# Recurring Idea: Give the ‘Tax Expenditure’ to the Poor

By Kerry Pechter *Wed, Jul 31, 2024*

*The Penn Wharton Budget Model, a group that assesses new spending programs, calculates that, if the US Treasury eliminated the tax deduction for contributions to retirement plans, it could afford to contribute up to $2,500 a year to savings accounts for the poor.*

Economists at the Penn Wharton Budget Model recently measured the potential economic impact of a proposal to eliminate the income tax break for contributions to 401(k) and 403(b) plans and redirect the windfall into retirement savings accounts for low-income Americans.

Under such a plan, the government would contribute $2,000 to $2,500 to new retirement accounts for workers who qualify for the Earned Income Tax Credit (EITC). It would finance the new accounts by ending the estimated annual $180 billion cost of savings incentives awarded to participants in employer-sponsored plans.

Overall, such a program would be a fiscal wash, PBWM analysts found; it would cost and save the government about $1.25 trillion over 10 years. (Like the Congressional Budget Office and the Tax Policy Institute, the PWBM estimates the fiscal effects of new spending proposals.)

“We analyze a new illustrative policy to create automatic retirement savings accounts for more than 56 million low- income Americans by 2030,” the PWBM **report** said. “The program is fully financed by removing the gross income adjustment for traditional 401k and similar retirement accounts without any additional contribution from households or employers.”

A typical low-earner would accumulate about $125,000 (in current dollars) in one of the new accounts over 41 years, assuming a growth rate of 3%. Maximum accumulations might reach $150,000 to $200,000. The report didn’t specify how the money might be invested. To qualify for the **EITC**, a worker and head of household would need to earn less than about $64,000 per year.

Kent Smetters

"We are using risk-adjusted returns to project accumulations," PWBM director Kent Smetters told *RIJ* in an e-mail. "For example, the government could just enroll people at the Federal Government's Thrift Savings Plan that is externally administered."

In PWBM's hypothetical, account holders would have no access to the money until age 65, when they could spend it as they wish. Survivors of deceased savers would receive the current value of the account as a death benefit. "Private providers could even provide annuity options for these accounts," Smetters added.

"To be clear, we are not advocating for the illustrative policy," Smetters said. "We are only showing how it could be done in response to numerous requests from members [of Congress] about how to increase low-income household saving."

**Third-rail of private retirement**

The retirement industry, represented by such trade groups as the American Retirement Association, the Insured Retirement Institute and the Investment Company Institute, would surely disagree with that sentiment.

If Social Security is the third-rail of American politics ("Touch it and you'll die"), the tax incentives for individual contributions to hundreds of thousands of private, voluntary, employer-based retirement savings plans is an untouchable foundation of the financial industry that serves those plans and its participants.

For high-earners, the tax deduction is a potentially powerful savings magnet. The 401(k) contribution limit has grown to $23,000 for employee contributions and $69,000 for combined employee and employer contributions in 2024. Workers age 50 or older are eligible for an additional $7,500 in catch-up contributions, raising the employee contribution limit to $30,500. The IRS has further **details**.

No one denies that tens of millions of Baby Boomers and Gen-Xers have under-saved for retirement and are at risk of reaching retirement without sufficient sources of income to complement their Social Security benefits—which themselves could drop after about 2034.

But there's wide disagreement on how to solve that problem. Federal approval of behavioral "nudges" such as auto-enrollment into employer-sponsored plans and auto-investment into target date funds have not moved the savings needle. Outcomes from state-mandated "auto-IRAs" in California, Oregon and other "blue" states have been uneven and faced resistance from the Trump administration.

"It is obvious that the PPA (Pension Protection Act of 2006, which allowed auto-enrollment) and the QDIA (Qualified Default Investment Alternatives, such as TDFs and managed accounts) have fallen short of expectations. So, policymakers are trying to figure out real solutions," Smetters told *RIJ*.

Between 1989 and 2022, the PWBM report says, Americans in the lowest 80% of the income distribution "saw the average value of their retirement accounts grow slower than the value of the stock market itself." Over the same period, those with below-median income fell farther behind the top half.

According to Smetters, redistributing the expenditure on tax incentives from the employer-sponsored system would not discourage high-earners from saving excess income and would not reduce their annual after-tax income by more than about 2%.

**Other views**

An **article** in NAPANet, an online publication of the American Retirement Association, criticized the PWBM study as "Another Call to Completely Up-End the Country's Private Retirement System." Another NAPANet **article** objected to the **"Retirement Savings for Americans Act"** sponsored by Sen. John Hickenlooper (D-CO), which also proposed to subsidize retirement savings accounts by directing tax expenditures away from 401(k)s.

Smetters is perplexed by the reaction. "I can't see why the private sector would fret over this change," he wrote in an e-mail. The higher accumulations of low-income workers would, in his opinion, offset any reduction in savings by high-income plan participants.

"Almost certainly, total retirement assets in the economy would increase since higher-income people losing the tax benefit will not reduce their retirement savings dollar-for-dollar," he said. "It would be absurd to think that the savings by high-income workers would fall by the entire amount of the maximum tax deduction, that is, by $7,500. As such, total retirement savings summed across all income groups should increase since the $7,500 is being invested in low-income worker accounts."

Other economists have urged the creation of universal savings accounts. In 2015, Teresa Ghilarducci of the New School and Hamilton "Tony" James, former chairman of Blackstone, proposed a universal Guaranteed Retirement Account that was endorsed by the Tax Policy Center.

"The idea of universal pensions has been discussed since the Carter administration and even earlier, reflecting a long-standing awareness of the need for a robust, inclusive retirement system. Given the maturity of the 401(k) system—now over 40 years old—it's clear that while it was designed to enhance retirement savings, it has disproportionately benefited higher earners due to its voluntary and individual-directed nature," Ghilarducci told *RIJ* in an email.

Inequality in the incomes and wealth accumulations of Americans is well-documented. Virtually all financial wealth is concentrated among the richest 10%. These inequities are mirrored by disparities in savings in retirement plans.

Vanguard's annual report, "How America Saves," perennially shows low median retirement plan savings (under $90,000) among participants ages 65 and older in plans Vanguard administers. Since employers are not mandated to offer retirement plans to their employees, only about half of American workers have retirement plans at work at any given time. Between 60% and 70% of US families have retirement accounts, according to the **2023 Federal Reserve's Survey of Consumer Finance (SCF)**.

The median combined IRA and DC pension account balance for families with plans was about $87,000 in 2022; the average was $334,000, according to the SCF. Among families in the bottom 50% of the distribution, the average balance decreased between 2019 and 2022, to $54,700 from $66,600. The average was $226,700 for the upper-middle income group and $913,300 for the top 10%. The median and average net worth of households ages 65 to 74 in

2022 was $410,000 and $1.8 million, respectively.

Along with disparities in the *quantities* of accumulations by Americans of different income levels, sharp disparities exist in the *quality* of the retirement plans themselves. This is true even though all 401(k) plans share the same alphanumeric name and all are governed by the Employee Retirement Income Security Act of 1974.

Large corporations and institutions tend to match at least part of employee contributions. Some even make “discretionary” contributions and/or profit-sharing distributions to participants in addition to a match. Smaller employers, if they offer plans, may offer plans with relatively high-cost investments, little or no “match,” and no discretionary contribution.