

Retirement Plans, Personal Saving, and Saving Adequacy

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Issue Brief

- This *Issue Brief* addresses three questions raised by recent trends in personal saving:
 - How are national savings measured and what is the meaning of the trends in measured personal saving rates, given what is included and what is *not* included in those measures?
 - What is the effect of retirement saving programs—in particular, 401(k) plans and individual retirement accounts (IRAs)—on personal saving levels?
 - What are the implications of existing saving behavior for the retirement income security of today's workers?
- The National Income and Product Accounts (NIPA), the most commonly referenced gauge of personal saving, is a widely misunderstood measure. One could argue that a complete measure of saving would include increases in wealth through capital gains, but NIPA does *not* factor accrued and realized capital gains on stocks and other assets into the saving rate. By one measure, accounting for capital gains results in an aggregate personal saving rate of 33 percent—more than double the rate of four decades ago.
- A major policy question is the impact of tax-qualified retirement saving plans (i.e., IRAs and 401(k) plans) on personal saving rates. Empirical analysis of this issue is extremely challenging and findings have been contradictory. These programs now represent an enormous store of retirement-earmarked wealth in tax-deferred vehicles: Combined, such tax-deferred retirement accounts currently have assets of about \$4 trillion. Ninety percent of IRA contributions are now the result of "rollovers" as employees leave employer plans, like 401(k) plans. While leakage from the system remains a challenge, the majority of the assets in the system can be expected to be available to fund workers' retirements.
- One could argue that, *from a retirement income security perspective*, workers in general are better off because IRA and 401(k) programs exist. Surely, many of the dollars in these programs would have been saved even without the programs; but they would not necessarily have been earmarked *for retirement* and been available to fund retirement expenses. As rollovers become larger, this "partnership" of employment-based qualified plans and IRAs will grow even more important.
- The evidence indicates that many groups of American workers appear unlikely to be able to afford a retirement that maintains their current lifestyle (at least not without working more years than currently planned). Consensus does not exist on how many workers are at risk or the typical magnitude of their retirement saving shortfall. There is a consensus, however, that a substantial number of individuals are at risk. This is not surprising—despite the fact that the 70 percent of workers are saving for retirement—since relatively few workers know how much it is that they need to accumulate to fund their retirement.

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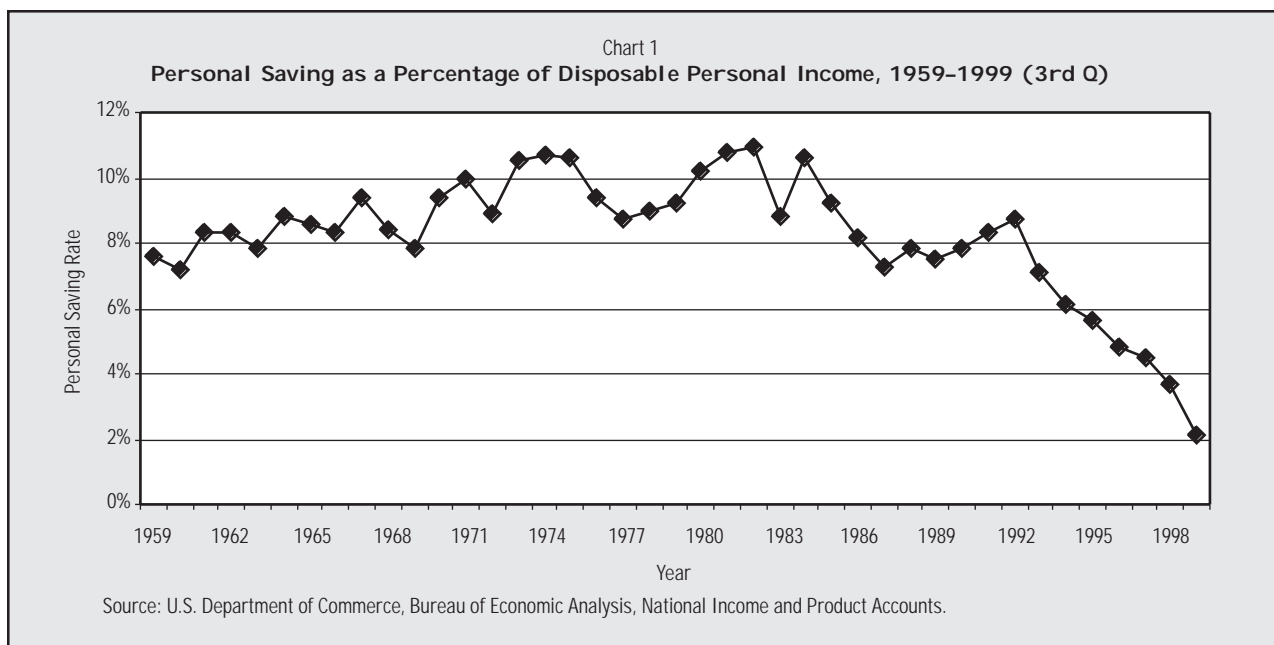
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Introduction

The personal saving rate in the United States, as measured by the National Income and Product Accounts (NIPA),

has declined dramatically over the past two decades. In the past five years alone, it has dropped by almost 50 percent. At the same time, however, more and more people are putting money away in 401(k) retirement savings plans, and more and more people own equities (either directly or indirectly through mutual funds), all while the stock market has dramatically risen to record highs. Are these trends not contradictory? And are “savings” being accurately measured? If personal saving rates really are declining, and if low levels of personal saving translate into low wealth accumulation for households, then the implications are clear: Many families at risk of having inadequate financial resources to retire or deal with unexpected financial emergencies.

According to NIPA, the most commonly reported statistical measurement, the deterioration in Americans’ saving rate is dramatic. In 1981, the U.S. personal saving rate stood at 10.8 percent, and by 1998 it had declined to 3.7 percent. Over the long term, between 1959 and 1993, personal saving rates remained in the 7 percent to 11 percent range. In 1994, the rate fell below 7 percent for the first time (to 6.1 percent), and it has declined steadily since then. Most recently, in the third quarter of 1999, the personal saving rate was 2.1 percent (chart 1, table 1). In addition, U.S. saving rates are low relative to those of other major industrialized countries,

with the exception of Canada (table 2).

The decline in measured personal saving has been the subject of much discussion but sharply different interpretation. At the national level, low levels of personal saving (unless offset by saving in the corporate and government sectors) could lead to low levels of investment due to lack of available capital, which ultimately could mean slower economic growth in the future and

Table 1
Personal Savings as a Percentage
of Disposable Personal Income, 1959-1999

Year	Percentage	Year	Percentage
1959	7.6%	1979	9.2%
1960	7.2	1980	10.2
1961	8.3	1981	10.8
1962	8.3	1982	10.9
1963	7.8	1983	8.8
1964	8.8	1984	10.6
1965	8.6	1985	9.2
1966	8.3	1986	8.2
1967	9.4	1987	7.3
1968	8.4	1988	7.8
1969	7.8	1989	7.5
1970	9.4	1990	7.8
1971	10.0	1991	8.3
1972	8.9	1992	8.7
1973	10.5	1993	7.1
1974	10.7	1994	6.1
1975	10.6	1995	5.6
1976	9.4	1996	4.8
1977	8.7	1997	4.5
1978	9.0	1998	3.7
		1999 (3rd Q)	2.1

Source: U.S. Department of Commerce, Bureau of Economic Analysis, National Income and Product Accounts.

Table 2
Ratio of Saving to Disposable Income Across Countries, 1980–1996

Year	United States	France	Germany	Italy	Netherlands	United Kingdom	Japan	Canada
1980	10.2%	17.6%	14.2%	21.6%	11.0%	13.4%	17.9%	13.3%
1985	9.2	14.0	12.8	19.2	13.1	10.7	15.6	13.1
1990	7.8	12.5	14.7	18.5	15.5	8.1	12.1	9.5
1994	6.1	13.6	12.3	14.7	11.4	10.1	12.8	7.5
1995	5.6	14.3	12.3	14.4	12.8	11.0	13.0	6.9
1996	4.8	12.5	12.4	13.4	NA	11.6	13.2	4.6

Source: U.S. Department of Commerce, International Trade Administration, Office of Trade and Economic Analysis, based on official statistics of listed countries.

lower standards of living (chart 2 presents time trends in the growth of productivity and worker compensation). However, the validity of NIPA as a yardstick for national saving has come under sharp attack, and many critics suggest there are other and better measurements that portray a far less negative picture.

This *Issue Brief* addresses three questions raised by the trends in personal saving:

- How is national saving measured and what is the meaning of the trends in measured personal saving rates, given what is included and what is *not* included in those measures?
- What is the effect of retirement saving programs—in particular, 401(k) plans and individual retirement accounts (IRAs)—on personal saving levels?
- What are the implications of existing saving behavior for the retirement income security of today's workers?

Personal Saving Defined

The concept of saving, although widely discussed, has not been consistently or clearly defined.

Do savings include only personal saving by individuals, or do they also include the saving by businesses and of local, state, and federal governments? Should personal and corporate saving be separated? Is the purchase of durable goods counted as saving? The sale of a home (or use of home equity line of credit) can provide access to a significant accumulation of wealth to meet financial needs, such as funding a child's education, dealing with unforeseen household situations, or funding retirement; but does the accumulation of housing equity count as saving?

There are two different methodologies used to measure personal saving in the United States: NIPA, produced by the Bureau of Economic Analysis (BEA) of the U.S. Department of Commerce, and the Flow of

Funds Accounts (FFA), produced by the Board of Governors of the Federal Reserve System. The news media typically cite the NIPA measure, and not the FFA measure.

NIPA

Under NIPA, personal saving is a residual. This means that personal saving is what is left over from personal income after subtracting payments for personal income taxes and individual payroll taxes (i.e., individual contributions for Social Security and Medicare), and personal outlays such as food, housing, and clothing expenditures.

Personal income includes the following:

- Wages and salaries.
- Other labor income (i.e., employer contributions to pensions and profit-sharing plans and group insurance, such as health, workers' compensation, and supplemental unemployment coverage).
- Rental income.
- Personal dividend income.
- Personal interest income.
- Transfer payments to persons (i.e., Social Security benefit payments, government unemployment and insurance payments, veterans benefits, government employees retirement benefits, and welfare payments).

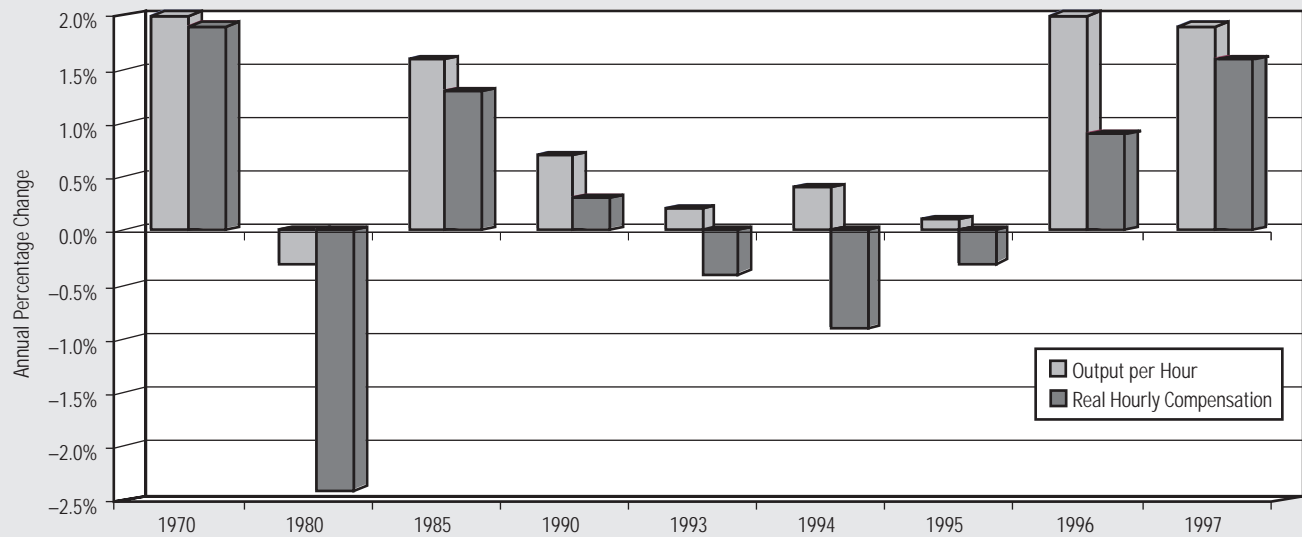
Personal taxes include the following:

- Federal income tax payments.
- State and local income tax payments.
- Any penalties, fines, or interest payments made on income tax statements.
- Contributions to social insurance programs (i.e., Social Security and Medicare payroll taxes).

Personal outlays include the following:

- Personal consumption expenditures (i.e., spending on

Chart 2
Productivity and Real Compensation Changes in the Business Sector, 1980–1996



Source: U.S. Bureau of Labor Statistics, News USDL 98-92, "Productivity and Costs."

food, housing, clothing, household operations such as utility bills, transportation, and medical care).

- Consumer interest payments (i.e., payments of credit card interest).
- Personal transfer payments to foreigners.

Disposable personal income equals personal income after deducting personal income taxes and payroll taxes, but before personal outlays are deducted. Personal saving is what is left over from disposable personal income after deducting the above personal outlays. Personal saving divided by disposable personal income is the personal saving rate.

FFA

Whereas NIPA measures personal saving as a residual, the FFA personal saving rate is a direct measure of the net acquisition of assets by households. FFA methodology differs from that used by NIPA in two ways: in the treatment of consumer durables and the definition of personal income.

The FFA treats the net acquisition of consumer durable goods (i.e., automobiles, major household appliances, and other products that can be used for several years) as a form of saving, whereas the NIPA treats expenditures on consumer durables as a component of personal consumption. The FFA also makes some adjustments to the NIPA measure of personal income: The FFA includes certain credits from government insurance programs and *realized* capital gains distribu-

tions, whereas NIPA does not. (*It is important to note that neither FFA nor NIPA includes unrealized capital gains.*) For example, if an individual purchases 10 shares corporate stock at \$10 a share, and the stock then increases to \$30 a share, the increased value of the stock is not considered part of personal income under FFA until the individual sells the stock and realizes the capital gain. By contrast, under NIPA the increased value of the stock is *never* considered part of personal income.

Table 3 provides a direct comparison of personal saving measures under the two methodologies. While the levels are notably different between NIPA and FFA (with

Table 3
Personal Saving as a Percentage of Disposable Personal Income: National Income and Product Accounts (NIPA) and Flow of Funds Accounts (FFA)

	NIPA	FFA
1960	7.2%	11.9%
1965	8.6	14.8
1970	9.4	14.2
1975	10.6	14.8
1980	10.2	12.2
1985	9.2	14.9
1990	7.8	13.6
1995	5.6	7.3
1997	4.5	5.4
1998	3.7	6.2

Source: U.S. Department of Commerce and the Federal Reserve Board.

the FFA measure consistently exceeding the NIPA measure), both standards of measurement clearly show a downward trend.

Implications

NIPA, the most commonly referenced gauge of personal saving, is a widely misunderstood measure. This is not the fault of the methodology, as the primary purpose of the National Income and Product Accounts is to show the composition of production and the distribution of incomes earned in production, and the measure of saving produced by NIPA is a residual of this process. Rather, the misunderstanding reflects the confusion of users who do not fully realize what the measure captures and omits.¹ On the surface, a NIPA personal saving rate near zero would appear to mean that individuals are consuming all of their income in a given time period and not saving. But income, as measured by NIPA, only includes wages, dividends, interest, and rental income; it does *not* include accrued and realized capital gains on stocks and other assets.

What does that mean? If individuals choose to spend more as a result of this increased wealth, such behavior would drive down traditional measures of personal saving. This is because under NIPA, the increase in wealth does *not* show up as income, but the increased consumption that some of it finances *does* figure into the saving rate calculation. It is quite possible to have households saving money—say for retirement through a 401(k) plan or an IRA—while simultaneously tapping into recent wealth gains to fund additional consumption.

Individuals who own equities have generally experienced tremendous increases in the value of those financial assets over recent years; i.e., they are wealthier. According to data from the Federal Reserve's Survey of Consumer Finances (SCF), the net worth (the difference between a family's gross assets and liabilities) of the typical American family (i.e., median net worth) rose 17.6 percent between 1995 and 1998, from \$60,900

to \$71,600 (Kennickell, Starr-McCluer, and Surette, 2000). This increase in net worth was driven by strong growth in the financial assets held by families, especially direct and indirect holdings of stocks. As of 1998, 92.9 percent of American families held some type of financial asset, and the median value among those with financial assets was \$22,400 (comparable figures for 1995 are 91.0 percent and \$16,500, respectively). Almost one-half (48.8 percent) of families held stock (directly or indirectly) in 1998, compared with 40.4 percent in 1995, and 31.6 percent in 1989. The median value of stock among families with holdings increased from \$10,800 in 1989 to \$15,400 in 1995, and to \$25,000 in 1998.

Over the same period, stock holdings as a share of families' financial assets increased from 27.8 percent (1989), to 40.0 percent (1995), to 53.9 percent (1998). Kennickell, Starr-McCluer, and Surette note that a slight rise in the SCF's qualitative saving indicator² between 1995 and 1998 contrasts with the savings decrease as measured by NIPA. They hypothesize this could be due in part to the strong gains in the stock market, if families include such gains in income when

¹ On Oct. 28, 1998, BEA released NIPA estimates beginning with 1959, reflecting a comprehensive revision of the accounts. This is the 11th such revision. Changes that affected the estimates of personal saving were the reclassification of government employee retirement plans and the reclassification of certain transactions as capital transfers.

As a result of the revisions, government employee retirement plans are no longer classified as social insurance funds within the government sector. Such plans are now treated analogously to private employer retirement plans. This change increases personal saving and decreases government saving by offsetting amounts, leaving the estimate of national saving unchanged. In addition, certain transactions now included in NIPA are reclassified as capital transfers. This reclassification results in an increase in measured personal saving.

The revised estimates of the personal saving rate and national saving rate are notably higher than previously published estimates; however, the personal saving rate continues to show a two-decade downward trend. For 1982–1998, the personal saving rate dropped from 10.9 percent to 3.7 percent after revisions, compared with a previously published decline from 9.0 percent to 0.5 percent. For a complete discussion of the revisions and their effects, see Moulton, Parker and Seskin (1999) and Seskin (1999).

² Respondents were asked whether, over the preceding year, the family spent less than its income, more than its income, or about as much as its income. The survey found that families saying they spent less than their income (i.e., saved more) increased from 55.2 percent in 1995 to 55.9 percent in 1998.

Table 4
Saving Rates, Unadjusted and Adjusted, 1960–1998

	1960–1969	1970–1979	1980–1989	1990–1994	1995	1996	1997	1998
Personal Saving ^a	5.2%	5.7%	4.8%	3.5%	2.7%	2.2%	1.5%	0.4%
Adjusted Personal Saving ^b	6.3	4.0	4.9	3.7	3.7	3.6	3.3	2.9
Capital Gains Inclusive Saving ^c	15.8	12.0	17.9	4.0	27.3	23.6	32.4	32.6

Source: William G. Gale and John Sabelhaus, "Perspectives on the Household Saving Rate," *Brookings Papers on Economic Activity* (Washington, DC: Brookings Institution, 1999).

^aNational Income and Product Accounts saving rates prior to the methodology changes made by the Bureau of Economic Analysis in the fall of 1999, which included the counting of public retirement plans as personal saving.

^bAdjusting for inclusion of durables in savings, inclusion of public retirement plans, inflation, and accounting for accrual of tax payments implicit in retirement plans.

^cAdjusting for inflation and accrued taxes.

reporting their saving behavior in the SCF.³

One could argue that a more complete measure of saving would include increased wealth through capital gains (both realized and unrealized) as part of personal income. As mentioned above, FFA includes realized capital gains in its saving measure, but not unrealized capital gains.

Gale and Sabelhaus (1999) identify other shortcomings, in addition to the exclusion of accrued and realized capital gains from income and thus saving, in the NIPA measure of saving:

- While net acquisition of owner-occupied housing⁴ is considered saving, net acquisition of other consumer durables is counted as current consumption, not saving.
- Nominal (as opposed to just the real component of) interest receipts are counted as income, whereas nominal interest payments are counted as outlays.
- NIPA does not factor in the implicit tax liability of saving in tax-qualified plans.

Gale and Sabelhaus adjust NIPA saving rates by allowing for the inclusion of durables, of public retirement plans (their paper was written prior to the change in NIPA methodology discussed in footnote 1), inflation, and accounting for accrual of tax payments implicit in retirement plans (table 4). They find that personal saving rates are consistently higher once these adjustments are made (for example, 2.9 percent versus 0.4 percent in 1998). Furthermore, they find that the decline in personal saving over the past four decades is much less

pronounced (3.4 percentage points when using the adjusted measure, versus 4.8 percentage points with the unadjusted measure). The decline is also less over the course of the 1990s (0.8 percentage points versus 3.1 percentage points).

Incorporating capital gains (unrealized as well as realized) as well into saving rates leads to even more dramatic changes (table 4): Measures of personal saving are much higher (32.6 percent versus 0.4 percent in 1998), Gale and Sabelhaus find. Furthermore, rather than falling over the past four decades, the level of personal saving has more than doubled (32.6 percent in 1998, compared with 15.8 percent during the 1960s) once capital gains are included.⁵

Using the FFA data to dissect the change in personal saving, the authors also find that:

- The long-term decline in household saving (when capital gains are excluded) is the result of a reduction in the net acquisition of financial assets, and almost all of the decline occurred in saving outside of qualified retirement plans.
- Borrowing rates have changed little over the long run.
- Capital gains have generally dominated measured saving as a source of wealth change over the past 40 years.
- Since 1995, capital gains have accounted for more than 80 percent of the gains in household sector net worth.
- In the 1990s, financial assets have accounted for almost all capital gains.

³ It is also possible for the fraction of families reporting that they saved to remain constant, while the percentage of income that they saved decreases.

⁴ This consists of owner-occupant purchases of new single-family dwellings, including manufactured homes; expenditures on improvements; and payments of commissions on new and existing residential dwellings, less sales of dwellings to government.

⁵ The authors point out that it is not always obvious that capital gains should be included as saving, and discuss major arguments for and against including capital gains as saving.

Plans and Saving Rates

A fundamental policy issue is the impact of tax-qualified retirement saving plans (in particular, IRAs and 401(k) plans) on personal saving rates. At the

Table 5
Financial Assets of Private and Government Retirement Plans, 1985–1999

End of	Defined Benefit	Defined Contribution	Assets Held By Life Insurance Companies	Federal Government Retirement Plan Assets	State and Local Government Retirement Plan Assets	Total (Not Including IRA ^a Plan Assets)	IRA ^a Plan Assets	Total (Including IRA ^a) Plan Assets
(\$ Billions)								
1985	\$ 814	\$ 417	\$347	\$154	\$ 399	\$2,130	\$ 235	\$ 2,365
1986	885	478	410	186	477	2,436	319	2,755
1987	883	523	459	219	524	2,608	390	2,997
1988	883	549	516	262	609	2,819	451	3,271
1989	983	673	572	289	767	3,284	546	3,830
1990	948	690	636	326	920	3,520	634	4,155
1991	1,120	843	678	366	1,032	4,039	774	4,812
1992	1,123	922	695	411	1,168	4,319	864	5,183
1993	1,232	1,043	739	465	1,256	4,735	993	5,728
1994	1,188	1,063	782	494	1,294	4,821	1,079	5,901
1995	1,364	1,234	828 ^b	537	1,325 ^b	5,288 ^b	1,352	6,640 ^b
1996	1,532	1,384	871	581	1,374 ^b	5,742 ^b	1,578	7,320 ^b
1997	1,821	1,634	896	625	1,479	6,455	1,948	8,403
1998	2,215	1,845	922 ^b	668	1,717	7,367 ^b	2,231 ^b	9,598 ^b
1999	2,378 ^b	2,074 ^b	948 ^b	714 ^b	1,993 ^b	8,107 ^b	2,420 ^b	10,527 ^b

Source: Employee Benefit Research Institute, *Pension Investment Report* (Washington, DC: Employee Benefit Research Institute, 1999); Employee Benefit Research Institute, *EBRI Databook on Employee Benefits*, 4th ed. (Washington, DC: Employee Benefit Research Institute, 1997); U.S. Bureau of the Census, *1998 Annual Survey of State and Local Employee-Retirement Systems, 2000*; and Sabelhaus, John, "Projecting IRA Balances and Withdrawals," *EBRI Notes* (Employee Benefit Research Institute, May 1999).

^aIndividual retirement account.

^bEBRI estimates.

aggregate level, tax-qualified retirement plans represent a tremendous store of wealth in vehicles earmarked specifically for retirement—\$10.5 trillion as of year-end 1998, up from \$3 trillion just one decade earlier (table 5). At the individual level, the latest data on 401(k) accumulations indicate the potential these vehicles have for generating retirement wealth. According to the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project, the average 401(k) account balance was \$47,004 at year-end 1998 (up 26 percent from the average account balance at year-end 1996). More significantly, the average balances of older workers with long tenure indicate that a mature 401(k) program will produce substantial account balances. For example, individuals in their 60s with at least 30 years of tenure have average account balances in excess of \$185,000 (chart 3)

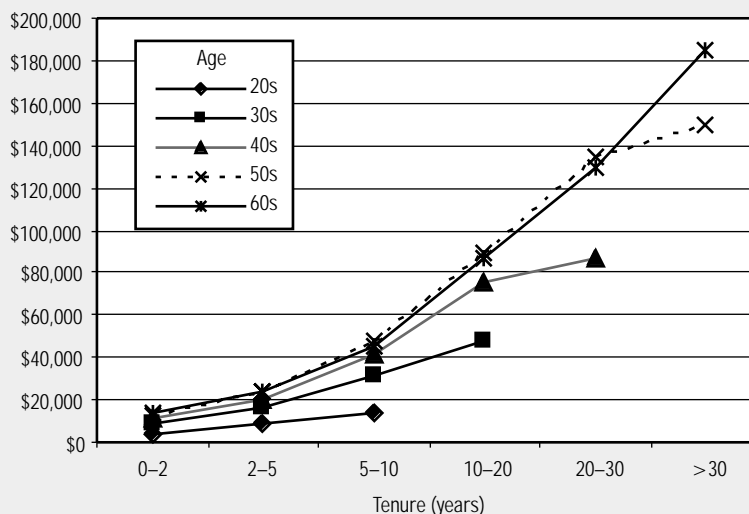
(VanDerhei, Holden, and Quick, 2000).

Nonetheless, debate surrounds the question regarding the degree to which tax-qualified plans result in increased levels of saving. Some argue that the tax-preferred treatment and the implicit government subsidy of saving through such plans, along with the provision of a degree of self-discipline that results from automatic saving, results in higher levels of saving than what would otherwise exist without such programs.

Others maintain that such preferential tax treatment merely serves as an inducement to transfer existing saving into such vehicles and/or to use such vehicles for saving that would have occurred even without such programs.

Interest in this issue is spurred by the fact that individual tax deferrals for employer-based retirement plan

Chart 3
Average 401(k) Account Balance by Age and Tenure, 1998



Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project.

contributions and earnings carry a high estimated cost to the federal government, relative to other programs. The U.S. Treasury Department estimates that in fiscal 2000, the net exclusion of pension contributions and earnings will result in a federal tax revenue loss of \$99.8 billion,⁶ and for fiscal years 2000–2004 these provisions will result in a tax expenditure of \$527.2 billion in revenue over the five-year period (Executive Office of the President, 1999).⁷ Prior EBRI work (Salisbury, 1993) found that about one-half of the retirement tax preference was attributable to public-sector defined benefit retirement plans, about one-third to private-sector defined contribution plans, 15 percent to private-sector defined benefit plans, and 2 percent to public-sector defined contribution plans.

EBRI research has focused on the impact of tax-qualified plans on saving since the early 1980s. An EBRI policy forum in 1981 included discussion of the impact of pension programs on capital formation and saving (Salisbury, 1981). Korczyk (1982) argued that private pension plans add to total saving because households continue substantially their pre-pension saving levels even with a pension plan, and because private pensions are funded. She concluded that between 30 percent and 80 percent of the growth in pension saving over the previous 30 years represented a net addition to total saving. A 1984 *EBRI Issue Brief* found that 54 percent of all funds contributed to IRAs in 1982 (the year after universal IRA eligibility was created by the 1981 Economic Recovery Tax Act, or ERTA) came from savings, while 43 percent came from earnings. This relationship was quite consistent across age groups and at all income levels. Two years later, another *EBRI Issue Brief* noted that ERTA's expansion of IRA eligibility had no apparent effect on aggregate personal saving in the United States. Over time, a significant body of research with conflicting findings has been devoted to this question. Subsequent *EBRI Issue Briefs* (Davis, 1989; VanDerhei, 1992) have examined trends in saving along with the underlying drivers of these trends, and the impact of pensions, IRAs, and defined contribution plans on saving.

Positive Impact

Poterba, Venti, and Wise (1996), based on a body of research that they have conducted over time, have concluded that contributions to tax-qualified personal retirement saving plans (IRAs and 401(k) plans) represent largely new saving and thus such plans have a significant positive effect upon saving rates. Saver heterogeneity⁸ is the main empirical obstacle that must be addressed in estimating whether tax-qualified saving vehicles have an effect on saving rates. There are various methods that can be used to control for heterogeneity in saving preferences:

- Longitudinal analysis of households over time.
- Inter-group comparisons of saving by different groups at the same point in time.
- Cohort analysis comparing asset levels at a given age among individuals attaining that age at different points in time.

Venti and Wise (1995), utilizing the Survey of Income and Program Participation (SIPP) and based on a household longitudinal methodology, find no significant reduction in other saving when households begin contributing to IRAs. Joines and Manegold conclude from their longitudinal work that an increase in the annual IRA contribution limit of \$1 would lead to increased saving in the range of 17 cents to 73 cents.⁹

Using inter-group comparisons, Poterba, Venti, and Wise (1994a, 1995) find that groups with longer exposure to 401(k) plans and/or IRAs experienced no

⁶ \$84.4 billion for employer plans, \$11.2 billion for IRAs, and \$4.3 billion for Keogh plans.

⁷ \$446.4 billion for employer plans, \$56.9 billion for IRAs, and \$23.8 billion for Keogh plans.

⁸ Some people tend to save and others do not. Those that do will save more in all forms, including IRAs and 401(k) plans, thus making it difficult to empirically isolate the effect (if it exists) of such plans on the level of saving.

⁹ Their best estimate of a specific number as opposed to a range for the resulting increase in saving is \$0.26.

A conservative estimate of the IRA effect on personal saving is \$0.26 in new saving per dollar contributed (with the true effect actually being larger).

noticeable reduction in other financial assets as IRA and 401(k) assets grew.

Poterba, Venti, and Wise (1995) look at eligible and noneligible workers at the beginning of the 401(k) program in 1984. The ratio of median assets (*exclusive* of IRAs and 401(k) plans) among the two groups was 1:1, and the authors conclude that this is evidence of similar saving propensities. But by 1991, the ratio of *all* financial assets (*including* IRAs and 401(k) plans) between eligibles and noneligibles had reached 2.22:1. This increase was accounted for almost entirely by differences in 401(k) assets. The authors conclude a sizable effect for 401(k) saving on financial asset accumulations with little substitution of 401(k) contributions for other saving. This conclusion is based on the observation that before the introduction of 401(k) plans, eligible and noneligible workers had equal median assets. Seven years later, 401(k)-eligible workers have twice the median assets as noneligibles, and the difference is accounted for almost entirely by 401(k) assets.

Venti and Wise (1996), utilizing cohort analysis, find that families which reached a given age at later years tended to have larger total real financial assets, and the larger assets were accounted for almost entirely by more funds in IRAs and 401(k) plans.

Hubbard and Skinner (1996) review the literature seeking answers to two basic questions:

- Do saving incentives such as IRAs and 401(k) plans stimulate new personal saving?
- Furthermore, what is the incremental gain in long-term capital accumulation per dollar of foregone government tax revenue from saving incentives (i.e., what is the cost/benefit tradeoff of these saving incentives)?

The authors note that a series of papers by Venti and Wise finds that 45 percent to 66 percent of the increase in IRA contributions comes from foregone consumption, about 30 percent from the tax subsidy, and 3 percent to 20 percent is reshuffled from taxable saving. At the other end of the spectrum, however, research by

Gale and Scholz (discussed below) finds no effect of IRAs on personal saving; they conclude that IRA saving comes completely from

reshuffled taxable saving that would have occurred anyway. Hubbard and Skinner conclude that the results indicating no (or little) effect do not appear to be robust and are likely biased downward when in actuality there is a positive effect.

Hubbard and Skinner (1996) conclude that a conservative estimate of the IRA effect on personal saving is \$0.26 in new saving per dollar contributed (with the true effect actually being larger). They reach a similar conclusion for 401(k) plans “if only because there is so little in the form of other financial assets or home equity among low-income and younger 401(k) contributors.”

Hubbard and Skinner (1996) also evaluate the effectiveness of saving incentives by comparing the saving generated with the cost (i.e., lost tax revenue) of generating it. They conclude that IRAs need not stimulate substantial amounts of new saving per lost dollar of tax revenue in order to generate favorable marginal increases in the capital stock per dollar of initial revenue loss. The authors examine the change in the stock of private wealth accumulated relative to the accumulated tax revenue loss (both for the period of time for which the IRA is held). Based on 1986 tax rates, they find:¹⁰

- If \$1 of IRA contribution generates \$0 in new saving, then the net national capital stock is reduced \$0.78 per dollar of tax revenue lost.
- If \$1 of IRA contribution generates \$0.26 in new saving, then the net national capital stock is increased \$1.21 per dollar of tax revenue lost.
- If \$1 of IRA contribution generates \$0.40 in new saving, then the net national capital stock is increased \$3.31 per dollar of tax revenue lost.
- The effects are even larger if one allows that the increased supply of loanable funds resulting from

¹⁰ Assuming federal budget deficit finance.

increased IRA contributions (new saving) will be used by corporations for increased investments. That would mean future increases in corporate income and therefore corporate income tax payments.

In addition, Dusseault and Skinner (1999) estimate that IRA contributions over the period 1982–1997 have resulted in a net gain of \$14.1 billion in federal revenue, and thus national saving, under the assumption that IRAs generated *no* increases in private saving. This result is driven by the observation that IRA contributors earned a higher rate of return on their investment than the U.S. Treasury pays on its bonds. If IRAs generate increased personal saving, then the effect on federal revenue and national saving would be greater.

Imrohorglu, Imrohorglu, and Joines (1998) developed a model that includes the major institutional features of IRAs and that represents individual consumption over time to examine the effects of tax-favored retirement accounts on the nation's level of saving and capital stock. They conclude that approximately 9 percent of IRA contributions constitute additions to saving. The authors attribute this relatively small effect of IRAs on aggregate saving in their model to the fact that the contribution limit for IRAs appears to be binding for a substantial fraction of savers (middle-aged workers in their model generally save substantially more than they are permitted to invest in IRAs.) Their results further indicate that an IRA system with near-universal eligibility for deductible contributions (similar to what was in effect during the early 1980s) would raise the net national saving rate by 5.5 percent and the stock of productive capital by 6.2 percent.

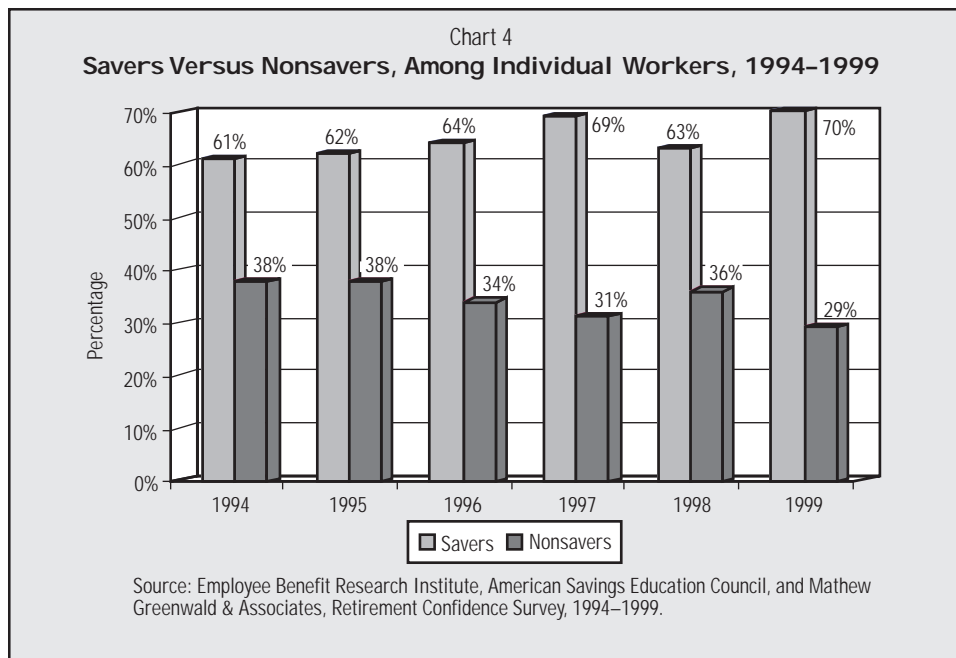
Little or No Impact

What would households eligible for saving incentives have saved in the absence of those incentives? Engen, Gale and Scholz (1996) argue that empirical analysis of that question is difficult and subject to biases that generally lead to overestimation of the impact of saving incentives. The biases they cite include:

- Household heterogeneity, especially in preferences for saving.
- The need to analyze wealth (assets less debts) effects, rather than just the level of financial assets.
- The effect of taxation on withdrawals (i.e., consideration that balances in saving incentive accounts will be taxed upon withdrawal, and therefore the entire amount is not consumable).
- The typical use of wages in empirical analysis as opposed to total compensation.
- The need to account for changes over time in the retirement system, the economy, and financial markets in any empirical analysis.

The authors conclude, based on a body of empirical work, that controlling for these biases largely or completely eliminates estimated positive effects of saving incentives on saving. They do qualify this conclusion by stating that such incentives may increase saving for some people and/or they may eventually increase saving in the long run.

The authors produce various arguments and evidence in support of their position. Regarding IRAs, Gale and Scholz (1994) analyze 1983–1986 Survey of Consumer Finance (SCF) data and conclude that people with greater assets find IRAs and other saving to be better substitutes for each other; hence IRA contributions are less likely to be new saving. Therefore, increases in the contribution limit would generate little (if any) new saving. They also conclude that in the absence of IRAs, contributors and noncontributors would have saved the same amount. Regarding 401(k) plans, the authors argue that eligibility is likely to be positively correlated with preference for saving (i.e., workers with a relative penchant for saving are more likely to work for employers that sponsor a 401(k) plan), and they present empirical evidence in support of this position. The conclusion being that comparisons of 401(k)-eligible workers and noneligible workers that do not control for preference for saving are biased toward showing that 401(k) plans raise saving (Engen, Gale and Scholz (1994).



The authors argue that cohort analysis is typically flawed due to lack of control for other changes that occur over time, which affect the cohorts differently, such as:

- Stock and bond returns.
- Shifting of nonfinancial assets.
- Changes in housing debt.
- Changes in defined-benefit coverage rates and/or plan generosity.
- Changes in Social Security benefit levels.
- Conversion of pre-existing thrift plans into 401(k) plans.

In addition, they maintain there is a bias if pre- and post-tax balances are compared.

Engen and Gale (1995) argue that it is appropriate to include housing equity in the analysis when evaluating whether retirement saving incentives increase wealth, since households can trade off increased retirement saving with decreases in housing equity (such as through increased use of home equity loans). Using 1987–1991 data, the authors conclude that 401(k)-eligible households accumulated more financial assets than other households, but *not* more wealth when housing equity is included (housing debt rose faster than housing values for 401(k)-eligibles).

Engen and Gale (1993) and Engen, Gale and Scholz (1994) developed a stochastic life-cycle simulation model to develop quantitative predictions for saving behavior and its response to government policies. They find a long-term impact by 401(k) plans and IRAs on national saving after a period of decades. But in the short run, they conclude, private and national saving

decline and do not recover to original levels for several decades—the reason being that shifting behavior (i.e., the transferring of saving via non-tax-qualified vehicles into tax-qualified vehicles) by individuals swamps all else in early years of the programs.

Boomers' Prospects

Another major policy issue is whether current workers are saving enough for their

retirement, in particular the post-World War II baby boom generation (born between 1946–1964). EBRI hosted a policy forum on this topic in 1994 (Salisbury, 1994) and subsequently published an *Issue Brief* on retirement saving adequacy (Yakoboski and Silverman, 1994). This section updates that material.

According to the 1999 Retirement Confidence Survey (RCS), 74 percent of workers say they have established an investing or saving program for their retirement, and 70 percent report they are personally saving money for retirement¹¹—an increase from 63 percent who reported saving for retirement in 1998 (chart 4). However, the amounts accumulated are generally unimpressive.¹² The median amount accumu-

¹¹ A slightly larger proportion of workers report that they and/or their spouse are saving for retirement (75 percent).

¹² See Ostuw, Pamela, Bill Pierron, and Paul Yakoboski, "The Evolution of Retirement: Results of the 1999 Retirement Confidence Survey." EBRI Issue Brief no. 216 (Employee Benefit Research Institute, December 1999).

Table 6
**Median Amounts Working Households
 Have Accumulated for Retirement**

All Workers	\$29,514
Ages 25–39	20,588
Ages 40–49	45,238
Ages 50–59	71,250
Ages 60 and over	39,286

Source: Employee Benefit Research Institute, American Savings Education Council, and Mathew Greenwald & Associates, 1999 Retirement Confidence Survey.

lated for retirement by all households is \$29,514 (table 6). While the median amount saved increases by age (ages 25–39, \$20,588; ages 40–49, \$45,238; ages 50–59, \$71,250), working households age 60 and older have accumulated less (\$39,286 median amount saved)—perhaps because they are more likely to expect to rely on Social Security for a major portion of their retirement income. To put these accumulations in perspective, assume a single male, age 65, purchases a life annuity today. With \$71,250, he could purchase a nominal monthly annuity for life of \$631; with \$39,286, he would get a monthly annuity of only \$348.¹³

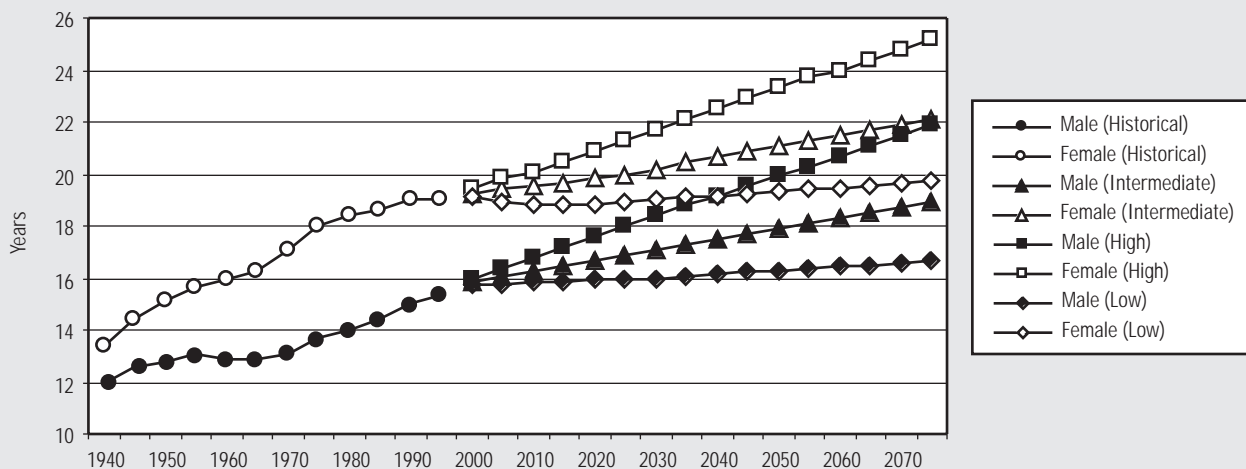
What is clear is that even though most workers and households are saving for retirement, relatively few have a good idea of how much they need to save. In 1999, 52 percent of all households reported in the RCS that they had tried to figure out how much money they will need to have saved by the time they retire so that they can live comfortably in retirement (among households that have saved for retirement the figure was 61 percent). So while most may be saving for retirement, they

appear to be simply assuming (or hoping) that they will accumulate enough. Given the upward trend in life expectancies of individuals once they reach age 65 and projections of future growth in these life expectancies (see chart 5), hoping and assuming likely will not be good enough in light of retirements that could well span decades.

It should be noted that, on average, those who have done a needs calculation have saved considerably more than those who have not done the calculation. The 1999 RCS found that the median amount accumulated by households that have tried to figure out how much money they will need in retirement is \$66,532, compared with a median of \$14,054 accumulated by those who have not done the calculation. These findings are reinforced by other research. Utilizing the Health and

¹³ This assumes that \$9.41 buys an annuity of \$1 per year payable monthly (See D.M. McGill, K.N. Brown, J.J. Haley, and S.J. Schieber, *Fundamentals of Private Pensions, Seventh Edition*, Philadelphia, PA: University of Pennsylvania Press, 1996).

Chart 5
Life Expectancy at Age 65, Historical and Projections



Source: Social Security Administration Board of Trustees, *1999 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*.

Retirement Survey (HRS), Lusardi (1999) finds that approximately 30 percent of households whose head is close to retirement have done little or no planning for retirement. More importantly, Lusardi finds that lack of planning results in substantially lower wealth holdings than households that have done some retirement planning. Lack of planning also results in portfolio allocations that are less likely to contain high-return assets, such as stocks. The conclusion being that planning plays an important role in explaining the saving behavior of many households.

Additional Findings

The question of whether workers in general, and baby boomers in particular, are saving adequately for their retirement has prompted much research in recent years. Bernheim has examined whether current workers are saving at a rate sufficient to allow them to maintain the same standard of living during retirement as they have during their working years.¹⁴ To answer this question, a microsimulation model was developed that calculates how much baby boom households with varying characteristics need to save throughout their adult lives to accumulate enough for retirement at age 65.¹⁵ Saving prescriptions generated by the model were then compared with actual saving deduced from a survey of baby boom households. The general conclusion, summarized in a “baby boomer retirement index,” was that baby boomers are saving at only one-third the rate necessary to maintain their standard of living in retirement.

It should be noted that Bernheim’s calculations discounted housing wealth. This exclusion has a dramatic effect on the findings; if housing wealth is taken into account, then the study found that baby boomers are saving at 84 percent of the rate necessary to maintain their level of consumption in retirement. The study also assumed a goal of maintaining a steady level of consumption after retirement. However, it is not clear that the same level of consumption will be necessary to maintain the preretirement standard of living.

Warshawsky and Ameriks (1998) utilize the Quicken Financial Planner in conjunction with data from the SCF to assess the preparedness of the American public for retirement. Their sample excluded individuals with more than \$1 million in nonfinancial assets and/or those earning more than \$125,000 annually, plus those younger than 25 or older than 70. Resulting sample members appear to have characteristics that they say approximately reflect those of “middle America.” The authors’ conclusion is that 52 percent of households in their sample will fail to fully finance their retirement (where failure means to run out of assets) given the self-reported age at which they plan to retire.¹⁶ They find that 15 percent of the households will run out of financial assets before retirement.¹⁷ By the tenth year of retirement, the overall “success rate” for retirement assets drops from approximately 85 percent to 65 percent. After 20 years of retirement, about 45 percent of household retirement assets are estimated to have failed, and after 30 years, more than half are expected to have failed. The older the household, the more likely is failure. Households with current outstanding debt (especially mortgages) are less likely to fail in retirement.¹⁸ Households with children are more likely to fail before retirement, but if their assets survive to retirement, they

¹⁴ See Douglas B. Bernheim, *Is the Baby Boom Generation Preparing Adequately for Retirement? Summary Report* (Merrill Lynch & Co., Inc., 1993); and Douglas B. Bernheim, *Is the Baby Boom Generation Preparing Adequately for Retirement? Technical Report* (Merrill Lynch & Co., Inc., 1992).

¹⁵ The model accounted for probable economic developments over the course of a lifetime and took account of Social Security, private pensions, taxes, interest rates, inflation, economic growth, family composition, and employment prospects.

¹⁶ Assumes that upon retirement, the household trades down its home and purchases a new residence worth 75 percent of the value of the original home.

¹⁷ Plan failure before retirement is solely the result of college expenses being too large for the family to fund or because they never had any financial assets to start with (the latter is the most frequent explanation for preretirement failure).

¹⁸ This is likely due, in large part, to the assumption that debt payments are shifted to net savings once the debt is paid off.

The authors find that older households nearing retirement are saving about one-third of the amount needed.

are less likely to fail. Failure rates also decrease with increases in beginning financial assets, education levels, annual earnings, and planned age for retiring. The authors also find that the average unfunded expense for households where the financial plan fails is approximately \$300,000 (in 1993 dollars).

Moore and Mitchell (1998) examine asset accumulation among a cohort of older Americans to determine:

- How much retirement wealth is held by older people on the verge of retirement.
- How much more they would need to save to preserve preretirement consumption levels into retirement.

Based on data from the HRS, the authors find that as of 1992, the median older household on the verge of retirement is projected to have total wealth of approximately \$325,000 (including net financial wealth, net housing wealth, the present value of employer-sponsored retirement benefits, and the present value of Social Security benefits), while the mean household has \$478,000. Household assets are then projected to assumed retirement ages of 62 and 65. Median household wealth is projected to be \$383,000 at age 62 and \$421,000 at 65. Using a “replacement rate” methodology, they find that the typical household still needs to save 16 percent of annual income leading up to retirement at age 62 to preserve preretirement consumption, and 7 percent of annual income needs to be saved for retirement at age 65. The authors further note there is extraordinary heterogeneity in assets (levels and composition), saving needs, and retirement income replacement rates in the older population. For example, given a retirement age of 62, 31 percent of the older population need not save any additional earnings; given a retirement age of 65, the comparable figure is 40 percent. Comparing actual saving rates with those “prescribed” by their methodology, the authors find that older households nearing retirement are saving about one-third of the amount needed.

Building upon Moore and Mitchell (1998), Mitchell, Moore, and Phillips (1998) use the HRS to examine where retirement saving shortfalls

appear most serious. They found a shortfall is more likely for households with greater earnings, less wealth, less education, younger age, and for households headed by a divorcee. Most variables reflecting health status¹⁹ are not statistically significant, nor are variables reflecting preferences.²⁰ The variables that have an impact on the likelihood of having a saving shortfall also have a similar effect of the size of the shortfall. The exception is preference proxy variables, which have an effect on the size of a shortfall, if it exists, but no effect on whether or not it exists.

Yuh, Montalto, and Hanna (1998) estimate the adequacy of wealth of preretirement households using the 1995 Survey of Consumer Finances. The authors project retirement wealth²¹ using planned retirement age and portfolio allocation and estimated retirement needs from expenditure functions. They find that 48 percent of working households²² will not have adequate wealth to maintain their preretirement standard of living, given the expected retirement date. Their analysis reveals that the two most important factors related to retirement wealth adequacy were planned retirement age of the householder and spending behavior (i.e., spending less or more than income). They found that only 44 percent of households with a householder who planned to retire at age 61 or earlier had adequate

¹⁹ *Self-reported poor health, own projected mortality, depression, and memory problems.*

²⁰ *Attitudes toward risk and peoples' planning horizons.*

²¹ *The study used a comprehensive measure of retirement wealth that includes financial assets, nonfinancial assets including housing wealth, and retirement income from defined contribution plans, defined benefit plans, and Social Security.*

²² *Households were included in the sample if the householder was age 35–70, worked full time, indicated the age he/she planned to stop full-time work, had positive noninvestment income, and total annual household income above the poverty threshold.*

retirement wealth, compared with 68 percent of those with a householder who planned to retire at age 66 or later. Other significant factors related to retirement wealth adequacy were household income, ownership of defined benefit and defined contribution plans, housing tenure status, proportion of nonhousing assets held in stock, and anticipated life expectancy.

Gist, Wu, and Ford (1999) attempted to estimate the saving required by representative baby boomers in different age and income groups to attain reasonable retirement saving targets. They first examined how much boomers have accumulated through traditional saving vehicles relative to annual income in selected years, and then used estimated levels of individual saving and earnings to construct hypothetical saving adequacy scenarios for representative families. They conclude that in analyzing retirement saving adequacy, financial wealth is far less important than either Social Security or pension saving, which when combined account for half of total wealth for 90 percent of the working population. (Related findings emerge from DeVaney and Su (1997), where the authors demonstrate that workers' expectations about primary retirement income sources were mainly affected by worker age and to a lesser degree by income and education levels.) They estimate that average baby boomers would need to save between zero and 30 percent of future wages to achieve reasonable retirement income replacement rates.²³ Couples are generally better prepared than singles, partly because of higher net worth to start, but mainly because their Social Security wealth is much greater than that for singles with comparable wage histories. The study finds that younger boomers are better situated for retirement security than older boomers, largely because they are assumed to have 10 more years to prepare. The authors caution that how much boomers will need to save is highly dependent on assumptions about rates of return, longevity, their standard of need, the presence of children, and numerous other factors.

Other research is more sanguine regarding the retirement income prospects of current workers. Gale

(1997) argues that the index developed by Bernheim reveals little about the overall adequacy of retirement preparations, since it does not measure the adequacy of saving by the ratio of total retirement resources (Social Security, pensions, and other assets) to total retirement needs (the wealth necessary on the eve of retirement to maintain preretirement living standards).²⁴ Rather, it examines the ratio of "other assets" to the part of total need not covered by Social Security and pensions.²⁵

Engen, Gale, and Uccello (1999) developed a microsimulation model of optimal wealth accumulation. In their model, adequate saving maintains preretirement standards of living in retirement (assumed retirement age is 65). The simulation model is used to benchmark "adequate" saving levels. The model generates a distribution of optimal wealth/earnings ratios and uses the distribution to gauge adequacy based on survey data (SCR and HRS) of actual wealth/earnings ratios across demographic groups.²⁶

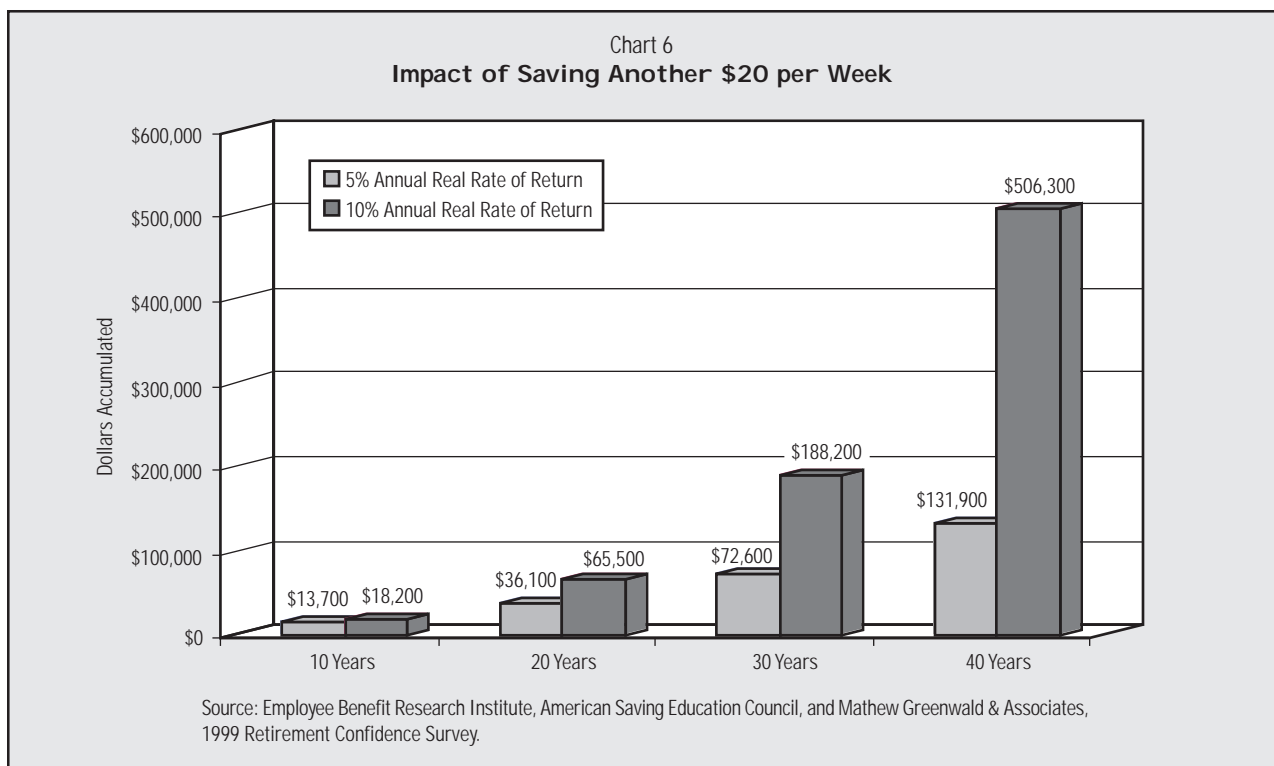
The authors find that holding preferences constant, households that look the same will typically have very wide ranges of optimal wealth-to-income ratios due to unexpected economic events (i.e., income shocks such as job loss). Such a distribution of optimal wealth-to-earnings ratios, as opposed to a single target level, changes the interpretation of data on wealth accumulation. Given such a distribution, low wealth, per se, is *not* an indicator of too little saving. In fact, their model indicates that a significant portion of optimizing households will actually have low wealth/earnings ratios. Based on comparisons of actual survey data of wealth/earnings ratios with simulation model benchmarks of optimal ratios, they find no evidence of undersaving

²³ The wealth calculations used to calculate the required saving rate include housing equity as a form of retirement wealth.

²⁴ See William G. Gale, "Will the Baby Boom Be Ready for Retirement?" *The Brookings Review* (Summer 1997).

²⁵ *Ibid.*, for additional critiques.

²⁶ All wealth (not just retirement saving) is considered in determining adequacy.



when housing equity (in total or in part) is counted as part of wealth. These results are generally contrary to the existing literature on the subject. However, the authors do not interpret these findings as proof that there is no saving problem, but rather that characterizing any undersaving problem is critically dependant on how researchers empirically specify the hypothesis that describes optimal saving behavior.

Can Workers Do Better?

The 1999 Retirement Confidence Survey found that 57 percent of workers who are not currently saving for retirement say it is reasonably possible for them to save \$20 per week for retirement. In addition, 69 percent of workers who are already saving report that it is possible for them to save an additional \$20 per week (Ostuw, Pierron, and Yakoboski (1999)). Saving \$20 per week amounts to more than \$1,000 per year, which saved over time can add up to a significant sum of money. The power of compound interest allows a 25-year-old saving \$20 a week, assuming a 5 percent annual real rate of return over 40 years, to accumulate a retirement nest egg worth nearly \$132,000. With a 10 percent annual real rate of return, \$20 a week saved over 40 years can accumulate to more than \$500,000 (chart 6).

To put these potential accumulations in context, note from above that the median amount saved for retirement by current households that are age 60 and older is \$39,286 (for those ages 50–59, the median

retirement saving is \$71,250). Further perspective is provided by data from the SCF: According to that data source, the median value of financial assets for families with any financial asset in 1998 was \$16,500. Among those nearing retirement age (household head ages 55–64), median net financial assets were \$34,800, and among those in early retirement years (household head ages 65–74) the figure was \$22,500. Median net worth among all U.S. families was \$71,600 in 1998. For those nearing retirement, median net worth was \$127,500. For families in the early retirement years, median net worth was \$146,500 (Kennickell, Starr-McCluer, and Surette, 2000).

Implications

Concerns about low levels of aggregate personal saving at the national level appear misplaced.

Americans—in the aggregate—are saving. That saving, however, is partially the result of large capital gains that have been experienced in the financial markets over recent years. Since the most commonly cited measure of personal saving (NIPA) does not factor capital gains (neither realized nor unrealized) into income, the savings rate appears to have dropped dramatically over the past decade. Accounting for capital gains changes the picture dramatically; by one measure, aggregate personal saving

is 33 percent of “income” and has increased dramatically over the past decade. However, while there may not be an aggregate “saving crisis” per se, a note of caution is warranted: To the degree that aggregate personal saving is currently being driven by the bull market in equities, a sharp contraction in the equities market could have potentially drastic consequences. How will individuals react with their spending and saving decisions if and when a significant market downturn occurs—especially one that lasts for an extended period of time? Until it happens, no one can say with any certainty.

Also, while the rate of aggregate personal saving may be healthy at the national level, this does not mean that fears about inadequate retirement preparations among current workers are misplaced. While sweeping generalizations are to be avoided, and while some workers are on-track, the evidence indicates that many groups of American workers appear unlikely to be able to afford a retirement that maintains current lifestyle (at least not without working more years than currently planned). Consensus does not exist on how many workers are at risk or the typical magnitude of their retirement savings shortfall. There is a consensus, however, that a substantial number of individuals are at risk. This is not surprising—despite the fact that the 70 percent of workers are saving for retirement—since relatively few workers know how much it is that they need to accumulate to fund their retirement.

This then begs the question as to the effectiveness of government saving incentive programs (i.e., IRAs and 401(k) plans) in generating increases in saving and wealth for individuals. As previously described, empirical analysis of this issue is extremely challenging and findings have been contradictory. What is beyond dispute, however, is that these programs now represent an enormous store of retirement-earmarked wealth in tax-deferred vehicles. Combined, such tax-deferred retirement accounts currently have assets of about \$4 trillion.²⁷ While leakage from the system remains a challenge, the majority of the assets in the system can be expected to be available to fund workers’ retirements.²⁸

One could argue that, *from a retirement income security perspective*, workers in general are better off because these programs exist. Surely, many of the dollars in these programs would have been saved even without the programs; but they would not necessarily have been earmarked *for retirement* and been available to fund retirement expenses. Therefore, such saving incentive programs have likely improved the retirement income security prospects of most participating individuals. Furthermore, given the cost (in terms of deferred or foregone tax revenue) versus benefit analysis of Hubbard and Skinner (1996), it appears that such programs represent a good expenditure (investment) for the federal government in the pursuit of an important public policy.

One question yet to be addressed is whether and how retirement assets will be affected by the ever-growing initiatives in Congress to expand tax-deferred savings accounts for nonretirement purposes (such as education, health care, job training, and other costs). As the options grow among tax-deferred savings accounts, or as Congress passes new laws relaxing the tax penalties for using retirement account assets for nonretirement purposes, the competition for retirement savings is certain to grow—just when the demographic wave of Americans reaching retirement age is starting to crest.

Issues regarding saving levels and the adequacy of retirement preparations will continue to capture the

Conclusion

²⁷ According to estimates by Sabelhaus (1999), IRA assets will reach \$2.6 trillion in 2000. According to estimates by the Investment Company Institute (1999), 401(k) assets totaled \$1.4 trillion as of 1998.

²⁸ See Paul Jakoboski, “Lump-Sum Distributions Total \$87.2 Billion in 1995,” EBRI Notes, no. 10 (October 1999); and Paul Jakoboski, “Large Plan Lump-Sums: Rollovers and Cashouts,” EBRI Issue Brief no. 188 (Employee Benefit Research Institute, August 1997).

attention of policymakers, the news media and the public as the baby boomer generation moves toward its retirement years. This is most evident with Social Security, as changes needed to ensure the long-term financial viability of the system are debated. Many reform proposals involve elements designed to give all workers their own individual retirement saving accounts through the Social Security system.

It is also evident in other areas. President Clinton, in his 2000 State of the Union address, proposed the creation of government-subsidized Retirement Savings Accounts (RSAs) designed to give 76 million Americans the opportunity to build wealth and save for their retirement through a progressive tax cut. RSAs would involve government matching contributions to low- and moderate-income families to encourage them to save. The president has also proposed a 50 percent tax credit for qualified contributions to employees' pensions in an effort to encourage more small businesses to offer retirement plans to their workers.

Government agencies, such as the Department of Labor and the Securities and Exchange Commission, along with private-sector organizations such as the American Saving Education Council, have been extremely active in reaching out to the American public with educational materials and tools designed to promote and encourage saving.

At one level, success has already been achieved: 70 percent of American workers report that they have begun to save for their retirement. However, this still means that 30 percent—disproportionately younger and lower-earning individuals—are not in the retirement savings game at all. These individuals likely do not appreciate the difference that even seemingly small amounts of money saved on a regular periodic basis can make over time. For the nation, a higher bar to strive for is not merely to create savers, but rather to create *planners* who can develop a specific dollar goal for their retirement and then save accordingly. On this latter point, there remains plenty of room for improvement—and this goal would seem to be the next crucial step to

ensuring individual retirement income security for American workers.

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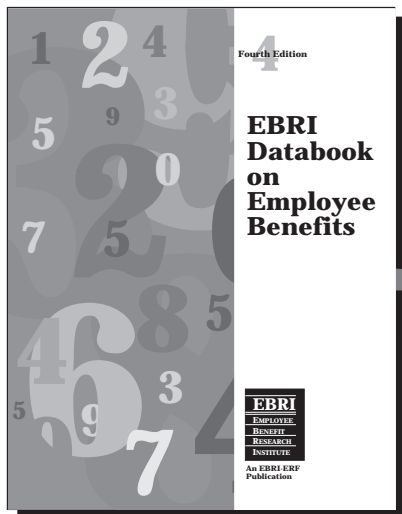
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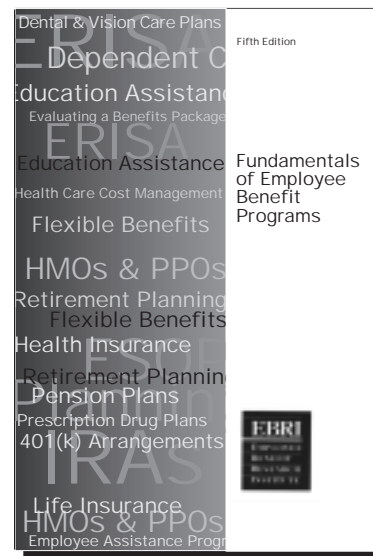
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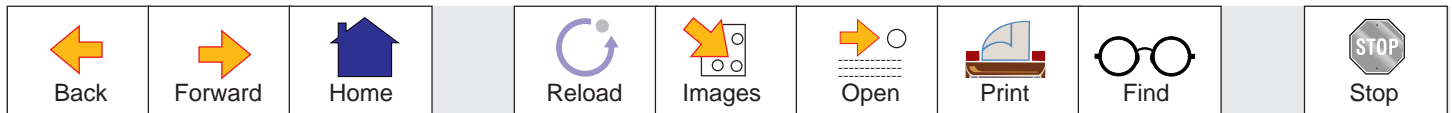


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