MoneyTalksNews

Would This Social Security Proposal Kill the IRA and 401(k)?

Chris Kissell

February 9, 2024

Everyone knows Social Security is in bad shape: Would you be willing to give up the tax benefits of your IRA and 401(k) plan to help fix it?

That proposal comes courtesy of two retirement experts — Andrew G. Biggs, a senior fellow at the American Enterprise Institute, and Alicia H. Munnell, director of the Center for Retirement Research at Boston College.

In a recently published brief, Biggs and Munnell note that the favorable tax treatment of retirement plans cost the government about $185 billion in tax revenue in 2020.

So Biggs and Munnell suggest the nation would be better off curtailing the tax-deferral features of these plans and redirecting the money. They advocate placing more stringent limits on contributions or accumulations in such plans, or taxing the earnings in these plans on an annual basis.

They write:

“Ultimately, reducing tax expenditures for retirement plans could be an effective way to help address other pressing demands on the federal budget, such as Social Security’s financing shortfall.”

The authors argue that IRAs and employer-sponsored retirement plans such as 401(k) accounts primarily benefit high-income earners who would likely save the cash even without the tax incentive.

They also contend that research has shown little evidence that the availability of tax-advantaged accounts increases retirement savings.

Biggs and Munnell say that if the government were to curtail the tax-deferral feature of traditional 401(k)s and IRAs, “comparable changes” would need to be made to Roth accounts “to avoid a wholesale shift in plan type to retain the tax advantages.”

Currently, the Social Security program faces a bleak future. As we have reported, the government’s latest projection is that the Social Security retirement trust fund will be depleted in 2033. At that time, incoming funds would be enough to pay for only 77% of benefits.

In an interview with Pensions & Investments, Biggs estimated the money that would be saved by eliminating tax deferrals in retirement accounts could fund 75% of the Social Security funding gap.

Perhaps to no one's surprise, howls of disapproval have greeted the proposal from Biggs and Munnell.

According to a report in Pensions & Investments, Brian Graff — chief executive officer at the American Retirement Association — stated his opposition to the idea in blunt terms in a LinkedIn post: "I personally cannot think of a more preposterous idea."

David Blanchett, managing director, portfolio manager and head of retirement research at PGIM, told Pensions & Investments that he also had major reservations about the proposal:

"We need to be doing more to actively encourage participants to save in retirement, not enact any kind of legislation that would in any way dissuade individuals from saving inside 401(k) plans."

In a blog post, Adam Michel, director of tax policy studies at the Cato Institute, pushed back on the authors' contention that tax-advantaged plans do not motivate people to save more for retirement.

He wrote that the "overwhelming evidence is that tax-advantaged accounts significantly increase private savings," and that the authors' claim to the contrary is based on "an overconfident misinterpretation of the academic literature that does not acknowledge the broader economic benefits of private saving."

Biggs and Munnell say they are aware of such concerns. But in an interview with Pensions & Investments, Munnell insisted that eliminating or reducing tax deferrals is the right way to go:

"I recognize it's a very controversial suggestion, but on the other hand, for decades, ever since I was at the Federal Reserve Bank of Boston, I have been persuaded that it accomplishes very little."