

Middle Class Proposal #4

Boosting Retirement Wealth

Americans aspire to a comfortable retirement after a lifetime of work. But for many households juggling the myriad financial demands of college tuition bills, a mortgage payment or even filling the gas tank, putting enough away for retirement can be tough. A generous federal match for 401(k) savings can help middle-class families save what they need to get the retirement they deserve.

THE PROBLEM

Retirees outliving their retirement accounts

Many Americans won't have the retirement savings they need to keep up the lifestyle they've come to expect after they finish their careers. College tuition bills, mortgage payments and other pressing priorities too often push saving for retirement to the bottom of Americans' financial to-do lists. As a result, while Americans are living longer, they are saving less.

The majority of retirees can expect to outlive their savings.

Experts say that to ensure a comfortable retirement, people should save enough to replace between 60% and 80% of their pre-retirement income. This means a middle-class household earning \$50,000 to \$60,000 a year will need about \$39,500 in retirement income a year, including Social Security.¹

But few households are meeting that standard. Three out of five retirees can expect to outlive their retirement savings if they maintain their pre-retirement standard of living.² At age 65, today's average retiree can expect to spend more than 18 years in retirement.³

Today's workers bear the burden of saving for retirement.

Traditional, defined-benefit pensions have gone the way of the dinosaur. In 2005, only 21% of private-sector employees participated in a traditional pension plan,⁴ compared to more than two-thirds of workers in 1980.⁵ While 401(k) plans are better suited to the mobile workforce of today, it also means that retirement planning rests wholly in workers' hands.

People need help to save more.

While two-thirds of Americans workers are saving for retirement,⁶ fewer than one in five say they're "very confident" of saving enough.⁷ Roughly two-thirds of

women and nearly half of all men say they are concerned about outliving their retirement assets.⁸ In 2006, the typical worker had \$18,969 saved for retirement,⁹ while workers between the ages of 55 and 64 had a median of \$50,000 put away.¹⁰ While not insignificant, \$50,000 will last less than five years, even with Social Security. And if converted into an annuity, the yearly benefit would be only \$4,400.¹¹

THE SOLUTION

A federal match for 401(k) contributions

A 25% federal match for 401(k) contributions by workers in the private sector—up to a maximum of \$1,000 a year—would boost the efforts of middle-class families to save for a comfortable retirement.

A federal match would help people save more.

Matching plans are effective in encouraging people to save. Federal workers, for example, enjoy a generous match under the government's Thrift Savings Plan.¹² As a result, 87% of federal workers participate in the plan, including 90% of younger workers under 40.¹³ In the private sector, studies find that retirement plans with an employer match are more likely to have higher participation rates¹⁴ and larger contributions.¹⁵ People are also more likely to open an account in the first place if a match is offered.¹⁶

This proposal would follow the lead of the Thrift Savings Plan. While roughly two-thirds of employers who sponsor defined-contribution retirement plans offer an employer match,¹⁷ it's still the case that one of three workers don't receive that benefit.

A federal matching program would be easy to administer.

The matching contributions would be electronically direct deposited to people's retirement accounts at tax time, after people have filed their income tax returns showing how much they have put away in their retirement accounts.

The match would be a dollar-for-dollar match equal to 10% of contributions, up to a maximum of \$1,000 per worker per year. The match would be available to individuals earning up to \$100,000 per year and joint filers with a combined income of \$200,000. The match would be available for any contribution to a defined-contribution retirement account, including 401(k)s, 403(b)s, and IRAs.

It's affordable.

This proposal would cost \$23 billion per year—a small price to pay for ensuring that more middle-class Americans are able to earn the comfortable retirement they have worked their lives for.¹⁸

THE ROLLOUT

Ideas for launching and publicizing a federal 401(k) match

- **Hold a press conference** with workers of varying ages—young workers just starting out on the job, mid-career workers struggling to put away money for retirement while also paying for college tuition or other bills and older workers nearing retirement.
- **Release a short report** on how much people are currently saving for retirement versus what they will need to maintain their lifestyles.

CRITIQUES & RESPONSES

Federal 401(k) match

It's too expensive.

This proposal would be *fully* paid for. For every \$1 in tax breaks that went to the middle-class, people making more than \$1 million a year received \$108.¹⁹ By letting President Bush's tax giveaway for millionaires expire, we could raise \$753 billion over the next ten years²⁰—more than enough that is needed to pay the \$23 billion per year to fund this proposal.

This is just more big government.

This proposal is administratively simple and builds on the existing structure of tax-preferred retirement accounts. The vast majority of people already receive their tax refunds by electronic direct deposit, so this adds no new administrative burden either. This proposal creates no new government bureaucracy, nor does it burden business. Instead, it encourages individual retirement savings and promotes the ability of individuals to manage and grow their own retirement wealth.

This is unnecessary.

It would certainly be preferable if that were the case. Unfortunately, while many Americans do try to save for retirement, many people also face financial pressures and immediate priorities that make saving enough for retirement difficult. Saving for retirement is also something that many young workers don't think of until it's too late. The reality is that the vast majority of Americans—even with Social Security—are not saving enough to maintain their pre-retirement lifestyles. Without a boost from government, many people will have to cut back on their standard of living.

Endnotes

¹ "How Much Money Do You Need to Retire," available at <http://www.lendingtree.com/smartborrower/Managing-your-money/How-much-money-do-you-need-to-retire.aspx>

² Reuters, "Ernst & Young Study Finds Most Middle-Class Retirees Will Outlive Retirement Savings," July 14, 2008.

³ National Center for Health Statistics, "Health, United States, 2007, With Chartbook on Trends in the Health of Americans, Table 27: Life Expectancy at birth, at 65 years of age, and at 75 years of age, by race and sex: United States, selected years 1900-2005," Centers for Disease Control and Prevention, 2007, available at [http://www.cdc.gov/nchs/data/07.pdf#027](http://www.cdc.gov/nchs/data/hus/07.pdf#027).

⁴ Bureau of Labor Statistics, "Trends in Retirement Plan Coverage," MLR: The Editor's Desk, Mar. 10, 2006, available at <http://www.bls.gov/opub/ted/2006/mar/wk1/art05.htm>

⁵ Employee Benefit Research Institute, "Campaign 2008: Facts on Benefits Issues," available at <http://www.ebri.org/campaign/>.

⁶ Employee Benefit Research Institute, "2008 Retirement Confidence Survey: Americans Much More Worried About Retirement, Health Costs, Health Costs a Big Concern," *EBRI Issue Brief*, April 2008, No. 316, available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_04-2008.pdf. This percentage has increased slightly over the past seven years.

⁷ Employee Benefit Research Institute, "2008 Retirement Confidence Survey: Americans Much More Worried About Retirement, Health Costs, Health Costs a Big Concern," *EBRI Issue Brief*, April 2008, No. 316, available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_04-2008.pdf

⁸ Ernst & Young, "Retirement Vulnerability of New Retirees: The Likelihood of Outliving Assets," July 2008.

⁹ This is the median total balance for all workers with defined-contribution retirement accounts. Employee Benefit Research Institute, "Campaign 2008: Facts on Benefits Issues," available at <http://www.ebri.org/campaign/>.

¹⁰ U.S. Government Accountability Office, "Private Pensions: Low Defined Contribution Plan Savings May Pose Challenges to Retirement Security, Especially for Many Low-Income Workers," Report to the Chairman, Committee on Education and Labor, House of Representatives, Nov. 2007, available at <http://www.gao.gov/new.items/d088.pdf>

¹¹ Ibid.

¹² Under the Thrift Savings Plan, the government matches dollar for dollar for the first 3% of an employee's salary that is contributed to the plan, and then 50 cents to the dollar up to 5%. Thrift Savings Plan, "TSP Features for Civilians," Feb. 26, 2008, available at <http://www.tsp.gov/features/chapter04.html>.

¹³ Federal Retirement Thrift "Thrift Savings Plan Participant Survey Results 2006-2007," November 2007, available at <http://www.frtib.gov/pdf/FOIA/2006-TSP-Survey-Results.pdf>.

¹⁴ TIAA-CREF Institute, "The Employer Match and Participant Behavior," July 2006, available at <http://www.tiaa-crefinstitute.org/research/surveys/docs/rs070106.pdf> (Citing: Gur Huberman, Sheena Sethi-Iyengar and Wei Jiang, "Defined Contribution Pension Plans: Determinants of Participation and Contributions Rates", June 2003).

¹⁵ Huberman, G., et al., "Defined Contribution Pension Plans: Determinants of Participation and Contributions Rates," June 2003, available at <http://ssrn.com/abstract=421020>

¹⁶ Duflo, E., Gale, W., Liebman, J., Orszag, P., and Saez, E., "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block," Retirement Security Project Policy Brief No. 2005-5, May 2005, available at <http://www.retirementsecurityproject.org/pubs/File/H&RBlock.pdf>

¹⁷ Fidelity Investments News Release, "Fidelity Investments Reports Higher 401(k) Balances," available at http://content.members.fidelity.com/Inside_Fidelity/fullStory/1,4227,00.html. Block, S., "Many 401(k) Matches Get Beefier, So Don't Leave 'Free' Money on the Table," *USA Today*, Mar. 6, 2007, available at http://www.usatoday.com/money/perfi/columnist/block/2007-03-06-401_N.htm

¹⁸ Third Way estimate based on data from "How America Saves: A Report on Vanguard 2006 Defined Contribution Data" and the 2007 March Supplement of the Current Population Survey. The Vanguard report provided the participation and saving rates by level of earnings while the CPS was used to get the number of private sector workers by these earnings levels. The median annual contribution to 401(k) is roughly \$2,400 per worker—or about 6% of the median salary. 41 million workers would potentially benefit from this proposal.

¹⁹ Greg Leiserson and Jeffrey Rohaly, "The Distribution of the 2001-2006 Tax Cuts: Updated Projections, November 2006," Tax Policy Center, Urban Institute and Brookings Institution. See Table 3 in the Appendix. According to this table, the average millionaire will receive a tax cut of \$130,423 in 2008, while the average person making \$50,000-\$75,000 will receive just \$1,203 in tax relief. This translates into a ratio of 108 to 1.

²⁰ Third Way calculation based on Tables 3, 4, 5, and 6 of Greg Leiserson and Jeffrey Rohaly, "The Distribution of the 2001-2006 Tax Cuts: Updated Projections, November 2006," Tax Policy Center, Urban Institute and Brookings Institution, available at <http://www.taxpolicycenter.org/publications/url.cfm?ID=411378>.