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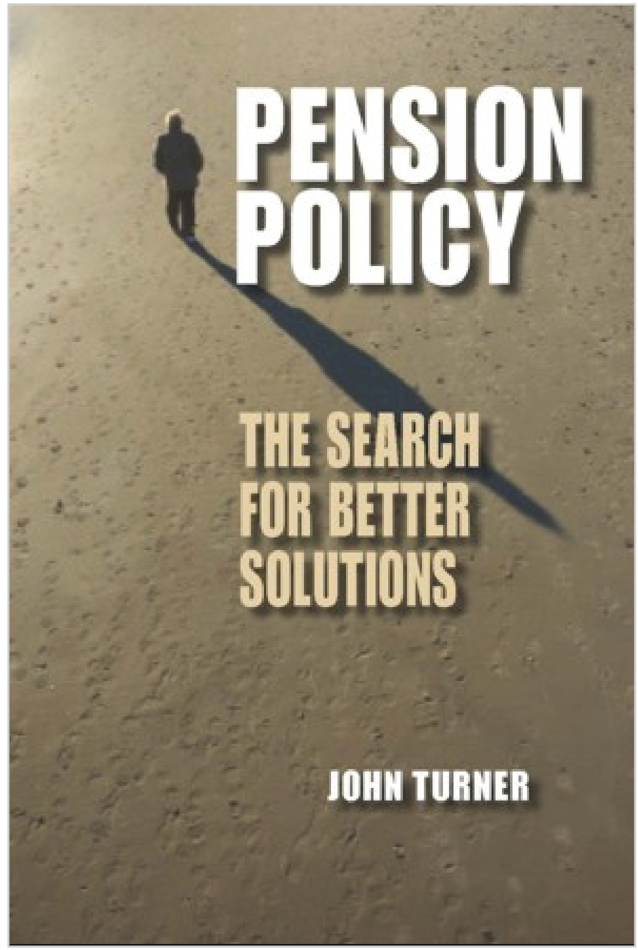
Better retirement planning

Pension Policy: The Search for Better Solutions. By John A. Turner, Kalamazoo, MI, W.E. Upjohn Institute for Employment Research, 2010, 243 pp., $40/cloth; $20/paperback.



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“The U.S. pension system needs fixing.”

This is author John A. Turner’s introductory statement, and it sets the tone for the rest of *Pension Policy: The Search for Better Solutions.* In Turner’s opinion, U.S. pension policy is poor by international standards as measured by a number of metrics. Turner wrote this book for the express purpose of proposing what he feels are much needed fixes to our current pension policy.

Turner is eminently qualified to write on the subject. Turner received his doctorate from the University of Chicago in 1977, taught as an adjunct lecturer in economics at George Washington University and Georgetown University, and was a Fulbright Senior Scholar in France. He has published more than 100 articles on pension and social security policy, authored or edited 14 books, and consulted and presented papers in more than 30 countries. His articles have been translated into eight languages. He is currently president of the Pension Policy Center, which provides retirement income planning, financial advice, and analysis and consulting on pension policy, social security policy, and policy concerning the labor market for older workers.

Turner starts his book by defining and explaining the two major types of benefit pension plans currently available to Americans: defined benefit plans and defined contribution plans. In a defined benefit pension plan, the employer or sponsor promises specified monthly payments upon retirement that are predetermined by a formula based on the employee’s age, tenure of service, and earnings history. Because recipients know that the exact dollar amount they receive in regular payments for the rest of their lives are guaranteed by their employer, risk is virtually nonexistent. Turner notes that, when the Employee Retirement Income Security Act (ERISA) passed in 1974, almost all pensions were defined benefit plans.

In a defined contribution benefit plan, the employer (and sometimes the employee and sometimes both) make regular contributions to the employee's retirement account. Pension benefits are based on the amounts credited to that account, plus any investment earnings on the money in the account. Only employer *contributions* to the account are guaranteed, not *benefits*, which are subject to fluctuation based on the types of investments chosen. Risk is thus shifted from employers, who would be obligated to make set lifetime benefit payments under a defined benefit plan regardless of how well or poorly the money is invested, to employees, whose retirement benefits now depend on the type of investments they choose to make. Defined contribution plans predominate today.

One suggestion Turner has for expanding coverage and adjusting for increasing life expectancy is a process he calls *mandating* (issuing a government directive ordering employers to provide employees a retirement plan). A primary benefit of mandating is that it would enable almost universal coverage, but there are also a couple of negatives. First, it is unclear how foreign direct investment would be affected; for example, would mandates preclude foreign companies from creating subsidiaries that would provide employment opportunities in the United States? This would seem to be a very real possibility. Second, U.S. employers generally haven't been keen on mandates in the past. Because voluntary participation is also dependent on a willful decision by the employee, Turner proposes making enrollment mandatory but encouraging gradual, capped increases in the amount the employee contributes. The tables he provides make that point, plus show that employees' failure to contribute typically result from not having enough money to invest rather than an unwillingness to participate.

Turner acknowledges one advantage that defined contribution plans currently have over defined benefit plans: they are highly portable. Unlike defined benefit plans, they can usually be easily converted to an identical plan with a new employer when an individual changes jobs. Per Turner, conversion issues can be overcome by pooling assets across multiple employers and establishing an employer-provided hybrid cash balance plan that continues to grow and earn interest even after the employee is separated from his or her job. Doing so would require that a link be created between the traditional single-employer defined benefit pension plan and a modern multiemployer retirement plan, and exactly how to achieve that end would require further research. But the multiple-employer aspect of this plan is all the more important, given that employees change jobs more frequently nowadays than in the past.

Turner notes the important role government has to play through its taxation policies. He quite rightly observes that governmental policies which would be more generous with pension benefits could also result in a loss of revenue to the government; such policies would disproportionately favor middle- to upper-income earners, who could easily shift assets around in their portfolio to lower their tax bill. Another taxation question is how to treat pensions and Social Security benefits. Policy analysts tend to prefer annuities over lump sums because annuities create stability while lump sum payments run the risk of miscalculating life expectancies. In Turner's opinion, it is extremely important that tax policy reflect this distinction and get it correct.

Dr. Turner recommends longevity bonds as a means of hedging against the life expectancy risk. These bonds structure their payouts according to the age of the cohort purchasing them. Risk can further be managed through the sale of government bonds, which offer their purchasers low risk because government has the right to tax; theoretically, default on these bonds would be impossible. Turner also addresses the risk that firms could attempt to buy influence over taxation policy, a consideration that is all the more important since the Citizens United decision.

Increased life expectancy has played a major part in the decline in the value of defined benefit plans that aren't adjusted for inflation. To hedge against this risk in his new idea for a pension plan, Turner recommends a modification of the Pension Protection Act of 2006 to allow sponsors additional time to amortize unfunded liabilities. He goes into great detail to explain how U.S. retirement income policy hasn't caught up with international standards with regard to inflation because it treats 401(k) plans as supplemental savings plans rather than as income. Treating income from defined contribution 401(k) plans the same as income from defined benefits plans would be a big step in the right direction. Turner devotes an entire chapter to the decline in the value of annuities and how to reverse that trend in the United States by using examples from Chile, Sweden, and the United Kingdom. Chile, for example, doesn't force workers to accept annuities, but those who don't accept them are required to make phased withdrawals.

To summarize, finding better solutions to the retirement decision is the author's goal. As a first order of business, Turner recommends regulating existing 401(k) plans and pooling assets among multiple employers. A system also needs to be established that takes into consideration life expectancy as well as employee contributions, because life expectancy is a major part of the retirement-planning process. Ideally, Turner is proposing a life-indexed defined benefit plan that would include features of a traditional defined benefit plan, an accounting of life expectancy, and a protection against inflation. Such a plan would provide a more balanced approach than a defined contribution plan offers and would reduce risk and cost.

This book, the result of extensive research by Turner, is intended for a broad audience, is an easy read, and is well organized. The author does an extraordinary job of explaining the current retirement situation and clearly defining well-thought-out solutions. *Pension Policy: The Search for Better Solutions* adds a wealth of knowledge and a practical approach to an important topic stressing the economy today. I recommend this text to anyone who has a goal of "better retirement planning."