RESTORING RETIREMENT SECURITY: THE MARKET CRISIS, THE "GREAT RISK SHIFT," AND THE CHALLENGE FOR OUR NATION

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The recent economic downturn has cast in stark relief the uncertainties associated with retirement and health care for older Americans. Yet, before the downturn even began, the economic landscape was already shifting in ways that concentrated more risk and responsibility on Americans planning for retirement and health care in old age. In this Article, Professor Hacker addresses the current risks faced by aging Americans, moving from the historical retirement framework of the "three legged stool"—Social Security, private pensions, and personal savings—to the current reality where pensions are few and far between. In doing so, he pays particular attention to special issues faced by working- and middle-class Americans. Additionally, drawing upon his knowledge of the health care system, Professor Hacker delves into the increasingly important role health care costs play in retirement planning, and how retirement planning should take into account potential future health care costs. Finally, he suggests a series of changes to restore retirement security by alleviating the problems produced by the disappearance of private pension plans and increases in health care costs.

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the Social Security system has the potential to shift risk from the old to the young and could make all generations better off.[95]

B. Fixing 401(k)s

Even with a secure Social Security system, today's workers will need other sources of income in retirement. 401(k)s as they are presently constituted are not the solution. Too few workers are offered them, enroll in them, or put adequate sums in them—a reflection of perverse incentives built into their very structure—and they place too much of the risk of retirement planning onto individuals, with too little information and insurance to help them build a secure retirement.

Three main options for the reform of 401(k)s vie for consideration: incremental fixes, large-scale reforms, and complete replacement. The first approach is exemplified by the Pension Protection Act of 2006, which tried to encourage employers to automatically enroll their workers in 401(k)s.[96] The research is clear that workers required to opt out of 401(k)s rather than opt in are much more likely to participate in plans.[97]

So far, however, results of the Act have been mixed, with surprisingly few employers adopting automatic enrollment.[98] Moreover, automatic enrollment does little to address other key concerns with 401(k)s, including the skewed tax subsidies for them, low contribution rates, leakage from the system due to lump-sum distributions, and, most fundamental of all, the reality that many employers do not offer a 401(k) at all.

On the other extreme, thoughtful pension experts have proposed mandatory government managed accounts with a guaranteed rate of return that would supplement Social Security, forming a "second tier"

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95. Alicia Munnell, *Bigger and Better: Redesigning Our Retirement System in the Wake of the Financial Collapse*, *in* SHARED RESPONSIBILITY, SHARED RISK: GOVERNMENT, MARKETS AND SOCIAL POLICY IN THE TWENTY FIRST CENTURY 23–24 (BERKELEY CTR. ON HEALTH, ECON., & FAM. SEC., 2009), *available at* http://www.law.berkeley.edu/files/chefs/10.16.09_Presenters_Research_Summary-_Pamphlet.pdf.

96. *Pension Protection Act Overview*, THE MONEY ALERT, http://www.themoneyalert.com/PensionProtectionAct.html (last visited Apr. 27, 2011).

97. David K. Randall, *401(k) Rethink*, FORBES.COM (Aug. 19, 2009, 6:00 PM), http://www.forbes.com/forbes/2009/0907/investing-retirement-ira-saving-401k-rethink.html.

98. *See* S. KATHI BROWN, AM. ASS'N OF RETIRED PERSONS RESEARCH & STRATEGIC ANALYSIS, AUTOMATIC 401(K) PLANS: EMPLOYER VIEWS ON ENROLLING NEW AND EXISTING EMPLOYEES, EXECUTIVE SUMMARY 1, 1 (2010), *available at* http://assets.aarp.org/rgcenter/econ/auto401k.pdf.

of compulsory retirement savings.[99] Contributions would be required, but unlike Social Security, benefits would be fully prefunded and there would be no redistribution from high-income to low-income workers. Instead, existing tax breaks would be restructured or replaced to provide a subsidy for low-income workers. These proposals generally envision that 401(k)s would gradually cease to exist.

Though these second-tier ideas have considerable merit, they also face serious political and logistical obstacles. Instead, I propose a middle way: a more robust version of plans for "universal 401(k)s" that have received substantial notice in recent years.[100] Universal 401(k)s should be available to all workers, whether or not their employer offers a traditional retirement plan. Employers would be encouraged to match employer contributions to these plans, and indeed, government could provide special tax breaks to employers that offered better matches to lower-wage workers.

Automatic enrollment would be required of all these plans, and the default contribution rate would be set at a level that would finance an adequate retirement along with Social Security. Existing tax breaks for 401(k)s would be replaced with a retirement savings credit that would be placed in the accounts of all workers. Such a credit would be the same for all workers and, hence, a much larger share of the income of low-wage workers.

To be sure, higher-income workers would be free to fund retirement accounts with after-tax dollars. In return for pre-committing resources to retirement, they would receive the benefit of not having their interest earnings taxed until withdrawals were made, allowing them to accumulate retirement savings tax-free. However, they would no longer be able to make tax-free contributions (as in 401(k)s and traditional IRAs) or receive final benefits tax-free (as in so-called Roth 401(k)s and Roth IRAs, which require after-tax contributions but keep accounts free from future taxation).[101]

Since universal 401(k)s would be offered to all workers, there would cease to be any problem with lump-sum payments when workers lost or changed jobs. All benefits would remain in the same

99. Munnell, *Bigger and Better*, *supra* note 95, at 25.

100. *See, e.g.*, *15 New Ideas: Universal 401(k)*, AM. PROGRESS, http://www.americanprogress.org/projects/15newideas/pensions.html (last visited Apr. 27, 2011).

101. COLLEEN E. MEDILL, INTRODUCTION TO EMPLOYEE BENEFIT LAW: POLICY AND PRACTICE 104–05 (3d. ed. 2011).

account throughout a worker's life. As with 401(k)s today, this money could only be withdrawn before retirement with a steep penalty.

Unlike the present system, however, 401(k)s would be governed by the same rules that now protect traditional pension plans against excessive investment in company stock. Moreover, the default investment option under 401(k)s should be a low-cost index fund with a mix of stocks and bonds that automatically shifts over time as workers age to limit market risk as workers approach retirement.

To help workers plan ahead, moreover, 401(k) balances should be reported to account holders not simply as a cash sum, but also as a monthly benefit amount that workers would receive when they retired if they had average life expectancy—just as Social Security benefits are reported.

After my criticism of 401(k)s, it may come as a surprise that I think universal 401(k)s are the best route forward. However, the difference between universal 401(k)s with strong incentives for contributions and the present system are profound. What is more, I recommend one dramatic additional change to improve 401(k)s that would transform them into a source of guaranteed retirement income. Under this proposal, 401(k) accounts would be converted into an annuity at retirement—unless workers specifically requested otherwise and could show they had sufficient assets to weather market risk. One reasonable concern about mandatory annuitization is that some demographic groups (such as African Americans) might end up receiving much less back than others because of shorter life spans. On the one hand, if annuities were based simply on average life expectancy at retirement, they would generally favor healthier and higher-income groups. On the other hand, it would be impracticable and undesirable (and in the case of some characteristics, like race, illegal) to have annuities based on very specific health and demographic characteristics. A reasonable medium ground would be to have annuities based on a few key characteristics that life insurers are now legally permitted to take into account that correlate strongly with life expectancy. In addition, annuities could have a provision providing some stream of payments to the surviving spouse or heirs of those who live for a very short period after retirement.[102]

102. I am grateful to Chad Henson, a University of Illinois law student, for raising this concern and clarifying my thinking about an appropriate response.

These new annuities could be provided by private firms under strict federal rules or directly by the federal government. (Interestingly, this proposal is not so different from an idea that was seriously considered by the developers of the Social Security Act in 1935, who argued that the post office should sell low-cost annuities to those who needed them.[103]) In essence, universal 401(k)s along these lines would bring back something close to a guaranteed private pension, with government, rather than employers, pooling the risk.

C. Confronting Health Care Costs

Health care security and retirement security are inextricably intertwined. Without serious efforts to control future health care costs faced by retirees, no pension system will prove adequate over the long term. At the same time, key distortions in our pension system reflect the growing challenge of retiree health care. For example, retirees are often loathe to take out reverse mortgages on their home or convert their savings into an annuity because of the possibility of having to finance very large health care expenses.

This is an area, however, where effective public and private efforts could make an enormous difference. As the economist Henry Aaron has shown, America's long-term budget challenge is principally a health care cost challenge.[104] Social Security, antipoverty benefits, discretionary social spending—all of these pale in comparison to the rising costs of Medicare and Medicaid. Failing to rein in costs means not just less income for retirees, but also federal and state budgets that are unable to accommodate necessary investments in education, infrastructure, technology, and other critical sources of future growth.[105]

Nonetheless, the focus cannot be simply on reducing federal expenditures on Medicare. While Medicare's costs are rising rapidly, the main reasons have little to do with Medicare and much to do with American health care. In fact, since payment controls were first introduced into the program in the early 1980s, Medicare's costs per pa-

103. *See Legislative History: Social Security Act of 1935*, SOC. SEC. ADMIN., http://www.ssa.gov/history/35acviii.html#Sale (last visited Apr. 27, 2011).

104. Henry J. Aaron, *Budget Crisis, Entitlement Crisis, Health Care Financing Problem—Which Is It?*, 26 HEALTH AFF. 1622, 1625 (2007), *available at* http://www.unmc.edu/publichealth/docs/Henry%20Aaron%20article.pdf.

105. *See generally The Long-Term Outlook for Medicare, Medicaid, and Total Health Care Spending*, CONG. BUDGET OFFICE, http://www.cbo.gov/ftpdocs/102xx/doc10297/chapter2.5.1.shtml (last visited Mar. 10, 2011) (finding that total health care pricing will be thirty-one percent of GDP by 2035).