Individual Retirement Accounts: 30 Years of Savings, February 2005

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An ICI Analysis of the Growth of IRAs

Washington, DC, February 14, 2005 – In the 30 years since Americans first had the opportunity to open an Individual Retirement Account (IRA), the IRA has grown to represent one of every four retirement dollars in the United States.

A new report, "The Individual Retirement Account at Age 30: A Retrospective," released today by the Investment Company Institute provides a summary of the growth and development of the $3 trillion IRA market. The report draws on surveys conducted by the ICI along with Internal Revenue Service Statistics of Income data and other recent research.

The size of the IRA market tells only part of the IRA story. "Experience shows that individuals respond positively to incentives to build retirement assets. Incentives work best when rules, structure, and provisions are simple, flexible, and predictable," said ICI Senior Economist Sarah Holden, co-author of the report. "In contrast, complexity discourages the use of IRAs."

"To see the benefits of simplicity in design, we need only to look at the early and mid 1980s when IRAs were 'universal' and all workers under age 70½ were eligible to make tax-deductible contributions," Holden said. From 1982 to 1986, contributions jumped to an average $34.4 billion per year. When the Tax Reform Act of 1986 reintroduced limitations on deductible contributions – along with increased complexity of determining eligibility – IRA contributions fell in 1987 to $14.1 billion.

Congress built flexibility into the IRA's design from the very beginning in the Employee Retirement Income Security Act of 1974 (ERISA). As a result, IRAs play a dual role in the retirement market. IRAs are a tax-advantaged contributory savings program originally geared to workers without an employee-sponsored retirement plan. In addition, workers are able to maintain the tax-advantage of assets accumulated in their employer-sponsored plans by rolling over those assets into IRAs at job change or retirement. Nearly half of all American households with traditional IRAs held rollover assets in those accounts in mid 2004, ICI research shows.

"Not only is the IRA a useful tool for workers to roll over their retirement savings, but it helps workers preserve their assets because very few tap their IRA nest eggs before they retire," Holden said. IRAs help individuals who have earmarked these assets for retirement stay committed to their goal.

The ICI report also tracks the impact of changes to IRAs enacted by Congress, from encouraging small businesses to set up special IRAs for their employees to recent increases in the contribution limits. In 2001, Congress increased the annual contribution limits for the first time in 20 years and encouraged more saving by workers 50 and older by permitting "catch-up" contributions. In response, American workers took advantage of these changes and deductible contributions to traditional IRAs rose to $9.5 billion in 2002, the largest amount since 1990.

Currently, more than 45 million U.S. households – or 40 percent of all U.S. households – own IRAs. Although the households that own IRAs tend to have higher incomes and financial assets than non-IRA households, "IRA owners come from a wide range of ages, educational backgrounds, and income groups," Holden said.

"The IRA has been one of the most significant financial developments in the past 30 years," said ICI Chief Economist Brian Reid. "It has successfully built and preserved retirement savings among millions of Americans."