

Universal Voluntary Accounts: A Step Towards Fixing the Retirement System

The retirement system in the United States is badly tattered. The traditional thinking has been that retirement income should be a three-legged stool. The first leg would be Social Security which provides a core retirement income to nearly the entire workforce. The second leg would be a defined benefit pension (DB), which would provide a substantial supplement to Social Security. The third component would be income from the savings that workers managed to put aside on their own.

The picture of the three-legged stool no longer fits the reality of the 21st century workforce. Less than 20 percent of the private sector workforce has a traditional DB pension, and this number is falling rapidly. Few, if any, firms are starting DB plans and the firms that do still have DB plans are shedding workers and freezing their plans at an alarming rate. There is little reason to believe that the decline in DB plans will be reversed.

Furthermore, the crash of the housing bubble has eliminated much of the equity that baby boomers had accumulated in their homes. Tens of millions of baby boomers are approaching retirement with little or no equity in their homes.¹

Defined benefit plans have to a large extent been replaced by defined contribution (DC) plans. DC plans are essentially a personal saving option with the difference that the money is deducted directly from workers' paychecks and that most DC plans include an employer side contribution. However, DC plans have not come close to filling the gap created by the dwindling of DB system. Only half the workforce even have access to a pension at the workplace (DB or DC) and most of those who have DC plans manage to accumulate very little wealth during their working years. Among the 94 percent of families headed by someone between the ages of 45 and 54 who had any financial assets at all, the median holdings was just \$48,000 in 2004.² This means that 56 percent of these near retirement families had managed to accumulate less than \$48,000 in financial assets. This figure includes assets in DC plans (although not DB plans), as well as any personal savings they had outside of their retirement accounts. If current trends continue, most workers will not have much besides Social Security to support themselves in retirement.

Unfortunately, most of the public debate on retirement income has focused on Social Security, the leg of the stool that is relatively solid. According to the most recent projections from the non-partisan Congressional Budget Office, the system can pay all scheduled benefits for the next 40 years with no changes whatsoever. Even after 2046,

¹ Baker, D. and D. Rosnick, "The Housing Crash and the Retirement Prospects of the Late Baby Boomers, Washington, D.C.: Center for Economic and Policy Research [http://www.cepr.net/index.php/publications/reports/the-housing-crash-and-the-retirement-prospects-of-late-baby-boomers/].

² Bucks, B, A. Kennickell, and K. Moore, 2006. "Recent Changes in U.S. Family Finances: Evidence From the 2001 and 2004 Surveys of Consumer Finance." *Federal Reserve Bulletin*, January 1-38, Table %. [http://www.federalreserve.gov/pubs/bulletin/2006/financesurvey.pdf .}

when the system is first projected to face a shortfall, the system would always be able to pay a higher benefit (in 2006 dollars) than what current retirees receive. Furthermore, the projected shortfall is smaller than the Social Security shortfalls that the country dealt with each of the decades from the 50s through the 80s, so maintaining full scheduled benefits (if Congress elected to follow this route) would not be a difficult task.

Given the relative financial health of Social Security, the private pension system clearly poses the more urgent problem. This paper describes a simple plan – a system of universal voluntary accounts (UVA), invested privately but administered through state governments, that can be an important first step in solving the pension plan. This system would immediately accomplish three important goals:

- 1) It would provide every worker in the state with access to a defined contribution pension at their workplace. They would be able to make contributions directly from their paychecks and employers could also contribute, if they chose;
- 2) It would provide a fully portable system that a worker could carry with them from job to job, as long as he or she remained in the state; and
- 3) It would provide a low-cost system with administrative costs that are far lower than in many existing DC plans. In current plans, as much as 20 percent of contributions can be eaten up by administrative costs.

In addition, UVAs are very small business friendly. The overwhelming majority of workers at large firms have pensions, while the overwhelming majority of workers at small businesses do not. The reason is that many small business owners lack the time, expertise and comfort level necessary to provide their workers with a pension. The UVA system will allow every small business owner to provide a pension to their employees with virtually no time or effort on their part, and zero risk. Employers will also be able to contribute to these pensions on their workers' behalf, if they choose. Since workers value pensions, UVAs will assist small business owners in retaining workers who might otherwise be attracted by pension plans offered by larger employers.

While UVAs will not provide a full solution to the problem of ensuring workers a decent retirement, they are important first step. They will put in place a structure from which a fuller solution can be constructed.