

## Pension Design, Retirement Well-Being, and the Residual Public Burden

By Jason Seligman and Rana Bose

In the past 30 years, defined contribution (DC) plans have become the primary employer pension vehicle. More than 60 percent of current salaried U.S. workers in the private sector rely exclusively on DC plans, and another 30 percent rely on these plans for a portion of their retirement savings (Buessing and Soto 2006). For 2005, the Investment Company Institute reported that the average private-sector 401(k) participant in the 50- to 59-year-old age range who had participated since 1999 had a retirement account balance of \$128,000 (Holden and VanDerhei 2006).

DC plans allow individuals to manage employer pension savings with a great deal of freedom, and they protect workers from certain risks such as employer bankruptcy. However, under DC plans, employees assume funding, investment, and longevity risks (Richardson and Seligman 2005). Evidence suggests that many workers do not contribute enough to approximate traditional employer pension plan amounts. Additionally, workers who underannuitize their savings at retirement run the risk of depleting their savings in retirement (Munnell and Sunden 2004). Moreover, research on DC plans indicates that their portfolio performance often lags behind that of traditional defined benefit plans. From 1986 to 2000, defined benefit plans earned a 7.9 percent average return compared with 7.1 percent for 401(k)-style plans (Munnell and Sunden 2004).

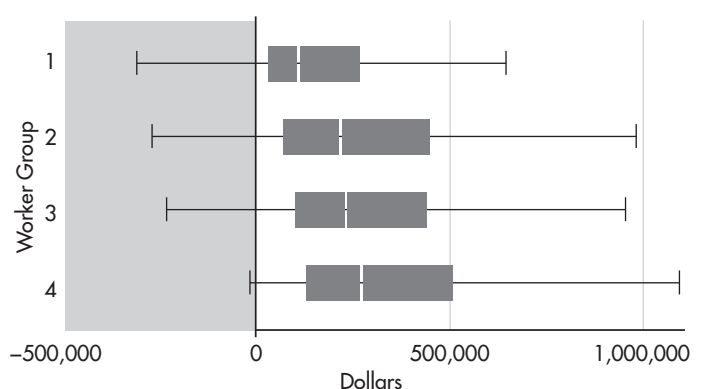
Compounding the problem is that as the population ages, workers may outlive their retirement plan resources. According to 2005 U.S. Census Bureau statistics, Georgia's elderly population is set to increase dramatically. By 2030, the population older than age 65 will increase from less than 10 percent to more than 16 percent. Additionally, rapid increases in health-care costs and recent reductions in retiree health benefits may have large negative impacts on wealth over the same time period, increasing draws upon Supplemental Security Income and state-supported programs like Medicaid. Although Georgia does not supplement the federal Supplemental Security Income benefit, it does share Medicaid costs and thus has a direct stake in retirement savings outcomes.

There is good news, however. Because Georgia's population is relatively young, with a median age of 33 (compared with 35 for the United States as a whole), workers have more

time to pay into newer pension systems. Moreover, there are plan options that may ease workers' retirement savings burden. Seligman and Bose (2005) find that specific employer pension design features can encourage workers to take a more active role in saving, even outside their pension plans. Importantly, financial education and active asset management both contribute to better financial outcomes. Chart 1 shows the distribution of wealth for workers who have these plan features available to them.

To understand the dynamics of the chart, compare worker groups according to their total distribution (within the T-brackets), the distribution of the 25th through 75th percentiles (represented by the gray boxes), and median values (denoted by the white vertical line within the gray boxes). Group 1 represents those who report neither receiving financial education nor being able to manage their plan assets. This group has the lowest retirement wealth. Workers who have both plan features available to them (Group 4) do markedly better. Groups 2 and 3, who have only one of these plan features, have outcomes between either extreme. A more careful comparison of Groups 2 and 3 with Group 4 suggests that some employer financial education programs for retirement preparation are better than others.

**Chart 1. Education, Investment Choice, and Retirement Wealth**



Source: Health and Retirement Study survey waves 1–6, 1992–2002. Institute for Social Research, University of Michigan. [hrsonline.isr.umich.edu](http://hrsonline.isr.umich.edu).

Note: Data are for workers retiring between 2000 and 2002. Worker groups are defined as follows: Worker Group 1 = DC plan provides neither education nor choice; Group 2 = choice but not education; Group 3 = education but not choice; Group 4 = education and choice. T-brackets represent total distributions, shaded boxes are interquartile ranges (25th to 75th percentiles), and white vertical lines denote median values.

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To help address the economic security of Georgia's population and ensure against potentially larger health- and retirement-related expenditures, the state should support the development and administration of financial literacy programs both through direct provision and by encouraging private employers to offer programs as a benefit of employment. Particular focus should be given to three worker groups: those who earn lower incomes, those who are nearing retirement, and those who participate in public employer systems that opt out of social security—the groups whose savings are most vulnerable to pension plan changes.

### Sources

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