HOW IMPORTANT ARE PRIVATE PENSIONS?

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INSIDE

Executive Summary

Employer-provided pensions play an important role in assuring a comfortable retirement. In 1992, they accounted for about 20 percent of the total wealth of middle-income households aged 51-61, second only to Social Security. However, many workers still lack pension coverage. After increasing sharply in the post-World War II period, the percentage of the private sector workforce covered by an employer-sponsored pension plan at any given point in time has remained around 50 percent since the 1970s. This constancy obscures two major changes, however. First, pension coverage has increased for women and declined for men, primarily reflecting the increased earnings and labor force participation of women and a decline for men in union membership and employment in large manufacturing firms. Second, a major shift has occurred in the types of plans from defined benefit to defined contribution. Defined benefit plans generally provide retired workers with a set amount based on their salary history, while benefits under defined contribution plans depend on the accumulated amount in a worker's account. The shift to defined contribution plans reflects employment trends as well as conversion of plans.

Whereas only about half the workforce is covered at a given point, pension coverage is more extensive when considered over workers' lifetimes and on a household basis. In addition, the length of time workers must be employed to

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become eligible for benefits — known as the vesting period — has declined, meaning that more plan participants are assured of receiving benefits. On the other hand, pensions are more important for high-income than for low-income workers. This would not be a problem if Social Security alone allowed those at the low end of the income scale to maintain their living standards in retirement, but it does not. All workers need more than Social Security for a comfortable retirement.

The primary challenge for those interested in retirement security is to expand coverage so that more workers have enough income in retirement to avoid sharp drops in their living standards. About one-quarter of those without coverage are employed in firms where the employer sponsors a plan. Within this group, the main reasons for lack of coverage are that workers do not meet the age, service, or number of work hours required. Another significant reason is that workers who are covered by a 401(k) plan choose not to participate. The other three-quarters of those without a pension work for employers who do not sponsor a plan. Smaller firms are the most likely not to offer plans, and the main reasons they cite are related to the nature of their workforce (e.g., high employee turnover, a preference for cash wages) rather than the cost and administrative burden of offering a plan. Since private pensions can provide an important source of retirement income, employers and policymakers should be concerned with finding innovative approaches to expand coverage and boost employee participation.

Introduction

Private pension plans in the United States date from 1875, but the early plans were financially vulnerable and most were bankrupted in the 1930s by the Great Depression. Contemporary U.S. pension plans, both private and public, are rooted in the search for greater financial security that became part of the national psychology after the onset of the Depression. During World War II, wage controls greatly stimulated the expansion of private plans as fringe benefits were used in lieu of higher wages to attract and hold workers (Munnell 1982 and Sass 1997). The growth of new pension plans fell off markedly in the immediate post-war period as employees focused on cash wages to recover ground lost during the period of wage stabilization. But, in 1949, pension benefits became a major issue of labor negotiation, and that began the main expansion of today's pension system in both unionized and non-unionized industries. The growth in pension coverage continued until the 1970s, but since then it has remained unchanged.

This *brief* focuses on trends over the past two decades in private sector pension coverage. It explores who is covered by private plans and who is not, how much retirees receive in pension income, and how pension coverage and receipt have changed over time.

FIGURES AND TABLES

Trends in Pension Coverage

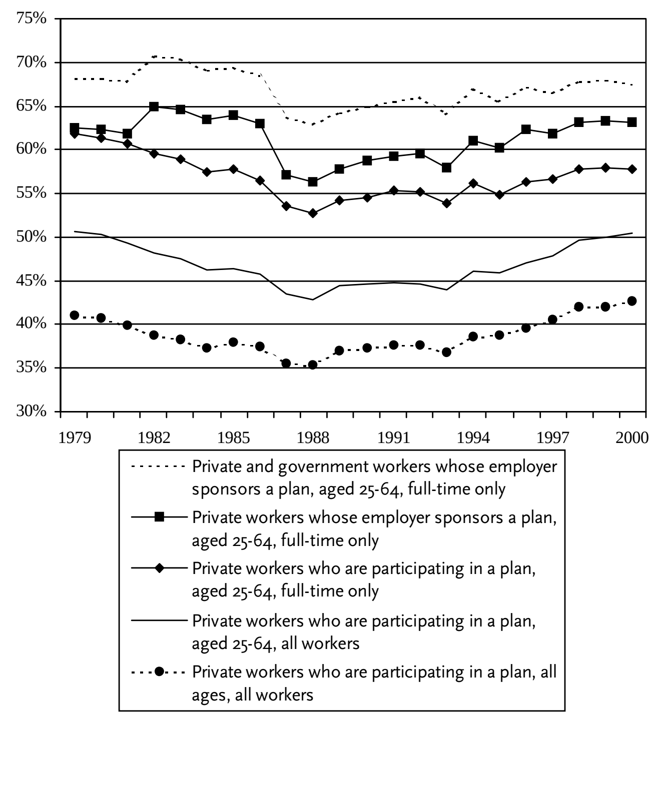
Before discussing pension trends, it is necessary to clarify three distinct ways in which workers can be associated with a plan. The first is that they could work for an employer that "sponsors" a plan for any of its employees. The second is that they could be "covered" by a plan, but not be eligible for benefits. And the third is that workers actually "participate" in the plan. Coverage and participation are not the same, since, for example, a percentage of workers covered in 401(k) plans choose not to participate. Nevertheless, this *brief* will use the terms coverage and participation interchangeably, except in the discussion of 401(k) plans. The data on coverage trends in this section are primarily from the Current Population Survey (CPS).[1]

Determining the share of workers covered by private pensions depends on how one defines coverage and the relevant population. This is shown clearly in Figure 1 where the population moves gradually from private and government full-time, full-year workers aged 25-64 whose employer "sponsors" a pension plan to all private sector workers who actually "participate" in a plan. Including government workers, restricting the relevant labor force substantially, and using employer sponsorship as the relevant criteria indicates that 68 percent of the population had at least the potential for pension protection in 1999. At the other extreme, focusing only on private sector workers and eliminating the age and full-time constraint shows that 43 percent of private sector workers participated in a pension.

What's the relevant number? First, this discussion focuses on the private sector, so government workers should be excluded. Second, the real concern is not simply whether the employer offers a plan to any of its workers but whether the worker actually participates, so participation, as opposed to sponsorship, is the important criterion. Third, part-time and part-year workers should probably be included since they are frequently regular participants in the workforce. Fourth, young workers — that is, those under 25 — generally are more concerned about establishing themselves in their careers than accumulating assets for retirement, so their pension coverage is not a major concern. That leaves the second line from the bottom in Figure 1, which shows that only about 50 percent of private sector workers aged 25-64 participated in an employer-sponsored pension in 2000. But one could argue that all the numbers are relevant, depending on the purpose — a narrow definition of the workforce to determine the success of the Employment Retirement Income Security Act of 1974 (ERISA), a broader definition of the workforce to assess the possibilities for expansion of coverage, and employer sponsorship to look at potential participation.

While the level of pension participation depends on definitions, the trend over time does not. Regardless of how the relevant population is defined, pension participation is just about where it was in 1979. In each case, participation dropped between 1979 and 1988 and then rebounded between 1988 and 2000. In both 1979 and 2000, only about 50 percent of non-agricultural wage and salary workers in the private sector aged 25-64 participated in a pension plan, even though 1979 was the end of a decade of stagnation and 2000 was the height of the longest expansion in the post-war period.

Figure 1. Pension Sponsorship and Participation, 1979-2000



[1] The CPS is administered jointly by the Bureau of Labor Statistics (BLS) and the Bureau of the Census. Another major source of pension data is the *Employee Benefits Survey* (EBS), which is conducted by the BLS. Although the EBS indicates more coverage than the CPS for comparable populations, the two series provide a relatively consistent picture of pensions in the United States. Among full-time workers, the gap between the two surveys is 10 percentage points (Herz et al., 2000). The difference between the two surveys can be attributed to sampling procedures and survey methods (Purcell 2000). This *brief* relies on the CPS because it provides better information for analyzing general trends. For additional details on data sources, see Munnell and Sundén (2001).

Coverage by Sex, Earnings, and Race

Although the overall participation rate remained virtually unchanged between 1979 and 2000, that stability was the result of offsetting changes for males and females. Figure 2a shows that pension coverage declined for all male workers except those in the highest-earning quintile (i.e., the top 20 percent of the population). In contrast, as shown in Figure 2b, participation for women increased at all earnings levels. The drop in male participation rates was caused by declines in union membership and employment at large manufacturing firms, and by the rapid growth in 401(k) plans that made employee participation in pensions voluntary.[2] Among women, the growth in pension participation was largely the result of improved earnings and an increase in full-time work and — to a lesser extent — increased union membership and employment at large firms (Even and Macpherson 2000). The remaining differential between coverage patterns for men and women can be explained by their different work patterns, since pension coverage among women who work full-time, full-year is virtually identical to the coverage rates for men (Copeland 2000).

Furthermore, Figure 2 shows that participation is closely correlated with earnings levels. In the top quintile, about 70 percent of workers — both male and female — participate in pensions; in the bottom quintile, that figure drops to about 20 percent for men and 10 percent for women.[3]

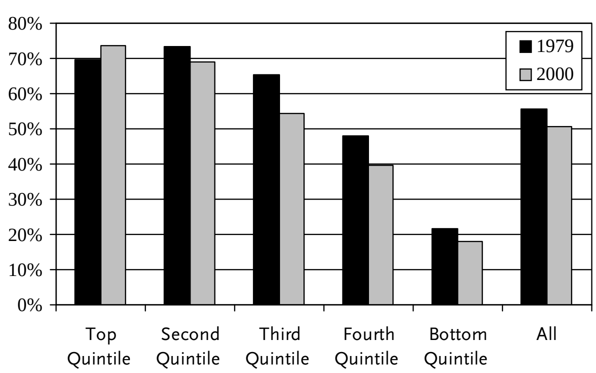
Lifetime Pension Coverage

The pension coverage data discussed above apply only to individual workers at any given point in time. Over a lifetime and on a household — rather than an individual — basis, coverage rates are somewhat higher. For households aged 51-61, approximately 65 percent had some sort of pension coverage in 1992. However, again, pension coverage is much more extensive for high-income households — coverage drops from above 80 percent in the top two quintiles of the income distribution to 30 percent for the bottom quintile.

The Uncovered – Firm Has a Plan

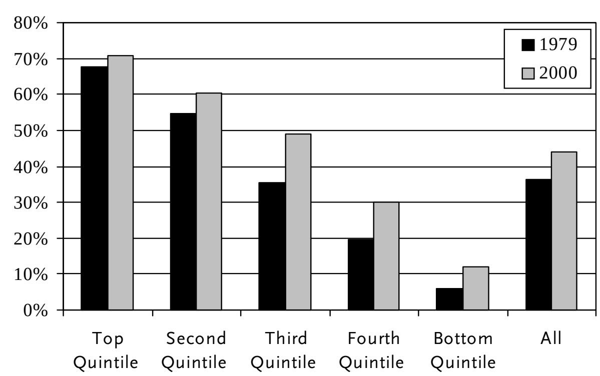
Of those not covered by a pension plan, roughly one-quarter work for an employer with a plan and three-quarters are employed in a firm without a plan. As shown in Figure 3, more than half of those who are not part of their employer's pension plan report that they do not meet the age and service requirements or do not work enough to qualify for the plan, and another 6 percent were excluded because their job was not eligible for pension coverage.[4] While the majority of non-participating workers, therefore, is not eligible to participate in their employers' plans, about one-quarter of workers say that they choose not to contribute to an available plan. This share rose slightly during the late 1990s, which is most likely an indication of the growing prevalence of 401(k) plans. Unlike traditional defined benefit plans, 401(k) plans are voluntary.

Figure 2a. Pension Participation for Male Workers, Ages 25-64, 1979 and 2000 by Earnings Quintile



Source: Authors' calculations using the U.S. Bureau of the Census, Current Population Survey, March 1980 and 2001.

Figure 2b. Pension Participation for Female Workers, Ages 25-64, 1979 and 2000 by Earnings Quintile



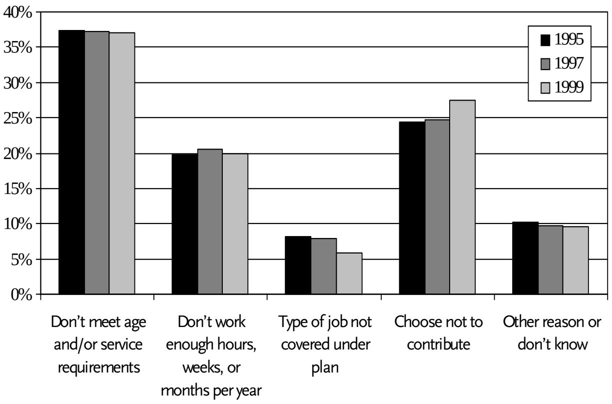
Source: Authors' calculations using the U.S. Bureau of the Census, Current Population Survey, March 1980 and 2001.

[2] Even and Macpherson (1994) showed that the growth of 401(k) plans caused participation rates to drop most for young and less educated workers.

[3] Earnings also appear to be more important than race in explaining pension participation. When examining participation by earnings groups, the picture for whites and blacks looks very similar. Hispanics, on the other hand, have lower participation rates in all earnings groups. For additional evidence, see Chen (2001).

[4] The Internal Revenue Code (IRC)'s minimum participation provisions allow firms to exclude employees under age 21 or with less than one year of employment with the firm. Since a year of service is defined as 1000 hours during a 12-month period, many part-time and seasonal workers never qualify to participate in the plan (Halperin and Munnell 2001). In addition to the exclusion for age and service, the IRC's minimum coverage rules permit a firm to exclude at least 30 percent of the remaining non-highly-compensated workers from the plan.

Figure 3. Percent of Workers Citing Reason as Most Important for Not Participating in a Pension Plan, 1995, 1997, 1999



Source: Authors' calculations using the U.S. Bureau of the Census, February Current Population Survey, Contingent Worker Supplement 1995, 1997 and 1999.

Researchers have explored the reasons why workers participate or do not participate in 401(k) plans. The explanations fall into two main categories: 1) worker characteristics; and 2) plan characteristics. First, a series of studies using data from the CPS show that both the likelihood of participation and the level of contributions rise with income, age, education and job tenure.[5] A recent study using the 1998 Survey of Consumer Finances (SCF) also documents the importance of an individual's planning horizon in the participation and contribution decision (Munnell, Sundén and Taylor 2000).[6] This finding reinforces conclusions from Bernheim (1998) and Clark and Schieber (1998) based on plan data indicating that employer-provided information can be very important in changing employees' attitudes about the necessity of saving for retirement.

Second, plan characteristics are also important for participation and contribution decisions. If employers offer a matching contribution, workers are more likely to participate since the match provides a large initial return that supplements the advantage of income tax deferral. If the 401(k) plan supplements a defined benefit plan, workers are less likely to participate. The research suggests that both participation and contributions are negatively related to the presence and generosity of a defined benefit plan. Finally, workers are more likely to participate and contribute if they can gain access to their funds through borrowing.

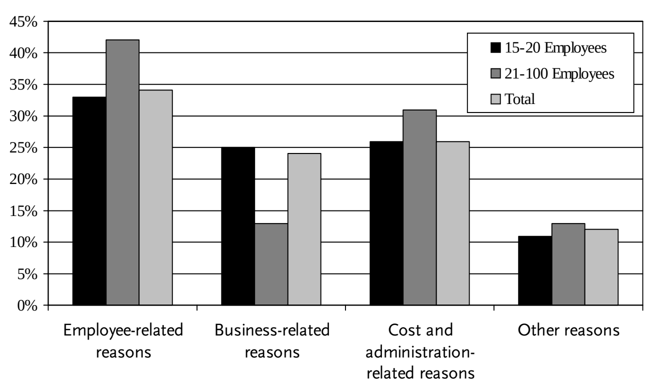
Studies have shown that individuals' behavior often reflects a surprising amount of inertia and that if employees are automatically enrolled in a plan, they are more likely to participate than if they had to opt in (Madrian and Shea 2000). In 1998 and 2000, the IRS issued regulations that permit employers to enroll employees automatically in 401(k) pension plans. Benefit consultants estimate that since the IRS issued its first regulation, 7 to 10 percent of 401(k) plan sponsors have adopted automatic enrollment (Jacobious 2000 and Purcell 2001). A study by Hewitt Associates found that only 4 percent of people who were automatically enrolled in a 401(k) plan subsequently opted not to participate (Purcell 2001).

Uncovered – Firm Does Not Have a Plan

The majority of uncovered workers is employed in firms without a pension plan. The existence of a pension plan varies sharply by size of firm; among private sector workers aged 25-64, the participation rate ranges from 23 percent in firms with less than 25 employees to 68 percent for firms with more than 1000 employees.

As reasons for not providing coverage, small employers frequently mention high employee turnover and the preference of their employees for cash wages. They also cite uncertainty about future earnings and the newness of the business. Figure 4, taken from a survey of small employers by the Employee Benefits Research Institute (2001),

Figure 4. Percent of Small Employers Citing Reason as Most Important for Not Offering a Retirement Plan, by Size of Business, 2001



Source: Employee Benefits Research Institute (2001).

[5] For a list of these studies, see Munnell and Sundén (2001).

[6] The SCF is a triennial survey sponsored by the Federal Reserve Board in cooperation with the Department of the Treasury that collects data on households' assets, liabilities and other items, including pension coverage.

documents the relative importance of these various factors. For the entire small business sample, only 12 percent say that a major reason for not providing a pension is that it costs too much to set up and administer a plan. Even defining cost broadly to include "required contributions too expensive" and "too many government regulations" brings the total to only 26 percent. These results suggest that, for small firms, cost is an important but not dominant consideration.

The low level of pension coverage in small firms is an important policy concern since about one-third of full-time workers are employed in firms with less than a hundred workers (Copeland 2001b). In an effort to make it easier for firms to establish and maintain plans for their employees, the federal government has passed several pieces of legislation over the years to ease financial and reporting requirements.[7] But, as noted above, while cost and administrative issues matter, they are not the primary reason for low sponsorship among small employers. Perhaps that is the reason that despite this legislation, the discrepancy in coverage between large and small firms remains. Alternatively, small business owners may not have had time to understand the new plans — particularly those included in the 1996 legislation.

A Shift to Defined Contribution and Cash Balance Plans

Although the percentage of the workforce covered by a pension plan has remained virtually unchanged since the 1970s, the nature of pension coverage has moved sharply from defined benefit plans to defined contribution plans. Defined benefit plans generally provide retirement benefits based on a percentage of final salary for each year of service and pay the benefits in the form of a lifetime annuity. For example, a worker with a final salary of $40,000 might receive 1.5 percent a year for 30 years of service, producing an annual pension of $18,000. The employer pre-funds these benefits by making pre-tax contributions into a pension fund; employees typically do not contribute. The employer holds the assets in trust, directs the investments, and bears the risk. Benefits are insured up to specified limits by the Pension Benefit Guaranty Corporation (PBGC).[8]

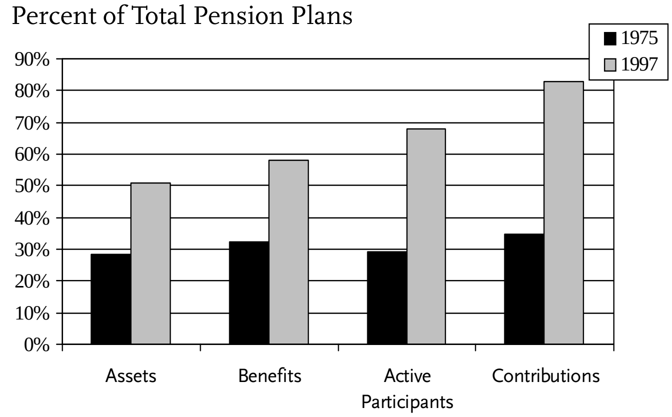
In contrast to defined benefit plans, defined contribution plans are like savings accounts. Generally the employer, and often the employee, contributes a specified dollar amount or percentage of earnings into the account. These contributions are invested, usually at the direction of the employee, in mutual funds consisting of stocks and bonds. When the worker retires, the balance in the account determines the retirement benefit. The worker then can decide how and when to withdraw the accumulated money.

A Shift from Defined Benefit to Defined Contribution Plans

Over the past quarter-century, private pensions have shifted dramatically from defined benefit to defined contribution plans. As shown in Figure 5a, which relies on data from the Department of Labor, growth in defined contribution plans outpaced defined benefit plans on every major measure of comparison between 1975 and 1997: assets, benefits paid out, active participants, and contributions.[9]

Within the defined contribution world, the fastest growing type of plan is the 401(k). The defining characteristics of 401(k) plans are that participation in the plan is voluntary and that the employee as well as the employer can make pre-tax contributions to the plan. These characteristics shift a substantial portion of the burden for

Figure 5a. Defined Contribution Pension Plans as a Percent of Total Pension Plans



Source: U.S. Department of Labor (2001 and 1999).

[7] The Revenue Act of 1978 authorized a simplified employer-financed defined contribution plan called the Simplified Employee Pension (SEP), which required very little paperwork and no government reporting if certain rules were followed. The Tax Reform Act of 1986 allowed workers in firms with less than 25 employees to contribute to a SEP on a tax-deferred basis through a salary reduction plan (SARSEP). The Small Business Job Protection Act of 1996 authorized another type of defined contribution plan called Savings Incentive Match Plans for Employees of Small Employers (SIMPLE). SIMPLE plans generally replaced SARSEPs, although firms can continue to establish SEPs funded exclusively by employer contributions (Purcell 2000).

[8] The PBGC monthly guarantee limit in 2001 was $3,392 at age 65, declining to $1,546 at age 55.

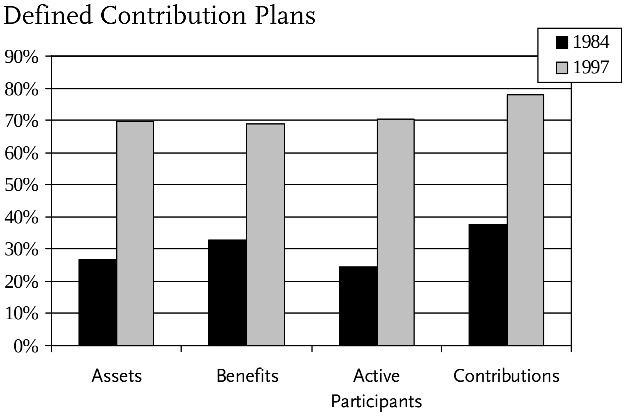
[9] For information on the data sources, see Munnell and Sundén (2001).

providing for retirement to the employee; the employee decides whether or not to participate, how much to contribute, and how to invest the assets. In addition, workers have some access to 401(k) plan funds before retirement, adding another element of individual responsibility.

Despite the fact that employees bear much of the risk in 401(k) plans, these plans have grown enormously for a number of reasons. They are more appealing to a younger, more mobile workforce. For these workers, greater portability — the ability to move accumulated pension benefits from job to job — clearly outweighs the predictability of benefits for the career employee under a defined benefit plan. Workers get statements several times a year and can see their balances grow, which makes defined contribution benefits seem more tangible. From the employer's perspective, 401(k) plans may be less costly to operate than defined benefit plans. They do not require employer contributions, although most employers do contribute to these plans. And they are fully funded by definition, eliminating the work associated with funding requirements and pension insurance. Portability, in some cases, eliminates the need for employers to keep track of pensions for departed employees. As shown in Figure 5b, between 1984 (the first year separate data are available for 401(k) plans) and 1997, all dimensions of 401(k) plans — assets, benefits, participants, and contributions — have increased from between 25 to 35 percent of total defined contribution plans to 70 to 80 percent.

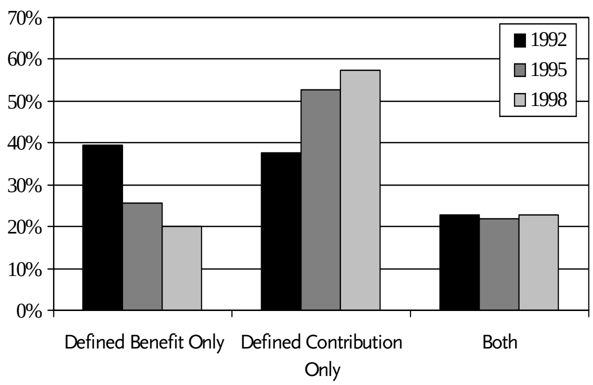
Given their popularity and growth, one would have thought that the introduction of 401(k) plans should have boosted pension plan coverage in the United States. But, as noted above, overall pension coverage has remained virtually unchanged. This means that the enormous expansion of defined contribution plans, especially 401(k)-type plans, has produced a sharp decline in the percent of the workforce covered under traditional defined benefit plans, as shown in Figure 6. This decline reflects both shifts in employment from manufacturing to service industries and employers substituting defined contribution for defined benefit plans.[10]

Figure 5b. 401(k) Plans as a Percent of Total Defined Contribution Plans



Source: U.S. Department of Labor (2001 and 1999).

Figure 6. Households Covered by a Pension, by Pension Type, SCF 1992, 1995, and 1998



Source: VanDerhei and Copeland (2001).

A Shift of Defined Benefit Plans to Cash Balance Plans

In addition to the shift in pension coverage from defined benefit to defined contribution plans, some employers have converted their pensions to hybrid plans that have both defined-benefit and defined-contribution characteristics. The most popular of the hybrids are the so-called cash balance plans. Bank of America created the first cash balance plan in 1985, but few employers followed suit until the late 1990s. Legally, cash balance plans are defined benefit plans where the employers pre-fund contributions, own the assets, select the investments, and bear the risk. And, like other defined benefit plans, the PBGC insures the benefits. To the employee, however, cash balance plans look very much like a defined contribution plan. Contributions made for the employees are recorded in separate "notional" accounts for each worker. Notional accounts are used for record-keeping purposes only; the pension funds are not invested through these separate accounts, but are instead pooled and invested centrally by the employer. The employees receive regular statements showing the balance in their notional account, and the benefits tend to accrue as a constant percentage

[10] Researchers attribute about half of the decline in defined benefit coverage to employment shifts and half to substitution (Ippolito and Thompson 2000 and Gustman and Steinmeier 1992).

of compensation plus a fixed investment return. At separation, the employee can withdraw the balance, which for younger workers is usually greater than they would get under a traditional defined benefit plan.

The most recent official statistics report that only 6 percent of full-time employees at medium and large private establishments had a "cash account" benefit formula in 1997. But surveys suggest that significant conversion has occurred since then. About 16 percent of pension plans among the Fortune 100 were cash balance plans in 1998, and, more generally, cash balance plans may have increased from 5 percent to 12 percent of all defined benefit plans between 1998 and 2000 (Elliot and Moore 2000).

Pensions as a Source of Retirement Income

Despite the constancy of the coverage figures, pension benefits from private sector plans have become an increasingly important source of retirement income. Part of this increase is the natural result of the expansion and maturation of private plans. That is, coverage expanded significantly after World War II, and, as those groups of workers retired, an increasing number of retirees qualified for private pension benefits. At the same time, vesting has improved considerably due to changes in federal law that have reduced the vesting period over time. With shorter vesting, more workers earned assured pensions.

Table 1, using data from the 1992 Health and Retirement Study (HRS), shows that pensions accounted for about 20 percent of the total wealth for individuals in the middle of the income distribution (Gustman, et al., 2000).[11] This share makes pensions the second largest source of retirement income, behind only Social Security.

Implications for the Welfare of Beneficiaries

What do the significant amount of pension benefits and pension wealth imply for the success of the private pension system and the welfare of retirees? First, pensions are much more important for high-income than for low-income workers. This pattern contrasts with that under Social Security where low-income workers receive a higher benefit relative to earnings. As shown in Figure 7, for those in the bottom quintile, pensions account for only 3 percent of income for those 65 and over according to the CPS. Two other data sources — the HRS and the SCF — show that pension wealth was only 6-7 percent of non-housing wealth for those aged 51-61 in 1992. Second, the fact that pension and Social Security wealth are being evaluated in a low inflation environment makes them appear closer in value than they would with moderate or high inflation, since Social Security benefits increase in line with inflation whereas private employers rarely provide cost-of-living adjustments (COLAs). Only about 10 percent of full-time participants in medium and large firms were in plans that provided any COLA in the 1990s (Mitchell 2000).[12]

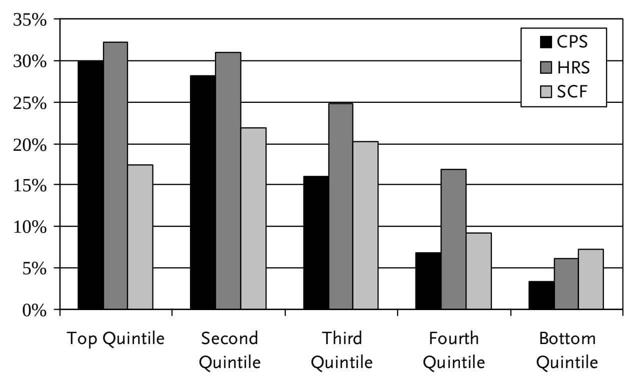
Table 1. Mean Wealth For Middle-Income Households Aged 51-61, 1992

	Middle-Income Households*	
Source of Wealth	Dollar Value	Percent of Total
Business Assets	14,511	5.5
Financial Assets	19,274	7.3
IRA Assets	10,948	4.1
Social Security	144,801	54.8
Pensions	60,102	22.7
Other	14,602	5.5
Total	264,238	100.0

Source: Gustman et al. (2000) based on HRS data.

*Note: Data represent the mean for the middle 45-55 percent of households.

Figure 7. Pensions as a Percent of Income or Wealth, by Quintiles, CPS 1998, HRS 1992, and SCF 1992



Source: Authors' calculations using the 1998 CPS, 1992 HRS, and 1992 SCF.

[11] The HRS — conducted by the University of Michigan — provides information on the income and wealth holdings for a sample of families with at least one member born between 1931 and 1941. SCF data also can be used to estimate how significant pensions are as a share of wealth. While there are clear differences between the two datasets, the 1992 SCF data also show that pensions were about 20 percent of wealth for middle-income households.

[12] Gustman and Steinmeier (1993) found that, in periods of high inflation, plans made some ad hoc adjustments.

Do Low-Income Workers Really Need Pension Income?

The lack of pension income for low-wage workers would not be a source of concern if Social Security provided enough income for them to maintain their pre-retirement standard of living. Most observers, however, conclude that Social Security alone is inadequate when viewed either in terms of the amount of pre-retirement income it replaces or in relation to poverty thresholds.

Ideally, retirement benefits should enable workers to maintain the same standard of well-being in retirement as they enjoyed while they were employed. Most analysts assume that retirees do not need to replace 100 percent of pre-retirement earnings, because they have lower clothing and transportation expenses as a result of not working, they pay less in taxes (particularly the payroll tax), they have lower housing costs because they have generally paid off their mortgages, and they have less need to save. As a rough benchmark, retirement income equal to 80 percent of pre-retirement earnings should be more or less adequate.

Using data from the 1994 HRS, which includes participants aged 53 to 63, replacement rates can be estimated for those opting for early retirement. Within this group, Social Security replacement rates averaged 55 percent for *couples* in the lowest quintile of the income distribution.[13] Thus, it would appear that low-income workers, just like their higher-income counterparts, do not receive enough from Social Security to avoid a decline in economic well-being upon retirement and, therefore, they need supplementary pension income. In the current environment, their only option is to continue working. That is a possibility for some, but for others unemployment and ill health make continued work very difficult.

How Do IRAs Change the Picture?

The lack of pension coverage for a significant portion of the workforce has been recognized as a serious problem for a long time. The framers of ERISA addressed the issue by attempting to encourage the growth of employer-sponsored plans, but they decided not to mandate coverage. Instead, for those workers whose employers did not provide a plan, ERISA authorized the Individual Retirement Account (IRA). However, the data suggest that IRAs have done little to expand pension coverage. Estimates show that 22 percent of the annual flow into IRA accounts can be attributed to rollovers — funds that are moved from 401(k)s and similar accounts — and 76 percent to investment returns primarily on rollover amounts; only about 2 percent of the inflow comes from tax deductible contributions (Copeland 2001a). A study of tax returns over the period 1987-1996 indicated that the share of individuals contributing to an IRA decreased from 8 percent to 4 percent (Smith 2001). Furthermore, in 1998 more than half of the 28 percent of total households with IRAs also had current pension coverage and probably a higher percentage had pension coverage at some time in their lives.

Thus, the pension story remains the same whether or not IRAs are included in the analysis. Private pension plans provide substantial benefits to middle- and upper-income workers, but a significant portion of the workforce — particularly those with low earnings — end up without any source of retirement income other than Social Security.

[13] The replacement rate in this calculation is the ratio of benefits in the year of retirement as a percent of earnings in the previous year. Where only one member of the couple was receiving benefits, the recipient was treated as a single individual, and the benefit was related to the beneficiary's pre-retirement earnings. This sample excluded people still working, so that benefits are not affected by the Social Security earnings test.

Conclusion

Private pensions can provide an important source of income for retirees. However, currently, pensions only cover about half of the workforce at any given time. About three-quarters of those without pensions work for companies that do not sponsor plans. Of the remaining one-quarter of workers, a majority is not eligible to participate in their companies' sponsored plans. However, a sizable number could participate, but choose not to contribute. These two distinct groups — those who lack coverage for any reason and those who choose not to participate — present separate challenges. For the former group, policymakers should continue to search for effective ways to increase coverage — both by making it easier for employers without plans to adopt them and by encouraging employers with plans to allow more of their workers to participate. For workers who choose not to contribute to a pension plan, a variety of approaches could succeed in expanding participation: improving efforts to educate employees about a plan's benefits, offering matching contributions, or automatically enrolling employees in a plan. Successful efforts to expand participation in private pensions would make an important contribution to assuring that more workers could maintain their living standards in retirement.

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