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P R O C E E D I N G S

MS. MENSAH: Good morning, everyone, and welcome to Rethinking Incentives to Save for a Secure Retirement. We are thrilled that you did not rethink your decision to get up and come to the Hart Building in the middle of this storm -- so very glad you're all here.

I'm Lisa Mensah, and I'm the Executive Director of the Aspen Institute Initiative on Financial Security. And it's my pleasure to be here this morning and lead what promises to be a very novel and stimulating discussion on rethinking retirement incentives.

A word about our work at Aspen -- we are a policy program dedicated to helping Americans save, invest and own. So this is a powerful topic that I really appreciate having a chance to participate in. In our work, we have been particularly focused on savings among low and moderate income Americans. And I want to commend Bill for this paper, which seeks to look hard at the challenges of low and moderate income Americans.

This is a room filled with many retirement experts, and you know our favorite analogy of the three-legged stool -- the Social Security leg, the pension leg and the personal savings legs. Lately, many of us have been feeling the wobbliness of all those legs. And I think what this briefing will talk about is really a new way to think about two of the legs, particularly the pension leg. It is, in fact, true that millions of Americans aren't saving enough for retirement, and that's the compelling fact that this paper tries to challenge, and this paper's particularly cued this lack of savings among low and moderate income Americans.

The nonpartisan Center for Retirement Research at Boston College has recently estimated that the current retirement income deficit, the gap between what

Americans will need and what they've saved is actually $6.6 trillion. That's a huge gap.

Scholars and policy experts alike have noted this dramatic shortfall in what people have saved and what they'll need is due, in large part, to low access and low takeup of our precious tax-favored retirement accounts, and the often weak or nonexistent financial incentives that many Americans face when deciding to save for retirement. So that's why this event is so important.

But the challenge we're facing is that millions of Americans have really been left out of the nation's tax-preferred retirement systems. So there've been many efforts to expand coverage and participation. The President's proposal for an automatic IRA, designed by one of our colleagues here today, would go a long way to bringing more Americans into the system, giving people a kind of automatic nudge that many of us enjoy at our workplace. That's one idea.

But at the same time, many low and moderate income Americans need more assistance as they work to increase their retirement savings, and that's what today's discussion really gives us a chance to look at. Our current system of tax deductions for retirement savings largely misses the American households most in need.

Peter Orszag, who was originally supposed to be part of our briefing today, wrote in a recent op-ed that if our goal is to use the tax code to encourage retirement savings, the current system is upside down.

So there have been past attempts to right-size the system of incentives. But so far, we still have a need to put more working Americans into the retirement system and to be savings in a way that strengthens their retirement security.

So during today's discussion, our esteemed panelists are going to take a closer look at traditional tax incentives for retirement savings, and also explore the policy options that will consider how to restructure our nation's retirement systems. Bill Gale will be discussing his newly released brief -- and you should've been able to pick it up on the way in -- "A Proposal to Restructure Retirement Savings in a Weak Economy with Long-Term Deficits." And Bill's proposal proposes to replace the current system of retirement tax deductions with a 30% matching credit for qualified retirement savings.

Once Bill describes his proposal, we will welcome David John, who will offer his perspective on the proposal and also explore the critical need for expanded retirement savings.

We've been talking a lot as a country about our jobs crisis, about our growth crisis, but very related to this is our lifelong financial security crisis. Personal savings is essential to the long-term financial security of households and our nation. And trying to improve this, particularly in a tough economic time, is really the question that's in front of us. And I think we've assembled a great team to dig into this. We're really lucky to have two of Washington's leading pension experts, and I want to thank the work of the Senate Aging Committee for bringing us all here.

Up first, we have Bill Gale. And Bill, as you know, is the Arjay and Frances Miller Chair in Federal Economic Policy at the Economic Studies Program at the Brookings Institute. Bill Gale's research focuses on tax policy, on fiscal policy, on pensions and on savings behavior. He's Co-Director of the Tax Policy Center, which is a joint venture of the Brooking Institution and the Urban Institute. Bill is also the Director of the Retirement Security Project.

Before coming to Brookings, Bill was an assistant professor in the Department of Economics at the University of California, and he was also a senior economist for the Council of Economic Advisors under President George H.W. Bush.

And to Bill's left is David John. David is the Heritage Foundation's lead analyst on issues relating to pensions, financial markets and institutions, banking regulation, asset building and Social Security reform. In 2006, with the Brookings Institute scholar, Mark Iwry, David developed a third way to promote retirement self-reliance -- the proposal called "Automatic IRAs." And this is just one of his many professional achievements. Since coming to Heritage in 1998, he's written and lectured extensively on the importance of reforming the nation's retirement system.

In the private sector, David was a Vice President at Chase-Manhattan Bank in New York, and he worked for three years as Director of the Legislative Affairs at the National Association of Federal Credit Unions. David's also been a senior legislative consultant for the Washington law firm of Manatt, Phelps & Phillips.

So Bill and David, thank you very much for being here. Again, our format here is that I'm going to turn first to Bill. We're going to have a few remarks from David. I will draw out both of our speakers a little bit, and then we're going to open it up to your questions.

So Bill, would you like to begin?

MR. GALE: All right. Thank you, Lisa, and my thanks to the Committee on Aging and Debra Whitman for organizing this.

We're here to talk about reform in the retirement system, which may seen impossible. But after earthquakes and hurricanes and biblical flooding, many of our notions of what's possible may have been knocked around a little bit, and so maybe this is possible too.

I want to discuss a proposal that at its core is very simple. The proposal, in a slightly different form, was laid out in a paper in 2006 by Jonathan Gruber, Peter Orszag and me. But the proposal has been modified somewhat, but the basic core is still the same -- and that's instead of using a system of deductions for retirement saving contributions, to change the deduction to a flat rate refundable credit that would be put directly in the saver's account. I'll come back to that, but that is the basic issue, the basic core of what we're talking about. And there's three ways into this proposal.

The first is what you might call the usual concerns about retirement security, retirement saving. We've discussed these things for years. Many households don't save for retirement. Many of those that do don't save enough, or they invest poorly, or they take the funds out early. Those kinds of patterns leave households vulnerable to not having enough resources in retirement, particularly low and middle income households.

And the proposal is designed specifically with raising the incentives for those households to participate in the system. The existing concerns with the retirement system may seem distantly related to the current status of the economy, but the current weakness in the economy actually poses a threat to the retirement system. If you think about what's been going on in the last few years, unemployment's gone up, long-term unemployment has gone up dramatically, housing values have fallen, real wages have been stagnant, stock market volatility has increased. If you think about how those things impact the retirement system, they put a lot of pressure on households either to cut back in their contribution, or to invest more conservatively, or to get out of the retirement system and use the money for current living expenses.

The point is a current weak economy poses a medium term, long-term concern for the vitality of the retirement system. And the proposal is designed with that in mind as well. It's particularly timely with that in mind, precisely because it increases incentives to contribute to retirement accounts for most households in the economy.

The third issue, of course, the third way into this is that as you know, we have a medium and long-term unsustainable fiscal issue -- even with the recent debt limit legislation. Central to that fiscal unsustainability is the status of Social Security and

Medicare. I won't go into any details here, except to note that pretty much any sensible plan to put the budget on a sustainable path is going to involve reductions and benefits for Social Security and for Medicare. That in itself will reduce the resources available to retirees. So as we're thinking about ways to bring the budget into long-term alignment, and thinking about ways to reform Social Security and Medicare, it's all the more important that we think about the private retirement system at the same time, to be sure that we can minimize the impacts on retirees' living standards of any given cut in Social Security or Medicare.

So basically, the proposal addresses or has links, has entry points, if you will, with all three of those issues. I think it would enhance the retirement system, would plausibly raise national saving, especially if it's a revenue-raising version of the proposal. It's timely in the sense that we need a boost to the retirement system right now because everything is pushing households away from contributing to retirement accounts. And it's not only consistent with the goals of broad-based tax reform, but it could be an active part of medium term and long-term deficit reduction.

To give you a flavor of that, the Tax Policy Center estimates that converting all of the deductions to an 18% refundable matching contribution would raise about $450 billion relative to current law. If you wanted to do a revenue-neutral version of the proposal that would be a 30% refundable matching contribution, which is the equivalent of about a 23% tax rate. So anyone who's in a marginal tax category below 23% -- and of course, there is no 23% tax bracket -- but anyone who's 15% or lower would be better off under even the revenue-neutral proposal, which would be three-quarters of households. Under the 18% credit, that raises $450 billion. Households in the 15% category would be held harmless. Those below would be better off. Those above would be worse off.

So let me just say a few more words about the background and then the proposal. As you can see, there's some flexibility in how this is designed. You can make it a revenue-raising proposal; you can make it a revenue-neutral proposal. But going back a little bit to the incentive issues, the idea behind the proposal is to raise the immediate incentive to contribute to 401(k)s and IRAs for low and middle income households.

The problem with participation in the retirement system is not that people are not eligible for retirement plans. Virtually every worker in the country is either in a DB - a defined benefit plan -- or eligible for a 401(k) and/or eligible for an individual retirement account. The problem is takeup. And takeup, particularly of IRAs, is very low. Takeup of 401(k)s and IRAs among low and middle income households is very low.

So the question is how do you stimulate take-up? One of the ways to do that, that David and I have talked about in the past, is moving toward automatic structures -- the automatic 401(k), we've talked about a lot. David and Mark Iwry have a paper on the automatic IRA, which would extend the automatic features to people who are not covered by a DB or a 401(k). Automatic is good and default structures work -- that is, requiring people to opt out rather opt in has a big impact on enrollment, as we've seen, but it's not the end of the story. There's more we can do, and that's where this proposal comes in.

The idea would be to take advantage of the fact that people pay attention to the immediate incentives to contribute to these accounts, and there's evidence of that from research that I've done and other people have done, to take advantage of that, to reform the system so that the incentives for most people to contribute are larger than they currently are.

Basically, right now, as Lisa indicated, we have a system of deductions for retirement savings. So if you contribute a dollar to a retirement saving account, your immediate deduction is essentially your marginal tax rate times a dollar. So if you're in the 35% tax bracket, you save $0.35. If you're in the 0%, 10% or 15% brackets, you save $0.00, $0.10 or $0.15. That's the notion in which this system is upside down. The deduction system provides lower incentives to people who have lower income. It shields more of current income, provides a larger, immediate incentive -- I should be clear -- for people with higher income. That's backwards or upside down for several reasons.

One is traditional ability to pay concerns. The second is the evidence suggests that high income households generally are not the ones who are not saving enough, that the lack of adequate saving is concentrated in low and middle income households. And the third way it's upside down is the literature on 401(k)s suggests that although high income people are more likely to contribute to 401(k)s, their contributions are less likely to represent net additions to saving because they're more likely to represent shifting among assets, whereas low or middle income households are less likely to contribute to 401(k) -- but to the extent they do contribute, their contributions are more likely to represent net increase in saving. And I cite a couple of papers that demonstrate that result in the paper.

So the system is not generating as much national saving as it could, and it's providing subsidies for people who need them less and can afford to do without them more. So the proposal is basically to revamp the system to eliminate those issues, and in the process, help traditional concerns with retirement saving, offset the effects of a weak economy on the retirement savings system and then contribute to a long-term fiscal solution.

So the proposal basically has three parts. One is to remove current reductions on the employer/employee side for contributions to 401(k)s and IRAs. The second is to replace those deductions with a matching contribution. In retirement language, we call it a matching contribution. In tax language, we call it flat-rate refundable credit. And the third feature is that that credit or matching contribution would be deposited directly into the account, rather than coming back to the taxpayer as lower after-tax income.

So let me just mention a few aspects of this proposal that I would like to highlight. First, credit of, say, 30% is the equivalent of taking a deduction at an income tax rate of 23%. This is sort of one of these keep track, watch the bouncing ball kind of numbers thing. But basically, under the current system, suppose you faced a 23% rate. If you put $100 in the account, you get 23% back. So the immediate after-tax cost would be $77 in a 23% income tax rate deduction. With the 30% credit or matching contribution, you'd put in $77 and then the government would add $23, which is 30% of $77.

So in both cases, you would've put in $100 and it would have cost you $77. I think I just raised the order of magnitude twice there, but in both cases, you put in 77 units and you get 100 units out of it, in terms of the immediate deduction. So the 18% matching contribution is equivalent to an income tax deduction at a 15% rate because of that equivalence.

So in terms of revenue effects, I mentioned the 30% credit, a 30% matching contribution would be revenue-neutral relative to current law over the next 10 years. The 18% matching contribution, which again would hold harmless everyone who faced the 15% tax rate, would actually raise about $450 billion if it were refundable. If it were not refundable, by the way, it would raise about $22 billion more -- but of course, it would strictly, seriously reduce the number of low and middle income households that were eligible for the contribution.

The distributional effects to this proposal are not surprising. Basically, because it shifts incentives to low and middle income households, it shifts resources to low and middle income households. There are two tables in the paper that go through this. I'd be happy to talk about it if the people want.

The impact on retirement contributions is not included in these estimates. We're holding retirement contributions constant, but it's likely that contributions would go up in response to the increased incentive. For that reason, you'd expect an increase in private saving because these contributions would be coming from low or middle income households. If there were an increase in revenue as well, that would further increase national saving, which is a sum of what the private sector does and the public sector does.

The feature that the contribution would go into the account, I think it's worth talking about for a second -- the matching contribution. Currently, when someone contributes to a retirement account, they get a deduction, which basically comes back to them in after-tax income. And if anything seems more likely to raise consumption, thereby saving, by putting the matching contribution in an account, the hope is that more of that government contribution, whether it's a deduction or a matching contribution, would actually be saved.

There's some light evidence in favor of this, but there's no hard evidence in favor because we've never actually run an experiment like this. But there's some evidence from the behavioral literature suggesting that if you put the money in the account, more of it will eventually get saved than if you give it back to the taxpayer in terms of consumption.

So there's a lot more to talk about with this proposal, but I think the best thing to do right now would be to just summarize. The goal is to increase takeup in the retirement savings system among low and middle income households, thus help addressing and allaying one of the long-term concerns that not enough people are participating in the retirement system -- and of course, if you don't participate, you can't benefit from the retirement system. So that's the first goal.

The second goal is to think about the current weakness in the economy, and how that would affect people's willingness to contribute or continue contributing, or continue to invest in a broad-based portfolio, and so try to provide some offset for that, rather than having people pull back or pull out of the retirement system.

And the third thing is to propose a way to reform the tax system that is consistent with the principles of broad-based tax reform and could also contribute to deficit reduction if policymakers chose to raise revenues.

So let me stop there, turn it over to David, I guess, and I'll look forward to questions and comments. Thank you.

MS. MENSAH: Thanks, Bill. David?

MR. JOHN: Well, it's a delight to actually spend a Friday morning on a rainy day in a roomful of people who actually care about savings. This is probably the highlight of my week.

Let me point out before I start that I am speaking here as an individual. I'm not speaking as the Heritage Foundation or anything along that line. I'm usually required to say that any time I do Congressional testimony, and I think that also applies in this instance also.

And second, I'm going to focus on Bill's revenue-neutral variation of this. I got a call from my brother-in-law the other day, and my brother-in-law -- this was after the stock market had done another one of its rollercoaster days where it couldn't decide it was going to lose 500 points or gain 300 points, or do something in between. He said basically, I'm thinking at this point of burying gold in my backyard. And I asked him for the location so that I could make sure that it remained safe, of course.

This is an interesting time to save. It's an interesting time of the economy, and Bill's proposal is especially timely because it reminds us once again that savings is crucial, regardless of the state of the economy. We just saw fidelity data within the last week or so suggesting that individuals in a 401(k) who continued to save and continued to have an equity position of some form or another ended up doing much better in the period starting about the 30th of June in 2008, and as I recall, going to the end of the last year, than those who panicked and either stopped saving or moved totally into a bond portfolio or something along that line. But the real losers are those who never start to save at all.

This is a strange time for retirement, and the news just from this past week points out that there is no such thing as a completely safe retirement alternative. The New York Times ran an editorial -- I think it was about two weeks ago now, on a Sunday -- suggesting the dangers on relying too strongly on individual savings.

But let me point out the alternatives. I mean, Bill has already noted questions about what Social Security benefits will be in the long run. We had news, particularly it was a Financial Times article pointing out that the corporate DB pensions as a whole at the moment are underfunded by $388 billion, which puts them at a 77% funding ratio at the moment, which is close -- actually, it's beyond the low of 79% that was reached in 2008/2009. So that's not necessarily a totally safe situation.

The state of Rhode Island is currently talking about major changes to the DB pensions offered to their state workers, and this follows the city of Central Falls, Rhode Island filing for bankruptcy, in particular because they have promised too much to their local government employees in pension benefits. The Postal Service has just asked for a pension reform because they are essentially running out of cash and they're looking at defaulting, if the Postal Service can actually do that. They may actually go down to opening certain letters and seeing if there are checks or cash in them that they might be able to use.

But this is a serious problem, and the IRI had a survey that came out that looked at baby boomers -- of which I am one -- where 7/10 of them said that they weren't saving enough, and only 1/3 of them really knew when they were going to be able to retire because, frankly, they didn't know how much they had in assets. And as I recall, less than half of the survey had actually done the incredibly scary thing of looking to see how much money they had, and how much they could actually depend on in their retirement.

So the bottom line is that retirement is a risky thing. And the one thing that you can say about your own savings is that you don't necessarily have to depend on somebody else contributing money -- a situation where you may not have any control.

I sat in a room at a hearing several years ago where we had a steel worker from Bethlehem Steel, and the steel worker had a gold-plated DB pension courtesy of his union and Bethlehem Steel, and this was a man who had done everything right -- had paid off his car early, worked late shifts in appalling conditions, et cetera, and just before he retired, he checked with both the union and the company to make sure pension was fully funded. And of course, they said yes, but it wasn't, and the net result was that after Bethlehem Steel filed for bankruptcy and the PBGC took over, he found that his new revised pension was just about enough to pay his healthcare benefits, which is not a good situation.

So Bill's proposal is especially valuable because we need to save. We need to be able to depend to at least some extent on ourselves. It is a rough world out there. Bill's proposal works especially well in an auto-enrollment situation. Auto-enrollment has, as Bill has pointed out, a special value to those of us who are not necessarily used to saving, who don't have an MBA or something along that line, and have really no idea how much they should save and what they should invest it in. Bill's proposal will couple with that.

As Bill noted, Mark Iwry and I have something called the automatic IRA, which would raise the proportion of the workforce who save for retirement at work through a payroll deduction system from about 50% of the workforce to about 90% of the workforce.

All of those are helpful, but any potential that helps to further increase this is a key value here. As Bill noted, matching is one of the things that people look at. It is one of the things that encourages individuals to save, and a matching tax credit that is added, especially to an employer tax credit, will be incredibly useful, and it will double and redouble the amount that goes into the account over a period of a number of years.

I don't believe that this is going to reduce the incentives of businesses to have 401(k)s and later, auto IRAs, once Congress gets around to passing that provision -- for the simple reason that the proposal should not really damage upper income workers. This is especially true for upper income workers who start saving young, because an upwardly mobile individual who is receiving a 30% match on top of their employer match -- and as I say, the employer match I expect to stay for simple competitive reasons -- that when it comes right down to it, they want to still attract and keep the best possible talent that they can get. Conversations that we've had with small business and large business suggests that this is going to continue to be true.

But as an upwardly mobile individual who starts to save, say, at age 21, 22 or something like that, receives an employer match and also this direct deposited tax benefit, they should, by the time they are ready for retirement, end up with at least the same amount of benefit that they would've gotten from moving from, say, a 35% tax benefit to a 30% tax benefit.

It is of special value to lower and moderate income workers. Even when Social Security is fully funded, for an average income worker, it only provides about half of what you need for a comfortable retirement. Anything that can assist these workers to save and to build balances is a valid thing, and the ability to open their quarterly statement or annual statement and see that the money they have put in there has gone up is going to be a valuable thing.

It is especially valuable because we have seen data fairly recently from Pew pointing out that there is a huge disparity among populations as to the type of assets and the amount of assets they've got. I meant to get the exact numbers and bring them today. Unfortunately, I was on a train that was flooded so I didn't get home until 11 last night. But as I recall, the numbers are for every dollar of assets that a white family has, an African-American has about $0.10 and a Latino family has about $0.12. Somebody, free to correct me as we go along here.

We cannot have a house divided. Lincoln pointed this out in very different circumstances 150 years ago, and it is dangerous for our economy to continue to have this type of disparity. A proposal such as Bill's, combined with automatic enrollment, automatic escalation and the auto IRA will put us in a situation where we can start to even out the distribution of wealth.

Last but not least, I would suggest that for people who look at this and they get into the details and say, well, oh my God, if you shift from this to this in a 24 hour or 36 hour period, you're likely to have some people who are somewhat shocked, that it would be very possible to phase in Bill's approach over three, five years, or something along that line, without damaging -- and again, I'm speaking of the revenue-neutral version -- and also without having the kind of shock that you see any sudden change.

So this is a valuable contribution to the whole idea of building savings, building savings among all populations, and especially providing an additional layer of retirement security for low to moderate income workers. It's something that needs to be very seriously considered and we hope that those of you who are in the room who actually do this sort of thing will take a look at it and give it some serious thought.

Thank you.

MS. MENSAH: Thank you, David. We've been asked for the question and answer period to have people speak in this microphone that's over on this little podium. So if folks could kind of be making their way that way, I will start off,

Bill, I think where David ended was an interesting point. It was really on the wealth divide, and on the way that you've positioned essentially a refundable match. I loved your distinction between tax language and real people language. Real people don't know the word refundable. They know the word match and they're most familiar when they have a great employer who will do a match.

And as we know, the saver's credit now that exists really is a ghost of its original intention because it's not refundable. So you have given us a way to have a match. You've given us a way for the $77 to get $23 and become $100, and that has been a Holy Grail of all of us who have been concerned about wealth gap. You've given us a way in a weak economy with long-term deficits to talk about credits.

But I want to push you a little bit on the do no harm question. And I want to start the do no harm question on the potential harm to an employee who's in a workplace plan and that enjoys an employer match right now. And I'd like you to dig in a little bit, to say, couldn't this person -- this person that wants to save their $77 -- end up worse off under this plan, by potentially losing what their employer might contribute in a plan?

MR. GALE: You mean, would they lose the employer --

MS. MENSAH: Losing the employer match.

MR. GALE: No.

MS. MENSAH: Could we have an unintended consequence? Love the idea of matching. You've done something -- we've all known that refundability is the way we try to get out of a person who can't enjoy the deduction because they don't owe the taxes in the first place. But could we actually cause harm in this?

MR. GALE: David hinted at -- there are different reasons why employers provide matches, and one of them, of course, is related to the tax deduction. But a second one is related to nondiscrimination rules. A third one is related to what David mentioned, trying to offer a competitive pay package.

For the nondiscrimination rules in the competitive pay package arguments, there'd be no reason for them to drop the match.

From the question of whether they get the tax deduction or not, possibly there would be an issue. The notion is, to the extent that they are contributing because they get a tax deduction, this proposal would change that.

There's a couple of responses. One is that conceptually, the employer part could be left intact and just change the employee part. That is, change the employee deduction to a credit, but continue to let firms deduct the way they do. That's perfectly reasonable and detachable. I don't think it's necessary or preferred, but it is certainly possible.

The argument is essentially that -- about the matching contribution -- is that essentially, you have to bribe the firm, particularly the high income workers in the firm, you have to bribe them to provide pension coverage for low income households. That's essentially what someone is saying if they say what you just said.

If that's the case -- I mean, there are a couple of implications that are worth emphasizing. One is that tax reform that lowered rates would therefore by definition hurt the pension system, which may or may not be right. A second is, again, the notion that the way we are providing coverage for low and middle income households is we're requiring firms to bribe their high income workers, to pay extra to high income workers, to have this plan so that low and middle income workers can participate.

If that's the case, then it sort of broadens the discussion as to whether this is really the best way to provide retirement income. I don't want to go there in this particular conversation, but that's kind of what that hints at.

MS. MENSAH: Fair. All right, let's start some questions. And I see Carol Wayman.

MS. WAYMAN: Great. Thanks, Lisa -- and thanks, Bill and David. Carol Wayman with the Corporation for Enterprise Development.

And Bill, I've got a really nitty-gritty question on the direct deposit structure of the government accounts. The CFED runs the Savers Credit Alliance, which is a group of about 100 groups that support expanding the saver's credit, making it refundable and putting the deposit into the account, and we left some information on the table about it.

And as Lisa mentions, the goal was to cover everyone under $50,000 a year. Thanks to the administration, we now have state by state data on the saver's credit claims, and it's about an average of $169 per filer so it's really miniscule. It's nowhere near the 30% that you're talking about.

But we wanted to do the same thing with the proposal -- is to put money directly into the account, and that would be very clear how you would do that. You would put it in at tax time.

With your structure, how do you put the deposit into the account? Is it payroll? Is it every two weeks? Is it every month? Is it at the end of the year? And then how does the government handle issues around loans -- because for low income households, the research is pretty clear that if a program has access to a loan feature, low income people save more, they participate more and loans aren't the cause of leakage -- less than 1% of leakage from loans is retirement that isn't repaid.

MR. GALE: Thank you. Those are good questions.

I understand your problem with the loan aspect in a proposal like this. I mean, it's always dangerous to say this, but it seems to me they would operate pretty much the way they do now. I don't see any reason for special consideration there.

In terms of putting the money in, the easiest way to do it would be to do it every -- you get a statement about your IRA every year, you get a -- 401(k) administrators can communicate with the government as well. It would require a step, but I don't -- it doesn't strike me that that's a difficult step. I mean, I imagine it could be done electronically. I'm certain it can be done electronically. I mean, the details would have to be worked out, but it seems to me to be basically a detail.

MS. MENSAH: Good. Next question? And I see Bill Sweetnam.

MR. SWEETNAM: Okay. Hi, Bill Sweetnam from Groom Law Group -- former Benefits Tax Counsel to Treasury, and I've been doing for awhile. And therefore I have to go really into the weeds.

I think one of the questions that I'd like to ask you is, what happens now with the taxation and distributions? Because under current law, if you make an after-tax contribution, that's basically so you don't get taxed on it when it comes back out. Pre-tax contribution gets taxed when it comes out. And then you have all your earnings. We've worked for a long time with that sort of system.

Are we changing that sort of system now? Because really, the tax effect of the credit for certain high income people -- if you decided that that entire amount would be taxed again when it came out, wouldn't there be really some sort of double taxation on those amounts?

And then the other weedy thing is, how do we sort of relook at the -- have you thought about relooking at the nondiscrimination rules? Because again, the nondiscrimination rules have different discrimination tests for pre-tax contributions versus after-tax contributions versus matching contributions. And now we're sort of fuzzing up the difference between a pre-tax contribution and an after-tax contribution.

MR. GALE: Okay, thank you. Good questions again.

In terms of distributions, what I envisioned is that distributions would be taxed as ordinary income. And that means that the effective tax -- let me take a step back. Right now, if you put in a dollar and you're in a 35% tax rate, you face a 39% tax rate, you get a deduction for that, then the stuff accumulates tax-free until retirement. Then you take it out, you pay $0.35 on it. In that situation, basically your effective tax rate is 0% -- because the value of deduction is exactly the value of the tax that you pay later on, accumulated over time. That's basically what people mean when they talk about consumption taxes on treatment of a retirement saving under that system.

Under the proposal, you would get -- say it's this is the revenue-neutral version -- you'd get the equivalent of a deduction at a 23% rate, and then you'd pay tax at a 35% rate under the circumstances I laid out. The effective tax rate there would then be positive. It wouldn't be exactly 12%, but it would be positive.

So we're moving from a system where there's 0% effective tax rate on the saving to a system where there's a positive tax rate for people who face high tax rates. For people in lower tax categories, it would correspondingly be a negative effective tax rate. So I don't see a big concern on the distribution side.

On the nondiscrimination rules, you're right, there' a current distinction between pre-tax and post-tax. I'm thinking of the pre-tax plan rules as applying, but again, the nondiscrimination rules are a mess, and if this became an opportunity to reform the nondiscrimination rules in a constructive manner, I think that'd be a welcome opportunity too.

MR. SWEETNAM: Okay, thank you.

MS. MENSAH: Maybe we should stand a little closer here. It feels like a wedding we're moving at.

Please go ahead.

MS. MORRISSEY: Hi, my name is Monique Morrissey. I'm with the Economic Policy Institute. First a statement, then a question -- and they're not related.

The statement is that I think probably a lot of other people in the audience here agree with me that there might -- we question the economic arguments for accepting the inevitability of Social Security cuts while proposing to subsidize private savings.

My question is actually just, I was curious as to whether you had considered for the revenue positive version of our plan -- and I haven't read your paper yet, by the way, so this might be -- also capping contribution limits in addition to or instead of lowering the refundable credit. And I was wondering what the arguments, pro and con, of doing it one way or the other, or some combination thereof.

MR. GALE: All right, thank you.

In terms of Social Security versus expanding private savings, this is a method of expanding private saving that leaves the budget either intact or raises revenues.

MS. MORRISSEY: Assuming no substantial increase in savings, and we already have a big retirement gap to fill.

MR. GALE: This is like when people talk about the gas tax and you say, well, it might actually reduce consumption of gasoline. So the rate estimates are obviously low. That would be a good thing, and you can adjust the rate based on that. If we have a 30% refundable credit instead of the current system and that generates so much new retirement saving, we can reduce it to a 27% refundable credit. I mean, that would be a good problem to have. Let me just put it that way.

The stuff that I worry about this proposal -- it's not that it's going to generate so much saving that it'd bust the budget. And again, the rates can be adjusted. The 18% rate, for example, which raises $450 billion over a decade would raise less than $450 billion, but still a fair amount.

In terms of capping contribution limits, there are arguments for and against that. As I mentioned earlier, this proposal is a revamped version of part of a paper I wrote five years ago with Peter and John. And in there, we discussed more of the issue of contribution limits. I wanted to isolate this one particular effect because I think it's kind of -- besides the automatic stuff that's in the paper, it's a clean change conceptually.

Raising the contribution limit raises a bunch of other issues. I'm not a fan of increasing the contribution limits at this point, but I'm not sure that cutting them would be the first thing that I would do.

MR. JOHN: Can I just --

MS. MENSAH: Yeah, David.

MR. JONES: -- drop in here for just a quick second and make the point that there is a value to this kind of a discussion, regardless of whether Social Security has changed or not changed.

The fact is, as I mentioned, that even a fully funded Social Security doesn't provide sufficient retirement benefits for anything other than the lowest income families. So anything that encourages savings is going to benefit the overall population, again, regardless of Social Security.

MS. MORRISSEY: Let me be clear that that's not -- my problem isn't with Bill Gale's plan. My problem is with the premise that Social Security -- filling that gap on the revenue side is unaffordable, and yet somehow this is affordable. That was the point I was trying to make, not that we wouldn't support -- I mean, that we don't think that refundable credits are an improvement over the current system. Obviously they are.

MS. MENSAH: Bill, any more?

Okay. Please.

MR. FRIEDMAN: Aharon Friedman, Ways and Means Committee.

Why wouldn't the proposal also apply to DB plans? The equivalent of the contribution is basically the normal cost of the benefit.

And putting aside the technical questions of how it could be missed -- or theoretically, you could set up a separate automatic IRA to put the matching contribution in.

MR. GALE: Again, it's conceptually a lot cleaner to focus on the 401(k) and IRA side of the world. And by the way, when I say IRA, I mean the non-Roth IRA part. We don't touch Roth programs in this.

It's messier to do it in terms of DB because the notion of putting it into the account -- David mentioned the unfunded nature and the formulas that get used. It doesn't make sense to me to do this in a DB world. Maybe you can convince me otherwise, but that would be more complicated. That would be a second step, it seems to me, rather than doing it in the DB plans.

Note though, that this issue about employer incentives kicks in here and that this plan, if it's junked for 401(k)s and IRAs, could actually marginally boost the viability of defined benefit plans at the corporate level because we're not changing their structure.

So if the argument is that there's a concern about whether employers would want to still do DC plans that same argument would suggest that firms would want to do DB plans more -- not that they're going to create new ones, but at least it might stem the tide or make DBs marginally more attractive. But I haven't really thought through how this would work in a DB plan. If the money just went into the account, the firm could just adjust their contribution down and meet the same funding ratio as before. So I don't --

MR. FRIEDMAN: In theory, the money could go into a new automatic IRA for the participant.

MS. MENSAH: All right, did you get your question answered? Would you like David to also react to that, since he's --

MR. FRIEDMAN: Sure, but I just -- you had said you had a technical concern with -- I wasn't talking about just the technical concern, whether you just don't want to touch DB plans. And to the extent it's a technical concern, it seems to me one could explore the possibility of setting up an automatic IRA for each of the employees.

MR. JOHN: In theory, the -- this is a question that Mark Iwry and I have addressed a numbers of times in concerns about whether the auto IRA would replace the 401(k) or something along that line. Now as far as a refundable credit that went into the auto IRA, obviously that just increases balances.

But the thing that we looked at was that if you remember, the IRA limit is $5,000. The 401(k) limit is three times that -- $15,500, as I recall, and there are other variations where you can further boost that.

The discussions that we have had with employers over the last five or six years throughout has suggested that employers who decided they were going to save money by moving from a 401(k) to an auto IRA would find themselves losing their best talent because their best talent would find themselves with only 1/3 of the contribution limit that they had before, and therefore would be much more likely to go to another employer that offered them the full opportunity to continue to save in a higher plan.

So this has been a discussion that has been played out, as I say, over the last five years on this. I don't see that Bill's proposal changes this situation much one way or the other.

We're actually about to have an interesting live experiment in the UK starting next fall, when their NEST program, which stands for National Employment Savings Trust, goes into effect, and we'll see to what extent there actually is a change.

But, as I say, our discussions with employers large and small have indicated that this would not be the case.

MS. MENSAH: We are already at our 12 noon cutoff time. But Mark Iwry is in the audience -- and I'm wondering, Mark, since we're talking a lot about some of your work as well here, whether you have a comment.

SPEAKER: Excuse me. He has speakers.

MS. MENSAH: Yes, I'm just giving the mic for a minute to -- I'm at the 12 noon --

SPEAKER: I think we have to play fair.

MS. MENSAH: Okay. I'm sorry. But I did want to ask -- we have a deputy secretary here, so I did want to ask if he has a comment.

SPEAKER: I think he can have a comment later -- or you want to allow me to speak later.

MS. MENSAH: Okay. Why don't you state your question?

SPEAKER: My question is, this panel has addressed the incentive to save. But I don't think you have what to save or whether the people can really have an incentive to save when they try to save. So eventually, what they try to save is where they realize that, because at this moment, all the financial institutions or even any other methods, the people's assets of property are lost or deprived of, so they don't have the assets. Leaving that up to the state, but they didn't really get it.

Even TIA Aircraft, they had pension or even IRA -- all those pension plans -- but after that, they don't realize because their property or their income has been deprived long ago.

MS. MENSAH: Okay. So you are asking about, what is the real incentive here?

SPEAKER: Whether that incentive is there or whether tax code can be simplified rather than -- whether it be the financial institution or brokers.

MS. MENSAH: Okay. Any comments on whether the incentives can be simplified or financial access expanded?

MR. GALE: Yeah, I think basically, I heard something in there about whether there's evidence about this stuff too. And the best evidence that I'm aware of is the experiments that were done with H&R Block a few years ago. I participated in some of them, not all of them -- which basically showed in a controlled experimental setting that people did respond to the immediate incentive to contribute, in terms of contributing more.

It's hard -- we haven't been able to do a long-term followup study on that because of privacy concerns and stuff like that, but I think that evidence and some other evidence is consistent with the notion that this wouldn't hurt and could well help. It'd be nice if we had more evidence than that, but we don't.

MS. MENSAH: Great. Mark, I'll stand by my invitation, if you have any comments to make.

MR. IWRY: Lisa, I don't want to extend the time here -- this is a great discussion, great points made all around, and I certainly look forward to hearing more about it offline after the --

MS. MENSAH: Thank you.

David, final comment?

MR. JOHN: Again, the real value here is going to be in increasing saving and increasing saving over the entire population. Any step that we can take that will increase this -- and I believe Bill's proposal would do so -- and again, I'm speaking of the revenue-neutral version -- would definitely be a step in the right direction.

MS. MENSAH: Bill, final comment?

MR. GALE: Thank you all for coming, adding to the notion of saving for a rainy day.

(Laughter)

MS. MENSAH: Thank you all. Please join me in thanking our speaker.

(Applause)

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