THE BROOKINGS INSTITUTION

FILLING THE SAVINGS GAP:
HOW TO GET MODERATE-INCOME HOUSEHOLDS
TO SAVE FOR RETIREMENT

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INTRODUCTORY REMARKS:

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MODERATOR:

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Joseph A. Pechman Senior Fellow, Economic Studies, Brookings

PANELISTS:

LEN BURMAN
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Nonresident Senior Fellow, Economic Studies, Brookings, Former Benefits Tax Counsel, Treasury Department, Clinton Administration

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QUESTION AND ANSWER SESSION

P R O C E E D I N G S

MR. ORSZAG: Good morning. My name is Peter Orszag. I'm a senior fellow here at Brookings, and I welcome you to our forum on retirement security and how to boost retirement savings for moderate- and lower-income households.

As many of you may know, there is legislation that is under consideration, a new version of Portman-Cardin, that will deal with many of these issues. So the meeting is particularly timely, and I look forward to the discussion this morning.

The order of events will be that we're going to hear some introductory remarks from Maureen Byrnes, who is the Director of Policy Initiatives and Health and Human Services Program at the Pew Charitable Trusts. She had previously worked as Vice President at the Association of American Universities and as Executive Director of the National Commission on AIDS.

As she will tell you, the Pew Charitable Trusts is sponsoring a new project, jointly run by Brookings and George Washington University, entitled the Retirement Security Project, and this event is the first event of that project.

After that, we will hear some presentations, starting with Len Burman, who is a Senior Fellow at the Urban Institute and Co-Director of the Tax Policy Center. He had previously served as the Deputy Assistant Secretary for Tax Policy at the Treasury Department from 1998 to 2000.

Following Len, Mark Iwry, who is a Nonresident Senior Fellow here at Brookings and had been the Benefits Tax Counsel at the Treasury Department from 1995 to 2001 will speak. He was a key player in the creation of the Saver's Credit, which I think you will hear much more about this morning.

Following Mark, Fred Goldberg, who is a tax attorney at Skadden Arps will speak. He was the Commissioner of the IRS from 1989 to 1992 and then was Assistant Secretary of the Treasury for Tax Policy in 1992. Fred has played a leading role in boosting retirement saving and other forms of saving among lower-income households.

Finally, we will hear from Robert Weinberger, who is the Vice President for Government Relations at H&R Block. H&R Block has more than 20 million clients and is a central player in getting lower- and moderate-income households to save because H&R Block is often the one filling out their tax returns and helping them decide whether to make contributions to IRAs and other tax-preferred vehicles.

Following that, we will have plenty of time for questions and answers and look forward to an active discussion with the audience.

So, Maureen? Thank you.

MS. BYRNES: Good morning. Thank you, Peter. I am very glad to have the opportunity to publicly express my gratitude to Peter for joining with the Pew Charitable Trusts and agreeing to serve as the Director of a Trusts-funded project called the Retirement Security Project. We are very lucky to have someone like you, Peter, with your intellect, your experience and good humor to work on these issues with.

I know that you and your colleagues have been working for months on research and outreach activities, and it's a pleasure to be here today for what's considered to be the public launch of that project. I would also like to say thank you to the Brookings Institution and the Tax Policy Center and all of your colleagues there that you have been working with, and I especially want to say thank you to the speakers today for

making the time to come and share some of your insights on some of these issues, and I look forward to hearing you speak later this morning.

As Peter indicated, I am the Director of Policy Initiatives in the Health and Human Services Program at the Pew Charitable Trusts. And as some of you may know, one of the missions of the Pew Charitable Trusts is to identify policy solutions, help identify policy solutions to compelling societal issues. We see our role as funding vigorous, nonpartisan research, convening experts on a particular topic and then looking to what the policy options in a particular area might be.

Some emerging issues and challenges in society are relatively hard to predict. The fact that 76 million baby boomers are approaching retirement age and the fact that half of households nearing retirement age have $10,000 or less in their 401(k) and the need to improve the retirement system is a problem that is essentially staring us in the face.

This is an area, this is an opportunity that the Pew Charitable Trusts thinks is ripe for an investment on our part. There is a sound research base on which to suggest that there are incentives that can be created for people to save at the moderate- and lower-income level, and there's clear, demonstrated bipartisan interest in trying to do something about this.

The 2001 Saver's Credit to provide an incentive for moderate- and lower-income families to save has had a significant impact. Data from the IRS shows that more than 5 million households claimed the credit in its first year of operation. But more can and needs to be done in this area. There are many other promising policy options to improve moderate- and lower-income families' retirement savings that have

the potential to generate bipartisan interest. I know we will be hearing a lot about those options later this morning, and I look forward to that.

This is an area where we see clear fertile ground. As I said, when we think about compelling policy issues, we're looking for those where there's an opportunity for change, the research base is clear, and there are experts that we can bring together to help inform balanced, well thought-out policy options.

The title wave of baby boomer retirement is fast approaching. It is our hope that today is an important step to preparing for that impact. Thank you again for the opportunity to be here. It's our pleasure to be partnering with the Brookings and the Tax Policy Center, and I look forward to the discussion this morning.

MR. BURMAN: Thank you, Peter and Maureen, for putting this together.

I want to give a little bit of background on how the defined contribution and IRA tax benefits are distributed and affect individuals under current law.

I am not going to talk very much about the Saver's Credit because that is going to be the focus of Mark's presentation. The defined contribution and IRA rules, are in flux due to legislation that was enacted in 1997 and in 2001.

This chart shows what's happening with IRA rules. In 1997, the contribution limits for traditional IRAs, for people who are covered by a pension plan were increased gradually through 2007. (Those not covered by a pension plan and whose spouse isn't covered are permitted to contribute to a traditional IRA plan at any income level.) For married couples filing a joint return, the phase-out started at $53,000 in 2001. The phaseout is scheduled to go up to the $80- to $100,000 in 2007, and the thresholds, as the chart shows, also are phasing up for singles and heads of households.

The 1997 legislation also established Roth IRAs, which are individual retirement accounts for which you don't get a deduction up front, but the earnings and withdrawals are tax free if they are held until retirement age. The contribution limits for Roth IRAs are significantly higher. For married filing joint returns, they don't start to phase out until an income of $150,000.

The 2001 legislation increased contribution limits for a variety of kinds of defined contribution pension plans, including 401(k), 403(b) and 457 plans, as the chart shows. The contribution limit was $10,500 in 2001, indexed for inflation. Thus, it would be higher now, even if the legislation hadn't been acted. Under the 2001 legislation, the maximum contribution phases up to $15,000 in 2006, and is indexed after that.

Like everything else in the 2001 legislation, in 2011, it goes back to what it would have been before the 2001 legislation had been enacted, assuming there's no change in policy. Thus, in 2011, the threshold will fall back to something like $12,500 under current law.

A new thing that was enacted in 2001 was a so-called catch-up contribution. That was probably my favorite part of the whole bill because it was in a part of the legislation entitled, "Fairness for Women." Now, as you know, women have long spells out of the labor force, and when they get back into the workforce, they are behind on their pension contributions, so they would want to contribute a lot more to their pensions, build up their 401(k) accounts, so they have just as much when they retire as a man would.

The only problem with that logic is that, because of those long spells out of the labor force and probably other reasons, women get paid less than men, and there

about three times as many men as women who could benefit from the Fairness for Women provision. Is this a great country or what?

[Laughter.]

MR. BURMAN: Anyway, that catch-up contribution phases up to $5,000 by 2006. The overall combined contribution for an employer and an employee with one of these qualified pension plans, 401(k)-type plans, is $40,000, which means that in 2006, the employee could contribute up to $15,000, and if the employee contributed $15- or $20,000 for someone 50 years of age or over, then the employer can contribute another $20,000.

IRA limits are also phasing up to $5,000 for both traditional and Roth IRAs, and there's a catch-up contribution for IRAs as well of $1,000 and, again, those limits go back to $2,000 and zero, respectively. in 2011.

We developed a model to look at the distribution of pension IRA benefits. The model uses a similar methodology to what the Treasury Department used to do distributional analysis when they used to do it. Like Treasury, we look at what would happen if a contribution to a 401(k) plan or an IRA was put into a taxable account instead, and compute the present value of tax payments over a lifetime, assuming that the money is held until age 65 and then withdrawn in an annuity over the following 20 years.

So this chart shows the present value of the defined contribution and IRA tax benefits in 2004. You can see that these benefits are larger as a share of income as income goes up. The tax benefits for the top quintile are worth 1.4 percent of income compared with only one-tenth of 1 percent of income for the lowest quintile.

These tax benefits are less important at very, very high incomes, and that's not too surprising. There's a cap on the overall contribution. As a result, the tax subsidy becomes a relatively insignificant part of income for the very, very wealthy.

If you just looked at defined contribution benefits by themselves, the distribution would look very similar, but individual retirement accounts are a relatively small part of the total, although they're the piece that's growing the most proportionately over the next five or six years. In 2004, you can see that, because of income limits, that these are a little bit less top heavy than the 401(k) benefits themselves. And at the very top, again, the IRA benefits are worth virtually nothing because most people aren't allowed to contribute who have very high incomes.

We looked at one option, which is one aspect of Portman-Cardin. It would accelerate the phased-in increases in contribution limits to 2004. This chart shows the distribution of those tax benefits by income. You can see that about 72 percent of the benefits would go to the top quintile. It's not too surprising. Higher contribution limits are only worthwhile to people who are contributing at the limit. But, again, if you look at the very, very top, they become smaller as a share of income because the overall amount that can be contributed is capped and also because individual retirement accounts are subject to income limits.

MR. IWRY: The Saver's Credit presentation that I'm about to do is based on a paper that Bill Gale, and Peter Orszag and I recently prepared, which is available on the desk and appeared in Tax Notes a couple of weeks ago. And the design of the Saver's Credit, the intent of the Saver's Credit, as put together mainly by a group of us at Treasury, in the Office of Tax Policy, in the late '90s and 2000, particularly Len Burman, and I and our excellent staffs, the design was to help address key shortcomings in the

existing tax-favored pension system. Len has just laid out those shortcomings, to a considerable extent, and I would only note that part of the mechanism that accounts for that distribution of benefits that Len described was, as he noted, that the tax advantages of the qualified plans, both the DC and IRAs, and the defined benefit plans, for that matter, are dependent on one's income tax bracket, one's marginal rate.

The mismatch that results because of that is that people with the lowest marginal rates, indeed, people who have no income tax liability, but are paying their payroll taxes, get no federal income tax benefit out of the tax-qualified plans. Whereas, those with the highest marginal rates get the most benefit.

The other consequence, which Bill Gale has pointed out with particularly persuasive evidence, is that to give an incentive that's mainly of use to higher-income people is to minimize the addition to national savings. Since part of the purpose is not only to get individual's prepared for retirement, but to contribute to national savings, to the extent that higher-income people get a new tax incentive, the tendency is to shift other assets that they're already saving or income that they would have saved anyway into the newly tax-favored vehicle. Whereas, moderate-income people, we believe, are more likely to respond to the tax incentive by actually saving more than they were before on a net basis.

So the strategy with the Saver's Credit was to level the playing field, to some degree, by using a tax credit instead of a deduction. A tax credit mechanism is such that the value of the benefit is independent of the marginal income tax rate, at least if it's a refundable credit, and this credit was designed to be progressive; that is, higher rates of credit for higher incomes--50-percent credit--higher rates for lower incomes, obviously--50-percent credit for people whose income is $30,000 or lower, joint HEI;

20-percent credit for people whose HEI is between $30- and $32,500; and a 10-percent credit above that.

The credit, of course, is not equivalent to a match; that is, it's a government match, but the rate of matching, if you were to compare it to an employer's 401(k) matching contribution, is a little misleading. For a 50-percent credit, you're looking at the equivalent of a 100-percent match of the individual's contributions. You put a dollar in, the government puts 50 cents in your 1040, in effect. It offsets your tax liability by 50 cents, so that your net out of pocket is only 50 cents. Yet the dollar you put in stays in that account. So you end up with a dollar in tax-favored savings, and you only are out of pocket 50 cents. So it's like a 1-to-1 match, even though it's a 50-percent tax credit.

The way the Saver's Credit was enacted though, it was missing four key features. As we designed and proposed it, it was not intended to be temporary, though in the legislation in 2001 that enacted it, it sunsets after 2006. It was a 50-percent credit that was refundable, and therefore available to 60 million households with incomes below $30,000 in joint AGI. Of those 60 million, though, only 10 million actually get anything out of the credit, and virtually none of them get the full $1,000 credit for a $2,000 contribution because it was enacted on a nonrefundable basis.

It was also designed to reach tens of millions of households who were above the income level that it reaches, that is, above $50,000, and the 50-percent credit rate, which covers only people up to $30,000 before it phases down between 30 and 50. That 50-percent credit rate was designed to go all the way up to people earning $50,000 or even higher in the original proposals.

The Saver's Credit works basically this way. Imagine a married couple. She's at work with a 401(k). She contributes $2,000 to the (k) or, for that matter, even a defined benefit plan, if it takes employee contributions. The husband contributes $2,000 to an IRA, let's say. If their AGI is $30,000, they get a 50-percent credit, and the $2,000 that she contributed to the 401(k) draws $1,000 credit, his $2,000 to the IRA draws another $1,000 credit, and then she can reduce her withholding, over the course of the year, in order to get the benefit of the credit up-front on an ongoing basis, rather than waiting until they file their 1040 during the filing season after the year when they contributed. They claim the credit on the 1040, ultimately, taking into account the withholding adjustment.

The credit was designed to help employers as well as employees. We designed it to enhance employer plans. I'll skip the reasons why it makes sense to enhance employer plans if you have a strategy of enhancing saving for moderate-income people in the interest of time, and the mechanism for helping employers is essentially that the 401(k) rules, as you know, have a nondiscrimination test. The more that the average workers contribute, the more the executive workers can contribute to the (k) plan.

The Saver's Credit gives an added match to the average or moderate- and lower-income workers, encouraging them to contribute more, thereby allowing the higher paid to contribute more. If the employer has its own match, the Saver's Credit is on top of that. It doesn't off-set it. So you get an employer match in most (k) plans, but not all, and you get, if you're eligible, a Saver's Credit-type government match.

Auto enrollment, automatic enrollment in 401(k) plans, that is, the procedure whereby an employee is automatically participating unless he or she opts out

of the (k) plan, which is now being increasingly used, was developed in conjunction with the Saver's Credit by the same group at Treasury around the same time to raise 401(k) participation, especially among average workers to overcome inertia that keeps a lot of people from, about 25 percent of the eligible workforce from signing up for a (k).

The Saver's Credit makes the automatic enrollment more valuable because someone who's automatically enrolled, if they are eligible for the Saver's Credit, gets an additional match from the government. And by the same token, automatic enrollment, if it's being used, expands the number of people who are getting the Saver's Credit.

The results. In 2002, which is the first year the Saver's Credit was in effect, the IRS has estimated 5.4 million tax returns claimed it. Many of them were joint filers, and some of those represented people who both contributed, both spouses, as in my example a moment ago, to a retirement savings plan. So 5.4 million is a lower bound on the number of people who actually contributed and got a Saver's Credit.

As you might expect, the distributional effects are very favorable to moderate- and lower-income people. The credit only applies to people up to $50,000 in joint income, $25,000 if you're single. And the bottom, that is, people who earn less than $10,000, get virtually nothing because the credit is not refundable. So they don't get a credit if they don't have income tax liability, even if they are paying payroll taxes.

In a fairly rough survey, about halfway through the first year of the Saver's Credit, by a private-sector group, about 71 percent of 401(k) sponsors said that the Saver's Credit was increasing 401(k) participation.

The options for expansion include to eliminate the sunset in 2006. That would add about a billion-and-a-half dollars, according to the estimates based on the

Urban-Brookings micro simulation model maintained in the Tax Policy Center. And the refundability feature, which if added to the Saver's Credit would make it available to another 50 million households, would add about $3 billion a year to the cost. Expanding it so that the 50-percent credit rate applied to everyone up to $50,000 in joint AGI, rather than $30- now, would add about $5 billion a year to the cost. And doing all of those things together, plus indexing the contribution, the income limits for eligibility, would add about $12.5 billion a year.

The Saver's Credit originated from the work being done at Treasury, and elsewhere, on Universal Savings in order to promote progressive savings. And the development was essentially that the Universal Savings Accounts and their progeny that were proposed in the late '90s experienced increasing budget constraints as a proposal were shrunk over time in order to meet lower revenue constraints, cost constraints.

Ultimately, what resulted from those proposals was a very small, but potent, proposal, namely, the Saver's Credit, essentially this match by the government of contributions by moderate- and lower-income people to existing vehicles: 401(k)s, IRAs, other employer plans.

As Peter mentioned earlier, there is interest now on the Hill in expanding the Saver's Credit. Some of you here are involved in that, in doing the kinds of things or many of the kinds of things that we have costed out and that I just mentioned. And the overall concept is that, in one way or another, the Saver's Credit would be made permanent, refundable or the equivalent of refundability and that the phase-out would be of the credit, as income rises, would be smooth so that high marginal tax rates would not result by a "cliff" effect, which we now have with the credit rate going down very precipitously as income rises.

MR. GOLDBERG: Thank you, Peter.

I want to apologize at the outset for lack of a PowerPoint presentation. I was on target to have it ready next Monday.

Instead, I'd like to talk for a minute about two subjects: The first is plumbing, and the second is pacts with the devil. There is a relationship there somewhere, and I will find it hopefully within the next 10 minutes.

The first has to do with plumbing. I think that a lot of the policy discussions about savings or, indeed, policy discussions about policy don't attend adequately to the plumbing. So I'm going to talk about how important plumbing is, and Bob is going to tell you how the plumbing works.

When we think about these programs, we tend to pay a lot of attention to the theory and, at least in my view, not enough attention to how it's going to work out there when you're interacting with real folks trying to cope with real rules. I would like to talk about four different areas to illustrate that point:

The first has to do with the very pedestrian subject of IRS refunds. The IRS, for many years, has taken the position that it will only wire refunds to one account because it is allegedly too hard for the IRS to wire refunds to more than one account. Having been there, seen it, tried to do it, I assure you it is not too hard. It could be done. It's merely a question of an act of will.

Well, the administration, in its most recent set of budget proposals, stated that the IRS was going to "split" refunds, meaning that a taxpayer with a refund will be permitted to direct wiring of those amounts to two different accounts, presumably, for example, a bank account and a 529 plan or an account that would qualify for the Saver's Credit or a Roth IRA account. I realize this gives new meaning to the word "prosaic,"

but I believe, in the real world, it is an exceedingly important initiative. And if one were thinking about how to spend one's time over the next couple of months, one might say one of the very important things one could do would be to get the IRS in gear to get done what the President promised the IRS was going to do.

At a more global level, to jump from the sublime to the ridiculous or vice versa, there is a lot of discussion, from time to time, about universal children's savings accounts. The U.K., as some of you know, is implementing that vision. There's lots of discussion about Social Security private accounts. Again, we talk about those kinds of notions from a policy perspective.

My personal view is that it is important to talk about those policies from the standpoint of the plumbing. If you build some kind of universal savings platform, which undoubtedly will be imperfect, unfair, and hard to administer at the outset, you are putting in place an infrastructure that can be built on in the years and decades to come. This is an aspect of these proposals that is not thought through or given as much weight as it should be.

A while back, there was a proposal for something called "R bonds," retirement bonds. They didn't go anywhere, but again it's a plumbing proposal. When you're talking small dollar amounts, when you're talking savers who are not experienced or sophisticated in dealing with the capital markets, an R bond could turn out to be a very simple, no-cost proposal that allows folks to transition into savings in an efficient and administrative way.

Finally, while we're talking about savings, but more attention needs to be paid to the other end -- the distribution side. There is a general view that the annuity markets do not function nearly as well as they should for a wide variety of reasons, some

of them having to do with tax policy, but a lot of them having to do with other aspects of the annuity markets; how they are regulated; the absence of financial instruments that allow folks to effectively index, for example, for inflation or health care costs, through the capital markets, and ways of addressing credit enhancement issues.

So there are lots of these areas that are pedestrian, if you will, but that merit a great deal more attention.

Now, let's talk about pacts with the devil. If one had to characterize or if I had to characterize the policy that we have agreed to by default, in terms of the world of savings, is there is a trade. This trade is as follows:

The Democrats, if you will, say, "Not a nickel for the rich. We have got to have phase-outs. Absent phase-outs, it's unfair. All of that money will go to the rich."

The Republicans say, "Fine, but not a nickel in refundable credits. The poor don't pay taxes. They don't get refunds."

This is another way to describe the policies implicit in what Len's charts tell you. And it is a terrible, terrible deal to be making.

From the standpoint of a goal of encouraging additional savings in a tax system where 30 to 35 percent of the workers don't have current income tax liability, the absence of a refundable credit undercuts everything that you're trying to accomplish. I agree wholeheartedly with every aspect of what Mark was saying needs to be done for the Saver's Credit. But the practical price you folks are going to have to be willing to pay for that refundable credit , is to lift the cap--income cap--on contributions.

There is an old joke about tax reform. The Republicans hate the consumption tax because it's a hidden tax. The Democrats hate the consumption tax

because it's regressive. Well, as soon as soon as the Republicans find out it's regressive and the Democrats find out it's hidden, it'll happen. Well, this is the same kind of question.

There's a second aspect to it. If you look at the data on advertising expenditures, marketing efforts, with respect to IRAs, post the law changes that put on income caps, it declined significantly. If you talk to the folks who do IRAs, they will tell you that one of the reasons that these programs are not ~~as~~ marketed as aggressively as they should be, and one will be is one of the reasons Saver's Credits are not marketed as aggressively as they should be, is that they are not part of a universal program. They are complicated. They're hard to explain. You've got one set of limits for traditional IRAs. You've got another set of limits for Roth IRAs. You've got a third set of limits for Saver's Credits, and the system is woefully complex.

I realize there are those who view the "marketing impact" of universal policies as not that important. They don't believe or they don't think there's adequate evidence to carry the case that marketing matters, but it does. Saving is sold not bought. And to be able to get financial intermediaries, make it easier for financial intermediaries to engage in an aggressive marketing effort, the result will be net-net increases in savings not just at the high end, but throughout the income spectrum.

And I think that as long as we are wedded to this pact with the devil, nothing for the high end in exchange for nothing at the low end, we will consistently miss, we won't get to the target we are trying to get to, and until folks are willing to trade it the other way, make it simple, make it universal, make it refundable, I think we're going to fall short of the mark.

Thanks.

MR. WEINBERGER: Good morning. I want to address three things: First, some brief background on H&R Block, less by way of advertising than simply to set the stage for how we're in a position to deliver the Saver's Credit to Americans; secondly, what our results have been with the Saver's Credit; and, finally, what are some lessons we have learned and some of the policy implications.

H&R Block has been in business for about 50 years, and that's enabled us to build a network of 10,000 offices through the United States where, during tax season, about 118,000 people--80,000 of them tax professionals--deliver tax services. Fifty-six percent of Americans use a paid tax preparer, and among low-income recipients of the earned income tax credit about sixty-eight percent do.

In the last few years, we've expanded beyond tax preparation to offer other financial services and financial education, connecting eligible clients, for example, to government benefits, through alerts and toll-free numbers they can call. We've also connected more Americans of all income levels to saving for four main goals--savings for emergencies, savings for education, savings for homeownership and, as we're discussing today, savings for retirement. So we made a transition from being a tax preparer to a tax and financial adviser.

Our clientele spans the income spectrum, but about 58 percent of our clients have incomes of $30,000 or less, which applies directly to the eligibility for the Saver's Credit. By comparison, the average adjusted gross income for a tax filer in America is about $28,000 a year. We prepare one out of every seven tax returns filed in America. Of the 20 or so million clients we have, about 16 million are served in retail tax offices.

This enables us to facilitate the use of billions of dollars of tax refunds. The average tax refund is in the $2,200 range. Many clients, as we know, have not saved effectively over time. Many are unbanked or only marginally banked. Significant opportunities, therefore, exist to help improve our clients' financial situations, and key to this is not just advice, but actionable advice at the one time a year when people have their financial records and are face-to-face with a professional, and a computer, and the opportunity to do something about it.

The two main products we use for savings are what we call an Express Savings Account and an Express IRA. We first piloted the Express IRA in the 2001 tax season and have opened about a quarter of a million accounts in the subsequent two years. It enables clients to make recurring monthly investments. The Express Savings Account, piloted in 2003-2004, is a simple savings account for emergencies, a rainy day fund, which is especially important for low-income taxpayers who may need some cushion in case they hit a bump in the road.

About half of those of our clients who set up an IRA in 2003 got a Saver's Credit. So there was significant interaction with IRAs and the Saver’s Credit. Here's an example of one of our ads for an Express IRA, showing a golden egg inside a nest with the message: “Save for Tomorrow and Pay Less Taxes Today.”

What was our Saver's Credit experience? In the first year of the Saver's Credit, we did about 24 percent of all of the Saver's Credits in America, or 1.3 million, in part because of the substantial overlap between our client base and the eligibility for the credit and in part because we identified the credit as benefiting our clients and aggressively trained our tax preparers on it. That rate was about three times the U.S.

average. Of 5.6 million eligible clients, 71 percent, or 4 million, did not have an existing IRA or 401(k) plan.

About 20 percent of eligible clients used the Saver's Credit. The average credit per tax return was $172. The average credit for clients using an Express IRA was $205. That compares with the overall average of about $199 per account for the Saver's Credit nationally. That enabled our clients to reduce their taxes by over $231 million.

The Saver's Credit is something that we were attentive to very early on. When the measure was proposed in Congress, we advocated refundability. We were not successful. And as we began the first tax season, a national poll showed that over 80 percent of taxpayers had no idea what the Saver's Credit was. So we feel very good about having been able to call it to the attention of our clients and to succeed in getting many to use it.

About three of four clients who used the Saver's Credit did it to match contributions they had made to a 401(k) plan, about 16 percent used it for an IRA, and about 5 percent used it for both. That may illustrate the importance of having a tax professional or an adviser as part of the process. Those 5 percent who used both could no longer make a contribution to their 401(k) plan for the year passed but they could still open an IRA until April 15th .

So, for those clients who had not maximized the opportunity to get full value out of the Saver's Credits from their 401(k) plan, we were still able to help many of them realize additional savings by opening an IRA.

Similarly, for a very small, but significant, number of clients, we were able to show a client how using a deductible IRA with the Saver’s Credit could deliver a triple benefit: an immediate tax reduction for the amount of their savings; a Saver's

Credit match; and a larger earned income tax credit because their taxable income had been reduced.

Many clients, we also know, facing financial pressure, may not utilize the 401(k) to full advantage, but at the end of the year, when they've taken stock of their bonus and financial situation, may want to do some additional saving. So, again, the period until April 15th is a wonderful opportunity to add savings. A tax professional, as part of the process, can help a client understand how to utilize benefits fully.

What works? Let me suggest some structural and some human elements. The structural elements for success include opportunity, an appropriate and attractive product, and scale.

The opportunity is, first, using the tax preparation process, which is, for many clients, a once-a-year financial check-up when they have their records and a chance to make New Years' resolutions actually happen; second, using the tax refund, which for many clients is the biggest single check they will see all year; and, third, using the incentive of the Saver's Credit to get many people over the hump with less impact on their bottom line.

The product is attractive in that there are low barriers to entry—a low initial deposit and low fees—and deposit insurance. An important lesson we learned is that in client surveys, deposit insurance registered as something that people considered very important. And, finally, familiarity over time—IRAs leverage a well-established structure and reduce the need for explanation.

All of our clients, at the end of the tax preparation process, get a computerized printout with advice based upon their occupation, their income, their family circumstance and so on. If they are eligible for a Saver's Credit, they will receive

a full alert and explanation of it. If they're not able to take it in the first year, the alert reminds them for the second year and is part of a process of financial education.

And, finally, scale. We have a large client base over which we can offer the product, and we don't have a need to cover all costs on that single transaction. It's part of a long-term relationship with the client. About 70 percent of our clients return year-to-year. Products like the Saver's Credit and IRAs help to improve client retention, which means, over the life cycle of a client's involvement with us, we have the opportunity to spread the cost, which reduces the need to have profits concentrated on single transactions.

The human elements of success include training, Trusts, and timing.

We've integrated this into the training of all our tax professionals. The context is as part of an evolving culture of advice rather than a single-shot product that is sold to someone. The training is reinforced through telephone help lines, through web resources and access to our H&R Block Financial Advisers subsidiary, where any of our clients is able to get a free financial plan.

Trusts builds on existing Trustsed relationships. For many of our clients, their relationship is not with H&R Block, but with the same tax professional they've gone to for years, and the loyalty is very strong in both directions.

With Trusts goes consumer education. Clear, easy to understand marketing materials and a clear explanation of costs and benefits.

Timing. As I mentioned, we see our clients annually. We provide alerts, and we find that as clients grow more familiar with products, their comfort level increases, and they are more willing to consider the prospect, if not immediately, then over time.

The single most significant thing I probably can say today is simply to tell you it works. The Saver's Credit is an important incentive for low- to moderate-income Americans to save. Permanence will raise adoption rates and encourage long-term commitment. Refundability, which would add 50 million people to eligibility, and expanded credit bands will broaden savings behavior. And the policy implication of that is to preserve and expand the credit.

One of the interesting areas deserving more study is the extent to which up-front tax deductibility is an incentive to save. Colleagues at one large financial firm, for example, tell me that most of the IRAs they sell are traditional IRAs and that the Roth has not taken off. I've heard contradictory information from other providers.

Our own experience is about 50-50. It is an incentive for some taxpayers, at tax preparation time, to know that if they make this investment in a savings account, they will reduce taxes or not diminish their refund. However, for some taxpayers, over the long haul, a Roth IRA may make more financial sense. And that takes us into the area where rational economics and behavioral economics may lead to somewhat different results.

We should consider new defaults for saving. Research shows that automatic enrollment with opt-outs is more effective than opt-ins at increasing savings in a 401(k) plan. And redesigning tax forms to allow refunds to be split so some can be directed to a retirement savings account should be adopted.

There are implications for financial education and retirement literacy. Many people have unrealistic ideas about how much they need to save, what they need

for retirement, how adequate their resources will be. Even when they have good information, there is often a disconnect between what they know and what they do.

There are limitations to what can be learned from brochures, classroom lectures, and the Internet. But a tax professional or a Trustsed advisor, which about 70 percent of people say they would like to have as part of the process, can deliver practical, unemotional advice. He or she can also help navigate a retirement savings structure that is far too complex for the people whom it was intended to benefit.

And, finally, moderate-income taxpayers behave very similarly to their higher-income brethren when they also work with a financial adviser.

MR. ORSZAG: Thank you.

If we can have all of the panelists come up so we can take questions from the audience, that would be great.

We have microphones that are coming around. If you do have a question, please raise your hand, identify yourself and then ask the question.

Bill?

MR. GALE: Thank you. Bill Gale at the Brookings Institution Tax Policy Center. My question is for Fred--two questions, actually.

First of all, I agree with you completely that marketing matters. I agreed with almost everything you said, by the way. But the question is what does marketing matter for? And if you look at the ads that used to push IRAs and push 401(k)s, it's always about taking money from this account and sticking it into your IRA and getting a benefit. No financial seller of these things ever goes out and says, "Hey, what you should do is cut your standard of living by $15,000 and stick it in a 401(k)."

So advertising I think emphasizes the portfolio-shifting aspect of these accounts rather than reduce your consumption, increase your net savings aspect, in my opinion. I'd be interested to know your opinion about that.

The other is about the deal that you mentioned. I agree with you again that the politics of this is a complete mess, but a couple aspects of the deal raised questions in my mind. One is you said the status quo was there's nothing for the high end, there's nothing for the low end. That's actually not right. The pension system is very regressive, as it currently is, as according to the charts that Len presented.

And then I'm curious about why, if we think that contributions to the Saver's Credit would be more likely to be net saving and contributions that you get from removing the income limit would be more likely to be tax shuffling, the question is why do we have to hold national saving hostage? Why do we basically have to give cash to the various wealthiest families in the country in order to enact a sensible program for low- and moderate-income saving? Isn't there any more productive increased research and development? Isn't there any other thing that could be part of the deal that would actually be a policy positive rather than just creating more loopholes very high-income households?

MR. GOLDBERG: Bill, I guess I just disagree. In terms of the marketing, I think you are, certainly, disintermediation is part of all of this. There is no question about it. But I think you underestimate--

MR. ORSZAG: Turn your microphone on.

MR. GOLDBERG: I'm not sure they want to hear any of this anyway.

[Laughter.]

MR. GOLDBERG: I think you significantly underestimate the impact of universality. I think that all of what you are talking about, in my judgment, ignores the historic lessons of Social Security, the family assistance plan, the earned income tax credit. If you look at how policy evolves over time, if you walk away from universality and make this all about the rich and the poor, you will not get where you want to go--period. That's just my judgment.

Second. Analytically, there's a very easy way to fix the distribution tables. If you eliminate the income tax on everybody making more than $200,000, then they will get no benefits from these incentives, and all of the benefits will go to low-income workers. It is a function of the progressive income tax. If you don't like the progressive income tax, go to a flat tax. You're simply arguing how much redistribution we want to accomplish.

In my judgment, it would be far better to raise maximum marginal rates and make these policies universal than to do what you're talking about. Now, the problem is, if you raise marginal rates, it will appear as though more benefits are going to upper-income taxpayers. So you're building an analytical box for yourself that just isn't going to work politically or from a policy standpoint.

Second, as an analytical matter, I'm curious, Len, your data is annual snapshots, I assume. We don't look to lifetime income cycles, I assume, or have you done some of that analysis?

MR. BURMAN: Well, our estimates are actually based on the lifetime tax benefits for a particular contribution. So, if you put $2,000 into an IRA, it's the amount of expected tax savings over a lifetime compared to the tax--

MR. GOLDBERG: At what assumed tax rate?

MR. BURMAN: We assume the tax rate stays the same.

MR. GOLDBERG: So, in other words, if I'm a low-income worker today, and I get no tax benefit, then you assume there are no tax benefits for my future contributions?

MR. BURMAN: That's right.

MR. GOLDBERG: So, if it turns out that I am a low-income worker today or I don't have tax liability today because I have four young children, but when I'm 45, and my children are off, I do have taxable income, you don't take that into account.

MR. BURMAN: Right.

MR. GOLDBERG: Okay. He said "right."

[Laughter.]

MR. GOLDBERG: And so I think that, Bill, a lot of what you say makes sense. I think all of us would restructure many pieces of the tax system, but I think you are underestimating the importance of marketing. Marketing is my crude, unattractive, politically incorrect word for "simplification," and I think it matters a lot.

In terms of should you make the political trade? I think it's a lay-down. Of course you should make the trade. If the argument is it's not perfect, it's not great, well, the EITC was really screwed up when it was first enacted. If you look at the coverage under Social Security in 1935, it was extremely limited. And if your vision is that you want perfect or nothing, you will always end up with nothing.

So, anyway, that's how I would try to answer your questions.

MR. ORSZAG: I know Len has a comment, but, Fred, if you could just comment for a second, you raised the EITC several times--

MR. GOLDBERG: I'm glad I've been invited to a--

MR. ORSZAG: No, no, no.

[Laughter.]

MR. ORSZAG: You raised EITC several times. I think that's an interesting model. Can you explain how that relates to universality, since there is an income-related component to the EITC.

MR. GOLDBERG: Sure. There are a couple of different lessons, at least, that I draw from some of these policies. One, I think the most important lesson that one can draw from Social Security and Medicare is universality, even though those programs, looked at all in, are both progressive—taking account of payouts , as well as contributions in.

The EITC is universal in the sense that it appeals to a, if you will, a core value, which is work, and it appeals viscerally to the notion that says we should not penalize people who work. And if you go back to enactment of the EITC, the trade-off, in part, was welfare and the effective marginal tax rates that you had under the welfare policies at the time.

It all started with Milton Friedman, who said, "Do a negative income tax." Again, a bunch of Democrats said, "Don't do a negative income tax." So the compromise was the earned income tax credit. But I think the key point of the earned income tax credit, the lessons at least that I draw, are, one, that it is universal in the sense that it appeals to this notion that we all share the value of in work.

Second, the related lesson from the earned income tax credit is that it enjoys a broad political consensus. EITC has been expanded with Republican presidents, Democratic presidents, Congress, the House and Senate under the control of different parties, and the House and Senate under control of the same political party.

And despite ~~all of~~ the efforts of a while back by the Ways and Means Committee to take a whack at the earned income tax credit, net-net, it is expanding. And the lesson that I draw is that a refundable tax credit is consistent with the core value of savings, and would be a durable policy breakthrough because it says we are going to have a refundable tax credit to promote savings by low and middle income workers.

The conceptual breakthrough of a refundable credit for low income workers is potentially for equal significance to the EITC. And so going back to Bill's question, am I willing to trade off some or other things I care about to get that policy breakthrough in place, I would make that trade in a heartbeat.

Finally, if you look at the history of the expansion of the earned income tax credit, the history and expansion of Social Security, the history and the expansion of Medicare, I think the conclusion you reach is, if it turns out that refundable Saver's Credit appeal viscerally to this kind of "we all agree" policy -- just like EITC I think appeals to "we all agree"-- the details are far less important than getting the overall policy in place. If the price for the policy is the trade I referred to, I just think it's an easy trade to make.

MR. ORSZAG: Len?

MR. BURMAN: First, I want to clarify one thing. The assumption that tax rates are constant through life actually tends to understate the skew in the distribution. Because, certainly for traditional IRAs, if a low-income person contributes at 15 percent, withdraws at 25 percent, they actually get less benefit than it would look like if you assumed the same tax rate.

Similarly, if somebody is temporarily high income, and they contribute at a high tax rate, and then they withdraw at a lower tax rate, their lifetime benefits are bigger.

MR. GOLDBERG: That's why I like Roth IRAs better.

MR. BURMAN: By the way, I also agree that the idea of being able to put refunds into IRAs is a great idea. Mark and I can tell you stories about how we tried to work for this in the Clinton administration and the bizarre story of why, after we got the IRS to agree they could do it--and everybody agreed it was a good idea--it still didn't happen. So I'm delighted that the Bush administration is finally moving on this.

MR. GOLDBERG: But it's just a promise. Again, if you're looking for something to do, get them to get it done.

MR. BURMAN: Yes. This is the best savings incentive you can imagine because it only costs money if people actually use it, if people actually save. People actually change behavior, they take the refund, and say, "Oh, at this point, we'll put it into an IRA," presumably, that's less likely to be shifting than other savings.

Now, the question about your undoing the pact with the devil, the idea, obviously, of encouraging savings is a good idea, but the problem with the proposals, actually, as they have come out of the administration, is that they are all financed with deficits. Now, you didn't say that. You said you'd raise tax rates--

MR. GOLDBERG: Don't say I said that.

[Laughter.]

MR. BURMAN: I think that would be a good idea, and our distribution tables would show that was a good trade. The problem is, if the government borrows money to encourage people to save, a lot of it, say, $16 billion a year for making IRAs

available on a universal basis, a lot of it is just shifting of savings from taxable forms into nontaxable forms, and national savings goes down. It just has to happen.

So eliminating caps on IRA contributions, depending on take-up rate, would cost between $8 and $16 billion a year on a fully phased-in basis. The Saver's Credit is a good idea, but it has to be paid for. The most expansive version of the Saver's Credit, proposal could cost something like $7 billion a year. If you had a package that did both of these things, and you were borrowing another $200 billion over the next decade to finance it, national savings would go down. There might be other reasons why you would want to do it, but it would have more to do with subsidizing people at the bottom and at the top--rearranging the deck chairs—than it would have to do with increasing national savings.

The other thing is this idea that savings is sold and not bought, I've heard that a lot. I've never seen any evidence that it works. But if advertising is really the main gain you get from this, the government could pay for a lot of advertising for $16 billion a year—and probably a lot less than that.

MR. ORSZAG: If you want to, sure. Go ahead, Fred. Fred, go ahead, and then we'll try to bring other people in.

MR. GOLDBERG: A couple of answers, Len. One, deficits matter. But I think if you go back to where you started, if you look at the overall budget, there are all of these expiring provisions. The fiscal situation is catastrophic, but the tax system has all of these self-destruct mechanisms built in--the rate cuts expire and the AMT swallows the world. And the Baby Boomers start retiring. There is a whole host of issues out there.

I just believe that getting in place today a structure that provides for refundable tax credits for certain kinds of savings puts that issue out there where, when the whole thing does start to fall apart, at least you have a marker that says, "When we have to decide what do we care about most, in light of this coming fiscal train wreck, one of the things we care about most is facilitating savings by low- and lower-middle-income workers, and the only way to get there is a refundable Saver's Credit."

And so you can buy that ticket now. If you wait six or seven years to try to buy that ticket, in the context where everybody is trying to get their expiring tax breaks made permanent, you don't even make it to the tadium. Maybe I'm wrong, but that is my political calculus. I know it sounds like, well, the deficits are so bad and getting so terrible, who cares, pile on. Yeah, that's exactly what I'm saying, and that's the trade I'd make. And why should you all be so disciplined, when everybody else is just grabbing what they can grab?

[Laughter.]

MR. ORSZAG: I'm sure this will continue to manifest itself throughout the discussion.

Yes, sir?

MR. ETHERIDGE: Hi. Lynn Etheridge, George Washington University.

I think there's potentially a great dialogue between people working on the uninsured for health care and savings. For starters, much of it is the same population. The 43 million people who don't have health insurance usually don't have savings accounts. And the sort of the preferred solution, certainly for the workers in both areas, is tax credits these days.

So let me raise another potential important dialogue, which is on the plumbing or the administrative side, the health coverage tax credit. And the administrative system that is in place there is a prototype for potential expansion to tens of millions of people to get health insurance coverage seems to me solves many of the problems that you were discussing that needed to be solved for a retirement vehicle.

First, it's a refundable credit in place already, fully refundable. It has a much higher match, in fact, a 65-percent match or 180-percent, depending on how you calculate it.

Even more importantly, it's set up to do the refunds automatically every month to the insurance companies. You don't send the money to the individual. In fact, the individuals contribute each month. The logistics are that that payment actually goes to the Treasury, a Treasury Service Center. Treasury puts on the refundable credit and sends the total sum to the insurance company designated by the individual.

So it seems to me to be a system that is sort of really in place and functional that could be used to get monthly savings from individuals, match it with a tax credit and automatically distribute it to a chosen savings vehicle, as well as getting health insurance.

Now, you guys have some things that I think the health people can learn, which is, among one of the very important things, is you got your tax credit enacted on a much larger scale.

So I think there is we're dealing with the same people, the same employers, the same IRS tax credit mechanism. It seems to me that if we matched the two systems together and thought that through, we could sort of make progress on both systems.

So I would appreciate any comments you have on those subjects.

MR. IWRY: I think, Lynn, your point is an excellent point. And those of us who worked on both at various times were thinking of it much the same way you're thinking of it and very much in accordance, Fred, with your global strategic notion of putting plumbing in place, having infrastructure, both the technical plumbing and at a kind of political level, developing that kind of infrastructure, a broad acceptance of a refundable tax credit certainly underlies both of those initiatives.

One caveat I would like to offer, in general, is that we need to be careful, as people recognize, about tax credits based on individual purchases of risk management, whether it's health coverage or pensions to the extent that they might threaten employer-sponsored coverage.

Of course, we have got somewhat similar problems in both health and pensions, that employer-sponsored coverage is plateaued out, to some degree, it's not universal. We desperately need to pick up the tens of millions who don't have employer plans--much more of a gap in pensions, about half, than in health care, but a critical gap in both.

And there the plumbing also, of course, is important; that to the extent we go with very large individual accounts, large in point of income limits that don't apply that would be lifted or removed or contribution limits, where the average person who contributes to an IRA doesn't contribute that much and only 1 out of 10 take up the IRA on a pension side, and where on the health side, we have all kinds of problems in our individual health care, as opposed to group insurance markets.

I think we just need to be very careful in the design of both the pension schemes and the health care schemes, when we go with individual accounts or individual tax credits, not to threaten employer plans.

Bob Weinberger pointed out only 16 percent of the Saver's Credit takers at H&R Block do so through an IRA and only another 5 percent partly an IRA and partly a (k). The vast majority benefit from the advantages of the employer plans, the cross-subsidization, the automatic nature of the coverage, the nondiscrimination rules on the pension side and so forth.

MR. ORSZAG: Both?

MR. WEINBERGER: But I think your question, Lynn, illustrates something Fred has said. The health coverage tax credit is sizeable--its benefits go up to about three times as much as the maximum earned income tax credit--but it is very narrowly targeted to people who are impacted by trade and have lost their jobs.

When it was enacted, we said this is terrific for some people, but it's a tremendous challenge to try to figure out how to reach them because you're talking about certain sections of Pennsylvania, around steel towns and so on. And I think that, in a way, gets to Fred's point, and my guess is that not very many people in the audience have heard very much about the health coverage tax credit, and that, in a way, is the problem.

Now, on the Saver's Credit, about 2.94 percent of tax filers had taken it at this time last year. This year, it's about 2.59 percent. It's about 400,000 fewer users—at least in an early estimate, which can change significantly in the final count.

But the point is in marketing to targeted groups there are challenges.

MR. GOLDBERG: Mark's point about the employer-based system is so important. On the Saver's Credit side, some of us have actually worked through what the forms would look like and the other technical fixes you need to make. But if you couple it with a split refund, and you allow funding directly to the employer-based plan, and the employer has an incentive to market it because it helps with testing, ~~that~~ then you really can design the system to create a bias towards the employer side. But Mark is absolutely right. If you screw up the employer's side, it's just not where you want to go. But you can make the plumbing work.

MR. BURMAN: There actually was a proposal. Retirement Savings Credit proposed in 2000 basically would have used a similar mechanism to the way the health credits worked. The match would have gone directly into the accounts.

MR. IWRY: You know, Fred, if I may add, as you well know, the incentive now exists in the Saver's Credit for the employer to market it, and the employer is able to give a notice to employees that you can get a credit if you contribute and thereby reduce the number of people who are noncontributors and who drag down the nondiscrimination results for the employer.

I have a concern about a proposal that some have been considering that would take the Saver's Credit and add another nondiscrimination break; that is, if the Saver's Credit were deposited directly to the employer's plan, in the case of a 401(k). And there I think the plumbing can work very well either way. You can put it into the plan or you can give it to people as a tax credit, a refundable tax credit. There are two ways and a legitimate debate about the incentive effects of the two.

But if you put it in the employer plan, there is no need to then treat that government contribution, government match, as if it were an employer contribution for

nondiscrimination purposes. The employer is getting juice out of the fact that the government is matching employees' contributions to the (k) plan, under current law, with the Saver's Credit. Whether the Saver's Credit goes into the employer plan or it goes into the individual's pocket, either way the employer gets more participation.

But if you put it in the plan and you deem the government contribution to be an employer contribution, you're effectively telling the employer you can do less to cover other nonhighly compensated people because the government, the burden of doing that or the obligation is shifting to the government.

MR. GOLDBERG: Or you're telling the employer do all the more to market it.

Mark, you can see all of these things, I think you can see them either way.

MR. ORSZAG: Are there questions?

MS. FREES: Hi. Maria Frees [ph]. I'm currently with the National Committee to Preserve Social Security and Medicare, but I just came from the Senate Finance Committee. So right now I'm with an organization that's spending a lot of time thinking about the deficits and debt load outside most people's revenue windows. We're talking about 20 years, 30 years out, 2042, some of our critical Social Security numbers.

And while I was over at the Finance Committee, I spent a lot of time trying to work on those deals that Fred's been talking about, and I don't want to pick on you, so actually I'm directing the question more to everyone else because we've been operating under the discussion here that the trade-off that we're talking about is some kind of refundable, expanded Saver's Credit in exchange for something on the IRA side.

But we're really not talking about that on the Hill right now. The current version of Portman-Cardin, they're not talking about expanding IRAs. What they're

talking about is trading off the Saver's Credit for the administration's RSA proposal, which is an unlimited Roth account. So we are looking at a situation where, at least with the IRAs, you have a tax deduction up front. Most of your deficit impacts are in the current budget cycle, and so at least there is not a devastating impact to revenue flows once you get 10, and 20, and 30 years out.

But the trade-off they're trying to make now is for a Saver's Credit. And I have questions about whether refundability actually increases savings at those low-income rates because I'm not convinced that people at those income brackets really are putting enough money into those accounts to justify the trade-offs for a revenue flow that could be significantly disrupted in the outyears, and you are not just talking about Roth IRAs. In this particular instance you are, but Roth IRAs were the first step toward HSAs, which are also being discussed in the context of RMBAs, which are also being discussed in the Ultimate Lifetime Savings Account that the administration has out, all of these vehicles that would allow people to get income outside the budget windows without having to pay a tax liability.

So I guess the trade-off I worry about is a Saver's Credit that I'm not sure is all that effective at a couple hundred bucks a return to really get people any savings in exchange for a devastating--potentially devastating--impact on our revenue flow once you get 10, and 20, and 30 years out. So I would be curious to see your views on that.

MR. ORSZAG: And that's not for Fred, right?

MS. FREES: He doesn't have to deal with that one because we already know--

MR. GOLDBERG: Kind of a broken-record answer.

MR. ORSZAG: Len?

MR. BURMAN: I agree with what you're saying. There are really two problems with Retirement Savings Accounts in the current budget situation. --. One is that a $5,000 Retirement Savings Account is equivalent to a much larger traditional IRA because in a traditional IRA, when you put $5,000 in the account, there's a tax component that you're going to have to pay back with interest when you take the money out, and then there's the tax-free component.

So a $5,000 RSA is equivalent to something like a $7,000 traditional IRA. It's a much bigger tax subsidy, and the timing is, instead of giving a tax break now and collecting revenue in the future, you're not giving any tax break now, but you're giving up the flow of revenue on the income forever and especially when the budget situation turns bad.

The other thing is that these proposals, I don't know exactly the details of what's being considered on the Hill, but the President's proposal would allow unlimited rollovers from traditional IRAs into Retirement Savings Accounts. That's a terrible deal from the perspective of the budget, but it looks like these things are raising revenues. And, sure, people pay tax on their traditional IRAs, but basically now they've juiced up their accounts, so now it doesn't have this tax account any more. They take their $100,000, for which maybe they owed $25,000 in tax, they pay the tax now, and then they've got $100,000 which grows tax free forever.

We did some calculations last year, and, in present-value terms, the government is losing about $1.30 for every dollar it collects now, and it's losing it after the baby boomers are retiring, when all of the budget numbers turn really, really scary.

Analytically, there are fine reasons to consider these kinds of back-loaded accounts, but in terms of the budget train wreck that we all agree is coming, it's

disconcerting to be basically giving up all of the future revenue streams on capital income.

MR. ORSZAG: Yes?

MR. WASOW: Bernard Wasow of the Century Foundation.

It seems to me that there's a danger that people are talking about a sheep that they're trying to get designed, but what's actually going on in the political process is a wolf that's just wearing those clothing, and what's really going on is moving capital income off the tax rolls.

And it seems to me that, unless part of the discussion deals with the question of whether capital income should be taxable at all and addresses the subterfuges, just as the war on Iraq was a war against terror, it wasn't that. That was part of the program from the beginning. And now perhaps the administration is talking about retirement saving, but that's not the program. The program is removing capital income from the tax base.

And by talking only about the ideal design of saving incentives, you're sort of letting the discussion be--you're contributing to this subterfuge. There's a danger. I don't want to accuse you.

[Laughter.]

MR. ORSZAG: Does anyone want to comment on that? No. Okay.

[Laughter.]

MR. ORSZAG: Final question, and then we'll wrap up.

MR. BRADY: I just want to comment on that. Pete Brady from Treasury.

I just think we should also look at the current system. I mean, this shift from capital income has happened. Five percent of assets in the '50s were in pensions. It's up to like 35 percent now. We've had massive expansions already. We have 529 plans, lots of things into the future.

I don't want to talk about the political aspects of funding, but a lot of the proposals for RSAs and LSAs were simplifications, and a lot of these problems aren't new to RSA analysis. We have that problem even if no laws change. We're having a big shift already. So I just want to put that in perspective.

MR. BURMAN: It's certainly true that that a number of changes have exempted various kinds of capital income from tax. The administration has been trying to set the stage for a new paradigm, where you look at the normal tax base as consumption tax. If you look at the tax expenditure budget now, they've got a new section which looks at tax expenditures relative to a consumption tax baseline, under which capital income isn't taxed. And they say, well, half of capital income isn't taxed anyway. We've got a hybrid tax so why not consider that the normal tax system?

I'm not going to sign onto a conspiracy theory, and I certainly won't link this to Iraq, but I agree that there ought to be a debate, before we totally poison the income tax, about whether the proper basis for taxation is an income tax or a consumption tax.

An income tax in which you exempt all capital income from tax and you still allow deductions for interest and other capital expenses creates all sorts of potentials for mischief. It's really good for tax lawyers, but that would be the worst of all possible worlds, to have the regressivity of a consumption tax and less efficiency even than a loophole-ridden income tax.

MR. ORSZAG: Okay. Well, I want to thank our panelists and thank everyone for coming this morning.

The meeting is adjourned.

[Applause.]

[Whereupon, the proceedings were adjourned.]