To Shore Up Social Security, This Controversial Proposal Calls for Limiting Retirement Plan Tax Perks

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There's no debate that Social Security's funds — which are projected to become insolvent in the next decade — need fixing.

But a new research proposal published by the Center for Retirement Research at Boston College by experts at the opposite ends of the political spectrum has sparked considerable opposition.

The research comes from an unlikely pair — conservative economist Andrew Biggs, a senior fellow at the American Enterprise Institute, and left-leaning economist Alicia Munnell, director of the Center for Retirement Research. (The brief is based on a paper Biggs and Munnell co-wrote with Michael Wicklein, a research assistant at the Federal Reserve Bank of Boston.)

Together, they call for limiting current tax preferences for retirement savings plans, and instead redirecting those funds to help shore up Social Security.

How retirement plan tax incentives work

In 2024, the limit for total employee and employer contributions to a defined contribution plan such as a 401(k) is $69,000. Individuals who are 50 and over can put away an extra $7,500.

However, the limit for employee contributions is $23,000, or $30,500 for those who are 50 and up. Those contributions are typically eligible for tax deferrals, whereby the money saved now is not taxed until retirement.

Only high-income individuals tend to meet those thresholds.

Individual retirement accounts also enable workers to put away up to $7,000 in pretax contributions, or $8,000 for those 50 and up.

The maximum contribution thresholds are adjusted each year.

In 2020, those tax preferences reduced federal income taxes by about $185 billion to $189 billion, the research found. That is equal to about 0.9% of gross domestic product, defined as the final goods and services produced in the U.S.

The tax incentives have "virtually no impact on retirement saving," the CRR research concludes.

Meanwhile, Social Security's combined trust funds are projected to run out in the early to mid-2030s.

By rolling back the tax incentives provided through defined contribution retirement plans, the money saved could be used to help fix a portion of Social Security's funding gap, the researchers contend.

That would provide immediate funding to the program that provides the nation's retirement, disability and family benefits, and give lawmakers more time to consider other changes such as tax increases or benefit adjustments that would have to be more gradually phased in, according to Biggs.

Losing tax breaks 'would be harmful,' critics argue

Biggs and Munnell's research, published in January, has been the subject of considerable pushback that aims to poke holes in their conclusions and defend the current defined contribution system.

That includes response pieces published by the Mercatus Center at George Mason University, the Cato Institute and the National Association of Plan Advisors.

Without a tax benefit, workers will likely be reluctant to save with their employer plans, said Jason Fichtner, chief economist at the Bipartisan Policy Center and a co-author of the response published by the Mercatus Center.

"We now have an industry and a policy based on 401(k)s and defined contribution plans that has been, relatively speaking, successful," Fichtner said.

"Does that help everybody? No," he said. "Can we do better? Yes. Would it be helpful to get rid of it? No, it would be harmful."

'Rich people are going to do it anyway'

Despite the pushback, Biggs and Munnell both say they are holding firm to their stance.

Admittedly, it is one of the rare issues upon which the two experts concur.

"Our disagreements go back decades," Munnell wrote in a recent blog post detailing their opposing stances on certain issues.

“Sometimes, however, we see things the same way,” Munnell wrote.

Neither Biggs nor Munnell are strangers to controversy.

Recently, Biggs’ views on the future of Social Security, specifically whether benefits should be cut or whether the program should be privatized, were called into question during a Senate Finance Committee hearing.

The testimony was part of a Senate hearing to consider Biggs’ nomination to the Social Security Advisory Board, an independent, bipartisan federal government agency. The SSAB is a technical advisory panel, notes Biggs, and has no power over Social Security policy put forth in Congress.

Munnell, for her part, has also received more attention, including a post on social media site X that received more than 750,000 views to the delight of her grandchildren.

It’s not the first time Munnell has been surprised by attention to her proposal. In the 1990s as a Treasury official in the Clinton administration, she was featured in a Star Magazine article with the headline, “Watch out! This White House whiz wants to tax your savings.”

Yet she hasn’t let go of the idea.

“I’m convinced that it’s a waste of money, that rich people are going to do it anyway,” Munnell said of retirement savings.

After reading the criticism, Biggs said he is also still confident in their ideas.

“By and large, I think 401(k)s have been good for retirement security,” Biggs said. “But what they confuse is the effect of the 401(k) plan versus the effect of the tax preference.”

While IRAs offer similar tax incentives, they are not as popular as 401(k) plans. The 401(k)s have an advantage because they are provided by an employer, who picks a plan provider and default investments, Biggs noted.

Those plans also encourage participation through automatic enrollment, which tends to have a bigger effect than the tax incentives, he said.

“A tax preference that doesn’t affect behavior isn’t doing what you want it to do,” Biggs said.