

# Entitlement Reform and the Future of Pensions

**Conference on Reimagining Pensions:**

**The Next 40 Years**

**The Wharton School**

**May 1, 2014**

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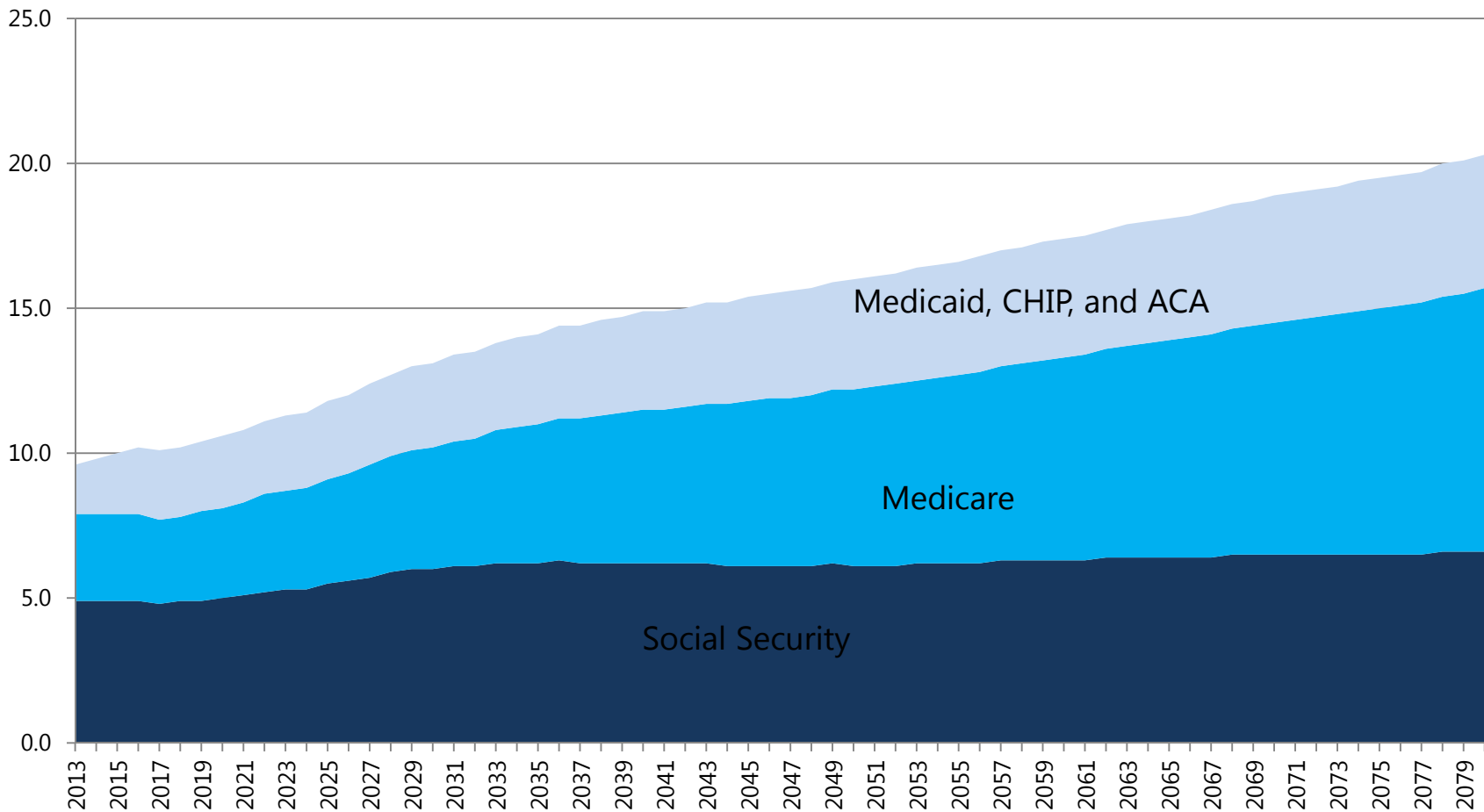
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# Basic Theme

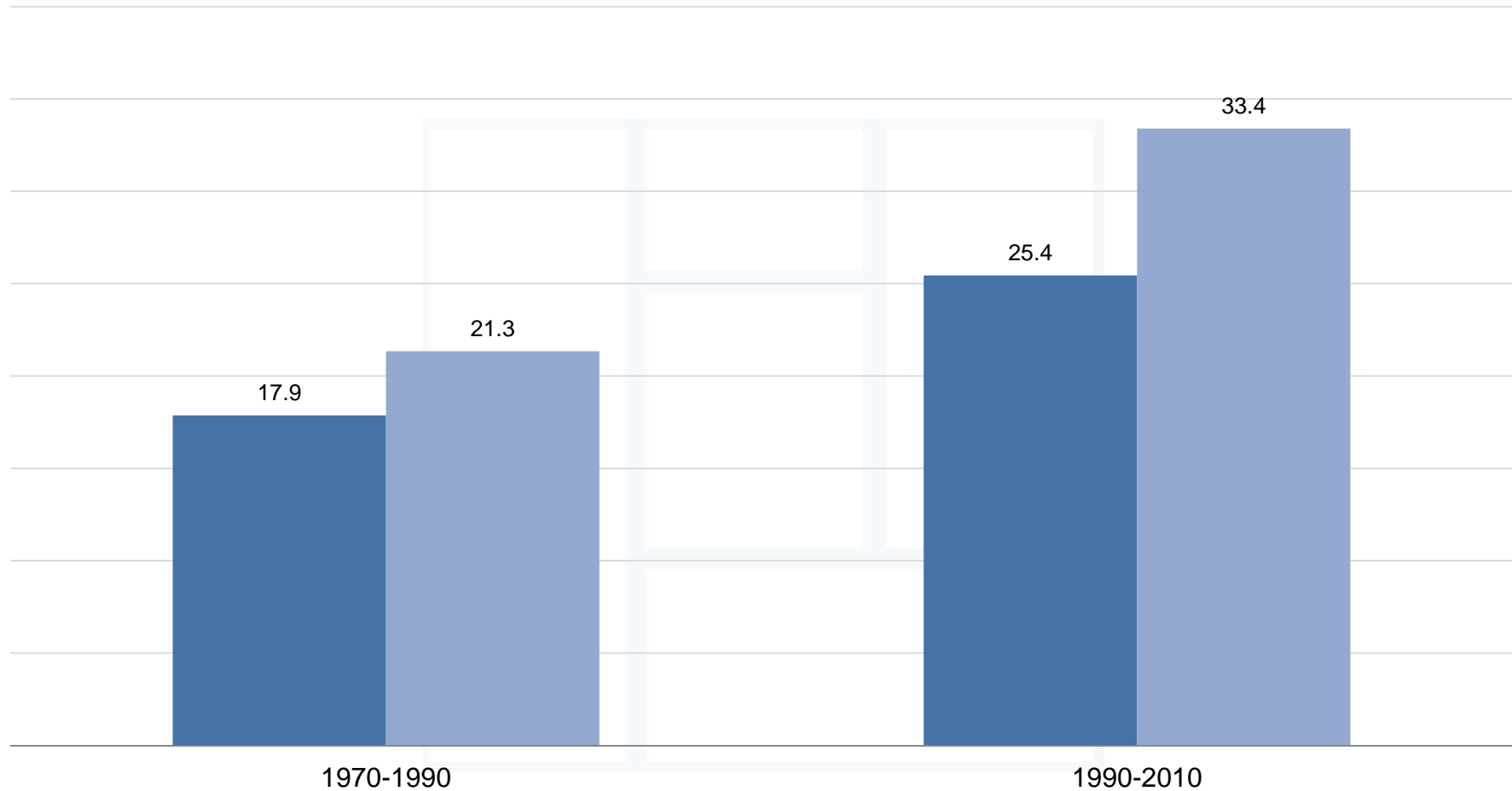
- Reform of entitlements inevitable
  - Our entitlement and private pension systems do not deal adequately with economic and demographic trends.
- Various positive forces are at play in the economy
  - Economic growth
    - Providing additional resources...though now committed poorly
  - Rise in supply and demand for older workers
- => Constructing reform around 3 goals:
  - (1) Better targeting of retirement resources to needier & older
  - (2) Removal of obstacles to employment of older workers
  - (3) Building up the second tier (private) of retirement support

# Spending on major health and retirement programs



## Health Spending as a Share of Total and per Capita GDP Growth 2005-2020 (Percent)

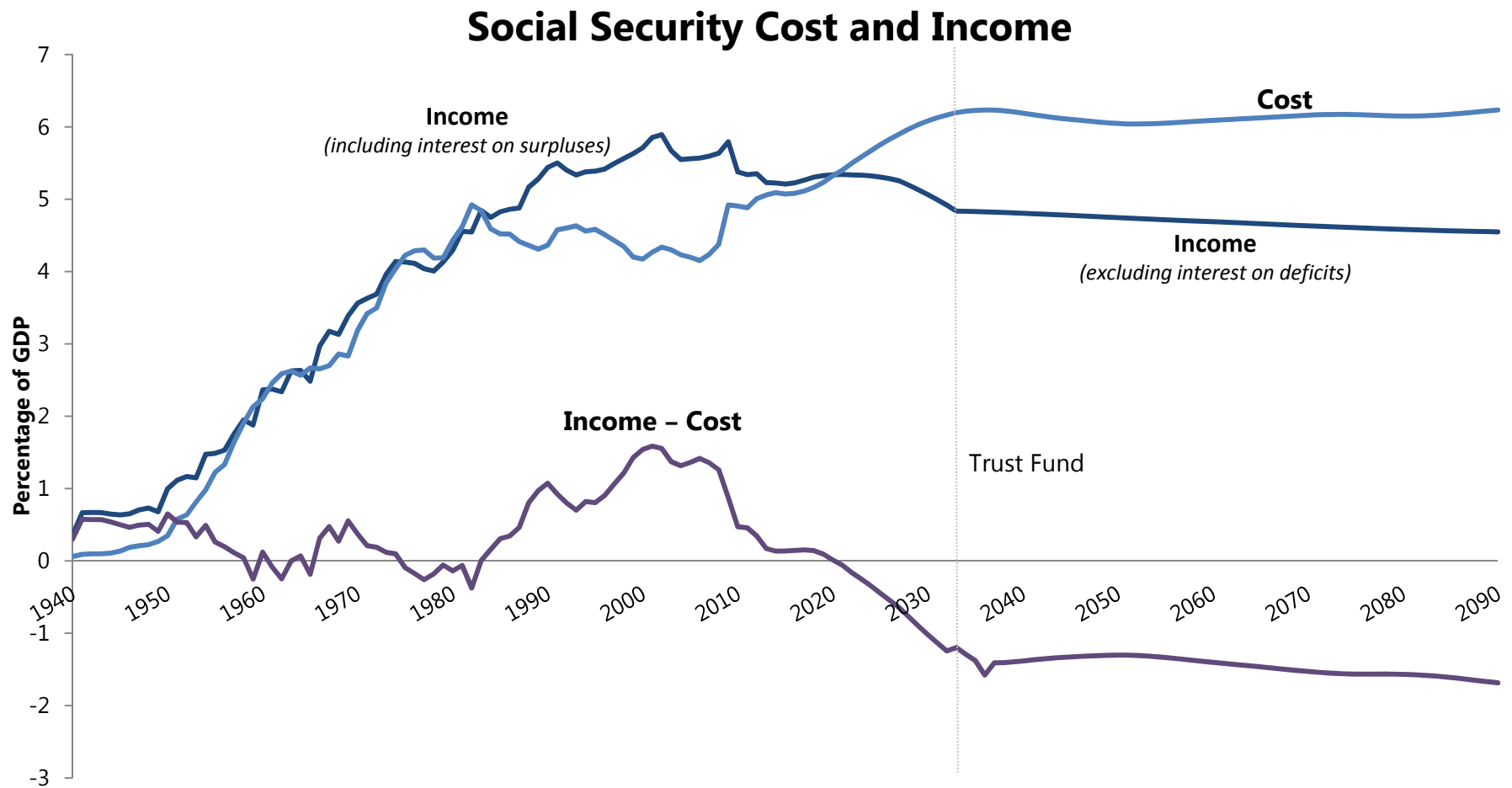
■ Total ■ Per Capita



Source: CMS National Health Expenditure data. GDP data from CBO and Federal Reserve Economic Data.



# Why Social Security Reform Is Inevitable

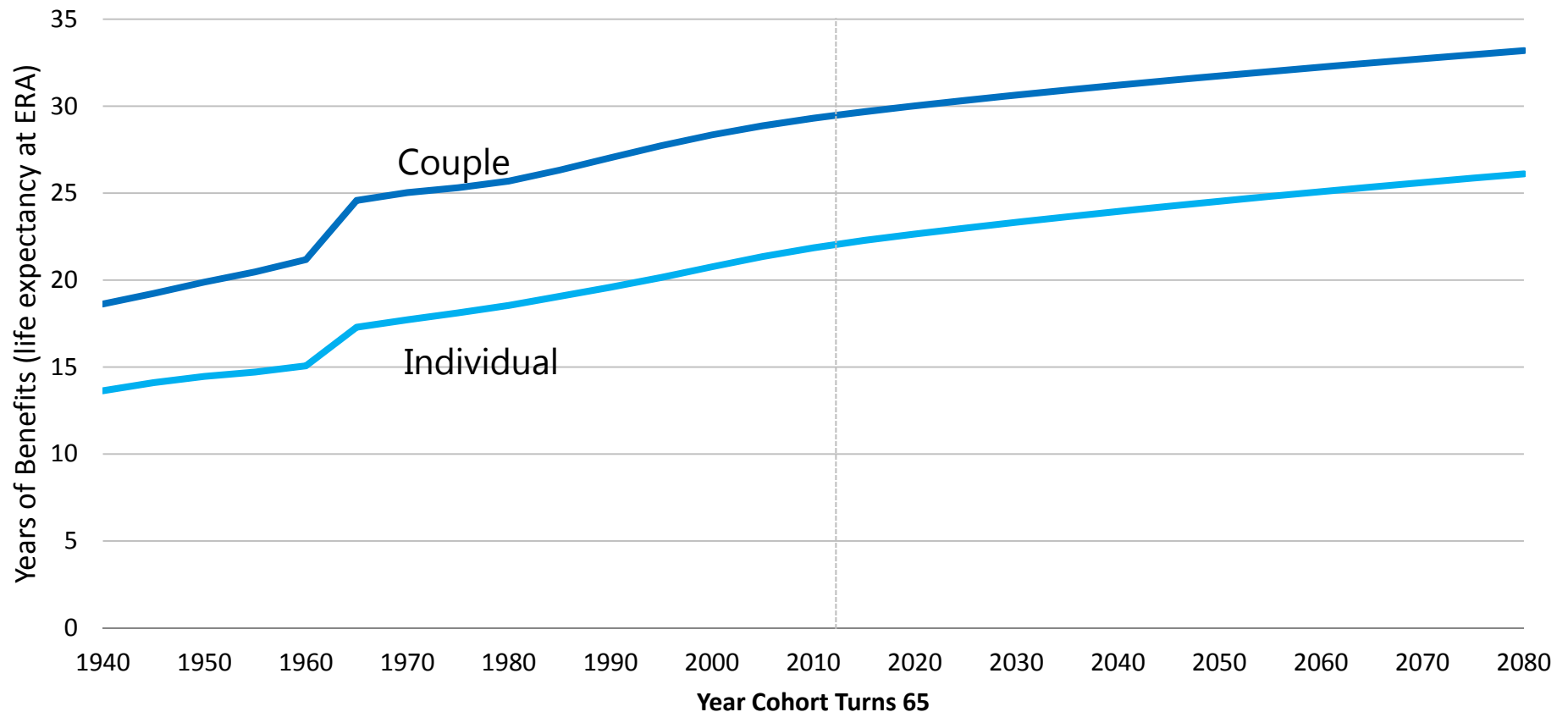


Source: 2013 OASDI Trustees' Report and Statistical Supplement. Projections assume Intermediate Cost Scenario. Yearly income only.

# A typical couple can expect to receive Social Security benefits for a decade longer than in 1940.

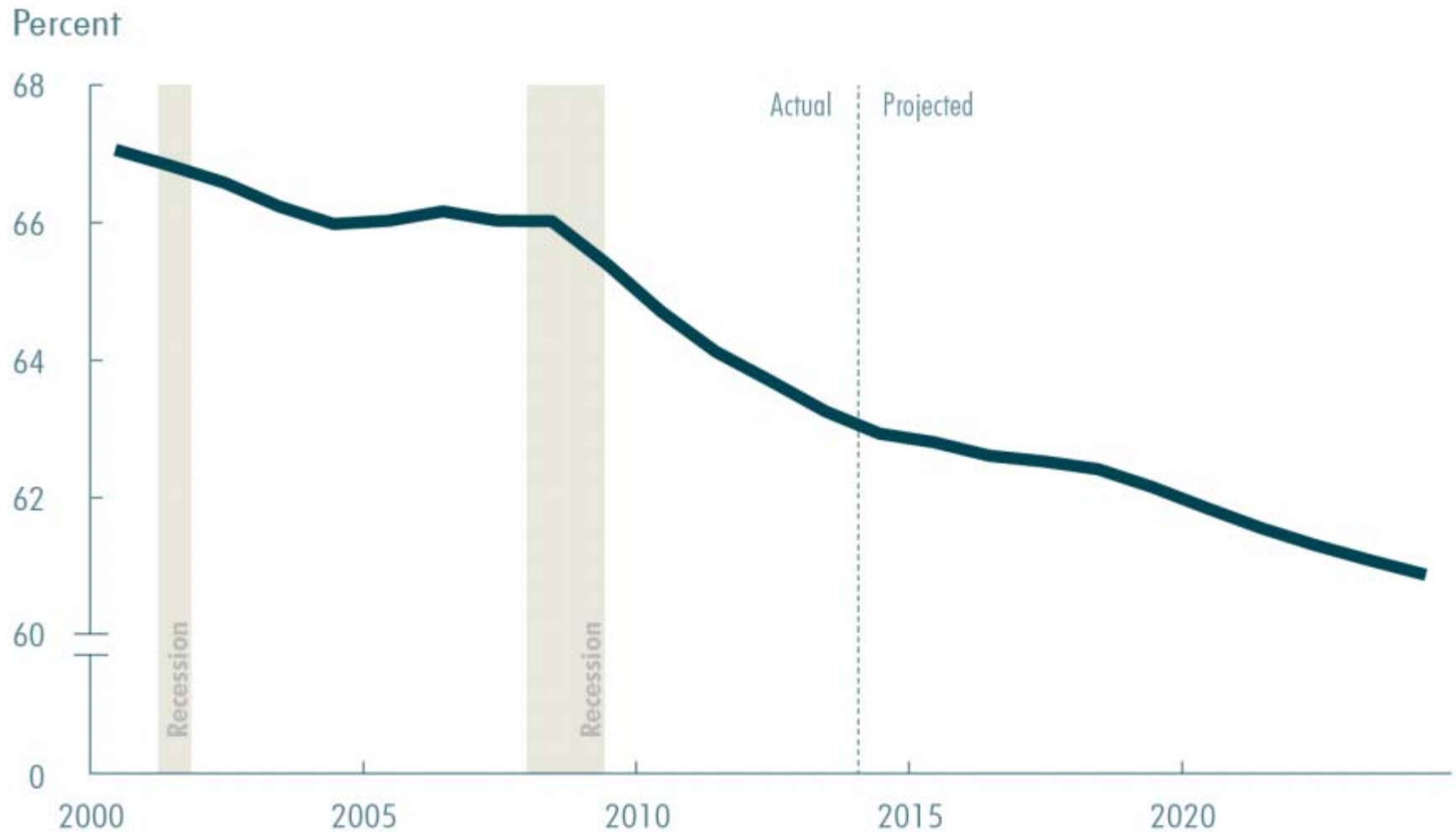
## Expected Years of Retirement Benefits, Earliest Retirement Age

Couple (at least one partner living) and Individuals



Notes: Calculations based on mortality data from the 2013 OASDI Trustees' Report . Calculations for a couple assume that at least one partner is still living. ERA was set at 62 for women in 1956 and men in 1961. C. E. Steuerle and C. Quakenbush, Urban Institute 2013.

# Labor Force Participation Rate—All Adults

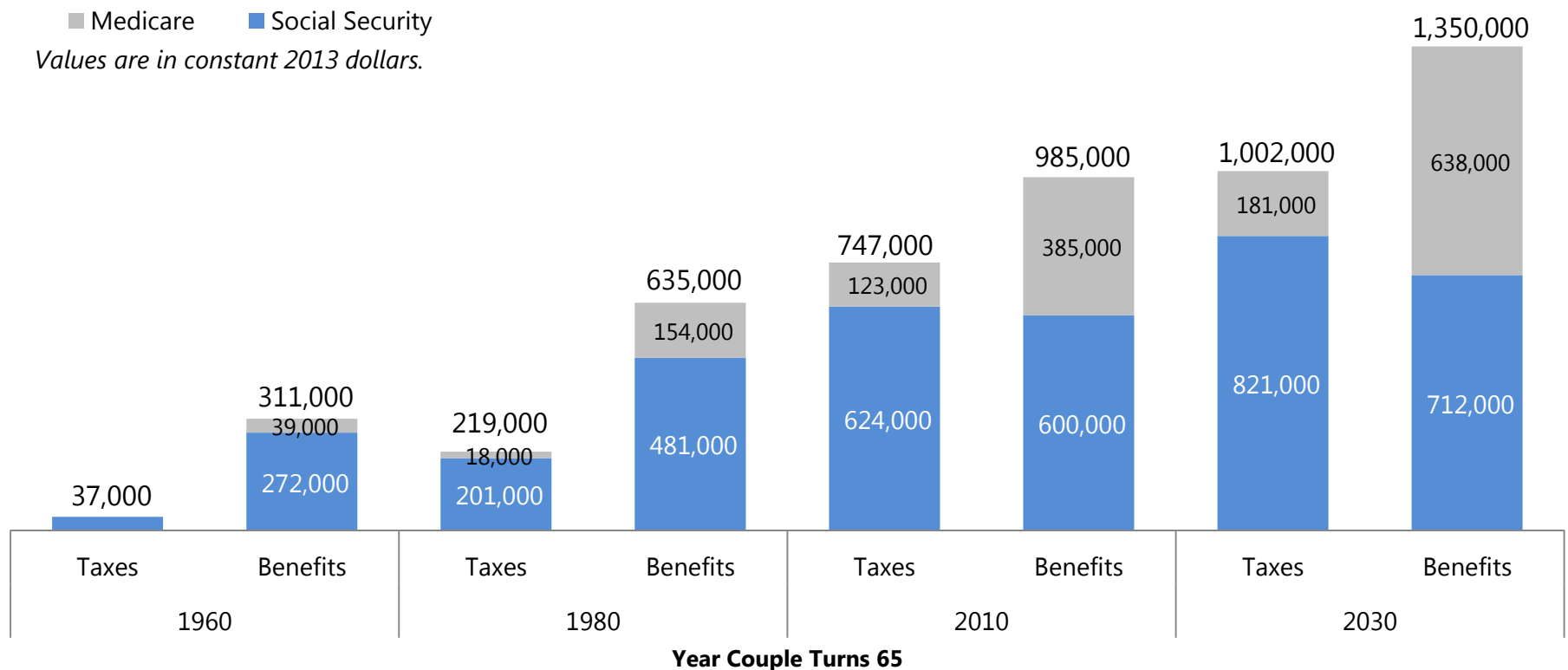


Source: Congressional Budget Office, 2014. Budget and Economic Outlook.

# Dependence Upon Social Security and Medicare

## Lifetime Social Security and Medicare Taxes and Benefits at Age 65

Married Couple Earning the Average Wage (\$44,800 each in 2013 dollars)



Source: C. E. Steuerle and C. Quakenbush, Urban Institute, 2013. Based on earlier work with Adam Carasso and Stephanie Rennane. Calculations based on data from Social Security and CMS trustees reports and supplements. Totals are expected present values at age 65 and assume a constant 2 percent real discount rate.



# No Growth in DB Assets, 2007-13

Total Financial Assets in Defined Benefit Plans, 2007 to 2013 (\$ trillions)

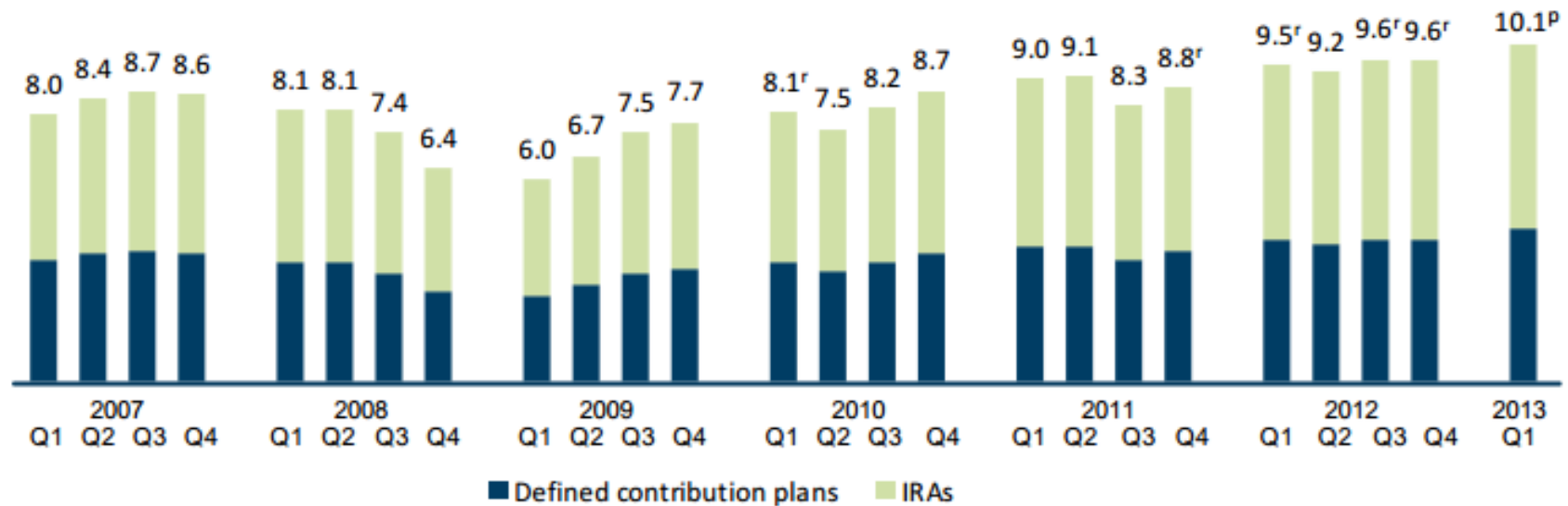


Source: Barbara A. Butrica, 2013, "Retirement Plan Assets." Calculations using the 2013 Flow of Funds Accounts of the United States and the Russell 3000 Index

Notes: The chart shows balances at the end of each quarter in current year dollars. r: revised p: preliminary

# But 25% Growth in DC Assets, 2007-13

Total Financial Assets in Retirement Accounts, 2007 to 2013 (\$ trillions)

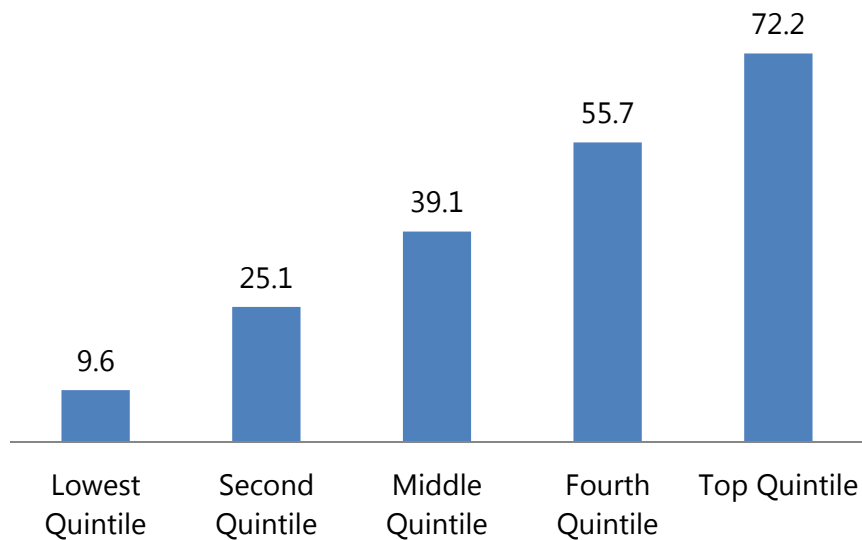


Source: Barbara A. Butrica, 2013, "Retirement Plan Assets." Calculations using the 2013 Flow of Funds Accounts of the United States and the Russell 3000 Index

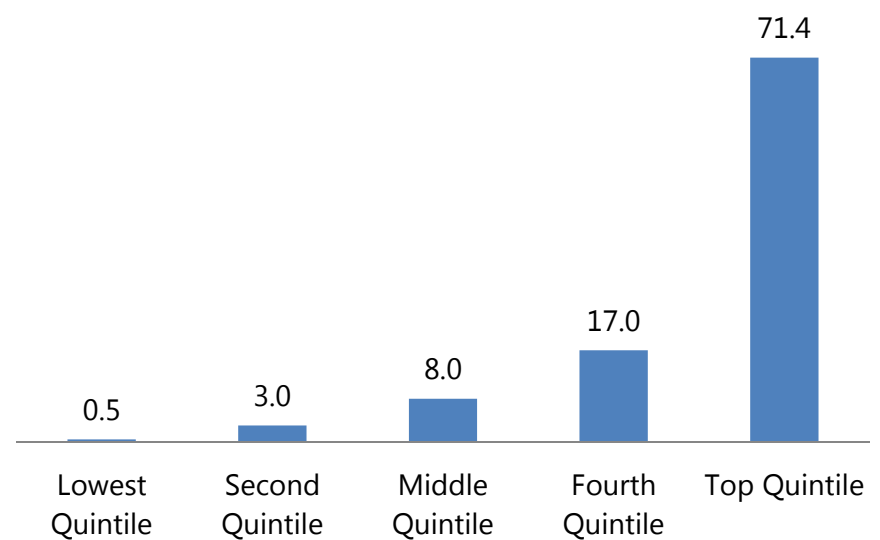
Notes: The chart shows balances at the end of each quarter in current year dollars. r: revised p: preliminary

# Distribution of Tax Expenditures for Employer-Based Retirement Plans, 2013

Percentage of tax units claiming deduction



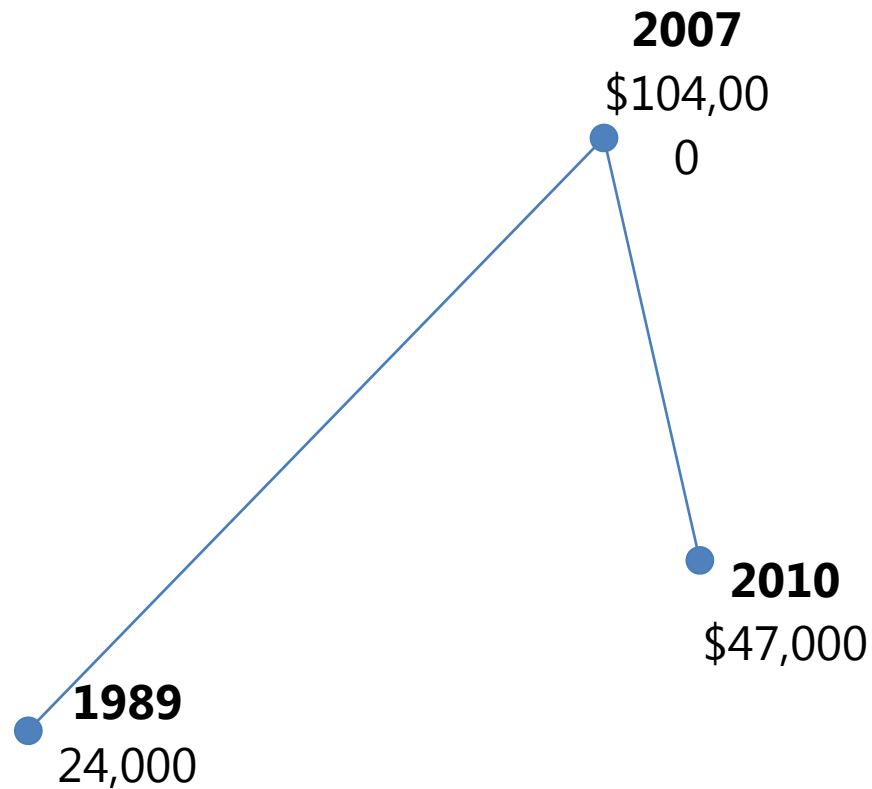
Share of total benefit



Urban-Brookings Tax Policy Center Microsimulation Model (version 0613-1e)



# Real median net worth of near-retiree households (ages 54-65)



Source: Author's calculations using Survey of Consumer Finances

# Opportunities at Hand

- Economic growth provides significant increases in incomes and revenues over time
  - Only imbalance between automatic spending growth and unwillingness to pay our bills hides opportunities
- Employment rates among those in late middle age, e.g. 65-70, are rising rapidly
  - Despite obstacles
    - Both incentives to retire
    - Inappropriate signals that we are old in late middle age

# An age of austerity? Or opportunity?

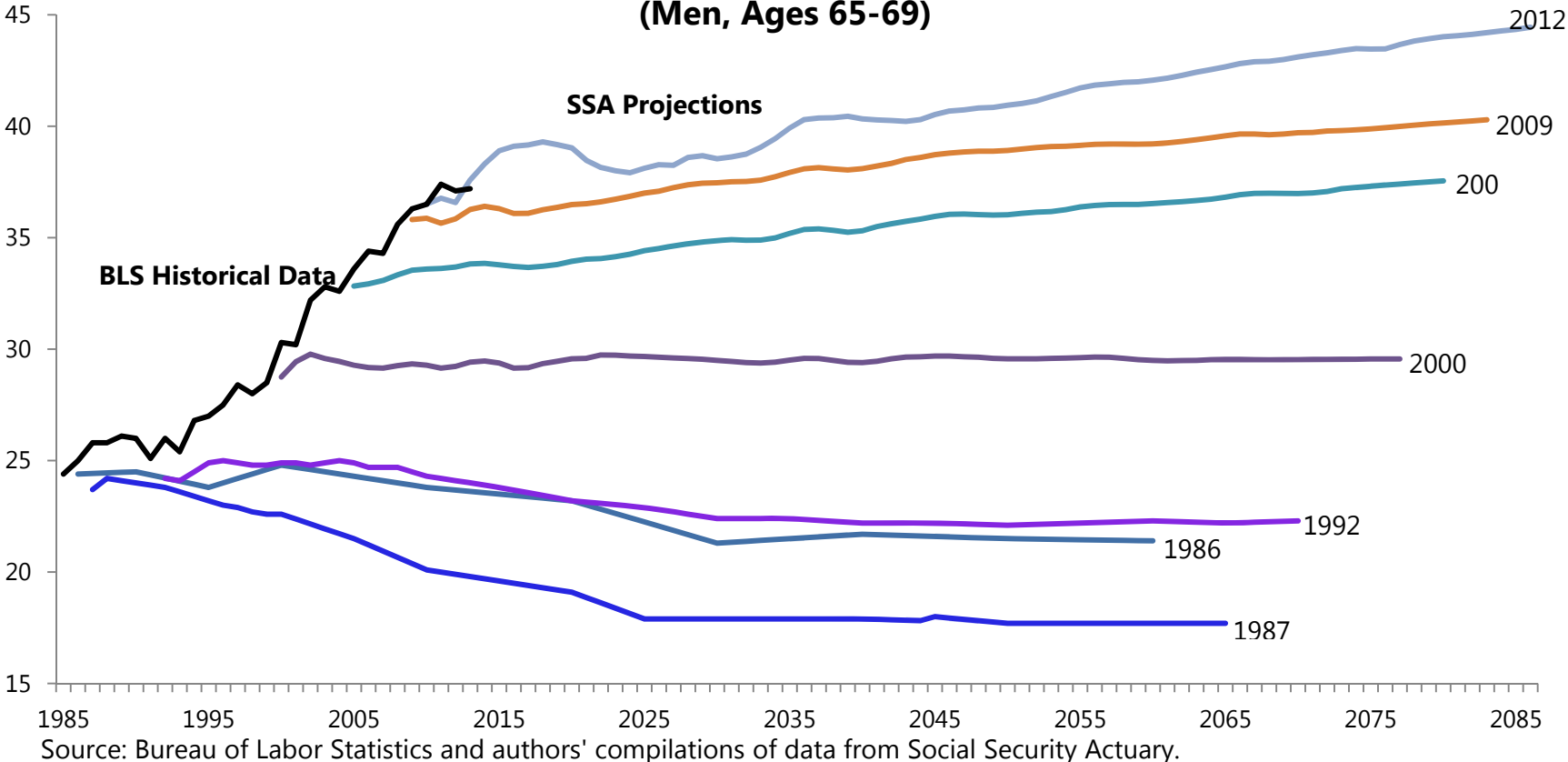
## Changes in GDP, Spending, and Taxes per Household, 2014 v. 2024 (2014 dollars)

	2014	2024	Change
<b>GDP</b>	141,000	168,000	27,000
<b>Direct Spending</b>	29,000	38,000	9,000
Discretionary	10,000	9,000	(1,000)
Mandatory	17,000	23,000	6,000
Net Interest	2,000	6,000	4,000
<b>Tax Expenditures</b>	10,000	13,000	3,000
<b>Taxes</b>	25,000	30,000	6,000
<b>Deficit</b>	5,000	8,000	3,000

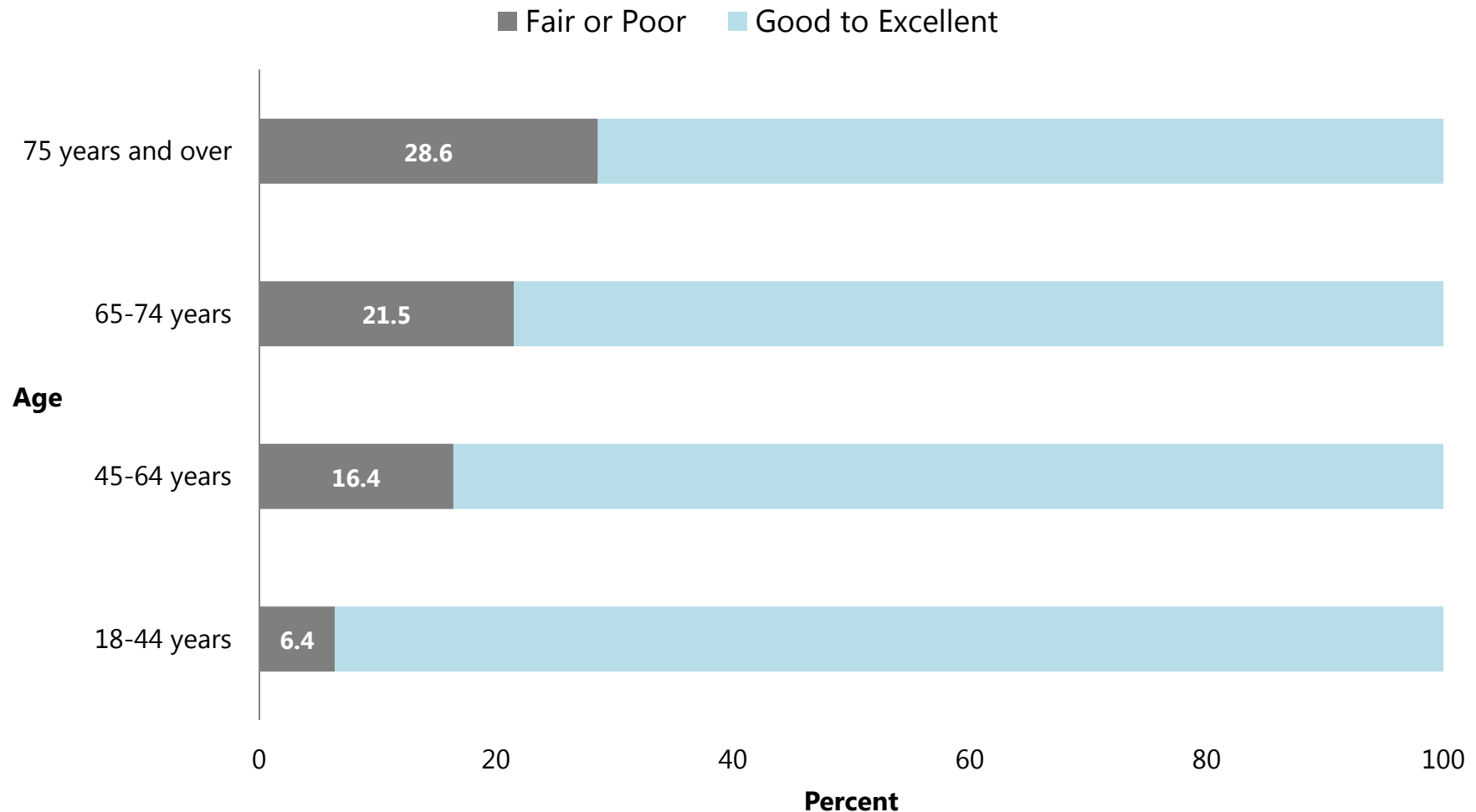
Source: Urban Institute, 2014. Estimates based on CBO, OMB, and Census projections.  
Figures rounded to the nearest \$1,000.

# Growth in Labor Force Participation Among the Elderly

**Participation Rates: Trustees' Assumptions versus Actual**  
(Men, Ages 65-69)



# Reported Health Status of Americans by Age, 2011



Source: U.S. Department of Health and Human Services, Center for Disease Control, "Summary Health Statistics for the U.S. Population: National Health Interview Survey, 2011" *Vital Health Statistics* 10(255).



## Reforms Suggested Forces at Play: (1) Orientation More to Poorer and Older

- Social Security reform can be oriented to:
  - Those with fewer resources
  - Those who are older
  - Today: every smaller shares to the old
- Vast expansion of years of benefits inures mainly to higher earners
- Income inequality grows when additional work concentrated among higher income

## Reforms Suggested Forces at Play: (2) Stop Discouraging Work at Older Ages

- Social Security discourages work by:
  - Signaling start of “old age” when one-third of an adult life remains
  - An earnings test interpreted as a tax
  - Confusion over how to buy a higher-value annuity
  - Cash replacement looking adequate in 60s but turning inadequate in 80s & 90s
- None of this is necessary regardless of overall size of the system

## Reforms Suggested Forces at Play:

### (3) Increase Adequacy of Private Retirement Assets for a Much Larger Share of the Population

- Current tax subsidies can be reshuffled
  - To favor middle-class and poor more
  - To take much greater advantage of behavior
    - Opt out
    - Retention of employer & government payments in retirement solution
    - Annuitization
    - And much more
- Moving beyond an employer-sponsored
  - Perhaps critical within small firms & workers with low wages or scattered work histories
  - Potential reform efforts already underway
- Reform best when coordinated with Social Security reform