Raising Private Savings

By Kerry Pechter *Mon, Jun 29, 2009*

What might be called the financial version of universal health care is currently the topic of intense discussions and negotiations on Capitol Hill.

In the marble corridors and mahogany-lined offices of our nation's Capital, legislative aides are dickering over the details of two proposals that, if linked and enacted into law, could increase the savings of American workers by more than $100 billion over the next five years.

The two proposals are the "auto-IRA" and an enhanced "Saver's Credit." The first would automatically open workplace IRAs for people who don't have an employer-sponsored savings plan. The second would match the workers' contributions by up to $500 a year.

Neither concept is entirely new, but the idea of tying auto-enrollment to a fully-refundable incentive is unprecedented. Advocates of the hybrid concept think it could inspire millions of middle- and low-income Americans to save more today and retire with a bigger nest egg. It's the financial version of universal health care.

"It starts people saving sooner, it increases the numbers of people who are saving and over time it will sharply increase the balances to be managed under 401(k) plans," said David John of the conservative Heritage Foundation, who co-created the idea with J. Mark Iwry, a Treasury official formerly with the liberal Brookings Institution.

John calculates that if only 20 million of the 70 million workers who today have no workplace retirement plan start saving $1,000 a year and earning the $500 government match, they'll save $30 billion a year and $150 billion over the next five years. "So this is real money," he told RIJ.

All in favor?

The responses of others range from enthusiastic to firmly opposed to wait-and-see. The American Association of Retired Persons, or AARP, thinks its politically viable. Teresa Ghilarducci, the 401(k) critic at the New School for Social Research, doesn't like it. She thinks retirement saving should be mandatory, with a guaranteed minimum return.

As for the private retirement industry, it frets that the accounts created under the program would be tiny and unprofitable to manage. The 401(k) industry also opposes a government-run 401(k) or an extension of the federal workers Thrift Savings Plan to private sector workers. The Investment Company Institute, for instance, which represents the fund industry, wants to promote savings but opposes any active government role in the workplace.

“We’re in favor of the Saver’s Credit, and we’re in favor of R-bonds, where people can buy inflation-adjusted bonds through a payroll deduction plan. But we have expressed concerns about forcing auto-IRAs on all employers, or running the IRAs through a single vendor or a government program,” said Mike McNamee, a spokesman for the ICI, which lobbies for the mutual fund and asset management industry.

The American Association of Retired Persons supports auto-IRA and the Saver’s Credit. “The history of this legislation shows it hasn’t been too popular with the financial or mutual fund industries,” said Jean Setzfand of the AARP. “But there are discussions to make it more palatable, it’s a very practical solution from our point, it’s implementable, and it’s a proposal that AARP is supporting. There are other interesting concepts that aren’t as politically or operationally feasible.”

The Corporation for Enterprise Development, a Washington-based nonprofit that helps poor people accumulate money to buy a home, start a business, or pay for college, also favors the new savings proposals. Carol Wayman, the CFED’s federal policy director, says that the program will also cost a lot less than opponents fear. Like John, she doesn’t all 70 million workers with no retirement plan to qualify for the maximum $500-a-year match.

“A lot of people are self-employed or work in businesses with fewer than 10 employees, so that they won’t qualify for the auto-IRA,” Wayman told RIJ. “And not all will qualify for the Saver’s Credit, because their income is too high. And even if people do qualify, it’s doubtful that they will save $1,000 a year and receive the full match. If you’re making $12,000, like people with the lowest incomes, and you contribute three percent of pay a year, you won’t get to $1,000 very fast.”

One outspoken critic of the initiative is Teresa Ghilarducci, a New School of Social Research economist and author of “When I’m 64: The Plot Against Pensions and The Plan to Save Them” (Princeton University Press, 2008). While she does prefer refundable credits to tax breaks as an incentive to save, she thinks voluntary, personally managed savings programs like the 401(k) don’t produce adequate retirement income.

“I am against this. It can make the problems we see in the 401(k) world worse. We know from 27 years of data that individuals chase returns. Unlike the health care initiative, which is a threat to the health insurance industry, this plan is golden to the financial industry,” she told RIJ.

“The government isn’t proposing an alternative to private plans, it’s trying to help people get into private plans. It’s a huge expansion of the retirement savings incentives,” she added. “We have to ask if this is the best way to increase retirement savings? I say no.”

Next steps

An Auto-IRA Act was introduced by Rep. Richard E. Neal (D-Mass.) and former Rep. Phil English (R-PA) in the 110th Congress. It wasn’t acted on, but Neal is expected to reintroduce a similar bill in the 111th Congress, while Rep. Earl Pomeroy (D-ND)-a sponsor of a bill that would exempt some annuity income from taxation–is expected to introduce the refundable Saver’s Credit.

Given the Democratic legislative majorities and the Democratic administration, both the auto-IRA and the new Saver’s Credit are obviously expected to have a better chance of passing this time around. The financial crisis has also re-focused attention on savings and retirement security, and the fact that the government’s incentives for saving for retirement never reach many who need them the most.

According to the CFED, only 10% of workers in the bottom income quintile (households under $18,500) account, compared to nearly 70% in the middle quintile ($34,700 to $55,300) and 88% in the top quintile ($88,000+). Only five percent of American households had incomes above $157,000 in 2004, according to the U.S. Census Bureau.

The auto-IRA and the new Saver’s Credit bills will take different paths through Congress, but may eventually merge into a single piece of legislation. “The administration supports both very strongly, and I wouldn’t be shocked to see the two of them joined at some point,” David John said.

The Saver’s Credit, which involves a change in the tax code, will be considered in the House by the Ways and Means Committee and in the Senate by the Finance Committee. The auto-IRA bill, which involves ERISA (Employee Retirement Income Security Act), will go through the House Education and Labor Committee and possibly the Senate HELP (Health, Education, Labor and Pensions) Committee.

As for now, various legislative aides are hashing out the exact terms of the two bills. Some big questions remain unanswered, such as how the government might help small business owners set up the program and educate employees, or whether the government will put a ceiling on administration fees.

“It’s a little premature to draw firm positions, let alone conclusions about the business impact,” said a fund industry executive who asked not to be quoted by name. “There are a lot of different permutations of the ideas, and the administration hasn’t quite nailed down all those ‘the devil-is-in-the-details’ details.”