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PROTECTING LOW-INCOME FAMILIES' SAVINGS

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MILLER REPORTING CO., INC.
735 8th STREET, S.E.
WASHINGTON, D.C. 20003-2802
(202) 546-6666

C O N T E N T S

Panel Discussion:

ROBERT GREENSTEIN, Executive Director
Center on Budget and Policy Priorities

AUDREY ROWE
AR Consulting

KENT SMETTERS
Associate Professor of Insurance and Risk Management
The Wharton School, University of Pennsylvania

Moderator:

PETER ORSZAG
Director, Retirement Security Project
Joseph A. Pechman Senior Fellow
The Brookings Institution

P R O C E E D I N G S

MR. ORSZAG: [In progress] —American workers. There is growing bipartisan interest in Congress in bolstering retirement security especially for lower and middle income Americans which makes a lot of sense because additional contributions that those households make to 401(k)s or IRAs are much more likely to represent net additions to saving as opposed to simply shifting assets, and because those households are the ones that are most at risk of living in poverty in old age if they don't save more.

So there is a lot of interest in bolstering the incentives for those households to save and making it easier for them to save, but what we want to talk about this morning is a critical impediment to retirement saving among such households and that is the asset test under various means tested benefit programs.

In particular we're going to discuss a new retirement security project policy brief that was written by a team of authors from the Center on Budget and Policy Priorities which documents the very steep implicit taxes on saving that are imposed under various means tested benefit programs. In particular, if you have money in a 401(k) or an IRA, you can disqualify yourself from a variety of government programs. What that means is that these rules penalize those who do the right thing, who sacrifice to put away money for retirement.

What's interesting is that these rules represent perhaps one of the most vivid examples of how our laws and regulations have failed to keep up with the shift from a defined benefit to a defined contribution dominated pension system. When the rules were written, defined benefit plans were the norm and they were therefore

exempted from the asset tests under these programs. 401(k) and IRA type accounts were seen as supplemental to the defined benefit base and therefore there was access that was allowed before retirement under certain situations and perhaps with a penalty, but because that access was allowed before retirement, the asset test counted the 401(k) and IRA plans while exempting defined benefit plans.

Now what's happened is that the pension system has come to increasingly rely on 401(k)s and IRAs and yet we haven't updated the rules. We still effectively force families to liquidate their 401(k)s and IRAs in order to qualify for means tested benefit programs even though those 401(k)s and IRAs are now the dominant form of retirement, in a sense, on top of Social Security, the real core of families' retirement security.

That imposes a very steep implicit tax on saving, and there's a paper that you should have outside or in your packets that documents or goes through the empirical literature suggesting that that steep implicit tax on savings does affect behavior.

More than that, furthermore, we have a very arbitrary system, so as Bob Greenstein will tell us, a lot of the rules just don't make any sense. Under food stamps, for example, 401(k)s are exempted, but IRAs are not. That means that if a moderate or low income household follows the advice of a financial planner and rolls the 401(k) into an IRA when switching jobs, the worker could be disqualified from food stamps as a result.

Similarly, there are rules under supplemental security income and other programs that just make no sense. So this whole system of assets tests are based on a set of rules that were written many decades ago, have really not been updated since and contain a lot of arbitrary and nonsensical inconsistencies within them.

I'm very excited that this morning we have an outstanding panel with us. We're going to first hear from Bob Greenstein who is the Executive Director of the Center on Budget and Policy Priorities and is one of the co-authors of the paper that's being released this morning. Bob will tell us about the findings of the paper which documents the way that the assets tests work and also proposes some policy options for addressing the problem.

Then we will hear from Audrey Rowe who will give us a practitioner's perspective on these matters. She served as Commissioner of the Department of Social Services for the State of Connecticut and Commissioner of Social Services for the District of Columbia, so has a real life perspective to bring to bear on the discussion.

Then we'll hear from Kent Smetters who is an Associate Professor at the Wharton School at the University of Pennsylvania and had previously served as Deputy Assistant Secretary for Economic Policy at the Treasury Department in 2001 and 2002.

Let me just emphasize that there is a growing body of evidence that moderate and low income households will save for retirement if it's easy for them to do so and if there are transparent and effective incentives for them to do so. There is growing bipartisan support in the Congress for taking some of the steps including making 401(k) enrollment automatic so that workers would opt out rather than opt into 401(k)s, and also strengthening financial incentives for moderate and low income households to contribute.

None of that will really make any sense if we don't fix this problem because by encouraging households to save for retirement and 401(k)s and IRAs but them hitting them over the head of they actually do so, it's not at all clear that we're

making those households better off. So unless we fix this problem, all of the other steps that again are attracting bipartisan interest in the Congress will really have been for nothing. So we need to fix this problem in order to move forward on the broader agenda, and with that I'd like to invite Bob Greenstein up to give his presentation.

MR. GREENSTEIN: Thanks, Peter. As you all know, many low income families rely on means tested programs during periods of need such as if they are laid off during a recession or they work for very low wages and have a family to raise. For the key means tested programs we're talking about food stamps, Medicaid, the Temporary Assistance for Needy Families Program, and the Supplemental Security Income Program for low income people who are elderly or have serious disabilities.

There is an asset test as part of the eligibility criteria. In these programs, total countable assets generally cannot exceed a limit such as $2,000 per family, and the asset limits in most of these programs or in all these programs are not indexed, have eroded over time and are continuing to erode with each passing year.

So this raises a critical question, how do the asset tests of these programs treat retirement saving accounts? That is the focus of the report by Zoe Neuberger, Eileen Sweeney and myself, two of my colleagues at the Center on Budget and Policy Priorities, that we're prepared for the Retirement Security Project and that the project is releasing this morning.

Unfortunately, the finding is that the means tested programs treat retirement saving in a confusing and arbitrary manner and, as Peter has indicated, in a counterproductive manner. There are variations from program to program, there are variations from state to state, but a couple of overarching themes stand out.

The first is that all of these programs generally exempt defined benefit pension plans from the asset tests, but with some exceptions count defined contribution plans. In other words, if your employer offers a defined benefit plan, you're okay. If your employer offers a defined contribution plan, you're stuck. If you need assistance through means tested programs to supplement low wages, you'd better not have a retirement account.

The Food Stamp Program has a variation of this. Under the Food Stamp Program, both defined benefit plans and defined contribution plans like 401(k)s are exempt from the asset limit, but IRAs count. So if your employer doesn't offer a plan at all and your plan is an IRA, you're hit in the Food Stamp Program. In other words, you're affected depending on what kind of an approach your employer does or does not offer. In the case of food stamps, what it means is if you have a 401(k) plan but you either switch jobs or you're laid off, say in a recession, and if the advice of financial experts would be for you at that point to roll your 401(k) over into an IRA, at that point you're going to become ineligible for the Food Stamp Program.

So the message is that these rules send to low income families, if you're a low wage working family, your family, for example, needs Medicaid coverage, your employer doesn't offer health insurance, you do not want to enroll in an 401(k) type plan. As soon as you begin to amass a modest amount of savings, you are, in the majority of states, going to lose eligibility for Medicaid.

Similarly, if you're a moderate income worker, suppose you have $7,500, not much, in a 401(k) and you lose your job in a recession, your family is in need of Medicaid and food stamps during the period of unemployment, your choice is either to

go without that assistance and be uninsured or to liquidate your retirement account and spend through it so you can get assistance for the remainder of your time in need. Then when your job comes back, you're starting off with virtually no retirement savings. So these rules undermine the broader goal of encouraging low and moderate income families to save for retirement.

How could we deal with this? The simplest way would be for Congress to amend the Tax Code to provide that retirement accounts that receive preferential tax treatment, whether they be DBs, DCs or IRAs, are disregarded for eligibility and benefit determination purposes in federally aided means tested programs. There is precedent for including a provision such as that in the Tax Code. In you look in the earned income tax credit part of the code, you'll see a broad provision related to the treatment of the EITC in means tested programs. Or for those of you who follow individual development accounts, IDAs, you know that there are provisions of federal law stipulating that most federally funded IDAs must be disregarded as assets in federal means tested programs.

Peter has noted that there is growing interest in including, whether in Social Security legislation or in separate pension reform legislation, provisions that would encourage more employers to move to opt out rather than opt in plans for employer provided pension plans. And there's growing interest in broadening the saver's credit to low income families as well.

As Peter has noted, in the absence of changes in the asset tests, the asset test provisions undermine and give counterincentives to what these other reforms would provide for. In fact, some people could be encouraged by an opt out to undertake saving only to find that it's made their family worse off rather than better off because of the

operation of the asset test. For all of those reasons, we would recommend that any broader legislation that is designed in part or in whole to promote more retirement saving and that it includes provisions like the opt out or savers credit reform and ought to include a broader provision dealing with the treatment of retirement accounts in the asset tests of these programs as well.

In addition to that, there are opportunities for states to make progress here as well. States obviously don't have authority over the rules for the federal SSI program, but they have complete discretion over the asset tests including what counts against them in the Medicaid and TANF programs, and they may shortly have some more discretion in food stamps. I'll have more on that in a minute.

For both the federal and state governments, obviously there is an issue that these reforms by disqualifying fewer people in their working years for the means tested programs would add somewhat to their costs. That ought to be weighed against the fact that increasing retirement savings, increasing national saving in general, is a critical national goal; that to the degree more low income and moderate income working families can amass retirement saving, they will have less need for means tested programs in old age which is when those programs cost federal and state governments the most. And finally, weighed against the extremely large amounts that federal and state governments now spend on tax subsidies for pensions and retirement saving with the vast bulk of that going to people in the top fifth of the income spectrum, the costs of removing barriers to retirement savings at the bottom end of the distribution are relatively small by comparison.

A few quick words on what can be done in individual programs. If we start with the Food Stamp Program, as I noted, it exempts employer provided pensions but counts IRAs. A provision of law enacted in 2002 provides that states may exempt items from counting as assets in the Food Stamp Program if those same items are exempted from counting as assets in either their TANF, the Cash Assistance for Low Income Families Program, or their Medicaid program for families with children, with certain exceptions. The exceptions are to be determined by the U.S. Department of Agriculture by regulation. The exceptions are the things that must count regardless of what states do in Medicaid and TANF.

We are awaiting final regulations from the Agriculture Department to determine whether IRAs would be among the items that states could now exclude if they exclude them in TANF or Medicaid, or whether states will be required to count IRAs, and if so, whether it will be all IRAs or some IRAs that must be counted.

We would urge that once these final rules, expected to be out later this year, are issued, that states exclude IRAs from the food stamp asset limit to the degree that the regulations allow, and that takes us to Medicaid and TANF. At a minimum states should be exempting retirement accounts from the asset tests in Medicaid and TANF to the degree that they do so in their Food Stamp Programs. That would allow a seamless set of consistent rules across the three programs, easing administrative burdens and costs and simplifying the rules for families and administrators alike.

In the Medicaid program now we have a wide variation. There are about 22 states if I recall correctly that have eliminated the asset test altogether for families

with children, but for the remaining 29 or so that have an asset test, most of them do count 401(k)s and IRAs against the limit.

The federal Supplemental Security Income Program raises its own set of issues. It generally counts to find contribution plans to find contribution plans and IRAs against it. This poses a series of problems. If you are a low income elderly person seeking to qualify for SSI and you have a modest retirement account, there are two things you can do to qualify neither of which may be in your best interests. You can on the one hand go out and purchase in the private market a lifetime annuity, but a lifetime annuity is not always a wise choice for low income people particularly if they're expected to have a shorter than average life expectancy, as the low income population in general does.

And given that somewhere in the vicinity of 15 percent of the balance of an account is usually taken by the annuity company to cover its costs and adverse selection issues, one would not want to blanketly recommend that every low income person with a modest account go purchase an annuity.

There's another way you could qualify and that is upon reaching age 65 and being eligible for SSI, you could liquidate your retirement account and convert it to nonexempt uses. Fix your home, upgrade it, patch the roof, buy a new vehicle, exhaust the assets so then you qualify for SSI. As a result of these, it isn't clear that the SSI program is actually saving significant amounts of money through this rule.

We recommend two changes in this report in the SSI rules. Firstly, the Social Security Administration which administers SSI, ought to exclude retirement accounts held by nonelderly people, people with disabilities who are of working age.

This would eliminate the need for such people to liquidate their accounts during periods when they're unable to work and need SSI benefits. It is increasingly federal policy to help and assist these people to go back to work to the degree that they can, and one should want them to be building retirement assets when they can work. If they built enough, they might not then need SSI when they got to old age.

Secondly, we recommend that SSI drop the requirement that you have to purchase a lifetime annuity to have the retirement accounts excluded when you're in the elderly SSI category, and instead that we move to a regime whereby SSI imputes a monthly annuity value from your account and counts it as income. It would be simple for the Social Security actuaries to annually publish a table. You would simply look up on the table your age and the amount in your account. The table would use the actuaries' projected average life expectancy and it would give you a monthly annuity value from your account. In this approach you wouldn't be able to game the system by never withdrawing any money.

Here the account would serve its intended purpose. It would give you an income stream in old age. The income stream would be taken into account in determining your eligibility and benefits, but you wouldn't simply be disqualified because you had $4,500 or some such amount in an account.

I would note that in 2003 then Representative Rob Portman and Representative Ben Cardin introduced a pension bill that included in it a provision that would exempt the first $75,000 in retirement account from the SSI asset test and required, just as we're suggesting here, that a monthly annuity value be computed based

on a table the SSA actuaries would issue with the monthly annuity value counted as income for SSI purposes.

There is one last rule in SSA which certainly seems out of date. Under current SSI rules, if an SSI recipient with a defined benefit pension has a choice in terms of whether to take a higher pension payment, that is, a single annuity and terminates when the individual dies, or a lower monthly pension payment that is a joint annuity that lasts until the spouse dies. SSI rules actually require that higher payment be taken, leaving the spouse out to dry unless the recipient knows enough such that the spouse refuses to waive her rights to the benefits. This is contrary to federal policy in most other areas and really ought to be changed forthwith.

In conclusion, we do have, as Peter noted, growing bipartisan interest in a series of reforms to promote retirement saving among low and moderate income people, but they have the high potential to be undermined by the archaic, arbitrary rules in the asset tests of the means tested programs. These rules were created 30 to 40 years ago when DCs and IRAs barely existed and if you had a pension it was likely to be a defined benefit pension, and the people that crafted the rules for these programs thought they were excluding pensions by excluding DBs and they then faced the question that given other kinds of savings accounts, somebody could have money in a savings account in trust that wasn't accessible, so they simply put in a blanket rule that if you could withdraw money from an account, it counted, and if you couldn't, it didn't.

Then as the pension system developed, we had a series of vehicles in 401(k)s and IRAs from which you can withdraw money, albeit with a penalty in many cases, prior to reaching retirement. Since there was no specific rule exempting pensions

other than DBs, the governing rule was the accessibility rule which is why under these programs these kinds of vehicles count rather than excluded against the asset test.

It was not as though any policy maker I am aware of in Congress or in the agencies explicitly said I think DCs should count while DBs should be exempted. It was simply an unintended outgrowth of well intentioned rules crafted 30 to 40 years ago and now it's time to change them.

MR. ROWE: Good morning. It's like to take a few minutes to talk from a practitioner's perspective on some of the comments that Bob and Peter shared on this report. I think it's an exciting opportunity for us to move forward to the next steps in welfare reform. In 1996 we spent a great deal of time focusing on reforming means tested programs so that they would move individuals from welfare to work and into the job market.

This report suggests that there is a next step that needs to be taken and that is to encourage savings so that individuals who have moved into the job market can now save for retirement without fear of penalty and can enjoy the benefits of some of these programs when they need them as they are working.

In Medicaid, disregarding retirement accounts and other means tested programs, will allow policy makers and program administrators to achieve the objectives or continue to achieve the objectives that were started in 1996 and certainly help to simplify the administration of these programs. And as I will mention later, also help to save administrative costs in administering these programs.

The rules as they are applied today result in complex and inconsistent eligibility determination, regulations within programs and between states. So within

programs in a state, the inconsistency exists, therefore making it much more complex to administer these programs, resulting in more complex systems design as well as more complex staff time in determining the eligibility for individuals.

Programs that are complex also make it much more difficult for individuals to avail themselves of the programs that exist for them. And as Bob mentioned, individuals who see this kind of complexity will sometimes forego having health care or other supports in time of need because of the difficulty in achieving an objective and participating.

As the report indicates, the federal framework from which the eligibility rules in Medicaid and means tested programs were derived need rethinking. As a program administrator in the 1990s working on welfare reform and changes, we thought a lot about a number of issues. I can honestly say that this issue never rose to a point of any discussion. We weren't thinking about it. It is now time, and many program administrators are starting to step back and say we've gone this far, now we need to start looking and rethinking what we do with regard to retirement and with regard to assets and what assets we count and what assets we don't count.

Welfare reform gave states a great deal of flexibility. You have the ability to determine what kinds of assets you want in means tested programs and which ones you want to disregard, and we think it is time that we really look at, again, simplifying programs. We talk a lot about how we simplify programs, but each time we add additional steps in eligibility rules we make the programs much more complex.

There is some evidence that states are starting to rethink their asset rules in this area. For example, many states have eliminated asset tests for families with

children in the Medicaid program. Just before I left Connecticut we were starting to do and to think through how we eliminated and made it easier for families and children to participate within the Medicaid program. And certainly with the Add on the CHIPs Program, many states have continued to eliminate all of the asset rules so that many more children can participate in the CHIP programs.

At the same time, for programs such as SSI or food stamps, states need federal government help. There is just so far states can go. Now we need to turn to the federal government and to have their help in simplifying the treatment of retirement accounts and to remove the penalty for savings. Congress could in fact address this problem in all means tested programs by creating a blanket disregard for 401(k)s and IRAs, therefore sending a message as they did in 1996, we want to encourage more savings for individuals as they move into retirement.

Many low and moderate income families rely at some time on means tested programs. That is a reality. If you're working, if you're a low income worker, not only job loss but some are part time workers, there are health crises, there are very crises that families face that they need to be able to benefit or to apply for some of the means tested programs. Under current rules, applying for Medicaid coverage would require depleting a modest savings account. As an administrator when I looked at some of the assets that families had at that time, of course, my favorite one was the automobile, but we got rid of that. But as you looked at some of the other assets that families had, you're talking about modest savings. So how do we ensure that individuals can hold onto these modest savings, benefit from means tested programs when they're needed, and therefore be able to when they retire have a savings that they can use?

Continue simplification of eligibility rules in means tested programs can result in both short term and long term administrative savings and cost savings to the programs.

Finally, a goal that I think all of us would want to support and the Congress I'm sure would feel is an important objective in continuing to reform these programs, and that is increasing savings for low and moderate income families. It would improve the standard of living and health well-being of these citizens. Most importantly, I think it will prevent many of these individuals as they move into retirement from relying on existing means test programs, again, an objective that we have talked about when we reformed welfare in 1996, one that we need to talk about today as we continue that reform

MR. SMETTERS: Thanks for the opportunity to come in and discuss this really great study which really represents a tremendous amount of work. Not only did the authors have to dig through very arcane and complex federal law, but the laws of 50 different states. It's deceptive in many ways when you read a couple of sentences about what states and cannot do, and you read it and take it as given, but when you think about somebody had to actually had to dig through all these state laws to try to figure out some of these things, it really represents a tremendous amount of work.

A couple of things I really learned a lot about this study, first of all, I didn't quite appreciate just how much flexibility states already do have under the existing law, TANF, SSI, food stamps. I think that's pretty interesting to learn that not only do they have lots of legal flexibility, but that lots of states have really taken advantage of

that flexibility and you see lots of exciting experimentation going on right now at the state level.

I think it really is a success with both TANF and even the broader vision surrounding TANF, you could almost call it the new view, toward welfare—away from this kind of very centralized federal structure to more of state experimentation, and I think it's really exciting to see all the heterogeneity and the difference sources of experimentation into what researchers can learn from what works and does not work.

I think the study is also very convincing that there is a lack of parity today between traditionally defined benefit programs and defined contribution plans, and I'll talk some more about that.

I have four points that I'd like to talk and the first one is the study's motivation. It starts out by arguing very correctly that there are really low retirement assets by poor households. It's completely clear from the study itself exactly what the reason for low saving is. Is it low access? And by access I mean primarily access to 401(k) accounts. I don't view IRAs as a very good substitute for employer based 401(k) accounts. IRAs take I think a lot more effort to think about. If you're a poor person working for somebody who doesn't offer a 401(k) account, yes, you could go out and set up an IRA, but that requires a lot more effort. So I think it's about access to 401(k) accounts.

Or is it due to people who have access but they just choose not to participate? Making that distinction is important. Empirically both are at work, of course, but the policy options are different between the two. If it's low access then as part of Social Security reform you want to start thinking about maybe having add-on

accounts where it would make it very, very easy for people to get access. Even if they work for a small employer who doesn't offer a 401(k), they just check a box and now they're enrolled in some type of add on type feature, maybe automatically enrolled with some hurdles to opt out.

Whereas if it's just low participation even though they have access, while low participation could be rational, I want to give the rational view first, it could be perfectly rational to have low participation because Social Security itself provides a progressive benefit and, in fact, a lot of our models that we have as economists suggest that poor people today shouldn't be saving that much, the reason why Social Security still provides fairly generous benefits in Medicare and so forth. But there are still a lot of people in poverty and who are poor and want to take that into account.

As well as younger people. A lot of low income people are just younger people and they should if anything be borrowing against future income, not necessarily saving that much. But still I think the ideas that were mentioned earlier about automatic enrollment with some opt out provisions where you have some hurdles to opt out is a good idea. But as Peter mentioned at the beginning of this, even if you try to increase access, if you don't get rid of some the disincentives to this means test, lots of that increase in access is just going to be undermined.

The second point that I would like to emphasize is that I think the study was very persuasive that poor people really do face lots of disincentives from the means tests. What wasn't so clear if were going to go out to the state level and see some of these ideas about removing the means tests, how much would we actually see in the increase in savings? By that I don't mean some complex macro simulation, but even just

some stylized numbers that you could glean from the empirical evidence about the means tests and how much it reduces private savings in retirement accounts.

How much could we expect to gain or benefit low income households if we actually removed the means test? I think the reason why that's kind of important is that it's not enough to simply say, yes, it would be a benefit. It's clear it's going to be a benefit, but there are going to be some costs to reform as well. In particular, if you thought that household increases in savings would not be that dramatic but there would be lots of more enrollments in terms of Medicaid in particular that could have serious budgetary implications, that might be something that policy makers would be quite concerned about. You could still have other reasons for why you want to cover households with Medicaid even though they have higher assets, but it wouldn't be the savings reason.

Related to that is my third point in which it would be good to have an understanding of the budgetary impact of removing the asset tests. Medicaid right now on the state level represents the largest single category of spending and states are very sensitive, obviously, about going forward, how much Medicaid is going to cost going forward and they're trying to figure out ways to trim not increase spending. So states will want to know relaxing asset tests especially for families with children. In terms of families without children, that's already been relaxed, but relaxing the asset tests, is this going to increase the case load a lot. If it would, they're just kind of hard sell.

Fortunately, 22 states have already relaxed this test, and so there are some opportunities for actually doing some empirical evidence to see if case loads and spending has increased a lot in response to removing these tests.

The fourth point, and this is where I'd like to see maybe the study take a little bit more specific stands on two key issues, and that is the asset for 401(k) type accounts and as well as IRAs with and without penalties for early withdrawals. You almost want to see the authors say suppose that the 401(k) accounts, or even think about new type accounts that people talk about in the future, where you could have one type of account for retirement and another type of an account that's tax free saving but it's not necessarily retirement, you could withdraw money earlier. The Bush administration has talked about those types of accounts. Would the authors in fact be in favor of applying the asset tests to accounts even if there were not substantial penalties for early withdrawal.

If you want to create parity with the defined benefit type system, presumably you would apply the asset test to accounts where it's very easy to access the money before retirement because if you didn't, it's not even an issue about retirement security anymore, someone with lots of assets could essentially put it into those retirement or nonretirement accounts, have it excluded and then still get access to the money before retirement. So it would to actually have a specific stand in terms of whether or not the asset test should be applied to accounts with and without those penalties.

Keep in mind that even though we're bashing the asset test, there is a logic to it. In fact, what's interesting is that there's literature now on disability insurance. As you know, disability insurance does not have an asset test, but this literature is arguing that you should actually have an asset test for disability and the logic is that it's very hard for the government to verify various disabilities, things like lower back and

neck injuries, all those types of things. So what an asset test does is that it separates the fakers from those who really do have the problems, and that is the fakers doesn't want to drain down his assets and go into retirement with a low amount of assets and the person who is not faking doesn't really have a choice, and so they're going to just do it either way. So the asset test is a way of trying to separate those who, they don't use the words fakers and nonfakers, but that's effectively what's going on.

[Laughter.]

MR. SMETTERS: Empirically in Chile, Chile has a privatized Social Security system and they also have a privatized disability system. What they require there is that you actually first dip into your own 401(k) plan's personal account when you need access to disability. It's like an asset test. It's not literally an asset test, you just have to first use some of your own money. So the idea there is that economists will tell you in a setting where it's hard to observe the behavior of people, are they poor because of lack of effort, are they poor because they're faking disability and all those types of things, you want some shared sacrifice. You don't want it just perfectly easy for them to get insurance, in this case social insurance, without some type of shared sacrifice. You want them to feel some of the pain.

Another way of saying it is that 100 percent insurance is never optimal. You always want a deductible and some co-insurance to deal with the moral hazard problems. So it's not a case where there's just no rationale for an asset test and some type of shared sacrifice, the point is to try to have it done in a logical way. It seems like this study is convincing that for combined contribution plans with a severe penalty from withdrawals that can't be easily gained, you can't just hide money there, that it makes

sense that you would in fact not apply the asset test for those. But for systems that don't have those penalties, then maybe you do and it would be good to see the authors actually take a specific stand on that.

The last point today I would like to see them take a specific stand on is fiscal federalism. Do the states really have the right incentives under current law to worry about retirement security? There are two issues there.

The first is that there is a free riding problem. You don't want to become the generous state when it comes to the provision of welfare, you become a magnet, and there are empirical studies showing that, that states don't want to get too far out of line of their peers. Their peers are typically not defined just geographically, but often by size.

Also a lot of state legislators may not really care about retirement if they believe a lot of their people will be done, a lot of their voters will be gone by the time they would retire.

What's interesting about it is the fact that you still lots of heterogeneity in state choices and it's really shocking to me how many states have actually dumped the asset test for things like Medicaid in terms of families with children. It seems like they're not completely trying to free ride and worry about becoming a little bit more generous or a little bit easier than other states. At the same time, I would note that the big states, the very populous states like California, Texas and Florida still have the asset test and the question is do they really have proper incentives.

Let me sum up and say this is a really phenomenal study. It's very convincing and it certainly convinced me that we really need to create some parity between defined benefit and defined contribution plans.

MR. ORSZAG: We'll open it up for discussion. If I could ask Bob to respond at least to the question that Kent raised about the asset test writ large, that is, whether there should be asset tests as a generic matter, as opposed to the focus of the paper which is that given that you have an asset test, does it make sense to have inconsistencies across various kinds of retirement plans.

Bob, if you could share your thoughts on whether asset tests in general are or are not desirable as opposed to the narrower question that was examined in your paper.

MR. GREENSTEIN: I think Kent raised some very important questions. My own view is it's not as simple as one should have asset tests everywhere or one should have asset tests nowhere. What I mean by that is I'm very attracted by the policy instituted in the 22 states that have instituted it that have eliminated the asset test for families with children in Medicaid.

There are strong reasons for not having children, for example, in particular possibly miss preventive health care because of an asset test. There also is a lot of evidence that when families can get health care together as a single policy, that eligible children are more likely to enroll and to get things like preventive care. So I think there are strong arguments, and given the importance of preventive health care up front for averting larger health care problems down the road, I think there is a strong argument on the behalf of the state activity in those 22 states to eliminate the asset test for families with children in the Medicaid program.

It should be noted that to the best of my knowledge no state has eliminated the asset test for Medicaid for elderly people, and I would think that states

shouldn't eliminate the asset test for elderly people. You don't want people who have lots of assets but low income at low age because they're already working to be able to organize their affairs.

MR. ORSZAG: Because they're already retired.

MR. GREENSTEIN: Did I say already working?

MR. ORSZAG: Yes.

MR. GREENSTEIN: Already retired to organize their affairs so they can get Medicaid.

With regard to food stamps and SSI, there too in my view there is a need for an asset test. Someone should not be able to get those benefits with extremely high levels of assets.

Having said that, I do think that the current asset tests in both programs, the limits are too low. They haven't been adjusted in either program since the 1980s, they have eroded due to inflation, and they’re effectively much lower than they were a couple of decades ago. I would like to see some adjustment there. But in all of the programs that maintain asset tests, I think the retirement accounts should be excluded from them.

Kent also raised the question are you talking just about retirement accounts or are you talking about savings accounts more generally. He sort of put it in terms of suppose there's not a penalty for withdrawal before retirement. Our focus in the paper was only on retirement accounts and my view is that regular savings accounts should be counted not excluded against the asset tests on things like food stamps and Medicaid. In other words, that the asset limits should be made more reasonable, they're

too low, that they should be adjusted for inflation so that they stay constant in value over time rather than eroding, that retirement accounts defined as they're for retirement, if you withdraw before retirement there is some sort of penalty, should be excluded, and that nonretirement savings accounts should be counted.

We didn't spell all that out in the paper. It was beyond the scope of the paper. I think Kent is absolutely right to put those questions to us. I should say those are not necessarily the views of my co-authors, but they happen to be my view.

MR. ORSZAG: If I can just add one other comment before we open it up, the theory on separating the fakers versus the nonfakers has a problem when the asset tests have a big hole in them, and in particular if, for example, home equity is exempted as it generally is, someone who is smart enough to game the system will quickly figure out that dumping all of the assets that they have into home equity gets around the rules. So in order to have that really be an effective screening device to separate the fakers from the nonfakers, you need a pretty tight test that makes it so that it's not possible to have any exemptions, and under the current system there already are various exemptions. So people who are very sophisticated and can figure out where the holes are can put their assets into those types of assets.

What I think disproportionately happens as a result is the people who are not as sophisticated wind up getting hit because they happen to have their assets in the nonexempt categories, but that's obviously a theoretical discussion.

Why don't we open it up for questions? I have two requests. One is that you actually ask a question, and the second is that you identify yourself and your affiliation.

MR. WEYMAN: Carol Weyman (ph), CFED, and my specific question is on the political process. Are there specific congressional champions or legislative bills in play to amend the federal Tax Code to talk about the things we've talked about this morning?

MR. GREENSTEIN: At the present time, no. I have been struck, however, at the speed with which the political system has responded to the recent studies on automatic enrollments on converting retirement plans so that they're more opt out than opt in. Also the response to the recent papers, these are pretty much from the Retirement Security Project, on the recent H&R Block in St. Louis on the saver's credit. Now there is interest in reforming the saver's credit to reflect some of the findings from those studies. Our hope with this study is that there now will begin to be some interest in addressing this on the Hill.

There are two little prior episodes. One was that in 2001 when the tax bill was being written, and of course, the 2001 tax bill includes some significant changes in pension legislation primarily at the upper end, increasing 401(k) and IRA contribution limits. The Senate Finance Committee did get interested on a bipartisan basis during the drafting of that legislation in dealing with this issue about retirement accounts and asset tests.

The problem which they were candid in discussing with us at the time was that they had more tax cuts competing and being championed by various members of the committee in the Senate than they could fit within the $1.35 trillion ceiling they had for tax cuts in that year's bill. They were in a sense already oversubscribed on the tax side.

They initially wanted to put this change on the asset limits in. My recollection is that they sent a series of inquiries to the Congressional Budget Office for cost estimates. They got one cost estimate from one program or maybe even a partial cost estimate from one program. They did not share with us what the cost estimate was other than that it was more than rather than less than $1 billion I guess over the 5 year period or 10 year period. It wasn't very specific. The response was sorry, we could only fit it in if it were in the hundreds of millions rather than in the one plus billion dollar category. To the best of my knowledge, CBO then didn't proceed to do the full cost estimate so we really don't know what the cost estimates are. They're based heavily on what behavioral assumptions one makes in terms of people entering the program, saving for retirement, keeping the retirement accounts.

The other little episode I mentioned is that when Congressmen Portman and Cardin looked into this issue in 2003, they concluded it was a problem and put this change in their 2003 bill that would have exempted accounts under $75,000 from the SSI asset limit and then imputed income from those starting at age 60-1/2. That was in their bill. Again, they never made public a cost estimate on it. I don't know what that provision costs.

The problem that we were informed of in 2003 was that if and when their bill was going to be moved, it would be moved as a tax bill only with revenue reductions. When you change the asset limits your cost is in the form of an increase in outlays, not a reduction in revenues, and that was outside of the scope of what the chairman wanted to consider in Ways and Means in 2003.

At the present time, there are not already bills out there. It is very much our hope that this bill becomes a part of the discussion of what needs to be done in the way that the automatic enrollment in 401(k) type plans and the reforms in the saver's credit have over the last 60 to 90 days.

MR. ORSZAG: Let me add one additional comment. This is an area in which there is again strong bipartisan concern. A lot of the early work on the distortionary effects of the asset tests comes from people like Glenn Hubbard who was President Bush's Chair of the Council of Economic Advisers. Marty Feldstein has written about the distortions that are caused by these kinds of asset tests. So among more conservative economists, a lot of concern about effectively (?) the implicit taxes on saving that are imposed. Then on the left you also have concerns that for many people, Social Security will not be enough even at the bottom end of the income distribution, and so a desire to build more retirement saving there.

All I would say is I agree with Bob that we have not seen specific proposals yet, but all of the activity that is going on including Chairman Grassley and including Chairman Thomas to try to bolster retirement security for moderate and low earners will really be undermined if we don't address this problem.

We don't have specific proposals yet, but we should, and many of the steps that people think will be productive will wind up being counterproductive unless we address those. I hope and expect that this issue will enter the fray much more forcefully over the coming weeks and months.

MR. GREENSTEIN: One quick point on that, over the last 4 years I've had several, not a huge number, but several discussions with staff or members on the

Hill about this issue. I have found that when people hear about the discriminatory treatment of DBs versus DCs, they are surprised and you get a pretty universal response that it doesn't make sense and should be fixed and that there is no difference between Republicans and Democrats and conservatives and liberals in how people respond to that.

I don't think that's where the political challenge lies. Where the political challenge lies is that if one wants to do some kind of retirement or pension reform legislation, in order to do these reforms on the asset limits, if you have a given dollar amount you can spend for the bill, you have to be willing to spend a little less on the tax break side in order to leave room for a little bit on the outlay side to address this problem.

That is the political challenge, but I don't think, I'll be very surprised, if we see people on the Hill arguing regardless of their political perspective or party affiliation that it makes sense to count 401(k)s but exclude defined benefit pensions. I don't think there's going to be much disagreement about that.

MR. ORSZAG: Are there other questions?

MR. MACLAURY: Bruce MacLaury of Brookings. Bob, I didn't hear you say anything about caps on the amount of disregard, and it seems to me you're inviting the few examples of welfare queens if you don't some sort of cap on the disregard. That's an observation, but I'd be interested in your point of view.

There is another way to even up DBs and DCs, and that is that you could eliminate or at least reduce the number of exemptions or abilities to withdraw funds from IRAs, Keoghs, et cetera. If you're really going to make them similar to DBs which

you can't anticipate, then you have to either eliminate or reduce the number of abilities to withdraw.

My third point, it seems to me you're expecting superrationality if you are arguing that an expected asset test 20 years down the road is going to prevent me or discourage me from saving today.

My last point is do you have any thoughts about whether the possibility of private accounts in Social Security, I know they aren't here, I don't imagine they're going to get here, but in thinking about assets, are these going to be personal assets that might be counted against an asset test?

MR. ORSZAG: Bob, let me just briefly answer or address the second and fourth questions and then the rest of the panel should feel free to answer all of them.

On the question about whether we expect any behavioral response, in other words, is it reasonable to think people actually figure this stuff out and base their saving decisions on rules, my general sense is the following. There is empirical literature on this, and we've up the results from that, but more importantly, that there is this social norm surrounding these rules, that people do know that if you build up too many assets you disqualify yourself from food stamps or from other programs.

I actually think this is the main explanation. This is a gut reaction as opposed to a hard research finding. I think this is the main explanation for the findings from the individual development account literature where you do get a response into the accounts, but then the money seems to disappear very quickly for all sorts of purposes like home purchases.

I think what's going on is it's not precise and it's not hyperrational econ 101 processing, but a loose sense that if I keep that money there, someone is going to figure that out and I'm going to have a problem and that there is a social atmosphere in which that knowledge is present.

Rephrasing it, simply changing the laws would do very little if it didn't then feed into those social norms, but if there were growing awareness that it's okay to save in IRAs and 401(k)s and those are safe, I do think that you'd see some behavioral response and the literature, while it's not the best literature in the world, suggests that people do respond to these incentives. For example, when you change the vehicle equity limit, people do respond by building up more vehicle equity, for example.

With regard to Social Security, as Bob had mentioned, the main criterion that's often applied is whether there is any access before retirement. According to the administration's proposal for individual accounts, preretirement—

[End of side A, begin side B.]

MR. ORSZAG: [In progress] —and so under that interpretation, the assets would not be counted. But, and I think this is a very important but, I find it completely implausible that the prohibition against preretirement withdrawals would actually be sustained over time especially given the way that the accounts are being sold as on the ownership and control theme, if you own the account you control it, your kid is sick, you need a new car, why can't you pull the money out before retirement?

What we've seen with regard to 401(k)s and IRAs and even the Thrift Savings Plan that's often offered as an example or the model for these accounts is gradually over time increasingly liberalized access before retirement. I think it's very

likely that the same thing would happen to individual accounts as part of Social Security and, therefore, if these rules were not addressed, talk about a major problem being created. If the rules were not modified and there were any preretirement withdrawals that were allowed, then at least according to the interpretation that I get from the paper, the assets would count if the rules were not changed.

MR. GREENSTEIN: Let me try and take each of your four issues, all of which I think are important.

To follow up with Peter's point on are people rational, do they understand this and respond, I think the situation could change significantly if we do go to more automatic enrollment of 401(k)s, and there are reforms in the saver's credit such that low income people have access to it. If that were the case and the proportion of low income workers' saving through 401(k)s or IRAs, particularly 401(k)s, went up significantly and people began within a few years of entering such a program to be thrown off of these benefits or were told add another couple hundred dollars to your account and you will be thrown off, I think we would begin to see a much more widespread reaction, and part of the concern here is not only the current situation, but the effect these rules would have if we really succeed in other policy reforms that encourage a lot more saving among the low income population.

Secondly, with regard to Social Security, I think there is such interest in promoting private accounts on the part of those who favor private accounts on a voluntary basis within Social Security, that I would expect that once they focused on the issue that they would agree that they would want to avoid a situation whereby if you

don't elect private accounts you're okay because Social Security is a defined benefit, but if you do elect private accounts, you're going to hurt yourself down the road.

So I think you would probably see once people focused on it a ready willingness to effectively exempt the private accounts within Social Security. Doing so would be scored as having zero cost. It's one of these peculiarities on how we do cost estimates. If you passed Social Security private account legislation and you included in the same bill an exemption for those private accounts, the exemption wouldn't be scored because there weren't yet any private accounts.

If on the other hand you pass the legislation with the private accounts and you came back the following year and wanted to pass a separate bill exempting them, the bill would be assigned to cost at that point because the private accounts would already a law.

So for all of these reasons, my expectation would be that people designing private accounts would focus on this. I don't think they have yet, but I think they quickly would.

The third point is you suggest that in conjunction with such changes one might want to tighten the rules regarding allowable withdrawals prior to retirement from 401(k)s and IRAs. I would agree with that, and I would agree for reasons extending beyond the integration with the asset tests. But having said that, I think the political likelihood of that happening is near zero.

Your fourth question is the most challenging, should there be a dollar cap on the value of the accounts that are exempt. From a standpoint of administrative simplicity and ease and having a clear message that these accounts will make you

ineligible, that would orient you towards not wanting to have—Audrey may want to jump in. My experience in other analogous circumstances of talking to administrators is don't make me go through the work of showing that someone's below the limit if 99.5 percent of people are going to be below the limit anyway.

I would also note that under the food stamp rules today, 401(k)s are exempt without regard to the limit, and I have not heard any criticism. There have been years when there were raging debates on the Hill of whether a vehicle should be exempt or would you have a Mercedes and get food stamps, I've never heard the issue raised with regard to 401(k)s.

Having said all of that, it is the case that when Congressmen Portman and Cardin wrote their bill in 2003, they did look at it the way your question implies and they wrote in not a total exemption, but an exemption for accounts under &75,000. And while it would be simpler administratively not to have a limit, I think that a limit such as $75,000 is going to address the majority of cases we want to address so long as that dollar limit is indexed and isn't still $75,000 half a century from now. So I think it's better not to have the limit, but if that's the only way to go to make this politically viable, then we ought to talk about a limit; just if there is a limit, you don't want a limit of $5,000 on an account. Policy makers would have to understand that you have to have the limit high enough for people to have a reasonable income stream throughout their entire period of retirement.

MS. ROWE: I think that discussion on whether you have a limit when some states were looking at their CHIP program, the Children Health Insurance Program, there was discussion of should we maintain an asset test with some limitations

or should we eliminate it. I think the thinking in the states was, one, we want to encourage individuals, families, children to participate in these programs so we want to send a clear message and make it as simple as possible for them to participate. Secondly, we want to make the administration of the program as simple to administer as possible.

I think the data, there is information in the report, speaks to the fact that states that have eliminated these asset tests have found cost savings certainly from an administrative point of view and the simplicity of integrating these programs is much greater and you're able to show and demonstrate a more cost effective way to provide these services.

So I would recommend and I would concur that having no limit from a program administrator's perspective makes the program much more effective and efficient.

MR. GREENSTEIN: I would add on this the politics of whether to have limits or not on asset tests, it's not clear always which way they fall and I cite the example of the vehicle limit of food stamps.

If one had proposed 5 years ago or 3 years ago to raise the vehicle limit $4,650 on the market value, not even the equity value, of the account to $10,000, you couldn't pass it. What was passed instead though was the provision that said that you can conform your vehicle limit to what your vehicle limit is in TANF or Medicaid. Policy makers doing that knew that many states had eliminated the vehicle limit in TANF and Medicaid and this effectively allowed states to have no vehicle limit at all.

Yet that was politically easier than writing what looked like a high dollar limit into the legislation.

So I'm not clear always which way it cuts. A $75,000 limit, is it easier or harder to promote that on Capitol Hill than no limit? It's not always clear I think.

MR. ORSZAG: Maybe we should have a limit that says an account that would generate an annuity income of X so that would make it sound lower.

[Laughter.]

MR. ORSZAG: It would actually also be age related which may also make sense.

MR. KRAUS: Adam Kraus (ph) of the Urban Institute. What still remains unclear to me is the size of the population that you think is affected by these asset tests. In particular, I'm having trouble getting my mind around the population that would have meaningful accumulations in retirement accounts and yet would still find the need to participate in these welfare programs.

In these studies you've conducted, do you have any estimates by which suppose that you got rid of these asset tests by how much program participation would increase?

MR. GREENSTEIN: Unfortunately we don't have data on those. It really would be useful if we did. We don't.

I do want to clarify that I do not think most of the people we're talking about have $50- or $100,000 in these tests. In fact, Peter, you can cite the data better than I. My recollection is that for people in the bottom fifth of the distribution who do have a 401(k), that the median value is something like $4,500, something very small.

I think the particular concerns, the biggest concerns, are about people who have fairly recently begun to save for retirement and have pretty small amounts they put aside each year and have $5,500, $7,500, $12,000 in one of these accounts and they meet a misfortune and they need means tested benefits. I'm talking now primarily about people during their working years.

I think for those people that the primary people we're concerned about and who would be affected are people with modest balances, not large balances. But if you're only at $7,500, you don't want that person to have to liquidate the $7,500 and start over again after the recession. I think that is the particular concern for those at working age.

My guess would also be that most people who otherwise have income low enough to qualify for SSI and are disqualified because of a 401(k) or an IRA probably also have pretty modest 401(k)s and IRAs. In those cases, they could if they choose to do so start to convert some of those assets to homes, cars, other kinds of things to be able to qualify for SSI, particularly given that in most states, qualifying for SSI brings with it eligibility for Medicaid which can be very important for low income older people.

We are not primarily concerned about people with large retirement accounts. In fact, if you had a rule in something like SSI that you would impute a monthly annuity value from the accounts and count it as income, then people who have large accounts are going to be ineligible anyway because their income is going to put them over the limit.

MR. ORSZAG: Adam, if I could just add three points quickly. This is not with regard just to retirement accounts but to the asset tests in general, the paper has a discussion of the new Medicare Prescription Drug Benefit which has a component for low income households where the coverage is more heavily subsidized. In order to qualify for that heavier subsidy there is an income test and an asset test.

The Kaiser Family Foundation suggested that there be 14 million Medicare beneficiaries whose incomes are low enough to qualify out of whom 2.4 million would be disqualified because of the asset test. That's not just because of retirement accounts, but assets in general that suggest that at least there is a nontrivial effect.

The second thing is I think it's hard to look at the existing population given the social norm that I at least perceive about saving and retirement accounts and conclude from that what the world would be like if we changed the rules because, of course, if people are responding at all to the current system, then you won't observe anyone who has assets over the limit or you won't observe that many people and so, therefore, it doesn't look like there's a big response even if the social norm changed.

Finally, and this picks up on Bob's point, we have to remember the limits here are really low. We're talking about $2- or $3,000. If you look at the automatic enrollment literature or you look at the H&R Block randomized assignment study, you can get to $2- or $3,000 fairly quickly with the kinds of contribution amounts that even EITC recipients or other low income households would be making if we changed the retirement system so that it was more sensible and it was easier to save and the incentives to save were stronger.

My final point is I do think that it's now more likely than not that we will make those changes to try to get the pension system or the retirement saving system rationalized in some sense. If we did so and didn't fix these rules, it would become a much bigger problem because it's very easy to start bumping up against those limits given how low they are.

MR. MOSES: Steve Moses (ph) from the Center for Long Term Care Reform. Given that you would not exempt retirement savings from eligibility determination for Medicaid long term care, and given as Mr. Orszag has observed that money is fungible and easily transferable from a nonexempt retirement savings account into home equity which is exempt, and given that we now have private financial tools that allow people to take out the equity in their home without giving up the opportunity to live in the home and without making payments, that is to say, reverse mortgages, would you then conclude that perhaps at least some home equity should be considered in determination of Medicaid long term care eligibility? And if that were the case, wouldn't it go along way to eliminate the problem of Medicaid being in essence inheritance insurance for the baby boomers?

MR. GREENSTEIN: This is a good question. I would like to distinguish Medicaid long term care from the rest of Medicaid. I think Medicaid long term care with its transfer of asset problems to which you have alluded raises some challenging issues of its own.

It is the sense of the authors of this report, none of whom are experts on Medicaid long term care and the asset issues related to it, it is our sense that there may be, I'm not sure about this, there may be a need to have some differences in the rules

regarding retirement accounts for long term care than for the rest of Medicaid. That would need to be looked at as part of an overall review and examination which may be starting anyway of how to have long term care rules such that people who need long term care get it, where people who don't need it don't have the same ability they may have today to transfer things around to get it.

I don't want to state this as a recommendation because I'm sure I'm not aware of all of the ramifications, but I think here is an interesting thing to look at. We suggest, we recommend, that for SSI generally in old age retirement accounts be excluded as assets but a monthly annuity value be imputed as income. It's my understanding that one of the tools that sometimes is used to qualify people for Medicaid long term care is that they can take a retirement account or other cash assets and purchase an annuity that has a value such that it's scored as a fair value for the purchase so it doesn't run afoul of the transfer of asset rules, but annuity pays very small monthly payments and has a big balloon payment at the end.

Suppose one foreclosed that, barred that for long term care and substituted for it our SSI recommendation, that the retirement account wouldn't count as an asset, but you have to impute a monthly annuity value, and then there are rules, as you know, whereby income that you receive if you're in long term care, all but a small amount, goes to defray the cost of that care. It's effectively a co-payment for your long term care.

So it could actually be that our SSI recommendation might be useful to look at as a way to help tighten those rules on Medicaid. It's my understanding that the State of Louisiana is seeking a federal waiver to try and close off this annuity balloon

payment approach. What I'm saying is maybe it's worth looking at that on a broader national scope tied to some of the other changes we're suggesting.

I state this again knowing that I don't understand all these ramifications of estate planning and asset transfer planning and long term care and that that probably deserves an examination of its own.

MR. ORSZAG: I want to thank the panelists and thank all of you for coming this morning, and our meeting is adjourned.

[Applause.]

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