How will State-Run Auto-IRAs Impact Workers?

Timothy F. Harris, Kenneth Troske, & Aaron Yelowitz[1]

Abstract

Using the 2014 SIPP, we find that auto-IRAs would impact over 24 million workers if enacted on a national scale. One-third of impacted workers hold credit card debt with an average balance exceeding $5,000. Roughly 15% of impacted workers had difficulty meeting basic needs.

Keywords: IRA, Default, OregonSaves, Secure Choice Savings Program

1. Introduction

Default enrollment in retirement plans significantly increases account balances and participation (Madrian and Shea, 2001; Chetty et al., 2014). Additionally, defaulting contributions to rise further increases total retirement savings (Thaler and Benartzi, 2004). Earlier legislation allowed employers greater flexibility to auto-enroll workers into retirement plans (Engelhardt, 2011). More recently, several states passed legislation to extend auto-IRAs (individual retirement accounts) that incorporate such defaults to workers without retirement plans.[2]

Oregon became the first state to do so with "OregonSaves." This program automatically enrolls workers—where the employer does not offer a retirement account—into a Roth IRA. The default contribution rate is 5% ultimately rising to 10%. Employees may opt out, yet prior work suggests few will take this active step.[3] Similar initiatives passed in California, Illinois, Maryland and Connecticut.

[1]Email: tfharr1@ilstu.edu (T. Harris), ktroske@uky.edu (K. Troske), aaron@uky.edu (A. Yelowitz). Corresponding Author Address: Department of Economics, University of Kentucky, Gatton College of Business and Economics, 550 South Limestone Street, Lexington, KY 40506

[2]See Benartzi and Thaler (2013) for arguments supporting state-run auto-IRAs.

[3]The pilot program had an opt-out rate of 23%. See https://www.wsj.com/articles/states-

Although default enrollment effectively increases retirement savings, there are perhaps unintended consequences. Primarily, workers with high interest debt will be nudged into contributing rather than reducing debt. Given that interest on credit card debt typically exceeds the expected risk-adjusted rate of return of an IRA, this policy effectively lowers the net worth of such passive participants. Furthermore, programs like OregonSaves default initial contributions into low-risk options. Even the interest rate on student or auto loans likely exceed the expected rate of return. In general, auto-IRAs will reduce net worth for passive savers with high interest debt.

We characterize debt and asset holdings for U.S. workers who would be impacted by auto-IRAs such as OregonSaves.[4] We use data from the 2014 Survey of Income and Program Participation (SIPP). These data contain essential questions regarding the offering of employer-sponsored retirement accounts. We find that 24.2 million workers would be impacted by an auto-IRA if applied on a national level. Virtually all of these employees are eligible to independently contribute to an IRA. Of those impacted, 33% have credit card debt, often with significant levels. Roughly 15% have difficulty meeting basic needs.

2. Policy Background

In 2016, the Department of Labor finalized a regulation that exempted state-run IRA plans from the federal Employee Retirement Income Security Act (ERISA) reducing state liability. Even though this exemption was later removed, five states used it to create state-run auto-IRAs.

Oregon initiated the first program with a pilot started in July 2017 and widespread roll out beginning November 2017. We focus on Oregon's plan fea-

test-workplace-retirement-plans-for-residents-lacking-them-1502881230. A similar plan implemented in the United Kingdom also has an opt-out rate of roughly 10%. See https://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/nest-insight-2015,pdf.pdf.

[4]Biggs (2017) summarizes findings from specialized populations.

tures in our analysis. Employers must use the state-run auto-IRA if they do not offer retirement plans to their employees. Even if an employer has a plan that is not offered to all employees they are still exempt from the mandate. The employee's initial default contribution rate is 5%, which increases by a percentage point annually until it reaches 10%.

Illinois Secure Choice Savings Program and California Secure Choice with similar features are slated to being in 2018 and 2019 respectively. Other auto-IRA programs passed into legislation include Maryland Small Business Retirement Savings Program and Trust and a program to be created under the Connecticut Retirement Security Authority. Together, these five states represent 21% of all private sector workers in the U.S.

3. Data Description

The SIPP is a nationally-representative longitudinal survey that contains questions regarding assets, liabilities and retirement accounts. A key motivation for using the SIPP is the availability of information regarding the offering of employer-sponsored retirement accounts.

The data contain 35,816 observations representing 313.6 million individuals. Restricting the sample to private sector workers aged 25 to 64 gives a sample of 8,722 observations representing 86.1 million individuals.[5]

4. Characteristics of Impacted Workers

OregonSaves only applies to employees whose employer did not offer an employer-sponsored retirement plan to *any* of their employees. Table 1 shows that 24.2 million workers (27.6%) would be impacted by a nationwide auto-IRA.[6] In addition

[5]SIPP samples sizes are too small for state-level analysis.

[6]This is lower than the 42% derived from the Current Population Survey (Pew, 2016), but nearly identical to the 26% derived from the National Compensation Survey for adults aged 25-64 (Munnell and Bleckman, 2014).

to those offered retirement plans, the program would not impact the 6.4 million employees who were not offered plans but worked for an employer who did offer a plan to some employees.[7]

Table 2 reports summary statistics for those that would and would not be impacted by an auto-IRA policy. The impacted group is less white, less likely to be married, has less education, and lower income/net worth. In addition, they are significantly less likely to have employer-sponsored health insurance consistent with less generous fringe benefits.

Almost every employee (96.8%) would have qualified to contribute to a Roth IRA and receive the tax benefits.[8] In 2013, 19.2% of impacted workers already owned an IRA and 7.5% contributed. Those that invested had significantly higher incomes ($62,415) than those that did not ($32,688). State-run programs typically default employees into Roth accounts, which reduces tax-revenue losses in the short-run. Of those that contributed, 25.3 % used a Roth account. This low proportion could reflect a desire to immediately defer paying taxes using a traditional IRA.

5. Impacts of Auto-IRAs

Based on an opt-out rate of 25% and no crowd-out of other accounts, IRA savings would increase $31.7 billion from a nationwide auto-IRA. This estimate depends greatly on the opt-out rate and the incomes of those that opt out.

One important factor to consider is individual outstanding debt. From Table 3,

[7] We classify workers as being offered a plan if the employer offered a plan to at least some employees and the respondent's reason for not participating did not include one of the following: job type not allowed, does not work enough, has not been employed long enough, started job too close to retirement date, or is too young.

[8] Individuals are eligible if they have taxable earnings and earn less than $118,000 if filing as a single individual or $186,000 if married filing jointly. The statistic assumes that the employees file as single individuals. See https://www.irs.gov/retirement-plans/amount-of-roth-ira-contributions-that-you-can-make-for-2017.

62% have debt with an average balance of $61,395. Housing debt accounts for the largest proportion of debt. A significant portion, 33%, has credit card debt with an average balance of $5,476 (median=$2,500) conditional on having a positive balance. Furthermore, there is significant education and vehicle debt.

If interest rates on debts exceed the rate of return for a Roth IRA, then the auto-IRA lowers net worth for passive savers with debt. Certainly, credit card interest rates exceed the expected rate of return of safe investments into money market securities. In many circumstances debts from mortgages, student, or automobile loans will also have interest rates that exceed the expected rate of return.

By design, auto-IRAs reduce current disposable income. The bottom panel of Table 3 illustrates impacted workers' ability to meet basic expenses with roughly 12% not able to pay rent/mortgage or utilities. Furthermore, 10% were skipping meals or eating less due to financial constraints. If these workers were passive, auto-IRAs would only exacerbate these problems.[9] While the table shows that impacted workers with higher incomes are more likely to have debt, lower income individuals are more likely to have difficulty meeting basic needs.

6. Conclusion

Nationwide auto-IRAs would impact 24.2 million workers aged 25-64. Many of these workers have high interest debt or are unable to meet basic needs. Auto-IRAs would impact these workers if they do not opt out. Madrian and Shea (2001) find that the lowest income employees were the most likely to increase retirement savings due to auto-enrollment. As time elapses, such issues can be explored empirically.

Although the SIPP sheds light on the financial situation of impacted workers, information on the use of payday loans, carried balances, and actual interest rates

[9] Individuals may take out distributions up to amount initially contributed without facing any tax penalty. Nonetheless, 36% of workers had both outstanding credit card debt and positive Roth IRA balances suggestive of a misunderstanding regarding Roth IRA withdrawals.

would further illustrate the impacts of state-run auto-IRAs.

References

Benartzi, Shlomo, and Richard H. Thaler. 2013. "Behavioral Economics and the Retirement Savings Crisis." *Science*, 339(6124): 1152–1153.

Biggs, Andrew G. 2017. "How Hard Should We Push the Poor to Save for Retirement?" *Working Paper*, Available at SSRN: https://ssrn.com/abstract=3001397.

Chetty, Raj, John N. Friedman, Søren Leth-Petersen, Torben Heien Nielsen, and Tore Olsen. 2014. "Active vs. Passive Decisions and Crowd-Out in Retirement Savings Accounts: Evidence from Denmark." *Quarterly Journal of Economics*, 129(3): 1141–1219.

Engelhardt, Gary V. 2011. "State Wage-payment Laws, the Pension Protection Act of 2006, and 401 (k) Saving Behavior." *Economics Letters*, 113(3): 237–240.

Madrian, Brigitte C., and Dennis F. Shea. 2001. "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior." *Quarterly Journal of Economics*, 116(4): 1149–1187.

Munnell, Alicia H., and Dina Bleckman. 2014. "Is Pension Coverage a Problem in the Private Sector?" *Issue in Brief*, 14-7, http://crr.bc.edu/wp-content/uploads/2014/04/IB_14-7-508.pdf.

Pew Charitable Trusts. 2016. "Who's In, Who's Out." http://www.pewtrusts.org/~/media/assets/2016/01/retirement_savings_report_jan16.pdf.

Thaler, Richard H., and Shlomo Benartzi. 2004. "Save More Tomorrow^{TM}: Using Behavioral Economics to Increase Employee Saving." *Journal of Political Economy*, 112(S1): S164–S187.

Table 1: Offerings/Participation in Employer-Sponsored Retirement Accounts

	Weighted Obs. (millions)	Percent
Offered Retirement Account		
Participates	44.4	51.6
Does Not Participate	11.1	12.9
Not Offered Retirement Account		
Other Employees Offered	6.4	7.4
No Employees Offered	24.2	28.1

Note: The sample includes 8,722 private sector workers representing 86.1 million individuals from the 2014 SIPP.

Table 2: Workers at Firms with/without Employer-sponsored Retirement Plans

Employer Offers Retirement Plan:	No Offer	Offer to Some
Demographics		
Age	41.80	43.18***
Male	0.56	0.54
White Non-Hispanic	0.51	0.69***
Black Non-Hispanic	0.11	0.11*
Other Race/Ethnicity	0.38	0.20***
Family		
Married	0.54	0.64***
Has Child	0.68	0.68
Education		
Less than HS	0.20	0.05***
High School Diploma	0.47	0.39***
College Degree	0.33	0.56***
Finances		
Annual Income ($1k)	34.93	70.67***
Net Worth ($1k)	68.52	183.55***
Has IRA	0.19	0.38***
Owns Home	0.54	0.68***
Employer-Sponsored Health Insurance	0.44	0.78***
Observations	2,411	6,311
Weighted Observations (millions)	24.2	61.9

Note: Individual sample weights were used. Indicators for statistical difference between *unweighted* means are given by *** p<0.01, ** p<0.05, * p<0.1

Table 3: Impacted Workers: Debt and Ability to Meet Basic Needs

	Annual Income Quartile				
	1st	2nd	3rd	4th	Full Sample
Proportion with Debt					
Any debt	0.53	0.53	0.65	0.78	0.62
Credit card debt	0.27	0.27	0.34	0.44	0.33
Student debt	0.14	0.11	0.15	0.20	0.15
Vehicle debt	0.13	0.17	0.24	0.35	0.22
Mortgage	0.22	0.17	0.26	0.46	0.28
Other debts	0.16	0.14	0.13	0.14	0.14
Mean Debt ($) if > 0					
Credit card debt	4,504	4,079	4,757	7,524	5,476
Student debt	17,758	16,472	23,141	28,087	22,372
Other debt	22,566	8,041	9,835	19,664	15,365
Vehicle debt	10,066	8,854	11,043	14,394	11,812
Mortgage	86,480	78,843	74,687	129,354	100,564
Total debt	52,490	35,964	44,240	98,283	61,395
Basic Needs					
Unable to pay rent/mortgage	0.13	0.14	0.11	0.07	0.11
Unable to pay utilities	0.17	0.15	0.11	0.07	0.13
Eat less or skip meals	0.13	0.14	0.08	0.04	0.10
Could not afford balanced meals	0.21	0.23	0.12	0.07	0.16
Observations	580	646	613	572	2,411
Weighted Observations (millions)	6.0	6.0	5.9	6.1	24.2

Note: The sample includes workers whose employer did not offer a retirement plan to their employees. Individual sample weights were used.