



The Role of Government in Life-Cycle Saving and Investing

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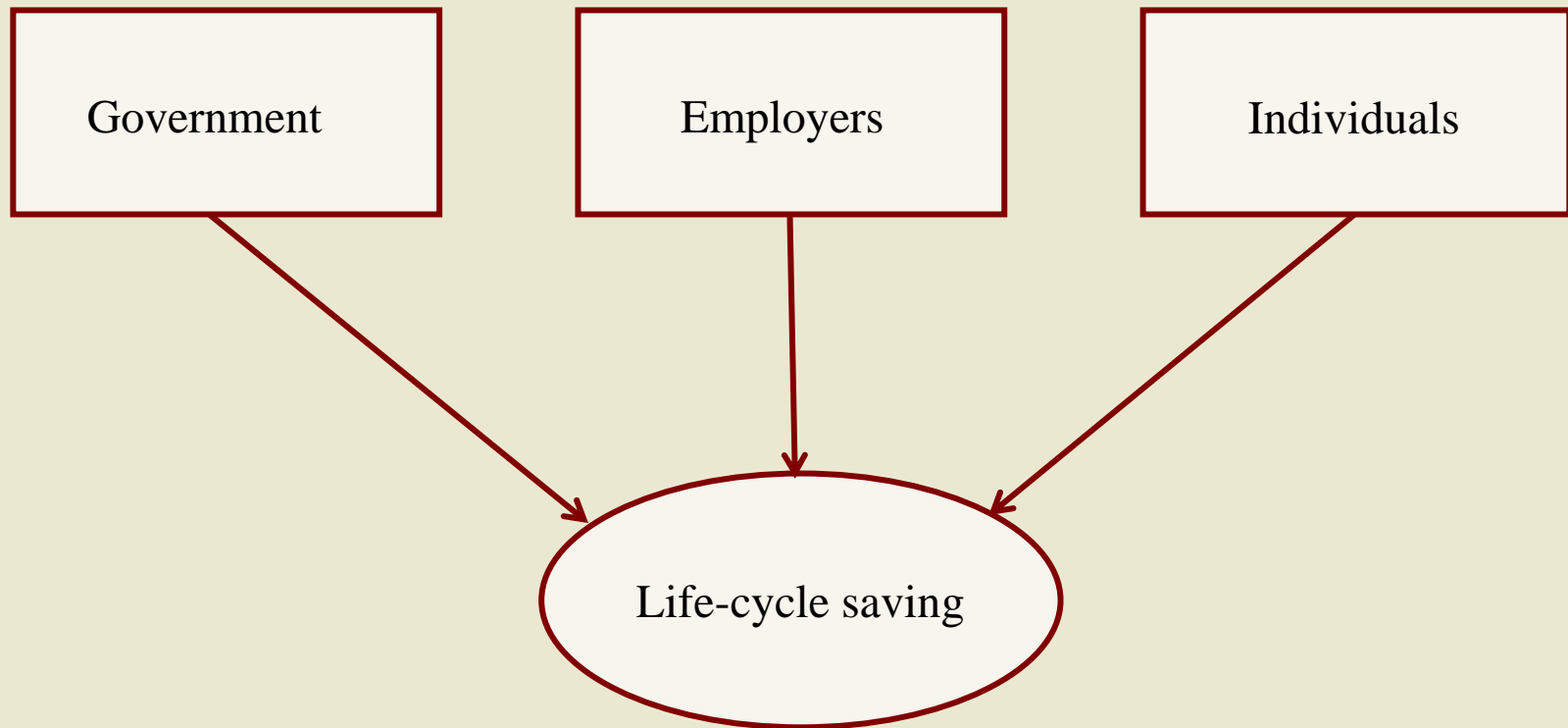
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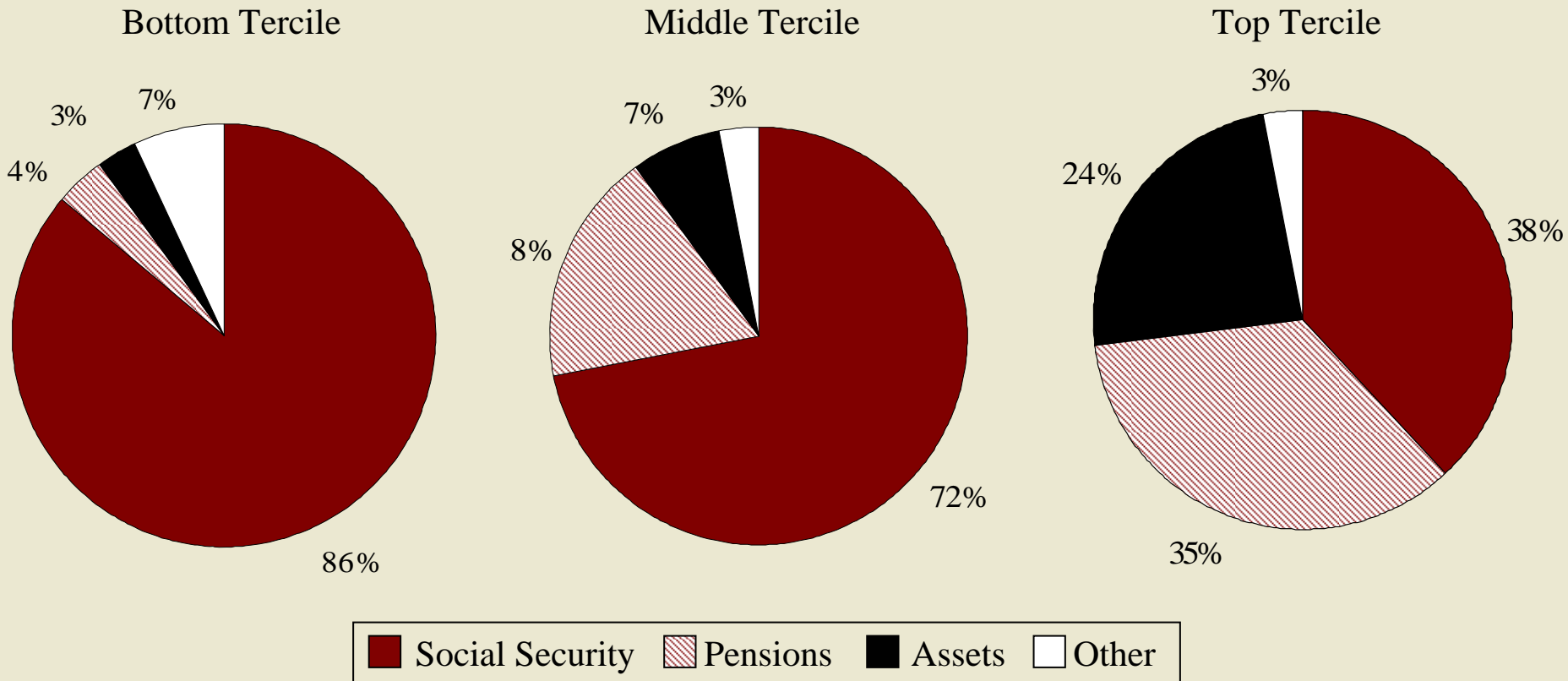
Historically, three players have participated in life-cycle saving.



Source: Author's illustration.

Government supports life-cycle saving through Social Security...

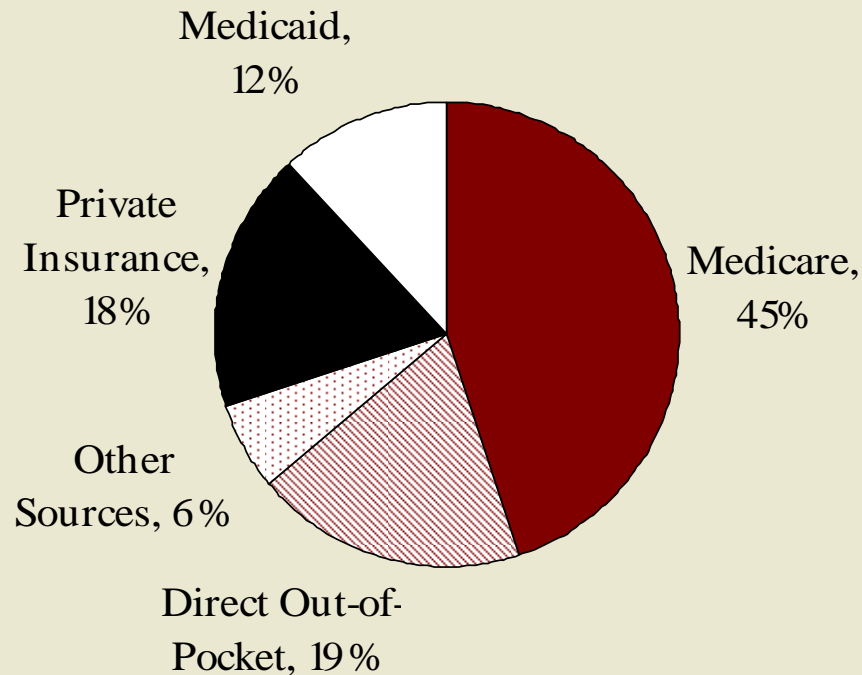
Share of Household Income by Source, 2004



Source: U.S. Board of Governors of the Federal Reserve System. 2006. *2004 Survey of Consumer Finances*.

...through Medicare...

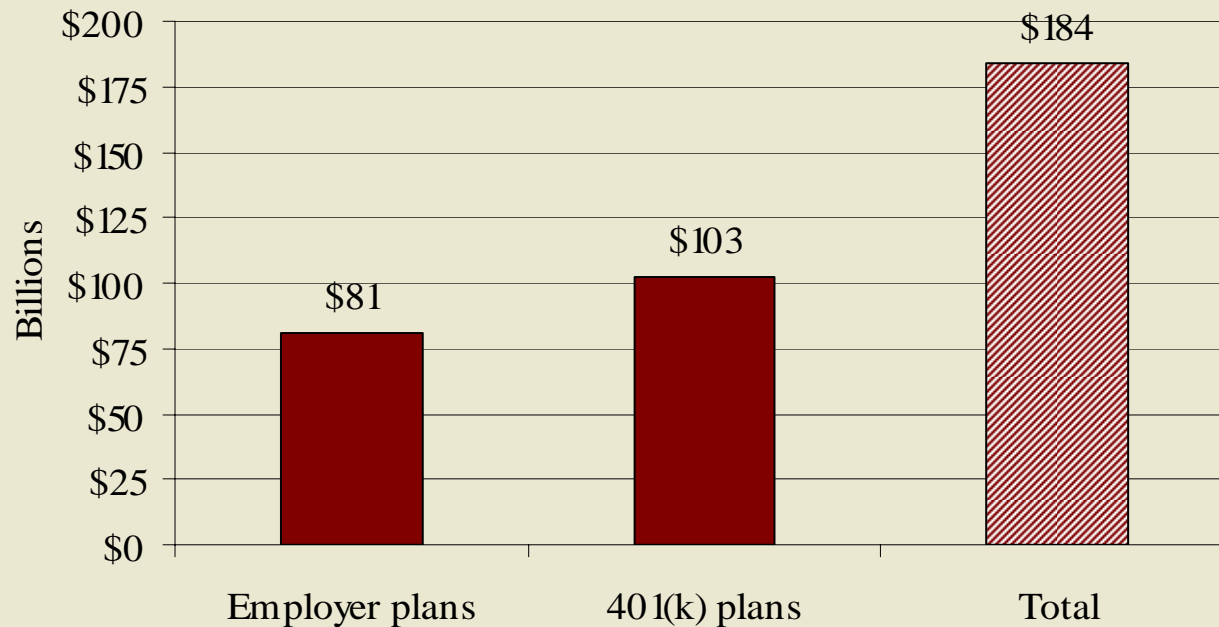
Sources of Total Health Care Spending for 65 and Over Population, 2002



Source: Kaiser Family Foundation. 2005. *Medicare Chartbook*.

...via tax expenditures for employer plans...

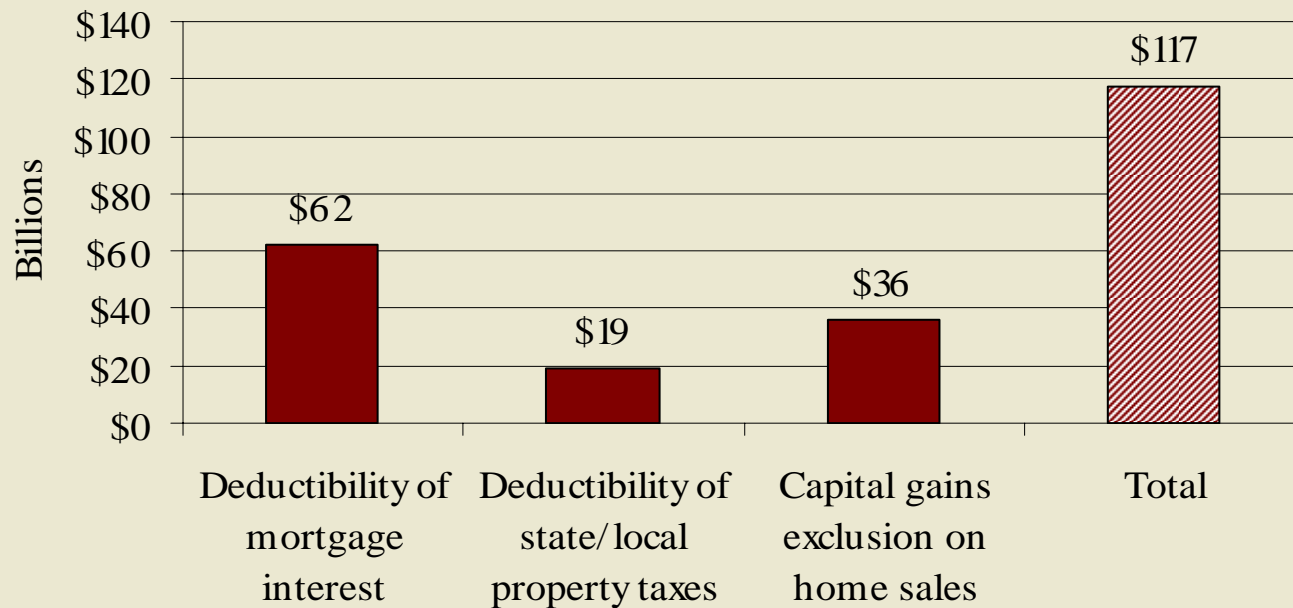
Tax Expenditure for Public and Private Pensions, Billions of Dollars, 2006



Source: Executive Office of the President, Office of Management and Budget. 2006. *Fiscal Year 2007 Budget of the United States Government*.

...and tax expenditures for housing.

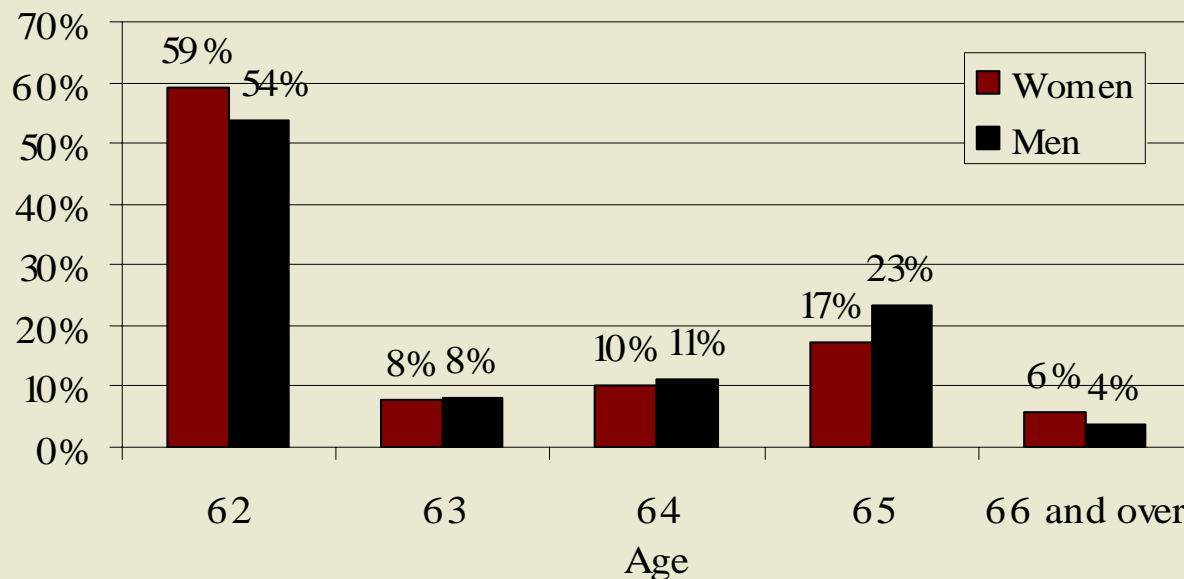
Tax Expenditures for Owner-Occupied Housing, Billions of Dollars, 2006



Source: Executive Office of the President, Office of Management and Budget. 2006. *Fiscal Year 2007 Budget of the United States Government*.

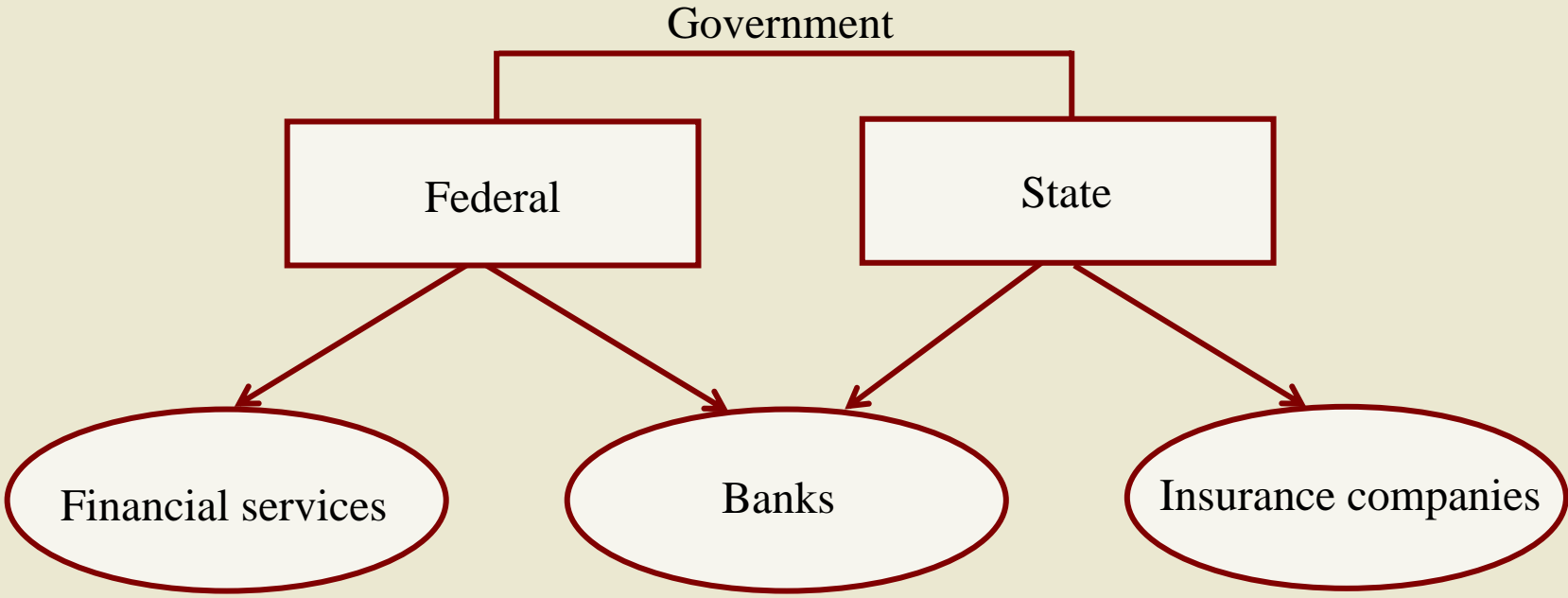
Government also defines the “life cycle” by setting the retirement age.

Percent Distribution by Age of Initial Social Security Benefit Awards, 2004



Source: Author's calculations and U.S. Social Security Administration. 2006. *Annual Statistical Supplement, 2005*.

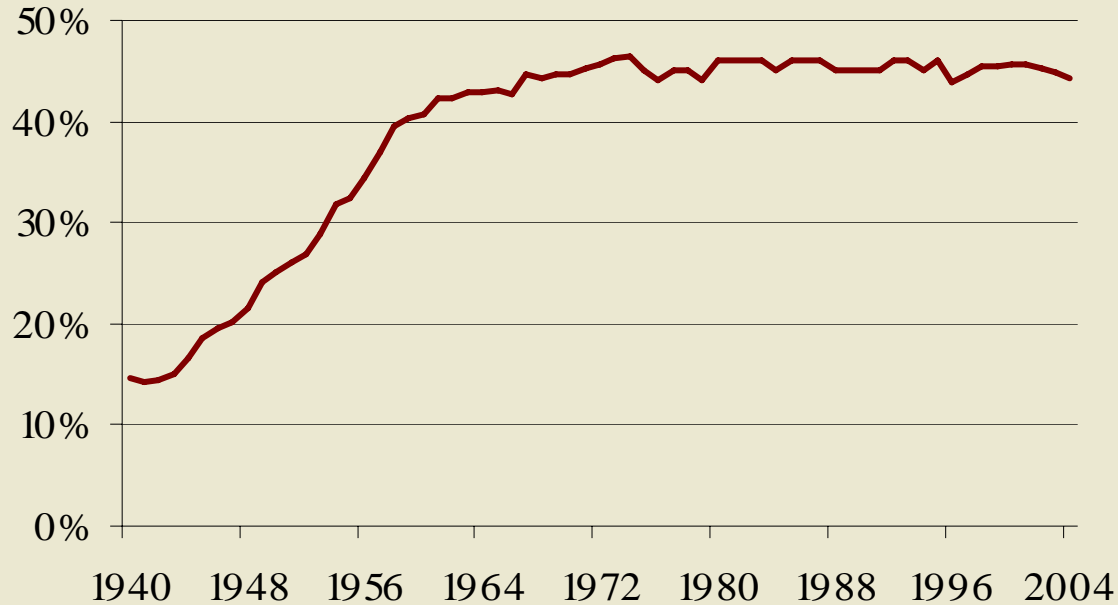
And government protects life-cycle savings by regulating financial intermediaries.



Source: Author's illustration.

Employers have played a major role through sponsoring pension plans.

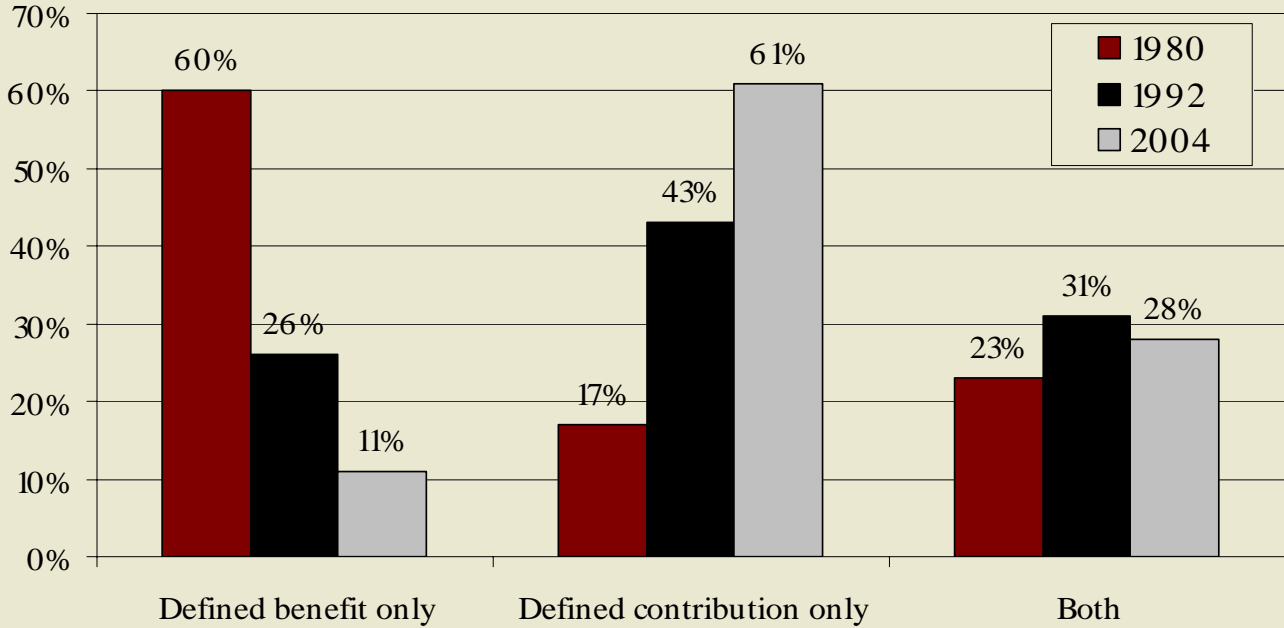
Percent of U.S. Private Sector Wage and Salary Workers Covered by Employer Plans, 1940-2004



Source: Alfred Skolnik. 1976. "Private Pension Plans, 1950-1974." *Social Security Bulletin*; and U.S. Department of Labor. 2006. *Annual Return/Report Form 5500 Series for Plan Year 2004*; U.S. Department of Labor. 1999. *Private Pension Plan Bulletin: Abstract of 1995 Form 5500 Annual Reports*.

But with 401(k)s, employers have withdrawn from bearing risk and responsibility.

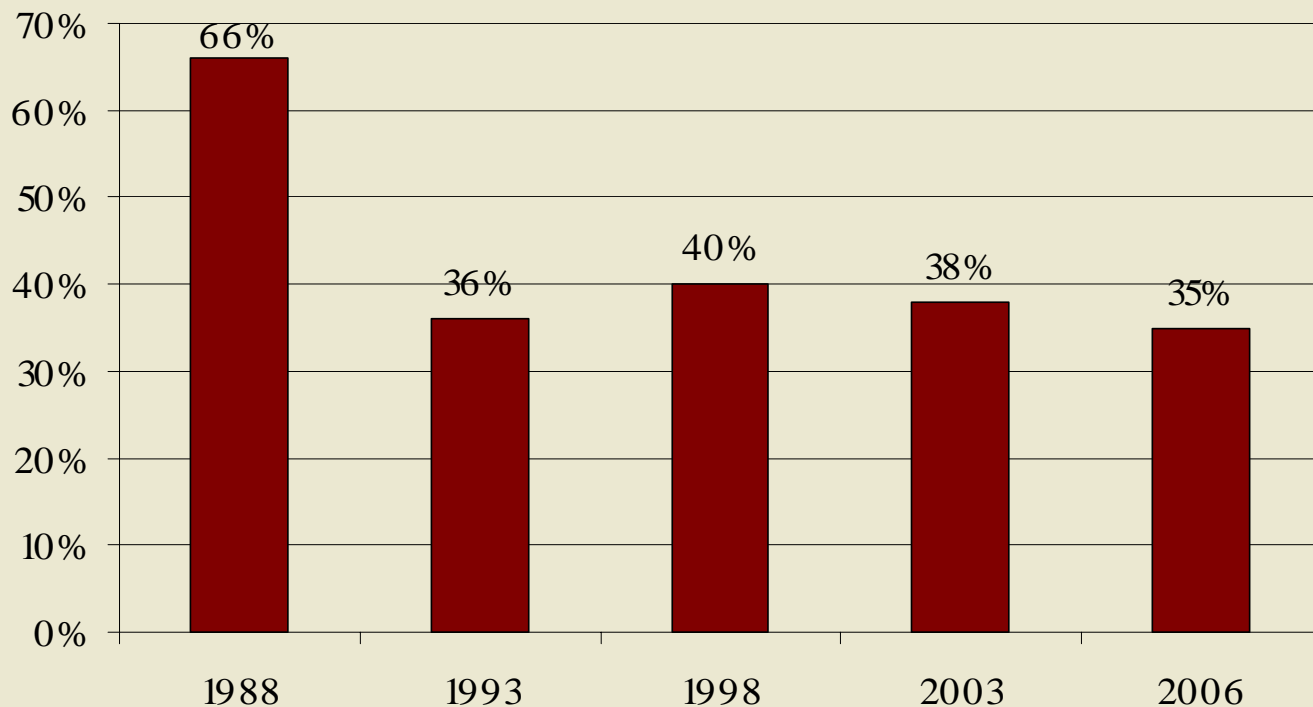
Private Sector Workers with Pension Coverage, by Pension Type, 1980, 1992, and 2004



Sources: U.S. Department of Labor. 2004. *Private Pension Plan Bulletin: Abstract of 1999 Form 5500 Annual Reports*; and author's calculations from U.S. Department of Labor. 2001-2006. *Annual Return/Report Form 5500 Series for Plan Years 1999-2004*.

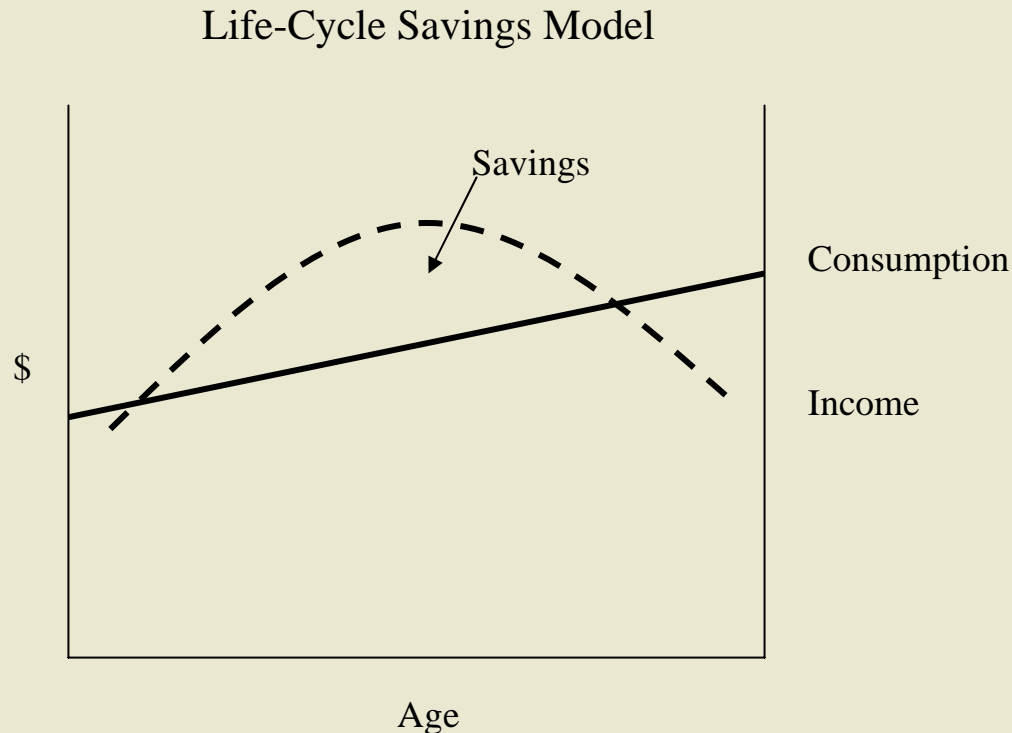
Employers have also withdrawn from post-retirement health coverage.

Percent of Large Employers (200+ Employees) Offering Retiree Health Benefits



Source: Kaiser/HRET. 2003. *The Kaiser/HRET Employer Health Benefits Survey*.

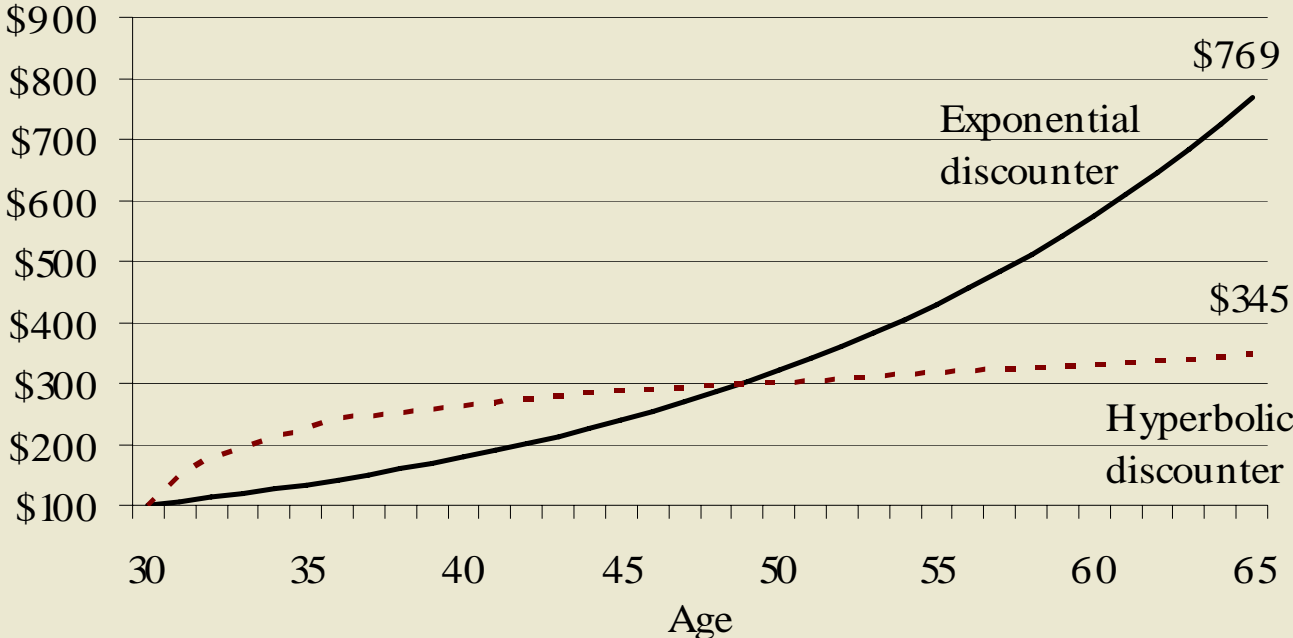
Individuals are assumed to engage directly in life-cycle saving.



Source: Author's illustration.

But individuals have very high discount rates.

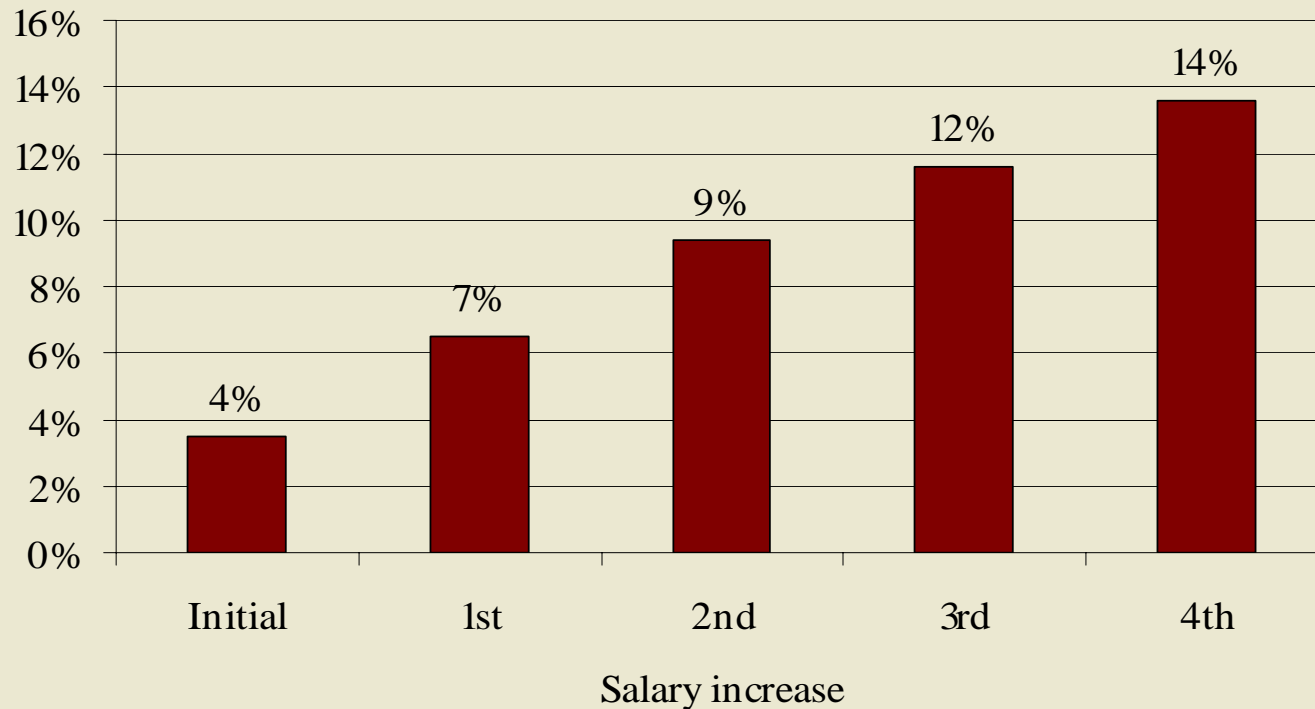
Exponential versus Hyperbolic Discounters — Growth of \$100 Over Lifespan.



Source: Author's illustration.

And they need commitment devices.

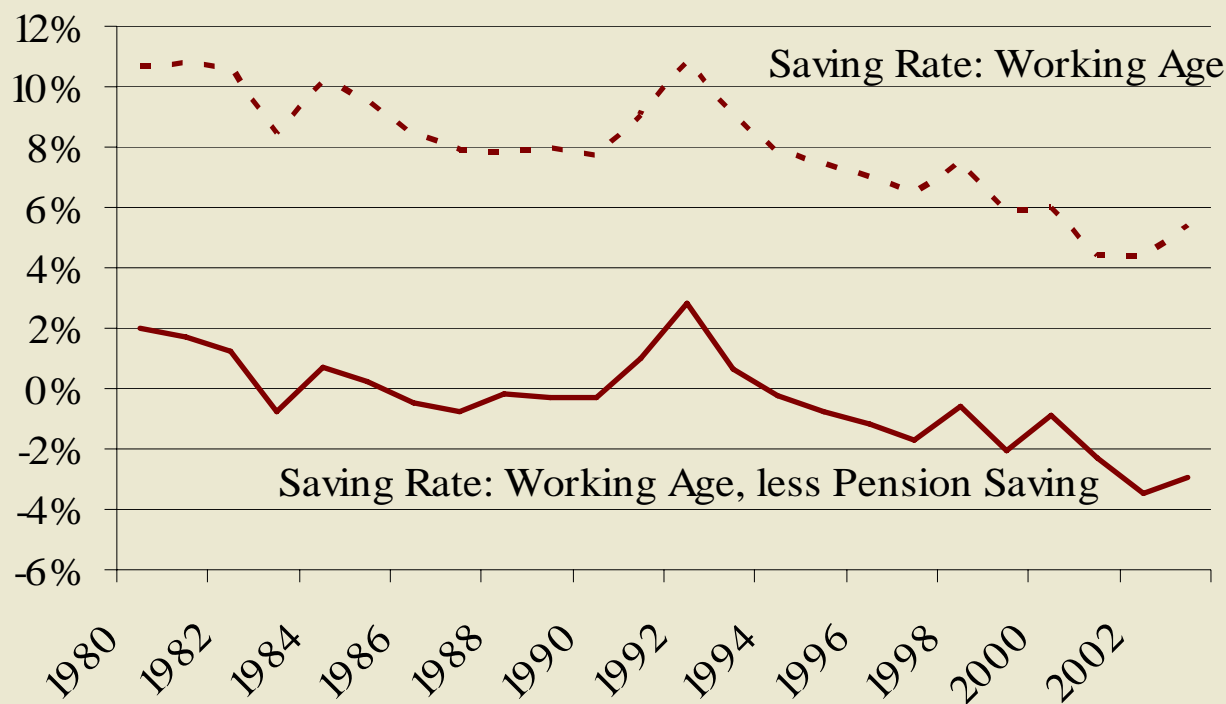
Employee Saving as Percent of Wages, with Automatic Increases



Source: Shlomo Benartzi and Richard Thaler. 2004. "Save More Tomorrow." *Journal of Political Economy*: 112 (1).

And, in fact, people have no financial saving outside of pensions.

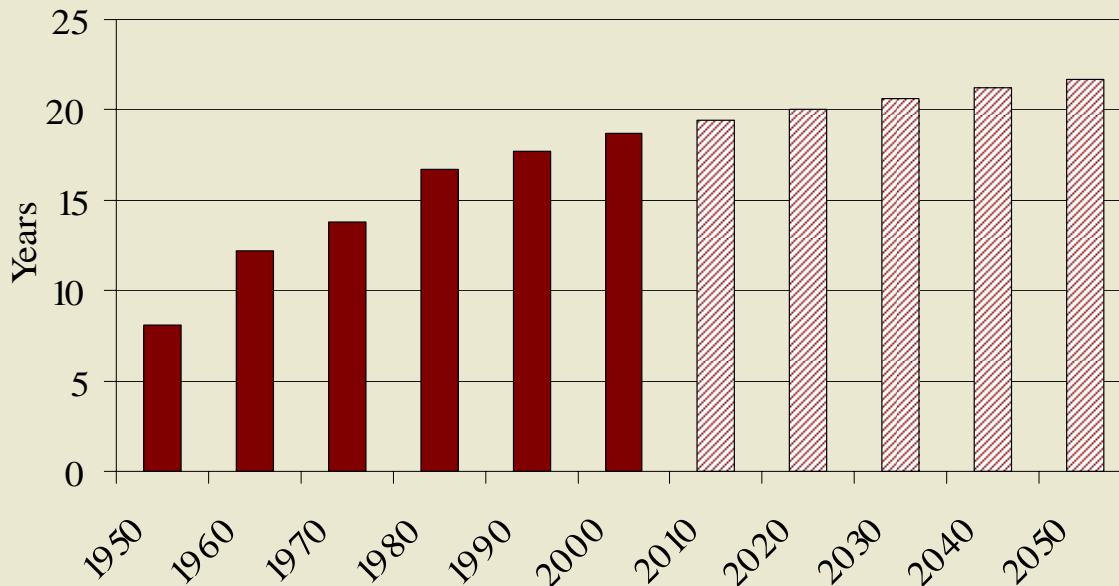
NIPA Personal Saving Rate: Working-Age Population with and without Pensions, 1980-2003



Source: Alicia H. Munnell, Francesca Golub-Sass, and Andrew Varani. 2005. "How Much Are Workers Saving?" *Issue in Brief 34*. Center for Retirement Research at Boston College.

And the landscape is getting more treacherous: first, the retirement span is increasing.

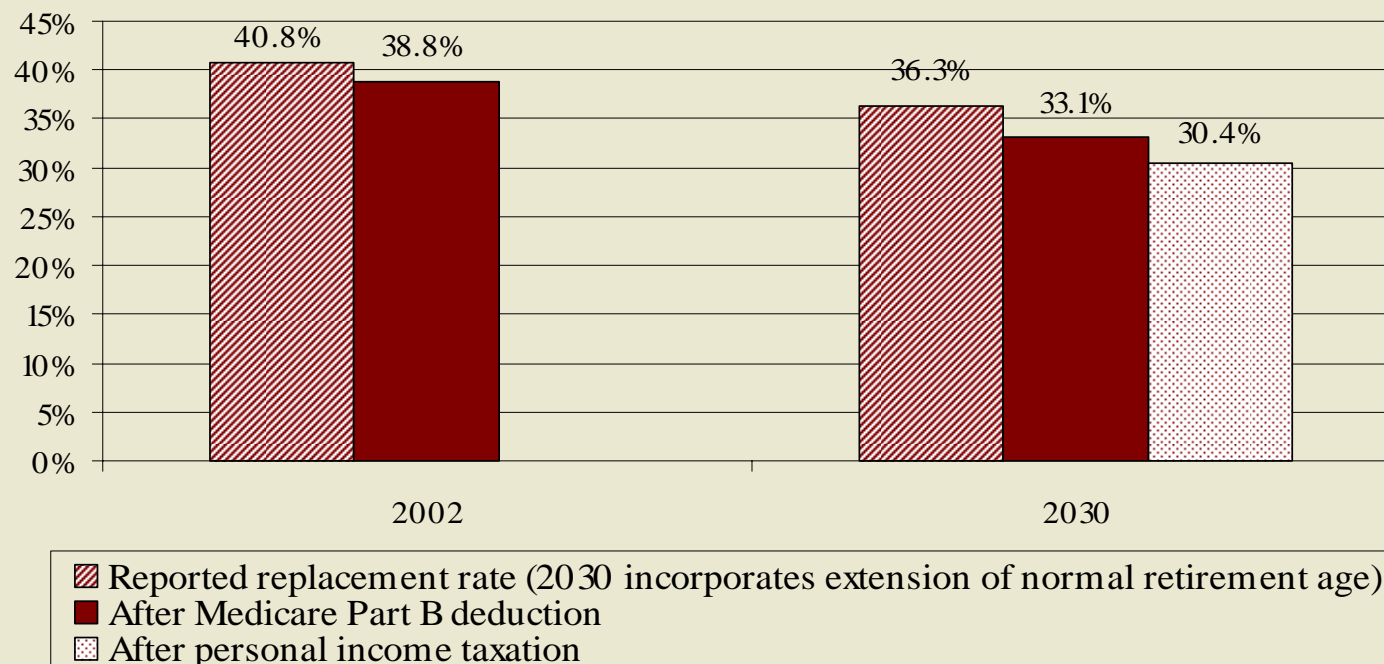
Retirement Period of Males, 1950-2050



Source: U.S. Bureau of Labor Statistics and U.S. Census Bureau. 1962-2005. *Current Population Survey*; and author's calculations based on U.S. Social Security Administration. 2006. *Social Security Trustees Report*.

Second, Social Security is contracting.

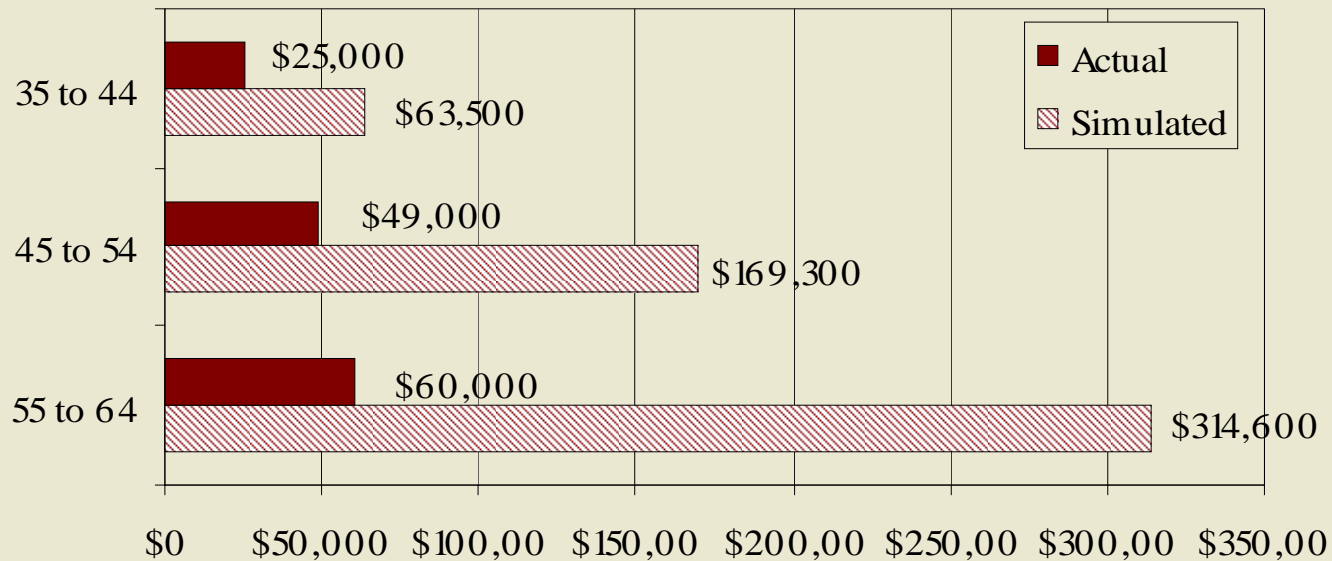
Social Security Replacement Rates for the Medium Earner, 2002 and 2030



Source: Author's calculations based on Alicia H. Munnell, 2003. "The Declining Role of Social Security." *Just the Facts on Retirement Issues 6*. Center for Retirement Research at Boston College.

Third, shift to 401(k)s is producing small balances.

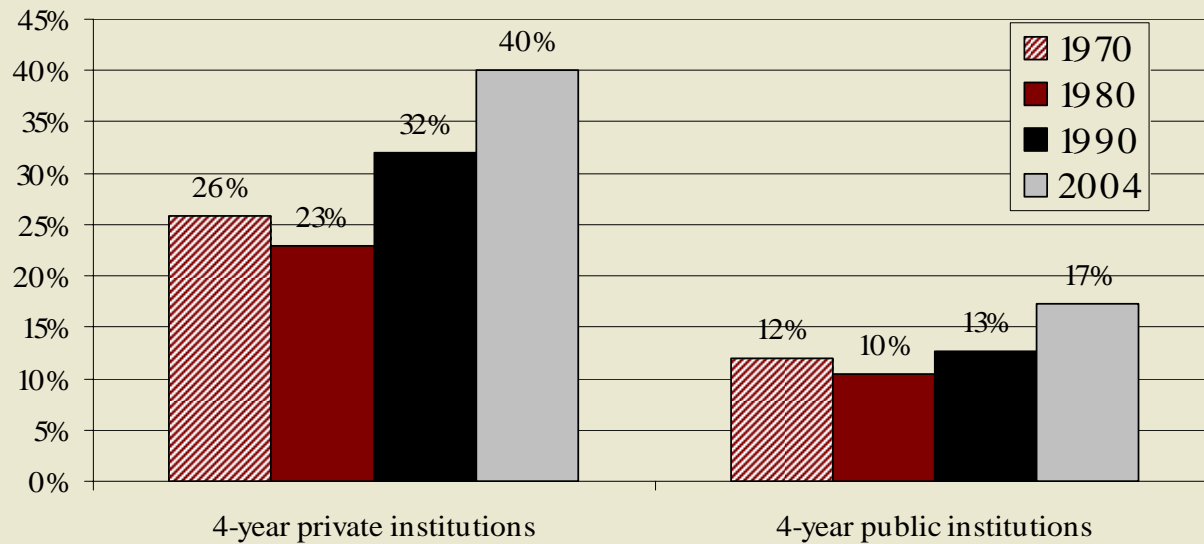
401(k)/IRA Actual and Simulated Accumulations, by Age Group, 2001 and 2004



Sources: Alicia H. Munnell and Annika Sundén. 2004. *Coming Up Short: The Challenge of 401(k) Plans*. Brookings Institution Press; and author's calculations from the U.S. Board of Governors of the Federal Reserve System. 2006. *2004 Survey of Consumer Finances*.

Fourth, college expenses are hindering retirement saving.

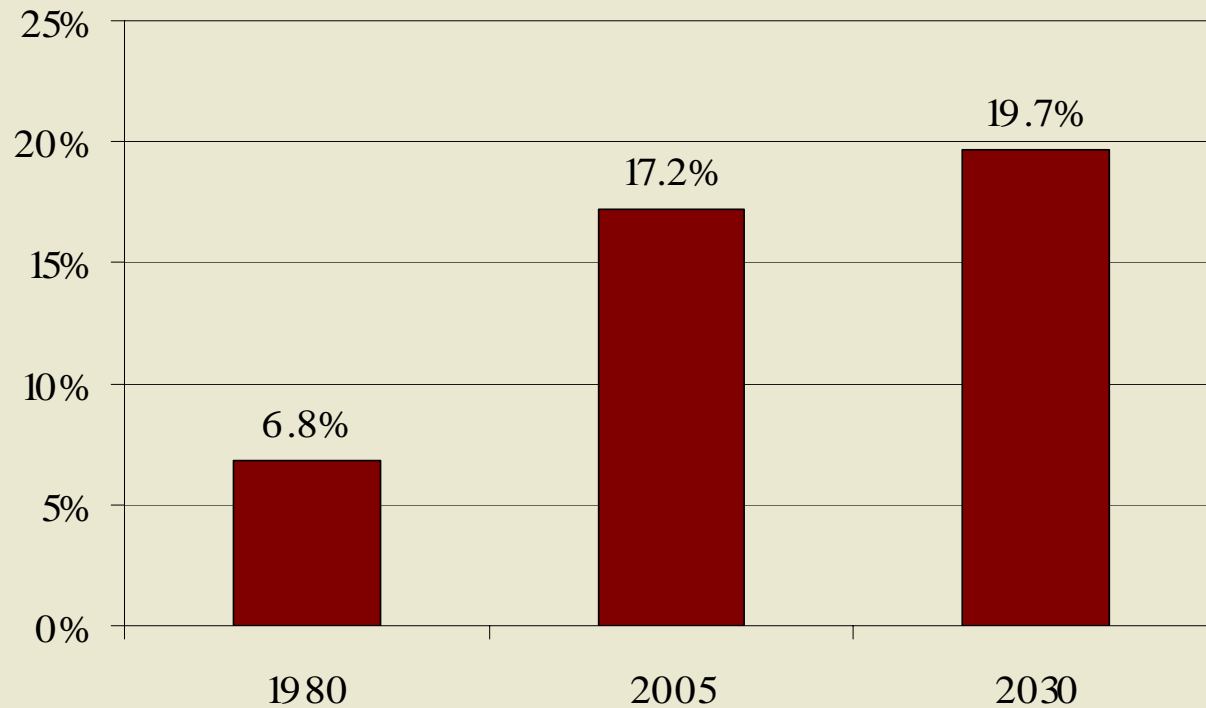
Cost of Higher Education as a Percentage of Median Income for 4-Person Families



Sources: U.S. Department of Education. 2005. *Digest of Education Statistics 2005*; and U.S. Census Bureau. 2005. *Median Income for 4-Person Families*.

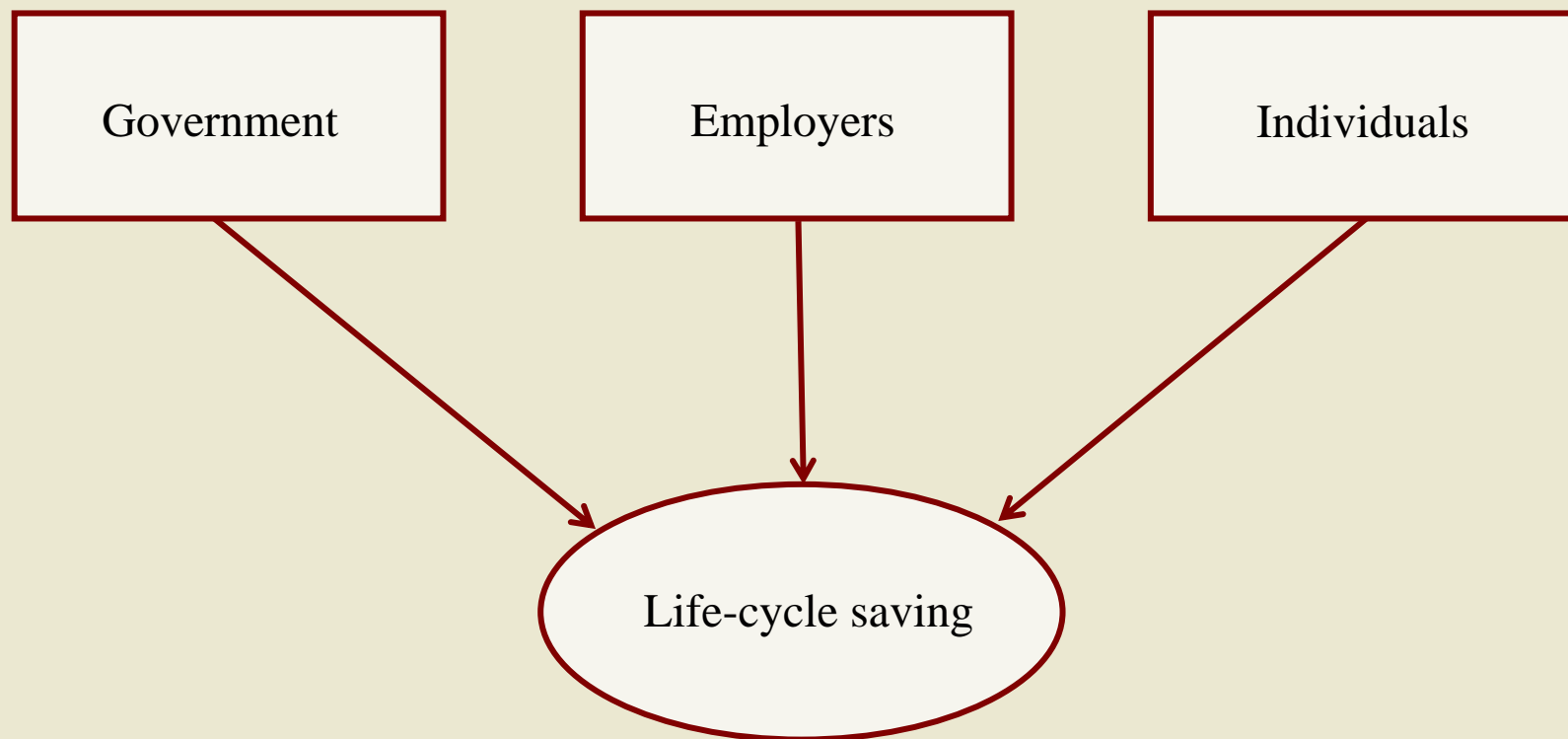
Fifth, health care costs are rising.

Medicare Part B Out-of-Pocket Expenditures as a Percentage of the Average Social Security Benefit



Source: Centers for Medicare and Medicaid Services, Office of the Actuary. 2005. "SMI Out-of-Pocket Expenses as a Percentage of Illustrative Social Security Benefit."

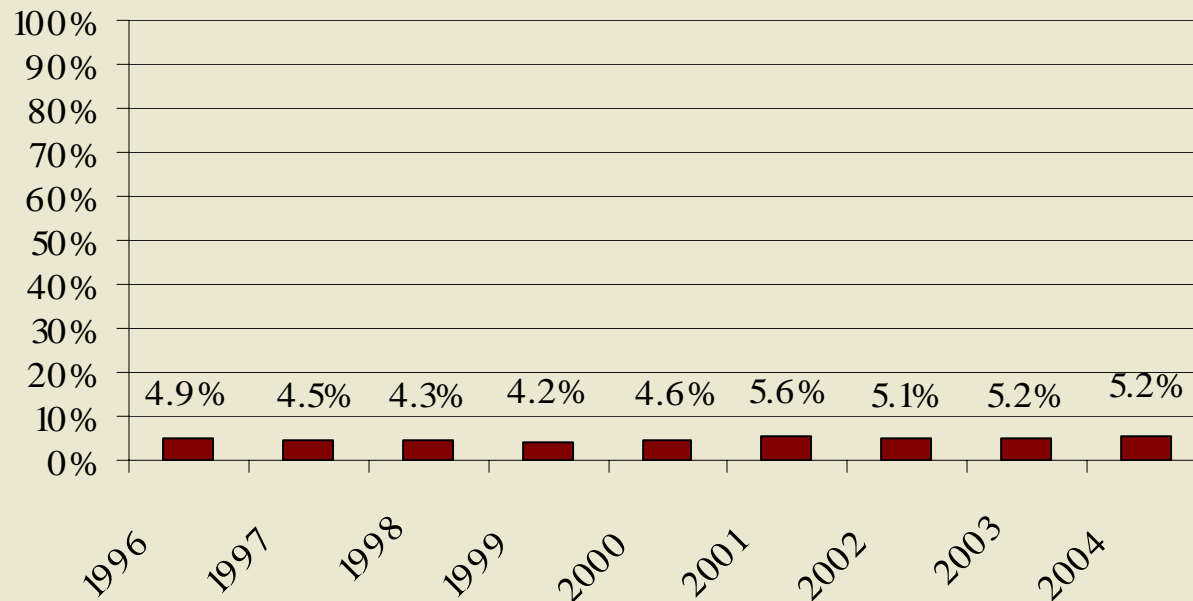
With more treacherous landscape and withdrawal of employers, government has to do more.



Source: Author's illustration.

First, government could improve markets for annuities generally...

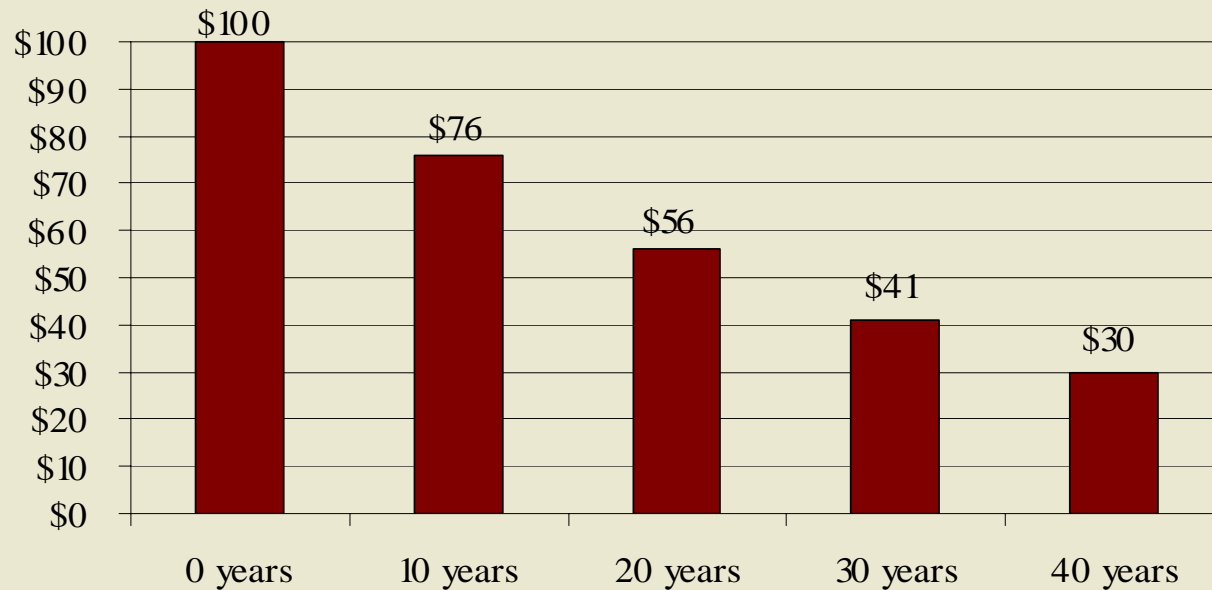
Immediate Annuity Premiums as Percent of Total Annuity Premiums



Source: LIMRA International. 2002. *The 2001 Individual Annuity Market: Sales and Assets* and updates from LIMRA International.

...and perhaps develop inflation-protected annuities.

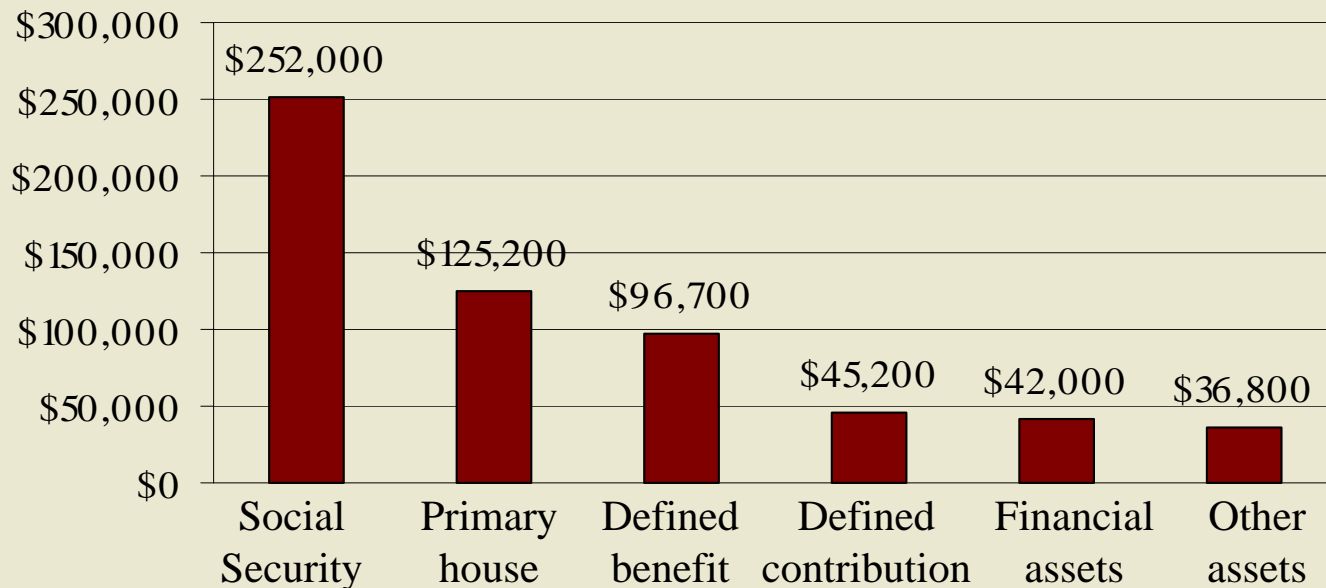
Value of \$100 with 3 Percent Inflation after Specified Number of Years



Source: Alicia H. Munnell, Kevin E. Cahill, Andrew D. Eschtruth, and Steven A. Sass. 2004. *The Graying of Massachusetts: Aging, the New Rules of Retirement, and the Changing Workforce*. Mass Inc.

Second, government could help households access home equity...

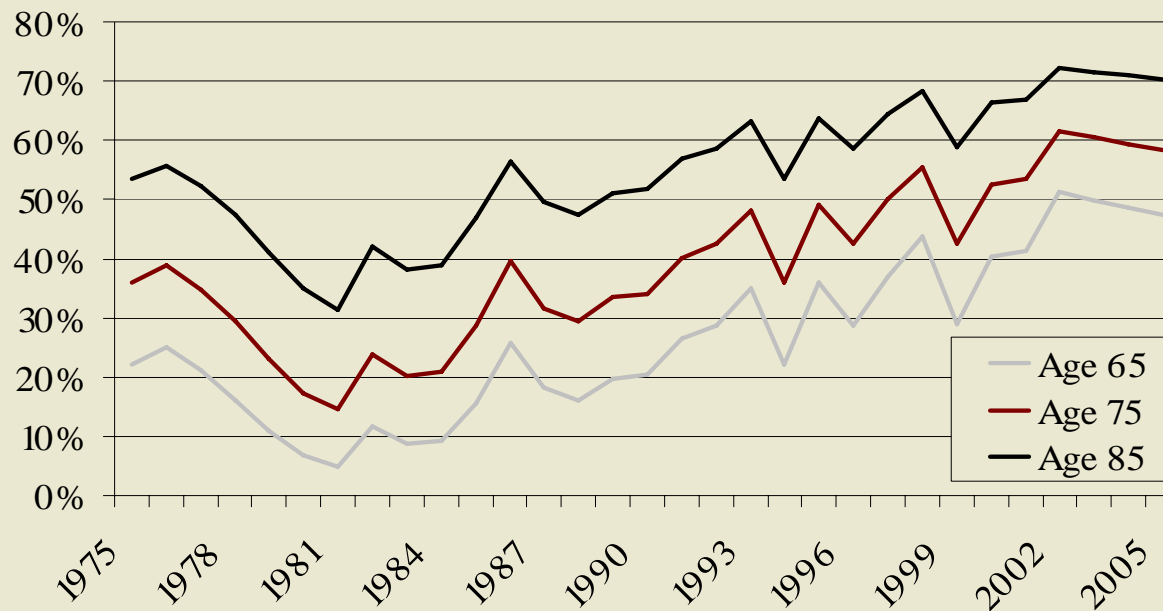
Wealth Holdings of a Typical Household Aged 55-64,
2004 Survey of Consumer Finances



Source: Author's calculations from U.S. Board of Governors of the Federal Reserve System. 2006. *2004 Survey of Consumer Finances*.

...and help make reverse mortgages less sensitive to interest rates.

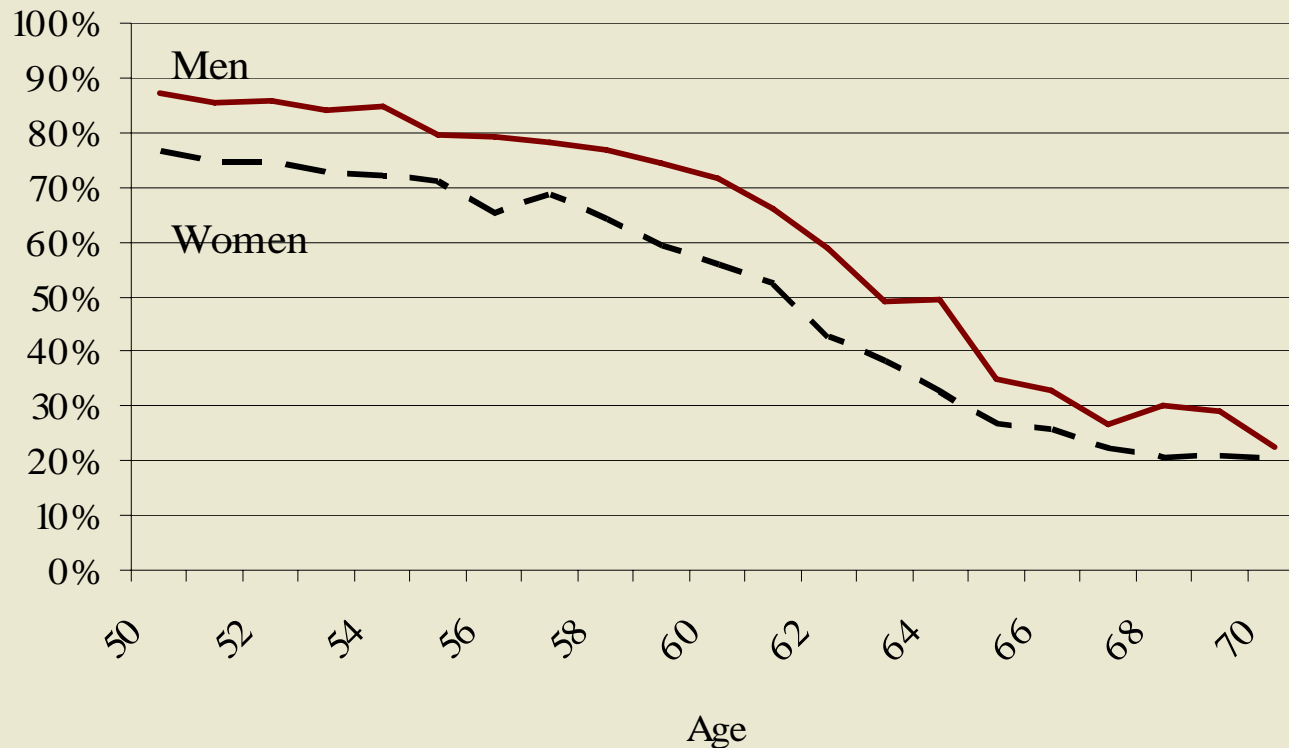
Percentage of House Value That Could Be Borrowed at Ages 65, 75, and 85, 1975-2005



Sources: Authors' calculations based on Federal Reserve Bank of St. Louis. 2006, "Series: GS10, 10-Year Treasury Constant Maturity Rate;" U.S. Department of Housing and Urban Development. 2006c. "Table of Principal Limit Factors;" and AARP. 2006b. "Reverse Mortgage Calculator."

Third, government could foster continued employment of older workers.

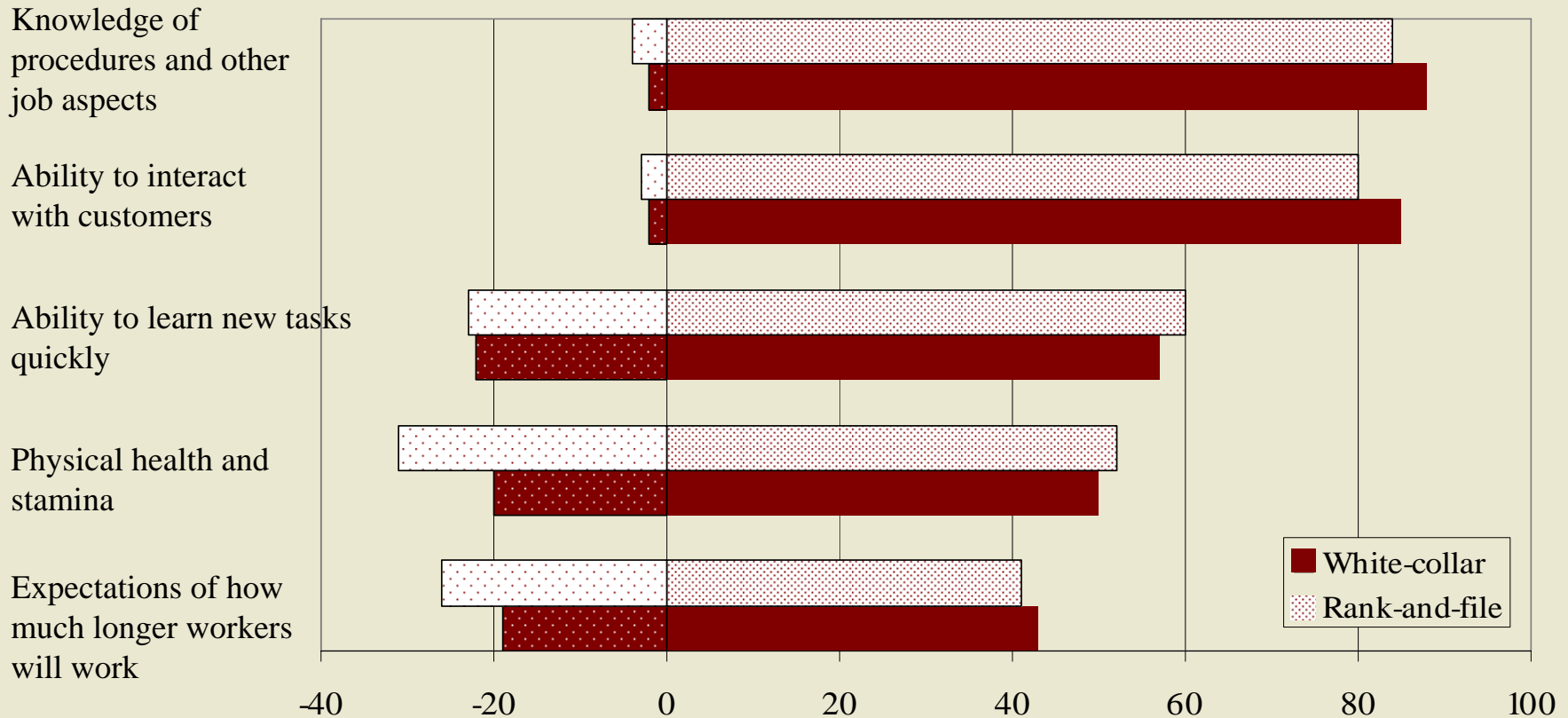
Labor Force Participation by Age and Gender, 2004



Source: U.S. Bureau of Labor Statistics and U.S. Bureau of the Census. 2005. *Current Population Survey*.

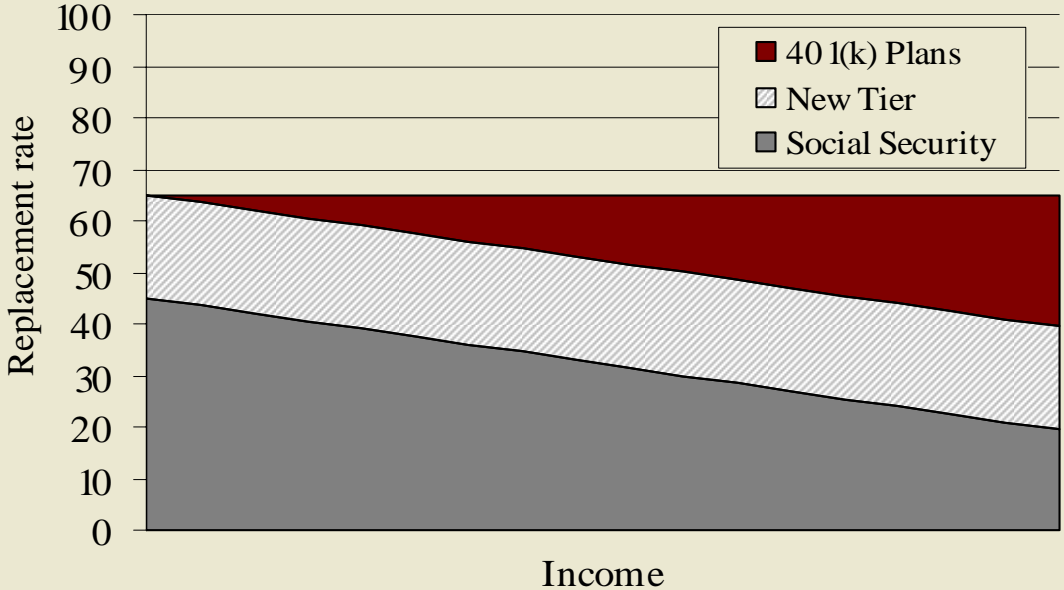
Later retirement would also enhance willingness of employers to hire older workers.

Percent of Employers Citing Positive or Negative Impact of Various Factors on Older Worker Productivity



Source: Alicia H. Munnell, Steven A. Sass, and Mauricio Soto. 2006. "Employer Attitudes Toward Older Workers: Survey Results." *Work Opportunity Issue in Brief #3*. Center for Retirement Research at Boston College.

Fourth, government could introduce new tier of life-cycle saving.



Source: Author's illustration.

Conclusion

- Employers withdrawing from life-cycle saving.
- Withdrawal occurring as life-cycle saving is getting harder.
- Government needs to assume new tasks.
 - Improve markets for financial instruments.
 - Foster continued employment of older workers.
 - Add new tier of life-cycle saving.