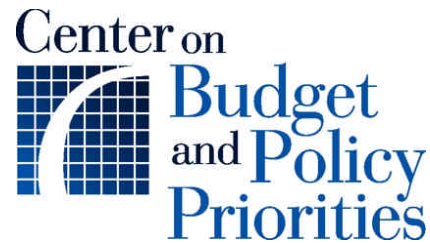




The Retirement Security Project  
1755 Massachusetts Avenue, Suite 550  
Washington, DC 20036  
Phone: 202-483-1370  
<http://www.retirementsecurityproject.org>



820 First Street, NE, Suite 510  
Washington, DC 20002  
Ph: 202-408-1080  
<http://www.cbpp.org>

## NEWS RELEASE

**For Immediate Release:**

Tuesday, June 21, 2005

**Contact:**

Michelle Bazie, 202-408-1080, [bazie@cbpp.org](mailto:bazie@cbpp.org) or

Bo Harmon, 202-483-1458, [bharmon@retirementsecurityproject.org](mailto:bharmon@retirementsecurityproject.org)

# GOVERNMENT PROGRAMS PENALIZE RETIREMENT SAVING BY LOW- AND MODERATE-INCOME HOUSEHOLDS Rules in Key Benefit Programs Poorly Designed and Inconsistent

Even as Congress looks for ways to encourage Americans to save more for retirement, key government benefit programs discourage saving by disqualifying people who have modest savings in accounts like 401(k)s and IRAs, according to a major new report prepared by staff of the Center on Budget and Policy Priorities and issued by the Retirement Security Project.

Programs such as food stamps, Supplemental Security Income, Medicaid, and cash public assistance for poor families with children often count funds in these accounts toward the strict asset limits for program eligibility. That creates powerful disincentives for low-income working families to build savings, since doing so can jeopardize their health coverage and other basic supports.

In addition, families with modest retirement savings who lose their jobs and become poor during recessions often are forced to liquidate their retirement savings because these savings prevent them from qualifying for basic help during a time of need. That leaves them with little or no retirement saving for old age.

“There’s growing bipartisan interest in Congress in encouraging low-income households to save more for retirement by making it easier for families to save in 401ks and IRAs,” noted Peter Orszag, head of the Retirement Security Project. “But the benefits of these positive steps will be substantially undercut if we don’t also fix the outdated and frequently irrational rules in means-tested programs that discourage and punish retirement saving.”

The report, *Protecting Low-Income Families’ Savings*, reviews the asset policies in major means-tested programs and details the steps that the federal government and the states can take to remove barriers these policies pose to retirement saving.

### **Rules Have Not Kept Pace with Changes in Pension System**

Asset tests in many means-tested benefit programs are based on rules designed 30 to 40 years ago. At that time, “defined-benefit” plans — such as traditional pensions — were the standard form of employer-provided pension, and benefit programs generally chose not to count the funds in these accounts when determining a person’s eligibility for benefits.

Since then, the pension system has shifted away from the defined-benefit model, and “defined-contribution” plans such as 401(k)s and IRAs have become the main form of retirement saving outside Social Security. Yet benefit programs generally have not updated their asset rules to reflect this shift by exempting funds in defined-contribution plans as well.

The result is inconsistent policies that disadvantage many workers. Workers whose employers offer a defined-contribution plan will find it harder to save for retirement while qualifying for needed benefits than comparable workers whose employers offer a defined-benefit plan. In addition, workers who change jobs or are laid off in a recession are generally advised to roll over their 401(k) funds into an IRA rather than cash them out, but doing so can make these workers ineligible for food stamps when their families are in need.

The failure to exempt retirement funds from asset tests has widespread effects because many programs’ asset limits are quite low. In many programs, individuals are ineligible for benefits if they own more than about \$2,000 in countable assets. Because these asset limits generally are not indexed to inflation and are raised very infrequently, they have shrunk substantially in inflation-adjusted terms over time.

“What makes outdated asset policies regarding retirement savings especially harmful is that they discourage saving among the people who are saving the least for retirement: those with low incomes,” noted Robert Greenstein, executive director of the Center and co-author of the report. In 1997, only 22 percent of households with adjusted gross income below \$20,000 participated in an employer-provided retirement plan or an IRA, compared to 51 percent of all households. Moreover, the typical household in the bottom fifth of the income distribution that participated in an employer-based plan or an IRA had only \$4,500 in this account, which would not last long in retirement.

### **Federal Government and States Can Eliminate Disincentives**

The federal government can address these problems by amending the tax code or other federal laws so that tax-advantaged retirement accounts such as 401(k) plans and IRAs are not counted against the asset limits in federal means-tested programs. (This is the same approach Congress has adopted with Individual Development Accounts (IDAs), where Congress generally has exempted funds in these accounts from counting as assets in federal means-tested programs.) At the same time, *withdrawals* from tax-advantaged retirement accounts would count as income in determining an individual’s eligibility for benefits.

In addition, states now have more flexibility over the asset rules in certain means-tested programs such as Medicaid and cash public assistance. With certain exceptions, they can elect not to count retirement savings accounts toward the asset limit. Alternatively, states can eliminate the asset test and consider only an applicant’s income when determining eligibility, or raise the asset limit so that modest retirement savings are less likely to push an applicant over the limit.

Such changes by federal and state governments would have some cost because they would make some households newly eligible for benefits. Yet the return should more than justify the investment, the new report concludes, for several reasons:

- Raising retirement saving by low-income households would reduce poverty among seniors. For many very-low-income households, Social Security benefits do not provide a poverty-level income. If low-income families can build retirement savings to supplement their Social Security benefits, fewer will be poor in retirement, and fewer should need to rely on means-tested programs in retirement to meet their basic needs.
- Raising retirement saving by low-income households also would increase national saving, a key economic imperative given the approaching retirement of the baby boomers.
- Encouraging low-income households to build retirement savings would modestly reduce the large inequities in government subsidies for retirement saving. In 2004, about 70 percent of the federal tax benefits for new contributions to 401(k) plans went to the 20 percent of tax filers with the highest incomes.

“Right now, government incentives for retirement saving are upside down,” Orszag noted. “They actually punish low-income people — the group that most needs help in saving for retirement — if they build modest savings and then try to obtain government support during a time of need. Updating the asset policies in means-tested programs is a critical step toward putting those incentives right-side up.”

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The **Center on Budget and Policy Priorities** is a nonprofit, nonpartisan research organization and policy institute that conducts research and analysis on a range of government policies and programs. It is supported primarily by foundation grants.

The goal of the **Retirement Security Project** is to work on a nonpartisan basis to make it easier and increase incentives for middle- and lower-income Americans to save for a financially secure retirement. The Retirement Security Project is supported by The Pew Charitable Trusts in partnership with Georgetown University’s Public Policy Institute and The Brookings Institution.