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Universal Pensions

A Common-Sense Approach to Retirement Security in the New Economy

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Executive Summary

Retirement security in America is at a crossroads. The debate over Social Security solvency remains mired in partisan politics, more and more Americans are forced to work longer into their retirement years in order to maintain their standards of living, and in the wake of Enron many Americans are concerned about the safety of their retirement nest eggs. Meanwhile, the private pension system is simply not expanding enough to meet the needs of future retirees.

While Congress regularly adds new incentives to the growing array of tax savings vehicles, retirement security remains stagnant. The U.S. personal savings rate continues its steady decline and too few Americans are saving enough for retirement. Many low-income individuals do not have any savings, and pension coverage for those employed at small businesses was less than 20 percent. And among those who do have savings plans, a large number of them are depleting their retirement savings by cashing out their 401(k) plans when changing jobs.

To really boost savings, we must overhaul the current system to let workers decide how much they can save up to some uniform limit, give workers control over their investment choices, and fold all the existing tax-favored savings accounts into one "universal pension" that workers would take from job to job. The key components of a universal pension include:

- **Universal Access.** To ensure universal access, the federal government will provide financial incentives to encourage Americans at all income levels to open a universal pension when they start working.

- **Greater Choice.** Because they are under the control of the individual worker and not the employer, Universal pensions will provide the individual saver a greater amount of investment choices.

- **Simplification.** By eliminating the complex system of IRA accounts and replacing it with one single account called a "universal pension," all Americans—not just the financially sophisticated—will get a good deal. The universal pension would encompass all the benefits of existing IRAs while reducing the amount of rules, paperwork, and fees associated with the current system. Like most IRAs, the money contributed to the universal pension and the interest on that investment would grow tax-free until it is withdrawn.

- **Portability.** Universal pensions provide complete portability by going with every worker from job to job. Furthermore, an employee's 401(k) balance would automatically transfer to the individual's

universal pension whenever the worker changed jobs.

- **Protecting Worker Savings.** To encourage diversification and decrease the likelihood that investors would lose their life savings because their portfolios were overly concentrated in their employer's stock, workers—after completing the three-year vesting period—could place a portion of their 401(k) into their universal pension. In addition, unlike IRAs, universal pensions would be protected from bankruptcy proceedings.

Background

While politicians debate the future of Social Security and Medicare, the foundations of retirement security for most Americans—the issue of expanding access to and increasing participation in private pensions—has been largely put on the backburner. Ensuring Social Security and Medicare solvency is a prerequisite to guaranteeing that the elderly do not retire in poverty. But a vibrant, private pension system is the key to guaranteeing that retirees are not just getting by, but are financially secure.

Retirement income security in the United States has traditionally been based on the so-called three-legged stool: Social Security, private pensions, and other personal saving. Since World War II the system has served the elderly well: The poverty rate among elderly households fell from 35 percent in 1959 to 11 percent in 1995. Yet there are cracks in the system. Minorities and older women living alone have poverty rates in excess of 20 percent. Moreover, a much larger fraction of the aged than of the non-aged live immediately above poverty—between 100 percent and 125 percent of the poverty line.[1] Furthermore, for too great a number of Americans, Social Security remains the predominant source of retirement income. Roughly two-thirds of the elderly receive the majority of their retirement income from Social Security; for almost 20 percent of the elderly, Social Security represents their only source of income. Finally, the rising costs of long-term health care have become an increasing threat to the financial security of the elderly, and more and more retirees are living longer, thus stretching their financial resources thinner.

As the limits of their financial resources have been stretched, many retirees have looked for additional sources of income in addition to that provided by the traditional three-legged stool. Today more than 32 million Americans age 50 and older are in the workforce. Delayed retirement has been partly encouraged, according to Gary Burtless of the Brookings Institution and Joseph Quinn of Boston College, because public and private pension programs now provide weaker financial incentives for workers to retire at particular ages, such as age 62 or age 65, and offer stronger incentives for aging workers to remain in the labor force.[2] Another change in the composition of the three-legged stool of retirement security is the merging of personal savings and retirement savings as a result of the shift from defined benefit (DB) plans to defined contribution (DC) plans like 401(k)s. According to one report, there has been a one-for-one transfer in employee pension coverage from DB to DC plans, and this trend shows no signs of abating.[3]

The transfer from DB to DC plans coincided with the change from the old economy to the New Economy. The economic expansion of the 1990s spawned jobs at a furious pace and drove unemployment down to levels not seen since the flush times of the 1960s. Yet, the current recession has exacerbated concerns that many Americans held during the boom of the '90s: In particular, the price of swelling prosperity and economic opportunity is less job security because of the New Economy's need for churning labor

markets. And there are some who question whether the movement to DC plans is really in the best interest of workers in the New Economy. Critics argue that DC plans are not as generous as traditional pensions, are more risky since they leave decision-making largely up to the individual instead of the company, and encourage less participation since they often involve voluntary participation rather than universal coverage of eligible workers. Although there is some validity to these concerns, the overall benefits of DC plans far outweigh the negatives: DC plans empower individuals by giving them control over their retirement investments, provide greater portability of benefits at a time when people no longer stay at one company until they retire, and are more understandable to employees. In fact, their full potential has not been tapped. The reason: The current system is overly complex and irrational, and does not provide sufficient incentives to maximize participation among Americans of all income groups.

We believe the New Economy provides new opportunities for government to underpin economic security in new and creative ways, including public incentives and reform of old rules and regulations that will increase access to and participation in retirement and savings accounts. The New Economy demands a new definition of economic security, one in which pensions become easier to access, in which everyone has the opportunity to own a stake in the future, and in which people can move from job to job without the fear of losing benefits and long-term economic security.

In this paper we offer a recipe for broad reform to spur much greater participation in private retirement savings plans. Without major reform and restructuring of the DC system, we believe the retirement savings rate will continue to stagnate. With it we can ensure a financially secure retirement for a greater number of Americans.

History of the IRA and 401(k)

The Individual Retirement Account (IRA) and 401(k) are the most common form of tax-favored retirement/savings accounts. Congress created IRAs in 1974 to give Americans an extra incentive to save for retirement. IRAs were immensely popular at first, but interest waned in the 1980s. The entry of 401(k) plans onto the scene gave workers another way to save for retirement, and drew further attention away from IRAs. Since its establishment, the "401(k)" has become a household word to the 42 million Americans who participate in 401(k) plans. With roughly $1.8 trillion in assets, the 401(k) is the fastest growing savings vehicle. Its assets are likely to soon surpass the $2.1 trillion in all institutional pension plans, whose growth rate is less than half that of the 401(k).

401(k)s, traditional IRAs, and Roth IRAs are protective shells that allow your money to grow tax-free, but there are substantial differences among them: In all three cases, the interest you earn is not taxed, so your investment keeps growing tax-free. In the case of a Roth IRA, your contributions are made on an after-tax basis—but you do not pay any taxes when you withdraw the money, providing you fulfill the requirements. With a traditional IRA and a 401(k), federal, state, and local taxes are due on the money you withdraw, but your initial contributions are tax-free. Some of the other differences include:

- **Employer Match.** Your employer may match part or all of your contribution to a 401(k). This is not the case with a traditional IRA or Roth IRA.

- **Early Withdrawal.** Under certain circumstances, and depending on the rules of your plan, you may be able to withdraw money from your 401(k) account before age 59½. However, in addition to paying local, state, and federal taxes on the money

you withdraw, you will most likely also have to pay a penalty of 10 percent of the money you withdraw. If you are 55 years old and quit your job or are fired, this early withdrawal penalty will likely be waived. Some plans also offer the possibility of taking out a loan and avoiding the 10 percent withdrawal penalty. But, you must repay this loan or the government will consider it an early withdrawal and charge you the penalty and appropriate taxes. With regard to a traditional IRA, in most cases, a penalty of 10 percent will apply to withdrawals before age 59½, in addition to local, state, and federal taxes. However, you can make early withdrawals without the 10 percent penalty to pay for college or graduate school education, or to make a down payment (up to $10,000) on a first-time home purchase for yourself, your children, your parents, or your grandparents. With a Roth IRA, once you have had the account for five years, you may be able to make a withdrawal without paying an early withdrawal penalty. However, if you are younger than 59½ and your withdrawal includes interest earned on the account (and not just your contributions) you may be charged a 10 percent early withdrawal penalty.

- **Investment Choices.** With a 401(k), the choices you have for investing your money are limited to the options offered by your plan. With IRAs, your choices are typically greater.

- **Protection from Creditors.** If you declare bankruptcy, federal law protects your savings in an employer-sponsored qualified plan such as a 401(k). Your creditors cannot touch it. (Only the IRS or, in the case of divorce, your former spouse or children, can.) IRAs, which are not qualified plans, are subject to state law. While most states protect IRA balances from creditors, not all do and the level of protection varies from state to state.

In 1997, Congress passed the Taxpayer Relief Act. This created new types of IRAs with different rules, among them the Roth IRA. Some rules for traditional IRAs were also changed, making the traditional IRA a more attractive savings tool. As a result, IRAs are no longer used only to save for retirement—under certain circumstances, they can effectively be used to save for higher education and first homes, or can be tapped for emergencies. Last year, Congress made additional changes to IRAs. The most significant change to the IRA regulations is the increase in the maximum annual contribution limit. The limit has been fixed at $2,000 for more than a decade. In 2002, the annual limit for both traditional and Roth IRAs rises to $3,000. In 2005, it will rise to $4,000, and in 2008, it will reach $5,000. Thereafter, further increases will be indexed to inflation. Additionally, the new regulations call for the maximum annual contribution limit for SIMPLE IRAs to rise to $10,000 by 2005 from the current $6,500 a year. The limit will rise by $1,000 a year from 2002 to 2005, and further increases will be indexed to inflation.

Other significant changes involve what is known as "portability," or the ability to move your money from one tax-deferred retirement account to another. Under the new rules, state and local government workers with Section 457 deferred compensation plans will be able to roll their money into an IRA when they leave their job—something they were previously unable to do. Also, a worker who rolled a 401(k) into an IRA, then wanted to roll that into a 403(b) at a new employer, previously could not do so. Now that will be allowed. Finally, pretax contributions that were made directly to an IRA can be moved into an employer's retirement plan such as a 401(k), 403(b) or 457 if a worker wants to consolidate his retirement money. Congress

also established an IRA catch-up provision for older workers. Once a worker reaches age 50, she will be able to make an additional IRA contribution each year. From 2002 to 2005, it will be an extra $500. The catch-up contribution will rise to $1,000 a year starting in 2006.

Finally, the law attempts to provide an incentive for low-income workers to save. Unfortunately, several crucial details of the credit make this of very limited value. For example, since the tax credit is not refundable, it provides *no* additional saving incentive to the vast numbers of families who otherwise qualify on paper for the 50 percent credit rate based on their income (under $30,000 for married couples and $15,000 for singles with no children). Most low-income families, especially ones with children, therefore do not qualify for it: More than 20 million low-income families with incomes in the qualifying range are automatically excluded from the 50 percent tax credit. For families with somewhat higher incomes, the fact that the credit is not refundable poses much less of a problem. But for these families, the credit provides such a small incentive for saving as to be of little value. For example, a married couple earning $45,000 a year receives only a $200 tax credit for depositing $2,000 into a retirement account. This small credit represents a very low matching rate and therefore provides little incentive to participate.

Problems with the Current System

Americans Are Saving too Little

A large percentage of Americans simply don't save enough. Over the past few decades, the rate of personal savings has declined steadily and is now is approaching historic. The U.S. personal savings rate has declined steadily from 7.8 percent in 1990 to 1.1 percent in 2001.[4]

Low savings not only threatens the ability of individuals to retire with financial security, it but also reduces the pool of capital available for investment—the pool that creates jobs and economic growth—all essential elements of higher standards of living for all Americans. From 1983-1997, only the top 5 percent of households experienced an increase in their net worth, while it declined for everyone else. According to one study by the Brookings Institution, only about one-half of all married households are saving enough for retirement. Although this share increases significantly when home equity is considered as part of the analysis, only about one-third of married households are putting enough away for retirement even under this more expansive definition. Most disturbing is that despite the expansion of tax-advantaged retirement accounts, these numbers have remained flat or in some cases decreased since 1983. Even those scholars (such as William Gale) who argue that the rate of wealth accumulation is high when capital gains are included admit that as many as 25 percent of households aren't saving enough. Indeed, even Gale admits that although one-third to one-half look as though they're doing pretty well, it is difficult to tell where the rest stand.[5]

Proportion of Households Saving Adequate for Retirement

Despite the addition of a plethora of new, tax-incentive retirement accounts, the share of Americans saving adequately for retirement has not risen substantially. According to research from Ohio State University, less than 50 percent of households aged 54 and under have adequate retirement savings, with the percentage dropping to 36 percent for those under age 35.[6]

Another indicator that Americans are not saving enough is the decrease in the number of individuals who say they have personally saved for retirement. According to one study, this figure decreased by 4 percent from 2000

to 2001. In addition, the survey shows that today's workers feel less confident about having enough money to live comfortably in retirement, and fewer are trying to figure out how much they will need to save for a comfortable retirement. The study states that 63 percent of workers feel confident that they will have enough money to live comfortably in retirement, compared with 72 percent last year.[7]

As savings have lagged, pressure has increased on the Social Security system. Anticipated Social Security payments are now the largest single "asset" for a majority of Americans. Unfortunately for future generations, the financial solvency of the trust fund beyond 2030 is uncertain. The intermediate estimates produced by the Social Security actuaries suggest that the Social Security Trust Fund will be exhausted in 2038, at which point incoming revenue would be sufficient to finance only about 70 percent of benefits scheduled under current law.

The Extent of Pension Coverage Has Remained Flat

Although the amount of assets in 401(k) and IRA plans has grown, overall employer-sponsored pension plan coverage increased only marginally. From 1972 to 1993, the coverage rate for full-time private wage and salary workers rose only marginally—from 48 percent in 1972 to 50 percent in 1993. Furthermore, while overall coverage has remained fairly constant, there have been significant downward shifts in relative coverage rates among subgroups. For example, coverage of men has decreased from a high of 55 percent in 1979 to 51 percent in 1993.[8]

Private Pension Coverage Has Not Adequately Extended to Small-Business Employees

Currently, fewer than half of all workers are enrolled in an employer-sponsored pension plan. The problem is even more acute for those working in small businesses. As of 1993, 84 percent of workers in companies employing more than 1,000 people had access to a retirement plan, but only 17 percent of workers in companies with 25 or fewer employees had a retirement plan available to them at work. As a result, only about 20 percent of Americans in businesses with 100 or fewer employees participate in a retirement plan. The problem is worse for women and minorities who tend to have shorter job tenures and who are more likely to be part-time employees without coverage by an employer-sponsored plan. Moreover, current pension rules allow for excessive leakage and can be overly complex and burdensome.

In fact, the very complexity of the system is one probable cause for the failure of small businesses to establish retirement plans for their employees, despite the existence of plans with reduced administrative burdens. According to one study, many small business owners without retirement plans are unfamiliar with the different retirement plan types available to them as potential plan sponsors. One-third of non-sponsors say they have never heard of the savings incentive match plan for employees (SIMPLE), and 54 percent of non-sponsors report that they are not aware of simplified employee pensions (SEPs). By comparison, very few non-sponsors say they have never heard of or are not too familiar with 401(k) plans.[9]

Too Many Individuals Cash-Out Their 401(k)s When Changing Jobs

Because defined contribution plans allow workers easy access to accumulated balances when they change jobs, there is a greater risk that these funds will be spent before retirement. According to the Employee Benefits Retirement Institute (EBRI), almost 60 percent of 401(k) participants who change jobs currently take cash payments rather than roll their balances over to their new employer's plan or an IRA. Although they occur less frequently among older workers and those with larger distributions, these cash-outs represent more than half of all amounts distributed.[10] Although some people may use their cashed-out 401(k) balances for worthy goals, this drain on retirement savings undercuts retirement security for many families.

The Pension Gap

One significant problem with the current private pension system is that low-income workers participate at much lower rates than middle and high-income workers. One study by AARP suggested that middle- and high-income retirees are twice as likely to have pension income than those with lower incomes. Almost 40 percent of middle-income individuals aged 62 to 74 have pension income, while only 15 percent of lower-income retirees of the same age had pension income.[11] Another study by Eric Engen and William Gale finds that only 14 percent of families earning between $10,000 to $20,000 participated in a 401(k) plan, compared with 51 percent of those earning $75,000 or more.[12] For policymakers, this is of particular concern given that recent research has underscored how critical pension income is in achieving retirement security and avoiding poverty in old age. Vast differences in retirement security exist between those at the top and the bottom of the economic spectrum. The combination of Social Security, asset income, and pensions works well only among the top 20 percent of the aged. The bottom 20 percent rely on Social Security for over 80 percent of their income.

Furthermore, the movement to DC plans has not helped close the gap between low and moderate to high-income individuals. For many low-income families struggling to make ends meet, DC plans do not provide enough financial incentives to justify contributions at the expense of other economic priorities.

An Overly Complex and Irrational Pension System

According to our research, there are some 16 different types of tax-favored retirement/savings accounts. This includes everything from the traditional IRA and the Roth IRA to Individual Retirement Annuities and profit sharing defined contribution accounts. In the *Addendum* we provide a detailed list and description of each account and their differences. While this arcane system of rules might make sense to expensive accountants and tax lawyers, most Americans would be lost if forced to try to explain the current system.

The very complexity of the current system provides a disincentive to those who want to participate. Every time an individual opens an IRA, a 401(k), or changes accounts because of a new job, a divorce, or for some other reason, new documents need to be read, signed, and filed with the correct entities. In addition, many taxpayers are not taking advantage of all the opportunities in the existing system because the federal government or Congress changes the rules every couple of years, adding new twists to existing programs. For example, a number of major changes were made in last year's tax bill, including the creation of several new types of accounts, including a new Roth 401(k) and a total revamp of the old Education IRA.

Those who can afford it pay for professional guidance to ensure they are taking full advantage of all the retirement savings tax breaks available. Others participate, but don't understand enough about the system to take full advantage of all the incentives. And some choose not to participate at all.

Another barrier to participation in DC plans is cost. When an individual opens a new account or changes an old one, the financial institution often charges a fee. Because we do not have a completely portable pension system, many individuals have more than one IRA and 401(k), each with its own schedule of charges. Over time these fees add up, and decrease the amount of potential dollars available for retirement savings.

The Solution: Universal Pensions

There is a better way to encourage Americans to save for retirement not requiring a law degree to understand. Such a system would give every American a real stake in their retirement security. The key aspects of this new retirement system would provide universal access to everyone who works hard and plays by the rules, provide better incentives to encourage a greater number of participants from all income levels; be completely portable; require relatively low service fees; and empower investors by providing them with more choice.

By getting every American to open and invest in a universal pension, we would immediately create a fourth leg of the "retirement stool" for all individuals, in a way that would give them a real stake in the market economy. One way to think of it is as a Homestead Act for the Information Age. Just as the federal government once gave citizens a hand up by giving them land to farm, it can now give them "seed corn" in capital to invest. Clearly, wealth-building assets are as critical a factor in upward mobility today as land-ownership was in the agricultural age.

Universal Access

The first step to guaranteeing total access to a universal pension is to provide incentives that make it possible for Americans of all income levels to contribute.

Like IRAs and 401(k)s, a universal pension and the interest on that investment would grow tax-free until it is withdrawn. Individuals could withdraw a portion of the money to use as a down-payment on a first home, which is a financial asset, but not for education, since there are a whole set of tax breaks that are specifically designed to encourage parents to save for their children's education. Individuals who do withdraw the money for other purposes would be subject to a 10 percent IRS penalty in addition to ordinary income tax rates, unless certain exceptions apply. These exceptions would include: a) death; b) disability; c) medical expenses exceeding 7.5 percent of AGI; d) health insurance premiums when receiving unemployment compensation for longer than 12 months; e) and substantially equal payments (annuitization). Payments from the universal pension must begin by age 70 ½, as under current law.

The contribution limits for universal pensions would be as generous as today's IRA accounts. Like IRAs, individuals could make contributions into their universal pension of up to $3,000 in 2002, $4,000 in 2005, and at $5,000 in 2008. In order to ensure that the value of their contributions does not diminish over time, the contribution limit would be indexed for inflation. If the individual is not eligible to participate in a 401(k), he/she could contribute an additional $10,000 to the universal pension. Like the current tax bill, the contribution limit would be indexed for inflation after 2008. For individuals with no 401(k) plan, the universal pension contribution level will rise to $20,000 by 2008.

Unlike IRAs, Americans of all incomes could contribute to a universal pension.

However, individuals with income above $110,000 and couples with income above $160,000 would be limited to a $1,000 contribution limit, indexed for inflation after 2008. While raising the income cap helps provide middle and higher-income individuals with an incentive to save for retirement, low-income individuals need real incentives as well. We propose changing the newly created retirement savings tax credit for low-income individuals to provide a true incentive to low-income individuals. The current 50 percent credit applies to married couples with income under $30,000 and singles with income below $15,000, and is non-refundable. As a result, more than 20 million low-income families with incomes in the qualifying range are automatically excluded from the 50 percent tax credit. The key change is to make the credit refundable, so that low-income individuals would benefit from it. Finally, to get young workers to start saving for retirement when they enter the workforce, the federal government would stake every 25 year-old with $500 against their income tax when they open a universal pension at a qualified, private financial institution. Even if they never invested another dime in their universal pension, the savings account could produce through the miracle of compound interest as much as $10,000 (assuming a 7.5 percent interest rate) or more, by the age of 67.

Although universal pensions would replace all existing IRA accounts, individuals who currently have Roth IRAs or other types of IRAs could maintain their existing accounts. However, these individuals could not make any future contributions to those accounts and no other individuals would be allowed to open new accounts.

Greater Choice

Under current law, employer contributions to 401(k) accounts are not vested until the employee has been at his or her company for at least 3 years. Furthermore, unlike IRAs, investment choices for 401(k)s are limited at the discretion of the employer. Usually an employer only provides a few choices to his or her employees. And unfortunately, as the Enron debacle showed, many employers strongly encourage their employees to invest in the company for which they work. According to *USA Today*, almost 30 percent of 401(k) holdings are in employer stocks.

One way to empower employees and provide them additional investment choices is to allow workers—once they have completed the three-year vesting period—to opt to have a percentage of their 401(k) account holdings and any further contributions directly deposited into their universal pension. To keep the system as seamless as possible 401(k) contributions from employers would be made by direct deposit into the account. To ensure that employers continue to match employee contributions, companies could continue to take a tax deduction for contributions to the worker's universal pension. Individual contributions could be made annually, quarterly, or could be subtracted directly from payroll.

This simple reform would give workers the option to manage their own retirement investments and gain more control over their retirement security. And because they are individual private savings accounts like IRAs, universal pensions will provide the individual saver with a greater amount of investment choices than the 401(k).

Simplification

By moving to a single universal pension, we can simplify the tax code and eliminate the myriad of IRA accounts. This new single account would encompass all the benefits of existing IRAs while reducing the amount of rules, paperwork, and fees associated with the current system. No longer will the self-

employed have to open both a SIMPLE IRA and a traditional IRA to reach the maximum contribution benefit. Instead, each individual could make the total contribution to a single universal pension. Because there will be one set of rules for all workers, taxpayers won't have to pay high-priced accountants to analyze whether they will be better off with a Roth IRA or a traditional IRA. And with one single account, the investor can more easily track how his or her portfolio is performing. Finally, a universal pension will mean only one brokerage fee, with the cost of managing that fee disclosed clearly each month on the investor's statement.

Another beneficiary of simplification will be small businesses that want to provide retirement savings accounts for their workers but are deterred by the cost of starting 401(k) plans or by the confusing rules that apply to SEP and SIMPLE IRAs. Under the universal pension system, small business employers could choose simply to match employee contributions to their universal pension rather than paying accountants and lawyers to start a 401(k). While small businesses would have to continue to abide by the existing non-discrimination rules, overall paperwork will be reduced and the movement to one account will allow small businesses to more easily track the retirement benefits they provide to their employees. Finally, small businesses that choose to utilize their employees' universal pension could receive the same tax benefits as employers who set up and match contributions to 401(k) plans.

Portability

For years Congress has tried to make pensions more portable by issuing new rules and regulations for the existing system. The problem with this approach is that their attempts to reform were focused on a flawed, overcomplicated system. The way to guarantee complete portability is to "junk" the current system in favor of simplicity.

Unlike a 401(k) or a traditional defined benefit plan, a universal pension goes with the worker from job to job. To ensure complete portability, all vested 401(k) contributions and earnings would automatically roll over into a worker's universal pension when the worker changes jobs. Under the current system, workers must fill out form after form to simply roll-over their 401(k) into an IRA. And for those millions of individuals who don't have one already, they are forced to pay fees to open a new IRA account. Because of all the paperwork and unfamiliarity with the rules that control the pension system, many workers choose to leave their money in their existing 401(k), with its limited investment choices and under the control of their former company rather than themselves, or worse, they simply cash their plans out, reducing their retirement nest egg.

The universal pension eliminates the need for paper and forms by creating a truly seamless and portable system. Since every worker will have a universal pension, no one will have to set up a new IRA when they leave their job. Second, a retirement fund would automatically transfer into a universal pension whenever the employee changes jobs. Under this new system, workers would simply provide their employers with their universal pension account number when beginning employment, thus allowing the rollover transaction to occur automatically.

Protecting Worker Savings

As the Enron debacle showed, we need to do more to protect the retirement savings of all Americans. The reforms associated with universal pensions will help make retirement savings safer in several ways. First, by allowing employees to choose to deposit a percentage of all existing and future 401(k)

contributions directly into their IRA after the three-year vesting period, we would empower workers with concerns about how their 401(k)s are being managed by their employers by giving them the option to manage their own retirement investments. Second, universal pensions will provide workers with significantly more diverse investment choices than most 401(k) plans. The Enron case illustrated how retirement savings are at a greater risk if an investor's portfolio is not well diversified. At Enron, many workers invested almost all of their 401(k) plan balances in Enron stock, only to see the assets evaporate over a matter of weeks amid a financial probe of Enron's dealings and a failed merger. The universal pension works under the belief that employees who have more investment choices are more likely to have diversified, and thus safer, portfolios.

Universal pensions also have other features that make them safer than IRAs. Like 401(k) accounts, universal pensions will be protected from creditors in bankruptcy proceedings to assist those who need a second chance. And to ensure that employees who choose to become full-time parents are not unfairly disadvantaged, 401(k) plans would be treated as vested and automatically rolled into a universal pension if the employee has worked at the firm for at least one year.

Budgetary Impact

The cost of providing access to a universal pension for all Americans includes the following:

- Staking every employed American $500 when they reach the age of 25: $20 billion over 10 years.
- Making the retirement savings tax credit for low-income individuals refundable: $20 billion over 10 years.
- Lifting the income cap but limiting contributions by higher-income individuals to $1,000: $7 billion over 10 years.

The total cost would amount to roughly $50 billion over 10 years. In light of the Bush budget deficit, we need to be fiscally responsible and provide offsets for the universal pension tax incentives. Fortunately, the costs associated with increasing the contribution limits for universal pensions would be smaller than the $70.8 billion IRA expansion signed into law last year. Additional savings would be achieved by eliminating the myriad of IRA type accounts including the Roth, SEP, and SIMPLE IRAs. Finally, other savings could be achieved by freezing the estate tax at its 2005 levels. Under this proposal, the current estate tax exemption would grow to $2 million, but total elimination of the tax would be cancelled. Holding the estate tax exemption to (approximately) $2 million would save $75.8 billion. Using the savings from the estate tax, which provides relief to less than 1 percent of the wealthiest Americans, and instead providing an incentive for all Americans to save and retire with economic security, is consistent with the principles of progressive taxation and sound growth economics.

Conclusion

For those Americans who love crossword puzzles and riddles, the ever-expanding maze of incomprehensible rules governing tax savings vehicles is the ultimate challenge. For most of us, the system is incomprehensible. If we are serious about ensuring all Americans have adequate means to retire, we need to create a simple, intelligible retirement savings system that works for everyone.

Addendum: A Brief Overview of Retirement Options

	Universal Pension	Traditional IRA
Characteristics	A new account that replaces all existing IRA type accounts. The account is available to any citizen once they reach the age of 25. Unlike the current IRA, there is a $500 stake for all employed 25 year-olds. To encourage participation by low-income individuals, a refundable tax credit of 50 percent will be available to those with qualified incomes (under $30,000 for married couples and $15,000 for singles with no children).	A traditional IRA is a way for individuals to save for retirement while benefiting from certain tax advantages. The amount of the tax advantage varies depending on whether you are an active participant in an employer-sponsored retirement plan. If so, you may not be able to deduct some or all of your contributions, depending on income. If not, you can make an annual capped contribution in this type of IRA and deduct the entire contribution from your income. There are two types of traditional IRAs—individual retirement accounts, set up with a bank or other financial institution, and individual retirement annuities, set up through an insurance company. "IRA" actually stands for Individual Retirement Arrangement. According to the Investment Company Institute, at the end of 1999, 49.4 percent of IRA balances were invested in mutual funds, 31.8 percent were held in securities directly through brokerage accounts, 9.9 percent were in bank and thrift deposits, and 8.9 percent were held with insurance companies.
Tax Treatment	Contributions and growth are tax deferred until withdrawn.	Contributions and growth are tax deferred until withdrawn.
Vesting	Immediate 100 percent vesting.	Immediate 100 percent vesting.
Employee Contribution Limit	$3,000 in 2002. In 2005 it will rise to $4,000, and in 2008 will reach $5,000. For individuals with no 401(k) plan, contribution level will rise to $20,000 by 2008.	$2,000 maximum combined contribution into Roth IRA or traditional IRA per individual per year. In 2002, the annual limit for both traditional and Roth IRAs will rise to $3,000. In 2005, it will rise to $4,000 and in 2008, it will reach $5,000. Thereafter, further increases will be indexed to inflation.
Employer Contribution Limit	After 3-year vesting period, employees can choose to have employer contribution placed in universal pension rather than 401(k).	Not allowable.
Income Phase-Out	No income phase-out. However, individuals with income above $110,000 and couples with income above $160,000 would be limited to a $1,000 contribution.	$50,000 to $60,000 for individual and $80,000 to $100,000 for joint by 2007.

	Roth IRA	401(k)
Characteristics	Roth IRAs have some similarities to traditional IRAs, and a few big differences. Contributions cannot be tax-deductible, but "qualified distributions" (withdrawals) at retirement will be tax-free. This means that you don't have to pay tax on the interest your money earns. What's more, you may continue to make contributions to your Roth IRA after you turn 70½, and you can leave money in the account for as long as you live.	A retirement plan set up by an employer. When joining a 401(k), you agree to contribute part of your salary to the 401(k) account. The money contributed is deducted from your paycheck before income taxes are taken out, so less income tax is paid up front. Additionally, you don't pay taxes on what you contribute (and any earned interest) until you withdraw money from your account at retirement. You cannot withdraw money from the account before you turn 59½—except in rare cases —without paying a stiff penalty. The 401(k) is not an investment in itself; it is a protective shell for your money. It is up to you to decide how to invest the money using the choices your employer provides. Generally, these are stock, bond, and money market mutual funds. Some employers offer a match, meaning that for every dollar you contribute up to a certain amount, your employer will also make a contribution (10 cents, 50 cents, a dollar—it depends on your employer). It is worthwhile to take advantage of this free money.
Tax Treatment	Contributions are not tax deductible. Interest grows tax-free.	Contributions and growth are tax deferred until withdrawn.
Vesting	Five years from first day of contribution.	Because of the 2001 tax act, matching funds will be fully vested after the employee completes three years of service, instead of five years now. Alternatively, employers could provide gradual vesting beginning with the employee's two years of service and ending after six years of service (compared with three to seven years now).
Employee Contribution Limit	$2,000 maximum combined contribution into Roth IRA or traditional IRA per individual per year. In 2002, the annual limit for both traditional and Roth IRAs will rise to $3,000. In 2005, it will rise to $4,000, and in 2008, it will reach $5,000. Thereafter, further increases will be indexed to inflation.	Elective contributions of up to 25 percent of net annual compensation not to exceed $10,500.
Employer Contribution Limit	Not allowable.	25 percent of employees gross pay or $30,000, whichever is less.
Income Phase-Out	$95,000 to $110,000 for singles and $150,000 to $160,000 for couples.	No income phase-out.

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Endnotes

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