NATIONAL INSTITUTE ON
Retirement Security
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Why Do Pensions Matter?

Just the Facts

State and local pension plans in the United States are an economic force. These plans hold $2.6 trillion in assets and serve 14.4 million active employees. They pay out some $162.7 billion in pension benefits each year to some 7.5 million retirees.

The data in this fact sheet were taken from a larger "Public Pension Resource Guide." This guide was developed to provide readers with facts and data on the important role that public pensions play in our economy—for employee and retirees, public employers, and taxpayers alike.

"Public Pension Basics" presents key facts about how pensions work—how benefits are earned, how pensions are funded, and how investment decisions are made. It also provides data on the number of Americans who rely on pensions for their retirement security.

"Why Pensions Matter" discusses the characteristics of pension plans that make them attractive to employees, employers, taxpayers, and the broader economy.

"Strong Public Pensions for Today and Tomorrow" identifies practices that can enhance the long-term sustainability of public pension plans, specifically through the integration of funding, investment, and benefit policies.

The full guide is available at **www.nirsonline.org**.

Pensions Matter to Employees: They Offer The Best Chance For Retirement Security

DB Pensions Play a Unique Role in Helping Americans Achieve Retirement Readiness

Very specific characteristics of traditional DB pension plans make them very effective at supporting retirement security for the middle class. First and foremost, DB pensions provide lifetime income. Also, DB pensions feature broad-based participation. Finally, DB pension plans provide ancillary benefits such as spousal protections and disability benefits.

DB pension income plays a substantial role in ensuring that Americans remain self-sufficient in retirement. DB pension receipt was associated with 4.7 million fewer households below or close to the poverty line in 2006.

As a Primary Source of Retirement Income, Defined Contribution Plans Are Insufficient

By contrast, defined contribution (DC) plans, such as 401(k) plans, do not offer these same features that make DB plans so effective at providing retirement security. The private sector trend away from DB pensions and in favor of DC plans is having a negative effect on retirement prospects for many Americans approaching retirement.

Among early Baby Boomers (born 1946-1954), 35% are at risk of being unable to maintain their pre-retirement standard of living after they stop working. This number is much larger for those with DC plans (49%) and for those with no retirement plan (50%). In other words, having a DC plan does not seem to reduce retirement risks at all. Among households with DB pensions, these numbers drop significantly—to 15% for those with just a DB pension, and 12% for those with both DB and DC income.

Thus, Americans with DB pension income are much more likely to achieve financial security in retirement than those without such pensions.

DB Pensions Reduce Risks of Hardships, Especially for Women and Minorities

Women and racial and ethnic minority groups are more at risk in retirement than their white male counterparts for two reasons. First, they still make less money over their careers, and second, they have less access to workplace retirement plans.

Yet DB pension plans seem to play a unique role in shrinking these gender and racial/ethnic gaps in retirement. That is, the percentage of American households classified as poor and near poor drops across gender and race categories when older Americans have pension income.

Pensions Matter To Employers: They Are an Effective Recruitment and Retention Tool

Employees, Especially in the Public Sector, Value DB Pension Plans Highly

Employees value DB pension plans highly, and are more committed to employers who offer them. A 2008 MetLife survey found that 72% of employees cite retirement benefits as an important factor in their loyalty to their employer. Among employers, a 2004 survey found that 84% of DB plan sponsors believe that their pension plan has a positive impact on employee retention.

Public sector employees in particular prefer DB plans to other forms of retirement income, and care more about their retirement benefits in general, than private sector workers. One survey found that public employees much preferred traditional DB pensions, and were much less likely than other workers to express a preference for DC plans.

Defined Benefit Pension Plans Can Help Employers Recruit and Retain Skilled Workers

DB pensions are an important recruitment and retention tool across industries. One study found that workers with pensions are 17% more likely than workers without pensions to stay at their jobs in a single year, all else equal.

Additional research has found that DB pension plans reduce turnover by 13 percentage points, and quit rates by 20 percentage points, on average.

Finally, there is some evidence that DB pension plans' retention effect translates into an increase in worker productivity.

Increased Recruitment and Retention May Be Especially Beneficial to Public Employers

Public sector managers, in particular, may benefit substantially from the human resource gains that DB pensions provide. Unlike private companies that exist to make a profit for shareholders, governments exist to provide essential services—safe streets, clean drinking water, good schools—to citizens and residents. These jobs tend to become quite specialized over time, which makes longer tenures beneficial.

DB pension plans are able to help reinforce public sector employers' human resources goals to recruit and retain a qualified, highly skilled workforce necessary to deliver public services.

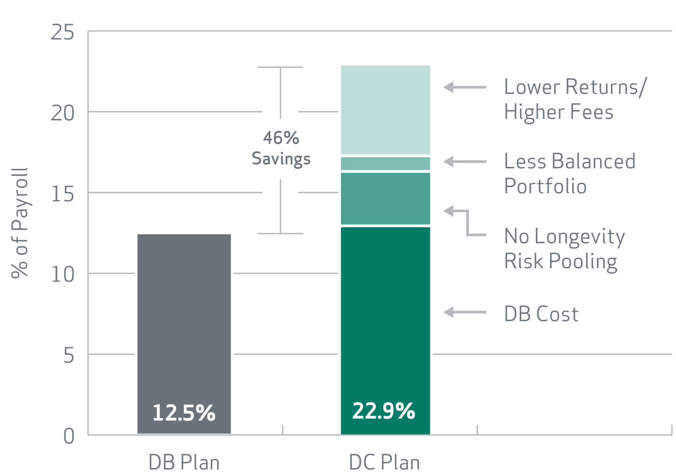
Pensions Matter To Taxpayers: They Are an Economically Efficient and Prudent Use of Funds

DB Pension Plans Are Economically Efficient

DB plans can be very economically efficient. A recent analysis of the cost to achieve a target retirement benefit under both a DB and DC structure found that a typical DB plan cost nearly half as much as a DC plan. That is, the cost to deliver the same retirement income to a group of employees is 46% lower in the DB plan than in the DC plan.

The reason for such cost savings is threefold. Firstly, because DB plans pool the longevity risks of large numbers of individuals, they need only accumulate enough funds to provide benefits for the average life expectancy of the group. Secondly, DB plans are able to take advantage of the enhanced investment returns that come from a balanced portfolio over long periods of time. Thirdly, DB plans achieve greater investment returns than DC plans.

Cost of DB and DC Plan as % of Payroll

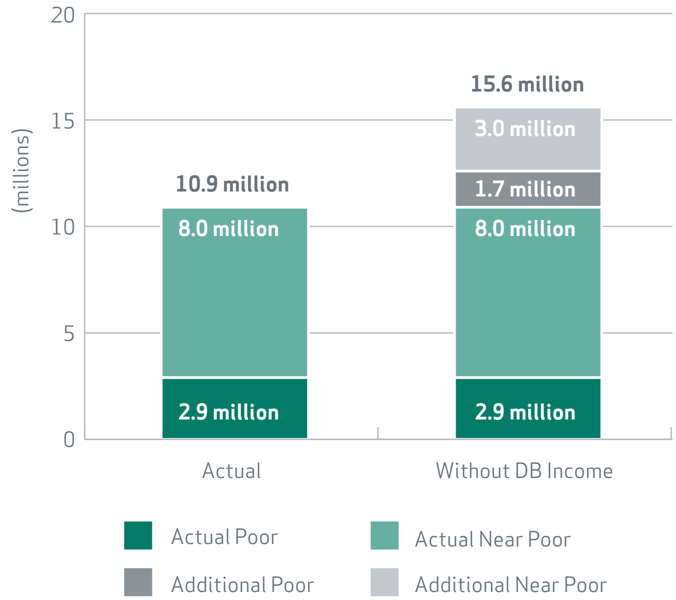


DB Plans Save Governments Billions in Public Assistance Expenditures

DB pension plans also save governments money in reducing citizens' need to rely on public assistance. A recent study finds that DB pensions have been instrumental at keeping elder Americans out of poverty. In 2006, poverty rates among older households lacking pension income were about six times greater than those with such income. Also, in that year 4.7 million American households avoided being below or close to the poverty line due to their DB pension income.

When fewer households experience poverty and financial hardship, federal, state, and local governments see a cost savings in terms of public assistance expenditures avoided. In 2006 some $7.3 billion in public assistance expenditures was avoided because of households' receipt of pension income.

Number of Poor/Near Poor Older Americans, Actual and Projected (Without DB Income)



Beyond Retirement: Why Pensions Matter to Local Economies and Capital Markets

Expenditures from DB Pensions Have a Broad and Deep Economic Impact

Expenditures made out of DB pension plans have a broad economic impact, both nationally and on the local level. In 2006, expenditures made out of public pension payments supported more than 2.5 million American jobs that paid more than $92 billion in total compensation. Pension expenditures also supported over $358 billion in total economic output nationwide and over $57 billion in federal, state, and local tax revenue.

State and local pension expenditures also have large multiplier effects. For each dollar paid out in pension benefits $2.36 in total economic output was supported. And for every dollar contributed by taxpayers to state and local pension funds, $11.45 in total output was supported.

DB pensions also act as "automatic stabilizers" for the economy. Pension payments to retirees do not fluctuate with the stock market or other economic indicators. Because retirees receive a regular monthly benefit, they can continue to spend on basic needs, providing stimulus even during tough economic times.

DB Pension Investments Are Crucial to Domestic Capital Markets

Because DB pensions are pre-funded, investment of pension assets provides capital to businesses to help develop products, invest in new technologies, and even create jobs.

DB pensions have longer time horizons than savers in DC plans, and because of this they can achieve greater stability in asset allocations. This "patient capital" offers benefits for financial markets, since professional investors who follow a long-term strategy are less likely to cause market disruptions by chasing short-term returns.