuity, is a form of insurance against the possibility of outliving one's saving. A traditional pension promises a stream of payments for the remainder of the participant's life. By contrast, a retirement saving account like a 401(k) is simply that – an account which, when it is depleted, is no more.

The shift from DB to DC plans has eliminated the longevity insurance aspect of employee benefit plans. In the DB world, the increased popularity of cash balance plans and cash payout options has a similar effect, though, of course, employees still have the options in these circumstances to leave their money in their pension plans and participate in the longevity insurance feature of such plans.

DC plan participants always have the option of annuitizing their plan balances at retirement through private providers of annuity contracts. Such an option involves taking on the credit risk of annuity providers, although until recently it was easy to contract with a highly rated insurer, and annuities are further backed by state insurance guarantee funds. A greater problem has long been the opacity of annuity structures and the high transaction costs associated with annuitizing retirement accounts with private parties, compared to the costs implicit in pension funds, particularly large pension funds.

**Rebuilding Retirement Security 145**

In recent decades, advances in medical care and consequent increases in life expectancy have made the issue of longevity risk of greater concern to participants, plan sponsors, and insurers. One of the troubling aspects of longevity risk may well be that one of the main reasons for low levels of annuitization among 401(k) participants is that annuitization results in payment streams much lower than that expected by plan participants. Sadly, the annuity terms, while in part reflecting a high fee margin for the annuity company, may largely be driven by the realities of longevity risk and the amount of money that must be set aside to provide for it.

*Portability and early withdrawals*

Portability is the great success of the DC plan revolution. Although portability within industries and geographical areas had always been a feature of multiemployer pension plans, there was no full portability in the multiemployer sector, and generally no portability between firms in the single employer pension sector. 401(k) plans brought with them portability throughout the entire economy, and the ability to enter and leave the workforce without having any disproportionate impact on retirement saving.

Full portability should have contributed to a much more effective level of lifetime retirement provision. This is because mobile younger workers could have accumulated retirement saving starting from the beginning of their workforce participation, rather than waiting until they had found long-term jobs a decade or more into their working lives. Although we lack a full time series to evaluate, initial indications are that full portability in the context of the typical 401(k) plans has not led to a more effective level of lifetime retirement provision.

Furthermore, along with portability came the right to withdraw money from retirement accounts. Even though the tax code imposes a 10 percent surcharge on any such preretirement withdrawal, this surcharge appears to be relatively ineffective in encouraging younger workers to roll over 401(k) plans, rather than cash them out when they change jobs (Munnell and Sundén 2004; Weller 2008).

In periods of stagnant wages or tight credit, workers have particularly strong incentives to use their retirement accounts as sources of consumer finance or as rainy-day funds. A particularly tragic form of this is the instinct to draw down on retirement savings during unemployment or financial crisis. Although the heyday of DB plans was also a period of economic cycles that brought with it industrial unemployment, in those days, it was impossible for workers in the postwar era to tap their pension funds.

While preretirement withdrawals from retirement plans can be harmful to participants' retirement security, withdrawals in times of economic

**146 Damon Silvers**

hardship may be particularly problematic; unless they are financed from sources outside the workers' accounts, withdrawals necessarily involve selling assets at depressed prices, locking in what would otherwise be paper losses.

In this respect, accessing almost any other source of emergency funds may be preferred to facilitating emergency withdrawals from benefit plans. Such other sources could include extended unemployment benefits, eased consumer bankruptcy provisions, universal health care, more direct aid for college students, and the like. As an aside, personal financial crises of the sort that lead to a temptation to withdraw money from retirement accounts usually turn out to be health-care cost related (Himmelstein et al. 2005).

*Regulation*

It has long been observed by plan sponsors that the regulatory environment surrounding DB plans has contributed to their decline, particularly compared to the relatively light regulatory environment for DC plans. The passage of the Pension Protection Act and its implementation in the context of the financial crisis that began in 2007 have only added to these complaints (Manning 2008; ERIC 2009).

There are several ironies to this situation. The first irony is that DB pensions that are backed up by the full credit of employers are more heavily regulated than plans where employees' money is fully at risk. Of course, there are historical and analytical reasons for this paradox, most importantly the long-standing combination of concerns that plan sponsors would either underfund plans or overfund them for the purposes of tax evasion, in the context of a regulatory regime where plan termination and fund recapture were possible. Nonetheless, one clear benefit of moving away from pension fund dependence on individual employer credit risk and employer management of pension capital would be to lessen the need for such detailed regulatory oversight of pension-funding issues. On the other hand, there is a clear and immediate need to strengthen the regulation of DC plans around issues like employer stock, mutual fund fees, and conflicts of interest in areas like investment advice where the Pension Protection Act actually radically weakened participant protections against conflicts of interest (United States Congress 2006*b*; Bullard 2009).

**A pension agenda that works for all**

In 2006, the AFL-CIO Executive Council (2006) passed a resolution laying out principles for broad-based pension reform. In the 3 years since, the

**Rebuilding Retirement Security 147**

AFL-CIO has worked with the Pension Rights Center (PRC) to formulate a pension reform agenda based on principles adopted in 2006, and now involving a broad coalition of pension and retiree advocates (PRC 2007). In pursuing these agendas, the labor movement has operated in an intellectual landscape defined on the right by proposals for universal voluntary saving accounts coming from the Brookings Institution, and on the left by proposals for national DB programs such as that put forward by Teresa Ghilarducci under the auspices of the Economic Policy Institute (Ghilarducci 2008: 237–90).

The thoughts that follow are not the official position of the AFL-CIO; rather they represent an effort to outline a possible program for addressing the problems outlined earlier, in the context of a national retirement policy consistent with the AFL-CIO's goals.

*Mandatory retirement contributions*

Any serious discussion of solving America's retirement security crisis must mandate a level playing field on contribution levels, and part of that mandate must be an employer contribution. In Australia, the mandatory contribution level is 9 percent of salary (Rix 2005); Teresa Ghilarducci suggests 5 percent for the United States (Ghilarducci 2007). Of course, there is a trade-off between comprehensiveness and percentage amounts. If the contribution is applied to all income (e.g., all payments recorded on Form 1099 and Schedule C of the Tax Code as well as on wages), then the percentage of payroll required could be lower.

There is also the issue of who technically makes the contributions. While economic theory tells us it should make no difference, the experience of the last 30 years suggests that both workers and employers perceive a difference in who pays. Employers are often unable to pass on the entire impact of mandatory employer contributions to their employees, and employees perceive deductions from their paycheck as a net loss of income compared to employers having to make contributions to a fund. The choice is whether society wants to encourage an overall higher level of wages, in which case we would tilt toward making the mandatory contributions come from the employer, or whether we wish to compete internationally on the basis of low labor costs, in which case we would seek to have retirement plans funded with direct employee contributions.

*Portability and withdrawal issues*

Any practical system of universal pension coverage conceptually requires benefit portability. Portability is often treated as somehow at odds with providing a DB pension, though in the United States, Social Security is a

**148 Damon Silvers**

giant, portable DB pension scheme. On a more limited scale, for generations, multiemployer plans have provided portable DB coverage to employees within particular industries.

What portability requires is either a standard accounting framework that can be applied across plans, or a scheme in which workers can participate in as they move from one employer to another. There are two options here, which would be most effective if combined. The first option is plans that people can participate in as they move from employer to employer – much as Social Security allows one to move from one company to the next. The second option is a common currency and set of benefit transfer rules for all tax-exempt plans, with the logical administrator of such a system being a government entity.

Mandatory portability must limit withdrawals from funds. One possibility would be a complete ban on preretirement withdrawals, perhaps with some sort of extraordinary administrative procedure for hardship situations such as terminal illnesses. In some respect, this achieves better outcomes than higher excise taxes – there is some reason to believe younger workers would still take the withdrawals and incur much higher taxes, which defeats the policy objectives. Historically, DB plans offered no ability to cash out early in life, and in the United States, Social Security offers no such option. An additional factor to consider here is that midlife withdrawals from 401(k) plans often occur in the context of health-care expenditure emergencies; a universal health-care system would remove this need.

*Asset management*

Collective professional management of retirement assets is clearly more cost-effective than individual amateur management of those assets. When 401(k) advocates talk about the need for investment advice, they are conceding this point. Encouraging cost-effective retirement asset management means channeling retirement assets into collective management vehicles. Similarly, it is advantageous for retirement plans to provide not just a vehicle for saving, but also insurance against investment and longevity risk. There are real costs to providing this type of insurance, just as there is a real risk-return trade-off around investment allocation.

Nevertheless, telling workers with existing 401(k) accounts that they must give up those accounts and their existing account balances is neither politically realistic nor necessarily good policy. A wiser approach would be to foster the creation of large investment management pools with clear government-monitored investment characteristics and low fees.



*Social insurance and the fate of the 401(k)*

Our model might resemble Australian superannuation funds or existing large US public pension funds, and it would involve several possible options: a traditional DB plan, a low risk (largely fixed income) DC plan, and a higher risk plan (mixed equity and debt). Such large multi-industry funds should be able to attract the bulk of both employers and participants because they would offer low fees, professional management, and relieve employers of the administrative burden of managing their own benefit plans. On the other hand, employers who wanted to offer particularly generous benefits or customized structures to attract or retain employees would be free to do so. Under such a policy, participants in existing DC and DB plans would be allowed to continue to participate in those plans if they chose – assuming these existing plans conformed to the minimum contribution and withdrawal regulation requirements. This would allow for plans that exceeded the minimum contribution requirements, and it would allow for workers to have the benefit of past accruals in DB plans, and for DC participants to remain with their existing plan options if they wished.

Finally, any serious effort at universal retirement income security would likely require compulsory annuitization at retirement. Hence, this approach ends up requiring insurance against longevity risk, but not against market timing risk. There is an issue with annuitization involving pooling the differing life expectancies of different occupational groups and income levels. One big national annuity pool could have the unintended consequence of a regressive subsidy toward higher income, higher life expectancy white-collar workers, and from lower income and lower life expectancy blue-collar workers. The alternative of mandating that all participate in a DB structure would be the only way to effectively require insurance against market timing risk. For reasons discussed earlier, this does not seem to be a realistic option.

**An alternative choice in the context of economic crisis: expanding Social Security**

The policy program described earlier is likely to involve a dramatic increase in the level of saving in the United States. But this could have a negative impact on consumer spending and aggregate demand, unless accompanied by the immediate deployment of the saving in job-creating activities such as infrastructure projects or large-scale responses to challenges in areas like energy and auto manufacturing. Even given large-scale investment of the saving, the net impact on economic activity could be negative

**150 Damon Silvers**

in the near term. Should our economy remain weak enough such that this is a valid consideration, policymakers might learn from the experience of New Deal policymakers in a similar situation. Rather than increasing saving, those policymakers created Social Security, a retirement program where the tax dollars raised by the program were immediately deployed in the economy in the form of benefits.

This logic would suggest dealing with dwindling retirement security by enacting measures to boost the income that Social Security provides its recipients. Such an increase in benefits would be funded entirely on a pass-through basis by current increases in tax revenues, separate and apart from the management of the Social Security Trust Fund. It would be difficult to make the transition from an expanded Social Security to a funded universal pension plan, for some of the same reasons that bedeviled the Bush Administration's effort to privatize Social Security.

**Conclusion**

Post-World War II economic growth offered a middle class standard of living to the majority of Americans. Part of the American Dream was the promise of retirement in dignity, and collective bargaining was the primary vehicle for the realization of that promise. Since the 1950s, the labor movement has weakened and life expectancies have dramatically increased, as has the economy's exposure to foreign competition. But at the same time, the nation has grown dramatically more wealthy. As DB pension coverage shrinks and 401(k) balances remain low, there is reason to worry that retirement once again will become a privilege of the affluent. But this trend is the outcome of choices made in the recent past. If these trends continue, it will be because we chose not to make retirement a priority: because policymakers decided our wealth was better spent in other ways than in keeping the American Dream alive in our old age. The labor movement takes the position that, along with health care and the right to have workers' voices heard in the workplace and the public arena, the right to a comfortable retirement defines a civilized society, and we need to act to revive that right as a living aspect of how our society functions.

*Acknowledgments*

The author wishes to express gratitude to colleagues and friends Joseph Canovas, Karin Feldman, and Beth Almeida for their assistance with this chapter.

## Notes

- <sup>1</sup> ‘Surveys by Wisconsin and New York, published in 1925 and 1929 respectively, found that over half of the population aged 65 and older had “insufficient subsistence income”’ (Altman 2005: 8).
- <sup>2</sup> In the United States in 1900, life expectancy at birth was 47.3 years; by 2005, life expectancy at birth was 77.8 years (NCHS 2007). In 1930, 43.9 percent of the population lived in rural areas; in 2008, only 16.5 percent of the population lived in rural areas (USCB 1993; USDA 2009).
- <sup>3</sup> In the 1880s, unions and mutual aid societies were often indistinguishable. In the 1920s, the American Federation of Labor founded its own insurance company, the Union Labor Life Insurance Company, and in 1929, the International Brotherhood of Electrical Workers established the first multiemployer benefit plan (Ullico 2005; Ghilarducci 2008: 240–1). By 1930, union pension plans covered 20 percent of all union members, while corporate pension plans covered only 15 percent of the private sector workforce (Latimer 1932; Ghilarducci 1992: 30).
- <sup>4</sup> Union density was greater than 30 percent from 1943 until 1960 (Freeman 1997: 59–60).
- <sup>5</sup> For a discussion on the increasing use of temporary employment arrangements, contract arrangements, and the misclassification of employees as independent contractors, see Ruckelshaus (2008).
- <sup>6</sup> Only 7.6 percent of the private sector workforce is unionized (BLS 2009*b*).
- <sup>7</sup> Annuity prices are widely available on the Internet. As of the drafting of this chapter, the calculator cited showed that a lifetime annuity paying \$1,600 per month would cost \$250,000 (NewRetirement, LLC 2009).
- <sup>8</sup> By comparison, Social Security provides a benefit in the range of 30–40 percent of preretirement income of the median worker at a cost of 12.4 percent of payroll. An extremely efficiently managed funded plan could achieve 30 percent replacement rates for around 8 percent. The typical DC plan, however, is likely to be less inefficient due to small size.

## References

- AFL-CIO Executive Council (2006). *Ensuring Retirement Security for America’s Workers*. Washington, DC: AFL CIO. <http://www.aflcio.org/aboutus/thisistheaficio/ecouncil/ec08082006a.cfm/aboutus/thisistheaficio/ecouncil/ec08082006a.cfm>
- Altman, Daniel (2002). ‘Enron’s Collapse: Pensions; Experts Say Diversify, but Many Plans Rely Heavily on Company Stock,’ *New York Times*, January 20: 26.
- Altman, Nancy J. (2005). *The Battle for Social Security: From FDR’s Vision to Bush’s Gamble*. Hoboken, NJ: John Wiley & Sons, Inc., p. 8.
- Benartzi, Shlomo and Richard H. Thaler (2007). ‘Heuristics and Biases in Retirement Savings Behavior,’ *Journal of Economic Perspectives*, 21(3): 81–104.

## 152 Damon Silvers

- Buck Consultants (2000). *Benefit Review Study of the Nebraska Retirement Systems*. Denver, CO: Buck Consultants. <http://www.pebc.ca.gov/images/files/Benefit%20Review%20Study%20of%20the%20Nebraska%20Retirement%20Systems.pdf>
- Bullard, Mercer E. (2009). 'Testimony of Mercer E. Bullard Before the Subcommittee on Health, Employment, Labor, and Pensions, Committee on Education and Labor, US House of Representatives,' Washington, DC, April 22.
- Bureau of Labor Statistics (BLS) (2009a). 'Major Sector Productivity and Costs Index, Business and Nonfarm Business Sectors,' Series Id PRS84006043 and PRS85006043. Washington, DC: United States Department of Labor. <http://www.bls.gov/lpc/#data>
- (2009b). *Union Members Summary*. Washington, DC: United States Department of Labor. <http://www.bls.gov/news.release/union2.nr0.htm>
- Burton, Jonathan (2005). 'Skimming the 401(k): Delayed Deposits Costing US Workers Millions,' MarketWatch. <http://www.marketwatch.com/News/Story/Story.aspx?guid={55D4E190-F43D-4919-851A-D3160C113D9D}&siteid=netscape&dist=netscape>
- Butrica, Barbara A. and Cori E. Uccello (2005). *Older Americans' Economic Security*. Washington, DC: Urban Institute Retirement Project. [http://www.urban.org/UploadedPDF/311431\\_Annuities\\_Spending.pdf](http://www.urban.org/UploadedPDF/311431_Annuities_Spending.pdf)
- Chao, Elaine L. (2007). 'Remarks Prepared for Delivery By US Secretary of Labor Elaine L. Chao, SOAFO 16th Annual Dinner and Scholarship Awards Night,' Flushing, New York, May 18. [https://www.dol.gov/\\_sec/media/speeches/20070518\\_SOAFO.htm](https://www.dol.gov/_sec/media/speeches/20070518_SOAFO.htm)
- Clare, Ross (2008). *The Age Pension, Superannuation and Australian Retirement Incomes*. Sydney, Australia: The Association of Superannuation Funds of Australia Research and Resource Centre. [http://www.professionalplanner.com.au/attachments/3522\\_ASFA%20-%20Retirement%20incomes%20paper.pdf](http://www.professionalplanner.com.au/attachments/3522_ASFA%20-%20Retirement%20incomes%20paper.pdf)
- Eisenbrey, Ross (2009). 'Setting the Record Straight on GM,' Economic Policy Institute. [http://www.epi.org/analysis\\_and\\_opinion/entry/setting\\_the\\_record\\_straight\\_on\\_gm/](http://www.epi.org/analysis_and_opinion/entry/setting_the_record_straight_on_gm/)
- Epstein, Abraham (1922). *Facing Old Age: A Study of Old Age Dependency in the United States and Old Age Pensions*. New York: Alfred A. Knopf, Inc., pp. 20–1.
- The ERISA Industry Committee (ERIC) (2009). 'Major Consulting Firms Write Congressional Leadership on Need for Additional Pension Funding Relief.' The ERISA Industry Committee. <http://www.eric.org/forms/documents/DocumentFormPublic/view?id=17F3B000001B3>
- Estreicher, Samuel (1993). 'Labor Law Reform in a World of Competitive Product Markets,' *Chicago Kent Law Review*, 69: 6.
- Feder, Barnaby J. (2002). 'Technology Briefing/Telecommunications: WorldCom Sued By Employees,' *New York Times*, March 21: C4.
- Feldstein, Martin S. (2008). 'Did Wages Reflect Growth in Productivity?,' *Journal of Policy Modeling*, 30(4): 591.
- Financial Accounting Standards Board (FASB) (2009). *Phase II: Postretirement Benefit Obligations, Including Pensions*. Norwalk, CT: FASB. [http://www.fasb.org/project/postretirement\\_benefits\\_phase2.shtml](http://www.fasb.org/project/postretirement_benefits_phase2.shtml)

## Rebuilding Retirement Security 153

- Freeman, Richard B. (1997). 'Spurts in Union Growth: Defining Moments and Social Processes,' NBER Working Paper No. 6012. Cambridge, MA: National Bureau of Economic Research.
- and James L. Medoff (1984). *What Do Unions Do?* New York: Basic Books.
- Fronstin, Paul and Dallas Salisbury (2003). 'Retiree Health Benefits: Savings Needed to Fund Healthcare in Retirement,' *EBRI Issue Brief 254*. Washington, DC: Employee Benefit Research Institute.
- Gettelfinger, Ron, General Holiefield, and Bill Payne (2009). *A Message to UAW Chrysler Retirees*. Detroit, MI: United Automobile, Aerospace & Agricultural Implement Workers of America International Union.
- Cal Rapson, and Bill Payne (2009). *A Message to UAW GM Retirees*. Detroit, MI: United Automobile, Aerospace & Agricultural Implement Workers of America International Union.
- Ghilarducci, Teresa (1992). *Labor's Capital: The Economics and Politics of Private Pensions*. Cambridge, MA: The MIT Press, p. 30.
- (2007). 'Guaranteed Retirement Accounts: Toward Retirement Income Security,' Economic Policy Institute. <http://www.sharedprosperity.org/bp204.html>
- (2008). *When I'm Sixty-Four: The Plot Against Pensions and the Plan to Save Them*. Princeton, NJ: Princeton University Press.
- Harris, David O. (2000). 'Switzerland's National Retirement Approach,' Heritage Lecture #672. Washington, DC: The Heritage Foundation.
- Himmelstein, David U., Elizabeth Warren, Deborah Thorne, and Steffie Woolhandler (2005). 'MarketWatch: Illness and Injury as Contributors to Bankruptcy,' Health Affairs. <http://content.healthaffairs.org/cgi/content/full/hlthaff.w5.63/DC1>
- Joint American Academy of Actuaries/Society of Actuaries Task Force on Financial Economics and the Pension Actuarial Model (JAAA/SA) (2006). Pension Actuary's Guide to Financial Economics. Washington, DC. <http://www.actuary.org/pdf/pension/finguide.pdf>
- Latimer, Murray Web (1932). *Industrial Pensions, vol. 1*. New York: Industrial Relations Counselors, Inc.
- Levitz, Jennifer (2008). 'When 401(k) Investing Goes Bad,' *The Wall Street Journal*, August 4: R1.
- Lim, Paul J. (2008). 'Don't Paint Nest Eggs in Company Colors,' *New York Times*, March 30.
- Lowenstein, Roger (2008). *While America Aged: How Pension Debts Ruined General Motors, Stopped the NYC Subways, Bankrupted San Diego, and Loom as the Next Financial Crisis*. New York: The Penguin Press.
- Manning, Stephen (2008). 'Companies Push Congress for Pension Relief,' *USA Today*, November 12.
- Millonzi, Tom (2008). 'Teamsters Refute Misinformation in Press by Waste Management; Official Statement of Teamsters Local 200 Secretary-Treasurer Tom Millonzi,' Milwaukee, WI, August 31.
- Mitchell, Olivia and Stephen Utkus (2004). *Pension Design and Structure: New Lessons from Behavioral Finance*. Oxford, UK: Oxford University Press.
- Munnell, Alicia H. and Annika Sundén (2004). *Coming up Short: The Challenge of 401(k) Plans*. Washington, DC: The Brookings Institution.

**154 Damon Silvers**

- Munnell, Alicia H. and Annika Sundén (2006). '401(k) Plans are Still Coming Up Short,' *Issue Brief 43*. Chestnut Hill, MA: Center for Retirement Research at Boston College. [http://crr.bc.edu/images/stories/Briefs/ib\\_43.pdf?phpMyAdmin=43ac483c4de9t51d9eb41](http://crr.bc.edu/images/stories/Briefs/ib_43.pdf?phpMyAdmin=43ac483c4de9t51d9eb41)
- Kelly Haverstick, and Geoffrey Sanzenbacher (2006). 'Job Tenure and Pension Coverage,' CRR Working Paper 2006-18. Chestnut Hill, MA: Center for Retirement Research at Boston College.
- Jean-Pierre Aubry, and Dan Muldoon (2008). 'The Financial Crisis and Private Defined Benefit Plans,' *Issue Brief 8-18*. Chestnut Hill, MA: Center for Retirement Research at Boston College. [http://crr.bc.edu/images/stories/Briefs/ib\\_8-18.pdf](http://crr.bc.edu/images/stories/Briefs/ib_8-18.pdf).
- Francesca Golub-Sass, and Dan Muldoon (2009). 'An Update on 401(k) Plans: Insights from the 2007 SCF,' *Issue Brief 9-5*. Chestnut Hill, MA: Center for Retirement Research at Boston College. [http://crr.bc.edu/images/stories/Briefs/ib\\_9\\_5.pdf](http://crr.bc.edu/images/stories/Briefs/ib_9_5.pdf)
- National Center for Health Statistics (NCHS) (2007). *Health, United States, 2007: With Chartbook on Trends in the Health of Americans*. Washington, DC: GPO, p. 175.
- NewRetirement, LLC (2009). 'Calculator Results, Lifetime Annuity.' [http://www.newretirement.com/Services/Annuity\\_Calculator\\_Results.aspx?AnnuityCalculatorTab.DateOfBirth=4/10/1944&AnnuityCalculatorTab.Gender=True&AnnuityCalculatorTab.HasJointAnnuitant=True&AnnuityCalculatorTab.SpouseDateOfBirth=4/23/1944&AnnuityCalculatorTab.DesiredSurvivorBenefit=75&AnnuityCalculatorTab.AnnuityStartDate=9/30/2009&AnnuityCalculatorTab.AddressState=MD&AnnuityCalculatorTab.DesiredMonthlyBenefit=1600&AnnuityCalculatorTab.LumpSum=-1](http://www.newretirement.com/Services/Annuity_Calculator_Results.aspx?AnnuityCalculatorTab.DateOfBirth=4/10/1944&AnnuityCalculatorTab.Gender=True&AnnuityCalculatorTab.HasJointAnnuitant=True&AnnuityCalculatorTab.SpouseDateOfBirth=4/23/1944&AnnuityCalculatorTab.DesiredSurvivorBenefit=75&AnnuityCalculatorTab.AnnuityStartDate=9/30/2009&AnnuityCalculatorTab.AddressState=MD&AnnuityCalculatorTab.DesiredMonthlyBenefit=1600&AnnuityCalculatorTab.LumpSum=-1)
- Pension Rights Center (PRC) (2007). *Covering the Uncovered: Final Report of the Conversation on Coverage*. Washington, DC: The Pension Rights Center. <http://www.conversationoncoverage.org/about/final-report/covering-the-uncovered.pdf>
- Ponds, Eduard H.M. and Bart van Riel (2007). 'Sharing Risk: The Netherlands New Approach to Pensions,' *Issue Brief 7–5*. Chestnut Hill, MA: Center for Retirement Research at Boston College. [http://crr.bc.edu/images/stories/Briefs/ib\\_7-5.pdf?phpMyAdmin=43ac483c4de9t51d9eb41](http://crr.bc.edu/images/stories/Briefs/ib_7-5.pdf?phpMyAdmin=43ac483c4de9t51d9eb41)
- Price, Lee and William E. Spriggs (2005). 'Productivity Growth and Social Security's Future,' *EPI Issue Brief 208*. Washington, DC: Economic Policy Institute. <http://www.epi.org/publications/entry/ib208/>
- Rix, Sara E. (2005). *Old-Age Income Security in Australia*. Washington, DC: American Association of Retired People. [http://assets.aarp.org/rgcenter/econ/fs108\\_ss\\_au.pdf](http://assets.aarp.org/rgcenter/econ/fs108_ss_au.pdf)
- Ruckelshaus, Catherine K. (2008). 'Labor's Wage War,' *Fordham Urban Law Journal*, 35: 373.
- Seburn, Patrick W. (1991). 'Evolution of Employer-provided Defined Benefit Pensions,' *Monthly Labor Review*, 114(12): 16.
- Sum, Andrew, Ishwar Khatiwada, and Sheila Palma (2005). *The Age Twist in Employment Rates in the US, 2000–2004: The Steep Tilt Against Young Workers in the Nation's Labor Markets*. Washington, DC: American Youth Policy Forum. <http://www.aypf.org/publications/EmploymentRatesofyoungworkers.pdf>

## Rebuilding Retirement Security 155

- Traffic World (2007). *Pension Freedom for ABF? UPS Withdrawal from Central States Could Be Good Omen for Others Hoping to Follow the Same Path*. Washington, DC: Traffic World.
- Ullico, Inc. (2005). *About Us*. Washington, DC: Ullico, Inc. <http://www.ullico.com/about-ullico>
- United Parcel Service of America, Inc. (UPS) (2009). *UPS Reports Results for 4th Quarter, Full Year*. Atlanta, GA, February 3. <http://www.pressroom.ups.com/Press+Releases/Archive/2009/Q1/UPS+Reports+Results+for+4th+Quarter,+Full+Year>
- United States Census Bureau (USCB) (1993). *Populations, 1790 to 1990, United States Urban and Rural*. Washington, DC: United States Census Bureau. <http://www.census.gov/population/censusdata/table-4.pdf>
- United States Congress (1974). 'Employee Retirement Income Security Act of 1974,' Public Law 93-406 § 407(a), codified at 29 U.S.C. § 1107(a). Washington, DC: GPO.
- (2006a). 'Pension Protection Act of 2006,' Public Law 109-280, codified at 29 U.S.C. §§ 1001, et. seq. Washington, DC: GPO.
- (2006b). 'Pension Protection Act of 2006,' Public Law 109-280, § 602(2), codified at 29 U.S.C. § 1108(g)(2)(A)(ii). Washington, DC: GPO.
- United States Department of Agriculture (USDA) (2009). *United States Fact Sheet*. Washington, DC: Economic Research Service. <http://www.ers.usda.gov/StateFacts/US.htm>
- United States Government Accountability Office (USGAO) (2007). 'Private Pensions: Low Defined Contribution Plan Savings May Pose Challenges to Retirement Security, Especially for Many Low-Income Workers,' *GAO-08-8*. Washington, DC: GPO.
- VanDerhei, Jack, Sarah Holden, Luis Alonso, and Craig Copeland (2007). '401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2007,' *EBRI Issue Brief 324*. Washington, DC: Employee Benefit Research Institute.
- Walsh, Mary Williams (2009). 'Government Takes over Delphi's Pensions,' *New York Times*, July 23: B1.
- Weller, Christian E. (2005). *Social Security Privatization, with Social Security Privatization, Timing Matters – for Some More than for Others*. Washington, DC: Center for American Progress. <http://www.americanprogress.org/issues/2005/07/b900925.html>
- (2008). *401(k) Financial Planning*. Washington, DC: Center for American Progress. <http://www.americanprogress.org/issues/2008/07/401k.html>