Testimony before the United States Senate
Committee on Health, Education, Labor and Pensions

For a Hearing

"The Power of Pensions: Building a Strong Middle Class and Strong Economy"

on

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Thank you Chairman Harkin, Ranking Member Enzi, and Senators on the Health, Education, and Labor Committee for the opportunity to testify today. I am Diane Oakley executive director of the National Institute on Retirement Security, or NIRS.   NIRS is a not-for- profit research and education organization committed to fostering a deep understanding of the value of retirement security to employees, employers and the economy. Our work is available on our website -- www.nirsonline.org.

Today, I would like to share our research regarding defined benefit (DB) pensions. I will focus on pension trends, how pensions fuel the American economy, how pensions ensure Americans can be self-reliant in retirement, and the economic efficiencies of pensions.

Before I get into the details, let me say a few words on the current state of retirement security in America.

For working American families, a key facet of the American Dream is to live in dignity and maintain financial independence in later years. Simply put, Americans do not want to be a financial burden for their families. Unfortunately, NIRS recent polling research finds that some 75% of Americans believe the disappearance of pensions has made it harder to achieve the American Dream. (Boivie, Kenneally, & Perlman, 2011)

When examining private sector pension coverage trends over the past three decades, we find that fewer and fewer employees are participating in pensions. In the 1980s, some 39 percent of private sector employees were covered by pensions, and this number has plummeted to 15 percent of private sector employees in 2009. (EBRI, 2011)

NIRS research finds that traditional pensions are essential to ensuring self-sufficiency for middle class Americans. More specifically, pensions enable nearly 5 million older American households to stay above the poor or near poor threshold levels, and thereby avoid reliance on assistance from family or the government to meet their basic daily living expenses.

Given the disappearance of pensions, it's not surprising that our polling research also found that 84 percent of Americans are anxious about their retirement prospects. An overwhelming majority also believe the nation's retirement infrastructure is crumbling and that stock market volatility makes it impossible to predict retirement savings. (Boivie, Kenneally, & Perlman, 2011)

This high level of anxiety about retirement security is echoed by others. An Associated Press/LifeGoesStrong.com poll found that 89 percent of baby boomers are not convinced that they will be able to live in comfort in their later years. (AP/LifeGoesStrong, 2011) Also, the 2011 Employee Benefits Research Institute Retirement Confidence Survey found confidence in retirement at a low point, with only 13 percent of respondents feeling very confident about retirement. (EBRI- RCS, 2011)

The retirement savings shortfall for Americans is startling. The Center for Retirement Research at Boston College, calculated that the estimated national retirement income deficit facing American households and is some $5.2 to $7.9 trillion. (Retirement USA, 2010) This retirement under funding for private sector workers could have significant negative impacts for individuals, the national economy, and struggling government budgets.

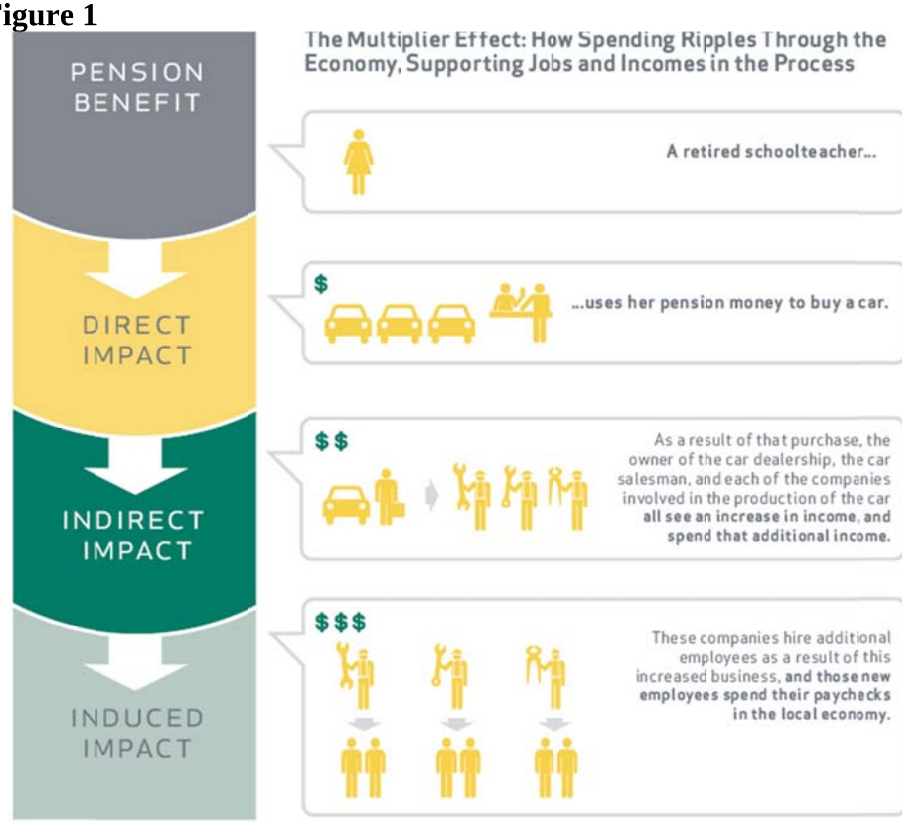
Therefore, we applaud the Committee's careful examination of the role of pensions for middle class Americans and the broader economy.

Pensions Strengthen National and Local Economies

The benefits provided by pension plans also have an impact that reaches well beyond the retirees who receive pension checks. Public and private pensions play a vital role in the national economy as well as in local economies across the country.

The steady, monthly benefit payments offered by pension plans provides peace of mind and security for retirees. At the same time, the national and local economies benefit from the regular expenditures retirees.

Figure 1



Source: *Pensionomics*, 2008.

As Figure 1 illustrates, a retiree in Iowa, Wyoming or Colorado, who receives a benefit payment from their pension fund, spends the money on goods and services in her community, thus supporting the local economy and industries. For example, a retiree may purchase food at the local diner or grocery store, medical services at their pharmacy or hospital, an automobile at the local dealership, clothing at the local mall, or tickets at the movie theatre.

Pension payments are particularly vital to small communities and economies across the country where there is a lack of diverse local industries or where other steady sources of income may not be readily found. For example, the Colorado Public Employees Retirement Association made pension benefit payments of $2.1 million in 2009 to its retirees in rural Costilla County and those payments comprise 35 percent of the earned income in that Colorado county.

In 2006, NIRS conducted the first national economic impact analysis of pension expenditures based on public pensions. In *Pensionomics* (2009), NIRS calculated that that each dollar of the over $151.7 billion in DB pension benefit expenditures made from state and local pension benefits in 2006 supported $2.36 in economic activity which:

- Had a total economic impact of more than $358 billion. (Almeida & Boivie, 2009)
- Supported more than 2.5 million American jobs that paid more than $92 billion in total compensation to American workers. (Almeida & Boivie, 2009)
- Supported more than $57 billion in annual federal, state, local tax revenue. (Almeida & Boivie, 2009)
- Nationally, had the largest economic impact in manufacturing, health care and social assistance, finance and insurance, retail trade and accommodations and food service sectors. (Almeida & Boivie, 2009)

Traditional pensions also have large multiplier effects, especially from the viewpoint of each taxpayer dollar contributed to pensions as part of public employees' compensation. Each dollar of the $64.5 billion public employers contributed to state and local pensions supported $11.45 in total economic activity.

NIRS will update the *Pensionomics* report in early 2012 and we will be pleased to share a copy of the final report with the Committee. For today's hearing, we took a preliminary look at the latest data on 2009 expenditures made from state and local governmental pensions and single-employer private sector pension plans combined. These rough data suggest that public and private sector DB pensions:

- Had a total economic impact of $756 billion.
- Supported more than 5.3 million American jobs.
- Supported more than $121.5 billion in annual federal, state, local tax revenue.

Additionally, one lesson from the recent recession and the sharp decline in the stock market values is that reliable sources of pension income may be especially important in stabilizing local economies. Comparing pensions to individual retirement accounts, we note that guaranteed pension income means retirees need not worry about reducing spending with every dip in the stock market. Thus, pensions are all the more important times of financial crisis and economic instability. Pension expenditures play an important role in providing a stable, reliable source of income for the local economies in which their retirement checks are spent—and therefore help the national economy recover as well.

It is also important to highlight the magnitude of pension assets. According to the Flow of Funds Accounts of the United States released by the Federal Reserve System on June 9, 2011, assets in Private Sector Retirement Funds and State and Local Government Employee Retirement Funds have almost reached their 2007 year-end values, recouping losses that occurred as a result of the stock market collapse of 2008-2009. At the end of the first quarter 2011, the value of financial assets in private sector defined benefit stood at $2.32 trillion and the value of financial assets held by public pension plans was $3.03 trillion. (BOG, 2011)

In the two most recent years for which we have complete data (2008 and 2009), total contributions to pensions exceeded $350 billion. Amounts contributed break down by sector as follows: sponsors of pensions among the Fortune 1000 companies contributed $96.4 billion (Warshawsky, 2011), public sector employers contributed $168.9 billion and public employees contributed $76.2 billion to their pension plans. (NASRA)

These numbers call attention to one aspect of pensions and the economy that often is overlooked, pensions are critical to our nation's capital development. Because pension plans are long-term investors, they can play a critical intermediation role in the economy at the most challenging times giving our financial markets depth and liquidity. While other lenders may close their doors to many kinds of financing due to higher risks during periods of tightening credit, pension plans have continued to lend and invest in areas like venture capital that grow new companies. Their longer view gives financial markets patient capital that can wait for investment returns to be fully realized over long periods. Thus, pension plans are compensated with higher returns while still maintaining properly diversified investments in their portfolios.

Pensions Ensure Retirement Self Sufficiency, Prevent Elder Poverty

In addition to the economic benefits of traditional pension plans, they also are of great value to Americans. They provide peace of mind and self-sufficiency with a secure, predictable retirement income that cannot be outlived.

Having pension income can play a critical role in reducing the risk of poverty and hardship for older Americans. In 2006, the mean annual pension income for elderly persons from their own employers was $15,784 and the mean pension income rose to $18,195 when pension income from a spouse was also counted. (Almeida & Porell, 2009)

NIRS research, *The Pension Factor* (2009), finds that pension income received by nearly half of older American households in 2006 was associated with:

- 1.72 million fewer poor households and 2.97 million fewer near-poor households
- 560,000 fewer households experiencing a food hardship
- 380,000 fewer households experiencing a shelter hardship
- 320,000 fewer households experiencing a health care hardship. (Almeida & Porell, 2009)

Overall, the rate of poverty for older households without pension income was six times greater than the rate among households that had income from a pension. (Almeida & Porell, 2009)

Moreover, NIRS found that pensions reduce – and in some cases eliminate – the greater risk of poverty and public assistance dependence that women and minority populations otherwise would face. (Almeida & Porell, 2009)

For almost 71 percent of the pension recipients in 2006, the source either in whole (63.7 percent) or in part (7 percent) of their pension income was a pension sponsored by a private employer they worked for. A little more than 36 percent of pension recipients had all or some pension income come from a public pension they earned while employed by a state or local government. (Almeida & Porell, 2009) Retirement income from individual 401(k)-type DC accounts play a lesser role in meeting the retirement security needs of elderly Americans, who were more likely to be covered by a pension during their careers. Based on DC plan income from their former employers, only 5.1 percent of all persons age 60 and older had such income and the percentage with DC income increased to 7.2 percent when spouses' DC plan income was counted.

When older Americans with pensions are able to be self-sufficient in retirement, the financial burdens on governments ease. In 2006, 1.35 million fewer households received means-tested public assistance as a result of having pension income. This translated into a $7.3 billion savings in public assistance expenditures, which is about 8.5 percent of aggregate public assistance dollars received by all American households for the same benefit programs in that year. (Almeida & Porell, 2009)

These impacts are significant, particularly given the pressures on safety net programs during the current fiscal crises experienced at all levels of government throughout the country. The American public sees the value that pensions give to their parents and grandparents today, and that could explain why some 81 percent of Americans believe that all workers should have access to a pension plan so they can be independent and self-reliant in retirement. (Boivie, Kenneally, & Perlman, 2011)

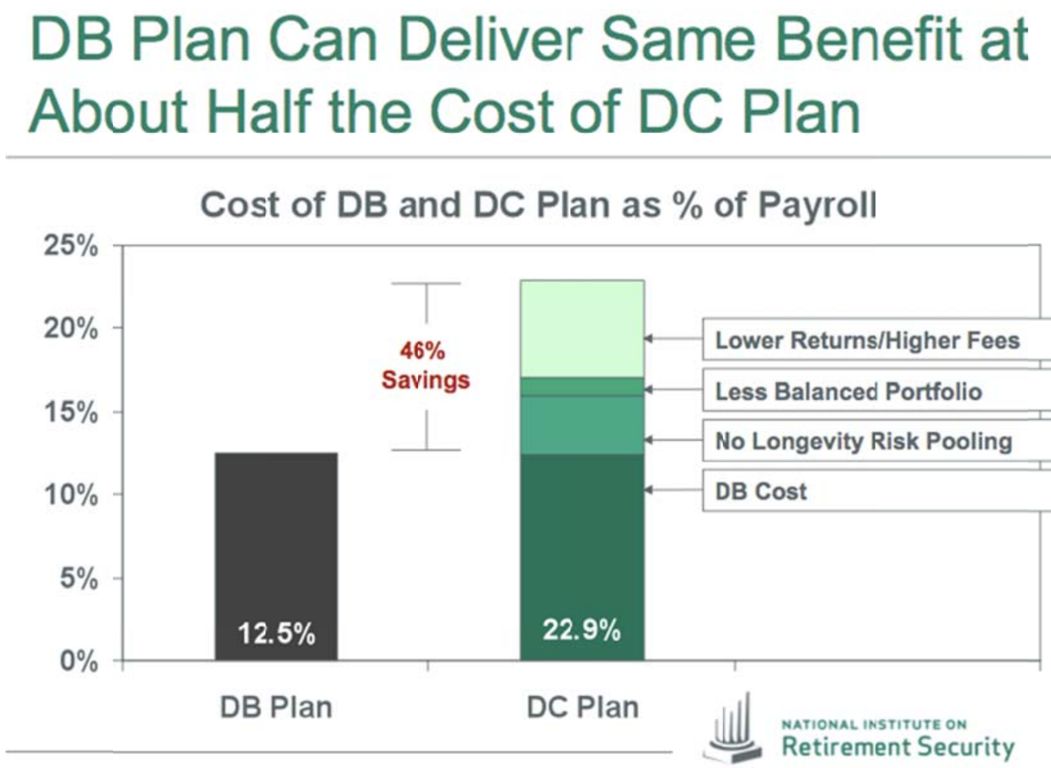
Pensions Are the Most Economically Efficient Retirement Plan

Pensions provide retirees and workers with a secure, predictable retirement income that cannot be outlived. One element of pensions that is not widely understood is their inherent economic efficiencies. Due to their group nature, pension plans possess "built-in" savings, which make them highly efficient retirement income vehicles, capable of delivering retirement benefits at a low cost to the employer and employee. NIRS research finds that a pension can deliver the same level of retirement income as an individual 401(k) type savings account at half the cost. (See Figure 2)

These savings derive from three principal sources.

First, pensions better manage longevity risk, or the chance of running out of money in retirement. By pooling the longevity risks of large numbers of individuals, pensions avoid the "over saving" dilemma. Half of the retirees who plan on drawing down their savings in their 401(k) account over their life expectancy will run out of money. To protect against outliving their money, these individual workers should save more so they have a bigger nest egg when they start retirement. In fact, to assure an adequate retirement income over the "maximum life expectancy" one would need about $100,000 more in a 401(k) account than what would be required in a pension. (Almeida & Fornia, 2008) Consequently, pension plans are able to do more with less.

Figure 2



Source: A Better Bang for the Buck, 2008.

Second, because pensions, unlike the individuals in them, do not age, they are able to take advantage of the enhanced investment returns that come from a balanced portfolio throughout an individual's lifetime. Financial advisors recommend that individuals gradually switch away from high risk/high return assets in their 401(k) as they approach retirement as a way of avoiding the downside risk of losses in stock values, for example. Consistently, maintaining a well-diversified portfolio gives a DB pension a 5 percent cost advantage. (Almeida & Fornia, 2008)

Third, professionally managed pensions achieve greater investment returns as compared with individual accounts. Research from the global benchmarking firm CEM, Inc. concluded that between 1988 and 2005 pensions showed annual returns 180 basis points higher than DC plans. (Flynn & Lum, 2007) Watson Wyatt found that, between 1995 and 2006, large pensions outperformed DC accounts by 121 basis points. (Watson Wyatt 2008) Also, Morningstar compared returns from retail mutual funds with returns from traditional public pensions and found public plans outperformed by 3.22 percent. (Morningstar, 2007) A retirement system that achieves higher investment returns can deliver any given level of benefit at a lower cost. Over time assuming a 100 basis point advantage for DB pensions each year compounds to a 26 percent cost advantage for the traditional pension. (Almeida & Fornia, 2008)

One can think of pensions as a buying club similar to Costco or BJ's. These buying clubs add value by operating on a large scale and using professionals who know markets to find high quality products at the lowest price for customers. Similar to buy clubs, pensions operate on a scale much larger than the average size individual 401(k) account plan, and also utilize professionals to manage pension assets. As a result, pensions can deliver a secure retirement income at a lower cost thanks to their economic efficiencies, professional asset management, lower costs, and better investment returns.

These finding are contained in NIRS' report, *A Better Bang for the Buck; The Economic Efficiencies of Defined Benefit Pension Plans*. Again, this analysis finds pensions can offer the same retirement benefit at close to half the cost of an individual account. Specifically, the cost to deliver the same level of retirement income to a group of employees is 46% lower in a pension than it is in an individual DC plan. Hence, it makes sense that pensions should remain a centerpiece of retirement income policy and practice in light of current fiscal and economic constraints facing plan sponsors. (Almeida & Fornia, 2008) As a nation, we need to deliver retirement benefits in the most economically efficient manner possible.

Conclusion

Pensions are the most cost-efficient means for ensuring Americans can be self-sufficient in retirement. Moreover, spending of pension benefits provides important economic stimulus and job nationally and across virtually every city and state from coast to coast.

Americans are highly concerned about their retirement prospects, while the nation continues to face severe economic challenges. As such, policymakers are wise to focus on protecting pensions that remain in place, and finding was to expand pension coverage for middle class Americans. I thank you for holding this hearing today to examine these issues.

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