RETIREMENT USA

Working for a ***Universal***, ***Secure***, and ***Adequate*** Retirement System

UNIVERSALITY ISSUES PAPER

Retirement USA is a national initiative that is working for a new retirement system, which, along with Social Security, will provide universal, secure and adequate income for future retirees. The initiative has developed *12 Principles for a New Retirement System* to provide a framework for a future system in which employers, workers, and the government would share responsibility for the retirement security for all American workers. The Principles are included as an appendix to this paper.

Retirement USA was convened by five organizations – the AFL-CIO, the Economic Policy Institute, the National Committee to Preserve Social Security and Medicare, the Pension Rights Center, and the Service Employees International Union. Twenty-one other organizations support the Retirement USA principles and are coming together to raise awareness about the need for comprehensive reform for the future. A list of conveners and supporters is attached.

These issue papers are part of Retirement USA's effort to promote discussion on a range of proposals that could lead to a universal, secure, and adequate retirement system. The issue papers cover five broad topics – universality, adequacy, security, design, and administration – and present options for designing features of a system that can provide an adequate and secure retirement for all American workers.

The papers were prepared for Retirement USA by Pension Rights Center staff and consultants. The principal authors were Jane T. Smith, Policy Associate; Norman P. Stein, Senior Policy Advisor; and John A. Turner, Consulting Economist. Editors were Henry Rose, Special Counsel; Nancy Hwa, Communications Director; and Karen Ferguson, Director. Invaluable insights and technical comments were provided for individual papers by Monique Morrissey, economist at the Economic Policy Institute; Alicia Munnell, director of the Center for Retirement Research; Daniel Halperin, professor at Harvard Law School, and Ben Veghte, research associate at the National Academy of Social Insurance.

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This paper is one of five papers focusing on issues to be addressed in meeting Retirement USA's 12 Principles for a New Retirement System. The papers address the topics of universality, security, adequacy, design, and administration.

A core Retirement USA principle is that every worker should be covered by a retirement plan: "A new retirement system that supplements Social Security should include all workers unless they are in plans that provide equally secure and adequate benefits."

This paper focuses on ways of defining universal coverage. Other Retirement USA principles focus on ways of achieving universal coverage, such as shared responsibility and required contributions.[1] These principles are discussed in the paper on design.

Policy experts differ in their views of what would constitute universal coverage in a new private retirement system. The goal of this paper is to explain these differences in order to provide a framework for future discussion.

I. INTRODUCTION – ALTERNATIVE APPROACHES TO DEFINING UNIVERSALITY

There are three major challenges in defining the parameters of a new "universal" private retirement income system. The first has been addressed and decided by the supporters of the Retirement USA principles, but is, nonetheless, important to explore: Should universal coverage be defined as universal "participation" or as universal "access" to an adequate and secure supplement to Social Security?

The second definitional challenge is whether it is appropriate to exclude certain individuals from the definition of "all workers." Finally, there is the question of what constitutes a plan that provides "equally secure and adequate benefits."

[1] See Monique Morrissey, *Toward a Universal, Secure, and Adequate Retirement System*, Retirement USA Conference on "Re-Envisioning Retirement Security," October 21, 2009, pp. 11 - 21. http://www.retirement-usa.org/wp-content/uploads/2009/10/Conference-Report.pdf

II. WHAT CONSTITUTES A "UNIVERSAL" SYSTEM?

The organizations and individuals that developed the Retirement USA principles shared a vision that all Americans deserve a secure and adequate income after a lifetime of work. In some nations, a social insurance system provides such income. In others, this objective is achieved through a combination of public and private pension programs.[2] In the United States, Social Security is a nearly universal retirement system that provides secure lifetime retirement benefits to retirees and their families. However, Social Security was never intended to be either the sole source of retirement income or a sufficient source.[3]

The United States has relied on a voluntary retirement system to supplement Social Security. This system is far from universal. It is subject to varying levels of employer and employee commitment and excludes tens of millions of workers. Over the past half century, private retirement programs have failed to cover more than half of all private sector workers at any given time, despite billions of dollars of tax incentives and nationwide education campaigns.[4] But the United States is not alone. No nation yet has been able to craft a voluntary retirement system that covers all or even most of its workers.

Although there is a growing consensus that the private retirement system's "coverage gap" should be closed and that a universal system is desirable, there is disagreement on the definition of "universal." For some, a universal system is one where all workers have access to a private retirement plan.[5] This plan can be a pension or profit sharing plan, a 401(k)-type retirement savings plan or other employer-sponsored arrangement, or an Individual Retirement Account.

Recognizing that mere availability of a plan will not result in universal participation, many who define universality in terms of access also envision that employers will be encouraged or required to automatically include employees in their retirement savings

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[2] See John A. Turner, *Pension Policy: The Search for Better Solutions,* Upjohn Institute, 2010.
[3] See discussion in the Retirement USA issue paper on adequacy.
[4] In 2008, 51 percent of full-time private-sector workers participated in an employer-sponsored retirement plan of any kind. Of full-time workers, 59 percent worked for an employer who sponsored a retirement plan. See Patrick Purcell, *Pension Sponsorship and Participation: Summary of Recent Trends*, Table 2, September, 2009, Congressional Research Service. http://assets.opencrs.com/rpts/RL30122_20090911.pdf. Tax subsidies for retirement plans are estimated to total $95 billion in fiscal 2010. Of the total $53.5 billion are attributed to 401(k) plans. See Executive Office of the President, Office of Management and Budget, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2011*, www.whitehouse.gov/omb/budget/Analytical Perspectives/. The Joint Committee on Taxation estimates that the revenue loss will be $67 billion. Of the total, $29 billion is attributable to defined contribution plans such as 401(k)s. See Joint Committee on Taxation, U.S. Congress, *Estimates of Federal Tax Expenditures for Fiscal Years 2009-2013*, Table 1 - "Tax Expenditure Estimates by Budget Function, Fiscal Years 2009-2013," P. 43, January 11, 2010. http://www.jct.gov/publications.html?func=startdown&id=3642
[5] See McKinsey & Company, *Restoring Americans' Retirement Security: A Shared Responsibility*, 2009, pp. 22 and 26

plans or in Individual Retirement Accounts. However, to avoid the appearance of paternalism, the employers will be required to give employees enrolled in the plan the opportunity to decline further participation.

Since the goal of universality will be defeated if employees do opt out – as some will for financial reasons – the Retirement USA principles envision a private retirement income system that does not allow individuals to choose not to participate.[6] This may not be a politically popular approach, but it is a necessary one for a system with universal participation rather than universal access.

Defining a universal system as one in which everyone participates is also a more efficient and less costly approach. Currently, all taxpayers pay higher taxes or receive less in government services to support pensions and retirement savings plans. Yet in a system that merely provides for universal access to plans, the benefits of those federal tax expenditures will continue to go disproportionately to those higher-paid individuals who do not need tax incentives to encourage them to save for retirement.

Also, billions of dollars are spent each year on marketing and educational programs to encourage people to save, yet the overall rate of plan participation remains largely unchanged.

III. WHO SHOULD BE INCLUDED IN THE DEFINITION OF "ALL WORKERS?"

The architects of a new universal private retirement system will have to decide whether any workers should be excluded. There is precedent for this in other retirement systems. For example, certain programs exclude specific categories of workers such as: the self-employed; temporary, part-time and seasonal workers; paid and unpaid caregivers and others who work in the home; and employees of religious organizations.

Also, some systems exclude certain employees on the basis of their income levels. For example, workers earning less than specified amounts may not be included. Similarly, higher income employees may not be allowed to contribute above certain income levels.

[6] The Retirement USA principles contemplate that additional voluntary contributions would be permitted above the basic system,

1. Should a Retirement USA system exclude individuals by job category?

Self-employed individuals

One question is whether a future private retirement income system should cover self-employed individuals or only those who work for others. A related question is whether the self-employed should have a choice about participation or be required to participate. Social Security includes the self-employed and requires that they participate. They also have the option of setting up certain kinds of private retirement plans.

The Current Population Survey for April 2010 reported 9.7 million self-employed persons in the United States. This represents seven percent of the civilian employed workforce. The self-employed in agriculture and related industries accounted for 37 percent of the workforce in those industries.[7]

From a policy perspective, it may be difficult to fashion an argument that self-employed individuals should be excluded from a Retirement USA system. However, farmers and business owners may argue that they can adequately provide for their own retirement through the appreciated value of their farms and businesses. Also, including individuals who own their own businesses can raise technical problems in determining contribution requirements, particularly where capital is a material factor in the business.[8]

Part-time, seasonal, temporary, and household workers

A new system must also determine whether to exclude part-time employees and, if it does, how to define who will be excluded on the basis of part-time status. The Current Population Survey defines a part-time employee as one who works between one and thirty four hours a week. Under the CPS definition part-time employees were 19 percent of total employees in May 2010.[9] The Employee Retirement Income Security Act requires private-sector employer-sponsored pension plans to include part-time workers who work 1000 hours a year (20 hours a week).

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[7] Calculations based on Bureau of Labor Statistics, U.S. Department of Labor, Current Population Survey, Monthly Household Data, Table A-7, *Employed persons by class of worker and part-time status, seasonally adjusted*. http://www.bls.gov/web/empsit/cpseea7.pdf The CPS also distinguishes between the incorporated self-employed and the unincorporated self-employed. If a self-employed respondent states he or she has a business that is incorporated, then he or she is treated as a wage and salary worker and an employee of the business. Persons responding that they are not owners of incorporated businesses are classified as unincorporated self-employed.[7]

[8] Assuming that the new system will not require contributions from people on return on investment, it may prove difficult in many businesses to distinguish between profits from labor and profits from deployment of capital. The problem would also arise in closely held business entities, since a business can pay salary to owner that may not fully reflect adequate compensation for the business owner's labor, particularly where profits are being reinvested in the enterprise.

[9] Calculation based on CPS data for May 2010. This data does not include the self-employed. See "Household Data Seasonally Adjusted, Table A-6., http://www.bls.gov/web/empsit/cpseea6.pdf.

While it is desirable to include part-time workers, there are administrative costs both to the employer and the employees when an employee's participation in the labor force is marginal, such as casual employment for a brief period of time or for only a few hours per year. A system might have different approaches to seasonal workers and perhaps to part-time workers who are still minor dependents.

Alternatively, participation in a retirement system could be limited to those who earn a certain amount per year or per month. The Australian system is available to workers earning more than AU$450 per month.[10]

Different issues are presented by household employees. Although Social Security requires contributions by and for domestic workers, there are no private programs to encourage household employers to supplement Social Security for their domestic workers. This is an issue that the designers of a new system may want to address.

Unpaid caregivers and non-working spouses and partners

Currently in the U.S., unpaid caregivers and non-working spouses or partners are included only indirectly in the retirement system. There is no provision in either Social Security or private retirement plans for retirement contributions for unpaid caregivers, such as family members who leave paid employment to care for a child or elderly relatives.

Although non-working spouses can generally receive benefits from both Social Security and employer-sponsored private retirement plan at death and divorce, no explicit contributions are made for them during their lives. However, spousal contributions are permitted for Individual Retirement Accounts.

One way of addressing this problem in a new system would be to permit additional contributions to be made to accounts shared equally by workers and their non-working spouses throughout the workers' careers. Alternatively, workers could establish and contribute to special accounts for a non-working spouses or partners.

These approaches provide explicit recognition of the value of a caregiver or partner's otherwise uncompensated work. They may, however, add some administrative complexity to and impose some cost on a retirement system, and at the margins

[10] David C. John and Ruth Levine, *National Retirement Savings Systems in Australia, Chile, New Zealand and the United Kingdom: Lessons for the United States*, p.9, The Retirement Security Project, No. 2009-1, Georgetown University 2009.
http://www.brookings.edu/~/media/Files/rc/papers/2009/07_retirement_savings_john/07_retirement_savings_john.pdf

compliance could be an issue (for people who do not report their marital status to their employer). It could also result in different annuity amounts for spouses or partners, since they could have different account balances or benefits entering a marriage or domestic partnership.

2. Should a Retirement USA system exclude individuals based on income levels?

Low-income workers

There are arguments that a universal system should not extend coverage to low income workers. The argument essentially reflects two major points: (1) Social Security already provides a relatively higher income replacement rate for low income workers (because of the progressive nature of the benefit structure);[11] and (2) it is objectionable to require low-wage workers to reduce their consumption during their working years by requiring them to defer part of that consumption until retirement, particularly when they are supporting a family.

A response to the first argument is that Social Security wage replacement rates are never 100 percent and are often far lower than the nominal percentage.[12] Moreover, some retirement experts have suggested that because of the increased expenses associated with the aging of lower-income individuals, that a replacement rate should be in excess of 100 percent for lower-income retirees.

The second argument -- that low-wage workers cannot afford to reduce current consumption -- can be addressed by calling for the government to share with employers and employees the responsibility for retirement savings to supplement Social Security, and to subsidize the contributions of lower-income workers, which is one of the Retirement USA principles.[13] Possible approaches could include direct government contributions or indirect refundable tax credits. This could involve a transfer of wealth from the relatively affluent to the less affluent, a generational transfer, or a combination of both.

[11] For workers who attain age 62 in 2009, Social Security replaces 90% of the first $744 of average monthly earnings. But the $744 is based on average indexed earnings during the 35 years in which earnings were highest. For people with stretches of joblessness, this figure can be considerably lower than the income they are earning prior to retirement.

[12] Also, Social Security beneficiaries pay premiums to Medicare (and to Medicare supplemental insurance) and those premiums have been increasing at a faster rate than the increase in Social Security benefits.

[13] "Retirement should be the shared responsibility of employers, employees and the government." Employers and employees should be required to contribute a specified percentage of pay, and the government should subsidize the contributions of lower-income workers."

High-income workers

High-income individuals do not need to participate in a Retirement USA system in order to avoid a decline in living standards in retirement. A system could theoretically exclude such individuals and not undermine the basic goals of Retirement USA. This would reduce the revenue costs of a new program.

But excluding such individuals from a new system might also impose financial costs since it could require a complex definitional and administrative apparatus for identifying who should be excluded. Moreover, there might be political cost to a system that excludes high-income workers since the excluded individuals would be less likely to support it.

A final point is that individuals can lose wealth and those who seem to have a secure retirement now might be in a different position in the future. It might be that, rather than excluding such higher-paid individuals from the system, the income on which their contributions (or benefits) are based (and thus their benefits) could be capped at a specific level.

IV. What Are Plans with "Equally Secure and Adequate Benefits?"

The Retirement USA universality principle excludes from participation workers who participate in employer plans that "provide equally secure and adequate benefits." This raises the issue of how to determine whether a plan is comparable. A related issue is how to guard against employers abandoning plans that are more generous than a Retirement USA system.

1. Determining whether a plan is comparable to a Retirement USA system

The conveners of Retirement USA and its supporting organizations share the goal of preserving and strengthening existing private retirement plans that provide adequate and secure benefits for their participants. These plans are likely to satisfy the principles of shared responsibility, required contributions, portability of benefits, lifetime payouts at retirement, and efficient and transparent administration.

Comparisons will be easiest when an existing plan closely resembles a new Retirement USA structure, such as a traditional or hybrid pension plan, or when it can readily be modified to conform to the new structure. However, comparability might also be possible where a very different structure meets the principles for a particular group of employees. For example, a retirement savings plan for higher-paid individuals who can afford to take full advantage of maximum contribution levels, who are not likely to need to cash out their funds before retirement, and who are provided pooled investment options and payouts in the form of a lifetime stream of payments, might also be deemed to be comparable.

2. Preventing abandonment of more generous plans in favor of Retirement USA

Some have argued that employers will abandon existing generous employer-paid retirement plans and participate instead in a new Retirement USA system. This is a realistic possibility since responsibility for contributions and benefits will be shared by employers and employees. However, employers who provide generous plans typically do so for a reason. In some cases, the plans purchase higher productivity with their particular workforce. In others, they offer higher benefits to company owners. The introduction of a Retirement USA program would not necessarily cause an employer to abandon a generous plan if the employer has determined that its current plan provides it with a competitive workplace advantage or a more secure retirement.

In any event, to the extent there is concern about so-called “crowding out,” it is possible to use tax and other economic incentives to reward employers that retain or adopt plans more generous than the program offered by Retirement USA.

RETIREMENT USA

Working for a ***Universal***, ***Secure***, and ***Adequate*** Retirement System

Principles for a New Retirement System

Universal Coverage. *Every worker should be covered by a retirement plan in addition to Social Security.* A new retirement system should include all workers unless they are in plans that provide equally secure and adequate benefits.

Secure Retirement. *Retirement shouldn't be a gamble.* Workers should be able to count on a steady lifetime stream of retirement income to supplement Social Security.

Adequate Income. *Everyone should be able to have an adequate retirement income after a lifetime of work.* The average worker should have sufficient income, together with Social Security, to maintain a reasonable standard of living in retirement.

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Shared Responsibility. Retirement should be the shared responsibility of employers, employees and the government.

Required Contributions. Employers and employees should be required to contribute a specified percentage of pay, and the government should subsidize the contributions of lower-income workers.

Pooled Assets. Contributions to the system should be pooled and professionally managed to minimize costs and financial risks.

Payouts Only at Retirement. No withdrawals or loans should be permitted before retirement, except for permanent disability.

Lifetime Payouts. Benefits should be paid out over the lifetime of retirees and any surviving spouses, domestic partners, and former spouses.

Portable Benefits. Benefits should be portable when workers change jobs.

Voluntary Savings. Additional voluntary contributions should be permitted, with reasonable limits for tax-favored contributions.

Efficient and Transparent Administration. The system should be administered by a governmental agency or by private, non-profit institutions that are efficient, transparent, and governed by boards of trustees that include employer, employee, and retiree representatives.

Effective Oversight. Oversight of the new system should be by a single government regulator dedicated solely to promoting retirement security.

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Retirement USA Steering Committee

AFL-CIO
Economic Policy Institute
National Committee to Preserve Social Security and Medicare
Pension Rights Center
Service Employees International Union

Supporters of the Retirement USA Principles

Alliance for Retired Americans
American Federation of State, County and Municipal Employees
American Association of University Women (AAUW)
Association of BellTel Retirees, Inc.
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