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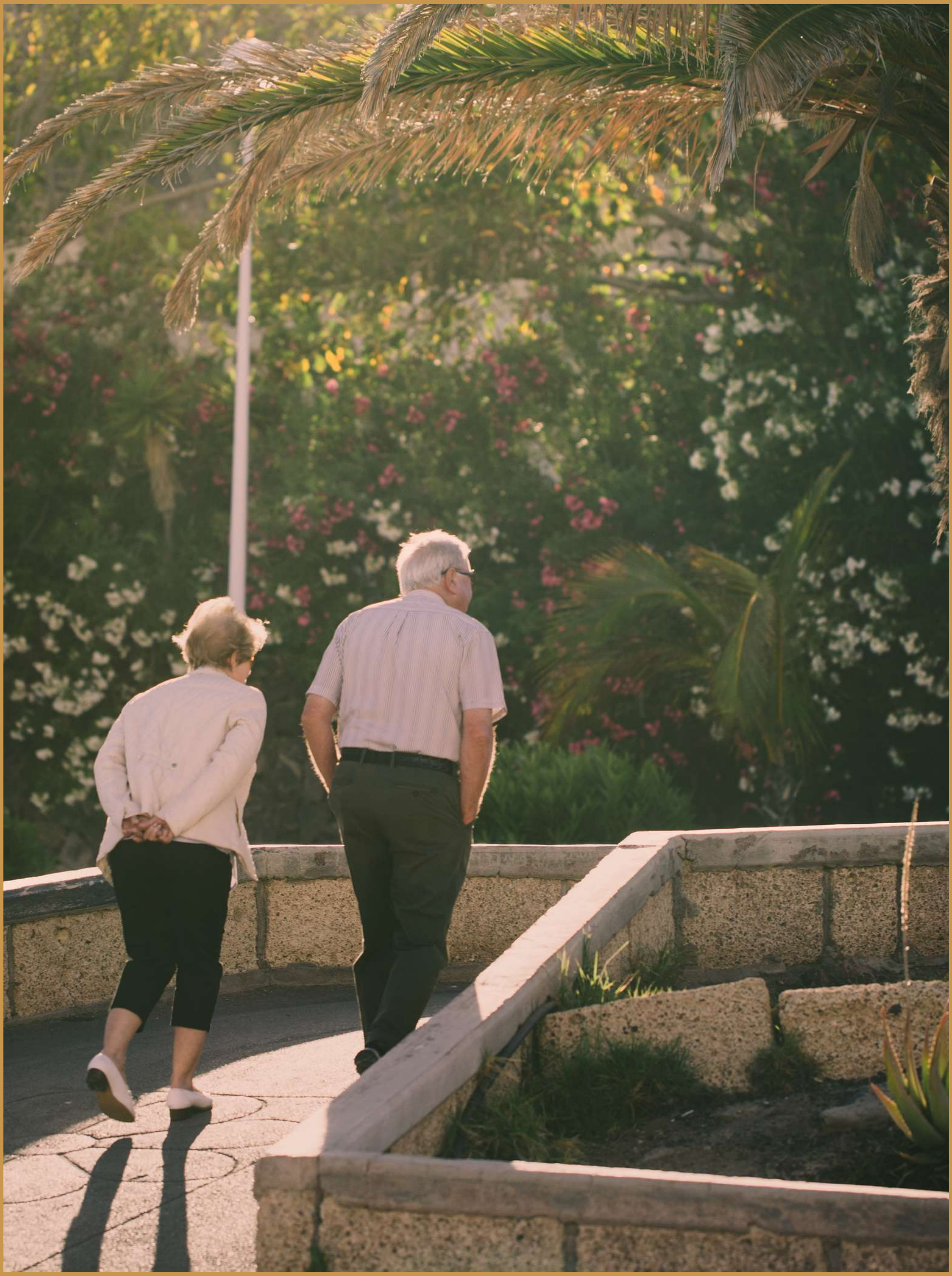

Policy Paper

October 2020

Beyond Social Security
Toward Real Retirement Secuity

BEYOND SOCIAL SECURITY

AND TOWARD REAL RETIREMENT SECURITY

October 2020

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ABOUT THE NEW CENTER

American politics is broken, with the far left and far right making it increasingly impossible to govern. This will not change until a vibrant center emerges with an agenda that appeals to the vast majority of the American people. This is the mission of The New Center, which aims to establish the ideas and the community to create a powerful political center in today's America.

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EXECUTIVE SUMMARY

When the Social Security Act of 1935 was signed into law by President Franklin D. Roosevelt, only six percent of Americans were over the age of 65, meaning only 7.8 million people were old enough to receive benefits from the new program. Today, 16% of Americans are over 65, meaning 54 million Americans are eligible to collect benefits, seven times as many as when the program began.

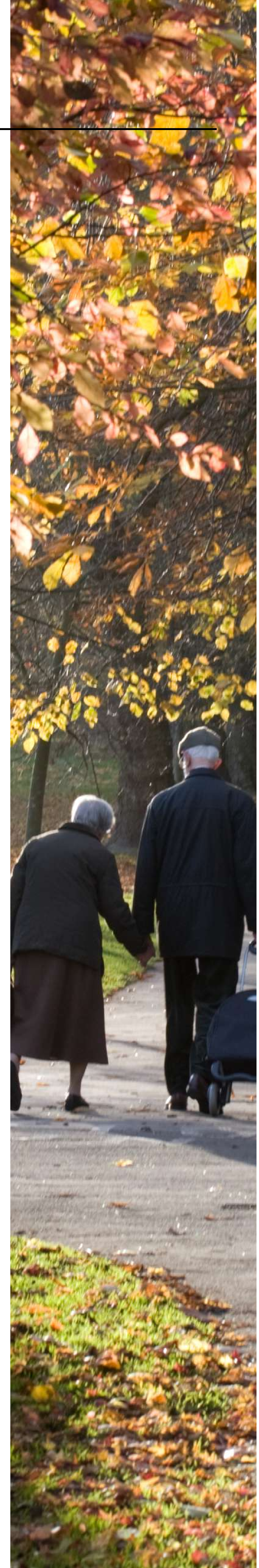
Social Security was designed as a program to keep the elderly out of poverty, and it has proven to be one of the most successful and wildly popular government programs ever created. If not for Social Security, 37.8% of elderly Americans would be living below the federal poverty line today (compared to the less than one in ten Americans who actually do). The program has broad bipartisan support, as 96% of Americans say Social Security is an important government program, according to a 2019 AARP poll.

"There is no tragedy in growing old, but there is tragedy in growing old without means of support... I hope that in time we may be able to provide security for the aged—a sound and a uniform system which will provide true security."—Franklin D. Roosevelt

However, Social Security was never designed to be the main source of retirement income for most Americans. But that is exactly what it is for tens of millions of Americans today, even though program itself will face funding shortfalls in the near future. In 2017, roughly half of all retirees relied on Social Security as their primary source of retirement income. The average Social Security retirement benefit in June 2020 was about $1,514 a month, an amount that many Americans would struggle to live on without outside income sources.

Today, only half of all Americans are offered any form of retirement savings plan through their employer. And although the S&P 500 has more than quadrupled since the depths of the Great Recession in 2008, only 55% of Americans hold any stock. In 2017, the median retirement savings for Americans between ages 55 and 64 was just $107,000, which translates to a $310 monthly payment if it was invested in an inflation-protected annuity upon retirement. More than 20% of Americans above the age of 55 have no retirement savings at all. Even if Social Security benefits are expanded at some point in the future, they almost certainly won't be enough to be the only source of retirement income for most people.

The New Center surveys creative solutions from policymakers, thought leaders, and research institutions on how to provide more Americans with a secure retirement.



A BROKEN THREE-LEGGED STOOL

The “three-legged stool” was the basis for individual financial planning in the post-World War II era. It described the three sources of retirement income—Social Security, employee pensions, and personal savings—that together could provide a comfortable retirement for most workers. But today, this three-legged stool is looking very wobbly.

1 PENSIONS

For most young private sector employees, the pension leg has disappeared entirely. A 2017 study by Willis Towers Watson found that while 51% of workers at Fortune 500 companies were actively accruing pension benefits, only 16% of newly hired workers were offered any form of a defined benefits plan.

Fifty-nine percent of newly hired workers were offered pensions in 1998, and most employees with pensions today were offered the plans decades ago. Starting in the 1980s, employers began to phase out pensions in favor of 401(k) plans that allow workers to save and invest for their own retirement on a tax-deferred basis. Today, just 51% of all private sector workers are actively participating in a retirement plan, either in the form of a traditional pension or employer-sponsored investment plans like 401(k)s. Only 68% of all private workers even have access to any form of retirement plan.

2 PRIVATE SAVINGS

Nearly half of working-age families have nothing saved in retirement accounts, and the median working-age family has only $5,000 in a retirement account. Meanwhile, families in the 90th percentile of annual income had $274,000 saved, and families in the top one percent of annual income had $1,080,000 or more. The large gap between mean (average) retirement savings ($95,776) and median retirement savings ($5,000) indicates that the families with the most savings are driving up the average for all families.

In addition, many children will enter college or the workforce without exposure to financial planning. Only five states—Alabama, Missouri, Tennessee, Utah, and Virginia—require students to take a personal finance course in high school. According to a 2014 Standard & Poor survey, 43% of adult Americans are not “financially literate,” a measure of the number of people who could correctly answer questions about five multiple-choice questions about risk diversification, inflation, interest, and compound interest.

For those close to or already in retirement, their income outlook just took a significant hit from the COVID-19 pandemic that could last for years. Near or current retirees typically shift more of their assets into less risky assets like bonds, certificates of deposit, and money market accounts. But yields on all these vehicles are tied to the Federal Reserve’s Funds rate, which is sitting at between 0%-2.5% as of September 2020. In its latest forecast, the Fed suggests its interest rate benchmark is likely to remain near zero through at least 2023.

3 SOCIAL SECURITY

A 2018 survey from the Nationwide Retirement Institute, conducted online by The Harris Poll, found that 55% of retirees and those within ten years of retirement say that Social Security will be their main source of retirement income, followed by 18% of older adults relying on their pension. Despite more than half of Americans leaning on this leg of the stool, Social Security was never intended to be the main source of income.

The program is now facing significant financial strain to support an American public that is living longer. The so-called “Baby Boomer generation,” born in the Post-WWII era from 1946 to 1964, is currently in or approaching retirement, while post-2000s birth rates are slowing. As a result, there are fewer workers available to support retirees.

Though projections for Social Security sustainability are always changing as a result of shifting fiscal policies, a 2020 annual report from the Social Security Board of Trustees expects Social Security benefits to be depleted by 2035. At this rate, 50-year-olds today would not have access to the current level of benefits, despite paying into the program their entire working life.

Even if Social Security’s finances are shored up in the near future—and there are several proposals in Congress to do it—the program still will not be equipped to meet the full retirement needs of most Americans.

INNOVATIVE IDEAS TO PROMOTE RETIREMENT SECURITY

The scale of America's gathering retirement challenge demands some creative thinking—and fast—on how to create a new framework for retirement security in the 21st century. Here are some of the most innovative policy ideas that merit more discussion among policymakers in DC.

1 INCREASE FINANCIAL LITERACY ACROSS AGE GROUPS

One-third of millennials—those born between the early 1980s and the mid-1990s—report being "very unsatisfied" with their financial situation. And it's no wonder young people are struggling to manage their financial situation when only 24% can demonstrate basic financial knowledge when tested. But financial illiteracy exists across all age groups. Only one in five Americans, when given a choice of answers, could correctly identify the way Social Security benefits are calculated.

While the Social Security Administration routinely mails "statements" explaining basic concepts, like how benefits are affected by the age you retire, these documents can still be difficult to interpret for those with little exposure to the basics of retirement.

- The Bipartisan Policy Center, through its Commission on Retirement Security and Personal Savings, recommends "incorporating personal finance as a regular part of the country's basic education curriculum. Coursework should start in K-12 schools, possibly as part of the Common Core State Standards Initiative. In addition, we encourage institutions of higher education to adopt more-comprehensive financial-capability coursework requirements. Graduation could be dependent upon either passing a course or a financial capability test."

- The Bipartisan Policy Center also recommends clear communication about retirement from the Social Security Administration to increase financial literacy among current and future beneficiaries: "One way to achieve this is by redesigning the Social Security statement to stress the higher monthly benefits that come from both continuing to work and claiming benefits later. For example, SSA could leverage behavioral insights by emphasizing in the statement how much workers stand to gain in benefits if they continue to work for steady earnings and claim at the full retirement age rather than at age 62, or at age 70 instead of at the full retirement age. Seeing this comparison in their SSA statement many times over their career could help workers incorporate the information into their retirement planning before they make the decision to claim."

2 UNIVERSAL INVESTMENT ACCOUNTS FOR ALL AMERICANS

Inequality in the U.S. is among the highest in the world, and it is generational, meaning it begins and continues well after a child is born. Leaders from both the private and public sectors have offered versions of a plan to endow every American, sometimes from the age of birth, with a portable investment account:

- Hedge fund manager Bill Ackman has suggested the federal government fund an investment account for every child born in America. Under Ackman's plan, each child born in the U.S. would receive $6,750 to be invested in a basket of index funds that could only be tapped at retirement. Assuming eight percent returns (the historic returns for a traditional 60/40 stock/bond portfolio) over 65 years from birth to retirement, the total would ultimately exceed $1 million, and it would cost the government about $26 billion a year, if the birth rate holds. For around the same amount that Washington spends every year on an array of subsidies for farm businesses, we could set up a secure retirement for every new child in America.

- Senator Cory Booker (D-NJ) has suggested endowing every child with $1,000 at birth, a so-called "baby bond," that would allow for additional deposits based on family income. The government would provide the initial money and invest it in Treasuries or equity funds. The account would be untouchable before the age of 18, at which point a child could use it for a "milestone event," such as paying college tuition or putting a down payment on a home. This would mitigate some of the major sources of debt for young people, allowing them to save more for retirement in their early years.

- Ric and Jean Edelman, husband-wife duo and founders of Edelman Financial Services, have suggested the "Tomorrow's Retirement for the U.S. Today (TRUST) Fund For America" plan. It's similar to the ideas of Ackman and Booker—except it envisions the replacement of Social Security entirely. The idea is that each child will be given $7,500 at birth through an account managed by the federal government. The money is put in a new type of low-risk savings bond issued by the Treasury Department. Newly issued bonds would cost roughly $29 billion a year, assuming about 4 million babies are born. To put this in perspective, the federal government spent almost $910 billion on Social Security benefits in 2016. At age 70, the account would begin generating monthly income to be, on average, equivalent to Social Security benefits.

- Professor John Friedman of Brown University has proposed replacing all tax-advantaged retirement savings accounts (e.g., 401(k)s) with a single, portable Universal Retirement Saving Account for each worker. Workers could take this plan between jobs easily. The plan would also provide a tax credit to employers that automatically enroll their workers in a plan where the worker contributes three percent of their income into retirement savings, which automatically increases each year until it reaches eight percent. Employees could opt out of auto-enrollment and auto-escalation.

3 TAMING LIVING EXPENSES

Housing and healthcare are simply too expensive for most Americans. Rent costs 31.1% of a person's income on average, the second highest among economically advanced countries, with young workers being especially cost burdened. In 2018, the average consumer spent $4,968 on healthcare, with one in four people having to forgo medical care due to high costs. It's no wonder, then, that so many people don't have the funds to effectively save for retirement. No single solution can solve the affordable housing and healthcare crisis overnight, but there are creative solutions that can serve as a jumping off point:

- According to The New Center's August 2020 paper on solutions to increasing housing affordability, "the enactment of policies that increase housing supply and the repeal of those proven to do the opposite are crucial first steps. No two housing markets are exactly alike, so localities must evaluate the consequences of each option and determine the specifics carefully." Our paper explains how the fundamental problem with housing is that the supply is being depressed by local zoning mandates. Local zoning regulations explicitly limit housing density by permitting some types of residential development but not others. Seventy five percent of all residential land in most cities is zoned exclusively for single-family development at the expense of more efficient multifamily housing. Abolishing or significantly reducing single-family zoning could go a long way in increasing the supply of affordable housing, and provide individuals more opportunities to save for retirement during their working lives.

- The No Labels' Ultimate Guide to the 2020 Election suggests expanding coverage for vulnerable individuals and lowering costs through a universal catastrophic care program: "Instead of Medicare for All… policymakers should consider a version of Catastrophic Care for All. Every American would be enrolled in a high-deductible health care plan that pays for basic preventive care and provides coverage for the catastrophic expenses, like accidents and serious diseases, that drive too many families to bankruptcy. The government could pay for it with a means-tested tax, so those who can't afford the coverage pay nothing."

4 STATE INNOVATION FOR AUTO-IRAS

Half of the private sector workforce—55 million Americans—lacks access to an employer-sponsored retirement savings plan. Numerous states have created innovative public-private partnerships to expand access to auto-enrollment individual retirement accounts (auto-IRAs) based on bipartisan research:

- In 2017, the Heritage Foundation and the Brookings Institution worked together on a bipartisan proposal to promote auto-IRA accounts at the state level. It's expensive and difficult for some small businesses to set up retirement plans, so some states are taking on the administrative burden for them. The automatic IRA would be funded through direct employees' payroll deposits to a low-cost, diversified retirement account, with deposits that continue automatically (an opportunity now limited mostly to 401(k)-eligible workers). Small businesses that opt into this plan for their employees would get a two-year tax credit equal to half of the cost of establishing the plan, up to $500 per year. Five states are now rolling out auto-IRAs for small businesses unless they choose to opt out, and more than 30 states are weighing plans in their legislatures.