Our Half-Full, Half-Empty Retirement Glass

By Editor Test *Tue, Nov 15, 2011*

The private DC system covers only about half of American workers at any given time. Proposals to open state pension plans to uncovered workers have been made, and the threat of competition may actually be healthy for the 401(k) system.

The Achilles heel of the defined contribution system in the U.S. is that too few workers enjoy its coverage. At any given time, almost half of America's private-sector workforce lacks access to an employer-sponsored retirement savings plan.

The half-empty status of our private pension system looks like this: Only 54% of full-time workers ages 21 to 64 have retirement plans at work; Hispanic workers, younger workers and people who work for small companies are less likely than average to have access to a plan, according to the EBRI, Employee Benefit Research Institute.

In part because of this shortfall, the U.S. received a 'C' in the 2011 Mercer-Melbourne Global Pension Index. "In the private sector, the coverage of the American system isn't as broad or as comprehensive as elsewhere," David Knox, a Mercer partner and author of the index report told RIJ. "Many people in the workforce have no provision other than Social Security."

That's a problem that we can't really afford to ignore or (in the all-purpose catch phrase) "kick down the road." It's a problem not only for the millions who might retire on little more than $1,000 a month from Social Security. It's also a problem for anybody who may have to help support (as a family members or a taxpayer) larger numbers of elderly poor.

More to the point, it's a problem for the huge defined contribution industry and the millions who make their living in it. Unless the 401(k) system becomes more equitable and more universal, the tax preferences that, in effect, help finance the whole system will be subject to attack from both liberals and deficit hawks. It will also be increasingly vulnerable to competition from alternative solutions that could eat at its assets under management, or AUM.

Several of those solutions are already on the table. For instance, the National Commission on Fiscal Responsibility and Reform to cap tax-favored contributions at 20% of pay up to $20,000, down from the current 100% of pay up to $49,000. William Gale of the Brookings Institution has urged the government to replace tax deferral that drives the 401(k) system with a flat-rate tax credit worth 18% of a participant's contributions. Mark Iwry, a Treasury Department official, has been promoting "automatic IRAs" for small company employees without retirement coverage.

More recently—and this is the topic of today's cover story in RIJ—there have been some surprising proposals to open up state employee pension plans to participation by people whose private or non-profit employers don't sponsor retirement savings plans.

That may seem like an odd idea. Considering all the criticism that state plans have received for overpromising benefits and using unrealistic discount rates to measure their funding status, relying on an expansion of state plans to provide coverage for private sector or non-profit workers might seem unlikely.

Yet the proposals are out there and people are working on them. According to pension experts who spoke with RIJ, theses plans, frankly, aren't considered likely to come to fruition. Anecdotally, they inspire a lot of opposition from private industry. That's not surprising. A worker who doesn't have access to a plan today is still a potential participant in a defined contribution plan in some future job.

The inequities of the pension industry resemble the inequities of the health care industry. Many people go uninsured, but public sector initiatives to make health care coverage universal meet with a lot of opposition. Both issues are related to ancient problems regarding free enterprise and the role of the state, which themselves tend to be paradoxical and may be insolvable.

If Republicans take the White House in 2012, some of those currently pushing for reform of the retirement system from within the government may lose positions and influence. We may hear less criticism of the status quo. On the other hand, conservative deficit hawks may scrutinize the cost of tax deferral more skeptically than ever.

If there is a silver lining here—we don't hear a lot these days about silver linings, do we?—it is that outside challenges are forcing the 401(k) system itself to become more efficient, more transparent, and more responsive to the ultimate goal of providing lifelong retirement income.