Pensions, Savings Plans, and Public Policy

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SIGH...
Y'KNOW, IT'S FUNNY...
I USED TO THINK OF RETIREMENT AS A THING OF THE FUTURE...

BUT NOW I CAN SEE IT'S BECOMING A THING OF THE PAST...
Wealth composition for individuals reaching retirement...

- Social Security, 42%
- Primary house, 21%
- Financial assets, 7%
- Defined benefit, 16%
- Defined contribution, 8%
- Business assets, 2%
- Other non-financial assets, 4%

About 24% of retirement wealth comes through employment-based programs

Source: Center for Retirement Research, calculated from the SCF
The Changing Pension Landscape

- Dramatic shift from DB to DC Plan
  - DC plans now outnumber DB plans 13 to 1
  - Active participants in DC plans outnumber those in DB plans 2:1
  - The total assets under management in DC plans exceeds that in DB plans
- Approximately 44 million private sector workers and retirees covered by DB plans (PBGC 2008 Annual Report)
  - Less than half of these are active participants
The Changing Composition of Employer Sponsored Retirement Plans

Number of Retirement Plans vs Year

- Defined Benefit Plans
- Defined Contribution Plans
The Changing Composition of Employer Sponsored Retirement Plans

Year
Number of Active Plan Participants
0 10,000 20,000 30,000 40,000 50,000 60,000

- Defined Benefit Plans
- Defined Contribution Plans
The Changing Composition of Employer Sponsored Retirement Plans

Defined Benefit Plans

Defined Contribution Plans
Why the Has the Pension System Evolved do Quickly?

- For the employer, DC plans are “the better mousetrap”
- DB pension plans are:
  - Complicated
  - More heavily regulated → larger compliance costs
  - Expose employers to large and unpredictable financial risks
    - Dramatic decline in funding status in 2008
Funding Status of DB Pension Plans, S&P 1500 Companies


http://www.mercer.com/summary.htm?idContent=1336100#figure1
The Decline in DB Pension Plans

- Plan terminations
  - Insufficiently funded plans insured by the PBGC
    - 3800 terminated plans
    - 1.2 million beneficiaries
    - $10.7 billion deficit
  - Pension freezes (GAO 2009)
    - 53% of DB pension plans frozen to some extent
      - Hard freeze
      - Soft freeze
    - 3.3 million (21%) active participants affected
Defined Benefit Pension Plans

- Many companies terminating, freezing, or cutting their DB pension benefits

DB Pension Plan Terminations

Source: GAO (2008)
Private Workers with Pension Coverage by Pension Type

The 401(k) is Here to Stay

Sources: 2007 Account Balances: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; 2008 and 2009 account balances: EBRI estimates. The analysis is based on all participants with account balances at the end of 2007 and contribution information for that year.
Making DC Plans Work Better

- Improving savings outcomes within DC plans
  - Increase employee participation
    - Automatic enrollment
    - Active decision
    - Simplification
  - Contribution rates
  - Investment allocation
Making DC Plans Work Better

- Expanding the availability of employer-sponsored savings plans
  - About half of all workers do not have access to workplace retirement plans
Making DC Plans Work Better

- Transforming retirement income into wealth
- Facilitating annuitization
- Expanding the availability of employer-sponsored savings plans.
Participation in Employer-Sponsored Retirement Plans of Any Kind

Retirement Savings Research—What Would We Like to Know?

- How much should individuals be saving for retirement?
  - What is individually optimal?
  - What is socially optimal?
- Total savings impact of employer-sponsored savings plans?
  - Is the increased saving in employer-sponsored plans with automatic enrollment new saving?
  - Or does it displace other saving?
  - Or is it offset by higher credit card or mortgage debt?
Research Gaps: What Would We Like to Know about Defaults

Gap #2: What are the optimal savings defaults?

- Current research
  - The distribution of transaction costs
  - Heterogeneity in savings preferences
  - Degree to which preferences are present-biased

- What if the default is construed as advice?
- What if different defaults are optimal for different agents: individuals, firms, the government, society?