THE HAMILTON PROJECT

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Building on What Works: A Proposal to Modernize Retirement Savings

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MISSION STATEMENT

The Hamilton Project seeks to advance America's promise of opportunity, prosperity, and growth.

We believe that today's increasingly competitive global economy demands public policy ideas commensurate with the challenges of the 21st Century. The Project's economic strategy reflects a judgment that long-term prosperity is best achieved by fostering economic growth and broad participation in that growth, by enhancing individual economic security, and by embracing a role for effective government in making needed public investments.

Our strategy calls for combining public investment, a secure social safety net, and fiscal discipline. In that framework, the Project puts forward innovative proposals from leading economic thinkers — based on credible evidence and experience, not ideology or doctrine — to introduce new and effective policy options into the national debate.

The Project is named after Alexander Hamilton, the nation's first Treasury Secretary, who laid the foundation for the modern American economy. Hamilton stood for sound fiscal policy, believed that broad-based opportunity for advancement would drive American economic growth, and recognized that "prudent aids and encouragements on the part of government" are necessary to enhance and guide market forces. The guiding principles of the Project remain consistent with these views.

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NOTE: This discussion paper is a proposal from the author(s). As emphasized in The Hamilton Project's original strategy paper, the Project was designed in part to provide a forum for leading thinkers across the nation to put forward innovative and potentially important economic policy ideas that share the Project's broad goals of promoting economic growth, broad-based participation in growth, and economic security. The author(s) are invited to express their own ideas in discussion papers, whether or not the Project's staff or advisory council agrees with the specific proposals. This discussion paper is offered in that spirit.

BROOKINGS

Abstract

Workers rely more than ever on individually directed retirement savings vehicles, such as defined-contribution plans and IRAs, to provide the income necessary for a comfortable retirement. Yet our current system contains many features that make it easier for workers to spend than to save, and it inefficiently spends federal dollars on incentives with questionable effectiveness. This paper proposes two related reforms that build on evidence about how to increase retirement savings by increasing the benefits and decreasing the costs to employers of helping their employees save. First, this paper recommends combining all of the various types of retirement accounts into a single Universal Retirement Saving Account. Second, this paper recommends replacing part of the individual tax subsidy for retirement savings with large tax credits directed to employers who help workers save. These two reforms would generate large increases in savings for middle-class workers and, ultimately, in the well-being of retirees.

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Chapter 1. Introduction

Imagine that federal law required workers to maintain a separate bank account for each employer they have worked for in order to receive a paycheck via direct deposit. Each new job would bring a new bank account, often with a new bank, but workers would be prohibited from using that particular bank account to deposit money from any other source. Employers could contract with banks to manage the accounts, but the employer (rather than a banking expert) would ultimately bear responsibility for ensuring the integrity of the accounts. Workers whose employers did not offer direct deposit—an understandable choice given these hassles—could not use any of their old accounts for everyday banking and instead would be limited to a special low-feature bank account.

While this hypothetical may seem far-fetched, it is analogous to the current system of defined-contribution (DC) retirement savings accounts. Workers rely critically on their employers for access to the retirement savings system, yet firms are burdened rather than rewarded for providing this access. Although there are other options, the vast majority of new private retirement savings occur through 401(k) accounts or other workplace-based savings accounts. Workers also collect a hodgepodge of retirement savings accounts (including IRAs) over their careers, adding unnecessary complexity to their retirement savings decisions; this complexity unintentionally encourages workers to withdraw their retirement savings early. The design of these accounts may have once made sense as a close cousin to defined-benefit (DB) pensions, but DC plans have now grown to dominate the retirement savings landscape. As the population continues to age, this shift makes it more important than ever that we modernize and simplify our retirement savings policies.

Our current system is also inefficient and inequitable in the ways it attempts to encourage savings. The federal government subsidizes most DC accounts via deferral of taxes on contributions, as well as through tax-free build-up, leading to forgone tax revenue (also called tax expenditures) estimated to total more than $500 billion over the next five years (Joint Committee on Taxation 2014).[1] But all this money results in very little additional savings; by one recent estimate based on the experience of Denmark, each dollar of spending on tax incentives for retirement savings generates only one cent in new savings (Chetty et al. 2014). This implies that the more than $500 billion of tax expenditures on retirement over the next five years will increase total savings by just $5 billion, which is less than 1 percent of personal savings in 2014 alone. Furthermore, these subsidies flow disproportionately to sophisticated and wealthy savers who are least in need of additional retirement assets: two-thirds of the tax expenditure accrue to the top fifth of the income distribution (Congressional Budget Office 2013).

This discussion paper draws on the latest economic research to offer a new and better way to encourage retirement savings while retaining the core of a defined contribution system. The broad aim of this proposal is to make it easier for middle-income households to save by simplifying access to retirement plans in a way that does not cost the federal government any additional money (aside from the mechanical decrease in revenue caused by additional saving). After discussing from a general perspective the approaches that best encourage retirement savings, the author proposes two key reforms that would dramatically increase the efficacy of the current system. These two proposed reforms would also increase the benefits and decrease the costs to employers of helping their employees save.

First, we should replace the current multitude of retirement savings accounts with a single account, the Universal Retirement Savings Account (URSA), for each individual. All retirement savings contributions would flow into this single account, which would stay with workers permanently, following them as they change jobs. Workers would hold this account directly with qualified financial institutions. This proposed reform not only would rationalize the confusing proliferation of different accounts, but also would limit leakage from the system through preretirement rollovers or loan defaults.

Second, we should replace some of the tax incentive for individual savers with large tax credits for employers that provide an incentive to help workers save through auto-enrollment into payroll-deductible contributions. Firms are both more knowledgeable about and more responsive to tax incentives than individuals. Individuals often poorly understand the benefits of tax-deferred savings, and their decisions are often influenced by inertia and procrastination as much as they are influenced by financial planning. These tax credits would directly link

worker savings to the company bottom line, thereby increasing a firm's interest in getting its employees to save. The employer tax credits would be based on the fraction of the workforce that contributes, so firms would have an incentive to continue to innovate on ways to increase participation.

These two reforms would require relatively little additional administrative machinery to implement; most of the necessary reporting already occurs, and these reforms would leave intact the core of the current retirement system. Though these reforms are designed to work together, they could also be implemented individually for more-gradual change. For instance, replacing some individual tax subsidies with incentives directed to firms would improve the efficiency of the retirement system with or without universal accounts.

If enacted, these reforms would have a large impact on private retirement savings in the United States. Under conservative projections, the number of workers participating in a retirement plan would increase from 41 percent to 65 percent, and annual retirement contributions would increase by 30 percent, or $70 billion. The middle class (defined as the middle three quintiles of the income distribution) would account for 56 percent of the increase in savings and 77 percent of the increase in the value of the tax expenditure, so the reforms are targeted at those for whom a lack of retirement savings is the most serious. The proposal would minimally affect households in the bottom fifth of the income distribution: because Social Security is enough to replace most of these households' preretirement income (Poterba 2014), they have a lower need to finance their own retirement savings. Furthermore, the use of default settings for participation and escalation of contribution rates focuses the policy intervention on those workers who are least attentive to their retirement savings and thus most likely to be undersaving, while not distorting the more careful choices of attentive workers. The additional savings from these reforms would both increase available capital in the economy and ensure higher standards of living for millions of middle-income workers in retirement.

Chapter 2. The Challenge

THE NEED FOR RETIREMENT SAVINGS

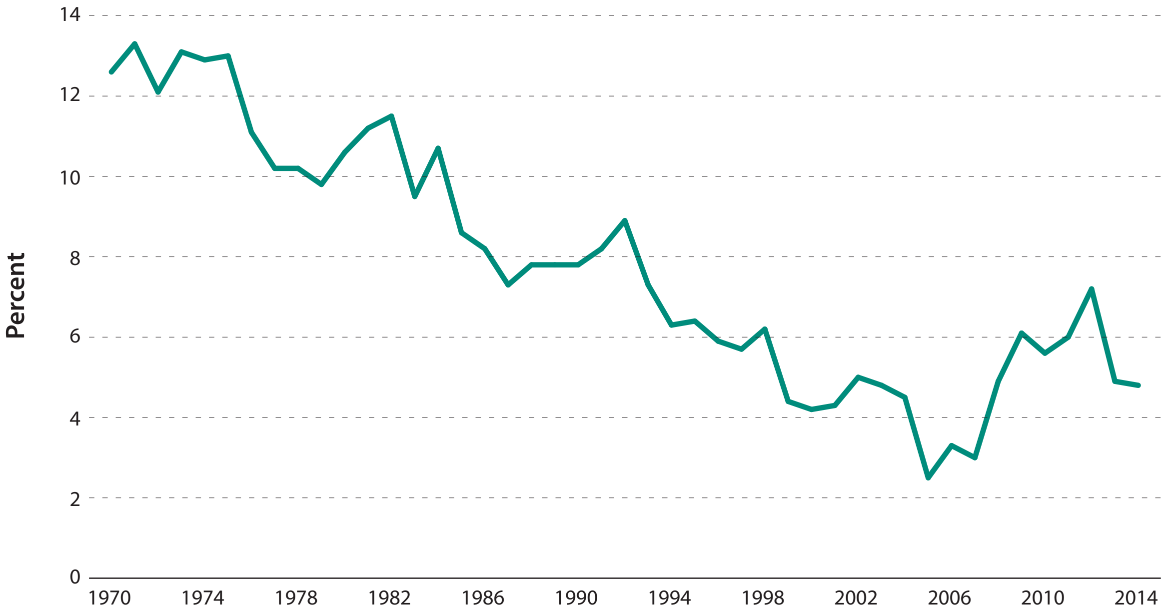
The aging of the U.S. population—one of the great demographic transformations of the beginning of this century—is placing strain on our current retirement system. The Baby Boomer generation has begun to retire and life expectancies have increased. Since 1970 life expectancy at age 65 has increased by 30 percent, and demographers project that 17 percent of men (and 29 percent of women) born in 2010 will live to age 90 (Arias 2014). By 2030 the fraction of the population that is age 65 or older will reach 20.6 percent, up from 9.9 percent in 1970 (U.S. Census Bureau 2002, 2014a). Seniors are not just living longer, they are leading costlier lives. Increasing medical costs, both on average and with age, make health care not covered by insurance (e.g., care in nursing homes) the single greatest financial concern among seniors (Merrill Lynch 2014). We now see an increasing number of seniors spending a significant fraction of their income on health care; the fraction of seniors aged 75 to 84 spending more than half of their income on health care is expected to increase to nearly 10 percent by 2019 (Skinner 2007).

Although these demographic shifts might have been expected to be associated with increased rates of saving in the United States, we have instead witnessed a sharp decline in the personal savings rate over the past few decades. As shown in figure 1, the savings rate fell below 4 percent in the mid-2000s from an average of more than 10 percent in the 1970s. Although rates rebounded somewhat during the Great Recession, they have already begun to fall again.

The lack of savings affects not just levels of investment and productivity growth in an economy but also the quality of life for seniors when it results in insufficient income during

FIGURE 1.

U.S. Average Personal Savings Rate, 1970–2014



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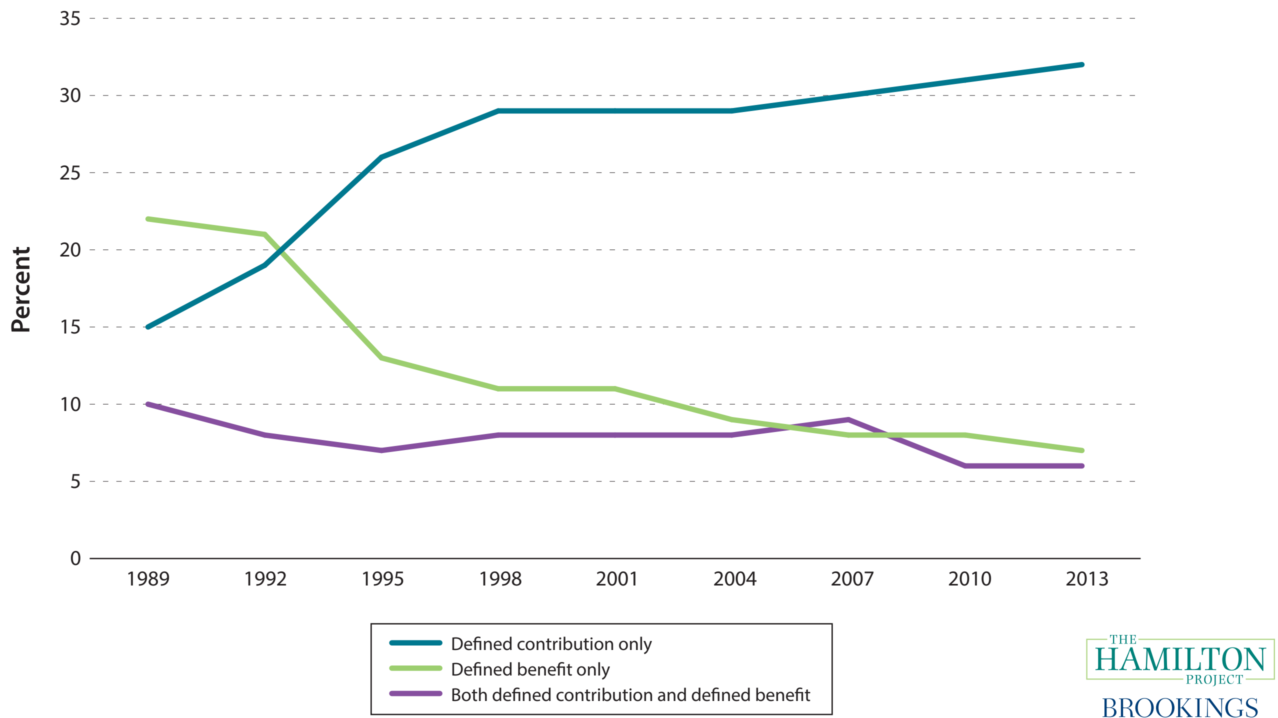
Source: Federal Reserve Bank of St. Louis n.d., using underlying data from the Bureau of Economic Analysis.

FIGURE 2.

Pension Participation among All Workers by Type of Plan, 1989–2013



Source: Center for Retirement Research n.d., based on Survey of Consumer Finance data.

retirement. For instance, Hurd and Rohwedder (2012) find that 29 percent of seniors aged 66 to 69 have not saved enough for retirement, in the sense that actuarial tables predict that there is at least a 5 percent chance that they will outlive their assets. Taking a different approach, Munnell, Hou, and Webb (2014) calculate that 52 percent of working households have sufficiently few assets that they will be forced into a sharp drop in consumption in retirement; this fraction has increased by 10 percentage points in just the past 10 years. Moreover, these problems are especially pronounced among households of color, who have substantially lower retirement wealth even after controlling for age and income. For instance, households of color are less than half as likely as white households to have retirement savings equal to or greater than annual income. These problems are also concentrated among middle-income households, for whom Social Security alone is insufficient but who often lack the private or pension wealth to live comfortably.

Due to changes in the traditional sources of retirement income, households must also rely more on individual savings than they have in the past. Social Security replacement rates have declined for most workers in the past decade, placing a greater emphasis on personal saving. Moving forward, the Social Security Administration projects that benefits will provide only about 40 percent of preretirement earnings for workers with moderate income levels (around $45,000), down from 50 percent in the early 1980s. Even these projections are likely to be optimistic, because they do not account for the potential impacts of any reforms to the retirement portion of Social Security that would likely reduce benefits, or the more dangerous risk of Trust Fund insolvency.

Other sources of retirement wealth are also declining. While home equity continues to provide about two-fifths of all net worth for households nearing retirement, employer-sponsored defined benefit (DB) pension plans, which pay out a fixed benefit amount for the remaining life of the worker, are rapidly disappearing. Figure 2 shows that just 13 percent of workers participated in DB plans in 2013 (either alone or in conjunction with a DC plan), down from 32 percent in 1989. These figures still overstate the importance of DB plans going forward, however, as many companies have frozen their plans in favor of DC plans instead; about half of those with DB plans also rely on DC plans. In contrast, the fraction of workers relying solely on DC plans has more than doubled to 32 percent in 2013 from just 15 percent in 1989. Within the private sector, total contributions to DC plans have also soared as those to DB plans have stagnated. Moreover, roughly half of workers do not participate in any plan at all.

All of these changes mean that households must accumulate even more private wealth in order to ensure their financial security in retirement. But even reaching a fixed wealth target has become more difficult in recent years as real interest rates have remained near zero. Through the first four months of 2015 the 20-year Treasury Inflation Protected Security interest rate averaged just 0.5 percent. In late 2004, at a similar point after the 2001 recession in terms of recovery, the Treasury Inflation Protected Security offered a return of about 2.0 percent.

PROBLEMS WITH CURRENT POLICIES

The mounting challenges faced by individuals saving for retirement and the focus on individually directed savings, whether through DC plans or IRAs, demand effective retirement policy. But our current system falls short in many ways. The system relies on two primary mechanisms in order to encourage individuals to save: employer-sponsored plans and tax subsidies for retirement savings. Both of these mechanisms are inefficient, and these inefficiencies have strained federal resources while leaving many workers out of the system.

Employer-Sponsored Plans

The first major mechanism used to encourage retirement savings is employer-sponsored plans. This arrangement might have made sense in an earlier era when more workers received retirement benefits through DB plans, which are inherently tied to an employer or other central fund. But as DC plans have come to dominate the market for retirement savings plans, the shortcomings of relying on employers for access to retirement saving accounts have become clear.

First, and most obviously, workers must rely on employers to provide convenient access to retirement savings plans. If all employers offered plans, access would not be an issue, but coverage is far from complete. In 2013 just 51 percent of private sector wage and salary workers aged 21 to 64 reported that their employer sponsored a retirement plan (Copeland 2014).[2] More generally, participation in retirement plans has been falling over time. Access rates are also much lower for part-time or part-year workers, who are often ineligible to participate in their employer's retirement plan. While some part-time workers have very little income, and may rightfully prefer not to save, others may work several part-time jobs and would like to participate in a retirement plan; unfortunately such workers often lack access. Coverage is particularly poor at small firms: at employers with fewer than 10 workers, just 17 percent of workers have access to a retirement plan (Copeland 2014). This is not the fault of small employers, who cannot defray the administrative and regulatory burdens across a large number of workers. This poor coverage, however, leads to a situation in which many workers are forced to turn to independent savings vehicles, such as IRAs, which are both less generous and less convenient than employer-sponsored plans. IRAs have much lower limits on annual contributions, and, more importantly, require individuals (in most cases) to make each contribution separately. In contrast, employer-sponsored plans usually provide for automatic payroll deductions, which are far more effective, especially for workers who may face the temptation to skip payments in favor of increased current consumption. Some hybrid examples exist, such as payroll-deductible IRAs, which provide the benefits of payroll-deduction without some of the responsibilities for employers; however, since their provision still relies on a choice by the employer, the spread of these hybrid plans has been limited.

> At employers with fewer than 10 workers, just 17 percent of workers have access to a retirement plan.

In the current system, employers are responsible not just for employees' access to retirement savings accounts, but also for fiduciary oversight over those accounts through the choice of account manager and investment options. The recent Supreme Court decision in *Tibble v. Edison International* (575 U.S. 13-550, 2015) clarified that plan sponsors must not only select prudent options initially but also monitor those choices to check whether they remain prudent, raising the standard of compliance for fiduciary conduct. Due to the lack of financial sophistication of the average investor, it is essential that workers receive fiduciary protection for their retirement accounts. It makes little sense, however, for employers—especially small employers—to bear the fiduciary responsibility for DC plans,

as expertise in financial advice is not closely related to the core competency of most businesses. To make the point most starkly, consider a young chef opening a small restaurant with no training in financial education. It makes no more sense that this entrepreneur should bear sole responsibility for her employees' retirement savings investment choices than for her employees' choice of credit card or home mortgage. Under the current system, the duty to manage this responsibility effectively, as well as the legal ramifications of violations, may dissuade some small firms from offering a plan in the first place.[3]

The second shortcoming that stems from dominance of employer-sponsored plans is that individuals often must manage a large number of accounts with varying rules for contributions, withdrawals, and asset management. The tax code currently provides for no fewer than 13 different types of individually-directed retirement savings accounts. Within these types, employer-sponsored plans are specific to each employer. Every time a worker begins a job at a firm with an employer-sponsored plan, the firm must establish a new account reserved exclusively for contributions made through that employer but that in other ways entirely duplicates any of the worker's preceding retirement accounts. This generates needless administrative burden and confusion for both workers and employers. (This author has accumulated seven separate retirement accounts over the past seven years of post-Ph.D. employment, including two new ones in the course of writing this piece.) These problems are especially acute for part-time or part-year workers who may work for a larger number of firms over time; this may help explain the low take-up rate for such workers even when their employer offers them access to retirement savings accounts.

The tax code currently provides for no fewer than 13 different types of individually-directed retirement savings accounts.

While employees can combine balances by rolling assets out of orphan retirement accounts set up by former employers, this option gives workers a salient opportunity for the premature withdrawal of funds. This leakage is an increasingly large problem in the current system; according to the most recent estimates, aggregate leakage (including IRAs and 401(k)s) amounts to between 30 and 45 percent of annual contributions (Argento, Bryant, and Sabelhaus 2015). While some of these early withdrawals are related to identifiable hardships that justify cutting into retirement savings, many savers simply want to fund general consumption or general expenditures (Beshears et al. 2012). Among the nearly 20 percent of workers borrowing against their 401(k)s, the risk of default—and permanent leakage—is particularly high when switching between firms, since loans against those accounts that are otherwise due over time must be repaid in full immediately when switching jobs (Lu et al. 2015; Vanguard Institutional Investor Group 2014).[4] Workers may also shift savings from employer-sponsored plans to IRAs, which often come with less guidance about broadly accepted investment principles such as low-fee diversified index funds. As a result, investors pay higher fees and manage investments more poorly, resulting in lower risk-adjusted returns and ultimately fewer assets at the time of retirement.

Tax Subsidy for Retirement Savings

The second major mechanism for encouraging retirement savings is the large tax subsidy. This subsidy takes two forms. First, individuals do not pay capital gains taxes on returns from retirement accounts. Even for a long-term buy-and-hold strategy that generates no dividends, this generates a subsidy worth roughly 24 percent of the initial investment (assuming an individual avoids paying a capital gains tax of 20 percent for 20 years and earns an average return of 4 percent). This benefit grows if investors receive dividends or intermediate capital gains. Second, individuals can defer income taxes to retirement when they may qualify for a lower tax bracket; alternatively, with a Roth IRA they can pay taxes now in anticipation of higher tax rates in retirement. When combined across all DC worker plans, these subsidies total nearly $100 billion annually and are growing rapidly (Joint Committee on Taxation 2014).

If these subsidies encouraged workers to save more, then this might be money well spent. But evidence suggests that

incentives based around tax deferral are not effective at raising savings rates for three reasons. First, many savers are unaware of, or inattentive to, the tax incentives; recent estimates suggest that 80–85 percent of savers are passive with regard to these incentives. Second, savers who respond to the incentives do so not by saving more, but instead by shifting money they would have saved anyway to nontaxable retirement accounts or by increasing debt. These mostly high-income savers might, for instance, keep less money in their bank accounts or personal stock portfolios and instead contribute the money to their retirement account to take advantage of the tax incentive or an employer match. Since these individuals do not actually cut consumption, the incentives cause them to save little more than they would have otherwise. This generates cost for the government but leaves total savings unchanged. Third, the savers who respond most to tax incentives tend to be wealthier individuals who are the least in need of further encouragement to save for retirement. In total, research suggests that each $100 of spending on these tax incentives generates only $1 of additional savings, so that the entire $100 billion of annual tax expenditure may increase savings by only $1 billion annually (Chetty et al. 2014).

THE EVIDENCE FOR WHAT WORKS

Although there are many problems with the current system, certain aspects have been strikingly successful at encouraging saving. Saving for retirement involves complex decisions that require workers to forgo current consumption in favor of building wealth for retirement. Decisions of this nature are highly vulnerable to procrastination and temptation. As a result, policies that help workers overcome these tendencies are critical to the successful functioning of the retirement system. Two features of the current retirement system stand out for their effectiveness along this dimension: payroll deduction and default settings. These elements should be retained and strengthened in any reform.

Payroll Deduction

Payroll deduction is the most convenient and effective way for most individuals to save. By allowing individuals to "set it and forget it," payroll deduction helps workers avoid having to repeatedly make the psychologically costly decision to save. It also helps workers adjust spending levels by making disposable income (i.e., after retirement contributions) the most salient earnings figure (because that is the actual size of each paycheck). Although there may be other differences correlated with savings rates, it is likely that the higher savings rates of workers with access to retirement accounts through employers—whether employer-sponsored plans or just payroll-deductible IRAs—are in part due to the effectiveness of payroll deduction.

Default Settings

Policies that set defaults for workers while still preserving individual choice are another feature of the current system that can increase savings dramatically. Auto-enrollment was the original "nudge" policy, and has been very successful at increasing savings rates as it has expanded over the past decade. By simply enrolling workers at a default contribution rate, while allowing them to opt out, auto-enrollment can substantially increase participation rates, even over the long run (Choi et al. 2004; Madrian and Shea 2001). Auto-enrollment has spread from just 5 percent of retirement plans in 2005 to 34 percent today; in 2013 62 percent of new savers were automatically enrolled (Vanguard Institutional Investor Group 2014). Any change to the retirement savings system should place great emphasis on further encouraging this trend.

In addition, recent research suggests that firms can increase savings rates not just through auto-enrollment, but also through automatically increasing the contribution rates of workers from year to year. For instance, by default a worker might start with 3 percent of her earnings being contributed to her employer-sponsored retirement plan, with this share automatically increasing by one percentage point each year up to a maximum of 8 percent from the sixth year onward. Participants can opt out at any time. Evidence shows that this auto-escalation can further increase average savings rates by substantial amounts (Thaler and Benartzi 2004). Auto-escalation is also an important complement to auto-enrollment, since research suggests that some individuals who might have eventually contributed at high rates might be stuck at the lower initial default rate (Choi et al. 2004; Madrian and Shea 2001). At the same time, some individuals may be encouraged to save too much by auto-escalation, so it is important that such parameters are fine-tuned for each worker's situation.

The portfolio of securities in which savings are to be invested is the final key default parameter and must be set carefully to avoid two opposing pitfalls. On the one hand, investors left to their own devices often pay fees that are too high, fail to diversify appropriately, and inefficiently churn their portfolios (Odean 1998). Providing a low-fee, diversified default option can mitigate many of these bad habits. On the other hand, research suggests that investors defaulted into safe, low-return assets, such as Treasury Bonds, may actually end up significantly worse off than they would otherwise, due to the very low rate of return as compared with a more balanced portfolio (Madrian and Shea 2001).

IMPORTANCE OF THE EMPLOYER

A common feature to each of these policy elements is the importance of the employer in helping workers to save. As argued above, it is highly inefficient for employers to entirely control access to the most attractive retirement savings accounts, but firms do play an important role by establishing the proper context within which workers rely on default options or choose to save themselves, rather than opting out. Even small details of the enrollment process—for instance, the length of the form an employee must complete to opt out of default saving—can have large effects on savings rates. It is therefore critical that any reform targeting employees' savings decisions involve firms, even as the management of retirement accounts shifts away from firms.

Chapter 3. The Proposal

Policies to encourage individual retirement savings have never been more important, yet our current policies are inefficient and outdated. However, there are ways that we can build on what we know works to make our retirement system both simpler and more effective.

This proposal details two crucial changes that would move our retirement system into the 21st century:

1. Consolidate all retirement savings accounts into a single Universal Retirement Savings Account (URSA) for each individual.

2. Shift savings incentives, in part, from individuals to employers through tax credits for each worker that contributes regularly to a retirement plan via payroll deduction.

Together, these two changes would increase access and savings for workers, reduce the burden on employers, and make more efficient use of federal tax dollars. The two prongs of this proposal complement each other in a comprehensive reform, but they would also be effective if undertaken in isolation.

1. UNIVERSAL RETIREMENT SAVINGS ACCOUNTS

Congress should amend the tax code and the law governing employer-sponsored retirement accounts to replace all existing tax-advantaged retirement savings plans with a single account type, the Universal Retirement Savings Account (URSA). Employees could contribute a portion of their paycheck to this account; employers could also make nonelective or matching contributions. Individuals would have only one URSA, though if they wanted to do so they could move their URSA between management firms without tax consequences. Due to the tax credits (discussed in section 2), firms would play a key role in

TABLE 1.

Characteristics of Proposed Universal Retirement Savings Accounts, 401(k)s, and IRAs

	URSA	401(k) or Retirement Plan	IRA
Different Employers Can Make Contributions	Yes	No. Only sponsoring firm can make contribution	Yes
Contribution Method	Payroll deduction or direct contribution	Payroll deduction	Payroll deduction (if firm approved) or direct contribution
Upon Job Switch	No change needed	Employee must open new account, but has the option to roll over old balances	No change needed
Annual Contribution Limits	$35,000 (for pre-tax accounts)	$18,000 (worker) / $53,000 (firm + worker)	$5,500
Restriction on Investments	Yes	Yes	Essentially none
Fiduciary Duty	ERISA-like best interest, borne by account manager	ERISA-like best interest, borne by employer	SEC suitability standard, borne by investment adviser
Regulatory Authority	CFPB / Treasury	U.S. Department of Labor (EBSA) / Treasury	SEC / Treasury

Note: CFPB = Consumer Financial Protection Bureau; EBSA = Employee Benefits Security Administration; ERISA = Employee Retirement Income Security Act; SEC = Securities and Exchange Commission; Treasury = U.S. Department of the Treasury.

encouraging workers without URSAs to establish one, as well as to contribute to it.

Regulatory Structure

Individuals would hold URSAs at any institution of their choice of regulated providers (hereafter referred to as the "account provider"). Most likely, these account providers would include major financial management firms such as Vanguard, Fidelity, BlackRock, as well as a potential new class of dedicated account providers that would arise to serve this market without offering investment products of their own. In order to guarantee the financial integrity of the accounts in the case of provider malfeasance such as theft of assets, URSA account providers would operate under regulations mirroring current rules for employer-sponsored retirement accounts (table 1).

URSAs would make it simpler and less costly for firms to help workers with retirement savings.

Conceptually, URSAs should provide an environment for investment similar to that currently offered by 401(k)-type plans, but some additional regulation governing the assets allowed and fee structures would also be required. For example, URSAs should exclude highly speculative assets, as well as employer-stock grants or founder's stock, as the risk properties of such holdings are inappropriate for retirement savings. If possible, URSAs should restrict savers to hold investments in low-cost index funds, which track broad stock market indexes such as the S&P 500 or Wilshire 5000; and lifecycle funds, which automatically adjust the mix of assets as account holders approach retirement age. One way to achieve this without a blanket restriction on allowable assets would be through a safe-harbor provision for fiduciary compliance: account managers would be presumed to have satisfied their fiduciary duty for any saver invested only in these preferred assets, but would have to actively justify any other asset allocation to the URSA regulator, described below. This setup would allow alternative asset allocations for savers with sufficient interest, while generating a useful benchmark that most savers should invest in low-cost funds. This could substantially improve asset allocation—for instance, by making savers much less likely to invest in actively managed funds that closely mirror lower-cost index funds.

Moreover, in order to minimize conflicts of interest, account providers should face standards of conduct similar to the fiduciary standard embodied in the law pertaining to current retirement plans (Employee Retirement Income Security Act [ERISA]), although the current regulations could be streamlined by the establishment of safe harbor asset allocations, as mentioned above. Account providers would be free to offer services and sell additional products to savers, though they would be required to institute a clear firewall between the account management and the sales divisions of the business. Account providers would be allowed to charge an annual fiduciary fee of one basis point to compensate them for taking on fiduciary status. This fee would automatically come out of assets under management, as do other management fees; making it a separate line item (rather than pricing it into the fees), however, would improve both transparency and ease of comparing fees between URSA accounts and other accounts.

Because account providers would be purely financial firms providing a financial service, regulatory responsibility would fall to a combination of the U.S. Department of the Treasury, Consumer Financial Protection Bureau (CFPB), and the Securities and Exchange Commission (SEC).[5] For instance, the CFPB would naturally take the lead on delineating the assets that savers would be allowed to hold within URSAs, while the U.S. Department of the Treasury would ensure that account managers satisfied standard obligations of financial institutions. However, much of the regulatory responsibility and expertise for existing retirement plans lies with the Employee Benefits Security Administration (EBSA) within the U.S. Department of Labor; any transition to the new system should take care to draw substantially on this expertise, perhaps in some formalized way, so as not to reinvent the regulatory wheel.

Contributions

URSAs could function under either a post-tax treatment, in which contributions are made after income tax has been paid but distributions are untaxed (as with a Roth IRA), or a pre-tax treatment, in which contributions are made before income taxes are paid but distributions are subject to tax (as with traditional 401(k)s and IRAs). Because some of the details of implementation would be different between these two options, I present both reform scenarios below, outlining the costs and benefits of each approach. URSAs should not allow both types of contributions, however, due to the increased complexity and potential for manipulation. In either case, as with existing retirement plans, contributions by employees to URSAs would still be subject to payroll taxes but contributions by employers would not.

URSAs would also feature a unified annual contribution limit, including both employer and employee contributions, of $35,000 for a pre-tax system or $25,000 for a post-tax system. These amounts are considerably less than the current legal maximum of $53,000 (including employee and employer contributions) for 401(k) plans. Roughly 1 percent of current savers, or 0.5 percent of the working-age population, contributes above these new proposed limits; almost all of these individuals are in the top 5 percent of the income distribution.[6] Many of those affected save exactly the maximum annual amount of $53,000 (plus additional catch-up contributions of $6,000 for workers over age 50). These few individuals would see a reduction in the tax benefit from their savings, but would still be free to save additional money outside of tax-preferred accounts. Because these lower contribution limits would make additional income subject to taxation, the additional tax revenues could be used to partially fund the tax credits discussed below.

Withdrawals

Withdrawals would be subject to rules familiar from the current system. All withdrawals made before age 59½ would face an additional withdrawal tax of 10 percent on the entire balance withdrawn, as in the current 401(k) system, except for certain hardship withdrawals. Individuals would not be allowed to withdraw contributions tax-free (as is allowed from Roth IRA accounts).

Transition

Workers currently hold retirement savings across a panoply of different accounts that include both post-tax and pre-tax contributions (box 1). Workers could designate one of these existing accounts as an URSA as long as the account were held with a qualified URSA account provider; alternatively, workers could open their URSA as a new account with a new account provider. They would then be required to roll savings from any other accounts they have into the URSA. Accounts with a tax treatment differing from the URSA tax treatment—e.g., Roth IRAs if Congress designs URSAs as pre-tax accounts—would have balances rolled into a special URSA subaccount for separate tracking. If Congress sets up URSAs as post-tax accounts, there would also be an option for a one-time conversion of assets from pre-tax accounts to the post-tax URSA at current income tax rates. Workers who do not exercise this option would continue to hold savings within the pre-tax subaccount until withdrawal, as under current rules.

It is likely that most current providers of various retirement accounts would also become URSA providers, since they would not only seek to retain money currently under management but would also want to attract some of the new accounts that would be created; this would minimize the volume of asset transfers between firms. Individuals with IRAs holding assets not permitted within URSAs (e.g., certain derivatives) would have the option to grandfather those assets into the new system, though the right to hold the asset would be lost once an individual sells it. This would minimize the forced sale of potentially illiquid assets during transition.

As the current fiduciaries for most retirement savings accounts, employers would play a key role in the transition. In particular, employers would bear responsibility for guiding their employees through the process of converting savings held in existing retirement plans into URSAs as their final fiduciary act. Although workers would have the option during this transition to establish their URSA with whichever account provider they wished, firms would default workers into an URSA with investments that are broadly suitable (e.g., low-cost lifecycle fund) as established by CFPB.

Rationale behind the Reform

URSAs would make it simpler and less costly for firms to help workers with retirement saving. The current system places on employers both an administrative burden for overseeing a plan (or overseeing the plan's designated account provider) and a regulatory burden of complying with the standards of fiduciary conduct. In each case, many employers—and especially small employers who are least likely to offer plans—are simply not well suited to handle these tasks. URSAs would not only make the administration of the system more efficient but would also generate better protections for workers by placing the burden on specialized firms with dedicated expertise in retirement savings. This reform also aligns with other policies, both proposed and enacted (e.g., the Affordable Care Act), that shift benefit management away from employers more generally into the hands of specialists in order to simplify the provision of benefits for employers and to improve service for workers.

URSAs would also dramatically simplify the current retirement system for savers. Although savers could always choose to move assets between account managers—to avoid account

BOX 1.

Should Universal Retirement Savings Accounts Be Pre- or Post-tax?

Both savers and employers could realize the same primary benefits of simplification from URSAs, whether Congress designs them as pre-tax accounts (like 401(k)s) or post-tax accounts (like Roth IRAs). However, the precise design of the retirement system would differ in important ways between these two alternative approaches, generating important costs and benefits.

Pre-tax Contributions (401(k))

Under this approach, URSAs would be most similar to the current system: the vast majority of retirement savings contributions currently flow through pre-tax accounts, and this would likely lead to an easier transition. This approach would also simplify accounting for any potential employer contributions, which would continue to be excluded from all current taxable wages. Administering URSAs as pre-tax accounts would come with important costs, however. Most importantly, options to reduce the tax expenditure on retirement savings are more complex for pre-tax accounts. In addition to a reduction in the maximum allowable annual contribution to $35,000, one notable option would limit the rate at which individuals may deduct retirement contributions from taxable income to 25 percent, similar to the broader rate limitation first proposed by the Obama administration in 2011. Although this effectively reduces the benefit of contributions for high-income households, it does so in a way that is not proportional to the benefit savers derive from these accounts; in extreme cases, savers might be worse off saving in such rate-limited accounts than in regular (nonretirement) accounts. Alternative options that are similarly clunky include an additional layer of capital gains taxation at withdrawal, or total balance limitations.

Post-tax Contributions (Roth)

Under this approach, URSAs would provide a relatively clean approach to reducing retirement tax expenditures. In addition to a reduction in the maximum annual contribution to $25,000, the system would levy a small tax on aggregate capital gains (i.e., the difference between total contributions and account value) upon withdrawal, equal to half the normal capital gains tax. The tax would be easy to administer through existing Forms 5498 and 1099-R, which account managers already file to record contributions to and withdrawals from IRAs. Because only households with incomes above roughly $75,000 are subject to the long-term capital gains tax, the tax on withdrawals would affect only the richest 15 percent or so of retired households. Another advantage of post-tax contributions would be the potential for increased tax revenues during a saver's working life, when incomes (and therefore tax rates) are typically higher. This effect might be offset in part by reductions in taxes paid on unusually high returns to investments, but these would largely be limited due to the restrictions discussed above on holding highly speculative assets or founder's stock in the accounts. Because of these restrictions, post-tax URSAs would also be immune from tax-avoidance behaviors that seek to convert wage income into sophisticated, tax-sheltered retirement assets. Finally, post-tax contributions have the potential to increase retirement savings directly as a result of many savers' inability to distinguish between pre- and post-tax accounts (Beshears et al. 2014). One drawback of a post-tax approach, however, is that it would generate a temporary surge in tax revenue by bringing receipts forward; it would be essential that Congress not spend this money in a way that drives an increase in future deficits.

provider fee increases, for instance—individuals would have the option to maintain one account for all retirement savings for their entire working life. Savers would no longer face a bewildering array of different contribution limits, income eligibility thresholds, and withdrawal rules. This would reduce both the time that workers spend understanding the system and the resources firms spend on advisers who explain the system to them. Eliminating the need for repeated rollovers also represents a major simplification to the system.

By simplifying the retirement system and increasing individual understanding, URSAs would also allow individuals to make better savings choices. Research suggests that individuals suffer from choice overload when given too many options and information in selecting a retirement plan, lowering participation rates and even changing the type of retirement funds they choose (Iyengar and Kamenica 2010). Individuals are also frequently unaware of many important features or options in the retirement savings system, including aspects of risk from portfolio choice, management fees, and tax preferences (Chetty et al. 2014; Lusardi and Mitchell 2014). By simplifying the system, we can make it easier for individuals to identify relevant information.

URSAs would also help reduce leakage from the system by reducing the frictions created when workers change jobs. First, when individuals seek to close down old 401(k) plans when leaving an employer, the plan often explicitly presents them with the option to withdraw funds in cash. Even though such withdrawals usually generate a penalty on top of income taxes withheld, the cash option serves to weaken the savings commitment device that retirement accounts provide.

Instead, URSAs would offer a single place where workers could always find their money without repeated temptation for withdrawals. Second, nearly one-fifth of individuals have outstanding loans from their retirement plans; while most of these loans will be repaid, borrowers who switch jobs are at far greater risk of defaulting, as rules for most plans dictate that these loans, which otherwise could be repaid over time, must be immediately repaid in full. Such a default converts a potentially temporary withdrawal into permanent leakage. URSAs eliminate this risk because they are portable accounts, and thus loans against them would not be subject to immediate repayment upon switching jobs.

Finally, URSAs would also equalize opportunities for retirement saving between individuals in firms that provide plans and those that do not. In the current system, employees without access to an employer plan can contribute just $5,500 per year through an IRA, as compared with $35,000 (pre-tax) in this proposal. This flexibility is especially useful for individuals with highly variable incomes, who might wish to save much more in one year than in others. While this proposal still relies heavily on firms to encourage workers to save, firm involvement is no longer necessary. URSAs would provide all savers with the more carefully structured investment environment that exists currently only in employer plans. By encouraging savers to invest in low-cost diversified funds, URSAs would help workers get more from every dollar they save.

2. TAX CREDITS FOR EMPLOYERS THAT HELP WORKERS SAVE

Tax Credits

The federal government should offer tax credits to employers that promote regular, payroll-deductible savings contributions among their workers. Specifically, employers should be eligible for a refundable tax credit for each worker that contributes at least 3 percent of earnings (including employer contributions if present) to a retirement savings plan each pay period. This credit would be available to firms of all sizes with no time limit, but the credit per worker would decline with the number of employees (scaled on a full-time full-year basis) to reflect the decreasing marginal costs of administration.

BOX 2.

International Comparisons: Denmark, New Zealand, and Singapore

A number of countries currently have consolidated individual retirement savings accounts that provide useful examples of the benefits of such a system.

Denmark

Retirement savings accounts are provided through independent worker organizations that also coordinate other benefits such as workers' compensation. Workers possess a unique account to which both individual and employer contributions are directed. When workers move to a new firm, they simply provide the number of their unique account to the new employer. This system considerably simplifies the savings landscape for workers. Because they do not face the temptation to withdraw assets during rollovers, there are far fewer early withdrawals than in the United States in any given year despite similar financial penalties (Chetty et al. 2014).

New Zealand

Under New Zealand's voluntary KiwiSaver scheme, employees can chose to contribute 3 percent, 4 percent, or 8 percent of their pre-tax wage to a long-term savings account. Employers must contribute at least 3 percent. Self-employed or unemployed individuals can also set up accounts, and employer and employee contributions are supplemented by an initial government contribution and an annual tax credit. KiwiSaver accounts are tied to individuals regardless of their employer. Workers cannot withdraw funds except for the purchase of a first home (under certain conditions) until age 65, the age of eligibility for NZ Super, the universal government pension plan analogous to Social Security.

Singapore

All employed Singaporeans are required to participate in the Central Provident Fund. Both employers and employees are required to make monthly contributions, with older workers contributing more. Money is credited into three accounts: an ordinary account used to purchase a home or to pay for education, a medical savings account, and a special account for retirement savings. At age 55, participants can withdraw all their Central Provident Fund savings as a lump sum payment, aside from a minimum sum kept in their retirement accounts from which monthly payments are made once the individual reaches the retirement age of 62.

As shown in table 2, the credit is structured to provide large per-worker subsidies initially to defray the larger administrative and other costs per worker for small firms. As economies of scale kick in, however, the credit for each additional worker drops to progressively lower levels. The higher per-worker credit for smaller firms also reflects the low fraction of small firms currently offering access to retirement savings accounts, and the larger incentive needed to induce them to establish plans. Administratively, the employer would claim the credit on an ongoing basis against payroll taxes due, so that firms that do not file federal corporate taxes (such as pass-through entities, nonprofit employers, and the self-employed) would be able to claim the credit. (Public sector employers would not be eligible for the credit, but participation rates among this group of workers are already high, at 74 percent.) This structure would automatically adjust for part-year workers, and it should be relatively easy to adjust for full-time status as well. The U.S. Department of the Treasury would then reimburse the Social Security (OASDI, or Old Age, Survivor and Disability Insurance) trust funds for any credits claimed, similar to the proposed structure for payment of worker credits by Graetz (2014).

TABLE 2.

Credit Design

Employees (FTEs)	Size of Credit
1–10	$1,000 per FTE
11–25	$10,000 + $500 for each FTE above 10
26–100	$17,500 + $100 for each FTE above 25
101 +	$25,000 + $25 for each FTE above 100

Note: FTE = full-time equivalent worker.

Default Settings

Firms claiming the credit would be required to default workers into an auto-escalating contribution that would begin at a minimum of 3 percent of earnings and rise by one percentage point each year to a stable value of 8 percent in the sixth year of employment. Each firm could, of course, adjust any part of this schedule higher if desired, though rates should not be set above 10 percent for any employee. Because lower-income workers are likely to benefit more from greater levels of current consumption rather than greater saving, all workers earning less than $20,000 (on a full-time annualized basis) would be exempt from the default setting, and workers earning between $20,000 and $30,000 would be required to contribute a minimum auto-escalating contribution equal to one-half the standard rate. (The contribution from such workers for the firm to claim the tax credit would also be one-half the standard threshold, or 1.5 percent of earnings.) The default asset allocation for workers opening an account for the first time would be a lifecycle index fund for the year in which the worker turns 65.

In addition to providing a solid base of retirement savings for most workers, this level of default contributions would also partially qualify employers for the auto-enrollment safe harbor under the rules for nondiscrimination, as defined in the Pension Protection Act of 2006.[7] As a result, these rules can, for the most part, stay in place to prevent employers from excluding lower-income workers while minimizing the burden on employers. Nondiscrimination rules play an important role in the retirement system by ensuring that executives do not reserve access for highly paid workers alone. These rules should continue to play a similar role in the new system so that all workers receive the same benefits from auto-enrollment and auto-escalation; firms would need to abide by an amended version of the rules of the current auto-enrollment safe harbor in order to receive the tax credit (even though URSAs would no longer be firm-sponsored plans). But it is also crucial that the nondiscrimination rules not serve as a barrier to employers who wish to help their employees save. Therefore, I propose amending the current auto-enrollment safe harbor so that employers would not be required to offer matching or nonelective contributions, as in current law; if they did, the current safe harbor rules would apply (either a 3 percent nonelective contribution or a full match of the first 1 percent plus a 50 percent match of the next 5 percent).

It is possible that this change would lead some employers to drop their contributions to worker retirement plans, which might reduce savings for some workers. The projected increases in savings from the reform would be roughly twice the size of average employer contributions, however, so net savings would almost certainly increase. In addition, competitive wage pressure suggests that employers who offer contributions might find it difficult to cut them without risking the loss of valuable employees.

I also propose that the safe harbor provision should account for the full (partial) exclusions for workers with annual earnings below $20,000 ($30,000), to accord with the exclusion from the employer tax credits for employers noted above. The system resulting from both these changes would provide protections for workers similar to those today but without the administrative burden, since the vast majority of firms would qualify through the safe harbor.

Financing

A tax credit of this size is not cheap: I estimate the direct cost to be $22.5 billion per year at projected take-up rates (discussed below), plus another $38 billion in indirect costs through forgone tax revenue due to projected increases in savings. I propose to fully offset the direct cost by reallocating the more than $100 billion spent annually through existing retirement savings tax expenditures. This reallocation would

be accomplished through a reduction in the maximum annual contribution limit (worth $3.6 billion) and a limit of 25 percent on the tax rate at which employee contributions could be deducted (worth $18.6 billion).[8] (If URSAs were designed as post-tax accounts, a choice discussed in box 1, the reallocation of the tax breaks would take a different form, but would be qualitatively similar.)

TABLE 3.

Effect and Cost of the Employer Tax Credits

Firm Size	Average Employer Credit
1–10	$2,660
11–25	$12,748
26–100	$19,952
101 +	$40,688
Total Annual Cost	**$22.5 billion**

Source: Calculations by the author based on the design of the credit (in table 2) and the distribution of firm sizes from the Quarterly Census of Employment and Wages (U.S. Census via the Small Business Administration 2011, Table F).

Note: Details of these calculations can be found in endnote 8.

In principle, a tax credit can be structured so that it is identical financially to an alternative mandate system with penalties for noncompliance. Research from the tax compliance and behavioral economics literatures suggest that otherwise-equivalent mandates may further encourage employer participation because of desires to comply with the law and the desire to avoid losses, commonly known as loss aversion (Auerbach et al. 2010; Erard and Feinstein 1994; Kahneman and Tversky 1984). Therefore, an alternative structure would be to mandate employer participation and institute a smaller tax credit for compliers and some penalty for noncompliers.

Rationale behind the Reform

There are a number of key advantages to offering retirement savings incentives for employers. First, and most importantly, firms control the context in which the vast majority of Americans save for retirement. Although workers can of course contribute to IRAs or certain other plans at any time, the majority of contributions for most workers come through regular payroll deductions that workers "set and forget." While 61 percent of households report having an employer-sponsored retirement plan, just 34 percent of households have an IRA, and just 12 percent made a contribution to one in 2014 (Investment Company Institute, 2015a).[9] As a result, increasing retirement savings boils down to two critical steps: giving workers access to savings plans and encouraging them to contribute. In the current system, firms exercise considerable control over both of these steps, and thus are the key to increasing retirement savings.

Even if the choice to offer workers access to a plan were moved out of the firm (as in the first part of this proposal), firms still control the process through which workers register for payroll deductions. As described above, research suggests that many aspects of the choice content—ranging from gross design choices (default settings) to subtle ones (the framing of the choice)—are critically important to an individual's savings decisions. No organization in the American economy, perhaps even including the federal government, possesses the same ability as most firms to not just create the context for workers to save, but also to tailor that context to local circumstances. For instance, the framing that would encourage newly hired college graduates to save may be very different from the framing that most effectively encourages their middle-aged parents to do so. These different workers might also desire different default savings rates. Recent research suggests that firms do in fact structure retirement benefits in a way that reflects worker preferences (Fadlon, Laird, and Nielsen 2015).

Second, firms are more attentive than individuals to tax policy and face fewer forces that work against the choice to save. Research suggests that most Americans lack financial literacy (Lusardi and Mitchell 2014). Furthermore, many individuals are unaware of the details of the tax incentives for retirement savings: for example, just 24 percent of workers with annual household incomes below $50,000 are aware of the Saver's Credit (Transamerica Center for Retirement Studies 2015). Individuals are likely even less attentive to changes in retirement policies (Chetty et al. 2014). In contrast, even small firms employ (or are temporarily in contract with) professionals who are dedicated to understanding the incentives that the tax code generates. These economies of scale are also useful to deal with any complexity that arises from applying or filing for tax credits. Once they choose to open a plan or default their workers into saving, firms are less likely to procrastinate or forget to execute this choice.

Third, even though the tax credits would statutorily accrue to firms, research suggests that workers would in fact benefit more from them. Employers that receive credits that lower the marginal cost of hiring workers will compete for those workers by providing more-attractive pay packages, so that the tax credits initially paid to firms are (at least in part) passed through to workers. For example, the federal government's place-based Empowerment Zone program, which offered employers tax credits on their wage bill, is estimated to have increased hourly wages of workers by approximately 8–13 percent (Busso, Gregory, and Kline 2013). The Work Opportunity Tax Credit, which offered incentives for employers to hire and retain certain types of disadvantaged workers, had relatively low take-up but substantially boosted earnings among affected workers in the target population (Hamersma 2005). More generally, well-designed wage subsidies have been shown to improve the earnings and employment of low-income workers (Katz 1998).

The structure of the employer tax credits proposed here—a constant amount per additional saver—would also distribute the benefits more evenly than the current individual tax incentive for savings, two-thirds of which go to individuals in the top fifth of the income distribution, who both save more and face higher marginal tax rates (Congressional Budget Office 2013).

Relationship to FY2016 Budget Proposal

The administration's FY2016 budget included a conceptually similar proposal that would expand tax credits to firms that offered retirement plans (in addition to requiring firms in business for more than two years to offer payroll-deduction auto-IRAs for workers). Specifically, that proposal included four elements (Office of Management and Budget 2015):

1. Give small firms (those with no more than 100 employees) that offered automatic IRAs nonrefundable tax credits of up to $1,000 per year for expenses related to the plan, for three years.
2. Give small firms that have plans $25 per enrolled employee (up to $250) for six years.
3. Triple the current start-up credit for firms that begin to offer employer-sponsored plans from $500 to $1,500 for up to four years. These credits could offset either administrative costs or employer plan contributions.
4. Give a credit of $500 per year (for three years) to firms that either begin to offer savings plans with auto-enrollment or add auto-enrollment to an existing plan.

Even though the tax credits would statutorily accrue to firms, research suggests that workers would in fact benefit more from them.

There are two key differences between my tax credit proposal and that in the FY2016 budget. First, unlike my proposal the budget proposal does not address the existing inefficiency of the individual tax subsidy for retirement savings. Second, the budget proposal seeks to build on existing credits, which limits the scope by being small in size, temporary, and restricted to small firms. In contrast, the credits offered in my proposal are relatively large, permanent, and available to all firms. The temporary nature and small-firm-size restriction of the budget proposal's credits dampen their incentive, even conditional on their small size, because forward-looking businesses understand that, once they start a plan, they must pay its expenses in perpetuity even after they are no longer eligible for the tax credit (Government Accountability Office [GAO] 2012). Fast-growing businesses are especially at risk, since they may grow beyond the 100-employee limit within three years. Some may argue that the temporary structure is justified because businesses face one-time plan start-up costs or are unlikely to eliminate retirement plans, and so it is inefficient to continue the subsidy beyond an initial start-up period. But perversely, the temporary nature actually makes the credit less efficient, because the limited incentive effect implies that the credit will largely flow to companies that would have started a plan anyway. In a similar setting, the temporary nature of the small business health-care credit anecdotally explains some of the very low take-up of that incentive. The inclusion of large firms is also justified by the fact that there are more workers without access to retirement plans at large firms than there are at small firms.[10]

OVERALL EFFECTS OF THE PROPOSED REFORMS

The proposed reforms, if implemented, would have large positive effects on workers, employers, and the economy.

Effect of the Tax Credits on Employers

The tax credits would generate large savings for businesses of all sizes. For a 10-person firm, this proposal would deliver an annual tax credit of $10,000; for a 100-person firm it would generate an annual credit of $25,000. This should be easily sufficient to cover the administrative cost of a plan, perhaps several times over, so that firms might also be able to fund a small nonelective or matching employer contribution for each worker. As a result, even firms not currently offering a

plan should gain financially from taking up the credit. On the other hand, if workers can gain access without the firm, this credit level will provide a large incentive for firms to work to optimize take-up. A reasonable benchmark would be for 80–90 percent of workers to gain access through default URSA enrollment, as employers seek the credit. Currently, only 51 percent of private-sector workers aged 21 to 64 report in the Current Population Survey that their employer sponsors a retirement plan of any kind.

Effect of the Reforms on Worker Participation

Although workers will have access to their URSAs through other channels, the active participation of employers in helping employees save through payroll-deductible contributions will drive the increase in participation. Once private sector workers have access through their firms, we might reasonably expect 85–90 percent of workers to contribute. The current average participation rate among workers with access is 79.5 percent, based on the 2014 March Current Population Survey (U.S. Census Bureau 2014a). Research suggests that automatic enrollment alone generates participation above 80 percent (Benartzi, Peleg, and Thaler 2015; Choi et al., 2004; Madrian and Shea 2001), and other techniques such as planning aids and financial education (Lusardi and Mitchell 2014), simplification (Beshears et al. 2010), or prize-linked savings (Kearney et al. 2011) could raise this rate even higher. Combining these two effects (and adjusting for the lower participation of those with incomes below $20,000) would substantially raise the average participation rate across all workers to between 65 percent and 80 percent, one and a half to two times the current average of just 41 percent.[11] For the remainder of this analysis, I assume a mid-range total participation rate of 69 percent, which would be the result of an increase to 82 percent of workers receiving access and to 85 percent of workers above the $20,000 threshold participating, conditional on access. This would raise private sector participation rates to roughly the same level as public sector workers in 2013.

Effect of the Reforms on Savings

By increasing participation and defaulting individuals into a 3 percent contribution rate that automatically escalates to 8 percent over time, the two proposed reforms would significantly increase average retirement savings rates. In 2013 the average savings rate through elective deferrals (payroll deduction) among those saving for retirement was 7 percent of income (Vanguard Institutional Investor Group 2014), which implies an average savings rate of 2.9 percent across all workers (7 percent x 41 percent = 2.9 percent). Under the conservative assumption that the additional savers would contribute at the minimum default rate of 3 percent, the proposed reforms would increase average savings rates to 3.7 percent (7 percent x 41 percent plus 28 percent x 3 percent). Under the more optimistic assumption that workers would increase contributions above the minimum in line with the auto-escalation, and accounting for job changes that limit the full extent of the auto-escalation, average saving rates would increase by nearly another full percentage point to 4.6 percent, an increase of about 61 percent from the baseline. Average savings for working-age households would increase by about $1,000 per year, including a 45 percent increase in savings for middle-class households (defined as the middle three quintiles of the income distribution). A household earning the (age-specific) median national income would, over the members' working lives, accrue more than $400,000 in assets by simply staying with the default saving rates; this is roughly four times the current median of retiree assets of $100,000 (calculated from Survey of Consumer Finances 2013). These proposed reforms would also significantly affect national savings. Annual contributions to DC plans would increase by

This reform would generate an additional $56 billion in annual contributions to retirement savings accounts.

about 25 percent, or $56 billion. Total national savings would increase by an estimated $45 billion, reflecting the strength of default mechanisms in increasing total savings and not just investment reallocation (Chetty et al. 2014).

Distributional Effects of the Reforms

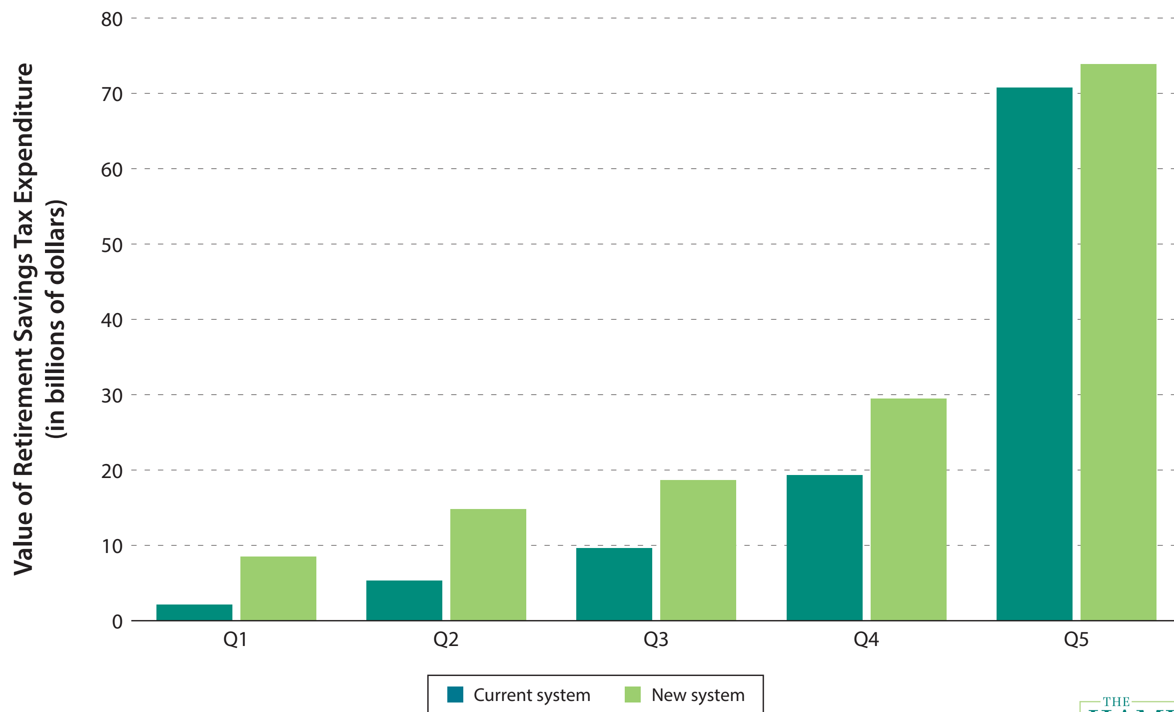
In addition to significantly increasing aggregate savings, the reforms would both increase and more progressively distribute the tax expenditure for retirement savings. As shown in figure 3, this tax expenditure is currently paid primarily to individuals at the top of the income distribution; those in the top quintile take 66 percent of the benefit, with only 32 percent accruing to workers in the middle quintiles. This skewed distribution results not only from the progressive income tax schedule, which provides a larger benefit to the rich from any given deduction, but also from the distribution of retirement savings, which is itself highly skewed. The proposed reforms would produce a less regressive distribution through two channels. First, the reforms would significantly increase savings among workers, especially those in the middle of the income distribution. Second, the reforms would replace part of the current tax expenditure, which is proportional to an individual's marginal tax rate, with a fixed per capita payment to firms, much of which would in turn be passed back to workers in the form of higher wages or benefits. Figure 3 plots the new distribution of this tax expenditure (accounting for the effects of the employer tax credits) that would result from this proposal; the fraction accruing to the three middle quintiles of the income distribution increases from 32 percent to 43 percent. High-income individuals gain slightly in absolute terms, however, due to increased saving and the partial accrual of the new employer retirement tax credit to firm owners, who are disproportionately high-income. The total value of the tax expenditure would increase by $37.9 billion annually, reflecting the increases in savings, of which 76 percent (or $28.9 billion) flows to middle-class households.

Effect of the Reforms on Financial Institutions

The increased savings generated by the proposed reforms would also benefit financial institutions by increasing money under management. As discussed above, this reform would generate an additional $56 billion in annual contributions to

FIGURE 3.

Distribution of the Tax Expenditure for Retirement Savings, by Household Income Quintile



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Source: Congressional Budget Office 2013; author's calculations.

Note: The distribution under the new (proposed) system is from calculations based on estimates produced by the Urban-Brookings Tax Policy Center (2015) of the distributional effects of limiting the tax expenditure on retirement savings. I assume that 80 percent of the tax credit is passed back to workers, proportional to participation, and that the remaining 20 percent accrues to the top quintile of the income distribution through the ownership of firms.

retirement savings accounts. Assuming that these assets are held in low-cost funds with annual fees of about 0.2 percent, each subsequent year of new contributions would generate more than $2 billion in net present value revenue—roughly $110 million annually for 20 years—for account managers. Because these contributions accumulate over time, once the new system reached steady state in the long run, fund managers would receive $3.3 billion in additional annual revenues from nearly $1.6 trillion in additional assets under management (relative to a current stock of $14.2 trillion in DC retirement accounts and IRAs; Investment Company Institute 2015b).[12] Although URSAs would result in the creation of millions of new, initially small accounts, the regular contribution stream provided through payroll deductions implies that the balances in these new accounts would quickly grow to a size that is cost efficient for account management firms.

Financial institutions would also take on fiduciary responsibility for workers holding URSAs with their firm. From a social perspective, financial institutions are best suited to bear this responsibility given their expertise in asset markets. Indeed, many asset management firms not only bear fiduciary responsibility already in parts of their business, but also are well-positioned to benefit from the shift to low-cost index funds and lifecycle funds that an expansion of fiduciary responsibility would entail. For instance, Larry Fink, CEO of BlackRock, commented that his firm would "be a big beneficiary" from the proposed Department of Labor regulation to expand fiduciary duty to investment advisors (Seeking Alpha 2015, 7). However, we must recognize the burden that comes along with this important role. The fiduciary fee of one basis point—0.01 percent—charged annually as a fraction of assets managed from each URSA would generate $1.42 billion in additional revenue in the first year of implementation, and more than $1.58 billion annually over time. This should be more than enough to fairly compensate firms for bearing fiduciary responsibility, but it is substantially less than what savers are estimated to gain from plugging existing holes in fiduciary coverage (Council of Economic Advisers 2015; Munnell, Webb, and Vitagliano 2013).

Chapter 4. Questions and Concerns

How will the new system treat defined-benefit (DB) plans?

This proposal focuses entirely on reforms to the defined contribution (DC) retirement system. By reducing the tax preference for retirement savings in DC plans, the reforms would slightly advantage DB plans relative to DC plans, as compared with current policy. This change would be smaller than it might appear at first glance, since much of the money cut from the individual savings incentive would be redirected to employer-side savings incentives, which would in turn be partially passed through to workers. To the extent that workers receive a smaller fraction of the benefit from the employer credits than from current tax incentives, DC plans would be slightly disadvantaged from a worker perspective (though advantaged from an employer perspective). To the extent that the cuts to the individual tax incentive were larger than the employer tax credits, then DC plans would be slightly disadvantaged in the aggregate.

In theory, one could enact a similar reduction in the tax advantage for contributions to DB plans, along with employer credits for providing a plan. But implementing such reform in the presence of the many problems facing DB plans seems both difficult and unnecessary. DB plans represent just 23 percent of net new assets to private pension plans; if the trend over the past decade holds constant, this number will fall to just 10 percent by 2030 (Board of Governors of the Federal Reserve System 2015). The proposal is unlikely to have a major effect on this trend.

Nevertheless, certain high-income individuals (especially at small firms) may seek to exploit the new difference in tax treatment between DC and DB plans by converting existing DC plans into essentially equivalent DB plans for future contributions.

Shouldn't the proposal combine not just retirement accounts but all tax-preferred savings accounts, including 529 education savings accounts?

This proposal focuses on meeting the increasing challenge of providing all households with adequate retirement savings, and thus it is beyond the scope of this paper to address all tax-preferred savings accounts. It is intriguing to consider further consolidation, however. One advantage would be the ability to cross-insure between what are now two separate accounts; for instance, retirement savings could help in the event of unexpected college costs. For less than fully attentive savers, though, this combination might prove dangerous. Keeping the accounts distinct might help to remind savers that they must save for both ends.

Why not completely eliminate the individual retirement savings tax subsidy?

Research shows that the individual tax subsidy for retirement savings has little effect on savings—by one estimate, using data from Denmark, each $100 of tax expenditure increases savings by just $1 (Chetty et al. 2014). The current system does provide a highly useful feature, however: the disincentive for early withdrawal. The combination of withdrawal penalties and capital gains deferral helps workers commit to leaving retirement savings for retirement rather than for buying a new car, for instance. If one entirely removed the favorable tax treatment, not only would it weaken the commitment device to save inherent in a designated account, but it would also make it very difficult to convince workers to contribute to such an account that would seem to offer no advantages—and some disadvantages—relative to ordinary savings accounts. Instead, the proposed rate limitation and tax credit would reduce the tax incentives for some workers but preserve the current sense that saving in retirement accounts is still an unambiguously "good deal." Especially if URSAs were designed as pre-tax accounts, the proposal would also preserve the benefits from tax-free accumulation that produce larger balances at retirement for each dollar contributed while working, since the additional taxes would not be paid out of proceeds from the retirement account.

How will self-employed workers or contractors be treated for the purposes of the employer tax credits?

In order to maintain self-employed workers and contractors on an equal footing with employees, these workers would also be eligible for the tax credits. Self-employed individuals would be able to receive a tax credit of $1,000 for making contributions of at least 3 percent of earnings to their URSA. This credit would be claimed as a deduction against payroll tax payments on Schedule SE during annual income tax filings. Contractors for whom payroll tax is not withheld by the firm for which they regularly work would also be able to claim the tax credit in a similar way. If possible, they should be able to request that the firm withhold retirement contributions and have these sent directly to the worker's URSA (although this might require an additional 1099), so that these contractors could benefit from the advantages of payroll-deduction contributions.

How does the proposal deal with part-time workers, part-year workers, or other workers with variable incomes, for the purposes of claiming the employer tax credits?

Employers would be eligible to claim the tax credit on a pro rata basis for any workers employed less than full-time full-year. For instance, a small firm (with fewer than 10 FTEs on average during a year) could claim $1,000 per full-time full-year worker, $500 per half-time full-year worker, and $500 for a full-time worker who worked only half of the year. Minimum required contributions would be the same 3 percent of income. Because contributions would be made on an ongoing basis, as a deduction from each paycheck, income fluctuations should not affect claiming of the credit, nor would individuals or employers have to estimate future annual incomes, as they must for the health insurance premium tax credit under the Affordable Care Act.

Employers claim the tax credit on a rolling basis against payroll tax withholding, a system that automatically adjusts credit rates for part-year workers. For instance, a firm with fewer than 10 full-time employees and a monthly pay schedule would claim a tax credit worth $83.33 each month (one-twelfth of $1,000) for each employee contributing the minimum amount of 3 percent of earnings. If an employee left the firm for three months of the year, the firm would be unable to claim the credit for that worker during those three pay cycles, so that the effective credit for those three months would be $83.33 less than it was before the employee left.

Firms would also be required to reconcile at the end of the year total tax credits claimed. In most cases, this would actually benefit the employer. Suppose, for instance, that a firm had 25 FTE employees on payroll for the first three months of the year and then only five FTE employees thereafter (for an annual average total workforce of 10 FTEs). In this example, the employer is entitled to the maximum $1,000 tax credit per FTE for all employment during the year, or $10,000. However, it would have claimed only $8,125 throughout the year on a pro-rated basis ($17,500 x 1/4 = $4,375 for the 25 employees for one-fourth of the year, plus $5000 x 3/4 = $3,750 for the five employees for the other three-fourths of the year). As a result of the reconciliation, the employer could claim an additional $1,875 tax credit.

Why not impose a mandate on employers to offer retirement savings accounts?

An alternative approach to broadening retirement access would be to mandate that employers offer access to retirement accounts, as in Iwry and John's proposal for automatic IRAs (2009). According to economic theory, it would be possible to set the penalties for noncompliance (i.e., the stick) such that employers would face the same incentive to participate as under the proposal outlined above (i.e., the carrot). Furthermore, loss-aversion and social norms suggest that a mandate plus penalty would generate higher take-up rates than an economically equivalent tax credit. Therefore, there is much to like in a mandate approach.

There are important drawbacks to mandates, however. For example, some employers might correctly choose to not default workers into contributions if they judge that it would implement savings for workers too far above their optimal rates. Under a mandate system, those firms and workers would be made worse-off; in contrast, this proposal would leave firms that choose not to take up the tax credits unaffected.

Nevertheless, if one could overcome these issues, this proposal could be strengthened with the addition of a mandate that would require employers to default workers into payroll-deduction contributions to their URSAs. A mandate that applied to all firms—just like the employer tax credits—would avoid the potentially harmful effects on business growth of other mandates that apply only to firms above a certain size threshold. Similarly, a mandate that applied to all workers (rather than only to full-time workers) would avoid distortions to the nature of employment. Such a reform would offer important advantages relative to other proposed mandates that do not change other aspects of the system. Notably, most current mandate proposals revolve around retirement access through IRAs, which, due to their lower contribution limit and lack of guidance on optimal asset allocation, provide a less attractive account structure than URSAs.

Why choose employer tax credits rather than simplifying the system, such as by changing discrimination rules?

The two proposed reforms generate the maximum effect on employer participation by combining account simplification with tax credits. Changing nondiscrimination rules alone might simplify the choice to offer a retirement plan for employers, but those employers would still face additional administrative costs and the burden of fiduciary liability for their workers' savings. In contrast, the establishment of URSAs under this proposal would go much farther to reduce the cost of offering retirement access for employers. In addition, the employer tax credits proposed here directly address concerns about compliance with nondiscrimination rules because the primary default settings are chosen—with small adjustments discussed above—to meet the auto-enrollment safe harbor provision under current rules.

Changing nondiscrimination rules would also do nothing to increase the benefits of offering a retirement plan. For many small businesses, any business decision that does not directly benefit the bottom line can easily be deferred to another day, reducing the incentive for employers to help their employees save. This proposal directly benefits businesses that help workers save by providing large tax credits.

Won't this proposal cost a ton of money?

At current levels of retirement savings, this proposal is roughly revenue neutral; the cost of the employer tax credits is offset by the reduction in current tax breaks for retirement accounts. This proposal shifts a relatively inefficient encouragement to save (tax-preferred accounts) to a more effective encouragement (employer tax credits linked to automatic default enrollment and auto-escalation), which would increase retirement savings substantially. A

natural consequence of this increase in savings, however, is a reduction of roughly $38 billion in tax revenues each year, as income that would have been taxed is redirected toward tax-preferred savings accounts.

Because these revenue losses come only from the increase in saving, it should not be necessary to find offsets. (If we suddenly learned the delightful news that workers were saving more, for no apparent reason, we would not rush to raise taxes.) If it were necessary to entirely offset this lost revenue, however, it would only require tightening the rate limit at which retirement account contributions can be deducted from income from the proposed 25 percent to 15 percent, according to the same Urban-Brookings Tax Policy Center (2015) estimates. This change would raise an additional $33.9 billion at current levels of saving in the first year the reform is fully in effect, and somewhat more if savings were to increase as anticipated.

Chapter 5. Conclusion

The time has come to update our retirement savings system. Seniors are living longer and need more savings to sustain standards of living in retirement than at any time in the past, yet they must rely on their own private savings decisions and investment choices as never before. The confusing mess of retirement accounts and account types does not make this situation any easier. The system relies too much on employers for access to retirement accounts, yet does not demand enough of them to encourage employee participation. At the same time, many firms seek to avoid the onus of sponsoring a retirement plan because of the costs.

But we know what works from a solid evidence base of academic research. This proposal builds on a deep reservoir of accumulated knowledge about how to best encourage saving to design a simpler and more efficient system. By establishing URSAs and offering large tax credits for employers who help their employees save, the proposal would increase benefits and lower costs to employers while simplifying the system for workers. Most importantly, these changes would increase savings and retirement security, particularly for middle-class households that need it the most. If adopted, this proposal would set our aging population on a much firmer path to a secure retirement.

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Endnotes

1. These estimates, like all those from the Joint Committee on Taxation, do not discount tax flows that occur in the future. As a result, because taxation is deferred in most retirement accounts, a net present value estimate of this same effect might be 75 percent larger.
2. For consistency, this paper uses data covering 2013 from the March 2014 Current Population Survey (CPS) for retirement plan access and participation statistics (U.S. Census Bureau 2014a). While estimates of plan participation vary, both across different surveys of individuals and between surveys of workers and those of employers, analyses of these differences suggest that true worker participation is no more than 50 percent (see Munnell and Bleckman 2014).
3. The Department of Labor's (n.d.) proposed fiduciary rule (http://www.dol.gov/ebsa/regs/conflictsofinterest.html) would make more financial advisers subject to fiduciary responsibility. This rule could benefit firms, especially smaller firms, by ensuring that more retirement advice is fiduciary investment advice. This in turn might reassure businesses that they will receive unbiased advice when setting up a plan and choosing investment options.
4. Lu et al. (2015) estimate that nearly 40 percent of 401(k) holders borrow from their retirement accounts over a five-year period; they estimate leakage from loan default to be approximately $6 billion annually.
5. The myRA (My Retirement Account) program, designed as a limited starter retirement savings program, is managed and regulated by the U.S. Department of the Treasury, and does not fall under ERISA.
6. Calculations are based on data from a large plan recordkeeper and are courtesy of John Beshears, James Choi, David Laibson, Brigitte Madrian, and Sean Wang.
7. Specifically, the safe harbor automatic enrollment option, also known as the Qualified Automatic Contribution Arrangement.
8. My calculation on the effect of the maximum contribution limit draws on the CBO (2014) estimate that a 15-percent reduction in all contribution limits would raise $7.2 billion in the first fully-in-effect fiscal year. However, in order to be conservative, I assume that the increased revenue will be only half as large. Although the proposed contribution limit reduces the maximum contribution currently available through 401(k)s, it raises the maximum relative to IRAs. Furthermore, because the proposed contribution limit is for any combination of employee and employer contributions, some employees would be able to contribute more than under the current regime. Finally, these calculations assume 82 percent firm take-up and 85 percent worker participation to determine the total annual cost of the tax credits. To calculate the effect of the 25 percent limit on tax deductions, I use customized estimates from the Urban-Brookings Tax Policy Center (2015). These estimates, however, assume no change in the level of savings. To account for the projected increase in savings, I scale up the additional revenues generated by the rate limit for each income quintile in proportion to the projected increase in savings and then reaggregate across quintiles. This step increases the revenue estimate from $15.1 billion to $18.6 billion for the first fully-in-effect fiscal year.
9. The Investment Company Institute (2015b) documents that the growth of IRAs has been driven by investment returns and rollovers from employer plans.
10. Based on estimates of plan sponsorship rates by firm size from the U.S. Census, combined with the distribution of firm sizes in the economy (from the Quarterly Census on Employment and Wages, U.S. Census Bureau via the Small Business Administration, 2011), there are 27.5 million workers without access in firms with 100 or fewer employees and 28.7 million such workers in firms with 101 or more employees.
11. Author's calculations are based on the 2014 March Current Population Survey (U.S. Census Bureau 2014a). I assume 80–90 percent take-up rates among workers (varying by income quintile, following the data) with 82 percent worker access. I also assume that workers earning less than $20,000 experience increases in access but are not defaulted into participation in line with the structure of the employer tax credits.
12. Calculations assume an additional $55.9 billion in contributions each year, earning 4 percent annual net-of-fee return, held in the account for 20 years before withdrawal, and paying 0.2 percent annual fee.
13. The trend is calculated based on the change between 2004 and 2014.

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Highlights

John N. Friedman of Brown University proposes a two-pronged approach to encourage workers to save more for retirement. Intended to help middle-class workers who do not save enough for retirement and who are thus at risk of hardship, these proposals would increase the number of workers participating in an employer-sponsored retirement plan from 41 percent to at least 65 percent and raise annual retirement savings by $45 billion.

The Proposal

Establish Universal Retirement Savings Accounts. These accounts, or URSAs, would replace the multitude of currently available retirement plans and remain with workers over their lifetimes. URSAs would be low-fee accounts managed by established account providers that are regulated by the U.S. Department of the Treasury and other federal agencies. Employers would support the transition from the many accounts available today to the URSA framework.

Institute Large Tax Credits for Businesses that Encourage Workers to Save. The federal government would offer businesses tax credits when their workers contribute to retirement savings accounts. In order to be eligible for the credits, firms would need to auto-enroll their workers at a 3 percent savings rate and auto-escalate the savings rate by one percentage point each year (stabilizing at 8 percent). The size of the tax credit would be tied to the size of the business, with the total credit increasing with the number of employees enrolled. At any point, workers could choose to opt out of their plans, or to adjust them to better suit their personal circumstances.

Benefits

Together, these reforms would substantially increase retirement savings for workers, reduce the burden on employers of offering and managing retirement plans, and more efficiently and equitably use federal tax dollars to promote retirement preparation. The two prongs of this proposal complement each other in a comprehensive reform, but they would also be effective if undertaken separately.

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