CENTER ON BUDGET AND POLICY PRIORITIES

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Pension Proposal Will Boost Deficit, Probably Won't Boost Retirement Saving

The full report can be viewed at http://www.cbpp.org/4-21-03tax.htm

A new report from the Center on Budget and Policy Priorities, *Examining the New Portman-Cardin Legislation*, explores several problematic provisions of the pension bill introduced April 11 by Representatives Rob Portman and Ben Cardin. The report's author is Peter Orszag, a senior fellow at the Brookings Institution with expertise in pension and tax issues.

The Portman-Cardin bill includes some positive changes, such as expanding and making permanent the "saver's credit" created by the 2001 tax legislation and modifying rules in the Supplemental Security Income program so a disabled worker is not forced to deplete modest pension savings before reaching retirement age. Yet most of its costliest parts are tax breaks primarily for high-income individuals, who would likely save without them and who already tend to be much better prepared for retirement than individuals with less income and wealth. The bill would:

- **Exacerbate the already-dire fiscal outlook.** At a time when substantial budget deficits loom as far as the eye can see, the bill would add more than $100 billion to the deficit over the next decade. That cost would be on top of the $350 billion to $550 billion in reconciliation tax cuts allowed by the recently adopted budget resolution.

- **Not significantly increase the amount that people save for retirement.** The bill is not well targeted to achieve its stated goal of encouraging retirement saving. Higher-income households are much more likely than poorer households to have retirement savings and to respond to new pension-related tax benefits by shifting existing savings from taxable accounts into tax-preferred accounts. Among poorer households, in contrast, pension contributions are more likely to represent new saving. Because (as outlined below) the bulk of the bill is aimed at higher-income households, it primarily will encourage the shifting of existing savings rather than an expansion of savings.

Key Elements of the Bill
• Accelerates to 2003 the scheduled increases in maximum 401(k) and IRA contributions contained in the 2001 tax legislation.
• Makes the above increases permanent.
• Raises the amount a household can earn and still contribute to a Roth IRA or traditional IRA.
• Raises to 75 the age at which an individual who has not yet retired must begin withdrawing funds from a 401(k) or traditional IRA.

- **Lock in temporary, unproven pension changes in the 2001 tax legislation.** The bill would accelerate the implementation of, and then make permanent,[1] provisions of the 2001 tax legislation that allow larger 401(k) and IRA contributions by high-income individuals, such as business owners and

[1] Under the 2001 legislation, these provisions would expire by the end of 2010.

executives. In 2001, supporters of these provisions claimed they would encourage more small businesses to offer pension plans, which in turn would expand pension coverage among rank-and-file workers. This approach lacked solid empirical backing when the legislation was passed, and little information has emerged since then to show that these provisions are promoting retirement saving among middle and lower earners. In view of the large deficits projected when the baby-boom generation retires, Congress should wait for data on the effect of these provisions before rushing to lock them into permanent law.

- **Create new tax subsidies for higher-income households.** The bill also includes tax subsidies for higher-income households beyond those in the 2001 tax legislation. For example, it would increase from $160,000 to $220,000 the amount a married couple can earn and still contribute to a Roth IRA. Also, it would entirely eliminate income limits for IRAs on workers who are not covered by an employer-provided pension plan but whose spouse is covered by such a plan. Only the top 10 percent of joint filers would benefit from these changes, according to data from the Urban Institute-Brookings Institution Tax Policy Center.

- **Encourage the misuse of retirement accounts as tax shelters.** In another new tax subsidy for higher-income households, the bill would weaken the "minimum distribution" rules intended to ensure that tax-advantaged retirement accounts are used primarily to finance retirement needs, rather than for other purposes such as estate planning by wealthy individuals. Specifically, the bill would raise from 70½ to 75 the age at which an individual who has not yet retired must begin withdrawing funds from a 401(k). This would enable high-income individuals to make tax-deductible deposits in these accounts that then could be used primarily to build substantial estates, rather than for retirement purposes.

  A preferable way to simplify the minimum distribution rules would be to exempt up to $50,000 of pension and retirement account assets. If this were done, the rules would no longer apply to two-thirds or more of retirees.

- **Not represent sound economic policy even if it did encourage saving.** If the bill *were* successful in achieving its ostensible goal of immediately raising retirement saving, it would be counterproductive now from an economic perspective. To boost the economy in the near term, additional spending, not additional saving, is the appropriate policy goal.

As the Center's paper concludes, the Portman-Cardin bill's emphasis on expanding tax benefits for high-income households is unfortunate. Pension reform should focus on expanding tax incentives for lower- and moderate-income earners. Contributions to tax-preferred retirement accounts by such workers are more likely to represent new saving, rather than asset shifting, and are much more likely to reduce the risk of living in poverty during retirement. Moreover, given the troubled fiscal outlook facing the nation, the bill's costly and not-well-targeted tax breaks are not fiscally prudent.