Conclusion

For some years now, a variety of interest groups and concerned citizens have emphasized that policymakers need to initiate concrete steps to prepare for the "graying" of America and the huge increase in the number of retirees. In fact, the number of people in the United States aged 65 and over is expected to nearly double by 2030; specifically, that age group is forecast to grow from about 13 percent of the total population in 2000, to 20 percent in 2030, and to remain above 20 percent for at least several decades thereafter.[1] In this context, there is growing concern that more attention needs to be directed toward retirement planning and developing a retirement infrastructure that has the capacity to absorb the retirement needs of all Americans. However, detailed analysis of the different elements comprising the nation's retirement architecture indicates some disturbing trends, a development that should cause a greater degree of consternation among both citizens and policymakers across the country.

Financial planners, as cited earlier, often recommend the three-legged stool concept in planning for retirement. Each leg of the stool is supposed to represent a source of income in retirement, and the goal is to cumulatively attain a standard of living comparable to, if not slightly below, the one experienced prior to retirement. In this analysis, if the first leg of the stool is Social Security income, the other two legs of the stool refer to personal savings and retirement or pension system income. Unfortunately, as indicated in the body of this report, a close review of national financial and demographic trends reveals that all three legs of this metaphorical retirement stool remain rickety, a development that could seriously endanger the retirement plans of a majority of Americans.

Social Security payments remain critical for most retirees; these payouts make up about 40 percent of the total income of people 65 and over. In addition, about two-thirds of those people receive at least half of their income from Social Security, and one-third receive at least 90 percent.[2] In fact, in 2008, a scant four years away, the first cohort of baby boomers will reach 62 and be eligible to claim Social Security benefits; a few years later in 2011, they will be eligible to claim Medicare benefits. However, the Social Security Trust Fund will start paying out more than it takes in by 2018 and be depleted by 2044, based on current projections, while Medicare will start running deficits in 2013 and run out of money in 2026 requiring remedial action from policymakers.[3]

Unfortunately, alongside the tenuous long-term financial viability of Social Security, there are serious problems associated with the other two legs of the symbolic retirement stool. In fact, it is becoming increasingly clear that relying on personal savings to bolster retirement income is not a realistic option for most Americans. According to the federal government, during the past few decades, savings as a proportion of disposable income has declined steadily. Specifically, the nation's personal savings rate has plummeted from 11.2 percent of disposable income in 1982 (the highest level in the past three decades) to 1.7 percent in 2001, a precipitous decline indeed, before rising marginally to 2 percent in 2003.[4] Further compounding this rapidly shrinking personal savings rate is the mountain of debt accumulated by most American households in recent years. Since 1999, household debt has leapt from 70 percent, to nearly 83 percent of the current gross domestic product.[5] Moreover, consumers racked up $1.1 trillion in new mortgage and consumer debt between the end of 2001 and the third quarter of 2003, bringing the total of consumer and mortgage loans held by the Federal Deposit Insurance Corporation (FDIC) insured institutions to $2.6 trillion.[6]

Finally, the remaining leg of the figurative retirement stool, income flows from both public and private pension plans, also is wobbly. The asset base of both private and public sector pension plans experienced substantial erosion as a result of the bleak economic tide that enveloped the country in the initial years of this decade. For 10 years, between March 1991 and March 2001, the American economy experienced an unprecedented growth spurt and the positive flows of this expansion reflected very well on the asset base of both private and public sector retirement plans. However, in mid-2001, the U.S. economy began lurching to a stop, and the tragic events of September 11, 2001, pushed the already teetering economy into recession. Despite technically emerging from this recession after two quarters, the lingering effects of the economy continued for several years later with job creation, in particular, being very tepid. Compounding these economic trends were a number of additional problems that resulted in the equity markets taking a walloping for almost a three-year period, 2000 through 2002. The combination of these negative developments saw the steady erosion of both public and private sector retirement system portfolios.

The Pension Benefit Guaranty Corporation, the federal organization that protects the pensions of 44.3 million American workers, indicated earlier this year that it was running a deficit of $11.2 billion and warned about its ability to protect private pensions in the future.[7] Deficit forecasts for 2004 continue to be alarming with an increasing number of corporations seeking to be "trusteed" by the PBGC. Major corporations ranging from Bethlehem Steel to United Airlines to a host of others indicated their inability to meet their pension obligations to their retired employees and sought the protection of the PBGC in meeting these retirement expenditures.

At the public pension level, the scenario remains bleak too. These economic and stock market developments, alongside crushing unfunded liability growth, according to the National Association of State Retirement Administrators, resulted in the actuarial funding levels of public retirement plans plunging to lower levels in fiscal year 2002, compared to fiscal year 2001.[8] Specifically, between the fiscal years 2001 and 2002, the actuarial value of public retirement systems' assets increased by 3 percent, or $57 billion; in contrast, liabilities grew by $154 billion, or 8.1 percent. Then, between fiscal years 2002 and 2003, while actuarial assets grew from $2.05 trillion to $2.06 trillion, actuarial liabilities exploded from $2.1 trillion to $2.3 trillion.[9] Also, studies released by Wilshire Associates in March 2003 and 2004 confirmed this trend, indicating that the funding ratio (the ratio of pension assets-to-liabilities) for all state pension plans combined declined from 106 percent in 2001, to 91 percent in 2002, to 82 percent in 2003; the median (50th percentile) state pension plan had a funding ratio of 79 percent in the March 2004 survey.[10]

In the last few years, these public retirement funds have attracted a great deal of attention, sometimes because of their shrinking asset base and sometimes for a variety of other reasons.[11] From an 1857 retirement plan established in New York City to assist policemen injured in the line of duty, according to the latest federal data (June 30, 2002), the number of state and local government pension plans across the nation had proliferated to 2,670, serving every stratum of state and local government. The importance of payments to beneficiaries from these state and local government retirement systems is a given, and the onus is on policymakers to ensure the solvency and financial health of these plans. Notwithstanding the $2.2 trillion in cash and investment holdings in these retirement systems at the end of fiscal year 2002, with more than 17.3 million total members and payments to over 6.2 million beneficiaries during this period, there is considerable interest in ensuring that this component of the U.S. retirement system remains on firm financial ground and continues to flourish in coming years.[12]The fact that about one-fourth of state and local government employees do not participate in Social Security, opting to channel their Social Security payroll deductions to their state or local government retirement plans,[13] only amplifies the importance of the financial viability of these public plans.

The stresses faced by state and local government retirement systems in the aftermath of what has been described as the worst fiscal crisis to sweep over states in more than six decades, and the continued sluggish performance of the economy, is illustrated by reviewing data over the most recent 10-year period. Specifically, total receipts plunged precipitously by 102 percent between June 1998 and June 2002 ($263.4 billion to -$6.1 billion), while they grew by 109 percent between June 1993 and June 1998 ($125.9 billion to $263.4 billion). Conversely, total payments by state and local government retirement systems more than doubled between June 1993 and June 2002 ($52.6 billion to $122 billion).

In addition to the information gleaned from the federal government, this report analyzes information obtained by means of a survey forwarded to 190 state and local government retirement plans in the 50 states and the District of Columbia. Of these 190 plans, 105 plans provided information for at least three of the five questions posed to them. Based on the survey responses, 36 of the 105 plans specifically had an asset base greater than 10 billion dollars but less than 100 billion dollars; two additional plans had an asset base greater than 100 billion dollars.

In terms of the number of annuitants (members or their family members receiving benefits) as a percentage of actives (members continuing to work and contribute), the survey indicated that a majority of the plans (70 plans) fell between 20 percent and 69.9 percent. The survey also revealed that in terms of actuarial funding ratios, i.e., the actuarial value of a pension plan's assets divided by its actuarial liabilities, only 25 of the 93 plans that provided information (of the 105 plans, 12 plans did not provide either the value of their actuarial assets or liabilities or both) were fully funded, with the remaining 68 plans underfunded to varying degrees.

State legislatures play a critical role in the administration of these retirement plans given the fact that they are responsible for some of the appointments to the boards of trustees, most often the administrative entity charged with the responsibility of managing and planning investments and benefit payouts. Hence, these trustees play a pivotal role in ensuring the continued growth of the retirement system funds taking into consideration a number of factors, such as the active-to-inactive member ratio, active participants to number of retirees receiving payments ratio, the overall investment climate (national and international) and ways to tweak an investment portfolio to diminish negative economic trends. One example where a legislature immersed itself in the activities of a state retirement system involves Maryland. After learning about their state pension fund's abysmal record, Maryland legislators and other state policymakers began a series of investigations and explorations into determining the reasons for this poor performance. In response to these queries and concerns, comprehensive reforms were introduced, both statutorily and organizationally, including a number of senior officials being relieved of their duties. In addition, federal authorities indicated that they had initiated a criminal investigation of a number of former employees, an investigation that eventually resulted in indictments, trials and convictions for several employees for fraud. A number of other legislatures also delved into the affairs of their public retirement systems either to buttress their finances through a bond issue (California, Illinois, Kansas, for instance) or to initiate reforms to enhance their efficiency and effectiveness (Louisiana).

If the performance of the last few years is any indication, the financial fortunes of state and local government retirement systems will continue to garner a great deal of attention from both policymakers and retirees alike. With the economy faltering during the initial few years of this decade, particularly the drubbing taken by the stock markets between 2000 and 2002, public sector retirement systems hemorrhaged great amounts of cash and added to the fiscal pressures faced by states and localities as they rushed to meet essential obligations. Yet, it is important that policymakers continue to monitor the performance of these portfolios in the context of possible negative economic times in the future. Also, in the context of the professed weaknesses in two of the three major sources of retirement revenues for Americans, Social Security and personal savings, it is imperative that financial deficiencies do not become endemic in the remaining revenue source, retirement systems.

Policy Options and Considerations

Ensuring both the short-term and long-term financial viability of the different elements in America's retirement systems, both private and public, remains of paramount importance. It is a challenge and responsibility that extends to policymakers at every level of government—federal, state and local—and every American. In fact, first resuscitating and then sustaining the financial health of our different retirement income flows provides the underpinnings for the foundation of the United States as an economic, political and military powerhouse in the global context. Consequently, it is imperative that policymakers and citizens alike initiate efforts now to bolster the shaky pillars of America's current retirement system so that the costs of making these fundamental reforms in the future are minimized.

In reviewing and analyzing the data contained in this report, it is quickly apparent that all three legs of the proverbial retirement stool are unreliable and require urgent attention. This report highlights the weaknesses in Social Security, Medicare and the PBGC; the abysmally low savings rate in contemporary American society coupled with the crushing level of consumer debt; and, finally, the severe losses suffered by a majority of the public sector retirement plans in recent years due to the souring economy, collapse of the equities markets, and occasionally lax oversight. The grim news percolating from these different retirement sources in recent years accentuates the importance for both citizens and policymakers to be energized about initiating remedial action. The fact that in a scant four years, the first wave of baby boomers will begin retiring in huge numbers, precipitating tremendous fiscal strains on these different retirement sources, further reinforces the urgency for these reforms.

In formulating comprehensive policy responses to this nascent crisis, it is important to consider the following issues.

» In order to overcome the severe disadvantages associated with an extremely low savings rate, is it time for policymakers—at all levels of government—to begin an assortment of educational and incentive programs to first, instill the importance of savings, and then increase savings rates? These programs could be introduced into the curriculum of schools throughout the country, possibly as early as the elementary level, building up in complexity as children proceed through the school system. At the other end, even greater incentives for individuals to save for retirement could also potentially be offered by the different levels of government. A quick comparison of household savings ratios among the world's three largest economic regions reinforces the fact that the United States lags significantly in this area, a statistic that should spur remedial action at every level of our society. While it is important to note at the outset that international comparisons of statistics are fraught with difficulties, it still is relevant to highlight the trend that the United States trails the Euro area and, Japan significantly, on this index. According to a report released in June 2004, the household saving ratio in 2002 in the Euro area loomed at about 15 percent, ahead of the approximately 6.5 percent in Japan and significantly ahead of the United States' ratio of about 2 percent.[14] The United States has to improve its performance in this critical area and the sooner policymakers initiate programs to do so, the better.

» In order to avoid a financial catastrophe related to Social Security, Medicare and the PBGC in the near future, is it time for policymakers, primarily at the federal level, to engage the public in a substantive debate about fundamental reforms? The sooner this discussion is initiated the better because the potential for these federal programs to quickly convert from ticking time bombs to explosive issues looms large. While there has been some peripheral discussion about reforming the Social Security and Medicare systems, the PBGC's plight has largely been out of the public arena. The PBGC, which is mandated to protect the pensions of bankrupt and failing corporations, remains severely underfunded and an ever increasing number of corporations, from small, relatively unknown ones to the more famous, established ones, have sought the protection of this federal agency. Bethlehem Steel, Consolidated Freightways, Acme Steel and the National Steel Pellet Company are a mere fraction of the companies covering more than 500,000 Americans that have failed in the past three years and been taken over by the federal government. The level of pension underfunding in the airline industry alone is estimated to be about $31 billion on a termination basis at the end of 2003, a staggering amount for just a single industry. Cumulatively, the level of pension underfunding for the companies seeking the protection of the federal government could be gargantuan, possibly eclipsing the magnitude of the federal government's bail out of the savings and loan industry in the 1980s. At a time when the fiscal demands being leveled at the federal government are increasing exponentially, and at a time when the federal government's budget situation is awash in a sea of red ink, the potential for these ticking fiscal time bombs (Social Security, Medicare and the PBGC) to explode remains a most alarming possibility.

» Finally, is it time for state policymakers and citizens to closely and continuously monitor the performance of state and local government retirement funds so as to avoid the financial pitfalls faced by some entities with the introduction of DROPs, the mismanagement of fund assets, the investment choices made by fund managers, the practice of deferring contributions to retirement funds during a time of budget shortfalls among other issues? Another important development related to these public sector retirement funds in these fiscally trying times involves the administrative entities of these plans whittling away at the benefits they offer to lower their expenditures. Will this emerging trend affect the ability of state and local governments to attract top-flight candidates to staff public sector positions? The case could be made that the ability of the public sector to attract high-caliber employees pivoted around the benefits offered in the public sector from the defined benefit retirement plan to healthcare coverage, both before and during retirement.

These policy considerations related to America's retirement systems remain of great importance as policymakers and citizens deal with the onset of an aging population and a series of other, complex policy issues that will confront the nation in the next few decades. The sooner we begin the discussion about strengthening the rickety legs of our figurative retirement stool, the better.