Testimony of
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the
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The views expressed are those of Mr. Salisbury and should not be attributed to EBRI, its officers, directors, staff or sponsors.
Mr. Chairman and members of the Committee, it is a pleasure to appear before you today to discuss the nation's experience with Individual Retirement Accounts.

The Employee Benefit Research Institute (EBRI) has undertaken research in this area for over a decade. EBRI is a non-profit public policy research organization located here in Washington, DC. We do not take positions on policy initiatives, but hopefully do provide research that allows others to make informed decisions.

Our most recent work on IRA's is based upon the May 1988 Census Bureau Current Population Survey Employee Benefits Supplement which was released to the public on September 15, 1989. The survey provides IRA information for tax year 1987. A similar survey taken in May 1983 for tax year 1982 allows pre and post tax reform comparisons. Further, since the survey also collected information on employment based pensions and 401(k) plans, it allows an assessment of the overall impact of tax reform on retirement savings.

The growth of 401(k) plans is relevant to an evaluation of IRA's since they have provided an alternative for pre-tax deductible contributions for millions of those who "lost" the IRA with tax reform changes. As a result, a full or partial return to pre-tax reform IRA rules may produce less new savings and lower revenue losses than some have argued. The 401(K)-IRA analysis has only been possible since September 15, 1989, when new government data were released.
401(k) Plan Coverage and Participation Have Grown Significantly

Over 27.5 million workers were covered by 401(k)-type arrangements (including 403(b) plans for nonprofit organizations and section 457 plans for state and local governments) in May of 1988, up from 7.1 million in May of 1983. This represented 24.2 percent and 7.1 percent of all workers respectively. Participation grew from 2.7 million workers in 1983 to 15.7 million in 1988, with the percentage growing from 2.7 percent to 13.8 percent. Coverage and participation grew significantly in both the public and private wage and salary sectors, with actual rates being higher for the public sector. Among public sector workers 19.3 percent participated, compared to 14.3 percent in the private sector.

Expansion of plan coverage and participation with before tax employee contributions was experienced at all earnings levels. More workers earning less than $15,000 participated in plans (1.89 million) than workers earning more than $50,000 (1.86 million). The majority of participants earned less than $30,000. However, because only 4.1 million workers earned more than $50,000 the reported coverage and participation rates were higher than any other group at 56.5 percent and 45.1 percent respectively.

Passage of TRA 86 does not appear to have slowed the growth of 401(k) plans through 1988, even though the possibility remains in the future as more restrictive provisions of that law come fully into effect (e.g., hardship withdrawals, loans, early distribution penalties, etc.)

Employee 401(k) Contributions Averaged $2,000

TRA 86 placed a maximum on allowable employee contributions of $7,000 (to be indexed beginning in 1988). At the time the limit was controversial, but it appears to have been approached by very few workers in 1988. Table 1
presents average contributions for all participating workers and by earnings level, showing that the overall average was $2,000. The high was $3,500 for those earning over $50,000. The average contribution was 6.5 percent of earnings, with the greatest concentration at 6 percent, 7 percent, and 10 percent.

Thirteen percent of all participants who reported the percentage of pay being contributed had a total contribution of less than $700; 5 percent more than $5,000. For those earning more than $50,000, 55 percent contributed $2,000 to $4,999, and 19 percent contributed over $5,000.

Three points should be emphasized. First, the average contribution of $2,000 is the IRA maximum. Second, most of those with 401(k) plans but above the deductible IRA income limit could apparently have contributed more to their 401(k) plans without exceeding tax reform limits. Third, all 401(k) contributions are deductible and for all post 1984 federal employees and over half of private workers an employer contribution is also provided.

**Employee 401(k) Contributions May Have Exceeded $24 Billion in 1988**

Using the numbers reported in the 1988 CPS EBS we estimate that employees contributed over $24 billion in 1988; $19.3 billion by private workers and $4.8 billion from public employees (Table 2).

**IRA Participation Has Changed Less Than Many Predicted**

The tax changes of TRA 86 reduced or eliminated allowable deductible IRA contributions for about 15 percent of the then eligible population. Interestingly, the number of workers reporting IRA contributions dropped by 15 percent between 1982 and 1987. Table 3 shows that this decline came from all age categories and most earnings levels, possibly meaning that more than the actual tax law change was at work. Confusion, less advertising, less tax
advantage due to lower tax rates, greater 401(k) availability, and other factors, may have contributed. In addition, the 1988 survey asked about contributions to an IRA, not only tax deductible contributions. It is certain that most of the nearly six hundred thousand workers earning more than $50,000 in 1987 who reported IRA contributions and pension coverage were making non-deductible after tax contributions. And, that many at lower earnings levels but above the TRA 86 income limits were as well. This indicates that the non-deductible IRA has also been more popular than many expected at the time TRA 86 was enacted. And, since published Internal Revenue Service reports on IRA use in 1987 report only deductible IRA contributions, they significantly understate total actual 1987 contributions.

IRA Users Have Changed

Between 1982 and 1987 the number of private sector workers with an IRA and an employer sponsored retirement plan declined from 23.1 percent to 15.0 percent, while the number with IRA's decreased in absolute numbers by 21 percent (from 6.8 million to 5.3 million) (Table 4). As a proportion of all workers without an employer plan, IRA holders declined from 11.8 percent to 10.4 percent, but increased in absolute numbers by 7 percent from 4.0 million to 4.3 million. The distribution of those with IRA's changed by income level among both groups. The proportion of those earning more than $50,000 and having an IRA plus an employer plan dropped from 58.9 percent to 22.0 percent; among those with only an IRA from 47.1 percent to 29.1 percent. Among those earning $30,000 to $49,999 IRA use among those with employer plans declined from 32.8 percent to 17.8 percent, and among those with no employer plan from 33.4 percent to 19.8 percent.
Employment Based Plans Have The Broadest Reach

Policy debates frequently center on individual freedom of choice and the value of tax incentives for employer sponsored plans relative to incentives for individual effort. Policy debates of recent years have also focused on the concept of non-discrimination in employee benefit provision (that is, trying to deliver benefits to the low earning worker). Table 5 provides a comparison of participation levels among the full population in all employer pension plans (42 percent), employer 401(k) plans (13.8 percent), and IRA's (12.5 percent). The table also underlines the significant growth of 401(k) plans between 1983 and 1988.

Conclusion

The data indicate that a significant percentage of those who lost the ability to make deductible IRS contributions are making non-deductible contributions and an even larger number may be contributing funds to 401(k) plans that were being contributed to IRAs pre-tax reform. A return to pre-tax reform IRA rules is not likely, therefore, to produce either the full saving effect or the full revenue losses that have been suggested in recent weeks. A move to rules allowing a 50% deduction for a $2,000 contribution are even less likely to do so if 401(k) use is an indicator: 37 percent of those who could make a fully deductible contribution to a 401(k) plan with an employer contribution as well do not do so and few that did contribute, contributed the tax reform maximum.