Better Retirements? Build on the System's Current Successes

By Brian Reid

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Providing a secure retirement for America's workers is a challenge facing us all, as individuals and as a nation. How are we facing that challenge? An accurate assessment of America's retirement system today must recognize three key facts:

First, America's retirement system is working. It's helping to build retirement security for the vast majority of Americans.

Second, the tax incentives for retirement saving—based on the deferral of taxes, not on exclusions or deductions—are key to the successes and strengths of that system.

And finally, though there are opportunities to improve our retirement system, changes should build on our current structure—and not put today's retirement system at risk.

Those statements contradict much of the public debate around retirement. But they're backed by a wide range of government, academic, and industry research demonstrating that the American retirement system has become stronger in the past half-century—and is working well for millions of Americans.

The poverty rate among elderly Americans, for example, has fallen since 1966 from nearly 30 percent to 9 percent—now the lowest among all age groups. Since 1975, the amount of assets earmarked for retirement per household has grown nearly seven-fold, even after adjusting for inflation. And over that same period, the share of retirees receiving private-sector pension income has increased, as has the amount that they receive—again, even after adjusting for inflation.

Social Security, which provides income in retirement for nearly all working Americans, provides a solid base for retirement security. But workplace benefits remain vital. The Investment Company Institute recently tabulated data from the Federal Reserve's Survey of Consumer Finances and found that among working, near-retiree households, more than 80 percent have accrued pension benefits, retirement assets, or both.

These findings speak to the impact of Congress' bipartisan efforts to transform Social Security into a strong foundation for American's retirement system, and to create a framework of laws and tax incentives on which voluntary employer plans and individual retirement accounts (IRAs) have grown and thrived. The tax incentives for retirement savings are central to those efforts—but are often poorly understood. These incentives take the form of tax deferral, because contributions and earnings in traditional retirement plans are taxed when a retiree withdraws income. This is fundamentally different from tax deductions or exclusions, where the initial tax reduction is never recovered.

In economic terms, it's the after-tax rate of return that provides workers with the incentive to save. Tax deferral effectively taxes the investment earnings in a traditional retirement account at a zero rate—regardless of the saver's tax bracket. This means that, rather than creating a so-called "upside-down incentive" for saving, tax deferral equalizes the incentive to save across retirement savers in all income groups, and encourages support for employer-sponsored pension plans among a wide range of workers.

Of course, our retirement system has room for improvement. Working together, policymakers and the financial industry can—and should—do more to promote savings and foster innovation and growth in the voluntary retirement savings system work. Congress should put Social Security on a sound financial footing as a universal, employment-based, progressive plan for all Americans, provide flexible approaches to retirement income, and help small employers by offering simpler plan features and easier access to multiple employer plans.

All of these ideas build on the successes of our current retirement system—rather than undermining or trying to replace it. None of these ideas would further limit or impair the tax incentives for savings.

But recent proposals in Washington to undermine those incentives would undoubtedly reduce the number of employers that sponsor retirement plans, which could then deprive workers of all ages and all incomes the many benefits of plan participation.

ICI's research finds that American households overwhelmingly believe that government should keep its hands off the tax incentives in their defined contribution (DC) accounts. In a fall 2013 survey, 86 percent disagreed with the idea of eliminating the tax advantages of DC plans, while 83 percent opposed any reduction in employee contribution limits. And strong majorities support the control and choice of investments that these plans provide to workers.

The U.S. mutual fund industry supports measures that strengthen the retirement system. But these efforts will do little good if misguided attempts at "reform" cut the incentives that fuel our current system.

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