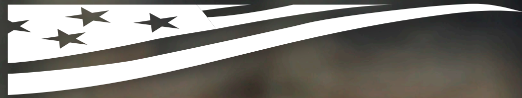

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Laying the Groundwork for More Efficient Retirement Savings Incentives

By Christian E. Weller and Teresa Ghilarducci November 2015

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Introduction and summary

Americans want to be financially secure throughout their retirement years. While Social Security offers a basic income to almost everybody, most people need to save a lot of money on their own to be able to enjoy the retirement they envision.

However, people often encounter substantial obstacles to saving more money, such as low income, lack of retirement benefits from their current employers, and limited help from existing savings incentives in the tax code. Hence, fewer and fewer working-age households can expect to maintain their standard of living in retirement. One widely cited 2013 estimate from the Center on Retirement Research showed that a little more than half—52 percent—of all working-age households were at risk of having to cut back their consumption in retirement, up from 31 percent in 1983.[1] As a result, a growing number of people are more likely to retire in poverty, to experience economic hardships such as not being able to afford necessary medication, and to have to rely on public assistance and family members for financial support.[2] This retirement crisis is real and is only getting worse.

The U.S. tax code offers financial incentives—such as contributions to certain retirement plans not being subject to federal income taxes—to encourage people to save more money than they would otherwise. These savings incentives exist under different rules in a wide variety of retirement savings accounts, including 401(k) plans and individual retirement accounts, or IRAs. The rules for these types of plans vary by how much people can contribute each year, the role employers play in offering these plans, and when people need to pay taxes.

Current savings incentives, though, are inefficient. People who need the most help to save more for retirement often get little or no help. Better designed savings incentives that target lower-income workers—for instance, those who do not work for an employer that offers retirement benefits—would make a real difference in workers' retirement preparedness. Economic research shows that low-income people do save for their futures when offered substantial financial incentives.[3] An often-cited 2005 experiment that researchers conducted with

H&R Block in predominantly lower- and middle-income neighborhoods showed that offering a 50 percent match—people received 50 cents for each dollar they saved—increased the likelihood that people participated in an IRA from 3 percent without matches to 14 percent with a match, an increase of almost 400 percent.[4] And in the same experiment, the amount that people who participated in an IRA saved increased sevenfold when they were offered a 50 percent match.[5]

These are examples of the potentially large benefits of well-targeted savings incentives. It is worth remembering, however, that more efficient savings incentives and greater access to these incentives are not the only fixes necessary to address the looming retirement crisis for many low- and middle-income people. But they would be important steps in the right direction.

What exactly are the problems with the existing incentives? The federal government and states forego revenue of more than $100 billion annually to help people save, but the effect on increasing savings is often small or negligible.[6] A recent estimate suggests that each $100 in savings incentives offered under the current structure increases savings by only $1—a low payoff for a big investment.[7] The reason for this small effect is that incentives are skewed toward high-income earners, frequently not reaching the Americans who need the most help with saving. And savings incentives are overly complex, possibly slowing savings for people who are unaware of these benefits or do not fully understand them. Moreover, how much people can possibly benefit from savings incentives depends to a large degree on whether or not they work for an employer that offers retirement benefits; employers that do can make it easier for their employees to qualify for savings incentives. Put differently, people who do not get retirement benefits at work likely also receive fewer savings incentives. The result is a well-intentioned—but dysfunctional—tax benefit system that is in need of reform to change the way that people save for retirement.

Because the current system only works for the lucky few, it does not offer much assistance to the vast majority of Americans who are trying to build a better future. Only households in the top fifth of the income distribution tend to have resources, receive substantial tax incentives, and have significant access to employer and nonemployer retirement plans to benefit from current savings incentives. It is, for example, only among households in the top fifth of the income distribution that a substantial majority of households have one or more tax-advantaged form of savings, while the majority of households in the rest of the income distribution—the bottom 80 percent—have no tax-advantaged savings.[8]

Reforming the tax code to make it more efficient should prioritize refundable tax credits over new tax deductions; emphasize progressive savings matches that offer relatively higher benefits to lower-income households; create savings incentives that are simple to use; and establish new savings options, such that gaining access to savings incentives depends less on employers offering retirement plans. Federal and state policymakers should consider five important steps that could make savings incentives more attainable and efficient. The benefits of these steps would largely go to the Americans who need the most help saving more, including lower-income workers and people who work for employers that do not offer retirement benefits. The five policy recommendations include:

1. Make the Saver's Credit fully available to lower-income households
2. Establish and expand progressive savings matches
3. Simplify retirement savings incentives by streamlining rules
4. Limit the automatic increases of tax deductions
5. Create simple, low-cost, and low-risk options for people to save for retirement outside of employer plans

Policymakers should pursue these steps to ensure that more middle-class Americans enjoy greater benefits from existing retirement savings incentives. All five recommendations would benefit lower-income earners, especially those who work for employers that do not offer retirement benefits.

Since a single report cannot possibly address all potential tax reforms, this report begins by highlighting a few basic reform principles that would make savings incentives more efficient to guide the subsequent recommendations. The report then summarizes the main problems that underlie the inefficiencies of current savings incentives,[9] followed by recommendations to address these problems.

A better network of targeted savings incentives and supporting policies would go a long way toward addressing the looming retirement crisis.

Goals and principles of reform

Savings incentives should be reformed to address the growing retirement crisis. Policy initiatives can best address the crisis by creating retirement savings for those who demonstrably need the most help to save. This includes low-income households and people who work for employers that do not offer retirement plans. These policy reforms will work best if they follow a few basic principles developed here to guide the subsequent reform discussion. Retirement savings incentives are large and complex; therefore, the recommendations that follow these principles are important specific examples, but they do not encompass all possible reform steps. These principles can help inform future discussions on savings incentives reforms, including those that are not specifically addressed in this report.

Retirement savings incentives should come in the form of refundable tax credits rather than new tax deductions

Existing savings incentives typically come in the form of tax deductions, but tax credits would better target assistance to those who need the most help to save more.

Consider what typically happens when households contribute to a retirement savings account. Households deduct—or, in tax parlance, exclude—their retirement savings contributions from their current taxable income[10] and, thus, reduce the amount of income subject to taxation. The federal tax code is progressive; in other words, higher-income earners pay higher marginal taxes—the taxes due on their last dollar earned—than lower-income earners. Because higher-income earners face higher marginal income taxes than lower-income earners, they have a stronger incentive to use tax deductions to reduce their taxable income than lower-income earners do.[11]

The highest tax bracket—for those making more than $406,750 individually or $457,600 jointly per year in 2014—is 39.6 percent.[12] Earners in this tax bracket, for example, would lower what they owe on their federal income taxes in the

current year by 39.6 cents for each dollar that is contributed to an eligible 401(k) or IRA. Low-income earners, in comparison, may face a marginal tax rate of 10 percent and thus save only 10 cents in current year income taxes for each dollar that they contribute to a retirement savings account.

Now, compare deductions to tax credits, which work differently than tax deductions to incentivize savings. With tax credits, households' behavior is directly rewarded, regardless of how much income they earn and thus what their marginal federal income tax rate is. With a tax credit for retirement savings, households may receive a fixed percentage of the amount they saved in a given year. A tax credit of 20 percent means, for instance, that a household that saved $1,000 for retirement in a given year would receive $200 at tax time. All households would receive the same tax benefit from a tax credit as long as they save the same amount and the tax credit is refundable—not dependent on what people owe in federal income taxes. Tax credits consequently can offer larger benefits to lower-income households than tax deductions since low-income households may face low or zero marginal tax rates and thus no immediate tax incentives from tax deductions.

Tax credits work best as savings incentives for low-income households if these tax credits are refundable.[13] Refundable tax credits are independent of the amount in federal income taxes a household owes, while nonrefundable tax credits—such as the current Saver's Credit[14]—are limited by the amount of federal income taxes a household owes. Households that do not owe any federal income taxes receive no money from a nonrefundable tax credit, even if they otherwise qualify for it.

Progressive savings matches can offer lower-income households extra help in saving for retirement

Refundable tax credits alone are not enough to get lower-income households to save what they need for retirement. Policymakers can structure refundable tax credits to offer greater help in saving for retirement to lower-income households. The idea is to still reward savings but offer lower-income households more of a helping hand.

Low-income households, for instance, could get a tax credit that is equal to 100 percent of the amount they save, while middle-income households may get only 50 percent and high-income households get 25 percent of each dollar they save, up to a predetermined maximum.

Savings incentives should be simple to use

Complexity hurts all but the most sophisticated households because it requires people to make multiple choices on where, when, and how much to save for retirement. Each such choice is fraught with the possibility of making the wrong choice and inadvertently incurring excessive costs and risks. Many households eventually decide not to make a choice—that is, not to save—rather than face the possibility of making the wrong one. Creating a multitude of savings incentives with separate yet interwoven rules impedes savings to some degree.[15] That is, people do not save as much as a result of the tax incentives as they would if the savings incentives were simpler.

The value of savings incentives should depend less on employers' decision to offer retirement plans at work

Working for an employer that offers retirement benefits is an important part of saving for retirement, but fewer and fewer employers offer such retirement plans and many employers have cut back on the amount they contribute to their employees' retirement benefits.[16] The goal is to give workers additional and easy-to-use options to save for retirement beyond the retirement benefits offered by their employers rather than to replace employer-based benefits.

Policy reforms that follow these principles would make a dent in the looming retirement crisis. Creating refundable tax credits, simplified savings incentives, and new and easy-to-use savings vehicles outside of the employer-employee relationship would increase the number of people who save for retirement. Such reforms would also increase the amount that people already save for retirement. Again, lower-income earners and workers whose employers offer no or few contributions to retirement plans would especially benefit from reforms that follow these principles. The winners of policy reforms that follow the above principles would be the households that benefit little from the existing system and experience the largest shortfalls in retirement preparedness, particularly lower-income households.[17]

Five possible ways to get to more efficient savings incentives

As explained above, existing savings incentives benefit higher-income earners significantly more than low-income earners,[18] and the unequal distribution of savings incentives follows in part from the fact that existing incentives typically come in the form of tax deductions. The following five recommendations would help make savings incentives more efficient.

1. Make the Saver's Credit fully available to lower-income households

Higher-income earners benefit a lot more from existing savings incentives not just in absolute dollar terms, but also relative to their income. Figure 1 shows the estimated amount of net pension contributions and earnings on retirement accounts as a share of after-tax income by income percentile in 2013. Households in the top fifth of the income distribution got tax incentives that are equal to 3.1 percent of their income, which is nearly double the 1.8 percent for households in the second-highest fifth of the income distribution.[19] At the same time, households in the lowest fifth of the income distribution barely benefited from the savings incentives and, on average, only received 0.4 percent of income.

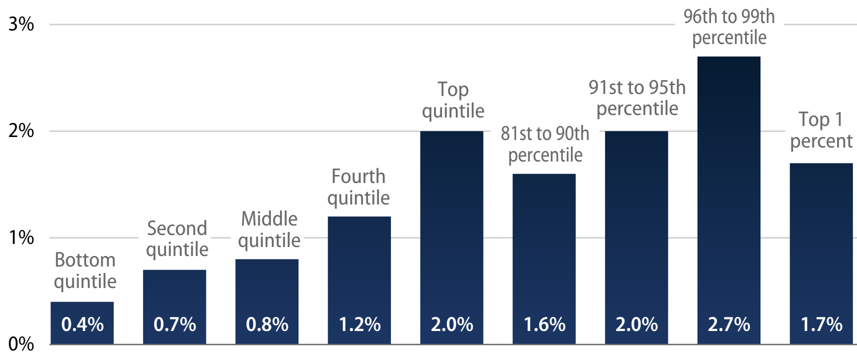
Designing a tax credit that is refundable could help level savings incentives for low-income and middle-income households so that these households are more adequately prepared for retirement.

The U.S. tax code currently offers an important tax credit—the Retirement Savings Contributions Credit, or Saver's Credit—that targets lower- and middle-income households to save more for retirement.[20] People can receive a match of 50 percent, 20 percent, or 10 percent of their savings, depending on their income, such that lower-income earners receive a higher percent match than higher-income earners.

FIGURE 1

Net pension contributions and earnings as a share of after-tax income

By income percentile in 2013



Source: Congressional Budget Office, "The Distribution of Major Tax Expenditures in the Individual Tax System" (2013), table 2, available at http://www.cbo.gov/sites/default/files/43768_DistributionTaxExpenditures.pdf. All figures are in percent of income.

But this tax credit does not work as well in helping low-income earners save for retirement as it could because it is nonrefundable.[21] Many people who qualify for this credit are not aware of it,[22] and many eligible low-income earners traditionally do not receive the Saver's Credit.[23] A detailed study comparing the effectiveness of the Saver's Credit with an experimental match administered in 2005 through a tax preparer—H&R Block—found that the experimental measure was more effective in getting lower-income people to save. Each client preparing a tax return in participating H&R Block offices was randomly assigned to no match, a 20 percent match rate, or a 50 percent match rate—up to a maximum $1,000-dollar match from H&R Block—for their contributions. The contributions went into a retirement savings product offered by H&R Block, called the X-IRA. Higher matches increased the number of people who saved and the amounts that they saved. The researchers concluded that the Saver's Credit was not as effective as this easier-to-use match in part because the Saver's Credit's nonrefundability made it difficult for people to know whether they would be eligible for the credit and thus whether they should save throughout the year.[24] The bottom line is that the Saver's Credit's nonrefundability appears to pose an obstacle to its ability to get more low-income households to save more for retirement.

The solution is to make the Saver's Credit refundable so that all low-income tax payers can better plan for this incentive and get extra help saving for retirement. The idea to make the Saver's Credit refundable enjoys widespread[25] and even bipartisan support.[26] Doing so would offer substantial assistance in saving for retirement for low-income and many middle-income households.

2. Establish and expand progressive savings matches for retirement

Making existing credits refundable may not be enough to offset the growing shortfall in American retirement savings. Lower-income earners may need additional incentives to save for retirement since they disproportionately struggle from weak and uncertain labor markets and a lack of employer-provided benefits.[27] Such additional efforts are commonly known as progressive savings matches since they offer greater assistance to lower-income earners than to higher-income ones relative to each dollar saved.

Several previous proposals have been aimed at creating progressive savings matches for retirement savings, as discussed in a Center for American Progress issue brief by Christian Weller and Joe Valenti in 2013.[28] In the late 1990s, President Bill Clinton proposed Universal Savings Accounts, or USAs, to help people save outside of Social Security. Under this proposal, workers could contribute up to $1,500 annually to the USAs. This annual contribution would have included an automatic contribution of $400 per year for the lowest-income workers plus 100 percent matching contributions for the first $550 saved by workers.[29] To be clear, low-income workers would have had to contribute only $550 of their own money under this proposal, with the federal government providing an additional $1,050 in different savings incentives so that they could have saved $1,500 in total each year. The savings incentives, however, would have declined relative to each dollar saved as people's incomes went up. Moreover, workers with annual earnings of more than $50,000 could have only qualified for matches from the USAs if their employer did not offer a retirement plan at work.[30]

President Barack Obama included a more modest proposal in his fiscal year 2011 budget. His proposal would have expanded eligibility for the Saver's Credit, which includes higher credits relative to each dollar saved for lower-income earners, to joint tax filers earning as much as $85,000—rather than the then-current limit of $57,500—in addition to making the credit refundable.[31]

Additional proposals from members of Congress in recent years could similarly improve savings incentives for lower-income workers because the proposals focus on matches for savings and offer higher matches to lower-income earners than to higher-income ones. For instance, the Savings for American Families' Future Act, or H.R. 837, sponsored by Rep. Richard Neal (D-MA) in 2013, would have expanded eligibility for the Saver's Credit and directly deposited the credit into

taxpayers' retirement accounts. And Rep. José Serrano (D-NY) introduced the Financial Security Credit Act, or H.R. 2917, in 2013, which included a 50 percent match on the first $1,000 saved by low- and moderate-income workers—defined as single filers earning less than $41,650 and joint filers earning less than $55,000. People could have deposited the match into a retirement account, education savings account, U.S. savings bond, certificate of deposit, or even some savings accounts, provided that families held onto the savings for at least eight months.[32]

The bottom line is that Congress could expand refundable credits to millions of Americans who save very little for retirement—and, thus, do not benefit from existing savings incentives—by increasing income limits and the generosity of savings matches. The combination of higher income limits and more generous matches would offer low-income and many middle-income households desperately needed help to save more for retirement.

3. Simplify retirement savings incentives by streamlining rules

Current retirement savings incentives apply to a wide variety of retirement savings options, such as 401(k) plans, IRAs, and Roth IRAs—each with a different set of tax rules. The combination of many different savings options with separate rules, especially tax treatments, makes savings incentives complex. Complexity especially hurts household savings since people generally have to make active decisions to save money on their own and have more possibilities to make decisions that can adversely affect their retirement savings. Before people decide where and how much to save, they first must work through the complicated process of figuring out which savings incentives are available to them. As the complex system hinders many households' attempts to save, they do not fully take advantage of the existing tax incentives. Many people simply do not save or do not save as much as they would if savings were made simpler and easier. Simplification should be a key component of tax reform efforts led by Congress because simplifying savings incentives would lead more households to start saving and increase the amount of their savings.

Making savings simpler has two separate aspects. First, simplification means combining retirement savings incentives into fewer tax-advantaged savings forms, streamlining the existing multitude of tax-advantaged retirement savings. A number of proposals have touched on this kind of simplification over time. For instance, Eugene Steuerle of the Urban Institute and Pamela Perun, then of the Aspen Institute, proposed streamlining 401(k)-type retirement plans by moving 403(b) plans, SIMPLE IRAs, and SIMPLE 401(k) plans, as well as all safe harbor plans—

or retirement plans that give employers some regulatory relief if they make it easy for people to save—into their proposed Super Simple plans.[33] Also, in 2005, the President's Advisory Panel on Federal Tax Reform under President George W. Bush recommended moving all employer-based retirement plans, such as 401(k) plans and 403(b) plans, into a Save at Work plan and combining all other retirement plans into a Save for Retirement plan that would be available to all workers.[34] And more recently, Christian Weller and Sam Ungar, then at the Center for American Progress, discussed the advantages and drawbacks of combining all federal savings incentives into one tax credit in 2014.[35] Moreover, Brown University's John Friedman proposed combining the various retirement accounts into a single Universal Retirement Savings Account in 2015.[36] The bottom line is that a number of possibilities exist to simplify retirement savings incentives, and such simplification would likely increase savings, especially among households with less income and savings.

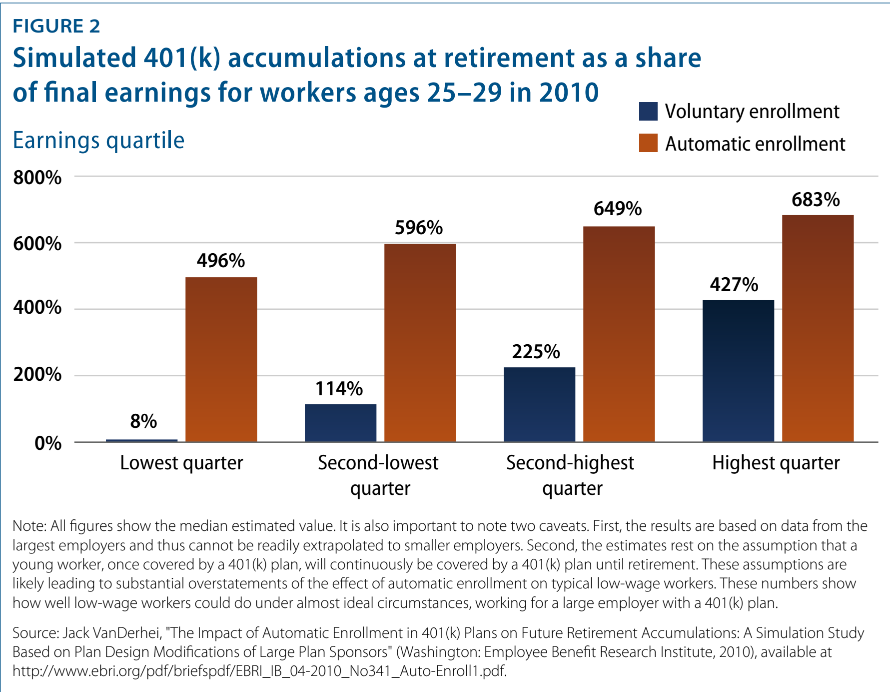
Second, simplification also means making it easier for people to save for retirement so that they can more readily take advantage of existing savings incentives. There has been a general trend toward so-called automatic savings features. The two features most relevant to this discussion are automatically enrolling people in a workplace retirement plan and automatically increasing participants' savings rates. Employees can still opt not participate, but because of inertia, many will continue to participate in their employer's 401(k) plan once they are enrolled. The Pension Protection Act of 2006 offered employers some regulatory relief—safe harbor rules—if they included these and a few other automatic features in their 401(k) plans.[37] Making savings automatic increases the number of people who save for retirement and the amount that they save, thus raising their access to federal savings incentives. The vast majority of American households would likely benefit from easier and simpler savings.

One of the most prominent examples of simplifying savings by making decisions automatic is so-called automatic enrollment. With this retirement savings plan design, employees are automatically enrolled in their employer's retirement plan as long as the employer offers such a plan. Employees can then opt out of the retirement plan, but many will decide to continue saving once they are enrolled due to inertia in making active decisions. Participating in an employer's retirement savings plan, such as a 401(k) plan, then gives many more people access to their employer's matching contributions, as well as the concomitant savings incentives, which help them build savings faster. In the past, retirement savings plans typically required employees to sign up for an employer's plan or opt in, but many failed to do so—again, often because of inertia.

The Employee Benefit Research Institute, or EBRI, created a simulation model based on the overwhelming majority of 401(k) plans and people in them, which allows researchers to assess the long-term effects of switching from an opt-in to opt-out approach through automatic enrollment.[38] Figure 2 shows EBRI's estimates for the median worker's total retirement savings relative to final income at retirement for workers who were between the ages of 25 and 29 in 2010 with voluntary enrollment—opt in—compared to automatic enrollment—opt out. These estimates, based on real life retirement plans and workers, show that automatic enrollment results in much higher retirement savings for workers at all income levels as long as workers continuously save. Typical retirement savings for workers in the lowest quarter of the earnings distribution could be as high as five times workers' final earnings when they retire with automatic enrollment, compared to only 8 percent with voluntary enrollment. This large improvement is greater than the improvements for higher-income earners in part because automatic enrollment has the biggest benefit among low-income earners in terms of getting more people to save, particularly those who often do not participate in a retirement plan at work.[39] (see Figure 2) These best-case estimates show that automatic enrollment can have a substantial effect on retirement savings, especially for low- and middle-income workers.

FIGURE 2

Simulated 401(k) accumulations at retirement as a share of final earnings for workers ages 25–29 in 2010



Note: All figures show the median estimated value. It is also important to note two caveats. First, the results are based on data from the largest employers and thus cannot be readily extrapolated to smaller employers. Second, the estimates rest on the assumption that a young worker, once covered by a 401(k) plan, will continuously be covered by a 401(k) plan until retirement. These assumptions are likely leading to substantial overstatements of the effect of automatic enrollment on typical low-wage workers. These numbers show how well low-wage workers could do under almost ideal circumstances, working for a large employer with a 401(k) plan.

Source: Jack VanDerhei, "The Impact of Automatic Enrollment in 401(k) Plans on Future Retirement Accumulations: A Simulation Study Based on Plan Design Modifications of Large Plan Sponsors" (Washington: Employee Benefit Research Institute, 2010), available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_04-2010_No341_Auto-Enroll1.pdf.

4. Limit the automatic increases of tax deductions.

Today, greater benefits go to high-income earners, while fewer benefits are available to lower-income earners. Part of the disproportional benefit of savings incentives to high-income earners stems from the fact that high-income earners are more likely than low-income people to benefit from the maximum contributions of employer-sponsored retirement plans, which are larger than for plans that are not employer based. High-income earners are more likely to have the money to contribute at the maximum, and they are more likely to work for an employer that offers a retirement plan.[40] In the end, maximum contribution limits for 401(k) plans are more meaningful for high-income earners than for low-income ones.

The maximum amount that people can contribute to their retirement savings accounts increases with inflation in at least $500 increments. The contribution limit for employee contributions to 401(k) plans in 2014 was $17,500, and it rose to $18,000 in 2015.[41] Similar increases occur for the maximum amount that employers can contribute. These maximum contribution limits and their increases are meaningless for the vast majority of people. Most people do not contribute near the maximum, so an increase does not change anything for them.[42] Put differently, the tax revenue lost from increasing the maximum contribution only benefits a small minority of people saving for retirement.

Policymakers have tried over time to limit the amount of tax deductions that people can take, for instance, to pay for the expansion of the Saver's Credit. President Obama proposed in his fiscal year 2016 budget limiting the total value of all itemized deductions, including retirement contributions, to 28 percent of income. This proposal would still allow for regular increases of the total tax deductions, as long as incomes go up, but it would lower the maximum amount of total tax deductions.[43] Similarly, Rep. David Camp (R-MI) proposed, among a number of other tax changes, limiting the value of contributions as tax deductions to retirement accounts in his 2014 tax reform proposal by suspending the automatic increases in the maximum contribution limits for a decade.[44] President Obama's budget proposal also limited additional retirement contributions if the total value of retirement savings exceeded $3.4 million.[45]

Importantly, policymakers of all stripes have been looking for ways to reduce the inefficiencies of the existing savings incentives by limiting the maximum retirement savings incentives. Policymakers could accomplish this by lowering the

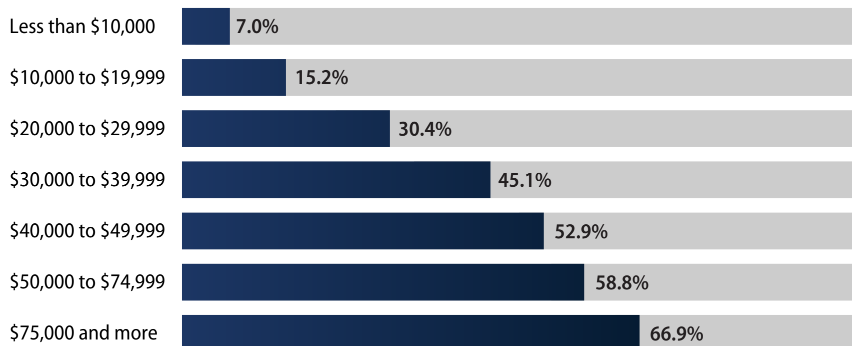
maximum retirement contribution amounts or by slowing the growth rate of these maximum amounts. This would free up government resources that are currently used inefficiently and could be paired with more targeted retirement savings to help low- and middle-income households save more for retirement.

5. Create simple, low-cost, and low-risk options for people to save for retirement outside of employer plans

People are more likely to benefit from savings incentives if their employer offers a retirement plan. The sad fact is that many lower-income workers do not participate in a retirement plan at work, largely because their employers do not offer such retirement benefits. Figure 3 shows the share of private-sector wage and salary workers between the ages of 21 and 64, who participate in a retirement plan—either a defined benefit, or DB, pension or defined contribution, or DC, retirement savings account. In 2013, the last year for which these data are available, only 15.2 percent of those earning between $10,000 and $20,000 participated in a retirement plan, or less than one-fourth the share of people who earned $75,000 or more. (see Figure 3) Still, even among the highest-income earners, only two-thirds participated in an employer-provided retirement plan, leaving many upper-middle-income earners to build their own retirement savings with less beneficial tax treatment than for employer-based plans.

FIGURE 3

Share of private-sector wage and salary workers ages 21–64 who participated in an employer's retirement plan in 2013, by income



Source: Craig Copeland, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2013" (Washington: Employee Benefit Research Institute, 2014), available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_405_Oct14.RetPart.pdf.

Federal and state lawmakers should create more ways to save for retirement outside of employer-sponsored retirement plans, which could improve access to these tax benefits for households that, on average, are more likely to fall short with their retirement savings. Alternative pathways to retirement savings can help shrink savings gaps by income. Overall, saving for retirement would be easier because benefits would actually be accessible to people who otherwise would have little or no access to savings incentives.

One important step for policymakers would be to create more low-cost, low-risk, and easily accessible savings options outside of the employer-employee relationship.[46] Having state—and federal—governments sponsor savings options for private-sector workers grows out of three realizations. First, households need help saving through low-cost and low-risk options since they otherwise incur too many costs, face too much risk exposure, and end up saving too little for retirement. Second, the current policy emphasis on getting employers to offer such retirement benefits to their employees has substantial gaps, leaving many households without enough savings. And third, states have the resources and expertise to offer retirement savings options to private-sector workers because they already offer retirement savings to public-sector employees and often sponsor education savings to all households. Having states sponsor a retirement savings option may be a suitable way to offer households more low-cost, low-risk savings.

The specific design of a state-sponsored retirement plan would vary depending on a few key choices that Congress and state legislatures would need to make. Lawmakers, for instance, would need to decide who could participate in such retirement plans, whether contributions would be voluntary or mandatory, and whether such new savings options would also include secure retirement payouts, such as annuities, that pay a lifetime stream of income.[47] The federal government has created myRAs that are intended to make it easier for people to save for the future.[48] This could be a first step in creating a federally sponsored retirement savings options. A number of state governments, including California, have started to look into offering retirement savings plans to private-sector employees who currently do not have retirement plans at work.[49] Greater access to low-cost, low-risk savings options should increase the number of people who save and possibly the amount that people save since they would theoretically enjoy lower costs and fewer risks than they currently do with IRAs. The increase in savings, and in the number of additional people who take advantage of savings incentives, would depend on the exact policy choices.

Conclusion

The U.S. tax code offers a wide variety of incentives for people to save for retirement. But these savings incentives are inefficient because they do not increase savings as much as alternative incentives would and are ineffective mechanisms to get people to save more. Federal and state policymakers can pursue a number of smaller reform efforts short of a massive overhaul of the entire tax code to improve retirement savings incentives. Better savings incentives would go a long way toward addressing the impending retirement crisis for America's middle class and give families are realistic shot at a dignified retirement.

About the authors

Christian E. Weller is a Senior Fellow at the Center for American Progress and a professor of public policy at the McCormack Graduate School of Policy and Global Studies at the University of Massachusetts, Boston.

Teresa Ghilarducci is the Bernard L. and Irene Schwartz chair in economic policy analysis in the Department of Economics and the director of the Schwartz Center for Economic Policy Analysis at The New School in New York.

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4 Duflo and others, "Saving Incentives for Low- and Middle-Income Families."

5 Ibid.

6 For supplemental data, see Congressional Budget Office, "The Distribution of Major Tax Expenditures in the Individual Tax System" (2013), Figure 2, available at https://www.cbo.gov/publication/43768. For one estimate on lost state tax revenue, see Teresa Ghilarducci and others, "Retirement Savings Tax Expenditures: The Need for Refundable Tax Credits" (New York: The New School, 2015), available at http://www.economicpolicyresearch.org/images/docs/retirement_security_background/Retirement_Savings_Tax_Expenditures.pdf.

7 See, for example, Raj Chetty and others, "Active vs. Passive Decisions and Crowd-Out in Retirement Savings Accounts: Evidence from Denmark," *Quarterly Journal of Economics* 129 (3) (2014): 1141–1219.

8 Christian E. Weller, *Retirement on the Rocks: Why Americans Can't Get Ahead and How New Savings Policies Can Help* (New York: Palgrave Macmillan, forthcoming), Chapter 10.

9 See Christian E. Weller and Teresa Ghilarducci, "The Inefficiencies of Existing Retirement Savings Incentives" (Washington: Center for American Progress, 2015), available at https://www.americanprogress.org/issues/economy/report/2015/10/30/124315/the-inefficiencies-of-existing-retirement-savings-incentives/.

10 This report uses the common term "tax deductions" to describe the tax preferences for retirement savings accounts rather than the term "exclusion," which is common in many tax publications.

11 See also Teresa Ghilarducci, *When I'm Sixty-Four: The Plot Against Pensions and the Plan to Save Them* (Princeton, NJ: Princeton University Press, 2008).

12 Internal Revenue Service, *1040 Tax Tables 2014* (Department of the Treasury, 2014), available at http://www.irs.gov/pub/irs-pdf/i1040tt.pdf.

13 Empirical research finds that savings matches, which are economically equivalent to refundable credits, successfully get people to save a lot more than they otherwise would. Deductions, in comparison, have a fairly small effect on savings. For matches, see, for instance, Duflo and others, "Saving Incentives for Low- and Middle-Income Families"; Mills and others, "Evaluation of the American Dream Demonstration." For the impact of deductions, see, for example, Raj Chetty and others, "Active vs. Passive Decisions and Crowd-Out in Retirement Savings Accounts."

14 William Gale, J. Mark Iwry and Peter R. Orszag, "The Saver's Credit: Expanding Retirement Savings for Middle- and Lower-Income Americans" (Washington: The Brookings Institution, 2005), available at http://www.brookings.edu/views/papers/20050310orszag.pdf.

15 Shlomo Bernartzi and Richard Thaler, "Heuristics and Biases in Retirement Savings Behavior," *Journal of Economic Perspectives* 21 (3) (2007): 81–104; Gary R. Mottola and Stephen P. Utkus, "Can There Be Too Much Choice in a Retirement Savings Plan?" (Valley Forge, PA: Vanguard Center for Retirement Research, 2006); Sheena Sethi-Iyengar and others, "How Much Choice is Too Much? Contributions to 401(k) Retirement Plans." In Olivia S. Mitchell and Stephen P. Utkus, eds., *Pension Design and Structure: New Lessons from Behavioral Finance* (New York: Oxford University Press, 2004).

16 Weller, *Retirement on the Rocks*.

17 Edward Wolff, "Household Wealth Inequality, Retirement Income Security, and Financial Market Swings 1983 to 2010." In Christian E. Weller, ed., *Inequality, Uncertainty and Opportunity: The Growth of Finance in Labor Relations* (Ithaca, NY: Cornell University Press, 2015).

18 Christian E. Weller and Teresa Ghilarducci, "The Inefficiencies of Existing Retirement Savings Incentives" (Washington: Center for American Progress, 2015), available at https://www.americanprogress.org/issues/economy/report/2015/10/30/124315/the-inefficiencies-of-existing-retirement-savings-incentives/; Weller, *Retirement on the Rocks*.

19 The value of these savings incentives as a share of after-tax income drops to 2.6 percent for the top 1 percent of the income distribution. This relative decline at the top of the income distribution reflects very high incomes and some limits on savings incentives. Counting all itemized deductions, the top earners still receive a larger share of income than lower-income earners. See, for instance, Tax Policy Center, "Table T13-0099: Tax Benefit of All Itemized Deductions; Distribution of Federal Tax Change by Cash Income Percentile, 2015" (2013), available at http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3857.

20 Internal Revenue Service, "Retirement Savings Contributions Credit (Saver's Credit)," available at https://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Savings-Contributions-Savers-Credit (last accessed November 2015).

21 For a discussion of the relevant provisions and changes made to the Saver's Credit with the Pension Protection Act of 2006, see Patrick Purcell, "The Retirement Savings Credit: A Fact Sheet" (Washington: Congressional Research Service, 2006), available at http://www.pensionrights.org/policy/legislation/ppa_2006/savers-credit/saverscreditreport.pdf.

22 Caitlin White, "The Saver's Credit: Don't Miss this Tax Break," Transamerica, February 6, 2015, available at http://blog.transamerica.com/savers-credit-dont-miss-tax-break#.Vdnr2_lViko.

23 Only 30 percent of those eligible for the credit made a contribution, and of those who made a qualifying contribution, only 60 percent claimed the credit in 2002. That is, less than 20 percent of eligible tax payers received the credit in the first year after its inception. See Lisa Southword and John Gist, "The Saver's Credit: What Does It Do for Saving?" (Washington: AARP Public Policy Institute, 2008), available at http://assets.aarp.org/rgcenter/econ/i1_credit.pdf.

24 Esther Duflo and others, "Savings Incentives for Low- and Moderate-Income Families in the United States: Why Is the Saver's Credit Not More Effective?", *Journal of the European Economic Association* 5 (2–3) (2007): 647–661, available at http://eml.berkeley.edu/~saez/duflo-gale-liebman-orszag-saezJEEA07savercredit.pdf.

25 For one possible way to pay for the small additional costs of making the Saver's Credit refundable, see Camille Busette and Jordan Eizenga, "A Small Change to the Saver's Credit Can Go a Long Way" (Washington: Center for American Progress, 2012), available at https://www.americanprogress.org/wp-content/uploads/issues/2012/01/pdf/small_change_savers_credit.pdf. For some estimates of making the Saver's Credit refundable, see Government Accountability Office, "Private Pensions – Some Key Features Lead to an Uneven Distribution of Benefits," GAO 11-333, Report to Congressional Requesters, March 2011, available at https://books.google.com/books?id=O3C10MRxDxwC&pg=PA29&lpg=PA29&dq=GAO+saver%27s+credit&source=bl&ots=W786NgcNUX&sig=flcxpexO0xLGDroP-11qHp3mT2A&hl=en&sa=X&ved=0CDQQ6AEwA2oVChMIr-Jm55sm_xwIVAgs-Ch0dsglb#v=onepage&q=GAO%20saver's%20credit&f=false.

26 See U.S. Senate Committee on Finance, "The Savings and Investment Bipartisan Tax Working Group Report" (2015), available at http://www.finance.senate.gov/download/?id=B4AEDDC8-9E94-4380-9AF4-9388953FB347.

27 Weller, *Retirement on the Rocks*.

28 See Joe Valenti and Christian E. Weller, "Creating Economic Security" (Washington: Center for American Progress, 2013).

29 Pamela Perun, "Matching Private Saving with Federal Dollars: USA Accounts and Other Subsidies for Saving" (Washington: Urban Institute, 1999), available at http://www.urban.org/research/publication/matching-private-saving-federal-dollars.

30 Ibid.

31 Executive Office of the President, *Budget of the United States: Fiscal Year 2011* (2010), p. 102.

32 *Financial Security Credit Act of 2013,* H.R. 2917, 113 Cong. 1 sess. (Government Printing Office, 2013), available at https://www.govtrack.us/congress/bills/113/hr2917/text.

33 Pamela Perun and Eugene Steuerle, "Why Not a 'Super Simple' Saving Plan for the United States?" (Washington: Urban Institute, 2008), available at http://www.urban.org/sites/default/files/alfresco/publication-pdfs/411676-Why-Not-a-quot-Super-Simple-quot-Saving-Plan-for-the-United-States-.PDF.

34 President's Advisory Panel on Federal Tax Reform, "Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System" (2005), available at http://govinfo.library.unt.edu/taxreformpanel/final-report/index.html.

35 Christian E. Weller and Sam Ungar, "Overhauling Federal Savings Incentives," *Tax Notes*, March 3, 2014.

36 John Friedman, "Building on What Works: A Proposal to Modernize Retirement Savings." Discussion Paper 2015-15 (The Hamilton Project, 2015), available at http://www.hamiltonproject.org/assets/files/friedman_proposal_modernize_retirement_savings.pdf.

37 *Pension Protection Act of 2006*, Public Law 109-280, 109th Cong., 2nd sess. (August 17, 2006).

38 Jack VanDerhei, "The Impact of Automatic Enrollment in 401(k) Plans on Future Retirement Accumulations: A Simulation Study Based on Plan Design Modifications of Large Plan Sponsors" (Washington: Employee Benefits Research Institute, 2010), available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_04-2010_No341_Auto-Enroll1.pdf.

39 It is important to note two important caveats. First, the results are based on data from the largest employers and thus cannot be readily extrapolated to smaller employers. Second, the estimates rest on the assumption that a young worker, once covered by a 401(k) plan, will continuously be covered by a 401(k) plan until retirement. These assumptions likely lead to substantial overstatements of the effect of automatic enrollment on typical low-wage workers. They simply show how well low-wage workers could do under almost ideal circumstances, working for a large employer with a 401(k) plan.

40 Craig Copeland, "Employment-Based Plan Participation: Geographic Differences and Trends, 2013" (Washington: Employee Benefits Research Institute, 2014), available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_405_Oct14.RetPart.pdf.

41 People age 50 and older can contribute an additional $6,000 in 2015. See Fidelity Investments, "Contribution limits for retirement accounts," available at https://401k.fidelity.com/public/content/401k/Home/VPContributionLimits (last accessed on August 2015).

42 In 2012, only 17 percent of people with a 401(k) plan were even offered a lifetime annuity, down from 33 percent in 2000. See Katherine G. Abraham and Benjamin H. Harris, "Better Financial Security in Retirement? Realizing the Promise of Longevity Annuities" (Washington: The Brookings Institution, 2014), available at http://www.brookings.edu/~/media/research/files/papers/2014/11/06-retirement-longevity-annuities-abraham-harris/06_retirement_longevity_annuities_abraham_harris.pdf.

43 See Andrew Lundeen, "Proposed Changes in President Obama's Fiscal Year 2016 Budget," Tax Foundation, February 11, 2015, available at http://taxfoundation.org/blog/proposed-tax-changes-president-obama-s-fiscal-year-2016-budget.

44 The proposal also limited the total value of tax deductions to 25 percent of income. See Jim Nunns, Amanda Eng, and Lydia Austin, "Description and Analysis of the Camp Tax Reform Plan" (Washington: Tax Policy Center, 2014), available at http://www.taxpolicycenter.org/UploadedPDF/413176-Camp-Plan-Description-and-Analysis.pdf.

45 See Lundeen, "Proposed Changes in President Obama's Fiscal Year 2016 Budget."

46 For a range of specific proposals, see Ghilarducci, *When I'm Sixty-Four*; Rowland Davis and David Madland, "American Retirement Savings Could Be Much Better" (Washington: Center for American Progress, 2013); Christian E. Weller, "PURE: A Proposal for More Retirement Income Security," *Journal of Aging and Social Policy* 19 (1) (2007), 21–38. These proposals all vary somewhat in who is covered, whether coverage is mandatory, how much employers and employees have to contribute, and how people receive their benefits. Moreover, Christian Weller and Amy Helburn offer a discussion on a broader range of proposals for state-sponsored retirement plans. See Christian Weller and Amy Helburn "States to the Rescue: Policy Options for State Government to Promote Private Sector Retirement Savings," *Journal of Pension Benefits* 18 (1) (2010): 37–47. Furthermore, David Morse offers a discussion of the legal issues involved in developing state-sponsored savings options. See David E. Morse, "State Initiatives to Expand the Availability and Effectiveness of Private Sector Retirement Plans" (Washington: Georgetown University Center for Retirement Initiatives, 2014). The Georgetown University Center for Retirement Initiatives also presents a map with summaries of current state-sponsored initiatives. See Georgetown University Center for Retirement Initiatives, "Look to the States for Innovation," available at http://cri.georgetown.edu/states/ (last accessed May 2015). Finally, the AARP Public Policy Institute has established a states resource page that highlights state initiatives and discusses some of the policy and legal issues involved in establishing state-sponsored retirement savings options. See AARP Public Policy Institute, "State Retirement Savings Resource Center," available at http://www.aarp.org/ppi/state-retirement-plans/ (last accessed May 2015).

47 Morse, "State Initiatives to Expand the Availability and Effectiveness of Private Sector Retirement Plans"; Robert J. Toth Jr., "Retirement Saving Policy: The Impact of ERISA on State-Sponsored Plan Designs" (Washington: AARP Public Policy Institute, 2014); Weller, "PURE: A Proposal for More Retirement Income Security." The following proposals envision a 5 percent contribution—split between employees and employers, or 2.5 percent each: Teresa Ghilarducci, "Guaranteed Retirement Accounts: Toward Retirement Income Security." Briefing Paper 204 (Economic Policy Institute, 2007); Ghilarducci, *When I'm Sixty-Four*. For a proposal that envisions starting at a 3 percent contribution and escalating to around 12 percent, see Davis and Madland, "American Retirement Savings Could Be Much Better."

48 U.S. Department of the Treasury, *myRA: A Simple, Safe, Affordable Retirement Savings Account* (2014), available at http://www.treasury.gov/connect/blog/Documents/FINAL%20myRA%20Fact%20Sheet.pdf.

49 Pension Rights Center, "State-based retirement plans for the private sector," available at http://www.pensionrights.org/issues/legislation/state-based-retirement-plans-private-sector (last accessed January 2014); Aleta Sprague, "The California Secure Choice Retirement Savings Program" (Washington: New America Foundation, 2013).

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