

Policy Levers for Changing  
Retiree Well Being:  
Tax Policy

J. Mark Iwry

Nonresident Senior Fellow

The Brookings Institution

EBRI/ERF Policy Forum

December 4, 2003

# Basic Propositions: Tax and Retirement Policy

- Purpose of private pension system
  - Enhance post-retirement security through saving and risk management
    - for those who have the greatest need
    - promote national saving
    - relationship to EBRI model

# Money's Worth for Taxpayers

- National saving = private saving +/- public saving (dissaving)
- Tax expenditure: \$192b for ret savings (present value net of revenue from payouts)
- Target tax incentives to moderate/lower-income
  - for them, added saving = added security
  - more efficient in increasing actual saving

# Replace Marginal Rate Benefits With Credits

- Central flaw: value based on tax brackets
- Most who are covered get little tax benefit
- At least half aren't covered at all (75 M)
- EBRI model: vulnerability and income
- Tax credits
  - expand saver's credit
  - broader approaches: matching & automatic

# Managing the Risks: Investment

- Overconcentration in Employer Stock
- The Enemy is Us: Self-Directed Investment
- Solutions
  - Default mode
  - Wholesale not retail
  - Pooling

# Managing the Risks: Leakage and Longevity

- It's not about "DB-ness"
- Cardinal Virtues -- Quality of Coverage
  - Employer funding (takeup risk)
  - Limit leakage (preservation risk)
  - Professional investment (inv't/inflation risk)
  - Cheap annuitization (longevity risk)
  - Don't forget basic adequacy (amount)

# Managing the Risks: Leakage and Longevity

- Defined benefit hybrid plans
- “Lump sum” plans
- Legislative resolution of cash balance controversy
- Automatic rollover
- Broader lump sum policy

# Protect Employer Plans

- Advantages of employer pension and health plans
  - collective risk sharing
  - cross subsidies in favor of lower-income and reluctant savers and risk managers
  - pooling of cost, knowledge for economies of scale



# Protect Employer Plans

- Substitution effects of individual accounts
- Incentives of decisionmaker and employees
- Contribution limits, liquidity, tax treatment, match, attitude
- LSAs/RSAs: large and leaky
- Virtues of social insurance: Social Security, Medicare

# Managing the Meta-Risk: Protecting the Nation's Capacity

- Fiscal Responsibility Protects National Capacity to Respond to Uncertain Future Needs
- Budget Deficits = Public Dissaving
  - Collective resources to manage risk
  - Social Security, Medicare, Medicaid
  - Age dependency ratio
  - Potential tax burden on future generations

# The EBRI Model: A Valuable Contribution

- Virtues
- Potential Further Uses
  - A wish list