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Administration Savings Plan Would Lead to Very Large Revenue Losses

The full report can be viewed at http://www.cbpp.org/2-5-03tax.htm

The Center on Budget and Policy Priorities has released *Proposed "Savings Incentives" Would Cause Revenue Hemorrhage in Future Decades,* an analysis of the Administration's new tax-cut proposal related to savings.

The proposal, which is being touted as a way to increase national saving and help workers save for retirement, would create three new savings vehicles: (1) "Retirement Savings Accounts," which would replace existing IRAs and be structured like Roth IRAs (except that there would be no income limits on who could use them and the contribution limits would be raised to $7,500); (2) "Lifetime Savings Accounts," which would operate like Retirement Savings Accounts except that funds could be withdrawn at any time and be used for any purpose; and (3) "Employer Retirement Savings Accounts," which would resemble 401(k)s but with fewer protections for low- and moderate-income workers. The Center's report finds that this proposal would:

- **Sharply reduce federal revenues over time.** While the proposal contains gimmicks that would *raise* revenues over the next few years, it would cause substantial revenue losses after that, with the revenue losses growing larger each year. Eventually the losses would become massive, as most of the nation's capital gains, dividend, and interest income would ultimately be sheltered from taxation.

  Moreover, these revenue losses would mount in the same period that the baby boom generation will be retiring in large numbers and Social Security and Medicare costs will swell. The Congressional Budget Office, the General Accounting Office, and independent analysts already project that federal budget deficits will reach alarming levels in those decades. This proposal would aggravate that problem, further burdening future generations.

- **Reduce states' revenues and raise their borrowing costs.** States, too, would experience revenue losses, since their tax codes are generally linked to the federal code in how they define taxable income. The plan also could force states to offer higher interest rates on the bonds they issue in order to compete with the tax-sheltered accounts the plan would make available to high-income investors.

- **Provide windfalls to wealthy taxpayers.** Unlike current Roth IRAs, which are not available to individuals with incomes over $110,000 or couples with incomes over $160,000, the new tax-free retirement and savings accounts that the proposal would create would have no income limits. This would give people at high income levels great incentive to shift large amounts of assets over time into the tax-free accounts.

  Today, a couple can contribute up to $6,000 a year to IRA accounts. Under the proposal, a wealthy couple with two children could place $45,000 every year into the new accounts, and all interest, dividends, capital gains, and other earnings on these accounts would be permanently tax free. Only people with very large incomes or considerable wealth would be able to take full advantage of these new accounts. These affluent individuals would receive extremely large tax cuts over time.

- **Not increase national saving.** The proposal is promoted as increasing national saving and thereby boosting economic growth. In fact, the proposal is more likely to *reduce* national saving and thereby *slow* long-term growth.

  National saving is the sum of *public* saving (i.e., government surpluses or deficits, with deficits constituting negative saving) and *private* saving (saving by private individuals and institutions). The Administration's proposal would substantially reduce public saving over time by swelling the deficit. It would be unlikely to generate enough new private saving to offset this decline in public saving because those who would be able to take full advantage of the proposal would primarily be high-income individuals with significant wealth. Economic research has shown that such individuals are more likely to shift *existing* savings from taxable accounts to the new tax-free accounts than to undertake *new* savings in response to tax breaks of this nature.

- **Likely reduce pension coverage for ordinary workers.** Today, if business owners want to put more than $6,000 a year for themselves and their spouses into tax-advantaged retirement or saving accounts, they must offer a pension plan that also covers their employees. (That limit is scheduled to rise to $10,000 by 2008.)

  By contrast, under the proposal, business owners and executives could put away $30,000 a year for themselves and their spouses through expanded IRAs and new "Lifetime Savings Accounts," plus an additional $7,500 a year for each child they have, *without having to offer any retirement plan through their firm*. Leading pension experts have warned that over time, this is likely to lead to a reduction in the number of small businesses that offer pension coverage for their workers and that make pension contributions on their workers' behalf.

- **Constitute a move toward a consumption tax.** The proposal constitutes a large step toward converting the current progressive income tax into a less-progressive consumption tax because, over time, it would largely eliminate taxes on saving and investment income, which tends to be concentrated among higher-income households.

The Center's analysis concludes that the proposal is likely to be disadvantageous to ordinary Americans over time. While some middle-income families would benefit from the new tax-sheltered saving accounts the proposal would create, they would be harmed by the larger federal budget deficits that would result (since the deficits would likely lead to slower economic growth, higher interest rates, and cuts in federal programs on which many families rely). Middle- and low-income families also would be adversely affected by state-level budget cuts and tax increases instituted to make up for the state revenue losses the proposal would trigger, and by the reductions that the proposal would induce in pension coverage for workers.