Disappearing Pensions Make Americans' Lives Less Secure

By John Gallagher, Detroit Free Press Business Writer

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Through most of his working life, steelworker Ray West looked toward a secure retirement.

His company pension was expected to bring in around $30,000 a year, his union contract promised retiree health coverage and he had 401(k) savings of about $50,000.

Three years ago, it unraveled. His company filed for bankruptcy. The collapse reduced his expected pension to around $5,000 a year and canceled his retiree health insurance. And, in three years of unemployment since then, West of Hazel Park blew through the entire $50,000 in his 401(k) just getting by as he trained for a new career.

"I lost my job after 27 years before I got my retirement. I ain't going to get nothing," says West, 52.

Of all the threats to the American middle-class standard of living, from stagnating incomes to piles of consumer debt, perhaps the least understood and among the most serious is the looming crisis in retirement.

Several trends, each debilitating alone, are due to converge on the middle class over the next decade or so.

Traditional pension plans are disappearing in the private sector. Workers aren't saving enough in their voluntary 401(k) accounts. Longer life spans are stretching savings even thinner. Social Security remains under stress. All that was going on before retirement plans lost $2 trillion in the stock market dive.

Taken as a whole, the trends point toward a massive problem as people now in their 40s and 50s start to retire in 10 to 20 years.

Alicia Munnell, a professor of management and director of the Center for Retirement Research at Boston College, has developed a retirement risk index that shows that 43% of households are in danger of not being able to maintain their living standard once they retire. She projects that risk to grow over time, and it gets worse for those lower down the income scale.

"A transition group is really going to suffer a lot until we say, 'Let's do something,' " Munnell says. "The early boomers and particularly the late boomers are going to have a terrible time." The baby boom is defined as people born between 1946 and 1964, a mass of Americans just reaching retirement age.

Of all the trends, perhaps the most worrisome is the failure of highly touted 401(k) private savings accounts to replace fast-disappearing traditional pensions. Not only do millions of workers not save enough, or like West drain their 401(k)s well ahead of retirement, but all the risk of making wise investment choices and planning for decades of retirement now falls entirely on workers who have no training to deal with it.

"The goal of trying to educate everybody up so they can do this kind of thing is just silly," Munnell says. "We don't need a whole nation of financial analysts. We need people to play with their children and coach Little League and do all that kind of stuff."

Grim numbers bear out the warnings about Americans' lack of retirement-planning savvy. The Employee Benefit Research Institute reported that 49% of workers say they have total savings and investments, not including the value of their home, of less than $50,000. And 22% of workers and 28% of retirees say they have no savings of any kind.

Andrew Stumpff, a Lansing-based pension expert and lecturer at the University of Michigan Law School, says the approaching storm of unsafe retirements is part of a general shifting of risk toward ordinary workers.

"You need to regard retirement as a do-it-yourself proposition nowadays in a way that it never was for previous generations," he says.

Skipping trips

That shift illustrates the potential change in living standards for retirees of the future.

Today, Vince and Joyce Orban live the sort of retirement that West might have imagined, and one that was typical in recent decades.

Vince retired from Ford Motor Co. in 1994. He and Joyce built a dream home near Gladwin in northern Michigan and settled in for rounds of golf, winter trips to the Sunbelt and visits with their grandkids.

Lately, though, rising prices of everything from groceries to gasoline have begun to crimp even this ideal retirement. For the first time, the Orbans skipped a winter trip to Florida this year. Their heating bills have risen so much they now pay more for winter propane than for their monthly mortgage.

The Orbans understand they're still among the lucky ones. They get Vince's fixed pension from Ford, where he worked as a union-represented millwright, and they have good health insurance. They're more concerned about the perils that face the next couple of generations.

"Our kids, God have mercy on 'em," Vince says.

"And our grandchildren," Joyce adds.

Indeed, many younger workers have barely begun to think about the retirement challenges ahead.

Jennifer Ruud, 30, of Madison Heights was laid off several months ago from her job as an art coordinator at an advertising agency. Since then, she's career-switched to a nonprofit agency, but $10,000 in credit-card debt and other worries have pushed retirement planning far to the rear.

"I have been trying to put money in my IRA," she says. "I think I put very little money in this year. I don't even know if I'm going to be able to put in anything next year." With finances tight, she fears she could lock up money and "potentially not see it for who knows how long."

Slower growth

Besides the potential human tragedy facing seniors who lack adequate means, a lowering of living standards among elderly people could blunt the growth of the American economy.

Seniors 65 and older make up 20% of all U.S. households today. As the senior portion of the population increases with the aging of baby boomers, widespread economic pain among elderly people could slow spending and place greater burdens on caregivers from families to social services agencies.

How bad will it get? Estimates vary, but a study by human-resources firm Hewitt Associates reported this summer that only 19% of workers studied were on track to be able to maintain their standard of living upon retirement.

The Hewitt study looked at the projected retirement levels of nearly 2 million current workers of varying ages at 72 large U.S. companies. Of those studied, more than 1.2 million employees, or 67%, were expected to have less than 80% of what they need to maintain their lifestyle at retirement.

The storm waters are already lapping around the feet of retirees like William Ware, 83, of Detroit, a former City of Detroit maintenance supervisor. Ware and his wife, Sarah, find that their fixed income buys less and less with each trip to the grocery store.

There was a time, Ware says, when he could "spend $100 and I have two carts full of food. Now you spend $100 and if you buy any meat you don't have a cartful. And that's just an example of how things have gone up."

Change of plans

Perhaps the biggest threat to retirees' living standards has been the demise of traditional pension plans in the private sector.

For decades a mainstay of retirement, so-called defined-benefit pension plans are those in which employers promise to pay a fixed amount of money to their retirees each month for life.

Those plans flourished after the 1940s as big carmakers, steelmakers and other industrial firms needed to build and keep a large, skilled, loyal workforce and buy labor peace. Promising lifetime checks to retirees became common. By 1980, about 60% of U.S. workers in private industry were covered by defined-benefit pensions.

For millions of workers, having a pension simplified retirement, because all a worker had to do was cash a check each month.

"You could plan, you could count on it, the investment risk was all on the company," Stumpff says.

But as retirees lived longer and as American manufacturers faced growing competition from abroad, such pension plans began to grow more costly to maintain. Then, too, the rise of a service economy, in which workers are more prone to change jobs frequently, put less of a premium on career-long loyalty and rewards.

The nonpartisan Employee Benefit Research Institute reports that, as mostly smaller and medium-size employers terminated their pension plans, the number of traditional plans declined by 75% from a peak in 1985.

The plans are still common in the public sector, with the Census Bureau reporting that in 2006, more than 18 million Americans were covered in some way by a government retirement plan.

Rise of the 401(k)

Some well-intentioned efforts to safeguard pensions may have backfired. In 1974, Congress passed the Employee Retirement Income Security Act, mandating stricter controls on private pensions.

Somewhat paradoxically, companies that were not required to provide any retirement benefits suddenly faced more regulation if they did. Lansing pension expert Stumpff says that provided an incentive to drop the pension plans.

A key factor in the disappearance of a fixed monthly retirement check was the rise of voluntary 401(k) plans. Based on an obscure clause in a late-1970s tax revision, 401(k) plans allow workers to defer taxes on retirement savings until they draw them at some future date.

By the mid-1990s, thousands of companies were cutting back on traditional pension plans in favor of contributing to workers' 401(k) accounts.

Under this switch, companies were no longer obligated to pay a fixed monthly benefit to retirees; instead, employers could limit their obligation to the upfront contribution to current workers. The risk of bad investment decisions shifted to employees.

The 401(k) plans didn't emerge from a national debate on how to replace pensions. They came about quietly as investment advisers explored the intricacies of the tax code and promoted the new accounts to consumers and to companies eager to get out from under pension obligations.

"This was not a national decision to move from one type of employer-sponsored plan to another," Munnell says. "It just happened."

The switch from defined-benefit to voluntary 401(k) plans has been almost complete. Today, barely 10% of workers in the private sector are covered only by a defined-benefit pension plan. And while most workers are eligible to participate in a voluntary company 401(k), economists and others who have studied the two systems say that 401(k) plans provide far less income than traditional pension plans.

The reason: Many workers eligible for a 401(k) plans don't enroll, don't save enough, invest in the wrong things or draw out all their investments when they leave a company instead of keeping the money in a retirement account.

In theory, a worker with a 401(k) might do better than with a traditional defined-benefit pension, as long as he or she made the best investment choices. A big problem, though, is that most Americans are woefully unskilled at complex financial planning.

In one notorious example, many Enron workers lost the bulk of their retirement savings when they loaded up their 401(k) accounts with company stock shortly before Enron went bust.

But even workers who make less spectacular misjudgments are prey to costly mistakes, Stumpff says.

"Even in perfect situations, there are going to be people who are victims of bad investment timing or otherwise victims of the markets, who are going to effectively lose their retirement savings," he says.

Smaller cushion

Some economists urge Americans to keep working beyond age 62 to delay claiming Social Security benefits. Working longer also allows employees to build up retirement accounts and defer drawing on them.

Munnell proposes the creation of a new tier of retirement savings program that would require workers to contribute 3% of pretax income to a retirement fund. It might mirror today's voluntary 401(k) programs but would have to be mandatory to get millions of people to participate.

Unless some sort of steps are taken, she warns, the nation can expect a sharp rise in poverty among its oldest citizens.

She adds, "To have people be vulnerable at that time just seems like a shameful way to run a country."

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