Statement for the Record
To The House of Representatives Committee on Ways and Means
Hearing on Tax Reform and Tax-Favored Retirement Accounts
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Submitted by:
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I would like to thank Chairman Camp, Members of the Committee on Ways and Means and Congressional staff for allowing us to submit this statement about an issue that has been elevated by the ongoing debate about our federal deficits and national debt: the need to preserve and enhance incentives for retirement savings in America.

Surging federal deficits and a national debt growing faster than our economy truly do pose a national security issue. To ensure the stability of our financial system and maintain global competitiveness, it is vital that we get our national debt on a sustainable track. America needs to get our economy growing faster than our public debt or risk a slide towards insolvency and debt-driven financial crisis such as we see playing out in Europe today.

As we struggle to bring federal deficits down and get our national debt back onto a sustainable path to solvency, savings, and retirement savings in particular, have a vital role to play in a transition that America absolutely has to make. Simply put, our nation needs to move away from rising public spending, surging debt, and excessive, debt-driven consumption to a new economic model, grounded on higher savings, and greater incentives for investment, business formation, and job creation. Ultimately, the best way to deal with our deficits and debt will be to outgrow them. And a robust retirement savings structure will be key to spurring such growth.

Regrettably though, there is now a real risk that tax incentives for companies to offer workplace savings plans and for individuals to participate in them could be undermined by ill-considered policy changes aimed at reducing the budget deficit. Proposals to cap or roll back tax deferrals for retirement savings, which have emerged from ongoing deficit debates, are particularly dangerous.

If adopted, such proposals could have the effect of reversing a generation's worth of congressionally driven progress on retirement savings. They would undercut incentives for thousands of small and emerging companies to offer their workers retirement plans and could thus deprive millions of future workers access to workplace savings plans.

Moreover, potential cuts to current retirement savings initiatives would likely return far less revenue to Treasury than their proponents estimate — even over the short-term – while placing millions of future retirees at risk.

National solvency and personal solvency, we believe, are mutually reinforcing. Our tax and economic policies should never pit one against the other. Strong personal and workplace savings are essential to restoring America's long-term solvency because true solvency includes strong household balance sheets as well as a sustainable federal budget. After all, every dollar that retirement savers set aside is one less dollar that will be asked from the government in the future.

The benefits of savings – and the negative impact of excessive household debt on national economies are both highlighted in a recent International Monetary Fund study, "Dealing with Household Debt." In it, the IMF found that, "Housing busts and recessions preceded by larger run-ups in household debt tend to be more severe and protracted." [1]

This suggests that personal solvency, which is grounded primarily, though not exclusively on retirement savings, is a key part of the solution to our national debt concerns -- not part of the problem. Whatever actions we take to curb federal deficits, we should preserve and indeed enhance incentives for the personal and workplace savings that enable millions of working Americans to secure their own retirement futures.

Savings Incentives Meet A Clear National Need

The need for enhanced savings in our country is clear and indisputable. Americans today live longer, more active lives. The cost of health care, especially in later life, is increasing steadily. Traditional defined benefit pension plans have declined in number and scope, and only a declining minority of today's workers, primarily in the public sector, have access to them. Meanwhile, Social Security's projected ability to replace pre-retirement income is declining, even under current law, as a result of rising eligibility age and the costs of Medicare deductions. This "perfect storm" in the retirement income arena makes incentives for saving even more essential.

To supplement dwindling sources of assured retirement income, working Americans have come to rely on a broad spectrum of voluntary, private retirement savings programs that Congress has created over the past several decades. These include individual retirement accounts (IRAs), defined contribution savings vehicles including 401(k), 403(b) and 457 plans, and tax-advantaged variable annuities.

[1] International Monetary Fund, "Dealing with Household Debt," April 2012, p.3

These programs have enabled millions of workers and their families to save for more secure, dignified retirements. While they can -- and should -- be improved, these programs represent a major, made-in-America success story.

Defined contribution workplace savings plans, and the incentives and programs that support them, have proven successful, enabling over 80 million Americans to accumulate more than $4 trillion. And with the passage of the Pension Protection Act of 2006, Congress significantly improved these plans by endorsing several key plan design elements which already show signs of enabling millions more participants to replace a greater share of their pre-retirement incomes for life.

These key elements include automatic enrollment of participants (who remain free to "opt out"), automatic escalation of participants' deferral rates and legal safe harbor for plan sponsors to default participants to qualified default investments (QDIAs) that include balanced funds and target-date "lifecycle" funds (strategies that systematically reduce investment risk as retirement dates approach). Numerous studies have illustrated the success of such automatic features in lifting workers' capacity to replace worklife incomes when they do retire.

Putnam's own research suggests that there is – already – a significant success story underway for millions of workers within the existing 401(k) structure. A survey of the retirement readiness of nearly 3,300 working Americans sponsored by Putnam Investments and Brightwork Partners last year found that working Americans overall were on track in calendar 2010 to replace 64 % of their current income in retirement. This is somewhat short of what they are likely to need, but close enough so that most people, though not all, can still achieve secure retirements if they act now to raise savings rates.

The details of these survey findings have major policy implications – and disclose "best practices" -- that policy-makers should seek to spread across the whole workplace savings system. For example, when you include future Social Security benefits, the best-prepared quartile of working Americans are on track to replace 100% of current income in retirement. The least-prepared quartile are on track to replace just 46% of pre-retirement income even with their Social Security benefits. Yet the mean household income of both groups in our 2010 survey was identical: $93,000.

Several factors account for this vast difference in retirement readiness, but one in particular appears crucial: The very best-prepared Americans – roughly 19 million workers according to Brightwork estimates – both enjoyed access to a 401(k) or other defined-contribution plan at work and contributed 10% or more of their income to their plan.

In short, today's existing 401(k) plan structure can deliver solid retirement security for those workers who make the decision to take part and who also defer 10% or more of their salaries. In effect, we have discovered an antidote to the risk of elderly poverty – and it has three simple ingredients: access to a workplace savings plan, the decision to save, and willingness to defer at rates of 10% or more.

Today's retirement savings programs were given the advantage of deferring federal income taxes precisely because they could deliver results that are clearly in the public interest. Tax deferrals offer a powerful incentive for workers to maximize their savings and have contributed greatly to the success of these plans. Today, roughly 70% of American families have tax-advantaged retirement savings[2] and assets held in employer-sponsored retirement plans, IRAs and annuities totaled $17.9 trillion at year end 2011.[3]

Tax incentives are important to workers saving for retirement. A recent survey by the Investment Company Institute found that 85% of households supported maintaining tax incentives for retirement savings. The survey also found that 45% of respondents reported they probably would not be saving for retirement if they didn't have access to a defined contribution plan.[4]

Limiting or eliminating these incentives could have a detrimental affect on workers' ability to save sufficiently for retirement and the propensity of employers to offer workplace plans. Recent analysis by the Employee Benefit Research Institute (EBRI) demonstrated that "modifying the federal tax treatment for 401 (k) contributions would result in an average percentage reduction in 401(k) balances of between 6% and 22%, at Social Security normal retirement age for workers currently ages 26-35." The study also found that "smaller employers were more likely to respond negatively to the proposed changes than larger employers." EBRI cited other recent surveys which reported that small companies may "have less desire" to offer a 401 (k) plan to their employees if the tax incentive structure changed.[5]

Indeed, some smaller business owners and companies are motivated to offer workplace savings plans to their employees because of the $50,000 pear year maximum that these owners can set aside for themselves under current law. If that amount is capped at a lower level, some business owners may become more selective about offering workplace savings programs or simply decide to save only for themselves and key employees.

[2] Investment Company Institute, 2011 Investment Company Fact Book, p. 102
[3] ICI, 2012
[4] ICI, "America's Commitment to Retirement Security: Investor Attitudes and Actions," 2012, p. 14, 17
[5] EBRI, "Modifying the Federal Tax Treatment of 401(k) Plan Contributions: Projected Impact on Participant Account Balances," 2012

Changes to savings tax incentives would impact workers of all income levels. But the worst impact would likely be on low- and moderate -income workers. In a study published in July 2011, EBRI found that proposals to cap tax deferrals would "most affect the highest-income workers, but it also would cause a very big reduction in projected retirement accumulations for the lowest-income workers."[6]

Without incentives, workers reported they would probably save less. In its 2011 Retirement Confidence Survey, EBRI found that lower income workers – even those earning between $15,000 and $25,000 -- would be negatively impacted if tax deferrals were eliminated. A full 76.2% of workers in this household income category cited the tax deductibility of contributions as "very important." Also in that same cohort, 56.7% said they would reduce the amount they would save if the tax deferral were eliminated.[7]

One frequently-cited argument in favor of limiting these tax incentives is the contention that the deferrals benefit the wealthy more than average workers. But, workplace-based retirement programs are particularly beneficial for lower- and middle-income workers. Research by the American Society of Pension Professionals & Actuaries found that households with annual incomes below $100,000 pay 26% of income taxes but receive 62% of the benefit from the tax advantages of 401(k) plans. In contrast, families earning more than $200,000 per year pay more than half (52%) of income taxes, but receive just 11% of the tax advantage benefits from these plans.[8]

Indeed, savings deferrals for the establishment of workplace plans are uniquely "progressive" because under the provisions of ERISA law, business owners and plan sponsors must meet non-discrimination rules that ensure that the benefits of savings deferrals are widely shared among all employees of a firm – not limited to top executives.

If similar rules were applied to, say, mortgage or charitable deductions, then affluent taxpayers could be required somehow to assure that lower income employees also had access to homeownership or were somehow subsidized in giving the charities of their choice. Seen in that light, retirement savings deferrals under ERISA represent a major policy success: effectively harnessing business owners' legitimate self-interest to the public good of retirement security for all.

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[6] EBRI, "Capping Tax-Preferred Retirement Contributions: Preliminary Evidence of the Impact of the National Commission on Fiscal Responsibility and Reform Recommendations," July 2011.
[7] EBRI, "The Impact of Modifying the Exclusion of Employee Contributions for Retirement Savings Plans From Taxable Income: Results from the 2011 Retirement Confidence Survey," March 2011, pp. 3, 5
[8] ASSPA, "ASPPA Testifies in Defense of 401(k) System," September 15, 2011

Savings Deferrals are not true "tax expenditures"

The core rationale behind proposals to cut or curb retirement savings incentives is that the tax deferrals at the heart of 401(k) plans and similar savings vehicles represent tax "expenditures" that significantly reduce needed tax revenue. Thus, in 2011 testimony presented to the Joint Select Committee on Deficit Reduction by CBO Director Douglas Elmendorf, retirement savings deferrals were calculated as tax "expenditures" comparable to employee health costs, mortgage interest deductions and charitable giving.[9]

We disagree with this assessment. Retirement savings deferrals, clearly, are not permanent tax expenditures -- only temporary postponements of tax obligations. When retirement savings are drawn down, the money is taxed as ordinary income, even though the retirement accounts themselves are typically composed mostly of long-term capital gains.

Equally misleading, the Congressional Budget Office uses a 10-year window for analyzing the costs of tax deferrals. As a result, it neither accurately measures the true cost of tax provisions that are incurred over the periods of decades that make up the typical worker's career, nor calculates the substantial tax flow-backs to Treasury decades into the future. Today's tax deferrals are counted as revenue losses, but the taxes that will be paid beyond a decade forward are not counted at all. This practice distorts the true "full-lifecycle" costs of these incentives, understates their social and economic benefits, and overstates the cost of the tax deferrals to the Treasury and the revenue that would be generated by cutting back on them.

In a recent report analyzing the challenge of individual income tax reform, the Congressional Research Service again included savings incentives in calculating revenue loss due to tax expenditures. But the researchers did note some obstacles facing proposals to cut savings incentives. In the report they found, "Modification of many of the savings incentives face significant technical or administrative barriers. Most of these tax benefits are associated with unrealized income (pension benefits, including those associated with defined benefit plans, unrealized gains at death, and inside buildup in insurance plans), which can be difficult or impossible to value properly."[10]

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[9] Congressional Budget Office, "Confronting the Nation's Fiscal Policy Challenges," Statement of Douglas W. Elmendorf, Director, September 13, 2011, p. 46

[10] Congressional Record Service, "The Challenge of Individual Tax Reform: An Economic Analysis of Tax Base Broadening," March 22, 2012

There are also many valuable economic and social benefits of the tax incentives that are not captured by government accounting methods – but which definitely should be taken into account by policymakers. Tax deferrals that support and strengthen our retirement savings system help:

• Fuel the rise of a robust American financial services industry, centered on capital markets, which, in turn, help finance innovation and thereby economic growth.

• Enable parents to provide for their own retirement without burdening their children, which is a foundational element in offering dignity and self-respect for older people.

• Free governments from possible demands for aid/welfare for elderly indigents – at least until their savings are exhausted

• Offer a counter-cyclical, smoothing influence on consumption patterns by capturing somewhat higher savings flows in boom times and enabling continued consumption by retirees right through economic downturns.

• Give all holders of retirement savings a material stake in political stability and in growth-oriented economic policy.

• Allow young and middle-aged people, who know they are on track to adequate retirement incomes, to take greater risks with other assets, including making the choice to pursue skills training or launch a business.

Congress should avoid any radical shift in savings policy

In the wake of the Great Recession, Americans are already struggling to save. As EBRI reported, two thirds of all workers saving for retirement report total assets under $50,000. Only about one quarter of U.S. workers have assets of $100,000 or more.[11]

Access to workplace savings is vital to workers' ability to save. Indeed, very little retirement savings by low to moderate income workers takes place outside the workplace system. An analysis by EBRI found that more than 70% of workers with annual incomes of between $30,000 and $50,000 do save for retirement if they have access to a workplace plan. Yet fewer than five percent of their peers who lack access to a workplace plan save through IRAs.[12]

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[11] EBRI, "The 2011 Retirement Confidence Survey," April 2011

[12] EBRI 2010 estimate using 2008 Panel of SIPP (covered by an employer plan) and EBRI estimate (not covered by an employer plan — IRA only)

Absent access to workplace-based savings, then, most American workers simply fail to accumulate any serious savings with which to fund their retirements or supplement their Social Security benefits. Reducing the incentive for retirement plan sponsors to offer workplace savings plans, then, could force millions of low- and moderate-income workers to face retirement with little or no savings. Building on these retirement savings programs, improving them and extending them to the tens of millions of Americans who still lack access to on-the-job savings plans should be among our most important national goals.

That is why we believe that Congress should not only preserve all existing savings incentives, but also support solid, bipartisan ideas such as the Auto-IRA, which could extend access to workplace savings coverage for millions of workers who lack such plans.

Capping or eliminating incentives for workplace savings would have almost the exact opposite effect. Indeed, cutting into tax advantages for retirement accounts would be far more than just a marginal revenue measure. It would mark a fundamental shift away from highly successful programs that Congress has supported for the past several decades. Long-term it would inflict compounding harm on millions of future retirees and by reducing investment flows to the capital markets, might also limit future economic growth. By reducing the incentive for millions of small- and medium-sized businesses to offer such plans to their employees, such a policy shift could send millions of low and moderate-income workers toward retirement with essentially no savings.

We live in a globalized economic and financial world. Whether we like it -- or not -- the United States, like every country interested in guarding its fiscal health, is caught up in a global "race to solvency." Nations everywhere are struggling to achieve fiscal balance and growth policies that will secure and sustain access to global capital markets and investment flows. The alternative is to lose global market confidence and risk the kind of debt-driven crisis Europe is struggling with today. We believe that strong national savings policies are vital to success in this competition. For that Reason, Putnam Investments supports policy choices that will sustain and strengthen all of America's retirement savings systems — public and private.

We do also view skyrocketing federal debt as a genuine threat to our nation's long-term prosperity. But attempting to reduce federal "dis-saving" by cutting incentives for personal savings is a bizarre and short-sighted policy option that would take our nation in the wrong direction.

Whatever limited tax revenues we might realize today from reducing savings incentives would be immediately offset by the loss of capital flows for investment in new business formation, job creation and economic growth. And such losses would compound, over time, by the loss of investment gains in workers' retirement portfolios and by the risk that many of these less-well-off workers may need public assistance in their later years.

Policy changes that could diminish retirement security for future generations of workers and increase poverty among elderly Americans would erode public confidence and betray the optimistic vision that has driven Americans for generations. For all of these reasons, we urge all members of Congress to oppose any policy change that would undermine incentives for employers to offer workplace savings plans or for individuals to use them to save for their retirement.

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See attached page for contact information.

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