Testimony by Olivia S. Mitchell[(1)]

before the Senate Special Committee on Aging

I am honored to be invited to testify before this Committee on what we can do as a nation to ensure that all Americans enjoy health and income security in retirement. I appear before you in several capacities. First, I am a professor of Insurance and Risk Management at the Wharton School of the University of Pennsylvania, with a specialization in retirement security. Second, I recently co-chaired the Technical Panel on Trends and Issues in Retirement Saving, a group established by the Social Security Advisory Council. In some of my remarks today I will be drawing on the conclusions reached in that Panel's final report (available on the internet at www.ssa.gov). Finally, I appear as a member of that most influential and rapidly aging group, the baby boom generation.

Given my background, I appreciate the opportunity to consider a range of issues pertinent to this Committee's work. I will begin by highlighting important developments in labor markets, pensions, and saving patterns of older Americans, and then I will talk about implications for the well-being of the elderly. I will conclude by touching on a few key issues that I would hope your Committee can devote attention to in the next year or two.

Work and Retirement Patterns

I begin by noting the fact that Americans are living longer and working less than at any other time in our history. Work rates among older Americans (especially men) have been falling since the 1940s. Most experts agree that this trend to early retirement coincided with expansion of retirement benefits under both social security and employer pension plans. Since the mid-1980s, the move toward early retirement has abated somewhat, but the fact remains: the average American wants to and does retire early in his or her early 60's and if possible, even younger.

Some see this trend to early retirement as a problem, one that must be stopped at all costs because of the large productivity loss sustained when older Americans drop out of the workforce. Others emphasize the cost of supporting non-employed people for two and three decades in retirement. My perspective is that there is certainly room for concern, particularly regarding the financing of the long retirement period. I will return to this in a moment.

But a long retirement period is also something that we should be proud of as a nation. The vast majority of older people today have achieved a relatively secure retirement, through their hard work and through the political process. Certainly if we compare the situation of the elderly here to that in other countries, most would agree that if you have to grow old, this is a far better place than most. And as a result, I believe there will not be any dramatic realignment of retirement ages in this country, absent major institutional change.

Why then, do so many people worry about what the economy will do when the Baby Boomers retire? Part of the concern has to do with much-publicized changes in the American labor market. The distribution of earnings and jobs is becoming bimodal, with growth concentrated among low-skilled, low-paid service occupations, and then also among high-skilled, high-paid technical and professional occupations. This pattern of job growth is reflected in the changing American income distribution, which is becoming more unequal. Offsetting this pessimistic perspective is the fact that most of those who exited the middle class over the last decade did so by moving up, not down. Nevertheless, job market worries translate into concern that baby boomers might not save as much as their parents did toward their retirement, if the job market fails to provide them economic returns in keeping with what they expected.

Another reason analysts are concerned about the prospects of Baby Boomers in retirement has to do with developments in the employer pension arena. About half the civilian labor force is now participating in a company pension, and going forward, it appears that coverage will not rise much more, barring some major change in incentives. One part of the story is that employers are backing off from offering defined benefit pension plans, mainly due to costs of administering them. Another critical issue is that even when workers with no plan are offered a pension, many of them turn it down. This is surely shortsighted and risky behavior. The one place that there has been pension growth is, of course, in individually-directed defined contribution (401(k) pensions offering faster vesting, elective contributions, and participant-directed investments. Yet here too there is concern, since contribution rates are not as high as they could be, and people may not be making the most sensible decisions about how to invest their money. Nonetheless, the bright spot in retirement saving is surely the 401(k) market, and I suspect this will continue in the short to medium run, barring a sudden turnaround in stock market performance.

The Economic Status of Older Americans

Where this leads us is, of course, to ask what these developments portend for the currently retired generation of Americans, as well as those on the verge of retirement? As I've said, it's far better to be old today than 30 years ago, and much of the credit for this improvement goes to federal programs especially social security and to the growth of employer based pensions. Around these encouraging averages, however, there remain groups vulnerable to economic distress, with poverty a larger concern for the very old, those living alone, older women, and particularly Black and Hispanic women. The financial costs associated with long-term care remain a major economic risk, even for middle- and upper-middle income Americans.

Looking ahead, what can we predict regarding how well today's workers will do in retirement? An initial set of lessons have recently become available from a new longitudinal data set known as the Health and Retirement Study. This is a large survey of almost 12,000 Americans age 51-61 in 1992 and their spouses, funded by the National Institute on Aging with support from the Social Security Administration, the US Department of Labor, and several other agencies. This nationally representative survey of older Americans shows that people on the verge of retirement today have saved much less than they need to be comfortable in retirement.

To be specific, James Moore at the Wharton School and I have found that the median household in its mid 50's falls far short of target retirement saving. Indeed, our projections show that the typical couple will need to save one quarter of its annual income over almost the next decade, to be able to maintain desired consumption levels in retirement. And this shortfall could be even worse, since life expectancy may increase even faster than we think in the future. Turning it around, if older Americans today do not save dramatically more, the research suggests that the median older household today has only enough liquid financial wealth to generate $5,500 per year in retirement, not counting their house or retirement pensions. Unfortunately adding housing values only boosts the annual income to $10,000 per household, and even after adding pensions, the total comes to only $15,000 per year. While this amount is more than the poverty line, it is not enough to guarantee economic security for the golden years and this is the situation the median household is likely to find itself in. This means that half of the older population will find itself below this level as it moves into retirement. Indeed, the shortfall is serious.

Social Security Options:

These facts highlight a point that you are, no doubt, well aware of that a key determinant of older American's future wellbeing will be what happens to the social security and pension systems. Given this assessment, what could this Committee do to help Americans confront a wider range of options that they can use to help them plan for, and live with, a healthy, well-financed retirement period?

While I do not want to speak to specific reform proposals to change social security benefits, taxes, and/or privatization options, I did want to share with you several concerns my Panel had about potential reforms. We were in agreement that there appeared to be few, if any, changes in the US economy already under way that would offset the effects of potential social security benefit cuts on the future economic well-being of the elderly. Because of this, far more substantial adjustments than are currently in place will be necessary to compensate for significant decreases in social security benefits.

Social security must be changed to achieve solvency, so it is critical that significant changes in social security benefits be announced soon with sufficient lead time for workers to adjust their savings, consumption and retirement plans. To achieve this, it is important to legislate changes promptly and allow some delay in implementation to help people plan for the future. The desirability of delayed implementation only increases the urgency of prompt legislation.

If payroll tax increases and/or benefit reductions are required to bring social security into solvency, they should be phased-in over time, rather than implemented abruptly. Gradual implementation reduces the magnitudes of notches (different treatment of cohorts close in age) and the perception of unfairness that notches engender.

The nation would benefit from more frequent discussions about retirement income policy at the national level. I believe that it would be helpful to open up the debate by having the Social Security Administration make available to the research and policy community the actuarial and economic models it uses for forecasting and analysis. Computer programs, documentation, and data should be more widely available, and analysts outside the Department should be able to evaluate forecasts and simulate alternative policy scenarios. In addition, to better predict strategies for successful aging, it is essential to support continued data collection and analysis of the Health and Retirement Study. Congressional understanding and sponsorship of these efforts is therefore essential, and your Committee support will be important.

Other Options to Consider:

Regardless of how the nation proceeds in reforming social security, there are several other areas to begin focusing on. These can, I believe, be important in strengthening the other legs of the three-legged stool of retirement income security.

As people spend longer and longer in retirement, it becomes essential to recognize that people need to invest throughout their entire lifetimes to survive retirement. Your Committee can do a great service by integrating this perspective throughout every policy decision made.

The financial issues are clearest: more saving is needed, as demonstrated above. In addition we must also think about other investments to carry us through the long term. These include investments in our health (prevention and exercise in middle age are key), in our intellectual abilities (ongoing education and training are essential for successful retirement), in our families (strong families supporting the young may translate into care for the old later on), and in our communities (involvement at all ages builds social support networks).

Delaying retirement appears to be the least disruptive way for most older Americans to improve their prospects for old age. For some, poor health late in life could make this adjustment difficult or impossible. The critical task is to make delayed retirement more appealing, while taking due account of those who cannot work. Your Committee could explore what policy tools could make continued work at older ages a reality.

We need to do more to build a national saving for retirement program. Improved access to and higher caps on tax-qualified retirement plans would help (401(k)s and IRAs for example). It would also be useful to limit people's access to the retirement assets while they are still young. It is also critical to do more to educate people on their likely needs in retirement, and the methods of meeting these needs. Employer match rates implemented in pension plans also provide incentives for people to save, and workers seem to respond in sensible ways. More should be done to involve people in their retirement investment process, earlier, and more often.

Your Committee could launch a thorough review and simplification of the tax rules under which employer pension plans operate. There needs to be more coordination between the ages the IRS uses in the tax code and the SSA uses in social security regulations. There could be more coordination of different benefit levels for different types of defined-contribution vehicles. Some support the idea of having streamlined regulations that companies can follow when establishing a tax-qualified defined-benefit or defined-contribution plan. A system of uniform, coherent, and less frequently changed regulations would do a great deal to help people make retirement savings decisions in a predictable environment.

Very low levels of private and aggregate national saving are a matter of substantial national concern. As I have shown, the average American family reaches retirement age with little personal savings beyond equity in a home. Unfortunately, few policies short of mandates are available to induce a significant change in American savings habits.

Conclusion

In closing, I would reiterate that retirement has become an attractive and successful stage in the life cycle for millions of Americans. Pensions and social security have been instrumental in this process. However saving shortfalls confront those on the verge of retirement, as well as the baby boomers next in line.

It is important to begin handling these shortfalls soon. Indeed, the earlier the necessary adjustments are legislated, the better, because early notification of impending changes gives people time to adjust their savings and retirement plans accordingly. Return social security's fiscal house to order is high priority, as is repairing the nation's system of saving via pension and other vehicles.

I commend the Committee for its interest in and concern about retirement issues and thank you for your attention.

1. [1] Mitchell is International Foundation of Employee Benefit Plans Professor of Insurance & Risk Management, The Wharton School, University of Pennsylvania, and Executive Director of the Pension Research Council**.** All opinions are solely those of the author and not those of any institutions with which she may be affiliated.