

# 13. Pensions and Retirement Savings

OVER half of all American workers face a bleak retirement future because they have not saved enough to provide for an adequate income. Fewer than one in five workers are covered by a traditional defined benefit pension that pays retirees a monthly amount based on their incomes and length of service. Many of the plans that still exist are so underfunded that the federal agency that insures traditional pensions, the Pension Benefit Guaranty Corporation (PBGC), faces huge deficits that are expected to get worse.

Traditional pensions are being replaced by 401(k)-type retirement savings plans, but over half of the work force is not in such a plan. Of 153 million American workers in 2004, 71 million worked for an employer who did not offer a pension plan, and 17 million more did not participate in their employer's plan. Most workers who do not participate are young, have lower incomes, or work for a small business. Workers can build an adequate retirement income through such plans, but they must have access to them and participate from an early age.

## Recommendations

### 1. Improve the funding of traditional defined benefit pension plans.

Funding rules for defined benefit pension plans are extremely complex and assume that the employer will always remain in business and contribute to the plan. Plans can legally avoid putting much or even any money in their plans and still be considered fully funded. Funding rules need to reflect the real financial status of the plan and require that companies fully fund the promises they have made to workers. In addition, both workers and stockholders need improved information about underfunded plans' actual status. Otherwise, taxpayers will be required to bail out PBGC and pay off failed companies' pension promises.

### 2. Add automatic features that increase participation and savings in 401(k)-type plans.

Under auto-enrollment, a worker is automatically part of an employer's pension plan unless he or she chooses not to join. Studies show that this raises participation into the high 80 percent–90 percent level, with the biggest improvement being among women, Hispanics, and lower-income workers. Without auto-enrollment, a worker

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must decide to participate, how much to save, and which investment to choose. Many workers find these decisions daunting and do not join their plans. Auto-enrollment can also include both automatic increases in a worker's contribution as his or her income improves and automatic investment in an appropriate option that is keyed to the worker's age. Workers always retain the ability to choose not to participate or to change their contribution or investment choices.

**3. Expand pension plans' coverage by requiring small businesses with over 10 employees to offer their workers the opportunity to save in an automatic payroll deduction IRA.** Almost half of all U.S. workers work for employers who do not offer any form of pension plan. This would improve if businesses with over 10 employees that have been in business for over two years were required to offer their employees an automatic IRA. Automatic IRAs would include direct payroll deposits to a low-cost, diversified individual retirement account. The firm would inform employees of the opportunity to begin an automatic IRA plan and receive from each employee a decision either to participate or to opt out. Employers using auto-enrollment to promote participation in direct deposit IRAs would not be required to obtain responses from employees who fail to respond to the request. Employers making direct deposit or payroll deduction available would be protected from potential fiduciary liability. In addition, employers would receive a tax credit to cover their initial costs that is very similar to the existing credit for employers that begin a 401(k)-type plan.

## Facts and Figures

■ Auto-enrollment increases overall participation in pension plans from about 75 percent to between 85 percent and 95 percent. More important, participation increases from 35 percent to 86 percent for women, from 13 percent to 80 percent for workers earning under \$20,000 annually, and from 19 percent to 75 percent for Hispanics.

■ Almost half of all workers and up to three-fourths of small-business employees have no pension plan. Overall, according to the Employee Benefit Research Institute, only 50.9 percent of workers participate in an employer-sponsored pension plan. Among firms with fewer than 25 employees, only 23.2 percent are able to participate. Most workers cannot participate because their employer does not offer a retirement plan.

■ The PBGC owes \$23.1 billion more in pension payments than it has in assets available to pay those promises as of September 30, 2005. The agency expects that it will likely have to take over additional plans that

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are underfunded by a further \$108 billion, and that number could grow much higher.

■ Defined benefit funding rules can hide reality. Just before it failed, Bethlehem Steel's pension plan was judged to be 84 percent funded even though it had only 45 percent of the assets needed to pay promised benefits. The PBGC had to cover the \$4.3 billion shortfall when it assumed Bethlehem's pension plans.

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*This chapter can be read online at [issues2006.org/retirement](http://issues2006.org/retirement).*

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### Additional Reading

David C. John, Tim Kane, Ph.D., and Rea S. Hederman, Jr., "Are Pensions the Next Fiscal Crisis?" Heritage Foundation *WebMemo* No. 756, June 7, 2005, at [www.heritage.org/Research/SocialSecurity/wm756.cfm](http://www.heritage.org/Research/SocialSecurity/wm756.cfm).

J. Mark Iwry, Retirement Security Project, and David C. John, The Heritage Foundation, "Pursuing Universal Retirement Security Through Automatic

IRAs," working paper, February 12, 2006, at [www.retirementsecurityproject.org/](http://www.retirementsecurityproject.org/).

David C. John, "Special Treatment for Airlines Flaws a Strong Senate Pension Bill," Heritage Foundation *WebMemo* No. 872, October 5, 2005, at [www.heritage.org/Research/SocialSecurity/wm872.cfm](http://www.heritage.org/Research/SocialSecurity/wm872.cfm).