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ARE NEW DIRECTIONS NEEDED IN STATE RETIREMENT POLICY?

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Opening Remarks:

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Session One: Structuring State Retirement Saving Plans -- A Practical Guide to Policy Issues

Presenter:

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Moderator:

JOSHUA GOTBAUM
Guest Scholar, Economic Studies, The Brookings Institution

Discussants:

DANIEL BISS
State Senator, Illinois 9th District (D)

LISA BLEIER
Managing Director, Public Policy and Advocacy, SIFMA

Session Two: Social Security Coverage for State and Local Government Workers – A Reconsideration

Presenter:

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Discussants:

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P R O C E E D I N G S

MR. GALE: I'm William Gale, head of the Retirement Security Project here at the Brookings Institution. I'd like to welcome you to this morning's event. As you know, in recent years there has been many changes in the landscape regarding state level retirement policies.

We all expect there to will be several more in the coming years. There was an article, for example, just earlier this week in the "Wall Street Journal" conveying the problems that Connecticut has had.

Connecticut has only a 52 percent funding ratio. They scaled back pension benefits in recent years reducing cost-of-living adjustments for retirees and pledging to make appropriate annual payments to fully fund the system in about 2032. They've raised taxes twice since 2011, reduced their workforce by 3 percent, held back on deeper spending on education and local aid. Connecticut now allocates 10 percent of its budgets to paying down unfunded pension liabilities.

So there's a couple of take aways from that. One is there are many dimensions to this. We're going to be talking today more about coverage than about funding, but funding, of course, is always in the background of these issue.

The second thing to think about is this is not just about workers and retirees. It's also about things like education, and other state budget functions. So it really affects everyone.

This is an issue that RSP has been actively involved in for many years, both at the research level and in assisting state governments sort of on an on-the-ground, in-the-weeds kind of basis. And in any case, policy action at the state level offers a very valuable lever to affect retirement saving generally whether it be encouraging more coverage, more participation, more contributions, or developing better options for investments for rollovers or payouts.

This is especially true or relevant in light of the federal gridlock that we're all very familiar with here in Washington over the last several years. And it's fair to say that most of the action, almost all the action, indeed, has been occurring at the state level in recent years.

So today, we'll discuss two papers that look at different aspects of the retirement landscape at the state level. I don't want to give away of the details in part because one of the papers is mine, but right now I'd like to turn the podium over to Josh Gotbaum, who will moderate the first panel. Thank you.

(Applause)

MR. GOTBAUM: Good morning. The single most important challenge to retirement security is that most people don't have any. A sad fact, but it is a fact, is that left to their own devices, most people don't save for retirement. The only successful way we found to get people to save is to make it automatic and have it be done through payroll deduction. That is why Social Security works. And it's why those who have employer-based retirement plans at least have at least something on which to retire.

The other sad fact is that most employers don't offer any retirement plan. There are lots of reasons. But for most small businesses, it's because they don't think they can afford to contribute to a plan, or they don't have the lawyers and staff to meet the requirements of a plan, or they don't want to become the legal fiduciaries for the operations and investments of a plan which is what ERISA requires of plan sponsors. As a result, roughly half of private sector workers have no plan and precious few ever manage to save on their own.

We are fortunate that we will hear this morning from David John. David, some years ago with his then Brookings colleague, Mark Avery proposed to solve the problem of lack of retirement coverage by requiring employers who did not offer a traditional retirement plan automatically to enroll their employees through payroll deduction in an individual retirement account. Employees could opt out, but the default would leave them to savings for retirement.

The Auto IRA, as it came to be known, was a brilliant opinion and for a time, bipartisan idea. Unfortunately, the very different employer mandate in the Affordable Care Act took the bi out of bipartisan.

Davis John did not give up. He and his colleagues went to the various states and suggested they consider a

State-based auto IRA. Here he found a more sympathetic audience, but as we will hear, there are plenty who opposed the idea. Many from the financial services industry view state plans as unfair competition.

And, perhaps surprisingly, the U.S. Department of Labor opposed them too. It did so because it viewed these programs as an attempt to evade ERISA and the protections that it provides. Nonetheless, David and his colleagues persisted.

Today, Illinois and three other states have already enacted legislation to implement what have come to be called Secure Choice Programs and many others are considering doing so. That's the reason for the paper this morning.

This morning, David presents a paper describing some of the options available to states. Think of this as his primer on security choice.

We will then hear from Senator Daniel Biss, author of the Illinois law, discussing some of the decisions they made in passing it. This July, David and his colleagues had a major victory when the president and the Secretary of Labor announced that DOL, the Department of Labor would this year issue regulatory guidance to facilitate state plans.

This change from DOL's prior opposition could remove a major roadblock to future secure choice efforts. Nonetheless, there remain many who are skeptical. We've asked Lisa Bleier of the Securities Industry and Financial Markets Association to explain both some of those objections and what alternatives the industry suggests to expand coverage.

After Lisa has spoken, we'll discuss some of these issues as a group, and then open up questions for others. I personally am relatively new to retirement policy. I've only been here five years which as the experts would tell you means I've just barely vested.

Nonetheless, personally, I think these efforts, if done well and widely, could be the most important improvement in retirement security in decades and improve the lives of tens of millions.

And so without further ado, David John.

(Applause)

MR. JOHN: Well, thank you, Josh. After an introduction like that, I think I'm better off just sitting down and we'll just go on from there. However, the ego still continues. So there will still be much more to say.

Thank you to Josh. Thank you to Bill. Thank you to Brookings for putting this together. I also would like to state that while I have an affiliation with an organization that has four initials to it, this is not an AARP paper, what I'm about to say is not AARP policy, and I am not speaking for AARP. These are my thoughts along with my coauthor bi and, et cetera.

So going forward there, Josh has laid out why we need to take action. He's also laid out why nothing has happened so far. Just to add a couple of quick numbers to this, we have by our estimates 55 million Americans who lack the ability to save through payroll deduction at their workplace.

For the most part, these 55 million Americans fall under five groups. Those five groups are woman, minorities, lower income savers, lower income employees, excuse me, employees in small business, and younger people.

Now, if you don't start saving young, and I can say that from personal experience, you have a much harder row to catch up. The United States Government Accountability Office says that for smaller businesses defined as 100 employees or less that, roughly, 1 out of 7 offers some sort of a retirement plan to their employees. For the most part, these are companies that have higher compensated employees.

Last but not least, we have said in the past or we have heard in the past that an individual can always go out and open their own IRA, but the simple fact of the matter is in an analysis of -- if you can get a musical accompaniment, that's just really too much. But an analysis of workers within the $30,000 to $50,000 income range which is one of the ranges that'll be most affected by state-sponsored plans, for those who only have an IRA, roughly one out of 20, 5 percent, roughly, actually save regularly in such a plan. And having a plan is not the key because you might have an IRA from a rollover from an employer plan, but the question is whether or not you actually continue to contribute to it and we know they don't.

Now, as Josh mentioned, there are two parts to this paper and I'm looking to focus on one. The second half of the paper deals with a series of management decisions. Where in state government you put this sort of a plan, who provides the services, how you deal with startup costs, and employer and employee responsibilities. And I say we can discuss that perhaps if there's time or maybe at a later date, but that's not what I'm going to look at today.

Today, I'm going to focus on specific policy decisions that need to be made in structuring such a plan. Those policy decisions include such things as what type of account you're going to offer, whether or not to include automatic enrollment or to require automatic enrollment, whether small businesses in a state above a certain size should be required to offer some sort of a retirement savings or pension plan to their employees, Can super protections, guarantees, contributions and investments, we won't go into detail on that, and last but not least, the overlay, as Josh mentioned, of ERISA, the Employment Retirement Income Security Act.

Now, obviously, if we cover all of those in great detail, we will be here until Thursday so I hope that you are all very comfortable and we'll go from there. But I'm going to try to do this very quickly.

First decision, what type of an account would a state look at? And there are essentially four different types of accounts that are available. One which Josh had mentioned is the Auto IRA. The Auto IRA is the basis for what has been passed in Oregon and Illinois. It is a simplified retirement savings account, payroll deduction, automatic enrollment. The money goes into an IRA.

The costs of administration are very low. The fees would be low in part because this is not a retail IRA. This is a wholesale IRA. So this is, if it is offered especially through a state-sponsored plan, it will be done through low cost investments rather than going through to your local bank or investment house and picking out investments that way.

It is very simple for an employer to deal with. The employer hands out materials, takes forms from people who don't want to contribute, and the next steps, basically, is setting up a payroll deduction and forwarding the money. Most of the rest, everything else is dealt with otherwise. We think an Auto IRA is especially valuable for this type of population, the small business population.

A second type of retirement savings plan is the MEP, the Multiple Employee Plan. MEP is not Member of the European Parliament. It is not an expression of, nah, or anything like this by any stretch of the imagination. A MEP is basically a plan which allows a variety of employers to band together to offer a 401(k) or another type of retirement savings account to their employees.

Obviously, one of the values of this is that while an IRA is an individual retirement account and the employer cannot make a contribution, under a MEP the employer could make a contribution.

A MEP, however, is an ERISA account by definition. And one of the things that we will discuss as we go forward here is whether or not coming regulations in the Department of Labor will allow states to offer that, and in particular, whether they will allow unaffiliated companies to join together in such a structure.

We also have an interesting question about what the administrative costs would be and what the ERISA responsibilities would be. The expectation is that most of the ERISA responsibilities would move from the employer to the providers of the plan. Again, the details are to be decided in this area.

A third type which I'm going to deal with very quickly is a defined benefit plan. There are some who have put a proposal out or a series of proposals out which would enable small business employees to enroll in a defined benefit plan offered through the state, perhaps as a subsidiary or something like that, of the state retirement plan for employees, public sector employees.

I have two concerns about this. The good news is that anyone who stayed in this type of an account for their entire working career would pretty much by definition have an annuitized stream of income at the end. And that's a very good thing.

The questions that are, are that we expect that a small business is population is going to be very mobile which means that whatever is decided as an account structure either is structured in a way so that people can move their savings from employer to employer, or somehow or other they've got to find a way to receive those savings when they reach retirement age, whether they've lost them or but growth, et cetera.

I have serious reservations whether a defined benefit plan is actually more appropriate for small business employees, especially if there's a vesting requirement. Otherwise, they're just going to get money back when they leave the plan.

And last but not least is the marketplace model. Marketplace model has been offered or has been introduced in the past in Washington state. What a marketplace model is, is essentially a state-sponsored website which preselects certain types of employer plans and then the state would encourage the employers to choose one of those plans.

Now, the good news is that because most of these marketplace models would include certain criteria for participation that takes a lot of questioning, guesswork from the employer. The bad news is that it does nothing actually to increase participation because the employer, unless they are inclined to offer something, won't.

The fact that this is available doesn't necessarily mean that it will be used. The experience of the Washington plan will be very interesting to see at this point.

There's also an interesting question with ERISA. The marketplace model by itself does nothing to move responsibilities, provide additional consumer protections, or anything along that line other than what is already present in the model.

So in other words, if the employer has a set of responsibilities and costs in the marketplace as it stands right now, they will also have that same cost and responsibilities through something they buy in the marketplace model.

The bottom line on all of this, which I want to emphasize, I mean to emphasize hopefully several time, is there isn't a bad decision that a state can make. However, some are going to be more likely to work out than others. Each state has to make their own decision as to which one of these account types and other features they decide to offer. Offering something is better than offering nothing. Even the least structured plan is better than having nothing whatsoever.

However, certain types of these accounts are going to work better than others. There's a question of automatic enrollment. Automatic enrollment works spectacularly and it works spectacularly, among other things, for the population that we're talking about, the small business employees.

What's more, employees like it at all income levels, at all various groups, age groups, race and ethnic groups, et cetera. The Retirement Security Project and AARP joined with Finerer several years ago to join something called Retirement Made Simpler with an R at the end because somebody else had taken the web domain Retirement Made Simple first.

And one of the things we did was to poll employees who had been automatically enrolled. We found 95 percent made automatic enrollment easier, 85 percent started saving sooner than they would have, 97 percent of those that were automatically enrolled and stayed in the plan which was roughly 90 percent of the sample said that they were satisfied with the process and glad that their company offered this. I mean, Vladimir Putin doesn't usually get that kind of number. And of those who opted out, 90 percent were satisfied with the process, and 79 percent were glad that they offered it. You do not necessarily have to offer automatic enrollment as a state in order for a plan to work, but it is something that makes it better.

One question that has to be dealt with is whether or not ERISA will allow automatic enrollment into a payroll deduction IRA. That we hope will be dealt with by the forthcoming DOL regs. The Department of Labor has said that a payroll deduction IRA is not an ERISA plan. And previously, it has ruled that workers could be automatically enrolled into a health savings account. So there is a precedent for this.

Now, we come up to the hardest question of all. Do you require companies above a certain size to offer some form of a plan? And they don't have to offer the state-sponsored plan. They have to offer something. So they could choose some other choice other than, say, the state-sponsored plan.

This is a political decision.

Obviously, if something like that is included, if there is a required offering, there will be a much greater participation. It also eliminates the question of whether Employer A faces higher costs than Employer B because Employer A has offered some sort of a retirement savings or pension plan and Employer B has not.

States have a very real role in this because if they don't have a population with retirement resources in addition to Social Security, they are going to face a much higher demand for state-sponsored or state taxpayer paid services. We already have data from the State of Utah that shows this, and we have a study forthcoming in early December from New Jersey which we think will show exactly the same thing.

So a requirement is key. There is a provision within ERISA that says that you cannot require an employer to offer an ERISA plan. So that's something that will have to be clarified or dealt with. And that means that if there is a required offering in a state, there are a couple so far, the state probably has to provide something like an Auto IRA for that.

Two quick points and then I will conclude. One, ERISA offers a certain level of consumer protections which are incredibly valuable to employees of all levels. However, those consumer protections can also be offered through laws that the state pass as they structure their retirement savings plan. And, frankly, given the fact that the state will be structuring that, the state can deal with those issues as they go forward.

Number two, and I'll do this just in a sentence or two. The question of the guarantee on returns. A guarantee on returns sounds very attractive. We have a paper forthcoming which reviews those and shows that if you look at the fact that if a state law says that a retirement savings plan cannot offer a contingent cost to the state, that means that the guarantee has to be offered by a private provider. And the private providers is likely to have either a very seriously high cost or it's going to require that you invest in a very safe asset.

Boston College did a survey for Connecticut recently which looked at the whole question of a guarantee and they pointed out that the guarantee would probably mean that you could only invest in assets that earned about 1 percent in returns. And it was shown that this was unpopular and increased the number of people who would opt out of such a system.

So we face a very important reality that states are acting and that states are doing the work that desperately needs to be done to protect their own financial futures and to protect the financial futures of their citizens.

The key, however, is how they structure it. Again, there is no bad decision, but there are some decisions that are better than others. And I know that sounds vaguely like Animal Farm, but it's not quite the same.

So in conclusion, we are thrilled that states are acting and we stand ready to help in any way and, hopefully, this paper will advance some of that.

Thank you.

(Applause)

SENATOR BISS: Good morning. Thank you very much to Brookings for having this conversation which is one that I have a great deal of excitement about, and for allowing me to participate in it. I'm looking forward to this very much, to the whole morning.

I'm Daniel Biss. I'm state senator in Illinois. I represent the north suburbs of Chicago. and if you lived in Illinois, you lived in my district probably. Many of you seem to have grown up in my districts. We're trying to take care of it for you. Feel free to come back anytime. We appreciate your sales tax dollars.

I was asked to speak about the efforts that we've undergone in Illinois to enact an Automatic IRA program, and I was asked to speak about a specific question which is not the question of whether there is a retirement savings crisis, or whether the lack of access to employer-based plans is a critical portion of that, or even whether the states have a role to play in addressing those problems.

The question I was asked to address is, hey, Daniel, in your efforts in Illinois to enact legislation on this topic, what decision points did you find yourself encountering and how did you address those?

And so I'm going to take that mandate seriously and literally because I think it's an interesting set of questions and, hopefully, an instructive one for those in other states and maybe one day here in Washington who are seeking to address this question.

The first point I'll make on this is that we, needless to say, acting in a state legislature, we're acting without the ability to change federal policy. We were acting based upon our best ability to interpret ERISA as it currently stands. And I won't speak to any hope one might have to change federal legislation either.

So the first decision -- maybe later. The first decision we came to was we took the position that if you had committed some really, really horrible crime that would be not only career ending for you but would bring dishonor to your descendants for several generations and it was your fervent desire to hide this fact from the world in the best manner possible, the way that you ought to set about to do this was to create a task force of the Illinois legislature and ask it to issue a report on the topic.

We felt that creating a study committee and having them report back to us so we could then act again was based upon the peculiarities of Illinois political culture, a path to failure rather than a path to success. And this was a very, very important principal of ours.

It is clearly specific to Illinois. Oregon took the exact opposite approach with great success. California took the opposite approach we hope, ultimately, with success.

But that was a core principal of ours. And it hemmed us in going forward on a negotiating basis because that was kind of the easy out that those opposing our efforts felt that they could trap us into. And by constantly resisting that, we kind of used up some of our ability to resist other requests at concessions.

The other core principals we brought to the discussion were really just two. Number one, for all the reasons that John laid out, we felt -- sorry, I do this all the time. It's just (inaudible). The data laid out.

We felt that in this decade it was just silly to implement something that didn't utilize the benefits of automatic enrollment. We thought that the evidence was too clear, the increase in utilization was too significant, particularly among the populations that most urgently needed assistance in saving early and so we were not prepared to negotiate on the question of whether automatic enrollment would be a feature of our legislation.

And the other thing that we were not prepared to negotiate about, which was, again, a subject of significant contention, was the question of whether there ought to be a requirement for some collection of employers.

So we took the basic position that there's a structural problem in the retirement infrastructure in America, and that we needed to change the defaults and structure so that if people aren't really thinking hard about this question in advance in a proactive manner in their twenties, nonetheless, by default things will be taken care of. Things might not be taken care of in a manner that's optimal for everyone, but things will be at least taken care of in a manner that's different than nobody saves anything.

And so to achieve that, it was again necessary to have some kind of requirement for some class of employers and automatic enrollment.

In that rubric, we then basically took the position that we'll take what we can get because once you have that structure in place, there's significant opportunity in front of you to improve upon what's been created.

So the next question that was posed to us is for which employers should this program be obligatory? And this was a politically difficult question about which we ultimately found ourselves obligated to make concessions that were pretty significant.

So the law that was enacted in Illinois applies for employers of 25 or more employees. And considering that the problem that we're discussing is focused in particular in the category of the truly small businesses, this does cut out of eligibility a significant portion of the 2.5 million Illinois workers who today lack access to any employer-based plan.

Our view was that this was a type of concession that can be over time when the program is up and running and successful and does not result in the sky falling and various tragedies befalling the people of Illinois could at that point then be adjusted.

And so we believe that when this program is rolled out in 2017 that threshold which is too high for my taste is nonetheless low enough to allow scale that will allow the program to be successful and that overtime when the program is successful and popular and benign that can be decreased.

The next question that we were posed was one that David also referred to which is do you structure this as an individual retirement account which is outside, one presumes, the purview of ERISA or do you structure it as a multi-employer plan under ERISA?

And I'll be very direct. We made this decision based on purely pragmatic concerns. The cudgel of ERISA as a set of obligations that would be burdensome and confusing and scary for Illinois employers, particularly in an environment where Illinois unemployment is higher than the national and Midwest averages, was a prospect that we couldn't withstand as a political matter in the Illinois General Assembly. It became very, very clear to us very, very quickly that legislation that did that, namely, created a multi-employer plan under ERISA, would not pass. So instead we went forward with an IRA structure outside of ERISA.

The next question is this question that was also addressed earlier which is the question of do you structure the plan as a purely defined contribution thing where you put money in and the overtime there are investment returns and fees, and then what's left if left or do you do something else? For instance, do you seek to guarantee a rate of return?

And we certainly were interested in the policy questions that David lays out. Namely, what kind of rate of return can you guarantee at what cost. But we were also dealing again with a very pragmatic problems.

It is possible that some people in this room have read about Illinois in the context of retirement policy but outside the context of automatic enrollment IRAs. Perhaps you're aware that we have some fairly significant pension debt in our state.

And as a result of that real empirical problem, but also, quite frankly, the enormous purchase that that problem has over the headlines and the kind of political discourse and culture in Illinois, we couldn't advance something that looked like we were setting up something that was basically another public pension system.

It was simply too easy for people to say we have 628 public pension systems in Illinois. They're in very, very bad shape. We do not need a 629th. So for that reason, it was just not practical to have a discussion about a structure that mandated a guaranteed rate of return. But we did feel that this question, and more broadly, the question of how to structure something that sets up appropriate levels of risk for employees who are in many cases least easily suited to bear that risk was a very important question and we didn't want to close the door.

And so we set up the framework of a program in such a way that should the discussion that's going on in California and elsewhere regarding the feasibility of this approach land on a favorable satisfactory answer that could be imported into the structure that we've built. And we do think that's a significant thing going forward because this discussion of risk, I believe, is not and should not be complete.

And then, as I see, there's a piece of paper been brandished at me in intimidating fashion, so I'll wrap up quickly.

There are two other questions that we just didn't think about at all. And they are important questions, but I think we were justified in not thinking about them.

One of them is the question of automatic escalation of the employee contribution. And the other is the question how do you devise a system of de-accumulation.

And we didn't think about them because it was essentially as a big a legislative project as we felt equipped to bite off in this moment, in 2014, that we passed the bill and because those are structural features of a program that become relevant later.

And so our initial employee contribution of 3 percent is clearly by itself as a sole supplement to Social Security inadequate. I recognize this without hesitation. But we also felt that implementing in three years after the thing is up and running effectively automatic escalation as opposed to implementing automatic escalation today are basically equivalent options. The former seemed to be politically feasible and the latter did not.

Similarly, the question of how to structure your mechanism into your accumulation so as to best approximate a real lifetime stream of income is not addressed by just saying here, individual worker, here is a lump of money that is sort of abstractly speaking there for you when you retire, but, of course, at the moment that we passed the law, the lump of money wasn't there at all, and we felt that of all the battles and policy discussions and structural debates to have that was the one that could most comfortably be delayed until the moment that the program was up and running and the lumps of money were, in fact, being accumulated and growing so that we then were, essentially, possessed of the fortunate standing to have a discussion about what to do with.

So this is kind of how we addressed these question. Surely, any state will find itself with different policy opinions and different political requirements. And I suppose I just want to close by saying I'm really, really thrilled to see that a number of states seem to be having robust discussions on this and if there's a way for me to be of assistance as those states are moving forward in that process, I would be really just absolutely ecstatic to do so.

Thank you very much.

(Applause)

MS. BLEIER: Good morning. So let me start by talking about where we have commonality. And, certainly, the service provider industry, the employers, everybody knows that we need to improve retirement savings in this country. So we can start there. It's a matter of how we're going to get there and what we need to do and then what hurdles we need to go over.

I'll start with the basics of looking at my own children and where I know I'm going to need to go with them and that is starting with education early.

So, yes, I know this is not the answer. It's not the total answer. Financial literacy is a problem in this country. But we need to talk more about the importance of saving that money and then leaving it there. There is so much legislation even on the Hill talking about money that you could take out for first home, money you could take out for everything under the sun that you can think of.

That money needs to stay in for retirement if we want people to be making it to retirement. Financial literacy, general investment education. I will tell you two of my kids, one of my kids in elementary, one in middle school, one in high school. My high school one is the only one who has started receiving something on financial literacy, investment education. She's not yet talked about retirement, you know, but they have only just started to talk about the importance of putting some money aside and it's not just about what you're going to purchase couple months down the road.

That's one type of savings, but we all know the bigger picture of savings is that longer term savings. If my kids right now, oldest one is a teenager, we can convince them to start saving, as she soon as she started earning money, which is now, and start putting some of that money aside, we started talking about the concept of compound interest and how she needs to start now and think of what that's going to be like by the time she hits retirement.

So what we disagree with though is the state being necessarily the right place to find the answer. So there is an entire structure that has certainly grown up around retirement savings. And there's a reason there's that whole structure. And there's a reason that things have been put together as they have.

Part of it is things like portability. If you're in a particular state, so we live here in the D.C. metro area and so some of live in Maryland. Probably part of the room is Maryland, part of the room is Virginia, and part of the room is D.C.

Just say Virginia manages to put a plan together and then they pass one. Well, what happens once you move from one of those states to the other? Because I'll tell you, in my last past 20 years, I actually have lived in all three of those jurisdictions because jobwise or house-wise, what we could afford, what was the right area to live in, and now I'm in Maryland. But I've lived in Virginia and I've lived in D.C. all within this 20-year time frame.

And there are going to be challenges. So if somebody in the state of Illinois or in any of the states that have passed legislation, state of Washington, if those are tied to your employer and that employer is only in that state, that small employer might only be right there, what's going to happen when that person moves to another state that maybe doesn't have that?

Say, they've managed to save $1,000 in that account. Is that one of the missing participant accounts of tomorrow? Where are they going to take this money? Are they going to take this money? Are they going to remember they have this money?

You know, there are so many jobs that people take. When you graduate now, I think it's something like seven jobs is the average, when you think about trying to keep track of that and keep a track, I mean, I've had several different jobs as well and so I personally have rolled over much of my money so I can keep it in one place so I could keep track of it.

Then once you marry, then your spouse has X number of accounts as well out there. It's just a lot to manage and keep track of.

The paper that Bill Gale and David John did is great because it highlights some of the potential liabilities out there as well. So often when we're talking about the state-run retirement plans, there are the issues of liability. There's the ERISA. There's also for the employer. There's also for the state. These are all still questions that are unresolved as of now.

Often when I talk about this, I talk about what we sometimes point to ERISA and some people they overlook, I'll stay away from that because we're fearful of it. But as the paper point out, there are a lot of positive things in ERISA as well. It does provide a lot of protections.

So I'm not sure the answer is to set up a parallel structure that's outside of ERISA that we're going to handpick which ones we want to put in there and which ones we don't want to put in there.

You know, there's a reason ERISA has the protections that it does have in there, and that there is a structure there that should be used and using that structure. If you use the private sector to move forward on saving for retirement, you are within the ERISA structure, and you are with those protections that are in place whether they're anti-discrimination rules, whether they're spousal protections, all the protections that are right now in there.

When people talk about setting up these additional or new structures whether through a state, that there's a lot of things that people don't consider when you have to put together a parallel structure. And I go back to why there is a structure in place today that is there. Because recordkeeping, the transmittal, basic transmittal of the funds.

When you're talking about a small business who is in business to make widgets and that is their job and they're not thinking about retirement. They're think about making payroll. They're thinking about making sure that everybody who's currently employed by their small business continues to be employed and that the business is able to market, sell, more of the widgets. That's where they're focused on.

And so that small business might not be on an ADP-type payroll system. They might still be using paper system. There are so many different systems that could be out there that then what is the structure then that's going to end up being around that in terms of education regarding all those individuals who are within that small business?

The small business owner is focusing on the widgets. Small business owner is not focusing on how to help his individuals save for retirement. Instead, he's worried about how to help them get a paycheck two weeks from now, four weeks from now, six weeks from now.

But there are avenues today. We believe there are a lot of avenues today and that the issue is not one of accessibility. There are IRAs today. Somebody could go set up an individual, can set up an IRA today. They could set up a low cost one.

We worked with the state of Washington on their legislation because the idea was to use the structure that's in place, that is providers today, but actually give them an avenue. So we set up the marketplace, what will be a website, which will have a certain product.

So if it's a low-cost product that allows the state to design the product and say it needs to be a product that meets all of these criterias. This needs to be the investment type. Here's what the fees need to be. And then they put that out. Any provider who wants to offer that product will then be the one to go and say I want to be listed on that website because I have that product. So that's an avenue. It's why we've been very supportive of what they've done in the state of Washington.

We're also very supportive of the MyRA. It is a federal solution here. And David John and Mark Avery quite a few years ago back when I was at the American Bankers Association, it was called the R-Bond, so for those who were very engaged in this some years ago but is now the MyRA, what we like about it is it is portable, addresses that issue. It is the federal government, government insured. It encourages principal preservation until it reaches a certain level at which time then they encourage you to actually go out there and put it into a product that then allows you to move closer to retirement.

I realize some of the criticism of the MyRA is that it's too small amounts. That it's not enough to get you to retirement. And that's true. But a lot of the people who were trying to engage by looking at state plans, by looking at these options, don't have significant amount of money that they're going to be putting away tomorrow.

We are talking about small amounts when we're talking about even payroll deduction, taking out an automatic amount of money, whatever that percentage is, we're talking about usually $10, $25, $30. That's all we're talking about taking from the paycheck right now in terms of that which is not going to get somebody to retirement.

So you've got to get them thinking about saving enough, and as they're thinking about saving and they create a little bit in that account, and then, hopefully, go from there to then entering the equities market and being out there and moving truly towards retirement.

I was going to talk a little bit about MEPS but (inaudible). I know my time is up here.

I would just conclude with the fact that we do believe that we need to change the dialogue to get more people thinking about savings. We don't believe it's a question of options or the products that are out there, but it's a matter of educating people to think more about saving now for their retirement tomorrow.

Thank you.

(Applause)

MR. GOTBAUM: We have, as we've all hinted, not nearly enough time to talk about all these issues here. But I wanted to tee up at least a couple of the issues.

Each of you has pointed out that ERISA, the Department of Labor, its stance affects your view as to, and in affect state views as to what options they'll consider.

When Lisa and I were talking last night, she said, you know, if it were legal and clear that you could have a multiple employer 401(k) plan, then that might be attractive. You all know and paid attention to the announcement by the Department of Labor that they were going to do something.

It'd be worthwhile maybe starting with David, but for you to talk a little bit about what folks are seeking from the Department of Labor and how it would change your views about what makes sense.

David, you want to start?

MR. JOHN: Well, as always, we're seeking more than they'll give. Just sort of a fact of life. But I anticipate that there will be two things coming out of the Department of Labor. And let me stress that any sort of prediction is just about as valid as my prediction of what weather will be on July 25th, 2062.

But we anticipate that one of the things they will do is to look at the Automatic IRA and eliminate any question as to whether or not this is both legal, whether you can include automatic enrollment in a payroll deduction IRA. As I said in my remarks, we believe that there is a precedent for that.

The second thing is going to be that, I expect that there will be some nod of some degree towards a MEP. Now one of the things this will do is to eliminate a large amount of the questions that various states have.

We are working currently in about 25 states now in one form or another that either passed plans or implementing, or they're starting to think about this. We anticipate in answer to one of Lisa's questions that if you move to a state you have one of these plans and you move to one that doesn't that you're going to ask why.

We believe that this will change the conversation. That it will encourage states. It will show what parameters they can use and how they can structure a plan and go forward. I think that the effects are only going to be positive at this point.

MS. BLEIER: Well, so I guess I would just ask that as the Department looks at this, I hope it will come out as a proposal and allow everybody an opportunity to look at what exactly it will entail, how they will handle it, and certainly liability. And that they'll create a structure that actually providers and others will want to engage in.

SENATOR BISS: I would just begin by saying that we in Illinois are ecstatic that the President and the Secretary have initiated this process. We think it's really important and valuable. And we're very sensitive to the concerns that exist about putting in place something like that outside of ERISA. So we think it's important that that be thought through carefully.

I think as David said, there's a question of automatic enrollment and whether obligating employers to engage in automatic enrollment as well as the forwarding of employee contributions can exist outside of ERISA is very important. And then there is also the question about if you do something with automatic enrollment, then the decision of what the default investment is becomes extraordinarily important. And, you know, we expect some kind of guidance on that matter as well, could potentially be helpful.

MR. GOTBAUM: Suppose you got the guidance you want. Not clear what the guidance you want is. But would that, for example, David, in your view having talked to a lot of states, would that open up the possibilities for the ERISA piece or the hybrid DB piece sufficiently that some states might consider it? I understand thus far no state has.

MR. JOHN: I think it would, actually. We know that there are at least a couple of states that very seriously want to include an ERISA type of plan for a variety of reasons. And depending on how strong the guidance is, I think that, yes, very definitely, this opens that up.

MS. BLEIER: So this would be within the ERISA structure --

MR. JOHN: Yes.

MS. BLEIER: -- is what they are talking about in terms of an option?

MR. JOHN: Yeah.

MS. BLEIER: Okay, in terms of an option. So, certainly, you know, if it's within the ERISA structure and it looks like a MEP but we think that would be the best (inaudible) for them to pursue.

MR. GOTBAUM: At that point, might -- as background, SIFMA (inaudible) has been among the most visible and consistent opponents of the Secure Choice Auto IRA notion, and my question is, and feel free to duck or not, but if the Department of Labor made it clear that this were a, that it were legal to have a multiple employer 401(k) model, is this something that you folks might be able to get behind?

MS. BLEIER: Well, I think if it is within the ERISA structure, and so it was providing all the same protections and responsibilities and liabilities, then, yes, it could be.

MR. GOTBAUM: That's interesting. Before we open up for questions from the audience, we have talked a lot about policy. The other part of David's paper, David and Bill's paper, excuse me, yes, is that there are management and implementation issue here. And I'd be interested especially, Daniel, if you could, but if everybody could talk a little about what are the practical implementations issues that when states consider this slow you down, take time, et cetera?

SENATOR BISS: Yeah, there are lots. The timeline in Illinois, by the way, is that the law went into effect on June 1st triggering the creation of a seven-member board chaired by the state treasurer, and also triggering a two-year implementation period so the program will be up and running June 1st of 2017.

And there's a number of categories. There is the question of how do you structure the investment itself, which is I think possibly one of the easier questions. There's the question of how do you the back end and the recordkeeping and how do you parcel out those tasks between in-house public sector functions and those done by outside vendors. And then there's the very, very crucial question of education both of employers and employees.

There are lots, and lots, and lots of employers. And, of course, many times that many employees to be educated. And there's a lot of communication that needs to be done for this to roll out smoothly.

MR. GOTBAUM: Lisa, David, you want to mention something?

MR. JOHN: Well, there are a couple --

MR. GOTBAUM: Since you wrote a paper on it.

MR. JOHN: Well, yeah, exactly. I just happen to have a few thousand thoughts on the subject. But two things that are going to be rather key going forward. One is Lisa talked about portability. The paper does discuss the fact of the need to structure whatever comes out of the states in a way that can be moved from employer to employer.

We cannot assume that because an employee of a small business starts with the plan in State X that they will stay in the plan with State X. It may well be that they stay in that state but they move to a company with a 401(k). So one of the design elements is making sure that these accounts can be portable and can be easily moved to something of a similar tax treatment.

Another one which is going to be important going forward is to structure something in a way that works because we have learned in particular from the United Kingdom's experience in the 80s and 90s, et cetera, that you can really damage the credibility of a retirement savings system by making some bad policy decisions and affecting the way people's savings go forward.

So a key factor is to make sure that it works. And that very likely is starting with something simple and then adding features as you go forward rather than trying to solve every problem at once and trying to have everything work the same way on day one. That's going to be a rather crucial issue going forward also.

These are not impossibilities. We've talked over the last several years with a wide variety of private providers who offer most of the services that the states are going to need. So, I mean, contracting out in a way similar to the 529 College Savings Plans is one way that can be used to start to structure these things.

But it requires a lot of thought and it requires the use of people who know the details of what they're talking about, the technical professionals.

MR. GOTBAUM: Before we open up to questions, did you want add?

MS. BLEIER: Well, I would just say that, you know, it's why I was so supportive of what the Washington legislation is because I'd agree that it's something that you're going to be doing in steps. And so they've taken a lot of steps by putting that out there and kind of needs an opportunity to see what that can lead to and how that might be able to help in terms of retirement savings.

MR. GOTBAUM: We've now allocated four nanoseconds for questions from the audience. There's a standard Brookings format which is a question needs to be shorter than the amount of time taken necessary to answer it, and it needs to end with a question mark. So questions? The gentleman in the back.

(Question for audience not recorded)

MR. JOHN: I think that's an utterly crucial issue and it's one --

MR. GOTBAUM: You should probably repeat the question since the mike didn't work.

MR. JOHN: All right, yes. The question is what do we do about a contingent work force, one that is not directly attached to an employer? This would be contract workers, a wide variety of others.

And that actually is a key issue that we're going to see and we are seeing worldwide. We are focused at the moment on an employer-sponsored plan. One of the things going forward is that we need to have a way so as an employer or employee, as an individual moves from job to job, they need to be able to have their retirement plan plugged into either the employer's plan or plugged into it so that they can continue to make contributions to this. This is a rather key issue going forward and one that we will be addressing.

SPEAKER: So my question is mainly for David. Starting from the admonition that we should start simple, I'm going to ask you to think about something that might not be quite so simple which is there's a lot of research that looks at the intersection, how families struggle with both long-term needs and short-term needs. And in some states people are starting to talk and think about whether you might create a side car project or some sort of parallel structure where families were able to save for emergencies and for long-term needs. Do you want to comment on that and, Daniel or Lisa, if you would comment as well, that would be great.

MR. JOHN: I'll comment very briefly. Just by coincidence, I happen to have a blog that's available both on the retirement security product site and the AARP's Public Policy Institute's site addressing that.

That actually is a serious question because when it comes right down to it, people below a certain income level are largely taking care of by Social Security. The retirement savings question is largely above a certain income level and below another. Roughly, quick numbers, say between $30,000 and $80,000 or something along that line. There's similar figure in the U.K. showing that that's their problem.

So there needs to be a structure. One of the values of having a Roth IRA, which is what most of us are talking about for a payroll deduction IRA, is an individual when they reach a financial crisis can draw out some of that money. However, if there was a parallel structure that allowed them to put money into, say, a passbook savings account or something like that at the same time, it both makes the retirement plan much more useful earlier, and it also helps to head off the idea that your retirement account is just a bank account to be used anytime that you run into a question.

MR. GOTBAUM: Bill Gale probably to avoid having to present his papers has given us a few more minutes. This gentleman here.

SPEAKER: Yeah. I'm very interested in the prospects for the MEP and so I wondered if you could comment on what the desirability and likelihood that we could get a fully open MEP, open to any employer and any state, any individual going back to contingent work force, and that the 100 percent of the fiduciary would be on the MEP itself that would have sort of a board of trustees, zero percent with the employee.

It seems to me something like that could be very attractive, but I don't know if that's realistic.

MS. BLEIER: So, certainly, there's a lot of legislation on Capitol Hill to try to address that. But there are still a lot of issues. It's from both sides of the aisle. There is definite support for MEPS.

In terms of where the liability falls, I think that's gonna be a little bit more challenging because if you put it, you do have to figure out where it resides. And if it resides, say, it's on a board of directors, maybe that's an answer. And there are some folks out there who want to put it 100 percent on the provider. I'm not sure there are a lot, if any, providers that will take it on. So if you create a program that because of how you structured it, there's nobody who's going to offer it, you haven't solved anything.

So I think that needs to be a conversation with the much wider community to resolve that. And, hopefully, we can get there.

MR. GOTBAUM: I'm going to step out of the role as a moderator. One of the hard parts of the multiple employer notion is that it goes against the grain of 40 years of ERISA. The basic theory behind ERISA was that you regulated the employer as sponsor. And the difficulty here, the challenge here which Lisa has talked about is that it is going to require the Department of Labor, the Congress, the industry, everybody to rethink, okay, if the employer isn't responsible for protecting the integrity of financial systems, who is, how, what are the rules, and that is a new and difficult ballgame.

MR. JOHN: If I could jump in.

SENATOR BISS: Everything you said is true, but to me the conversation we're having is fundamentally about the fact that the system has failed. The system that exists is a dismal, tragic, catastrophic, and moral failure. And that is my core disagreement with your talk, Lisa.

(Laughter)

SENATOR BISS: And so we need to set up something outside of that system. And if I understood your question properly, what you were saying is given the assumption we're going to be doing that, then you factually are less radical against the grain step to somehow under the element of ERISA take a step back from the failed experiment of reliance on employer plans but still live in that ERISA world and that could be true.

And it could be on some level a more radical nature of the Auto IRA is what gives people some of that discomfort. So I'm certainly not, I can't speak to what the Department of Labor will do and I'm almost agnostic on what they should do, but I think that's probably the spectrum on which to view the options.

MR. GOTBAUM: I'm not sure we can beat that as a close, but, yes, ma'am.

SPEAKER: Would you clarify how your bill defined an employee? Because there can be someone with one hour, 22 hours, 40 hours.

And secondly, how you defined an employer, and then thinking, for instance, some franchisees are considered part of a corporate structure, I don't know about McDonald's, but, blah, blah, and others are considered small employers even if they have ten franchises.

So in your construct --

MR. GOTBAUM: Yes. So what is the question?

SPEAKER: How did you deal with those sort of basic definitions?

SENATOR BISS: So to the second question, likewise, typical do we duck that question entirely and leave that to the regulatory and NLRB processes and so forth.

To the first question, employee means anybody. So then that's sort of a counterbalance to the relatively high 25 employee threshold. That threshold is reached if an entity employer satisfies the criterion that at all times during a
12-month period there are 25 employees whether they be one hour a week, or 40 hours a week, or on hourly salary, or on annual salary, or what have you.

And then once that threshold is triggered, all individuals in that broad, broad definition are then automatically enrolled unless they opt out.

MR. GOTBAUM: In the back.

SPEAKER: Question for Senator Biss. My impression is the Department of Labor spends a lot of time making sure that workers' money gets from the employer into their 401(k) plans. Under your plan, what have you done, you know, in a non ERISA world, what are you doing to make sure that happens given, you know, we're talking about relatively small employers are going to be affected. Those who don't have plans, frankly, even have a bigger problem here and you're going to have to deal with employer bankruptcies where money coming out of workers' paychecks is probably not going to be covered under the wage priority under the Federal Bankruptcy Law so it's going to be complicated.

So what have you built into your plan to deal with that?

SENATOR BISS: That's a wonderful question. And to the extent that we continue to move forward in this path of peril to ERISA, that question of how many ERISA-like protections do you import into these state laws and how do you enforce them becomes massively important.

So in this instance, we have protections reasonably analogous to ERISA regarding the amount of time that employers have for the monies. We set up inside the Illinois Department of Revenue an audit function with an escalating series of fines in the event that there are violations found.

But I will freely admit that this is a real potential vulnerability of one of these plans that has to be addressed really meticulously. The thought that you would in the hope to expand retirement coverage instead of open yourself up to a whole new category of innovative wage stuff is not an attractive one and needs to be dealt with as though it is the serious damage it is.

MR. GOTBAUM: One last question. The gentleman again.

MR. HARRIS: Yeah, again, David Harris from Toll Financial in the U.K. Just a question to the panel. How important do you think that technology, (inaudible) technology will be in driving cost down in such a program, and also engaging, as a mechanism of engagement?

We have all got iPhones and now Apple watches. And our experience globally is that countries have not embraced technology smartly. Australia ended up with 34 million individual accounts for 11 million workers at one point. Congratulations on that score. And the comparison is the U.K. tick positive is that all their transmissions now to NEST. My trust solution is done electronically not by checks. It's fully automatic. So just some thoughts on technology as we plow along.

MR. JOHN: I have two very quickly. One is I sat down with a technology person who set up a new retirement savings platform. He was showing me how it worked on a really cool new Apple computer that I want.

But he pointed out, look, we can import all the employees in this small business in 90 seconds. And somewhat sarcastically I said, oh, 90 seconds. That long? And he said, yes, that's exactly the point. It doesn't need to be 90 seconds. We can do it even faster and we will in a second version.

So the technology is there, the technology is growing, and I think it's going to make a huge difference, and it's going to be up to all of us to embrace that. This really is a different world.

Second, just very quickly on the NEST, the National Employment Savings Trust of the U.K., which is something that they have as part of their reforms. They're way ahead of us as far as coverage. It's being phased in, et cetera. They have very real experience that shows that something along the scale of a state-sponsored plan giving the differences in our relative populations actually works, and it can be structured and it can be structured in a low cost way.

Quick, shameless plug. E Organizations, I believe it is, are putting together, including several in this room, are putting together a conference November 3rd and 4th in Chicago where we are bringing in the CEO of NEST and a wide variety of other people, as well as states and the like, to look at how they've actually implemented it and how that has worked.

MS. BLEIER: So just a little something on the technology. And I'm certainly not the expert on that and I would be most interested in whether studies or analysis has been do done, particularly regarding small businesses that might not have electronic platforms, might not be, have even their payroll systems set up that way, as well as the issue of the unbanked, and that is those who are not yet using a lot of technology.

And so I think, I'd love to know how those numbers compare to the numbers of people who are not currently saving for retirement.

MR. GOTBAUM: Last word?

SENATOR BISS: Yeah, I think it's enormously important. And one kind sort of anecdotes to illustrate it is our law has a cap on the total cost of the program of 75 basis points, and I've been inundated by people who are sort of interested in being vendors, essentially, to the program who don't realize that I don't get to decide.

But if you (inaudible). And basically, they divide into two categories. The sort of traditional entities who say the only problem is that fee is literally unachievable, and the sort of more modern electronically-based platforms that say I can't figure out why that cap is so high.

And so I think in the long-term goal of reducing costs, particularly when you have lots and lots of comparatively small accounts, smart use of contemporary technology will be essential.

MR. GOTBAUM: Let us thank the panel for an incredibly substantive discussion.

(Applause)

MS. LUSARDI: Well, good morning. Unfortunately, there is no break between the two sessions, but I think I'm going to use my prerogative as moderator to say it's okay to go and get coffee.

So we need to be well caffeinated because we are going to have a great session now. And the topic is Avery, very important one.

Robert Lucas, which is a Nobel Prize economist from the University of Chicago once said that when you start thinking about economic development, you cannot stop thinking about it. But the same can be said for retirement security. This is an incredibly important topic. It really can come from very different, you can look at this from very different ways, and you can also consider many different solutions.

What is at stake in the next session is actually talking about state and local workers. As you know, we have 24 million state and local workers, and about a quarter of them are actually not participating to Social Security but they are covered instead by the state and local pensions.

So we can kind of think -- the questions should instead should we have a more universal coverage of all workers. Any in particular, in the current situations where a lot of states are actually experiencing a lot of financial difficulties and some of their coverage really push for being potentially underfunded, can we think of a solution about adding, or of course, we are only talking about the new hires be covered by Social Security.

This is, of course, a very important but also a very difficult topic. The first question we can ask is will these workers benefit from being covered by Social Security versus state and local pensions. And as I always remind my students when we talk about Social Security, Social Security does not only provide pension benefits, it also provides a lot of other coverage. For example, survivor benefits, disability benefits, and, really importantly, an inflation index annuity that you cannot buy in the market. So Social Security is an incredible institution, and should some workers really not be covered by that?

There is, of course, the other issues that, well, perhaps even Social Security is going to experience problems. And as you know, in the way the Social Security is set up, as pay-as-you-go system, we have, in a sense, given to the first generation and so everybody has now to pay for the legacy cost of having given to the first generations.

So would the state and local worker actually really benefit for joining the Social Security system? As you can imagine, this is a really, really complex topic, and that's why, you know, it's very exciting to have such a really well done paper by Bill Gales and David John. David seem to have an infinite amount of time or, perhaps, he doesn't sleep.

And I want to give the floor now to Bill, who is really going to provide this incredible analysis and really calculations about will the worker benefit, what are the costs of Social Security of doing such an initiative, and really understanding the policy implication of these important questions.

We have an amazing group of discussants, people who I cannot think of two better experts on this topic. So without further ado, Bill, this is for you to present.

MR. GALE: All right, we just need the slide show to work. Ah, it's working. Okay.

I should mention both papers are on our website, the paper that David presented earlier and this paper. And this paper is jointly authored with Sara Holmes, who is not here today, but played a pivotal role in writing it.

The issue here is -- oh. Let me be clear too. We're sort of changing gears entirely from the first session. The first session focused on workers in the private sector who had Social Security but did not have employer-sponsored pension. This session is focusing on workers in the public sector who do have employer-sponsored pension but don't have Social Security.
So it's a completely different set of people we're talking about.

Basically, as was mentioned, about a quarter of state and local government workers are not covered by Social Security in their current jobs. Some of these, of course, are covered by having worked in Social Security-covered jobs earlier in their lives. Some of them are covered under the spousal rules under Social Security.

But there's been this longstanding question should these people be moved into the Social Security system. Should we extend Social Security coverage to all state and local government workers. And typically in the political area, something like that would be phased in and the question then becomes should we extend Social Security coverage to all new state and local government workers.

So we're not really debating putting in all government workers, a 60 year old that's been working state government for 30 years, and we're debating whether they should come in and get credit for all those 30 years. Typically, the debate is limited to new workers.

And the traditional arguments on this coming from a Social Security perspective argue that it will be a good idea. The pension situation at state and localities have faced recently provide a new reason to reexamine this issue.

On the one hand, if state pensions are more insecure, that gives you an increased need for retirement security. On the other hand, if state pensions are facing funding shortfalls, that makes it even harder to add to the burden of retirement saving at this point for those workers.

One way to think about it though is this is sort of a transition issue. That doesn't mean it's minor, but if let me just do a following thought experiment, if all state and local government workers were covered, we would not be talking about removing coverage for a quarter of them. It's only that they're not covered now that we're talking about adding them.

So state and local government were not included in the original Social Security legislation in the 1930s because there were issues, constitutional concerns about the federal government could impose taxes on states. You see this in the deductibility of state income taxes. You see this in the nonfederal taxation of municipal bonds, et cetera. So it's a longstanding issue.

But gradually, I'm not a lawyer. You should not take legal advice from me. But my interpretation, our interpretation is gradually this concern has eroded over time. In 1950, the states were given the option of covering Social Security. Later in the '50s there was a whole series of extensions. The Social Security reforms in the 1980s prohibited state and local governments from leaving Social Security if they had already signed up. This was after the three counties in Texas departed from Social Security.

And then in 1986, all newly-hired state and local governments were required to be covered by Medicare. The legal distinction between requiring somebody to pay Medicare payroll taxes versus Social Security payroll taxes escapes me. And then in 1990, Social Security coverage was mandated for all state and local government workers that were not covered by a separate retirement pension from the state or local government.

So from the perspective of Social Security reform, I'd say it's a no-brainer, but let say it's almost a no-brainer, because nothing is not as black and white as we would like it to be, but from the perspective of Social Security adding state and local governments workers would be consistent with the goal of providing retirement security for all workers. It would help Social Security finance this over the next few years, and then this is where the almost comes in, eventually, it would hurt Social Security finances.

So it depends, your view on how it affects the finances depends on whether you think of the public policy concern as getting Social Security through the next 30 years and letting the next generation deal with it, or you think of the public policy concern as solving the long-term, infinite horizon Social Security funding shortfall.

There is a number of intergenerational equity issues that would work better if state and local government workers were covered. In particular, the earlier, as Annamaria mentioned, there's this legacy cost. Early generation of Social Security retirees benefitted far more than they put into the system. That cost is being borne by future generations. And so having, there's no reason why state and local government workers shouldn't share in that cost with the rest of us. All right. That's basically an inter and an intergenerational concern.

So in that sense, state and local government workers that are not covered are free riding on the rest of us. That's a strong way to say it, but analytically that's accurate.

And then, of course, coverage under Social Security would improve the quantity and quality of retirement benefits. As Annamaria mentioned, it's not just retirement pension. There's also disability, spousal issues. There's full inflation indexing and dependent coverage as well. And, of course, diversifying the funds back in your retirement can only reduce the risk associated with it.

There's a few other issues about why Social Security coverage makes sense for state and local government workers. One is that vesting in state and local government pension plans tends to take a long time. So someone who's changing jobs every three or five years could never get vested in a plan. And if they don't have Social Security either, then they're out of luck on both fronts.

This is a particular issue for public school teachers. A big fraction of the state and local government workers who are not by Social Security are public school teachers.

And then there's WEP/GPO. I don't think I'm going to spend any time on this except to say that Social Security coverage will eliminate the need for WEP/NGPO and that would make a lot of people happy. I'd be happy to take about that more in detail, but it's a little bit in the weeds.

Then if you look at the Social Security report, Social Security Commission reports over the last 20 years, basically everybody recommends bringing state and local government workers into the system.

Now granted, these people are looking at it from the perspective of Social Security which is what I'm doing in this part of the talk. But even in 1997, the Social Security Advisory Board which famously split into three different plans, the one thing they all agreed on was that state and local workers should be brought into the system.

The one exception to this was the Bush commission in 2001 that Daniel Patrick Moynihan was the head of. But Moynihan went out of his way to write a New York Times piece afterwards saying that there's enormous politics involved with this issue. And if you read it, or if you read between the lines, you can basically see he's saying that (inaudible) politics.

Now other people argue strenuously that there are policy issues and we'll get to that in a second. But the point is generally from the Social Security perspective, it makes almost complete sense to bring workers in, and the almost is only that Social Security is in long-term shortfall so bringing more people into that system increases the long-term shortfall.

From the perspective of state and local pensions, it's more complicated. And as I mentioned, on the one hand, if state and local pensions are in worse financial situations than we thought they were a while ago, then that highlights the insecurity of retirement benefits, one of the possible options for dealing with pension underfunding is either to cut benefits or to let them erode, if you will, via lack of COLA or lack of other increases.

So I'm arguing for or against any particular way of fixing the state pension issue. I'm just saying that the existence of more funding shortfalls raises the concern about the security of state pension benefits.

On the other hand, the harder the situation is that states face right now and that workers, state and local government workers face, the more costly it is to add a new burden, Social Security payroll taxes, to both employers and employees.

So let me just turn now to some background on that before we look at some other graphs. As I noted, about one-quarter of state and local government workers are not covered by Social Security, that's up from zero again in the 1930s. So we're talking about an evolutionary change from 75 to 100 not really a revolutionary change.

Most of the uncovered workers are concentrated in eight states as listed here. And so it's not an issue that all states don't cover their workers, or all states cover half of their workers, or something like that. Most of the non-coverage is concentrated in these eight states.

So a particular question of interest is how is pension funding doing in these eight states. And more generally, what's the relationship between pension funding and the coverage of state and local government workers under Social Security.

So it turns out that the stylized fact is that states that have lower coverage rates also tend to have larger pension underfunding. And so this is what this graph looks like. The line -- I want to caution you on a couple of things about this draft. Most importantly, we are not presenting this as a causal relation. We're simply trying to summarize the data.

The second point is the data come from different sources. The underfunding comes from state budget solutions. The coverage rations come from CRS. And they actually represent slightly different years.

So this is just meant to be a first cut at looking at the relationship between the two. We are not arguing at all that it's causal. But the stylized fact seems to be that in states with more underfunding, or states with less Social Security coverage there's more underfunding.

We've done this not only with the state budget solutions data, but with pure data and with data from Novi, Marks and Rall and you get the same correlations.

So this shows, this is the same graphic that show this as funding ratios and non-coverage rates. If you look at unfunded liabilities of the state as a percentage of GPD in the state which is a measure of how much resources the state has to pay, you find the same thing.

I know this is upward sloping and the other one was downward sloping, but it's the same thing. This says that states with higher unfunded liabilities also have higher percentage of uncovered workers, and if you scale instead by tax revenue, you'd get the same thing. There's a positive correlation between unfundedness and uncoveredness, if those are words.

The second issue then is the relationship between state pension benefit levels and Social Security coverage. Alicia Munnell found that there was a little bit of compensatory behavior in state pension benefit levels. That states with higher benefits had lower, states with lower Social Security coverage had higher pension benefits. So in some sense, those states are making up part of the lack of Social Security coverage. Jeff Brown in a work recently also found the same thing.

We get similar results when we look at the correlations across the data. So states with on the more uncovered workers, sorry. The lower Social Security coverage has is higher benefit accrual rates in their pensions.

What I want to emphasize though is this is for full career workers. And Andrew Biggs, by the way at AEI, is the source of the data on the pension benefits so anything that Andrew Biggs and Alicia Munnell agree on with respect to Social Security I'm willing to go with as a fact.

But the caveat is this is for full career workers. And there's this big issue that, as I mentioned earlier, the state and local pension plans don't vest very fast. So it would be nice to have similar data on workers that are changing jobs that don't end up vesting or don't spend their full lifetime in a state government. But in any case, it confirms the results in earlier studies.

Lastly, I want to talk about cost issues. The big concern among state and local government worker groups that if you did this you would raise costs, obviously it depends on how the state pension responds.

Alicia Munnell and others found that if the state pensions respond by preserving first-year retirement benefit costs, the cost to new hires would go up by about 6 percent. That would raise state budgets but not by that much. About 1.5 percent as an impact.

The reason is that new hires are a small part of labor costs. Pensions are a small part of new hires. Obviously, as the work force turned over and a greater share of your work force was covered under these new, under such a new plan, those costs would rise over time.

Constitutionalists, as I already discussed, and you shouldn't listen to me on legal issues anyway, so let me just mention that having said all this, there's wide opposition to mandatory coverage in the state and local pension world.

Basically, every state and local government and every state and local government worker group that has reported an opinion on this has opposed mandatory coverage. Their main concerns are the potential increase in costs and, obviously, worried about benefit reductions in the systems that they've worked hard to obtain.

There's also this issue that both state and local governments and state and local workers can free ride on the legacy costs of Social Security which doesn't get discussed much, but should be in the mix of the policy discussion.

So this is actually a funny issue in that the proponents, obviously, emphasize the benefits of mandatory coverage. The opponents emphasize the costs. And they may well both be right. Nothing that I read in the literature struck me as egregiously unbalanced or wrong, and so this just makes it harder for policymakers. The issue, obviously, has become more urgent but more costly to deal with. And these are the types of issues that policymakers will have to balance as they figure out how they handle state and local government workers and Social Security. Thank you.

(Applause)

MR. FICHTNER: Good morning. Bill's concluding slide kind of takes off where I'm going to start which is good. So, first of all, my name's Jason Fichtner. I'm a Senior Research Fellow at the Mercatus Center of George Mason University. I'm also an adjunct professor down the street here at the Johns Hopkins School of Advanced International Studies where I teach public finance. In my current life, I was with the Social Security Administration as the Acting Deputy Commissioner and Chief Economist.

Caveats are as follows: These opinions are my own not those of my employers and do not necessarily represent people past, present, future living or dead.

(Laugher)

MR. FICHTNER: I want to frame some comments. First of all, I only have ten minutes. I'm not going to get bogged down on methodological issues. Bill did a very good job caveating his paper, the correlations not causations, different data sources so it's useful for discussion. I won't get bogged down there.

I want to focus on policy-relevant issues for discussion so that when we get to it, we can identify some of the opportunity costs and tradeoffs of this type of proposal to mandate state and local workers joint Social Security.

Some general thoughts first. The authors are approaching this paper with their motives in the right place. They are trying to improve retirement security for state and local government workers.

I think we need to recognize that because sometimes the normative values are very important. They are here trying to do something to help people improve their retirement security. And I want to take that as a given because they're not trying to underhand state and local governments. They're not trying to scrupulize Social Security (inaudible) pensions in state and local governments. They are trying to actually help people have a more secure retirement. This is why we're all here.

But what about the empirical evidence? Does the empirical evidence support mandating new workers join Social Security who are state and local government workers? Well, yes and no.

The authors do a good job of showing the correlation between the underfunded nature of the current pension plans in state and local governments and the number of workers who aren't covered under Social Security. That's the yes part.

The no part is there's stuff in there that says if we were to now start requiring new hires of state and local government workers, would they be better off, and would the state and local government finances be better off because in some ways you've got to fund one plan or the other. So (inaudible) question whether or not the alternative is better than the current state.

So would the policy goal requiring all state and local government workers to participate in Social Security do better and more secure entitlement? It depends.

The authors focus on just new state and local workers. I have all in here because there's a question of, as Bill pointed out in his presentation, do you look at new hires over time or all new hires become all employees because you have (inaudible) retiring.

The second is what do you consider a new employee? If we were to enact a mandatory coverage requirement today, someone tomorrow being hired would be on Social Security. How about the person who was hired yesterday? Would you leave them out? How about someone who was hired three years ago or five years ago who might be better off under a new plan than the old?

So you should also think about transition costs. We did this in the federal government back in the mid '80s. We went from the Civil Service Retirement System to the FIR System. We allowed for some transitions to employees to pick in some ways if they are in the margin. So we should consider that as well.

Some pros of including all or new state and local government workers under Social Security. Mandatory coverage would be fair. Bill sort of mentioned this. There will be a share in the legacy costs. Annamaria mentioned this in her opening remarks as well. There will be a share in the cost of socioeconomic benefits, basically helping to contribute to the overall level of who would be less poor. Keeping them in a society in which they are better off helps the social welfare system, economic growth, et cetera.

Social Security provides a progressive benefit formula. Bill just touched on this quickly, no WEP or GPO (inaudible) provision or government pension offset.

We can talk about this in the question and answer. What I will say is that this ticks off a lot of people who are state and local government workers who had some intermittent time in the private sector. They get a Social Security statement. Social Security does not know they had time in the state and local governments. They don't get that data yet so they've estimated the benefits as if they are poorer workers than they actually are and say you're going to get X benefit retirement. They retire, if they're gonna if they're gonna be X plus their Y pension and the government says wait a minute, you're a pension. We're going to reduce your Social Security benefits now. People think they're getting their benefits stolen from them and they complain to congress and the administration and Social Security, you just took our Social Security check. We want it back. Sorry, that's not how it works. So it's very confusing and so adding them would get rid of this.

I will add that there are no new data agreements so starting in 2017 Social Security should be able to start getting some of the data from some of the states on the pension issues and covered employees. So maybe you ought to at least be able to tell people whether they're going to be subject to WEP or GPO.

Mandatory coverage would result in better quality benefits. Inflation adjusted benefits, addition of survivor and disability benefits, improve retirement security as Social Security benefits cover the entire work history. Again, this would be better off as Bill mentioned those who only have a few years in state and local government, or hop in and out and have intermittent coverage. This would help to provide a more consistent coverage base.

It would also remove a moral hazard problem. Bill kind of alluded to this but didn't actually get into it very much about why do we have some states that seem to have a large unfunded liability and also a large percentage of their work force not covered in Social Security.

Part of this is there's an incentive if you are a labor union trying to negotiate higher wages for your state and local workers and you go to the politicians and say we want a higher wage, the politician says, sorry, I can't afford to raise taxes on the taxpayers right now, but I'll tell you what. I'll give you a higher benefit guaranteed tomorrow.

And (inaudible) going to get an 8 or 9 percent discount rate, rate of return and so there's no cost. I can't give you this raise today, but I can give you a raise in pension benefits tomorrow.

So I think what we're seeing is an incentive, a moral hazard problem to promise higher benefits than can be afforded today because we want to see it in higher wages. It's a gimmick. And that in some ways led to the problem of an underfunded pension system. And so by having people come under Social Security, you kind of remove that moral hazard problem.

Also, for a lot of state and local governments right now, they're very concerned about their access to credit markets. Because of the pension system underfunded, there's a question of who's going to pay for it. Will the courts mandate that the states have to raise taxes to cover it? Will they allow you to cut pension benefits from retirement? How will that affect the government's ability to borrow and pay for money? That led to uncertainty. Uncertainty leads to a higher interest rate to borrow. It leads to higher cost to local government.

By adding some of the people to Social Security and state and local workers, you might have some predictability then in the financing which could help lower the interest costs to state and local governments today. So it's important to think about the credit market access issues as well.

Some cons. Would Social Security provide more, quote/unquote, secure benefits in retirement? Well, you're trading one underfunded pension plan for another. As we know, the Social Security right now does not meet the 75-year test for solvency. The delta just gets larger at each passing year.

We add some new employees today, we get some revenues coming in but the costs increase in the future. What's more likely? Have a cut under Social Security or a cut under state and local pension? Are you trading one off for the other? Which is more secure? I don't know.

State and local government funds for current pensions will now go to Social Security, or some of those funds would which could worsen the already underfunded state and local pension plans.

So how it's financed, the transition, is also important to consider. Would this lead to higher state and local taxes regardless of what we do? So again, there's a question of how are states and local governments going to fund their current gap? Are they going to raise taxes? Will it be on payroll taxes? Will it be on property taxes? Will it be sales taxes? That's an issue regardless of whether they transfer over to Social Security or not and that's a question that needs to be explored.

Either way, workers will likely bear the cost of transition, again probably through lower wages. One of the hypotheses now is that pension benefits have been higher guaranteed in the future, or have they been promised to be higher in the future in exchange for lower wages today? If that benefit goes away and that's a pay for, perhaps we'll actually even see lower wages. So in some way shape or form, workers have to bear the burden of this.

Also, what we're adding these workers to retirement security for existing workers covered by Social Security. Again, if we add these state and local workers with some revenue coming in but in allowing it worsens the financing of the trust fund. So for those who are in Social Security, does that mean that they're going to fact higher taxes? Are they going to face more of a benefit cut? And how are we going to fund those issues as well which leads to the question of how do we pay for the shortfall in the long run of newly covered state and local workers when we haven't covered the shortfall for existing workers in Social Security today?

A quick note on costs. I'm going quickly because I see I'm running out of time. The author has already discussed the tradeoff between and (inaudible) advocate for mandatory exclusion because they get higher better benefits and those who are arguing against due to higher costs.

But I point out that costs due to state and local governments have been understated for a long time. Hence, why these plans are underfunded. A lot of this discussion has been on the discount rate. What we promised based on rates of return. A lot of state and local governments are using 7, 8, 9, 10 percent discount rates. They should probably be using 3 or 4. So we've been understanding the costs all the time which means maybe we could have a more realistic discussion about what the costs are (inaudible) or not we should mandate a change.

Again, the authors talk about the idea of constitutionality. Like Bill, I'm not a lawyer. I don't play one on TV. But I question whether it actually is or not. They point to the fact of Medicare now state and local government workers without a pension have to be covered under Social Security.

But we've seen with the ACA debate and the Medicaid expansion in the courts that maybe we can't put these mandates on the states. So we're in a hyper partisan environment right now. Let's be honest. It's best to convince the state and local governments and the employees that to transfer is in their best interest because voluntary participation is better than mandatory. It produces opposition and basically, gets legitimacy.

This is my last side. We need to demonstrate that transitioning to Social Security for new state and local government workers is financially better for both workers and employees at state and local government levels. We haven't done that yet. We need to start doing that.

Similar research is needed for you to transition existing employees, not those with 40 years of employment history like Bill mentioned, who are 60 years old, but those who might be at the margin, with me, five years or less.

Again, keep in mind that costs to state and local governments have likely been underestimated for a long time. These true costs are becoming evidence now and only grow over time.

Equity or fairness is in the eye of the beholder both from an individual standpoint and an inter and intra generational government viewpoint. There's an idea of whether or not transitioning would be fair because of legacy costs and socioeconomic costs being borne, but what's fair to one person might not be fair to another so keep in mind that equity is a subject term.

For (inaudible) government, the tradeoff is upfront costs for longer term benefits. For (inaudible) trust funds, the tradeoff is up front financial gain for long-term costs. That was Bill's concluding slide.

Which one do we value more and how do we then weight off the tradeoffs? The burden of any change will likely fall on workers. Increased payroll taxes or reduction of benefits. But whether you pay now or whether you pay later, you're going to pay.

One of the problems I have with the discussion going on today on state and local pensions is that people are looking for the elusive free lunch. One side looks at it and says if we just hold out, the market will get better. We'll get those ten percent rate of returns again. Don't worry. We'll be able to pay benefits. The other side says, oh, don't worry. We'll get to the point of the fiscal cliff, we can't pay benefits. Politicians won't let it happen. We won't cut your benefits. They're be forced to raise taxes. What you've got now are citizen bases not wanting to see their taxes go up.

So there's no free lunch here. We've got to pay one way or the other. The longer we wait, the higher the cost, and the harder it's going to be. So we've got to figure this out sooner rather than later. From a political standpoint, again, voluntary participation is preferred to mandatory participation. Thank you.

(Applause)

MS. GHILARDUCCI: Hello. I'm Theresa Ghilarducci. I'm a professor of economics now at the New School for Social Research which is in New York City, and I'm a full vested member of the member community. Thanks to see some new faces and for many of my colleagues in that debate.

Thank you to the Brookings Institution, and for the Arnold Foundation to provide yet another sensible paper on this radioactive issue about whether or not state and local government workers should be in the Social Security system.

This certainly connected to the previous session in our seminar today because this is about a mandatory coverage in a universal pension system for all. That's actually what we're talking about.

And I think one of the headings in your slides, Bill, made sense. Mandatory coverage made sense.

MR. GALE: Is that just one?

(Laughter)

MS. GHILARDUCCI: Further advances in this paper could be, maybe, perhaps, for the researchers what you touched on, Jason, is about the nitty gritty about how to move from here where we have pockets of state and local government workers, teachers, police and fire, mainly, who aren't in the system, to the system.

Could they buy themselves, can they buy their way into the system? What kinds of taxes, what kind of relief from Congress could help with this transition cost? So somebody needs to go those nitty gritty, and you were right to point that out.

But I recommend this paper to everyone. It's almost a perfect piece, a template for a policy paper. I really even though I've read much on this issue, there are some fresh angles here. One is this very clear point that experts agree that if we were going to design the system, we would put everybody in it.

There are political reasons why clergy were not included, why agricultural workers were not included. There really are no good reasons, even political reasons why some state and local workers were excluded and some weren't except an historical point, and I want to lift up those plans, those states that had plans before Social Security. Bravo. Thank you for setting the way for the nation to provide pensions for their employees.

And, again, to refer back to the other session, 23 states had old age security legislation being considered or drawn up the year before Social Security was passed. The way we do federal policy in this country is to experiment in the states. Thank you, Illinois, for those experimentation.

But it does make sense not to have these state-by-state plans. We're doing, we're all working very hard to get these state-by-state plans, but doesn't it make more sense for everybody to contribute more to Social Security in an advanced funded plan, perhaps a sovereign wealth fund, managed by professionals, invested correctly, and then paid out in annuity on top of our Social Security system?

That would be what experts would design if we could start from the beginning. But this is a normal pathway for American policy to get to where it makes sense.

So back to the issue of bringing all state and local government workers into the Social Security system. As Bill pointed out, the experts had agreed it would make sense. The winners would be diffuse across the country.

The debate about whether or not they should be brought in was in a very particular context. And now I understand why it never advanced. The context in which these issues were brought forth were in debates, looking at a Chinese menu of ways to solve the Social Security solvency problem, and you would pick out expanding the earnings base, raising the payroll tax, a whole series of issues.

And there at the bottom were adding in all state and local workers, and it brought in a little bit of revenue. So it sort of fit the whole meal, but the stakes weren't very high. And so we had been debating this in a context where it really didn't matter. And the losers, the employers and the representatives of the employee had a lot at stake. These police and fire and teacher plans were highly fought for. These were big contributions to these systems, and they were tailored for the employers of records.

Every employer and employer group have a personnel reason to have their own plan, and each one was delicately designed. So the losers were concentrated and they had a lot of stake in it and the winners were diffuse. So in all policy settings, that's a reason why a sensible thing that would have been built into the system doesn't pass.

But what this paper does is point out that the losers may not be represented. That the losers may be all those police, fire, and teachers who are in plans that are struggling with a mature system and can't keep up. So the risk of not getting those benefits are higher than they were ten, 20 years ago.

Also the vulnerable group of workers not represented are those that move between different states. Contingent work, private sector, and state and local work who actually don't have good vesting in any of those plans.

Again, going back to the first part of our seminar this morning, a need to have a portable universal mandatory pension system that not only solves what Josh Gotbaum said is a major problem, non-coverage. Over half of workers today do not have anything at work.

Coverage is a problem, but there's a middle and third step to a good pension system. Proper investments, and a reasonable efficient payout system.

Right now we have a system in Daniel Biss' words that is tragic and doesn't work. We have long-term investments going into 401(k)s and defined contribution plans that are all dedicated to short-term liquid investments. There's a huge mismatch between the major reason why we save and where we save it. That's an accident. And it makes no sense for an economy that wants to grow.

So we need a system where the fees are low and the liabilities and assets are matched more sensibly. Long-term savings to long-term investments.

We also need a system that pays out annuities in an efficient way. Social Security, defined benefit plans, institutional investors have done it for decades. So we need to use that financial infrastructure to get every piece, coverage, investment, de-accumulation right.

Again, the paper is an excellent piece of work, a little more balanced than Bill's presentation. The pros and cons are there. Again, I want to emphasize that the costs of non-inclusion is actually growing.

Bill, you want to make your graphs making that case go all the same way so that you don't bury your lead. It's a very good compilation of evidence of the growing risk and the identification of vulnerable workers who aren't covered.

There's one more group of workers that are also hurt by this scattered coverage. And those are people that are locked into their pension system because they're teacher, and they're police, or fire that really have to stay because their important employee benefit is not portable.

That creates what we say in labor economic a monopsony situation, and ever since Bagoo, Joan Robinson, and John Hicks, Johansen economics, this situation where workers with an employer creates a situation for monopsony exploitation.

So it's important for workers to be fully mobile so they can fully realize their own potential to match their abilities with a proper employer. So that's another hidden set of losers.

There's another reason, and Jason so clearly lifted it up, is that this actually may help state and local finances. That if the pension costs are clear to all bondholders, it will be easier to sell the debt.

Universal pension coverage, the flip of that, would have been very helpful in the Detroit bankruptcy, municipal bankruptcy discussion. Those city employees were not covered in Social Security. Thank goodness they were covered in Medicare. But those negotiations were bogged down because those pension were everything to those city employees.

So, God forbid, you look forward to more municipal restructurings, universal coverage settled those issues.

The second reason why this issue is important is it lifts up to the reason we're here, and that is a way to have a universal, guaranteed, national, advance-funded system that supplements a strengthened and solvent Social Security system.

So thank you Brookings for this morning.

(Applause)

MS. LUSARDI: So we are already running late so will you speak faster?

MR. FICHTNER: Sure, I can do that.

MR. GALE: I can do that.

MS. LUSARDI: So we can actually take some questions. But I'm just going to start with a simple question. And I wanted to tell Bill that as a European in a sense, we find it very strange that not everybody is covered by the Social Security system. And, of course, no (inaudible) has happened that way. And, of course, now it's so much harder now if you want to mandate this coverage.

So I'm going to use first like the doctor approach of first do no harm so I don't want these Massachusetts people showing up at your door.

And my question is can you say a little bit more about who are the workers who would benefit or not (inaudible) versus a Social Security coverage. And second, what do the workers think? I haven't seen any evidence, but did anybody ask or is there any survey about, for example, the worker really thinking about these issues and, perhaps demanding it?

MR. GALE: In terms of who would be most affected, geographically, it's the people in those eight states I listed. Ohio and Massachusetts, in particular, have extremely low rates of coverage.

In terms of the types of professions, I think Theresa mentioned police and fire, and I mentioned public school teachers. And all the stuff happens as you mentioned, for historical reasons.

MS. LUSARDI: Right.

MR. GALE: If you set up the system now, you wouldn't presumably set it up the way it started and evolved, but we are where we are.

Your second question was?

MS. LUSARDI: About the workers themselves, right. Is there any evidence about what they would like?

MR. GALE: So as I mentioned in the talk, most of the worker groups, in fact, all of the worker group as far as I know, that have issued opinions on this have said they don't want to join Social Security. And there are obvious reasons why which is the increase in costs. I thought Jason's framing of when the costs and the benefits come in each of the programs was actually quite instructive.

But there's also this fact that doesn't get mentioned in the analysis or press releases of the employee groups that they're avoiding paying the legacy costs of Social Security -- MS. LUSARDI: Right.

MR. GALE: -- and estimates are something like one-quarter of Social Security revenues essentially going toward paying legacy costs. So we would all like to avoid having to pay legacy costs, but they are out there.

I think it's important that we still focus again on the idea of cost because this is a clearly important issue and I did my slides. I used the word "underfunded." I admit the first word I typed was "fraudulent." I thought, well that's accusing someone of doing something illegal. I shouldn't say that. Maybe I should use the word "misleading."

And I paused. But the thing is you think about how these pension plans are being sold to state and local workers. They're being sold is this is guaranteed. They're constitutionally protected. They can't be taken away from you. So if they're underfunded, we'll have to raise taxes to pay for it later.

Don't join Social Security. That's going bankrupt. We're safe because we will be forced to raised taxes to cover it. If that assumption is false, and you can actually do bankruptcy (inaudible) Detroit go after retirees, then that is not a true statement anymore and we're misleading people to think that their state and local pension is more secure than a Social Security pension. And that gets into the idea of how do we define cost.

If you go and promise someone today a benefit tomorrow, you should fully fund that benefit today. State and local governments by and large have not been doing that. They've been misrepresenting those costs. And I think that's the (inaudible) cost we'll really have a honest discussion of have these been properly funded. Have we been properly discussing and measuring costs. If not, we're short. We need to make that up one way or the other.

And I think the more discussion we have with state and local workers that they realize their pensions may not be secure, that may change the perception of whether or not it's better to join Social Security or not.

MS. LUSARDI: So that clearly could be provocative --

MS. GHILARDUCCI: I can do that.

(Laughter)

MS. LUSARDI: No, let me ask the question. But actually you had some comments. I'll let you have the comment have the comment and then I'll ask the question.

MS. GHILARDUCCI: Oh, I would not go as far as Jason. Many plans have been underfunded for decades. And my car was running on half empty for 20 years so I'm, you can run a plan as long as you do the normal cost. It actually keeps benefits low in most places. I was a trustee in Indiana for quite a while.

So I just want to frame this. Yes, the paper talks about the growing cost of funding these generous plans who don't have Social Security coverage. And that is a risk. But the main reason to include everyone is because the design of universal coverage makes more efficient. So that will lower the cost.

MS. LUSARDI: But just to be provocative, you know, let's maybe think more of it in a dynamic way. You know, we are trading an unfunded system for another, and it's the right chance, right, that, you know, when I listen to these smart, you know, Senator and the work that they doing at the state level, is there a chance that the state might have more flexibility? Or, for example, that they can invest in risk (inaudible) so that they can find a way to do so or so on. And I'll let you answer and, you know, (inaudible).

MR. GALE: Every poll that I've ever seen lists Social Security as the single most popular program. I think Americans regard it was a birthright, at least those that are in it, and if I had to bet, I would bet that Social Security benefits were safer than the government worker pension benefits.

MS. GHILARDUCCI: And just quickly, many of us in the community feel that it was accident of history that state plans were not covered by ERISA. There were constitutional issues that were settled just a few years after ERISA was passed. And so the flexibility states had wasn't such a good thing. That if they had been covered by ERISA, we probably would not have the problems that you are stating now are in the public plans.

MR. FICHTNER: I'd only sort of add this idea of state's with flexibility. They do have flexibility to put things into market assets. But be very careful the idea of trying to chase the currents. Because what you're doing is you need to think about pension plan, you are basically funding something today to pay out assumed benefits in the future.

And so if you're guaranteeing that, you need to have as much money up front today to weather sort of ups and down in the market so those benefits are there when you need them if you retire.

And so if you say I'm going to assume an 8 percent rate of return, 9 percent, and you don't get it, you start chasing even more riskier assets.

Pension plans should use a risk adjusted rate of return depending on the guarantee they're actually offering people which means a lower discount rate and assuming rates of maybe 3 or 4 percent like Treasury Bonds. So you've really got to balance this out. And so while the states do have flexibility and should utilize that, they should also be very prudent in how they invest and not try to chance higher and higher returns which actually be more risky and actually result in losses to the program not getter gains.

MS. LUSARDI: Let's actually open the floor now for questions because I think is really important and I see these hands up there so I'm going to give it to Katiana, of course to Diane.

MS. GHILARDUCCI: When I look at the eight states that are not, you say are lower funded, they're fairly wealthy states. These are not poor states. So if I'm in that state, I think they can afford it. I know, for instance, that if Illinois had the same tax system as Wisconsin, it could fully fund its retirement system.

So there are other answers if you're at the state level. And if you're going to have a judge whose pension is going to be affected by a lawsuit which has happened, they're going to make sure that they are required to fund that system. At least that's the case in Illinois. I don't know what the law was in Michigan. But some of those states, the way this discussion has gone is as though all the states are the same. But Illinois has its particular situation. And Massachusetts is a pretty well off state and could fund their employees if they wanted to.

They may not want to. But it's not like these are poor states. It's not, it's just interesting when you chose those states.

SPEAKER: Can I bring up now because you make a great point. (inaudible). How do you want to pay things for revenues.

The issue comes it's not whether states can afford it. It's are the citizens willing to pay for it through taxes and something else. And it's the willingness and the problem you see in the public choice perspective is that too often politicians are willing I'll pay you a benefit tomorrow for (inaudible) today. It's the old Popeye approach or the (inaudible) approach.

MR. GALE: Thank you.

MR. FICHTNER: And then issue then becomes if they're not willing to do it, this goes to the state (inaudible) in Detroit because they governor is was little bit more proactive. Basically filed a bankruptcy in federal court and the federal court (inaudible) and said, sorry, you can't do it. We're now doing it in federal. There's no way we have that public choice problem with a local judge saying I want my pension protected.

The Bankruptcy judge took it out in the federal level. So, again, my caution is, and I want to make sure people understand, I'm not advocating for or against this proposal. I'm actually agnostic. What I want is a realistic discussion of the opportunity costs and tradeoffs that come with this one way or the other. And a realistic discussion of what are you basically basing your assumptions on.

Are you basing your assumption on that the courts are not going to let these plans go under in a fully promised basis and that taxes won't be raised? Or are you saying, no, there's a chance they're not going to in which case you should have considered Social Security and the balance of which one will be less, more funded (inaudible))

SPEAKER: I think that's a really good question.

MS. LUSARDI: So I want to really have our senator speak, but I also wanted to acknowledge that the Georgetown Center for Retirement Initiative is doing a lot of work at the state and local level so I do hope that you follow their work and there's a lot (inaudible).

MR. FICHTNER: So this is a much more specific narrow question. It's for, I think, Bill, maybe all of you, this question of whether there's a correlation between offering Social Security benefits and having a lower external benefit level is in Illinois, at least, not abstract at all. We have lots of employees in each category and there is a very different benefit package. The ratio, in fact, is 1.67 to 2.2.

So I think that that they employee groups as you call them, or unions as a lot of us call them, they're right when they say that this change would very likely result in a decrease in the pension benefit.

And my question for you specifically is have you thought about the impact of that transition on the liquidity and cash flow and long-term funding status of the state and local pension plans in question.

MR. GALE: Yeah, that is a great question. And I was running out of time at the end of my talk, the part of the paper that addresses that. It clearly depends on how state pensions respond to the inclusion of their workers and Social Security.

You can think of -- the one change I mentioned was that if they normalize pension benefits so that first year benefits under the old system are equal to first year benefits under the new system with Social Security, then you get the numbers that I presented.

And that sort of, that strikes me as a reasonable benchmark because it would leave the combined system more generous than the current system because Social Security is indexed for inflation, fully for inflation.

But there are other ways to do it and, you know, it's pretty, the laws of arithmetic still hold. It's pretty mechanical, you know, the more you adjust state benefits down, the less retirement security you've added.

But there's also this notion that Social Security provides a broader array of retirement benefits like disability and spousal and in particular complete inflation coverage, and so the quality of the benefits might go up even if the first two benefits don't.

But it's, I agree, it's a key question.

MS. LUSARDI: Would you like to add?

MR. FISCHNER: And again, I have not run the math for Illinois or other states. (inaudible), but again, think about the transition and as well as the time span of costs. So again, for Illinois, Chicago, et cetera, a lot of people credit markets are looking at those governments and saying we're not sure how worthy our borrow base. We're ranging the costs.

That raises their interest cost to base. So you've got interest payments being higher than we normally -- does that Delta cover the cost of transitioning to a Social Security program, I don't know, but that's a math you can do.

Again, you have some predictability. Markets hate unpredictability instability. If they have predictability and stability, you get lower rates. And that might help. And the thing is can you model that so Bill can do some sort of model that shows him the tradeoff between high interest rate, lower rates, and the transition cost.

MR. LUSARDI: We only have a few minutes left, so can you take more questions? There is a question over there. And please let's keep the question brief.

SPEAKER: So current law generally says state and local governments, put your workers in Social Security or you have to do something else. You have rules to kind of flesh out what that something else is.

Bill, did you look at those rules and think about whether or not those rules create an incentive for employers with workers out of Social Security to stay out and potentially cut benefits to, especially when they were under fiscal pressures with underfunded pensions, to cut benefits in the future to levels that maybe are too low from a retirement security perspective?

MR. GATES: That's a really interesting question. If I can rephrase that, and tell me if this rephrasing is correct. If a state, basically, the rule is if a state doesn't cover its workers, it's got to enroll them in Social Security. If it enrolls them in Social Security, it has a payroll tax, employer payroll tax contribution that's required by law, by federal law. If it doesn't, if it keeps them in its own state pension plan, it has much more variability in what it contributes, when it contributes, and how high those benefits actually are.

So I interpret your question as saying states are keeping their options open given the current law that they either have to cover people or put them in Social Security, they're keeping their options open by covering them rather than committing to having to pay a certain amount in payroll taxes by sticking them in Social Security.

Is that a --

SPEAKER: My focus is really on the benefit level question. I mean, there are standards in the rules now, don't ask me to repeat what they are, but there are standards in the rules about what benefit levels need to be, depending on whether it's a DB or a DC and do they give states too much flexibility to provide inferior benefits for people who are outside of Social Security?

MR. GALE: Well, in terms of DB, I think the concern is the vesting, a concern is the vesting period which I mentioned is longer, (inaudible) longer in state plans than private plans. And even after you're vested, there can be a pretty long period at which point you don't get back more than the actual contribution you actually made.

And so I think that's a big concern, but again, I haven't thought of it this until your question. But what it does it gives states more flexibility than if they commit to Social Security.

MS. LUSARDI: Senator, did you want to add briefly to this?

SENATOR BISS: Briefly, yes (tape malfunctioning).

It's not a 10 BD. It said here's your payment. It said here's your contribution.

MS. LUSARDI: Thank you. Okay. Question over there.

Wait for them, the mike.

SPEAKER: ... funding, but it seems to me there's also a credibility issue because certain politician have periodically advocated for private, privatization of Social Security or other funds. So there's not just a funding question, it seems to me with Social Security, but there's a long-term credibility. What will it be in ten or 15 years.

And secondly, when the federal government shifted from the old system to the new system, most people believed that if they opted for the old system, they were better off. And very public sector unions talked to state public sector union.

So if I were a state public sector union, I might look at the federal example and again have a credibility issue. So my question to you all relates to those kind of credibility proposal issues.

MS. LUSARDI: Yes, please.

MS. GHILARDUCCI: There's really good research out of the University of Minnesota that looks exactly at those, the first issue.

Ron Jacobs has looked at the cyclical opinion about whether or not Social Security is solvent. So it's not a

long-term credibility issue. It actually fluctuates. And it fluctuates with utterances of political elites.

So if the President is saying we should privatize Social Security or three times says it's an insolvent, unsustainable problems, credibility goes down. If another presidential candidate whose rising in the polls says this is an easy fix. We need it. It's an important program. Credibility goes up.

The same thing happens in more local issues about what union leaders might be saying to their members, or as you say, the transmitted from federal employees who stayed in FERS to state locals.

So my answer is that it very much depends upon leadership and evidence shows that the utterances and framing of political elites matters a lot. There's no long-term credibility problem. It fluctuates.

MR. LUSARDI: Well, we are already late so thank you for staying longer, but please join me to thank --

(Applause)

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