Barriers to Saving

by Zoë Neuberger, Robert Greenstein, and Peter Orszag

In recent years, policymakers of both parties have expressed growing interest in raising retirement saving by low-income households. Such households are much less likely than higher-income households to participate in employer-based retirement savings plans, and few of them contribute to IRAs. Moreover, when low-income households do participate in retirement saving plans, they tend to contribute a smaller share of their income than higher-income households.

Illustrations by Kirk Lyttle

A growing body of evidence suggests that low-income families will save more if saving is made easier for them and if they are given a clear financial incentive to do so. For example, 401(k) participation rates among new employees rise substantially when such employees are enrolled in the plans automatically unless they opt out. Congress is likely soon to adopt legislation making it more attractive for employers to establish automatic enrollment for 401(k)s. Congress also may at some point extend the benefits of the Saver's Credit—a tax credit for low- and moderate-income individuals who save for retirement—to workers who do not earn enough to owe income taxes.

Such changes are important, but they will not be fully effective unless policymakers also address the barriers to saving posed by the asset tests of many means-tested benefit programs, such as food stamps and Medicaid. To qualify for these programs, applicants often must have total countable assets that do not exceed a dollar limit set by the program. These asset tests can penalize those who save for retirement. Fortunately, there are steps the federal government and state governments can take to reduce the savings barriers such asset tests can create.[1]

Existing Asset Rules Punish Savers

Many low-income families rely on means-tested programs such as food stamps, Medicaid, or cash assistance at times during their working years—for example, during temporary spells of unemployment or when their earnings are insufficient to make ends meet. In addition, many low-income people who are unable to work for a while because of a serious disability rely temporarily on Supplemental Security Income (SSI).

In many of these programs, the asset limit is set at or about $2,000. Moreover, the asset limits in these programs generally are not indexed to inflation and are raised infrequently. As a result, the asset limits have shrunk substantially in inflation-adjusted terms and are expected to continue to do so in the future.

Counting retirement savings toward the asset test of programs like Medicaid or SSI could force a family or individual to deplete those savings before qualifying for benefits.

In addition to imposing what amounts to a steep implicit tax on saving, asset tests in means-tested benefit programs treat retirement saving in a confusing and seemingly arbitrary manner. One family may be able to retain its retirement savings when it needs to turn to means-tested benefits, while a similar family that uses a different retirement saving vehicle or lives in a different state may have to deplete its retirement savings or forgo means-tested benefits during a time of need. Also, a household may qualify for some programs but not others solely because of the different rules across programs for counting retirement accounts.

Adding to the confusion, some employer-based retirement plans are exempt from the asset limits in these programs, while others are not. Means-tested programs generally do not count employer-based retirement plans if they are structured as "defined-benefit plans" such as traditional pensions, but often *do* count them if they are structured as "defined-contribution plans" such as 401(k)s. Since these asset rules were developed in the early 1970s, employers have shifted away from defined-benefit plans, putting more workers—those without a defined-benefit plan—at a distinct disadvantage.

A different inconsistency exists in the Food Stamp Program, which generally does not count employer-based retirement plans toward the asset test but does count IRAs. This, too, is inequitable, since many low- and moderate-income people work for companies that do not offer an employer-based retirement plan. Furthermore, many workers are encouraged to roll their funds over from a 401(k) into an IRA when switching jobs, which could disqualify them from receiving food stamps.

Counting retirement savings toward a program's asset test could force a family or individual to deplete those savings before qualifying for benefits, even when doing so would involve a financial penalty. As a result, asset tests often penalize low-income families that save for retirement and discourage others from saving in the first place.

Consider, for example, individuals whose earnings were consistently low throughout their career. (As defined by the Social Security Administration, or SSA, a low earner is someone whose average earnings are about 45 percent of the average worker's wages, or about $16,000 in 2004.) To avoid living in poverty during retirement, such workers would need about $2,000 in income from savings *for each year of retirement* to supplement their Social Security benefits, or around $30,000 in savings at retirement (if they have average life expectancy). Clearly, subjecting households to a $2,000 asset limit can prevent them from saving enough to support themselves for even a brief period, much less their entire retirement.

Eliminating Barriers

The most straightforward and comprehensive way to eliminate the retirement savings barrier posed by these asset rules would be for Congress to amend the tax code so retirement accounts that receive preferential tax treatment—such as 401(k) plans and IRAs—do not count toward eligibility and benefit determinations in federal means-tested programs.

Short of that, the federal government and states can take steps to substantially reduce savings barriers. At the federal level, the Social Security Administration could take two steps to facilitate retirement saving by low-income people with disabilities who need SSI benefits:

- SSA or Congress could exclude from the SSI asset test retirement accounts held by non-elderly individuals. That would eliminate the need for working-age individuals with serious disabilities to liquidate their retirement accounts during periods when they are unable to work and need SSI benefits to make ends meet.
- SSA or Congress could eliminate the requirement that elderly individuals convert their retirement accounts into a lifetime annuity in order to have these funds excluded from the SSI asset test. A lifetime annuity is not always a wise choice for low-income people. Instead, in determining individuals' SSI eligibility and benefit levels, SSA could exclude their retirement accounts as assets, while counting as income the monthly amount that could be taken from their account for the remainder of their life, based on the account's value and the individual's projected life expectancy.

In addition, states have the flexibility to craft a more coherent set of asset rules in means-tested programs, thereby exempting more retirement savings from asset tests and making these programs easier to administer.

- **Food stamps.** The food stamp asset limit is $2,000 ($3,000 if at least one household member has a serious disability or is age 60 or older). Most employer-based retirement plans, including defined-benefit plans and 401(k)s, are excluded from the asset limit, but IRAs are counted. The 2002 Farm Bill gave states a new option to exclude certain types of assets from their food stamp asset test if they exclude these assets from their asset test for Temporary Assistance for Needy Families (TANF) cash assistance or family Medicaid coverage. This provision appears to apply to IRAs, according to the U.S. Department of Agriculture's proposed regulations. If the final regulations confirm that the provision applies to IRAs, states could exclude IRAs from the food stamp asset test if they also exclude IRAs in their TANF cash assistance or family Medicaid program.
- **Temporary Assistance for Needy Families.** States have complete discretion over their TANF asset limits and the types of assets that count toward them. Therefore, states have the flexibility to exclude retirement accounts from the asset test for TANF-funded programs.
- **Medicaid and the State Children's Health Insurance Program (SCHIP).** Nearly all states, including all New England states, have eliminated the Medicaid asset test for children, but the majority of states continue to apply an asset test when evaluating Medicaid eligibility for parents, and most of these states count 401(k)s and IRAs toward the asset limit. States could dispense with their Medicaid asset tests for both children and parents, or if they wish to retain an asset test for either group, they could exclude retirement accounts from the asset test. Also, by excluding retirement accounts from the Medicaid asset test applied to working-age people with disabilities, states could encourage them to save for their old age.

Conclusion

Modifying asset rules that discourage low-income families from building retirement savings would help reduce elderly poverty and increase the national saving rate. There would be some budgetary cost because these changes would make some low-income households newly eligible for benefits. Yet the return should more than justify the investment. The changes would simplify program administration and reduce administrative costs. Most important, if low-income households could save more for retirement, the economy as a whole would most likely benefit, and fewer people would have to rely on public benefits in old age.

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[1] See Zoë Neuberger, Robert Greenstein, and Eileen Sweeney, *Protecting Low-Income Families' Savings: How Retirement Accounts Are Treated in Means-Tested Programs and Steps to Remove Barriers to Retirement Saving* (The Retirement Security Project, report no. 2005-6, June 2005), http://www.cbpp.org/6-21-05socsec.pdf. Sources for the information cited here are included in the report.