Lobbying 101

By Kerry Pechter *Wed, Dec 12, 2012*

Retirement industry trade groups don't want deficit hawks to reduce the tax incentives for retirement savings. Last week's Senate resolution affirming the status quo was a result of their lobbying efforts.

Last week, a group of 11 Democratic and Republican U.S. Senators, led by Richard Blumenthal (D-CT), co-sponsored a "Concurrent Resolution" endorsing the existing federal tax incentives for contributions to 401(k) and other qualified retirement plans.

"It is the sense of Congress," the resolution said in part, "that tax incentives play an important part in encouraging employers to sponsor and maintain retirement plans" and that "existing tax incentives have increased the number of Americans who are covered by a retirement plan."

Retirement industry trade groups applauded the resolution, but they were partly applauding themselves. The resolution, similar to one introduced earlier this year in the House, was the fruit of lobbying by the trade groups themselves, including the American Council of Life Insurers, the Insured Retirement Institute and the American Society of Pension Professionals & Actuaries (ASPPA).

The resolution was intended as a display of strength to discourage anyone in Congress or the administration from trying to raise revenues by reducing the upper limit of tax-deferred contributions to 401(k)s, now at $17,500 for employee contributions ($22,500 for age 50 and over) and $51,000 for combined employer/employee contributions.

On the one hand, there's no evident appetite in Washington for rattling the defined contribution industry. But the annual tax expenditure for retirement plans is arguably too large and conspicuous—$162.7 billion overall Congressional Budget Office (CBO) and $50 to $75 billion for 401(k) plans alone—not to be a prime candidate for cuts. And President Obama has already suggested the possibility of capping the tax savings on deductions at 28%.

Hence the pre-emptive strike. It won't immunize the 401(k) tax break from caps or cutbacks, by all accounts, but it doesn't hurt. "While nobody is referencing cutbacks to retirement savings' tax treatment directly, the effort is designed to prevent it from being swept up in discussions and for Washington not to view it as a source of revenue," a member of one of the trade groups told *RIJ* this week.

"It was a team effort. We want to get as many senators on record as possible. It will be helpful in terms of protecting incentives for retirement as we deal with the deficit," said Brian Graff, president of ASPPA.

Unique incentives

At the nucleus of this debate is the unusual, if not unique, nature of 401(k) tax incentives. Some academics have argued that the incentives are largely wasted, since they disproportionately go to people in high tax brackets who would probably save a lot for retirement anyway. Industry groups counter that the incentives help millions of rank-and-file participants who wouldn't otherwise save.

But there are more complex factors at work. Any reduction in incentives for business owners will discourage them from offering plans at all, it's been argued. Second, any reductions in incentives for business owners (or other highly compensated employees) could trigger proportional decreases in incentives for rank-and-file participants.

A recent example of the argument against savings incentives was offered up last month by a Harvard-led team of academics, who published a paper entitled "Active vs. Passive Decisions and Crowd-Out in Retirement Savings Accounts: Evidence from Denmark."

The study, based on 45 million observations of defined contribution participants, found that tax breaks on savings don't encourage people to save more; they simply encourage wealthier, financially savvier people (about 15% of Danish participants) to shift savings from taxable accounts to tax-deferred accounts. If you want the majority of people to save more, they found, you should institute automatic contributions.

Ninety-nine percent of incentives are wasted, they said. "Tax subsidies, which rely upon individuals to take an action to raise savings, have small impacts on total wealth. We estimate that each $1 of tax expenditure on subsidies increases total saving by 1 cent. In contrast, policies that raise savings automatically even if individuals take no action—such as employer-provided pensions or automatic contributions to retirement accounts—increase wealth accumulation substantially."

John Friedman of Harvard, one of the study's co-authors, told *RIJ* this week, "The ideal change would be one where we reduced the subsidy, and made it a 15% or 20% tax credit, and then provided an option for 401(k)-like savings outside of the business setting."

The retirement industry trade groups in the United States disagree with this view. In arguing that the benefits of the incentives are broad, they point to the depth and breadth of the private pensions in the U.S., now valued at some $11.9 trillion.

According to the Senate resolution, for instance, 67 million Americans hold $4.7 trillion in 670,000 401(k), 403(b) and 457 plans, 19 million Americans participate in 48,000 defined benefit plans worth $2.3 trillion, and Americans collectively hold another $4.9 trillion in individual retirement accounts (much of it formerly in defined contribution plans).

Addressing the question of equitable distribution of the incentives, Graff told *RIJ* that "66% of the tax benefits in the deferral go to people who pay 26% of the income taxes." He also discounted Friedman's study. "The Danish study is stupid. It was written by a bunch of academics in cubicles who don't know what they're talking about."

Nonetheless, there is a concentration of contributions at the top end of 401(k) plans. According to an October 2011 CBO report, people who earned $160,000 or more per year comprised 12.7% of participants (5.6 million of 44.1 million) in 2006 but made 32% of contributions ($61.6 billion of $191.8 billion). Few participants other than people earning $120,000 or more contributed the maximum.

Small employers hold the key

This is an apples and oranges discussion because, in the U.S., small business owners sponsor the vast majority of plans. “We see about 700,000 filings per year,” said Brooks Herman, head of research at San Diego-based BrightScope, which benchmarks 401(k) plans. “Only about 55,000 of those have more than 100 employees.”

Given the expense and effort required to sponsor a plan, it’s presumed that if the law doesn’t provide employers with enough tax savings on their own contributions, they might not bother to sponsor plans at all. If that’s true, i.e, if their demand for sponsoring plans is “elastic” (to use an economics term), then taxing them more would be self-defeating.

“Eighty-five percent of all plans are small business plans and 36% of all participants are in those plans,” said Graff. “If you reduced the contribution limit to $20,000 [from $51,000], hundreds of thousands of small plans would close.”

Here’s the crux of the problem. Reducing the limit to $20,000 for business owners and other high-earners wouldn’t merely take money out of their pockets. It would take money out of the pockets of rank-and-file participants—people who never come close to deferring $20,000.

That’s because complex “anti-discrimination” rules require that the plan benefits be fairly proportioned across pay levels. If you reduce the owner’s incentive to give himself a generous match, you reduce his incentive to give his employees a generous match.

Harvard’s Friedman called this situation a “tragedy.” “The whole anti-discrimination thing is silly,” he told *RIJ*. “It’s silly for the incentives of a firm owner to have anything to do with retirement savings options of the employees, or for the employees to need to have a savings plan set up for them in the first place. But we live in the world that we live in.”

“For better or for worse, the employer plays a central role in the U.S. retirement system,” Jeff Brown of the University of Illinois recently blogged at the Center for Business and Public Policy. “Although there are several reasons that employers offer retirement plans and other employee benefits (*e.g.*, to differentially attract certain types of workers, to help manage retirement dates, to motivate workers, etc.), there is little question that the large tax subsidy looms very large in their decision to use retirement plans—as opposed to other types of benefits—to achieve these outcomes.”

Little danger

Given the gnarliness of this arrangement—and given the current absence of viable alternatives, such as a national defined contribution program or the proposed “auto-IRA” for workers not covered by other plans—few expect that Congress or the administration intends to tinker with the status quo. Last week’s Senate resolution reinforces that impression.

David John of the Heritage Foundation, for one, doesn’t think that President Obama’s re-election mandate extends to cutting retirement incentives. “The victory to the president is in terms of [marginal] tax rates and nothing else,” he added. Although he thinks it might be appropriate “to consider not just how high to tax the income of the wealthy but also what kind of subsidies we should allow them,” he doesn’t think that will happen. “There’s no sign that the president has a mandate beyond changing the marginal rates,” John said.

At BrightScope, Herman said he sees a variety of industry groups “circling the wagons” to protect their tax or spending perks these days. But he doubts that the retirement incentive will be sacrificed on the altar of deficit reduction. “It’s in government’s best interest for Americans to have enough money to retire,” he said. “It would surprise me if the government did something drastic in the coming year [about tax expenditures for retirement]. It would be pennywise and pound foolish.”