Retirement News Highlights

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Piecemeal Reform Won't Solve the U.S. Retirement Crisis

By The Editors | Bloomberg
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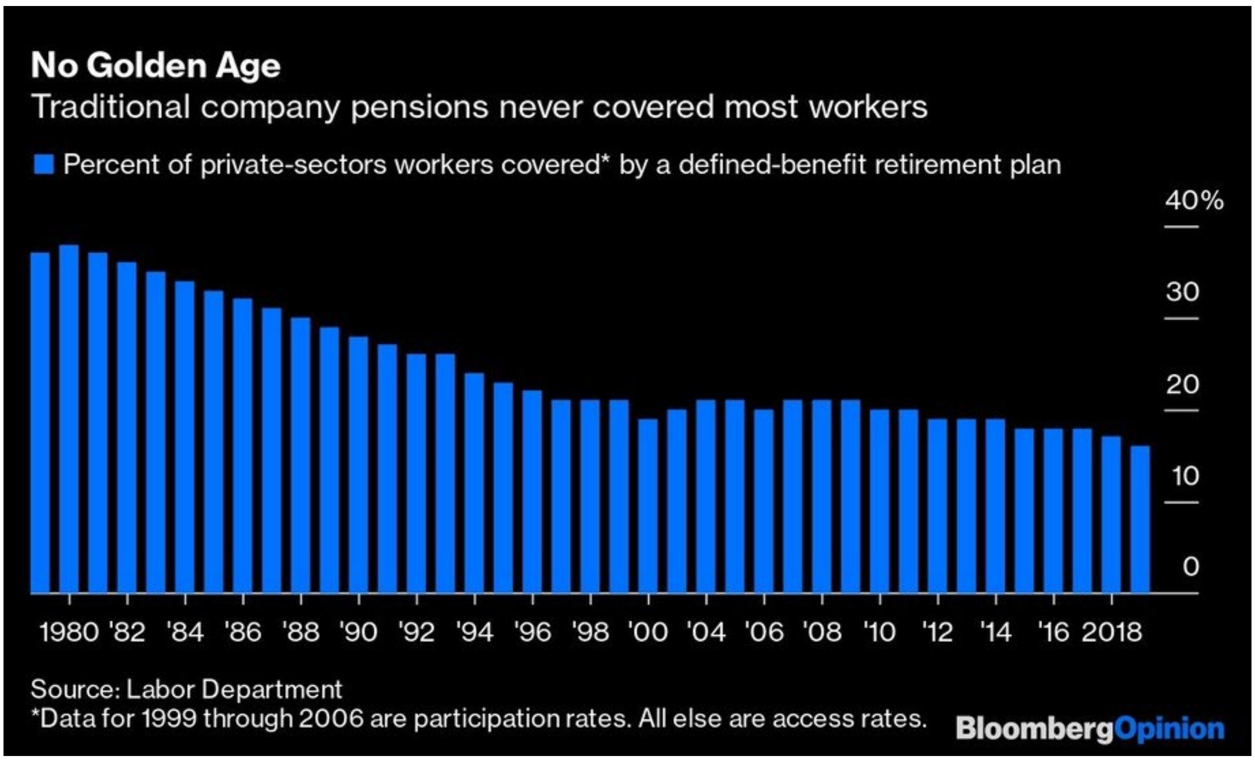
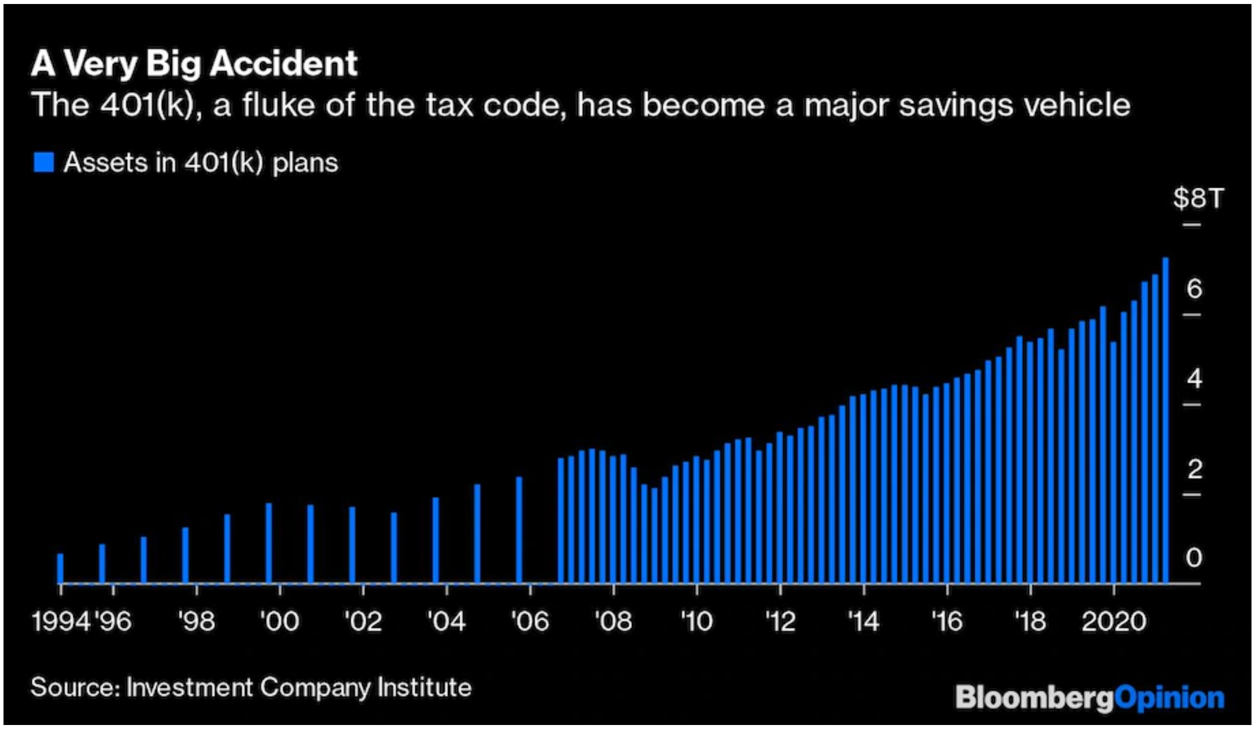


The U.S. is among the wealthiest countries in the world. Yet many Americans face the prospect of great financial strain and even poverty in old age, because they lack the resources to support themselves after they stop working.

Addressing this impending crisis will require a lot more ambition than Congress has yet demonstrated.

The U.S. has never squarely considered how best to encourage people to supplement their expected Social Security payments and set aside enough for old age. For much of the 20th century, the government left the issue mostly to employers, which offered pension benefits to long-serving workers. People today often look upon such defined-benefit plans as a sort of gold standard of retirement security, an attribute of a gentler, more benevolent time.

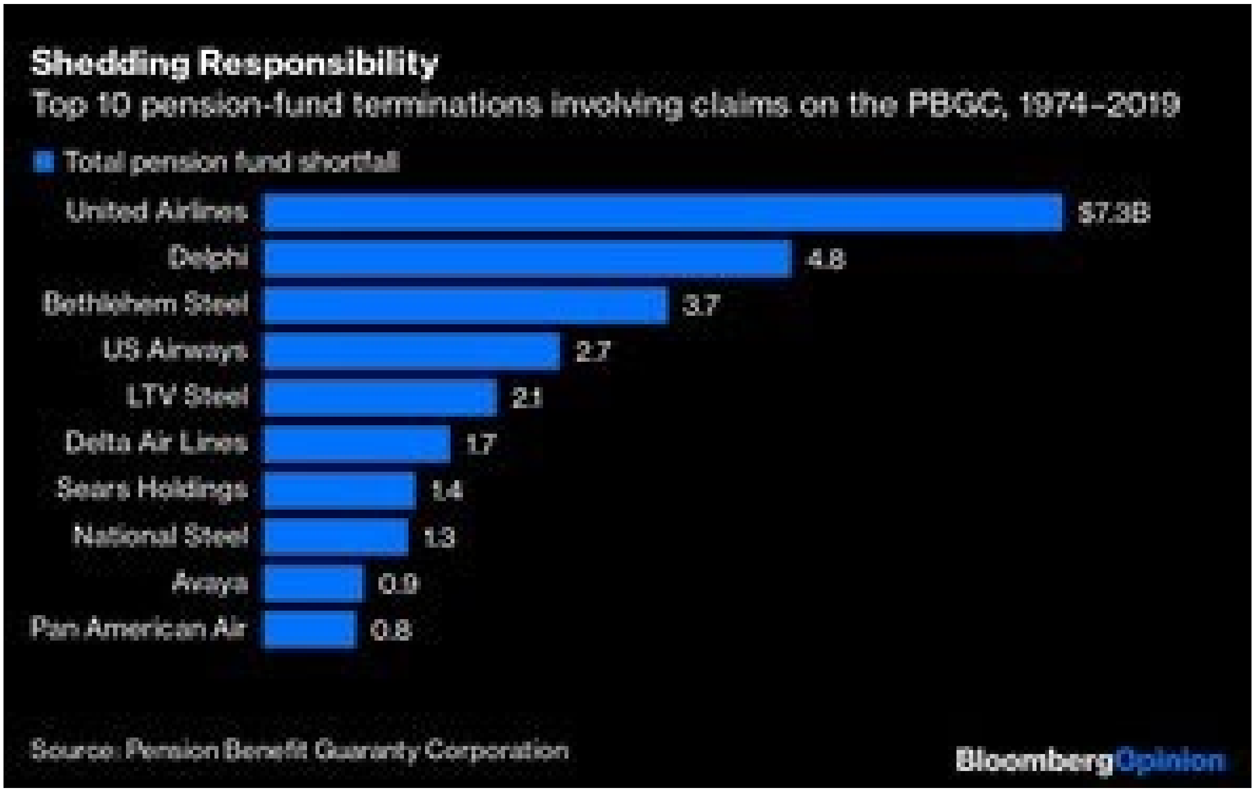
Hardly. The traditional company pension arose in part by accident: Price and wage controls, imposed to combat inflation during World War II, forced companies to compete for scarce workers by promising better retirement benefits. Such perks then became a fixture of collective bargaining agreements, and were enshrined in the 1974 Employee Retirement Income Security Act. Still, they never covered more than about two-fifths of private-sector workers.



Even for those lucky enough to be covered, relying on employers to ensure income in old age was never a great idea. People tend to live longer than businesses, and many employers are poorly equipped to manage pension finances. Since 1974, more than 140,000 companies have ended their defined-benefit plans. Thousands more have transferred distressed plans to the Pension Benefit Guaranty Corporation, a government insurer that could yet cost taxpayers dearly.

Companies needed an alternative, and in the early 1980s they found one. Again, it arose by accident. Congress had inserted language in the tax code — at line 401(k) — designed to let executives defer taxes on certain types of compensation. Benefits consultants creatively interpreted the provision to allow retirement accounts for all employees, with contributions and gains accruing tax-free until the money was withdrawn. Employers administer the plans, offer a menu of investments, and in many cases provide a matching contribution. Employees make the crucial choices about whether and how much to save — and bear all the risk of accumulating too little.

This slipshod arrangement would be fine if it worked. It doesn't. The tax break on contributions overwhelmingly favors people wealthy and sophisticated enough to derive the maximum benefit. More than a third of workers — more than 50 million people — don't even have access to a 401(k) or other so-called defined-contribution plan. Of those who do, more than a quarter don't participate. Most of the rest contribute too little and achieve poor returns, thanks to high fees and the daunting complexities of managing their own money.



Congress has complicated things further with an array of alternatives including the IRA (individual retirement account), the Roth IRA, the (not-so-simple) SIMPLE IRA, the SEP and the SARSEP, each with its own set of rules. Again, the main beneficiaries have been those equipped to game the system. Consider, for example, the “backdoor Roth,” which entails circumventing the Roth IRA’s income limitations by transferring money from other retirement accounts. Or the multi-million-dollar IRAs that some finance executives — most famously Mitt Romney — have managed to accumulate despite tiny contribution limits.

Legislators keep trying to address the flaws with tweaks, such as the SECURE Act, adopted in 2019, and a sequel now under consideration. Among other things, the initiatives seek to enroll more people automatically, cover part-time employees, nudge more small businesses to offer 401(k) plans, and encourage the inclusion of annuities designed to help retirees make their money last. Such reforms are a mixed bag. Automatic enrollment can help people save, but can also harm them if fees remain unduly high. And some U.S. insurers market unnecessarily complicated annuities that incur high costs without delivering the security they advertise. By limiting 401(k) providers’ liability for such products, Congress has made abuse troublingly easy.

This just isn’t good enough. The U.S. needs a simpler and more comprehensive approach. The essential components: universal coverage, automatic enrollment in low-cost plans, a limited menu of well-curated investments, easy portability when workers change jobs, and subsidies for the low-paid. Such a system would reduce unnecessary risks, minimize fees, maximize returns, slash red tape, and benefit businesses and the broader economy — while ensuring many more Americans can retire comfortably. The next and last editorial in this series will explain how.

More in this series:

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