

*Testimony of*

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*Before the*

**Subcommittee on Health, Employment, Labor & Pensions  
Committee on Education and Labor  
U.S. House of Representatives**

**“Universal 401(k): A Retirement Saving Plan for Every Worker”**

*November 8, 2007*

Thank you, Mr. Chairman and members of the Committee, for this opportunity to testify today. I am Vice President of the New America Foundation, a nonpartisan policy institute here in Washington. I co-direct New America’s Next Social Contract Initiative, which focuses on updating the nation’s policy framework for promoting the basic economic security of workers and their families, particularly with respect to health insurance, retirement saving, income security and access to higher education.

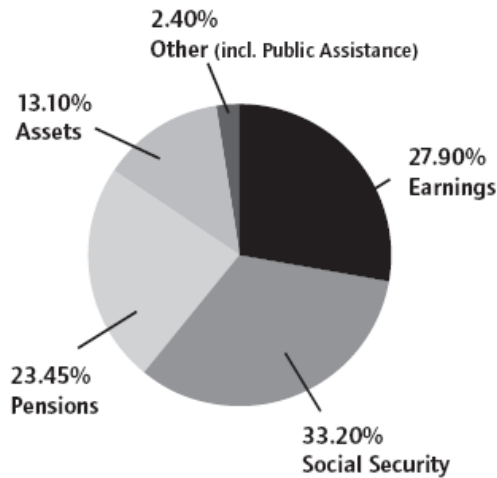
I also served as co-chairman – with John Kimpel, former deputy general counsel at Fidelity Investments – of the Conversation on Coverage Working Group on individual, defined-contribution saving reform. That diverse Working Group developed a universal “Retirement Investment Account” proposal that is very similar to New America’s Universal 401(k) plan that I describe in my testimony today.

With over \$12 trillion in assets, traditional pension trusts and 401(k)-style saving plans account for the vast majority of financial assets accumulated by households in recent years. For those with access, America’s employer-based private pension system provides powerful saving incentives—both tax breaks and employer contributions—as well as the convenience and discipline of automatic payroll deduction.

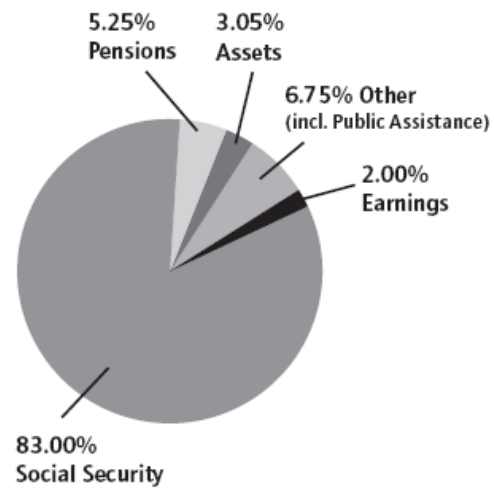
Unfortunately, employer-sponsored plans cover fewer than half of all workers. America’s real retirement security crisis is not Social Security solvency, nor even the many big companies freezing their traditional pension plans. The larger problem is that a steadily declining minority of American adults are participating in *any* retirement plan—whether pension or 401(k) plans or Individual Retirement Accounts (IRAs). Participation in employer plans peaked back in the late 1970s. Since I first proposed this Universal 401(k) reform in testimony before the Subcommittee back in September 2000, participation in private employer plans has fallen by 4 million to what appears to be the lowest level in more than 30 years.

SHARES OF U.S. RETIREMENT INCOME BY SOURCE, POPULATION 65 AND OVER, 2004

TOP TWO INCOME QUINTILES (HIGHEST 40%)



BOTTOM TWO INCOME QUINTILES (LOWEST 40%)



Only 43.2 percent of all private-sector workers participated in an employer-sponsored retirement plan in 2006, a striking decline from the 50.3 percent participation rate in 2000, according to a recently updated Congressional Research Service (CRS). Only 54 percent of older workers (aged 45 to 64) participate in a retirement plan. The percentage of private sector workers whose employer even sponsors a plan (whether or not they are eligible or participate) has fallen steadily to 57 percent in 2006.

One result is that fewer than 55 percent of today's older workers, those aged 47 to 64, are on track to replace even half of their pre-retirement standard of living during retirement, based on projections using the Federal Reserve's Survey of Consumer Finances. SCF data indicate that even among workers and families with a defined contribution account (including 401(k)s, IRAs or Keoghs), the median balance is \$25,000 – and less than \$10,000 for households with incomes below \$50,000.

As a nation, we are saving too little and not doing enough to give lower-paid workers the combination of opportunity and security they need to cope with accelerating economic and technological change. A projected 40 percent of today's baby boomers are likely to depend almost completely on Social Security's poverty-level benefit after age 70, just as today's lower-income seniors do today (see chart above). We need to facilitate pension portability while simultaneously shifting the burden of subsidizing basic benefits from American business to society as a whole.

The solution is a Universal 401(k) plan that gives *every* worker access to an automatic, professionally administered retirement saving plan—what I call an Individual Career Account (ICA). The plan would supplement, not supplant, the existing private pension system.

## Individual Career Accounts: A Universal 401(k)

Today's private pension system works well for those workers who have consistent access to a plan and choose to save. One big reason retirement plans are effective in generating saving is the powerful incentives provided by immediate tax deductions and employer matching contributions. Another reason is infrastructure: employer-sponsored plans create the positive inertia of automatic payroll deductions while also managing the complexities of investment management at relatively low cost. These two key attributes—incentives and an infrastructure for automatic saving—is what needs to be replicated for all Americans.

Every working American needs access to both a potent tax incentive to save and automatic payroll deduction into a portable, professionally-managed account *whether or not* his current employer sponsors a retirement plan. The fact that so few workers save regularly in IRAs reinforces what demonstration projects in asset-building among low-income families have found: it is not primarily access to a savings account that spurs participation, but the three “I’s”—Incentives, Infrastructure, and Inertia.

A Universal 401(k) would recast federal pension policy by adding:

- A tax *incentive* for saving that is more inclusive—and potent—by expanding the Savers Credit, making it refundable and directly deposited into an ICA.
- An account-based *infrastructure* that is citizen-based, rather than strictly employer-based, yet enables every worker to save by automatic payroll deduction.
- Default options that convert myopia into positive *inertia*, through automatic enrollment, automatic escalation, automatic payroll deduction, automatic asset allocation, and automatic annuitization.

Under a Universal 401(k) plan with these three key attributes, all workers not participating in an employer plan, including recent hires and part-time employees, would be automatically enrolled and contribute by payroll deduction, although an individual could opt out and choose not to save. The government would match voluntary contributions by workers and their employers with refundable tax credits deposited directly into the worker's account. Workers participating in their employer's plan would receive stronger tax incentives to save, but otherwise see no difference. Contributions for workers not participating in an employer plan would be forwarded to a federally-chartered clearinghouse, which would manage small accounts at low cost and could even convert account balances into guaranteed income for life at retirement. Individuals could maintain the account throughout their careers, since it would remain open as they moved from job to job. This supplemental system would make saving easier, automatic, and fair.

## **The Limitations of America’s Employer-Based Pension System**

When the landmark Employee Retirement Security Act (ERISA) became law in 1974, its fiduciary, funding, vesting and other provisions were designed to perfect what was then a system of employer-sponsored defined-benefit (DB) pensions. From 1945 to the late 1970s, the percentage of private-sector workers covered by pension plans grew rapidly from 20 percent to just above 50 percent. Employers made all the contributions and shouldered all the investment risk, managing pooled trusts subject to government oversight at relatively low costs. Workers—at least those who clocked more than 20 hours per week—were automatically covered and received, at retirement, guaranteed monthly income for life.

This industrial-era system was based on assumptions of career-long job tenure, stable corporate structures, pressure from strong unions, and large doses of employer paternalism—conditions that have been eroding as steadily over the past two decades as the prevalence of DB plans. Since the first 401(k) plan emerged out of an unintended tax loophole in 1981, the number of U.S. firms with DB plans has plunged from 100,000 to fewer than 30,000 now. Today, we are a 401(k) nation. More than 60 percent of private-sector workers lucky enough to have any pension benefit work at firms that sponsor only a 401(k)-type contribution plan.

This shift makes perfect sense from the perspective of employers who face increased health benefit costs, more intense competition, less pressure from unions, more corporate volatility, shorter job tenures and a desire to appeal to younger workers who don’t expect to remain until retirement. But although 401(k)s are less expensive and risky to employers, there has been no great increase in plan sponsorship among smaller firms – and a distinct decline in participation among workers at every income level, particularly middle-to-low earners, compared to the automatic inclusion that characterized traditional DB plans. Clearly the nation needs a new approach to promoting retirement saving that can offer the best features of private sector 401(k)s to all workers lacking coverage.

## **What Is Needed**

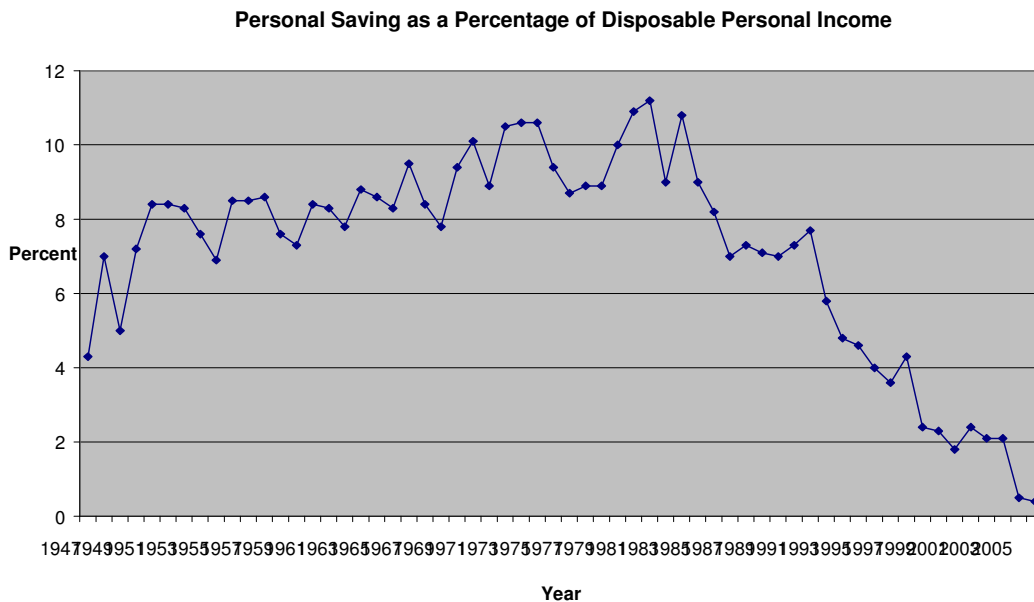
A renewed and updated effort to facilitate saving and retirement security for *all* Americans should be designed to address the following unmet needs:

***Improve individual retirement security.*** More than 75 million American workers do not participate in a tax-subsidized, payroll deduction saving plan—and therefore they tend to save very little for retirement. While participation is slightly higher among full-time workers (49 percent), participation rates are also strikingly lower among workers who are low-income, young, work part-time, or work at small firms. Approximately 85 percent of Americans without a pension benefit at work shared one or more of these four characteristics, according to a General Accounting Office study. Whereas 63 percent of full-time workers at firms with more than 100 employees participate in retirement plans, that rate sinks to 42.6 percent at firms with fewer than 100 employees, and it plunges to 23 percent at firms employing fewer than 25, according to a CRS analysis of *Current*

*Population Survey* data. Rising numbers of part-time and contingent workers are even less likely to be offered coverage. Only 23.3 of part-time workers participated in private sector plans in 2006, according to CRS.

A similarly striking disparity in pension participation occurs at different income levels – and not primarily because low-income workers choose to save in 401(k) plans at lower rates. In 2006, whereas 71 percent of full-time private sector workers in the top quartile by earnings worked at a firm offering pension coverage, among workers in the lowest-earning quartile, only 36.6 percent worked at a firm sponsoring a retirement plan. Even in the second earnings quartile, only 56 percent worked at a firm that sponsored a plan.

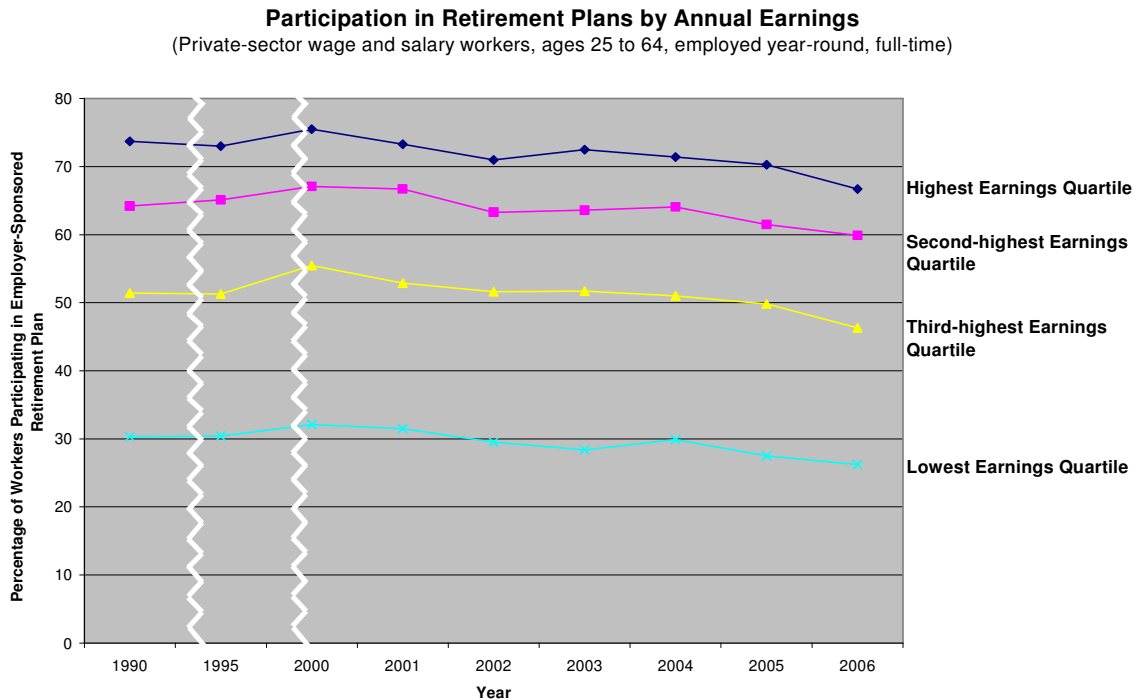
Too many individuals and families are headed toward retirement age with little more than Social Security’s safety net. A great deal of the opposition to partial privatization of Social Security undoubtedly related to the average citizen’s keen awareness of how many elderly desperately depend on the program’s meager but guaranteed (and inflation-adjusted) monthly payment. More than a third of Americans over age 65 rely on Social Security’s poverty-level benefit for 90 percent or more of their income—a dependency ratio that is even higher for widows and unlikely to improve for the baby boomer generation, according to government projections.



***Boost national saving and investment.*** Despite the fact that baby boomers—the largest segment of the adult population—are in their prime saving years, the personal saving rate actually turned *negative* during 2005 for the first time since 1933, during the Great Depression, and has averaged less than one-half of one percent (0.48 percent) over the past eight quarters. If we truly want to promote national saving, reduce dependency on social insurance, and create an inclusive “ownership society,” we will need new mechanisms that extend the advantages of private pensions to everyone. After all, retirement plans are how America saves: tax-deferred pension plans (of all kinds) have

accounted for the vast majority of net new personal saving in recent years. Among households with an IRA or 401(k)-type plan, which are more affluent on average, retirement account balances represented 62.5 percent of their total financial assets, according to an EBRI analysis of the 2004 *Survey of Consumer Finances*.

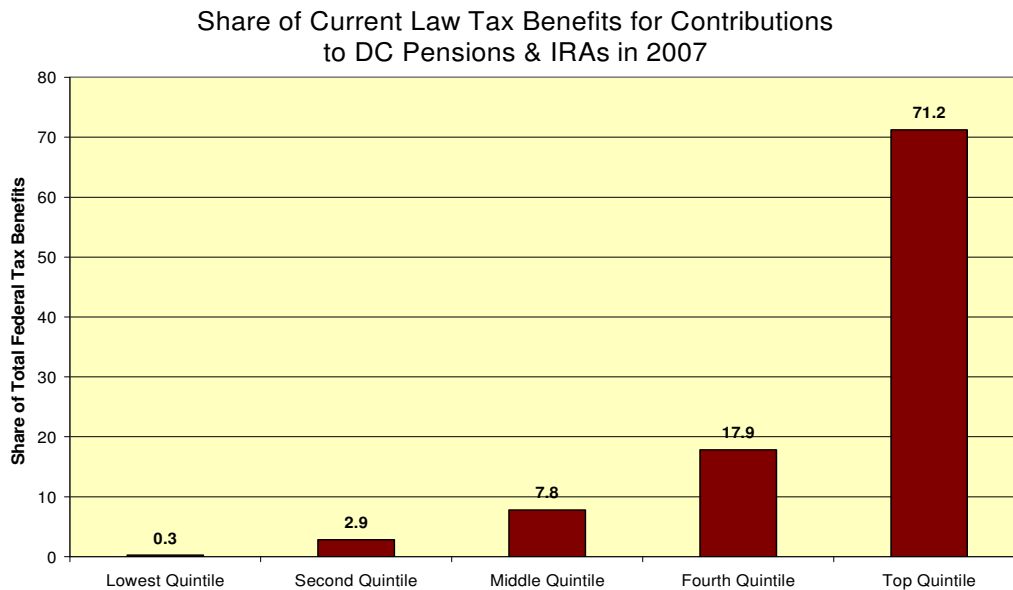
Not surprisingly, pension participation is lowest among workers whose savings would truly *add* to net national saving: workers who earn less than the median wage. While the affluent can respond to tax incentives for saving by *shifting* rather than actually increasing their net saving effort, households that would not otherwise save generate net new national saving. Indeed, a majority of middle-to-low-income households are not responding to current incentives. Among the bottom 60 percent of all workers by income—those earning less than \$40,000—only about a third (36 percent) participate in employer plans, according to the Congressional Budget Office.



We might at least expect the workers lucky enough to participate in 401(k)-type plans to be accumulating significant savings. Among the subset of high-tax-bracket earners with steady access to a 401(k), this is the case. But participation rates in the bottom two quintiles of the earning distribution are far lower, and the average account balance is below \$10,000 for this group. One reason for the low participation rates and accumulations is that even if a worker has coverage today, he or she may not have access to a plan next year in a new job. Even if the new employer sponsors a plan, new hires are not eligible to participate for at least one year. The result is gaps in coverage. What is needed is a seamless, lifelong saving system.

**Stronger tax incentives for saving.** Even when lower-wage workers have consistent access to an employer plan, the tax incentives for saving are upside-down. The tax break for retirement saving is one of Washington’s most expensive programs, costing a projected \$134 billion in uncollected federal tax revenue in fiscal 2007 alone, according to Joint Tax Committee estimates. Yet at least 70 percent of those tax subsidies for retirement saving goes to the most affluent 20 percent of taxpayers—and virtually none (3 percent) goes to encourage saving by the lowest-earning 40 percent. The reason is simple but too often overlooked even by liberal policymakers: a program subsidized by tax *deductions*, as opposed to refundable tax *credits*, is highly regressive.

Qualified retirement saving today reduces taxable income, a deduction that is worth 35 cents on the dollar to high-bracket taxpayers who need little incentive to save. In contrast, a tax deduction for saving is worth *zero* to the more than 40 million low-earning taxpayers who have payroll tax liability, but who don’t have any income tax liability to offset. Even median-income families in the 10 and 15 percent income tax brackets receive a weak subsidy compared to the 35 percent subsidy rate that applies to those earning over \$200,000 a year. In contrast, the effect on higher-income workers – who would likely save anyway – is primarily a shifting of assets from taxable to tax-deferred accounts.

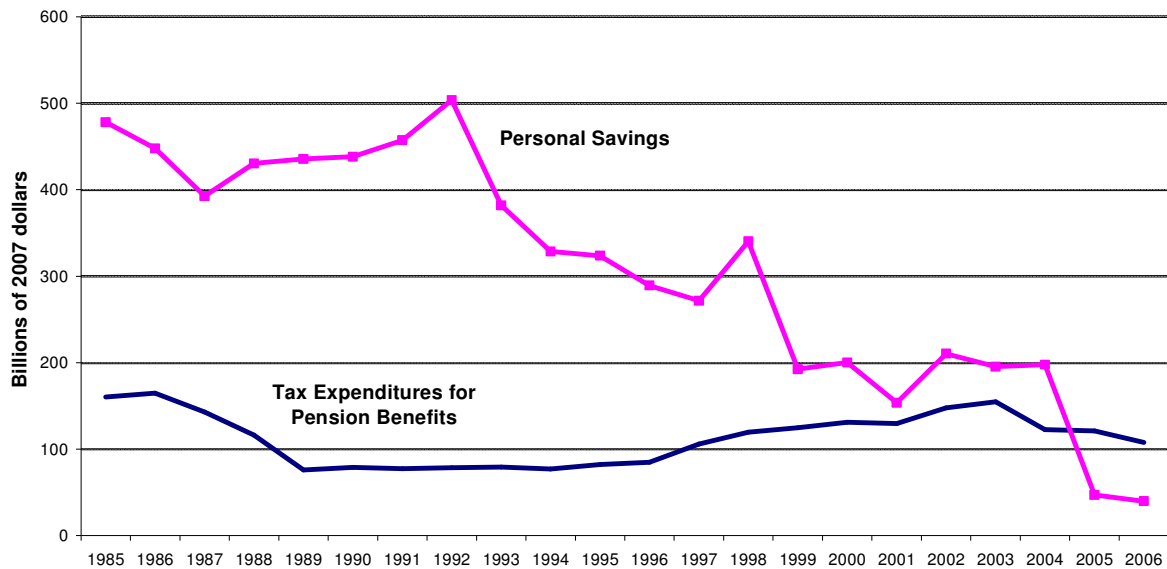


Source: Adam Carasso and Jon Forman, using the Urban-Brookings Tax Policy Center Microsimulation Model (version 0305-3a).

As the chart just below indicates, the fact that the revenue loss from federal tax deductions for retirement savings now actually *exceeds* net new personal saving suggests that the current tax expenditure is highly inefficient and needs to be retargeted at low-to-middle-income earners who are not saving (and whose new saving would therefore add to net national saving, as well as boost their retirement income adequacy).

The most effective way to target a saving subsidy using the tax code is through a credit, which directly reduces taxes due. In fact, the Saver's Credit, made permanent last year in the Pension Protection Act, creates this incentive and could be used as the matching incentive for a Universal 401(k). Unfortunately, because the current Savers Credit is limited to very low-income taxpayers with income tax liabilities to offset, it fails to provide a meaningful saving incentive to most workers and families who need it most. According to estimates by the Urban-Brookings Tax Policy Center, only one in seven tax filers with incomes low enough to qualify for the 50 percent credit receives any benefit – and less than one out of every 500 qualified filers could receive the maximum credit of \$1,000 per person. And while a larger share of lower-income workers benefit from the Savers Credit in its 20 and 10 percent phase out range (for single incomes between \$15,500 and \$26,000), the lower benefit and uncertainty that surrounds receiving any subsidy in a given year undermines the effectiveness of the incentive.

**Figure 1. Federal Retirement Savings Subsidies Vs. Personal Savings, 1985-2006**



Federal amounts are by fiscal year and personal savings are by calendar year. Note: Tax expenditures are not strictly additive. The cash flow measures above do not reflect the present value of pension subsidies. Source: Adam Carasso and C. Eugene Steuerle, 2007. Based on data from the Office of Management and Budget, Analytical Perspectives (prior to 1990, Special Analyses), Budget of the United States Government, 1987-2008. Personal savings data from the Bureau of Economic Analysis NIPA Table 2.1 as of November 2007.

The most powerful way to ensure that low-income workers receive an incentive at least as generous as an affluent worker is to make the Saver's Credit *refundable*, as the Earned Income Tax Credit (EITC) is, so that the low-wage worker receives it even if she has only payroll tax and not income tax liability. Moreover, directly depositing the Savers Credit into a worker's personal account – rather than rebating it, as current law provides – *doubles* the amount of saving actually accumulated (at the 50% credit level and assuming the worker would save the same amount). The design of a Universal 401(k) match is discussed further below.

***Increase benefit portability and workforce flexibility.*** In yesterday's more stable, goods-producing economy, traditional pensions were designed to reward seniority and to retain older, long-tenured workers with firm-specific skills. Domestic firms were more insulated

from foreign competition, unions were stronger, job tenures were longer, and a much higher share of the (predominantly male) workforce occupied standard full-time jobs. The 21st century workforce is very different. The service and information technology economy puts a premium on younger, more educated workers with transferable skills. Competition, both foreign and domestic, creates enormous volatility for companies and workers alike. Median job tenure has declined significantly over the past two decades, especially for older workers. Even at firms with retirement plans, an increasing number of workers cycle through jobs without earning employer-paid benefits, since it typically takes one year to be eligible to participate and multiple years to vest. A combination of two-income families and just-in-time labor strategies by firms has increased the share of nonstandard work arrangements. Nearly 30 percent of U.S. workers are working in part-time, temporary, or contract arrangements that rarely include pension coverage. While this emerging “free agent” workforce may be good for flexibility and productivity, it makes the current employer-based pension system increasingly inadequate.

***Lighten the social benefit burden on business.*** It’s clear that most small and start-up companies either cannot or prefer not to shoulder the administrative burden and financial risk of sponsoring a pension plan. Indeed, despite the “carrot” of tax subsidies for pension plans, a majority of firms with fewer than 500 employees do not offer one. In addition, even very large companies with a predominantly low-income workforce—the Wal-Marts and McDonalds among employers—have little incentive to sponsor a plan for workers who (a) receive little or no financial benefit from a tax deduction, and (b) without a strong incentive would prefer a higher wage now to an employer contribution for retirement. In contrast, large high-wage employers—the Microsofts and Intels—use retirement plans to steer tens of millions of dollars in pension tax subsidies to their employees every year.

This creates the anomalous situation whereby the federal government provides more than \$100 billion in compensation subsidies to the employees of a minority of companies—most of which are large firms with workers paid above-average wages. Meanwhile, companies with a substantial percentage of low-wage workers that *do* offer good benefits (employers like Starbucks) are paternalistically shouldering a cost that should be borne by society as a whole—and which will need to be if we want to achieve universal retirement security. If, instead, contributions by both workers and firms were matched by a refundable federal tax credit, then—as with the EITC—the after-tax value of benefits paid to low-wage workers would be less expensive, rather than more so.

## **Basic Program Elements: Incentives, Infrastructure, Inertia**

A Universal 401(k) system can accomplish the various national policy objectives described above by combining the following basic elements:

### ***1. Incentives: Matching, Refundable, and Deposited Credits for New Saving.***

Just as most employers match contributions to 401(k) accounts, the government could provide the strongest saving incentive by matching voluntary saving with a refundable

tax credit that would be *deposited directly* into the worker's account. This would create a far more powerful saving incentive for middle- and low-wage workers than current law. As noted above, a tax *deduction* is neither an effective nor an equitable means to encourage pension saving among lower-income and younger workers, whether or not they participate in an employer plan. And although the current Savers Credit provides (most commonly) a 10 percent tax credit for retirement saving by low-income taxpayers, the lack of refundability means that millions of working-poor families—who have payroll tax but no current income tax liability to offset—receive no credit at all.

Instead, a refundable credit would operate just like an employer match in a company 401(k) plan. Studies show that workers are far more likely to save if given generous matching credits—and once they develop the habit of saving by payroll deduction, most continue even when the match rate is reduced. A sliding-scale credit could give a greater incentive to low-income workers who are least likely to save. For example, using the existing limits that apply to the Savers Credit for 2007, workers in families (joint filers) earning below \$31,000 could receive a \$1 per \$1 (1:1) matching credit on their first \$2,000 in savings; whereas workers in families earning above that level (up to \$52,000 if the Savers Credit phase out is maintained) could receive a \$0.50 per \$1 (1:2) matching credit on their first \$4,000 in savings. This would give all workers the opportunity to receive as much as \$2,000 each year in matching deposits to their accounts, but the higher-wage earners would need to make twice the saving effort.

Like the current Saver's Credit, the refundable credit should apply equally to contributions to 401(k)s and other employer-sponsored plans. Eligibility for the credit would be reconciled annually through the income tax return process, which would also be used to encourage taxpayers to save all or a portion of their tax refunds.

It is important to note that a \$1:1 matching credit that is deposited into the workers' personal account is equivalent to the 50 percent Savers Credit in terms of cost to the Treasury for a given amount of saving. The \$1:1 match appears to be more generous because the credit adds directly to saving – just like an employer match on a worker's 401(k) contribution – and so the worker can achieve the same net saving with a far lower monthly deduction from pay. For example, if today a low-wage worker eligible for the 50 percent Savers Credit contributes \$1,000 to their company 401(k), at tax time the \$500 credit reduces other taxes owed – and new net retirement saving for that year is \$1,000. In contrast, a worker who receives a \$1:1 match deposited into his account would only need to make a \$500 contribution upfront to end up with net new retirement savings of \$1,000. If this worker contributes \$1,000 over the course of the year, he ends up with \$2,000 in new saving. While more research is needed to compare the behavioral impact of these two approaches, it seems likely that a dollar-for-dollar match will be perceived as a more generous incentive and, since it also requires the worker to save less each pay period to achieve the same outcome, yield more savings over time.

Matching credits should be available for both individual and employer contributions. This would give employers a greater incentive to make deposits on behalf of their low-wage workers. Yet, by extending pension saving incentives to all workers as individuals,

employers would have the option to provide a pension benefit without the need to administer a pension plan. Employers would have the flexibility to decide from year to year whether to contribute to their workers' accounts, in many cases doing so as a type of year-end, profit-sharing bonus depending on circumstances. Employer contributions should also be deductible from income and payroll tax liability, as they are with other qualified pension contributions. However, employer contributions should be limited to a flat percentage of wage income, or a flat dollar amount, and made on behalf of *all* payroll employees, including part-time workers. Without such a requirement, ICAs could undermine ERISA antidiscrimination rules to ensure that employers are not using the tax subsidies to favor only their higher-wage employees. In fact, the Conversation on Coverage Working Group that developed the similar RIA plan was concerned enough about this risk that they decided to initially limit contributions to workers.

## ***2. Infrastructure: Automatic Payroll Deduction and Account Administration.***

Equally important is replicating the retirement plan infrastructure that is key to the success of employer-sponsored 401(k) plans. As with 401(k) plans, every worker should have access to the convenience, discipline, and protections provided by automatic payroll deduction and professional asset management. This will require two essential pieces of infrastructure: access to automatic payroll withholding and a central clearinghouse to receive the deposits and manage very low-cost investment accounts. We are very encouraged to see legislation in both the House and Senate this year that addresses both of these critical needs: the Automatic IRA Act of 2007 (H.R. 2167), introduced in the House by Reps. Richard Neal and Phil English.

Enrollment and access to payroll-deducted saving should be easy and automatic for every employee whether or not their firm sponsors a retirement plan. When a worker fills out the required IRS Form W-4 (used to calculate tax withholding), he or she can simply specify a monthly saving deduction. That's the only decision a worker needs to make—a choice to save. In fact, as described in the next section, it would be even better to combine this with *automatic enrollment*, so that the W-4 actually indicates that 3 percent of pay (initially) will be deducted for saving unless the worker either opts out or chooses a different saving level.

The sole burden on employers would be to forward this automatic payroll deduction to the employer's own retirement saving plan (if there is one and the employee participates) or to a government clearinghouse. Since most employers today use automated payroll processing services, there would be virtually no cost to forward the deduction to a central clearinghouse. Even employers who do not automate payroll must forward income and payroll tax withholding to the Treasury, so including withholding amounts for saving would be a minor burden. It appears that small business owners recognize that given today's technology, payroll withholding is not overly burdensome compared to the benefit. The Economic Opportunity Institute, based in Seattle, conducted focus groups with owners and managers of small firms (between 5 and 25, and between 25 and 100 employees). Although two-thirds of the firms participating provided no retirement saving

program for their workers, 17 out of 18 participants supported a proposed state-level program, called Washington Voluntary Accounts, even if employers were required to withhold and forward payroll deductions for participating workers.

With respect to cost, the Conversation on Coverage Working Group investigated the mechanics and cost of payroll deduction and account administration during a day-long session in Boston with the defined-contribution experts at Fidelity Investments. They confirmed that for any firm using a payroll processing service or software (which is typical for all but the smallest employers), multiple deductions and electronic fund transfers have become so routine that it should not increase the cost of payroll processing at all. This would particularly be the case if – like income tax and FICA withholding – the saving deduction for each worker is sent to a common clearinghouse. The Conversation on Coverage Group nevertheless observed that Congress could initially exempt the very smallest employers (e.g., under 10 employees) and/or enact as part of the program a tax credit for small businesses to offset the cost of implementation. The Automatic IRA Act of 2007 sensibly adopts both of these approaches, allowing startups and employers with fewer than 10 employees to opt out, while providing a tax credit of up to \$250 during the first two years for participating small employers.

The second critical piece of “plumbing” is a new entity—a clearinghouse akin to the Federal Thrift Savings Plan (TSP), which manages very low-cost 401(k)-style saving accounts for 3 million federal military and civilian personnel. The clearinghouse would receive all deposits and be the default administrator for small accounts. Record keeping should be centralized – primarily because of the need to coordinate with the IRS – but the investment management would be contracted out to private investment firms, as TSP does today. The clearinghouse would strive to keep costs and complexity to a minimum.

As the Auto IRA Act proposes, participants should have at most a choice among a small number of very low-cost index funds, similar to the approach used by TSP. Although payroll-deducted savings and matching tax credits would flow through the clearinghouse, the assets should be fully portable and transferable at any time at the worker’s request to another qualified financial institution, or to a future employer’s pension plan. Indeed, because the primary function (in addition to record keeping) is to manage relatively small accounts that would be unprofitable to a private money manager, we would expect that as account accumulations grow over time, most participants will eventually roll over to a more full-service IRA provider.

The Neal-English Automatic IRA Act of 2007 – and its Senate companion, S. 1141, introduced by Senators Jeff Bingaman and Gordon Smith – is an essential step toward giving every American worker access to an easy, automatic and professionally-administered saving system. We applaud the co-sponsors for their well-designed and carefully balanced proposal.

Although the Auto IRA Act would be a very positive first step, the one design issue where the bill falls short is in restricting contributions to today’s meager IRA limits (\$4,000 or \$5,000 for workers over age 50). While this may be as much as we can

realistically expect very low-income workers to save in a year, most middle-income workers – of whom there are tens of millions who lack access to a 401(k), SIMPLE or other employer-sponsored plan – simply cannot hope to achieve retirement adequacy with their saving restricted at this level. Moreover, while higher-income earners can contribute \$15,500 to a 401(k) – receiving \$5,425 in tax breaks (at the 35 percent bracket) – the bill would limit the majority of American workers limited to far less. We concur with the concern that an Auto IRA – or Universal 401(k) – not undermine the incentives for business owners to sponsor a SIMPLE or 401(k). However, as the Conversation on Coverage Working Group agreed, we believe the best way to balance these concerns is with a contribution limit that is between today’s IRA and SIMPLE limit (which is \$10,500). An individual limit in the neighborhood of \$8,000 would still leave business owners with the incentive to “graduate” up to the higher SIMPLE or 401(k) limits if they personally wish to save more. The reality, however, is that for a variety of reasons, a very substantial number of new, small and even medium-sized employers will not sponsor a qualified plan and may welcome the ability to facilitate an adequate level of saving by their employees – and even to contribute to those accounts if it could be done at their discretion and with minimum regulation (as proposed in the section above).

### ***3. Inertia: Default Options for Enrollment, Escalation, Investment and Annuitization.***

The W-4 form required of every worker would provide a simple means of indicating how much an individual wants withheld and saved each pay period. Even better, the Universal 401(k) system could convert myopia into positive inertia by making participation the default option for everyone. Studies have shown that automatic enrollment has boosted 401(k) participation rates as high as 95 percent (when there is also an employer match) and to 80 percent among low-income workers.

Although the Pension Protection Act clarified that plan sponsors can choose to implement automatic enrollment, it is not required. It should be. The Economic Benefit Research Institute estimated this year that if automatic enrollment was required for all employer-sponsored plans, it would raise the median replacement rate for lowest-earning 20 percent of workers from 23 to 37 percent (with a 3 percent default contribution rate) or to 52 percent (with a 6 percent default).

Under a Universal 401(k) plan, unless the worker decided to opt out, the W-4 should give notice of the amount to be deducted and saved each pay period. The initial default contribution could be modest – probably the 3 percent currently specified in the Pension Protection Act. This default contribution rate should *escalate* automatically by 1 percent a year thereafter, as pay increases, until it reaches a level likely to achieve an adequate accumulation over time (probably up to 6 or 8 percent of pay on a default basis).

Unless a worker opts out – or participates in his employer’s plan – the payroll deduction would flow automatically each pay period to the federal clearinghouse and into his or her Individual Career Account. Although the worker should be able to switch, periodically, between a very limited number of broad and low-cost index funds, there would be a

*default asset allocation* for workers who made no choice at all—most likely a life-cycle fund, or other balanced fund, that would automatically adjust the mix of stocks and bonds to match the worker’s age and years until retirement age.

Finally, at retirement age, the default payout option should be in the form of an *annuity*: monthly payments, rather than a lump-sum withdrawal, to ensure that retirees do not outlive their benefits. Although individuals could choose to withdraw (or roll over) all or part of their nest egg, there should be incentives to encourage and facilitate annuitization, which is one of the great (and disappearing) advantages of a defined-benefit plan. This annuity benefit could be contracted to one or several private insurers, as DB plan sponsors do when they purchase a Guaranteed Investment Contract, or taken on by the Pension Benefit Guarantee Corporation, the federal pension insurer that currently manages guaranteed annuity payments each month for millions of private-sector retirees who were participants in a defaulted employer plan.

Although the Universal 401(k) system proposed here would be voluntary and rely on the stronger incentives of a refundable matching tax credit, a similar system of universal “add-on” accounts could be implemented on a non-voluntary basis. My colleague Adam Carasso, and Jon Forman of the University of Oklahoma, have proposed a universal pension system (“UPS”) comprising a system of individual retirement savings accounts financed by a compulsory 3 percent of payroll contribution by individual workers. They propose to collect these individual savings account deposits automatically by piggybacking onto the existing Social Security withholding system. The individual accounts would be taxed like 401(k)s and traditional IRAs under their proposal. Carasso and Forman’s rationale for making a base contribution mandatory is the likelihood that even with retargeted tax incentives and employer matching contributions, many young and middle-to-low-income workers will not save consistently for retirement on a voluntary basis. Mandatory savings proposals are not new. In 1981, for example, the President’s Commission on Pension Policy recommended adoption of a Mandatory Universal Pension System (MUPS). That proposal would have required all employers to contribute at least 3 percent of wages to private pensions for their workers.

While Americans clearly support retaining Social Security’s defined-benefit safety net, neither Social Security nor the inadequate coverage of today’s private pension system are providing enough income in retirement. Thus, the combination of a citizen-based, portable, and automatic system—providing those who find it most difficult to save with both powerful right-side-up tax incentives and an infrastructure for automatic saving—may be exactly the retirement revolution we need.

