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Federal 401(k) Match

By Anne Kim, Tess Stovall, and Kirsten Harbers

Americans aspire to a comfortable retirement after a lifetime of work. But for many households juggling myriad financial demands like college tuition, mortgage payments and other bills, putting enough away for retirement can be tough. That challenge has been compounded by the devastating impact that the recent economic downturn has had on retirement savings and investments. A generous federal match for 401(k) savings for individuals age 35 and under can help middle-class families get a jump start on saving what they need to get the retirement they deserve.

THE PROBLEM

Workers aren't saving enough to get through retirement

Many Americans won't have the retirement savings they need to keep up the lifestyle they've come to expect after they finish their careers. College tuition bills, mortgage payments and other pressing priorities too often push saving for retirement to the bottom of Americans' financial to-do lists. As a result, while Americans are living longer, they are saving less.

Retirement savings have evaporated in the economic downturn.

During the height of the financial crisis, the stock market plummeted, dragging down the value of middle-class retirement savings along with it. The average worker lost $10,000, or about 14% from his or her 401(k) in 2008, with employees in the mid to late stages of their careers losing up to a quarter of their retirement investments.[1] Workers already facing serious retirement saving challenges are now being forced to watch as the money they have been able to set aside disappears with every decline in the Dow Jones Industrial Average.

The majority of retirees can expect to outlive their savings.

At age 65, today's average retiree can expect to spend more than 18 years in retirement,[2] and experts say that to ensure a comfortable retirement, people should save enough to replace between 60% and 80% of their pre-retirement income.[3] This means a two income middle-class household earning $70,000 a year will need about $55,000 in retirement income a year, including Social Security.[4]

But few households are meeting that standard. Three out of five retirees can expect to outlive their retirement savings if they maintain their pre-retirement standard of living.[5]

Today's workers bear the burden of saving for retirement.

Traditional, defined-benefit pensions have gone the way of the dinosaur. In 2005, only 10% of private-sector employees participated only in a traditional pension plan,[6] compared to almost two-thirds of workers in 1980.[7] While 401(k) plans are better suited to the mobile workforce of today, it also means that retirement planning rests wholly in workers' hands.

People need help to start saving more, earlier.

In 2008, the typical worker had only $12,665 saved for retirement.[8] In fact, fewer than one in five Americans say they're "very confident" of saving enough for retirement,[9] and roughly two-thirds of women and nearly half of all men say they are concerned about outliving their retirement assets.[10] Yet, according to the Employee Benefit Research Institute, in 2005 only 11.4% of workers age 21 to 24 and just 46.8% of workers age 21 to 35 owned an IRA or 401(k) plan.[11] Because early contributions are so important when saving for retirement, it is essential to encourage these young workers to begin saving as soon as possible.

THE SOLUTION
A federal match for 401(k) contributions

Third Way proposes a 25% federal match for 401(k) contributions by workers age 35 and under in the private sector up to a maximum of $1,000 a year. This generous match would boost the efforts of middle-class families to save for a comfortable retirement.

This proposal would be easy to administer.

The proposal creates a dollar-for-dollar match equal to 25% of contributions, up to a maximum of $1,000 per worker per year. The match would be available to individuals age 35 and under earning up to $100,000 per year and joint filers with a combined income of $200,000. The proposed match would be available for any contribution to a defined-contribution retirement account, including 401(k)s, 403(b)s, and IRAs.

The matching contributions would be electronically direct deposited to people's retirement accounts at tax time, after they have filed their income tax returns showing how much they have put away in their retirement accounts. By directly depositing the match, this proposal ensures that an individual's match goes toward building his or her retirement savings.

This proposal would help people save more.

Matching plans are effective in encouraging people to save, and to do so earlier. Federal workers, for example, enjoy a generous match under the government's Thrift Savings Plan.[12] As a result, 87% of federal workers participate in the plan, including 90% of younger workers under 40.[13] In the private sector, studies find that retirement plans with an employer match are more likely to have higher participation rates[14] and larger contributions.[15] People are also more likely to open an account in the first place if a match is offered.[16] If an individual starts to save for retirement at 25 rather than at 35, his or her financial situation at retirement will be substantially better. For example, assuming a conservative 3% annual rate of return, an individual who saves $1000 per year beginning at age 25 will have approximately $37,000 more in retirement funds than an individual who begins saving at age 35. With a federal match through age 35, that amount would grow to approximately $78,000.

This proposal would follow the lead of the Thrift Savings Plan. As tough economic conditions have put the squeeze on employers and workers alike, more businesses are resorting to cuts in their retirement plan contributions. In a survey of more than 300 companies from the summer of 2009, nearly one in five employers reported that they have either decreased, temporarily suspended or eliminated the employer match of 401(k) contributions. In this context, employees are increasingly in need of retirement saving partnership.[17]

THE ROLLOUT

Ideas for launching and publicizing a federal 401(k) match

- **Hold a press conference** with workers age 35 and under who are saving for retirement but are struggling to save enough.
- **Release a short report** on how much people are currently saving for retirement versus what they will need to maintain their lifestyles.

CRITIQUES & RESPONSES

Federal 401(k) match

It's too expensive.

This proposal would cost $10.4 billion per year.[18] This would be a worthwhile investment in making sure that middle-class Americans are able to prepare for a secure, independent retirement by saving earlier and building savings faster.

This is just more big government.

This proposal is administratively simple and builds on the existing structure of tax-preferred retirement accounts. The vast majority of people already receive their tax refunds by electronic direct deposit, so this adds no new administrative burden either. This proposal creates no new government bureaucracy, nor does it burden business. Instead, it encourages individual retirement savings and promotes the ability of individuals to manage and grow their own retirement wealth.

This is unnecessary.

It would certainly be preferable if that were the case. Unfortunately, while many Americans do try to save for retirement, many people also face financial pressures and immediate priorities that make saving enough for retirement difficult. Saving for retirement is also something that many young workers don't think of until it's too late. The reality is that the vast majority of Americans—even with Social Security—are not saving enough to maintain their pre-retirement lifestyles.

Why isn't the match available for all individuals, not just those 35 and under?

It is important for individuals of all ages to save for retirement, but starting to save early can make a critical difference in the effort to ensure a comfortable, successful retirement. Making a concerted effort to save for retirement early in their careers will not only get individuals in the habit of saving throughout their careers, but will help to jump start their account balances and bolster their retirement reserves. This proposal will help individuals start saving at an earlier age and save more than they currently are.

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ABOUT THIRD WAY

Third Way is the leading think tank of the moderate wing of the progressive movement. We work with elected officials, candidates, and advocates to develop and advance the next generation of moderate policy ideas.

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ENDNOTES

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18 Third Way estimate in 2010 dollars based on data from the March 2008 Current Population Survey. Of the 51 million workers aged 18 to 35, just 43% work for a company that has a pension plan. Of those with a plan, 70% participate, and we assume that the participation rate would rise to 80% as a result of the proposal. In addition, 8% of these workers have an IRA but do not participate in a company plan. We assume that the percentage of people with only an IRA will double as a result of the proposal. Together, the total who participate in a company plan or have an IRA represent approximately 26.5 million workers. We determined retirement savings using a sliding scale from 2 to 6 percent depending on the level of earnings, which resulted in an average match of $375.