Dēmos

MILLIONS TO THE MIDDLE *SERIES*

AMERICAN RETIREMENT ACCOUNTS

HELPING AMERICANS BUILD ASSETS

POLICY IN FOCUS

AMERICAN RETIREMENT ACCOUNTS

Create universal American Retirement Accounts with a $600 annual government contribution, an optional employer contribution and a guaranteed inflation-adjusted rate of return of at least 3 percent to ensure retirement security. Funding for the program could be raised by capping 401(k) tax deductions at $5,000 annually.

Widely shared middle-class prosperity has made the United States the most hopeful and dynamic country on earth and is a foundation of strong democracy. Yet today, America's middle class is in trouble: the traditional routes into the middle class have become more difficult to travel and security has eroded for those already in the middle class. Major economic and policy changes over the past three decades have widened economic inequality and reduced mobility in ways that go far beyond the impact of the recent recession. Too many people who play by the rules and do everything right find that they cannot climb into the middle class—or stay there. To meet this challenge, Millions to the Middle offers dramatic public policy initiatives to rebuild and grow the nation's middle class.

We aim to accomplish two broad interrelated goals: to ensure that all Americans have a chance to move into the middle class and, second, to ensure greater security for those in the middle class. The 14 policies we offer are rooted in mainstream American values and able to command strong public support over the long term. Together, they go beyond the confines of the current policy debates and are of sufficient scale to firmly establish a middle-class America.

Our policy agenda is based on the three broad pillars of middle-class opportunity and security: investments in human capital and education; support for growth, job creation, and career development; and helping Americans build assets. This policy is part of the **Helping Americans Build Assets.**

POLICY: AMERICAN RETIREMENT ACCOUNTS

Create voluntary annuitized pensions with a guaranteed minimum rate of return to increase Americans' retirement security.

POLICY RATIONALE

In 1935, with the passage of the Social Security Act, our national leaders made a promise to all citizens: after a lifetime of hard work, no older American would suffer from poverty in their old age. The passage of this landmark legislation was the embodiment of a deeply shared value: a dignified, economically secure retirement. Seventy-five years later, however, our nation has greatly changed and our ability to uphold this value is severely threatened.

Social Security was never intended to be the sole source of income for retirees. Rather, it was supposed to be a supplement to other steady forms of retirement income, primarily employer-provided "traditional pensions," as well as individual savings. Throughout the last few decades, however, traditional pensions have been largely replaced by employer-based retirement savings plans, shifting the risk of retirement onto workers, forcing them to gamble their retirement savings in the stock market or on even riskier investments. In addition, workers have been suffering from increasing economic insecurity, resulting in a decrease in personal savings. Even Social Security, the bedrock of retirement for most workers, is under political attack by those ideologically opposed to the system.

OPINION SNAPSHOT

- 75 percent of Americans believe the disappearance of guaranteed pensions—in favor of 401(k)s—has made it harder to achieve the American Dream of a secure retirement.[6]
- 83 percent say government should make it easier for employers to offer pensions. [6]
- 81 percent believe that Washington leaders need to give a higher priority to ensuring more Americans can have a secure retirement.[6]

The erosion of retirement savings will take a toll: a recent report by McKinsey & Company asserts that, if current patterns continue, the average working American household is facing a 37 percent shortfall in the income they need in retirement. This shortfall is larger both for lower-income households and for younger workers.[1] Forty-four percent of households have no retirement savings accounts at all.[2] As a result, less than half of Americans are projected to have sufficient income to adequately maintain living standards in retirement, even when Social Security is accounted for.[3] The economic crisis makes matters still worse: Americans are increasingly withdrawing money from their existing retirement accounts to meet immediate needs. Many older people are postponing retirement or trying to reenter the workforce at a time of high unemployment.[4]

401(k)-style plans are an inadequate solution to the nation's mounting retirement crisis. First, they're expensive. The exorbitant fees charged by firms that manage 401(k) accounts can cost workers a quarter or more of their retirement savings. Over a lifetime, these fees can add up to more than $155,000 in losses for the average household.[5] Fees are levied on employers' matching contributions as well. Another serious problem is the way that 401(k)s place the burden of investment risk exclusively on individual workers. After working throughout their lives, older Americans relying on individual retirement plans could lose their savings in a market crash, invest so conservatively that they ensure themselves weak returns, or outlive the funds they have been able to save. Pension-style plans, meanwhile, ensure security by spreading these risks among many plan participants over a long time horizon – no individual puts their entire retirement in danger.

POLICY DESIGN

Our proposal for American Retirement Accounts, a modification of the Guaranteed Retirement Account plan proposed by Dēmos fellow Teresa Ghilarducci, would establish voluntary, portable accounts that workers and employers could contribute to. While employers would be required to set up the accounts, they would not be obligated to contribute. The government would defray administrative expenses. In addition, a $600 annual government contribution would be given to everyone participating. Professional private sector managers would invest the ARA money at low fees, with the government guaranteeing an inflation-adjusted rate of return of at least 3 percent to ensure retirement security. When individuals retire, the value of their account assets would be distributed back in the form of an annuitized pension, similar to plans currently available to university professors, nonprofit employees, and public-sector workers.

The proposal is designed to provide retirement security by eliminating market risk (since the government's guaranteed minimum return would protect against market crashes), longevity risk (through the annuitization of benefits, ensuring fixed payments throughout an individual's life), and investment risk (through conservative investments in low-fee accounts).

Funding for the program could be raised by capping 401(k) tax deductions at $5,000 annually. This tax subsidy disproportionately benefits people with high-incomes who already benefit the most from public policies and market incentives.

ENDNOTES

1. "Restoring Americans' Retirement Security: A Shared Responsibility," McKinsey and Company (2009). http://www.mckinsey.com/clientservice/Financial_Services/Knowledge_Highlights/~/media/Reports/Financial_Services/Retirement_Security.ashx
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3. Munnell, Webb, and Golub-Soss, "National Retirement Risk Index," October 2009. http://crr.bc.edu/briefs/the_national_retirement_risk_index_after_the_crash.html
4. Helman and Copeland, "2011 Retirement Confidence Survey," March 2011. http://www.ebri.org/pdf/surveys/rcs/2011/EBRI_03-2011_No355_RCS-11.pdf
5. "Robert Hiltonsmith, "$155,000 Swindle: The Hidden and Excessive Costs of 401(k)s," Dēmos (April 2012).
6. Brian Perlman, Kelly Kenneally, and Ilana Boivi, "Pensions and Retirement Security 2011: A Roadmap for Policy Makers," National Institute on Retirement Security (March 2011). http://www.nirsonline.org/storage/nirs/documents/Public%20Opinion/final_report.pdf

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