S. HRG. 102-200, PT. 2

BENTSEN-ROTH IRA

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

ON

S. 612

JULY 31, 1991

(Part 2 of 2)

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

49-352 WASHINGTON : 1991

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-037011-6

COMMITTEE ON FINANCE

LLOYD BENTSEN, Texas, *Chairman*

DANIEL PATRICK MOYNIHAN, New York
MAX BAUCUS, Montana
DAVID L. BOREN, Oklahoma
BILL BRADLEY, New Jersey
GEORGE J. MITCHELL, Maine
DAVID PRYOR, Arkansas
DONALD W. RIEGLE, JR., Michigan
JOHN D. ROCKEFELLER IV, West Virginia
TOM DASCHLE, South Dakota
JOHN BREAUX, Louisiana

BOB PACKWOOD, Oregon
BOB DOLE, Kansas
WILLIAM V. ROTH, JR., Delaware
JOHN C. DANFORTH, Missouri
JOHN H. CHAFEE, Rhode Island
DAVE DURENBERGER, Minnesota
STEVE SYMMS, Idaho
CHARLES E. GRASSLEY, Iowa
ORRIN G. HATCH, Utah

VANDA B. MCMURTRY, *Staff Director and Chief Counsel*
EDMUND J. MIHALSKI, *Minority Chief of Staff*

CONTENTS

OPENING STATEMENTS

COMMITTEE PRESS RELEASE

CONGRESSIONAL WITNESS

PUBLIC WITNESSES

ALPHABETICAL LISTING AND APPENDIX MATERIAL SUBMITTED

Communications

BENTSEN-ROTH IRA

WEDNESDAY, JULY 31, 1991

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:34 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Also present: Senators Daschle, Roth, and Symms.

[The press release announcing the hearing follows:]

[Press Release No. H-29, July 12, 1991]

BENTSEN-ROTH IRA HEARING SCHEDULED, CHAIRMAN SEEKING COMMENTS ON BILL TO EXPAND, RESTORE IRA

WASHINGTON, DC—Senator Lloyd Bentsen, Chairman of the Senate Finance Committee, Friday announced a hearing this month on what Americans think about the Bentsen-Roth IRA.

The hearing will be at *10 a.m. Wednesday, July 31, 1991* in Room SD-215 of the Dirksen Senate Office Building.

The proposal by Bentsen (D., Texas) and Senator Bill Roth (R., Delaware) would restore the traditional IRA that allows Americans to contribute $2,000 tax-free or choose a new IRA that provides no upfront deduction but interest and earnings can be withdrawn penalty-free after 5 years. Withdrawals could be made penalty-free for buying a first home, for college expenses or for financially devastating medical bills.

"Restoration and expansion of the IRA is an idea that truly makes sense for all working Americans. It will encourage millions of Americans to save, help families plan for an uncertain future and give them a choice between writing that full check to the IRS or writing $2,000 of it to an IRA," Bentsen said.

"This proposal has the overwhelming bipartisan support of 78 Senators and more than 240 members of the House—Republicans and Democrats, liberals and conservatives. We've received a lot of positive reaction from people who would be affected by the bill. And this hearing will provide us with further insights about how expansion and restoration of the IRA can help jump start savings and ease Americans' concerns about home ownership, health care, college education and a secure retirement," Bentsen said.

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS, CHAIRMAN, SENATE FINANCE COMMITTEE

The CHAIRMAN. If you will cease conversation and please take seats, this hearing will get under way.

There are some very persuasive arguments for passing the Bentsen-Roth IRA bill and making the fully-deductible IRA available to all Americans. Study after study demonstrates the importance of encouraging Americans to save more. Other studies show Americans know the IRA. They want to use it to set aside a little more for their future, and for their children's future.

Today we are going to hear from some real experts; people who know first-hand how the IRA works, and how the fully-deductible Bentsen-Roth IRA would help them and their families save more. Four of them will be here today from across the country from Delaware and Ohio, North Carolina and Massachusetts. We will hear indirectly from thousands of them via Frank Lalli, the managing editor of the MONEY magazine which has conducted reader surveys and had record responses. I think that is demonstrated by what you see here in front of you in the way of the packages of mail.

My mail box and the phone lines backed them up. Every day I get another batch of letters; a steady stream of calls and letters from all over the country since Bill Roth and I introduced our bill last March.

One young man from Fort Worth wrote to me to tell me that everything costs so much money to do, and since I plan to go to college, I know it would really help my parents not to be penalized for an early withdrawal for college tuition.

I had another letter from a 55-year-old woman who lives in Dallas. The paltry $150 a month she said her company pension plan provides simply is not enough for her retirement in 10 years. She wants a fully-deductible IRA to help supplement that pension. It would help her secure a better retirement and prevent her from having to impose on her three children.

One man grew so disgusted with a complicated tax form trying to claim some IRA contributions as deductible and some non-deductible that he quit contributing. But he said if the bill passes, he will go back to making contributions.

I heard from a woman in Lowell, IN who has two sons she wants to send to college. Their family income is $47,000, which gets eaten up pretty quickly when you are talking about paying college tuition these days. She may have to pull money out of an IRA and take a 10-percent hit, regardless of whether our bill passes, but a college education for her children is that important. But she would like to have that money penalty free, and we ought to help.

One woman said she cannot have an IRA just because her husband was covered by a pension plan. She thinks that the current rules are "discriminatory, both toward women and toward married people." She does not think that is fair, and I agree.

We can help people like these, and millions of others, by bringing back the IRA—restoring its full deductibility, making it more attractive to younger people through penalty-free withdrawals to buy a home or to go to college. That will help America get back on the savings track.

The Bentsen-Roth IRA bill has received overwhelming support in both the House and the Senate. A majority of both parties are sponsoring this bill. But most gratifying is support from people across this country who consider the IRA a trusted friend, and they want it back. Today we are going to be able to hear from some of these people.

I defer now to my friend, Senator Roth, who is the co-sponsor of the legislation.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE

Senator ROTH. Well, thank you, Mr. Chairman. I think it is clear by the turn out this morning that the interest in a solid, pro-family individual retirement account is strong.

And I want to commend you on the attention you have given this timely issue, as I also commend the vast majority of our colleagues who have already enthusiastically embraced our proposal.

I believe that the positive reaction we have seen is due to the fact that the Bentsen-Roth IRA meets fundamental criteria necessary not only to the future of our Nation, but to the futures of each and every one of our Nation's families.

And this is what we are about today; the future. Providing a stable foundation upon which Americans can reclaim their heritage of self-reliance, and a foundation upon which Americans can reclaim their heritage of rewarding hard work, rewarding thrift, and rewarding cooperation and support within the family unit.

And what makes this hearing different from many others is that today we will listen to testimony from those most important to the Bentsen-Roth proposal; men and women from across the country who have to live with the laws we create inside the Beltway.

These are not only special interest groups, lobbyists, or economists called here to espouse one view or another. No, these are real live men and women, mothers and fathers, community leaders, concerned citizens, who depend on stable policies from Washington; policies that they can count on in order to plan for the education of their children, the care of their parents, as well as their own retirement. It is because of their telephone calls and letters that we are here today.

And Mr. Chairman, I was particularly taken by one letter from Paula Baker from my own State of Delaware, and I am honored to have her with us as a witness, and I will want to introduce her later. But at this time, I will yield back the floor.

Thank you.

The CHAIRMAN. Senator Symms.

OPENING STATEMENT OF HON. STEVE SYMMS, A U.S. SENATOR FROM IDAHO

Senator SYMMS. Mr. Chairman, thank you very much for the opportunity that you are giving the committee—you and Senator Roth—by introducing this legislation. And I think it goes without saying that oftentimes what we do in Congress interferes with incentives to work, or to produce, or to save.

This legislation is one vehicle that will offer the American family—as Senator Roth says—an opportunity to enhance their own savings and enhance the capital base of America, which is so important to reducing crime in the streets; to improving education; to improving health care. We must first allow the individuals to improve their own individual capital base.

So, I am pleased to be a sponsor of this legislation, and I hope we can see it move forward in the process of this Congress.

Thank you very much.

The CHAIRMAN. Thank you very much, Senator Symms.

Senator SYMMS. I look forward to the witnesses this morning. Mr. Chairman, I apologize to the witnesses. I will follow what they say, but we have a mark-up in the Public Works Committee, which I will have to attend.

The CHAIRMAN. Well, I understand.

Well, we are very fortunate this morning to have a man who is a most successful entrepreneur, a very able Senator; a man of compassion and understanding; a man who has an interesting approach to savings, and one that he thinks would help, I am sure, abate the emergency conditions faced by a person who is unemployed.

Senator Lautenberg, we are very pleased to have you. Would you proceed?

STATEMENT OF HON. FRANK R. LAUTENBERG, A U.S. SENATOR FROM NEW JERSEY

Senator LAUTENBERG. Thank you very much, Mr. Chairman, Senator Roth, and Senator Symms. Thank you very much for the opportunity to testify today.

First, I would like to congratulate you, Mr. Chairman, for your outstanding leadership along with Senator Roth on this issue; the effort to expand the availability of individual retirement accounts, and thereby encouraging savings; a very important factor in the American economy. And I am pleased to be an original co-sponsor of your legislation, S. 612, and I fully agree with you about its purpose.

And I want to express my appreciation also for your efforts, Mr. Chairman, to address another important problem, and that is unemployment and the inadequacy of our Nation's unemployment compensation system. As a supporter of your bill to expand the availability of unemployment insurance, I look forward to working with you for its prompt approval.

Today, I would like to discuss a proposal of mine—and I am grateful to you for the opportunity to appear here—S. 693, that I hope you will see as a logical extension to your two initiatives.

S. 693 would allow people who are laid off, unemployed, to withdraw funds from their IRA's or other retirement accounts without the 10-percent penalty that would otherwise apply.

Now, Mr. Chairman, I know that I do not have to tell you about the severity of our Nation's unemployment problem. Seven percent of the American work force is now out of work; the highest rate in almost 5 years; nearly 9 million people cannot find employment.

In most cases, Mr. Chairman, these Americans have been laid off not because they are poor workers or because they did not try hard enough; they are simply innocent victims of a troubled economy; of forces larger than themselves.

For those unlucky enough to be laid off, the experience is often traumatic. There is a sense of rejection and betrayal; there is anger. And perhaps, most importantly, there is fear. Fear for one's self, and fear for one's family.

The anxiety is understandable, because while their short-term employment prospects are often bleak, the unemployed faces enormous financial pressures. As mortgage and rent payments come due, and bills pile up, millions of American families find themselves trapped by high fixed expenses, and without a paycheck to make ends meet.

Unemployment insurance can help, but if often falls short of families' real needs, particularly in areas like mine, New Jersey, where the costs of housing and other basic necessities are unusually high.

Even if a family manages to survive on unemployment compensation, there may not be enough to overcome joblessness by relocating, or training for a new job.

Compounding matters, in an increasing number of cases, unemployment benefits are expiring.

And yet, in some cases, Mr. Chairman, the unemployed have their own savings in IRA or other retirement plans. These savings can provide a financial life raft to get through the unexpected financial storm.

Unfortunately, it is a life raft with a large hole, because for those under 59½, withdrawals generally trigger a stiff, 10-percent tax penalty.

Mr. Chairman, Americans never believe in hitting people when they are down. And I believe that there is something fundamentally wrong with imposing a heavy penalty on those who want to gain access to their own funds to cope with unemployment. The bill I have introduced, co-sponsored by Senators Bingaman, Inouye, Kerry, Kohl, Levin, and Lieberman, proposes to eliminate the 10-percent penalty for people who have been laid off and who are trying to find work. It is targeted to people who need it; those who have been unemployed for at least 30 days. I think that is only fair.

Mr. Chairman, while the bill's primary purpose is to provide relief to the unemployed, it would also provide at least two additional benefits. First, an objective of yours, Mr. Chairman, it would increase the savings rate by encouraging Americans to participate in IRA's and other retirement plans.

Currently, many people—particularly young people—are reluctant to tie up their money for decades in a retirement plan. They are concerned—understandably—that their savings would be inaccessible in an emergency, such as an unexpected period of unemployment, without the imposition of a heavy penalty. Allowing greater flexibility during periods of involuntary unemployment should reduce this concern, and that should lead to increased savings.

The bill also should provide another indirect benefit by unlocking savings and injecting money into the economy during periods of high unemployment. This would provide a modest, counter-cyclical stimulus, and that would help revive a slow economy to the benefit of all Americans.

Mr. Chairman, you have been an advocate for allowing early withdrawals from retirement plans for specific, compelling reasons—such as to pay for college education, first time home purchases, and high medical expenses. I hope you would agree that helping the unemployed is at least as important a goal.

I also want to point out that the cost of my bill in the context of things is very reasonable. The Joint Committee on Taxation estimates that the proposal would cost $100 million in total over the next 5 fiscal years.

Considering the importance of the problem, Mr. Chairman, that is a modest amount. The estimate is not higher, in part, because while the bill would exempt eligible withdrawals from the 10-percent penalty, money withdrawn would remain subject to ordinary income tax.

In sum, Mr. Chairman, this bill would provide relief to the unemployed, increase our Nation's savings rate, and provide an automatic stimulus to the economy during slow periods. All at a very modest cost to the Treasury. I hope you will give it serious consideration as the committee moves forward with the super IRA bill, and other related legislation.

Thank you very much for the opportunity to be with you today.

[The prepared statement of Senator Lautenberg appears in the appendix.]

The CHAIRMAN. Senator, as you have stated, we are trying to take care of some emergency legislation now on the unemployed. And what you are proposing is, perhaps, a little more long term in the way of assistance trying to help people when they are down on their luck.

You are quite right when you talk about young people; they do not think they ever are going to have to retire, and that is way off someplace in the future, and they look to more immediate concerns.

There is no question about what you are saying it would add to savings, because you would appeal, perhaps, to a different group. But I am curious how you decided on 1 month unemployment? Some people have suggested that perhaps we ought to have a more extended period of unemployment before qualifying for that kind of a withdrawal.

Senator LAUTENBERG. Mr. Chairman, it looks like—and we have had discussions about this—the unemployment cycle is going to be longer for people.

And it seemed to me that after one has been eligible for unemployment compensation for 30 days, that this was a good time to start the process of reassurance, because this is when the bills have started to accumulate, and when, for many people, the loss of income gets to be fairly severe.

Lots of folks are forced to live from paycheck to paycheck. And when the 4 weeks have gone by and just unemployment—which is typically meager compared to one's income—it looks to me like that is a good time to say, all right, if you want to take your money out and pay the income tax—because the deduction was there once—but avoid the 10-percent penalty, you can do it. And this is, again, an option. We think that 30 days is the right time to permit that to happen.

The CHAIRMAN. Senator Roth.

Senator ROTH. I have no questions. It is always a pleasure to see my neighbor from New Jersey.

Senator LAUTENBERG. Thank you very much. Thank you.

The CHAIRMAN. I would say to you, Senator, we will take a very close look at it. It is a very interesting proposal, and I can understand the need. Thank you very much.

Our first panel consists of Mrs. Paula G. Baker from Dover, DE, if you would come forward, please, and be seated. And Mrs. Barbara J. Green, from Boston MA; Mrs. Vaughn Hobson, from Raleigh, NC; and David Williams, from Columbus, OH.

Senator ROTH. Mr. Chairman, could I just make a couple additional comments?

The CHAIRMAN. Yes, of course.

Senator ROTH. As I indicated in my opening statement, I was particularly taken by one letter from Paula Baker, who just happens to be from my own State of Delaware. I am very honored to have her with us as a witness. She is accompanied by her husband, Brad. I would like Lt. Col. Baker, wherever he is, to please stand, because he served with honor and distinction during the Persian War, and it is a pleasure to have him here today.

And they are accompanied by her parents, John and Therese Glennon. They have three children, and are a perfect example of the dedication and diligent neighbors who were detrimentally affected by Congress' mistake of slashing the IRA's in 1986.

I believe having Paula here not only gives us a rare, and, I hope, a sobering dose of common sense. But it also sends a message to folks across the country that it is your opinion we are here to take into account.

So, Mrs. Baker and Mrs. Green, it is indeed a pleasure to welcome you.

The CHAIRMAN. Ms. Baker, I understand you are a mother of three and you teach part time?

Mrs. BAKER. Yes, sir.

The CHAIRMAN. Why don't you tell us about your experiences on savings?

STATEMENT OF PAULA G. BAKER, DOVER, DE

Mrs. BAKER. I would be glad to. Thank you.

Like many American families, my husband and I are concerned that we are not saving enough of our income. With frequent military moves which always end up costing $2,000-$5,000 out of our pocket, and college tuitions for three children on the horizon, I felt I needed to go back to work, at least part time.

So, last year when our youngest child started pre-school, I started teaching part time at the same pre-school. The salary was very small; only $1,200 last year, but since we both went to the same location, I did not need to make day care arrangements.

This situation enabled us to deposit each of my paychecks into our savings accounts. We were pleased to see the account grow, along with some other investments that we had made; a mutual fund, a money-market fund, savings bonds, and some stock, and a mutual fund and a CD that are designated as our IRA.

All of our investments were paid for by squeezing what we could out of our moderate income. There were no trust funds or family monies involved.

Well, at tax time it was a shock to find out that since the $1,200 I made put us over the $50,000 limit to deduct our IRA, the tax consequences of this $1,200 just about equalled my salary.

My husband is a lieutenant colonel in the Air Force. With the Desert Storm emphasis on all aspects of military life, it was ironic to note that the salary—which the country now realizes is far below that earned in a comparable civilian position—is considered too wealthy to claim the IRA deduction.

Nobody expects to get rich by serving their country in the military, yet we were suddenly considered too wealthy to provide for our own future. As the system stands now, there is no incentive to save.

As we get older, what little we have been able to save on our own and pay taxes on will be rapidly depleted, forcing us to rely more heavily upon already over-burdened social programs in order to maintain even a minimum standard of living.

Furthermore, a military member is considered to have a vested retirement plan for the purposes of establishing the deductibility of the IRA, but in actuality, if the member separates from the military before 20 years, he gets no military retirement. With almost yearly a tax on the military retirement system, there is no assurance that military will remain intact when my husband becomes eligible for retirement.

In 1989, even before I began working part time, our IRA was also non-deductible. My husband received a small aviation continuation pay—also known as ACP, or the pilot's bonus—that year, which, along with our investments, brought our income over the $50,000 limit.

The bonus was paid in two installments in January and October of 1989. This spread the payments over 2 fiscal years, but left them in one tax year. This is another example of maximizing our tax liability while minimizing our ability to save.

One does not have to be an economist to realize that saving money is good for our economy. If this country truly wants to increase the amount of savings in order to—among other things—generate cheap capital for businesses, and stabilize the current economic downturn, we need to reapply the same incentives that the original IRA legislation assured the American taxpayers.

In summary, I feel that we need to make the IRA universally deductible. Furthermore, we need to realize that some groups of people—such as the military—are not so easily labeled as having a retirement plan, or not having a retirement plan. Just as importantly, we need to find a way to eliminate the bookkeeping nightmare that alternating years of deductibility and non-deductibility have produced.

I would like to thank Senator Roth for this opportunity. What a valuable lesson to show my children, that even in a country as large as ours, a single citizen's voice can still be heard. I appreciate this opportunity to appear before the committee, and welcome any questions you may have.

[The prepared statement of Mrs. Baker appears in the appendix.]

The CHAIRMAN. Thank you. Our next witness is Mrs. Barbara Green. Ms. Green, I understand you are a secretary.

Mrs. GREEN. Yes.

The CHAIRMAN. And a mother of two sons. We are looking forward to hearing your thoughts about the IRA.

STATEMENT OF BARBARA J. GREEN, BOSTON, MA

Mrs. GREEN. Good morning Thank you for the opportunity to appear and to state why I believe that this bill should become law.

As Senator Bentsen has told you, I am a secretary. My husband, Larry, is an electrician. We have two sons from my previous marriage; they are aged 9 and 10.

Our need is a very simple one. We would like to buy our own home. Before Larry and I married, he began contributing to the 403(b) plan provided by our employer, and he saved up quite a bit. And these funds could provide for the major portion of a down payment on a new home for us.

Without the passage of this bill, with the responsibility of two young sons to raise, it is very possible that we would not be able to raise the amount of cash needed for a down payment on a home.

Home ownership is something that Americans have come to expect. This is the way you are expected to live. When you grow up, you get a job, you marry, you raise your family, and you raise that family in a home that you own. We grew up in homes owned by our families, and we want our sons to have that experience, too.

As probably everyone knows, real estate prices in the Northeast are very high. The median home price fluctuates anywhere between $150,000 and $160,000.

Most lending institutions require a 20 percent down payment, and if you add in the related costs, such as mortgage application fees, home inspection fees, legal fees, points and closing costs, you generally need between $30,000 and $40,000 in cash just to buy your average home.

Some lending institutions and governments have realized that citizens need relief, and they have established first-time-home-buyer programs.

But the catch to these programs is that they exclude families whose income exceeds $40,000. Many couples, like my husband and I, did not marry until we were in our thirties, and meantime, we started stashing money in our 401(k) and 403(b) plans.

If we were to withdraw the funds in those plans before we reach age 59 and a half, we would have to forego 90 days interest and pay a 10-percent penalty. And when you are talking about sums that are in the tens of thousands of dollars, that is just like taking thousand dollar bills and burning them.

This bill would provide much-needed relief for middle class couples like us who are seeking a piece of the American dream, and I would very much like to express my gratitude to the sponsors of this bill for their thoughtfulness in realizing that this was a need that needed to be met, and having the courage to go forward with this bill.

[The prepared statement of Mrs. Green appears in the appendix.]

The CHAIRMAN. Thank you, Mrs. Green.

Our next witness is Ms. Vaughn Hobson, of Raleigh, NC. Ms. Hobson, you are an office manager, I believe.

Mrs. HOBSON. Yes, sir.

The CHAIRMAN. With two children. Would you tell us what you are seeking in a savings account?

STATEMENT OF VAUGHN HOBSON, RALEIGH, NC

Mrs. HOBSON. Yes. Thank you.

Mr. Chairman, Senator Roth, I am married and have three married children. I did not start work until my children started grammar school, and I have been working about 20 years.

For the first 15 years, I worked in a very small office that provided no pension plan. For the last 5 years, I have worked at my present position, and I do participate in our pension plan. My husband has worked for the same company for 25 years, and also has a pension plan.

Mr. Chairman, no one wants me to save money. I am pestered at home by computerized recordings that call and tell me they have a credit card reserved in my name. Banks do not advertise the interest rates that they will pay for savings accounts, they simply tell me that I can get a home equity loan.

My kids are married adults, but I am concerned that the same problems that my husband and I are dealing with—earning money to live decently and still save for retirement—are problems that they are going to have to deal with.

It is difficult for both young people and people closer to retirement age to pay for their everyday expenses, let alone save for retirement. Every direction I turn, there are people who want me and my family to buy something, preferably on credit.

The President's economists tell us we can work our way out of the current recession if Americans will just open up their wallets and be a little less frugal.

There is no one, except their parents, telling Americans to think about what will happen when they retire. We need a mechanism, and we need it soon, to encourage Americans to practice a little delayed gratification.

I do not expect the private sector to come up with this mechanism. They are the ones whose livelihood depends on separating me from as much as my income as possible. Congress and the executive branch are the only entities with the motive and the opportunity to help taxpayers.

We need Congress to pass S. 612, which will make IRA's much more attractive. We need President Bush to sign it, and we need a massive publicity campaign to make Americans realize they ought to take advantage of the opportunity this new law will give them. We have all seen the figures on our pitiful savings rate. The constant barrage of inducements to buy now and save later is one big reason for it. But I do not think we are naturally any more spendthrift than the Germans or the Japanese. Americans really do have less savable incomes than they did 20 or 30 years ago. We are strapped and we need some help.

Congress, as we know, took a look at the savings picture in 1986, and decided to restrict the use of the main government-sponsored savings plan: IRA's.

The restrictions generally do not apply to couples whose combined income is less than $40,000 a year. But I am here today to tell you that that $40,000 ceiling is unrealistic in the truest sense of the word. It does not have any connection with reality.

If both married partners are working and making a decent salary, chances are they are exceeding that $40,000 limit. If only one spouse, however, is working in a job that provides a pension, the couple will have to do some real belt tightening come retirement time. Then they live on a fraction of one income, plus Social Security, in all likelihood. These are just the people who need IRA's; the hard-working, middle-class, single-pension workers whose combined incomes are between $40,000 and, say, $80,000. But the cards are stacked against them. These families should be putting aside money to supplement the single pension, but the government is discouraging, or at least not encouraging them.

I read articles and columns that maintain that IRA's do not encourage savings, they just let people switch their savings from one mechanism to another. That might be true.

But the Federal Government has got to do something to boost the savings rate, as well as counteract the factors that have made us—as an article I read the other day called us—"a nation of spenders." We have done IRA's before, and we know that they can work; common sense tells us that.

With the new college tuition and homeowner purchase provision in Senator Bentsen's bill, IRA's are going to be a lot more attractive to new savers than they were a few years ago.

I heartily endorse your efforts to enact S. 612, and I hope that the House of Representatives and the President will join you in those efforts.

Thank you.

[The prepared statement of Vaughn Hobson appears in the appendix.]

The CHAIRMAN. Thank you very much, Ms. Hobson.

Professor Williams, you are a tax professor, I understand?

Professor WILLIAMS. Correct.

The CHAIRMAN. Two children.

Professor WILLIAMS. Three, Mr. Chairman.

The CHAIRMAN. Concerned about their education.

Professor WILLIAMS. That is true.

The CHAIRMAN. Tell me about it.

STATEMENT OF PROF. DAVID WILLIAMS II, COLUMBUS, OH

Professor WILLIAMS. Thank you, Mr. Chairman, and other members of the committee. My name is David Williams, II, and as the chairman said, I am a professor of tax law at the Ohio State University. I have a number of degrees that helped me get to this position, and I have practiced tax law both in accounting firms and law firms before going into teaching, and still actually do some consulting for businesses and individuals.

And so, I could speak to you today as a tax educator, or a tax professional, or practitioner, but what I want to speak to you today is as a parent; a parent who has three children, and a fourth one on the way, and a parent who is interested in making sure that these children get the same opportunity that I had, that of getting a good, solid college education.

While I wholeheartedly endorse all measures of S. 612, I want to speak specifically to the educational portion of the special IRA bill.

When you look around now and you look at the landscape of how we, parents, are to go about financing college educations for our children, you can be mislead, because there seems to be a lot of different available vehicles. But what we do not seem to understand, as a consumer, are all the traps, or all the restrictions that exist in these sort of vehicles.

There are many States that have pre-paid tuition plans. However, they have a lot of hidden tax consequences, both on the front end—is it a gift—and on the back end when you take it out—will someone be taxed on it?

They have a lot of restrictions as to what schools you can go to; certain schools in the State. And you are obviously at the mercy of the financial integrity, not only of the State, but the sponsor of the bill.

Then we have the series EE savings bonds, which were a great idea, except for one thing: there is an income cap. And I do not understand why one would think that a family making $60,000 with one child should have the benefit of this, but not a family making $90,000 with six children. And that is basically what happens with the series EE savings bonds. There is a phaseout as you approach a higher income.

The other problem with the savings bond program is if I am to start saving now for my youngest child, or child-to-be, I will have to anticipate what my income will be 17 years down the road to see if this EE savings bond program benefits me.

And then we have some, what we call "pre-purchase tuition credits," which would allow me—for example, if we had that at Ohio State—it would allow me today to purchase credits for my children 17 or 18 years from now to go to Ohio State. I can purchase the credits at today's price.

Well, once again, you have a problem with that, because those credits are only good if my child decides to go to Ohio State. And if the child does not, now I have an investment that I am trying to sell on a secondary market; something that I do not want to get into as I think about providing education for my children.

So, what does this bill do? Well, there are four things that I really want to touch on real briefly, that we get out of this bill as it relates to education.

One, it removes all of the problems that we have with all those other things. There is no restriction. You save money tax free, you take the money out tax free, and send the kid to whatever school you want to. There is no restrictions on schools. Safety. You have the safety that you would have with a bank, but without the tax consequences.

The ease—and let me say one thing about the ease and confusion. As I teach tax, one of the least favorite classes for students to take is tax. I hope it is not because I am the professor, but it is basically because the Tax Code is very confusing.

And I am talking about college graduate law students who cannot figure out a way to put money aside after reading the tax code without feeling somewhere along the line they are going to run into a hidden tax trap. The IRA removes all of this uncertainty. It is very easy to understand, and there is no hidden tax cost in the beginning, or later on.

Third, the flexibility. With these special IRA's and the elimination of the 10-percent penalty, this bill will allow us to have a lot of different vehicles, not just one, to fund college education.

And finally, the cost. I have heard a lot of cry about the cost of IRA's. I read one report the other day that set the cost at $26 million. I am not sure what the cost is, but there is two things about it. One, people who have college educations, statistics show, earn many times more than people that do not. So, where you might lose revenue on the front end, you will pick up much more later on throughout the college graduate's life.

And second—and I think even more important—all returns are not measured in cash. A better-educated citizenry will be a more informed one, and a more informed one will be a more active one. And that will give us much more revenue—not only cash revenue—but in a lot of different ways.

In conclusion, thank you very much for this time. I hope that we will pass a bill that will allow all the kids of the United States to have the same advantage that you and I had—to get a college education.

Thank you.

[The prepared statement of Professor Williams appears in the appendix.]

The CHAIRMAN. Well, that is very interesting testimony. It is interesting to me listening to the fact that both parents are working. More than ever in the history of our country, we have both parents working in this country. And why are most of them doing it? Most of them, because they are trying to make ends meet. They are middle-income folks having a tough time of it. So, when you talk about a limit of $40,000, I doubt any one of you feels rich. You middle-income people are in a squeeze. That is why you are seeing first home purchases for young couples actually declining in the country. And that is why you see the problem Professor Williams is talking about in trying to save for that child's college education and the difficulties of it.

And then the comment Ms. Hobson made about some people say it is just a shift in savings, I do not believe that. I think one of the big things that happens is the tremendous amount of advertising that you get about the time you are going to pay your taxes, and you have got all the big brokerage houses, the banks, the insurance companies, all advertising about the IRA when we had the IRA in effect. So, as you sit down to write that check to the IRS, you say, how about writing it to the IRA for me, for my kids? And I think you will have a great increase in savings in the country as a result of that one.

Ms. Baker, let me ask you—let me ask any one of you on comment. How many of your peers do you think are adequately saving for their retirement at the present time? I know that is a subjective question, not a very scientific survey here. But what is the reaction you get from your peers?

Mrs. BAKER. When everyone found out I was coming to this panel, people talked about IRA's and their savings more than usual to us. And a lot of our peers are no longer saving in an IRA. It just does not pay off. They do not do it anymore.

The CHAIRMAN. Well, I think that what we have put together here in satisfying some of the primary needs and concerns for families today would be very helpful in getting that first home purchase, or taking care of some disastrous illness, or the college education, and ultimately retirement. When you talk to a 30-year-old about saving for retirement, however, that seems way off there somewhere. They are really much more concerned about immediate things, such as that home that they would like to buy. If we can create a savings pattern for younger Americans, however, I believe we can accomplish both short- and long-term savings goals. I defer to my colleague, Senator Roth.

Senator ROTH. Well, thank you, Mr. Chairman. I first of all would like to comment to all four of the panelists. I have heard more common sense expressed today than the many years, Mr. Chairman, I have served on this committee. And I can even understand——

The CHAIRMAN. You be careful about that, now. [Laughter.]

Senator ROTH. And I can even understand what they have to say. But I think—I am very serious—I have never heard a better explanation or need for savings than made by the four of you today. And, as the Chairman touched on in opening remarks, in many cases you mentioned that your wife or husband, as the case may be, works. Do any of you think of yourselves as being rich? Ms. Green?

Mrs. GREEN. No.

Senator ROTH. Ms. Baker?

Mrs. BAKER. No.

Senator ROTH. Professor?

Professor WILLIAMS. No.

Senator ROTH. Mrs. Hobson?

Mrs. HOBSON. No, sir.

Senator ROTH. And that is one other thing that bothers me. Down here, people say we should not extend the IRA because it only benefits the rich. Now, Professor Williams, you are a distinguished scholar. Is this not one of the rarer situations where we have a program that is good for the family and good for the Nation?

Professor WILLIAMS. Without a doubt. I mean, I think that the rich really do not need a $2,000 IRA. They will have a lot of other ways to take care of themselves, if for no other reason they can hire people to advise them properly. But this is certainly a sort of thing where you will find many more middle income and even some below middle income who will take advantage of this.

Senator ROTH. Available to everybody.

Professor WILLIAMS. Exactly.

Senator ROTH. Now, you talked about education, Professor Williams. I was very much interested, because that is a critical problem for the typical American family, and it is going to become even more serious. If we do not have IRA's, is that going to handicap you, Mrs. Baker, or you, Mrs. Green, or you, Mrs. Hobson, in sending your children to college?

Mrs. BAKER. Yes, sir. I feel that it will. I am not sure how we are going to send our children to college. We have a 4½-year space between number one and number three, so we are looking at 6 years of two children in college.

As Professor Williams said, even the EE savings bond relief, which ought to help a little bit, by the time in 10 years when our oldest is ready for college, if that cap is not raised, that is going to be too small, also. My husband jokes and says that our children can go anywhere they want, as long as it is West Point, Annapolis, or the Air Force Academy, so that we do not have to pay for it. [Laughter.]

But I do not know how you send three children to college anymore.

Senator ROTH. Mrs. Green.

Mrs. GREEN. That is our next big problem. Once we buy our house, is how we are going to send Philip and John to school. And we have committed ourselves to the idea that they need to have a college education. And they are 18 months apart, so they are both going to be in college at the same time. We do not know how we are going to do it, but we know that we have to do it.

Senator ROTH. Well, our time is going on. Mrs. Hobson, would you care to add anything?

Mrs. HOBSON. Well, my children are through college, but I still have to encourage them to save and to plan for their retirement, for their children's college educations, and for a way for them to be able to purchase a home. And I think that is important.

Senator ROTH. You raise a very interesting point. I do not know whether you are aware or not, but our legislation also would enable a grandparent to help a grandchild go to college, or a grandchild help a grandparent, in the case, let us say, of catastrophic health.

Mr. Chairman, I just want to express again my personal appreciation to each of these splendid witnesses. They have been very helpful.

The CHAIRMAN. Well, I certainly concur with that. I appreciate the contribution you have made. Thank you very much for coming. Thank you.

Our next witness is Mr. Frank Lalli, who is the managing editor of MONEY magazine from New York.

I would say for those who are in attendance, my understanding is we have three back-to-back votes scheduled starting in about 10 minutes, and we will recess for 45 minutes at that point.

Mr. Lalli, we are very pleased to have you, and knowing of your very fine publication and your probing inquiries of your readers concerning savings accounts, I think your testimony will be quite meaningful. We are looking forward to it.

STATEMENT OF FRANK LALLI, MANAGING EDITOR, MONEY MAGAZINE, NEW YORK, NY

Mr. LALLI. Thank you, Senator. I would like to submit the full testimony for the record, and I will summarize here today.

The CHAIRMAN. That will be done.

[The prepared statement of Mr. Lalli appears in the appendix.]

Mr. LALLI. I am here to deliver this mail and the clear message it contains. A surprisingly vast number of Americans from all across this country would pour billions of dollars into savings each year if Congress added the proper incentives to individual retirement accounts.

In June, MONEY magazine, the largest financial magazine in the country with a circulation of 1.8 million, invited readers to mail in their views on the Bentsen-Roth plan to restore the fully-deductible IRA.

Based on several other polls of our readers—most notably one concerning the magazine's own proposal for a tax-deferred savings plan, SAFE, the Savings Account for Future Education—we anticipated a highly positive response, but nothing like this. More than 23,000 readers have sent us their answers so far. That is well beyond any response we have ever gotten in the magazine's 19-year history.

Furthermore, an overwhelming 97 percent said they would contribute to a re-vamped IRA, and most of the remaining 3 percent said they would not only because they were already retired.

The pollsters who worked with us say a virtually unanimous vote like that is extraordinary, even for a self-selected survey such as this one.

Why the outpouring? I can only guess that our readers are seeing the same headlines as everyone else. They are reading that Social Security may dry up just when they need it; that giant insurance companies holding millions of workers' life savings are being seized by regulators; and that corporations with underfunded pensions are going under. A new IRA that they control, with tax incentives for all, must look awfully good to a great many people right now.

Perhaps it is no wonder then that our survey respondents under 40 years of age said they expected to depend more on their IRA's for their retirement income than Social Security or company pensions.

Taken overall, the results of our survey tend to rebut five of the most pointed questions IRA critics have raised.

Question No. 1: Would the new IRA attract new money, or just siphon off existing savings? Nearly four out of five of the readers said they would take their contributions entirely out of their earned income, rather than from existing savings.

Question No. 2: Would restoring the right to fully deduct IRA contributions from income taxes stimulate much saving now that tax reform has lowered rates? The answer is yes.

Our readers call tax deductibility far and away the IRA's most attractive feature. Even more telling, 97 percent of those who have not put money into IRA's since deductibility was restricted in 1986, said they would start funding the new accounts.

Question No. 3: Would the proposal to allow early penalty-free withdrawals to pay for first homes, higher education, or large medical bills actually undermine the IRA's primary purpose, that is, to build long-term saving for retirement? Not among the people we surveyed. More than two-thirds of those over 40 years of age said they would not be inclined to withdraw any money before retirement.

Question No. 4: Would the new IRA merely amount to a tax break for the rich? It is true that among those with household incomes of $100,000 or more, virtually every person—99 percent—said he or she would contribute. So, yes, in that sense, the new IRA would offer a tax break for the relatively rich. But not only for them. Our survey shows massive support for the new IRA across all income levels, including 96 percent of those with more normal family incomes of around $40,000 and $50,000, who were largely ineligible to fully deduct their contributions today; plus, 82 percent of those making under $30,000.

Furthermore, the $560 in taxes that rather average workers could save on a $2,000 IRA contribution can make a difference to them in any year. In the long run, those deductible contributions, plus earnings, can have a profound effect on the quality of a family's later life in a country where the typical family reaches retirement age now, with a mere $7,000 in liquid assets.

And last, question No. 5: How can this country afford the new IRA? Here, unfortunately, our survey does not provide an immediate answer about where to find the money to finance a better IRA, but the long list of tax targets mentioned by the respondents suggest that many of those we polled are willing to make trade-offs to help you find the money.

If I may, on behalf of MONEY magazine, I would add that the money to encourage more personal savings must be found, whether it be for the new IRA, our own SAFE proposal, or some other idea.

We need to take a long range view and ask this question: in an age when the far superior savings rates enjoyed by our major economic rivals are sharpening their competitive edge, how can this country afford not to provide the tools to expand our savings pool, drive down interest rates, raise productivity, and ultimately enhance our standard of living?

Thank you very much for the opportunity to testify.

The CHAIRMAN. Well, that is interesting. I am going to look forward to your full testimony that we have in the record. Let me hear that one again. Did you say that a person reaching retirement, that they have an average of $7,000 in liquid assets?

Mr. LALLI. That is correct. That is all. Many people in this country have lost the habit of saving, Senator. And I think one of the things that this poll is saying is that they want an incentive to start saving again. They are looking ahead to their futures. If you read the letters that came in this mail, and that is 23,000 responses, 10–15 percent of those——

The CHAIRMAN. That would take me on into the night.

Mr. LALLI. Yes, it would, indeed. [Laughter.]

Some. You could look at some.

The CHAIRMAN. All right.

Mr. LALLI. Ten to 15 percent of those people enclosed long, handwritten letters signed both by the husband and wife.

The CHAIRMAN. I tell you, that is the one that you really want to read, when they take the time to write a handwritten letter, and it is their thoughts.

Mr. LALLI. That is right.

The CHAIRMAN. We take our mail seriously, but particularly those letters. And when people sit down and spend the 29 cents for the stamp to send it to you, that is because they are concerned, and they are sounding off. And we are the group they can sound off to.

I know yours is kind of a self-selected survey——

Mr. LALLI. That is correct.

The CHAIRMAN [continuing]. But what I am concerned about is in a magazine such as yours, some folks say, well, it is the rich people that read it. How many millionaires do you have in that group, do you think?

Mr. LALLI. We have some, but that is certainly not all. I think what separates our readers from the average people in America is not income; it is not geography; it is essentially education. They have focused on their personal finances as a major issue in their households, so they are a little bit more sensitive.

But I think what you have got to focus on here is that we poll our readers on major financial questions every month. We talk about medical bills, education, taxes—all sorts of things. We have never gotten this kind of a response to any poll that we have ever done. We have touched—with the IRA, certainly—we have touched a nerve out there in America.

And when you find massive support for a revamped IRA that cuts across all income levels, with that kind of an outpouring, I think we have touched something in the American public. They are starting to focus now on saving and taking care of their own futures. That is self-reliance.

The CHAIRMAN. What I am concerned about, it seems to me we are dissaving. Our savings rate in this country is very low. We look at about a 4-percent rate, and the Japanese at about a 16-percent rate.

And I believe, as Ms. Hobson was commenting, the bank says, well, you can get an equity loan on your home. You cannot do that in Texas. But the fact that you are supposed to be able to get it, and people are taking advantage of that, in effect, their equity has been shrinking on that home lately.

Mr. LALLI. That is right.

The CHAIRMAN. And they are dissavings. Now, if we are going to have the capital in this country to increase our productivity and compete—and I look at a Japanese factory with an average of 10 years and our factories with an average age of 17 years; and I look at the West Germans now putting their money into East Germany and the Japanese finally beginning to be concerned about their infrastructure—we better have some capital here. And that means increasing those savings——

Mr. LALLI. That is right.

The CHAIRMAN [continuing]. So these people can achieve their objectives in life, to the extent they can through savings, and, in turn, we can increase the productivity and keep jobs in this country.

Mr. LALLI. That is right. I think what you are hearing—and certainly from this eloquent panel that preceded me—is that people want to get back into the habit of saving. But they need an incentive; they need that tax break. That $560 a year is important to them. It jump-starts the saving process. In the studies I have looked at, putting money into an IRA is a habit-forming exercise.

The CHAIRMAN. Yes, but do you not think all that advertising at that time by the brokerage houses and banks influences many peoples' decisions?

Mr. LALLI. Yes. I think hearings like this, I think stories in MONEY magazine, and I think the advertising, too, would get across the education that is needed. The need is there, the incentive to save is there, and the education is the final piece of the puzzle.

The CHAIRMAN. Senator Roth.

Senator ROTH. Yes, thank you, Mr. Chairman.

I wonder what you think would be the reaction of your readers to a front-loaded IRA versus a back-loaded? Do you——

Mr. LALLI. We did not go directly at that question. The closest we came is when we asked the readership what they thought was the most popular, what they would think was the best feature. And in our readership, that was five to one in favor of deductibility over the freedom to withdraw.

However, if you look at the poll results, you realize that the popularity of the freedom to withdraw money early rises markedly with people at about 40 years of age and under. And I think what may happen—but we certainly do not know until it does—is that the freedom to withdraw may draw younger people to open up their first IRA.

They may. indeed, even tap it once or twice for emergencies, or something important, like a first home along the way. But as they age, I think their focus then will shift to retirement savings, and that is where the bulk of the money will be.

Senator ROTH. The ultimate. So, there has been some criticism that we are defeating the purpose of the IRA's by permitting withdrawals.

Mr. LALLI. This poll does not support that. In fact, it says the opposite. It says that people over 40 years of age have focused on their retirement, and, therefore, will save for that purpose. They are not inclined to take the money out. People under 30, who probably do not have an IRA at this point—we did a national Gallup poll a month ago with people in their twenties, and we asked them whether they had any money in IRA's. Ninety percent do not, even though, in many cases, it is fully deductible for them, and in many cases, they have the money.

And also, there is a fear out there—a substantial fear—that they will lock their money up and then they will not have it for that emergency, the college education, or that first home. So there is some reluctance.

If this bill passed, I think you would find younger people coming to the IRA first perhaps with education in mind, opening those accounts, and then their priorities will shift toward longer-term savings naturally as they grow older.

Senator ROTH. And is it not true that the more savings there are in this Nation, irrespective of who does the saving, that helps everyone? In fact, it probably helps those on the low end of the scale the most, because by creating capital, we create productivity; if we create productivity we create jobs.

Mr. LALLI. That is right.

Senator ROTH. Is that not what the game is all about?

Mr. LALLI. That is right. The letters are very instructive. The letterwriters do not only talk about their own personal goals, the letters talk about this country; the future of their children. And they talk about our competitiveness with foreigners, and who will have the jobs, and where those jobs will be. The readers are very smart on this subject. They just need some help, as the panel said, to get started.

Senator ROTH. And you say something like 82 percent of those with income of $30,000 or less are supportive of this expanded Super IRA?

Mr. LALLI. It is even higher, Senator, if you take out people at retirement age with incomes of less than $30,000. They are already retired and probably past their IRA years. If you take them out of the equation, it is about 94 percent. In other words, you are getting the same kind of enthusiasm at under $30,000 as you are at $40,000, and $50,000, and $60,000, and $70,000.

Senator ROTH. That, as the Chairman said, is fascinating. I can tell you that will come as a shocker to a lot of our colleagues, but it is fascinating.

Mr. LALLI. There is the mail. They can pour through it.

Senator ROTH. Thank you, Mr. Chairman. Thank you.

Mr. LALLI. Thank you very much.

The CHAIRMAN. Thank you very much, Mr. Lalli.

I am not certain about how long we are going to be able to continue before this recess, because we have those three votes forthcoming, but they have delayed it for the moment, anyway. So, let us see if we can get started with the next panel, and that is Father William Bryon, president of Catholic University of America; Mona K. Draper, member of the pensions committee, the Institute of Electrical and Electronic Engineers, from Louisiana; Harley Rouda, who is the president of the National Association of Realtors; Judith Brown, a member of the board of directors, the American Association of Retired Persons; David Lifson, who is a partner at Hays & Co., on behalf of the American Institute of Certified Public Accountants.

Senator ROTH. Mr. Chairman, may I apologize that because we have a mark-up in banking and I have a "Women in Combat Amendment" on the floor in a few minutes, I am going to have to leave. It is not a lack of interest in what these fine people have to say, but I will read with great care their contribution. I want to express my appreciation.

The CHAIRMAN. Thank you very much, Senator. I understand the competing assignments.

Father Byron, if you would proceed, we would be delighted to have your testimony.

STATEMENT OF WILLIAM J. BYRON, S.J., PRESIDENT, CATHOLIC UNIVERSITY OF AMERICA, ON BEHALF OF NATIONAL ASSOCIATION OF INDEPENDENT COLLEGES AND UNIVERSITIES, WASHINGTON, DC

Father BYRON. Thank you, Mr. Chairman. I am here representing the National Association of Independent Colleges and Universities, as well as the American Council on Education; the Association of American Universities; and the National Association of State Universities and Land Grant Colleges.

I am speaking for the higher education community, and I have the feeling because the previous testimony that you received was of such high quality—it was really superb—that I run the risk, perhaps, by adding, of subtracting. So, what I want to do is just put my testimony in the record, and underscore one essential point, and I will be happy to yield back the balance of the time.

The CHAIRMAN. That will be fine.

Father BYRON. Parents and others, especially grandparents, as the point was made here a moment ago, need both the incentive to save and the option to convert IRA savings into tuition payments for their young. That is the essential point that we want to make, focusing just on the higher education benefits.

And we are here to encourage, commend, and to thank you and Senator Roth for taking the lead in proposing in this legislation to restore the deductibility of certain IRA contributions, and to create a new kind of IRA where contributions would not only be deductible, but the interest earnings would not be taxed as earned or upon withdrawal, so long as withdrawals are not made for at least 5 years. Then penalty-free withdrawals would be available for application to the college education expenses of young people.

We believe that financing higher education is a shared responsibility. Families, the institutions themselves—and we are putting a considerable amount of money into financial aid—private donors, and government, and we think what you are doing is going to be a big step in facilitating that kind of cooperation.

We are grateful, and the testimony will be there in the record.

[The prepared statement of Father Byron appears in the appendix.]

The Chairman. Thank you very much, Father Byron.

Ms. Draper, if you would proceed with your testimony.

STATEMENT OF MONA K. DRAPER, MEMBER, PENSIONS COMMITTEE, INSTITUTE OF ELECTRICAL AND ELECTRONICS ENGINEERS, INC., U.S. ACTIVITIES, METAIRIE, LA

Ms. DRAPER. Good morning, Mr. Chairman and members of the committee. I am Mona K. Draper of Metairie, LA. I am a member of the Institute of Electrical and Electronics Engineers, Inc., and currently serve on the Pensions Committee of IEEE's U.S. Activities Board.

Since 1986, I have worked in engineering departments for public utility companies. I have experience in data and voice communications systems design, telephony circuit design; econometric, energy and load forecasting, and project management.

I have also taught statistics at the University of New Orleans, and have published several papers on forecasting. I am currently employed in the quality management department of a major public utility.

I sincerely appreciate the opportunity to express IEEE-USA's view on S. 612, the Savings Investment Incentive Act of 1991.

The Institute of Electrical and Electronic Engineers, Inc. (IEEE), is a transnational professional/technical society whose membership currently includes more than 320,000 electrical, electronics, and computer engineers in 130 countries throughout the world. IEEE's

U.S. Activities Board is responsible for promoting the professional careers and technology policy interests of IEEE's 250,000 U.S. members.

Personal savings are a critically important supplement to Social Security and employer-sponsored pension plans as a source of income in retirement for middle-income Americans. Private savings also represent a major source of the investment capital so urgently needed to increase the Nation's industrial productivity and to maintain our standard of living.

IEEE-USA has long been concerned about the importance of personal savings as a source of retirement income for individual Americans, as well as a major source of capital needed for productive investment in the Nation's economy.

For both of these reasons, the IEEE-USA actively supported legislation to expand tax incentives for contributions to individual retirement accounts in the late 1970's and early 1980's.

We opposed the cut-backs in eligibility to make tax-deductible IRA contributions contained in the Tax Reform Act of 1986. Supplemental savings programs, including individual retirement accounts, have been particularly important sources of retirement income for engineers and scientists, who make up so large a part of America's increasingly mobile professional and technical work force.

Although most of IEEE members are covered by employer-sponsored pension plans, lack of pension portability, particularly from defined benefit plans, means that many of our most mobile members receive very meager pensions from former employers.

We are especially pleased, therefore, to offer the enthusiastic support of more than 250,000 electrical and electronics engineers, and computer scientists for S. 612, the Savings Investment Incentive Act of 1991.

In addition to support from IEEE-USA, I also bring the endorsement of the Engineers and Scientists' Joint Committee on Pensions, a coalition of 33 major national engineering, scientific and technical organizations that operates under the auspices of the American Association of Engineering Societies. Collectively, ESJCP member organizations represent some 1.4 million engineering, scientific, and technical personnel throughout the United States.

To cover just some of the highlights of the proposal, as introduced by you and Senator Roth, S. 612 will promote individual savings by permitting all taxpayers to make tax-deductible contributions of up to $2,000 annually to conventional front-loaded IRA's under the rules in effect prior to the Tax Reform Act of 1986.

Alternatively, taxpayers will be permitted to make non-deductible contributions to a new, back-loaded IRA under which earnings on contributions held for at least 5 years would not be taxable as income at withdrawal.

The Bentsen-Roth Super IRA proposal has the added advantage of indexing the $2,000 limit on contributions to IRA's for inflation. In addition, the Bentsen-Roth Super IRA bill would provide exemptions from the 10-percent penalty tax on premature withdrawals, which are used to help pay for first home, educational expenses, or financially devastating medical costs.

S. 612, by extending IRA deductions eligibility to all workers, would increase the proportion of all workers who would be eligible for the $2,000 IRA deduction from 58 percent to 94 percent.

Engineers and scientists, many of whom earn more than $40,000 a year, would be among the major beneficiaries of this change in tax policy.

And, by allowing penalty-free withdrawals for first time home purchases, educational costs, and major medical expenses, this bill will help to make IRA's much more attractive as a savings vehicle for younger, middle Americans like myself.

The CHAIRMAN. Ms. Draper, we will take your entire statement in the record. I see your time has expired, and I have a vote on the floor, and that will be the start of three votes. So, we will recess until 11:15.

Ms. DRAPER. Thank you for listening to the views of the IEEE-USA.

[Whereupon, at 10:46 a.m., the hearing was recessed.]

[AFTER RECESS]

The CHAIRMAN. If you would please take seats and cease conversation, we will get the hearing under way again. Let me see. I believe, Ms. Draper, I think you had finished.

So, Mr. Rouda, who is the president of the National Association of Realtors, if you would proceed, please.

STATEMENT OF HARLEY ROUDA, PRESIDENT, NATIONAL ASSOCIATION OF REALTORS, CHICAGO, IL

Mr. ROUDA. Thank you, Mr. Chairman. I am Harley Rouda, from Columbus, OH, a realtor. I represent 750,000 realtors in every phase of the real estate industry. We compliment you, as well, Senator Roth, for S. 612.

The Super IRA proposal, a plan to enhance savings investment in the United States, is of national interest. Reinstating IRA's for all taxpayers fosters a general climate that favors savings.

S. 612 permits a penalty-free withdrawal for the first time purchase of a home. This provision not only permits the withdrawal by the purchaser, but also the purchaser's spouse, parents, and grandparents.

This proposal would help young people buy their first home by helping them with their down payment and their closing costs. As many of you know, on July the 1st of this year, HUD issued a ruling that only 57 percent of all closing costs could be financed, versus 100 percent. Realtors and mortgage bankers across the country tell us that many people who bought homes prior to July 1 would not have qualified under the new rule. This provision in the IRA proposal would help.

The housing affordability crisis is known to all of us. The decade of the eighties saw a steady decline in the Nation's home ownership rate. The percentage of home ownership declined only slightly; 2 million fewer today than before 1980. They did not realize the American dream of owning a home.

The largest decline in home ownership was those people under 25 years of age, and more importantly, among those in the family formation years of 25 to 34.

Today, fewer than half of these people own their own home. Their percentage of home ownership dropped the most in all categories. Under 25 years of age, their percentage of home ownership dropped 27.2 percent. Between 25 and 34 it dropped 14 percent. These statistics carry with them one important message: we must have new sources of capital for young families who are attempting to purchase their first home.

In 1987, the last full year for which published data are available, 28 million returns claimed mortgage interest deductions. Two-thirds of those returns were filed by individuals with less than $50,000 in income and they accounted for more than half of all the interest deductions as measured in dollars. Thus, the benefits of home ownership appear to be substantial for those with less than $50,000 in income.

Why a withdrawal feature? We believe that using IRA funds to purchase a home makes sense for everyone. A home is the center of savings plan for most American families. Thus, we would strongly contend that the use of an IRA account to acquire a residence is totally consistent with the savings objectives of this country.

Why should parents and grandparents be allowed to withdraw for their kids? I have four children, and selfishly, I want to be very kind to my children, because they are probably the ones that are going to pick my retirement home, and I suppose we are all about the same shape.

The National Association of Realtors recommended in 1989 and 1990 that the IRA proposal be expanded to include penalty-free withdrawals by the spouse, parents, and grandparents of prospective purchasers.

Our studies, together with other research data, have consistently shown the IRA account balances of prospective home buyers are small when contrasted and compared to their parents and their grandparents.

Owners of IRA's are 50 years of age are married, and they own their own home, whereas a principal household formation group is under 35 years of age.

If older persons tend to own IRA's and tend to own their own homes, they can make the most significant contribution to expanded home ownership. Parents' and grandparents' IRA's should be made available to contribute to the housing cost of the younger family members.

About 80 percent of all individuals between the ages of 65 and 69 own their own homes. Only about 33 percent in the 25 to 29 bracket own their home. We believe it is in the national interest to enlarge the number of homeowners, and believe that home ownership should be widely available to all age groups.

We therefore believe that IRA funds of family members should be made available to young people trying to purchase their homes.

As a side comment, we have done surveys, and other groups have, that homeowners tend to be more responsive citizens to the community as taxpayers, as voters, and involvement in community affairs.

In conclusion, we believe the purchase of a home is one of the most important saving events in the life of any family.

Accordingly, we wholeheartedly support the tax incentives embodied in S. 612, particularly those provisions that permit individuals to make penalty-free withdrawals from their individual retirement accounts for the purchase of a home.

This proposal will make a significant contribution to helping large numbers of Americans begin to participate in the American dream of home ownership. And last, but not least, more importantly, it would eliminate the confusion about who qualifies for an IRA. In this case, everyone.

Thank you.

[The prepared statement of Mr. Rouda appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Rouda.

Ms. Brown, our next witness, is a member of the board of directors of the American Association of Retired Persons, from Minneapolis, MN. We are pleased to have you.

STATEMENT OF JUDITH N. BROWN, MEMBER, BOARD OF DIRECTORS, AMERICAN ASSOCIATION OF RETIRED PERSONS, MINNEAPOLIS, MN

Ms. BROWN. Thank you, Mr. Chairman. My name is Judy Brown. As you indicated, I am a member of the board of directors of the American Association of Retired Persons.

The association is pleased to present our views on legislation and to encourage savings and investments through IRA's. The association remains vitally concerned about improving the retirement income security of today's and tomorrow's workers and retirees.

By whatever measure one uses, the U.S. savings rate declined during the 1980's. This is a troubling fact, since increased saving and investment are necessary for economic growth if we are to meet the diverse needs of our society.

The next two decades, as we prepare for the retirement of the baby-boom, is an especially important time. While some view the sheer size of this group as a burden on society, it can and should be an unprecedented opportunity for boosting the Nation's savings rate. The Tax Reform Act curtailed one savings vehicle, IRA's, for taxpayers above certain income thresholds who are covered by a pension plan.

The first year after these restrictions were put in place, the number of IRA contributors was cut by more than half. In addition, the income limits on IRA's are not indexed for inflation, and the number of individuals eligible to make deductible contributions will continue to decline in the future.

Given the importance of increasing the national savings rate, the association believes the Federal Government must continue to play a leading role. As people live longer and inflation erodes their buying power, it becomes even more important for them to have dollars to supplement their other incomes during retirement.

Of course, a number of questions arise with any government action, and we believe the following questions must be addressed when considering restorations of IRA's.

First, the effectiveness of IRA's as a method of increasing savings. Despite liberal IRA rules in the early 1980's, savings declined steadily throughout this period. Research findings are mixed on the effectiveness of IRA's in creating new savings. The association would encourage this committee to further explore this issue.

Second, there is a question of financing. Last year's Budget Act requires that any expansion of IRA's be paid for by raising taxes or cutting entitlements.

The association must reserve judgment on this legislation until the financing is in place. The sources of financing and any impact on the deficit will ultimately be major factors in determining the association's position.

Third, targeting savings. Upper-income Americans are the most likely to respond to improved savings incentives, but what will this do to help those of modest means who really need to save for retirement?

Fourth, is other priorities. Given IRA's large price tag, are there better uses of scarce Federal funds? Should more resources be targeted, for example, for improved health care for all Americans? Once again, you in Congress are asked to make the very hard choices.

In addition, would we better promote savings by devoting resources elsewhere, such as encouraging simplified pensions for small employers, such as SEP's.

Other measures, such as pending legislation which you, Mr. Chairman, have sponsored to modify pension distribution rules, will also help to improve saving. Proposals to liberalize IRA rollover rules and to require direct trustee-to-trustee transfers of pension funds to IRA's should help improve savings.

A final concern is whether early consumption of retirement funds undermines the goal of "retirement" accounts. The association generally opposes exceptions to the requirement that funds not be withdrawn without penalty before retirement.

As parents, we become hard-pressed during life to provide things for our children; new homes, as you have indicated; medical issues; and college educations.

We are concerned that people will spend their IRA monies for these issues and not have it when they need it for retirement. While many exceptions can be defined as alternate means of investment, the slippery slope of exceptions may easily undermine ultimate retirement savings. The broader the exceptions, the less likely that these monies will be available in retirement.

The biggest and most obvious bias against national savings continues to be the large public deficit. Trimming the deficit should be a savings priority. Reducing debt will make it possible to improve productivity and improve national savings.

In conclusion, the association believes savings are critical for both today's growth, and tomorrow's retirement security. While IRA's are clearly very popular, a number of questions must first be answered.

We thank you for hearing us.

[The prepared statement of Judith N. Brown appears in the appendix.]

The CHAIRMAN. Good to have your testimony.

Mr. Lifson, if you would proceed, please.

Mr. LIFSON. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Lifson, as I understand it, you are a partner of Hays & Co., and you are speaking on behalf of the American Institute of Certified Public Accountants, is that correct?

Mr. LIFSON. That is correct, Mr. Chairman.

The CHAIRMAN. And what is the button?

Mr. LIFSON. Simplify. Simplify is our slogan.

The CHAIRMAN. That would put a lot of you out of work. [Laughter.]

Mr. LIFSON. We welcome the opportunity.

The CHAIRMAN. You do? Oh. Okay. I think I must have left my button on my pajamas, but go ahead.

Mr. LIFSON. Well, I am sure the American Institute would be happy to offer you one.

The CHAIRMAN. Thank you.

STATEMENT OF DAVID A. LIFSON, PARTNER, HAYS & CO., NEW YORK, NY, ON BEHALF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. LIFSON. Thank you, Mr. Chairman, for the opportunity to testify today on this subject that is of great importance to all American taxpayers. I am David Lifson, chairman-elect of the Individual Taxation Committee of the American Institute of Certified Public Accountants. Accompanying me today is Donald H. Skadden, vice president, Taxation of the AICPA.

The AICPA is the national professional organization of CPAs, with over 300,000 members. We compliment the committee, and you, Mr. Chairman, for your desire to encourage savings and investment by the American public.

The AICPA is not taking a position on the policy question of whether or not the individual retirement account is the most appropriate mechanism for encouraging savings and investment. Rather, we come here today to offer our assistance on the technical aspects of the bill.

Mr. Chairman, there are problems with the current IRA system. They include the fact that the IRA is terribly complicated. Different rules apply to different taxpayers. And various factors make the current system inefficient and very expensive to those who are currently eligible.

The income limitation and pension plan participation disqualification work in tandem to deprive many who want to contribute to an IRA the opportunity to do so.

The earned income limitation discriminates against non-working spouses. Neither the $2,000 contribution limit, nor the income phaseout for active participants in employer plans is indexed for inflation.

Harsh penalties assessed on early withdrawals, even when hardship requires access to the funds, are surely a disincentive for IRA savers. Your proposal would restore the deductible IRA for millions of Americans, and would attack the problems in the current system in several ways.

The AICPA takes no position on the policy question of whether there should be both deductible and non-deductible IRA's. If it is deemed desirable to have non-deductible IRA's, we believe the following suggestions would make all IRA's in the proposed system easier for taxpayers to comply with, and easier for the IRS to administer.

Inasmuch as many taxpayers would use the non-deductible IRA for purposes other than retirement, it would be more descriptive and less confusing to them to call the non-deductible account an individual savings account.

You should be more specific in separating deductible and the new non-deductible IRA's. It would be particularly helpful if legislative intent could be made explicit on certain questions, such as, are the non-deductible IRA's to be subject to spousal rules; are they to be included in the calculation of excess distributions from qualified retirement plans; are they to be included as income in respect of a decedent; should they be included in minimum distribution calculations?

We recommend that the statute also include the method for allocating earnings to contributions, rather than leaving the decision to future regulation writers.

The definition of eligible education institution in the bill ultimately cross-references to both the Higher Education Act of 1965, and the Carl D. Perkins Vocational Education Act, neither of which is readily available to taxpayers or most tax practitioners. It would be most helpful if the legislation or the committee report included a more specific definition. The definition of a first-time home buyer might provide the opportunity for abuse by taxpayers. We envision a scenario that would include IRA funds used, and a tax-free rollover from the sale of a prior residence accomplished in the same transaction.

We would suggest the following changes to minimize potential abuses in this area: limit the use of this provision to a one-time only election, similar to the once-in-a-lifetime election under Section 121; expand the 2-year rule to 4 or 6 years, thus preventing many of the potential abuse scenarios for ex-patriots, recently married taxpayers, and others; limit the availability to those situations where neither the taxpayer, nor the spouse have owned a principal residence during a qualifying period.

Again, we thank you for the opportunity to speak. We hope that our comments prove to be useful. If you or your staff desire further assistance with technical matters in the bill, we would be pleased to offer our expertise.

Thank you, sir.

[The prepared statement of Mr. Lifson appears in the appendix.]

The CHAIRMAN. Well, I think those are interesting comments, and we will certainly take them into consideration as we work on this piece of legislation. That is the purpose for this type of hearing, to try to anticipate potential questions of implementation and try to get away from some of the problems that might develop from over-complicated procedures and fuzzy legislation.

Mr. Lifson, when someone comes to you now and asks you about going into a non-deductible IRA, what do you tell them?

Mr. LIFSON. We generally advise against it. Too complicated.

The CHAIRMAN. I still put money in mine by force of habit, I think.

Mrs. Brown, I can understand your focus on retirement, your organization, and the competing objectives of this approach to the IRA.

The question we have to decide is does that mean that you get that much more in the way of savings because you are satisfying the more immediate objectives of younger people than you might get otherwise? I am not sure that we can truly measure that one. It seems almost a subjective judgment. But one of the things that happens in that first home purchase, it seems to me, is one begins to build up an equity that can be helpful at the time of retirement. How would you respond to that?

Ms. BROWN. It is true that one would build up equity, but I think that what is going to happen is that young people will not be able to save enough in their IRA's to buy the homes by themselves, so we are going to be looking at parents and their grandparents helping them with it, and——

The CHAIRMAN. Don't they always?

Ms. BROWN. They do. They do always, but they do not take it out of their retirement money. The issue becomes more critical as more people retire and live longer. If I retire when I am 60 and I am going to live till I am 90 or better, because my parents are still living at 91, what am I going to do? How will I provide enough money to take care of myself as inflation erodes my ability to buy the necessary things that I have to have? There is no easy answer. We would say that perhaps we could encourage simplified pension plans and help individuals who work for the small employer. They are very inexpensive to run and they are easy to administer. And if more people had those, we could accomplish a similar improvement in savings, but it would be less costly to the budget. We are concerned, Mr. Chairman, and I do not envy you your choices.

The CHAIRMAN. Well, that is what I hired out for.

Mrs. Draper, in talking about pensions——

Ms. DRAPER. Yes.

The CHAIRMAN. Not all people who are on pensions have a reasonable retirement out of that pension, do they? Some of them are really quite limited in the amount of money that is available on retirement, and yet, precluded from coming into an IRA, is that not correct?

Ms. DRAPER. Yes, that's right. And we are interested in increasing personal savings for retirement by expanding eligibility to make tax deductible IRA contributions.

The CHAIRMAN. Senator Daschle.

Senator DASCHLE. Mr. Chairman, I have no questions.

The CHAIRMAN. Well, I think that the comments that have been made are helpful to us, and you have posed some interesting choices for us as we try to further evolve this piece of legislation. I feel so strongly that not just the question of the individual, but for the country itself, is at hand. That is why it is important to get these savings up and to try to have the capital we need to invest in the future of our country; this will then reflect on the standard of living of all of us. Thank you very much.

We have another panel, I see. Our next panel will be Mr. John Steffens, who is the vice president of Merrill Lynch from Princeton, NJ. He is co-chairman of the Tax Policy Committee for the Securities Industry Association; Mr. Matthew Fink, who is a senior vice president and general counsel for the Investment Company Institute from Washington, DC; Mr. Edward John Sebastian, chairman of the board, chief executive officer of Resource Bank Shares Corp., on behalf of the American Bankers Association; Mary Mohr, the past president and member of the Legislative Committee of Retirement Industry Trust Association, Denver, CO; Mr. Peter Roberts, who is the chairman of the College Savings Bank, Princeton, NJ.

Mr. Steffens, if you would proceed.

STATEMENT OF JOHN L. STEFFENS, EXECUTIVE VICE PRESIDENT, MERRILL LYNCH & CO., INC., CO-CHAIRMAN, TAX POLICY COMMITTEE, SECURITIES INDUSTRY ASSOCIATION, PRINCETON, NJ

Mr. STEFFENS. Thank you very much, Mr. Chairman, and members of the committee. Senator Bentsen, I wanted to make sure that we have a badge for you, sir.

The CHAIRMAN. All right.

Mr. STEFFENS. I am John L. Steffens, the co-chairman of the Tax Policy Committee of Security Industry Association, and executive vice president of Merrill Lynch & Co.

The SIA membership, as you may know, accounts for more than 90 percent of the securities activities in North America. Its roughly 600 members range from large full-service firms engaged both in international as well as domestic activities, as well a wide variety of small and local firms that are engaged primarily in retail brokerage business. The Securities Industry manages about $247 billion of current IRA assets, or about 44 percent of the total.

I am going to present a summary of my statement, and I ask that the text of the complete statement, along with an additional document entitled "The Public Policy Case for IRA's," be included as part of the hearing record.

The CHAIRMAN. That will be done.

[The prepared statement and document of Mr. Steffens appears in the appendix.]

Mr. STEFFENS. Mr. Chairman, the SIA certainly commends you for your extensive leadership in the efforts to restore tax incentives to increase personal savings. We agree with you and 75 of your colleagues in the Senate and 250 in the House who are attempting to bring IRA's, so to speak, back out of retirement.

As America moves towards the 1990's and beyond, two issues should be paramount in the whole discussion of public policy concerns.

Number one: Is American focusing its resources in a direction that will stimulate economic growth and global competitiveness?

And second, are Americans adequately focusing their individual resources on their own future economic needs, especially in retirement?

America has an aging infrastructure, lower productivity than we would like, a shortage of domestic investment capital, and faces large trade and Federal budget deficits. Virtually all economists will agree that increasing national savings is essential if we are going to compete effectively in the worldwide competitive arena.

Over the next few decades, declining growth in the working age population, increasing growth in the retirement population, and spiraling debt service, will place a tremendous financial strain on the U.S. economy.

Low savings and investment rates will make it even more difficult to overcome these demographic and budgetary facts of life, and may even defeat many of the efforts going on to produce productivity gains. Without increased savings, the result is going to be a lower standard of living for all Americans.

The aging of America adds a new sense of urgency to savings. The next century will see many Americans—and I think this is really critical—spending as much time in retirement as they worked.

So, we will see them spending 30 years with no paycheck coming in, and having to depend upon their savings to a much greater degree than is usually appreciated. Individuals are not prepared to meet the increasing cost of that new longevity. Families headed by individuals aged 45-54, have merely $2,300 in median financial assets. $2,300. Hardly an adequate source for future security or income. Yet, we calculate that today's average 35-year-old will need $5,004 in current dollars by the year 2020 to provide for typical, basic financial needs.

Mr. Chairman, there is another reason for Americans to increase savings. The sagging U.S. savings rate of the 1980's was fortunately offset by a surge in foreign capital in-flows. In effect, the significant excess savings of many of our competition bolstered the domestic savings lack.

We have learned from the recent experience in Iraq that reliance on foreign resources in a variety of areas can, in fact, be very costly to America. By increasing personal savings at home, we secure future resources of income and double reward of spurring the economy at the same time.

The Securities Industry Association is convinced that bringing the IRA out of retirement with the proposed enhancements that you all have created will, in fact, help address the real savings crisis in this country. We can assure you that IRA's will, in fact, work. Our members' experience with IRA's, and the interpretation of a variety of the studies done lead to the conclusion that from 1982 to 1986, IRA's did, in fact, increase savings; they simply were not given enough time. Without IRA's, savings from 1982 to 1986 would have, in fact, been lower.

And we are absolutely convinced that well-designed savings incentives that stimulate new personal savings are not just shifts from one pocket to the other.

IRA's also appeal to Americans at all income levels. The Super IRA will be a great success in the marketplace, and will stimulate active competition amongst the financial services industry.

Finally, it should be noted that the success of IRA's does not depend solely on the features of the account, but financial institutions will aggressively market these benefits to their overall constituencies.

The SIA believes that public policy can have a positive impact on savings. The impact can be immediate, significant, and left to mature; enduring. All parties must educate the American population to save more, not only for the country, but for themselves, as well.

We believe that the Super IRA is a very important step in this direction, and we applaud your taking those steps. Thank you very much.

The CHAIRMAN. Thank you, Mr. Steffens.

I have a competing committee I have to go to, but I would ask Senator Daschle if he would complete the hearings, please.

Mr. Fink, if you would proceed.

STATEMENT OF MATTHEW P. FINK, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, INVESTMENT COMPANY INSTITUTE, WASHINGTON, DC

Mr. FINK. Thank you, Senator. I am Matthew Fink, senior vice president and general counsel of the Investment Company Institute, which is the national association of the American mutual fund industry.

As an industry whose primary focus is on savings and long-term investment, we enthusiastically support S. 612, the Savings and Investment Incentive Act of 1991. We do not need to be convinced of the benefits provided to individual workers and to the economy as a whole by long-term savings through a simple vehicle, such as the universal IRA.

The benefits of savings are twofold. First, long-term savings help assure individual retirement security. Increased personal savings will be needed by many retirees to offset the impact of a wide-ranging metamorphosis occurring today in the private retirement plan system.

Available data indicate a clear trend away from the use of defined benefit plans in favor of defined contribution plans. The impact of this trend will adversely affect individual retirement needs. Under a defined contribution plan, no specific level of benefits are promised or ensured by the employer. Moreover, it is the employee, not the employer, who bears the risk of plan investment performance.

Actual experience has shown that even when employees can direct the investment of their defined contribution accounts, the employees tend to be conservative investors who accept lower long-term returns in exchange for short-term investment stability. This new uncertainty regarding the adequacy of the private pension plan benefit system has been compounded by the impact of demographic trends which other witnesses have mentioned.

As Mr. Steffens and others have pointed out, future retirees will have a longer life expectancy and, therefore, a longer retirement period than any prior generation.

It is also well-known that the increasing cost of maintaining Social Security benefits must be funded by a shrinking work force. When the so-called baby-boomer generation reaches retirement, there will be a greater number of retirees supported by a smaller work force than ever before.

And what are Americans doing in the face of this increased need for increased personal retirement saving? Unfortunately, statistics indicate that Americans are saving less than ever before. We believe that the universal IRA can help Americans begin to accumulate the increased retirement savings they will need.

The second beneficial effect of long-term IRA saving is, of course, increased capital formation for economic growth. Only by raising our National savings rate will it be possible to reconcile the goals of increased capital investment and reduced trade deficits.

The importance of increasing domestic saving to finance growth in the United States is heightened by potential shortages of capital abroad, resulting from such factors as the modernization of Eastern Europe.

The mutual fund industry's substantial experience in the IRA market has taught us a very, very important lesson. Saving incentives work best if the rules are, first, simple and second, permanent. A savings program which is not amenable to simple, effective marketing is not likely to be promoted by mutual funds and other financial institutions. Thus, an IRA savings program with universal coverage and simple, easy to understand rules is most likely to be successful. The Bentsen-Roth IRA meets these tests.

A success savings program can result in new contributions year after year. According to a recent review of IRS tax return tapes for the years 1982 through 1986 by Prof. Jonathan Skinner, IRA contributions are persistent. Once individuals start contributing to IRA's, they tend to make contributions year after year.

In addition, the analysis show that prior to its discontinuation, the universal IRA was increasingly attracting contributions from lower income tax brackets. The median income of new IRA contributors dropped from over $41,000 in 1982 to $29,677 in 1986. Once adopted, a simple, permanent savings program, such as the universal IRA, creates a recurring pattern of saving which, although most prevalent initially at the upper income brackets, develops rather quickly among lower brackets as well.

I would like to thank the members of the committee for the opportunity to testify. I would be pleased to answer any questions.

[The prepared statement of Mr. Fink appears in the appendix.]

Senator DASCHLE. Thank you very much, Mr. Fink.

Mr. Roberts.

STATEMENT OF PETER A. ROBERTS, CHAIRMAN, COLLEGE SAVINGS BANK, PRINCETON, NJ

Mr. ROBERTS. Yes. Thank you. I would like to thank the members of the committee for giving me this opportunity to discuss the role that the private sector can play in concert with the Federal Government to increase the rate of saving, and in particular, saving for a college education.

Briefly, I am chairman and chief executive officer of College Savings Bank, a New Jersey chartered, FDIC-insured savings bank located in Princeton. I am also the inventor of the patented CollegeSure CD, America's premier college cost pre-payment product. College Savings Bank has depositors in all 50 States, and in 15 foreign countries.

My comments today are directed to S. 612, the Savings and Investment Incentive Act. This initiative is aimed at increasing the rate at which American families save. Encouraging savings, and in particular, encouraging saving for education expenses, are critical to ensuring that our children will not be denied the opportunity to attend college due to a lack of financial resources. College Savings Bank endorses this initiative.

As college costs soar, more and more families are struggling with the task of planning how to finance the cost of their children's college education; a cost that threatens to escalate beyond their reach.

The gap between college costs and family savings is widening at an alarming rate. The rapidly widening gap is caused by the simultaneous decline in the savings rate, coupled with the very high rate of college inflation.

Within the past decade, tuition fees and room and board at public and private universities more than doubled, up over 100 percent, outpacing personal income growth, and eclipsing personal savings per capita, which increased only 32 percent.

It now takes approximately 11 years of total savings—not merely college-dedicated savings—for the average family of four to send their two children to a private university. Furthermore, only 50 percent of families with college-bound children are saving to meet that need.

Surveys have repeatedly found that most families recognize their responsibility toward providing for their children's education. Saving for college ranks one or two among parents who expect to send children to college. However, with the upward trend in college costs continuing, even those families who save need effective savings incentives to help them reach their college savings goal.

College Savings Bank is dedicated to assisting families save for college. We have conducted extensive investigation and research into how people save for college and what motivates them. Now approaching our fifth year of service to college savers, our customer base provides us with a good view of who saves for college.

As observed by College Savings Bank, college-savers are younger and have less income than retirement savers. More than 50 percent of college savers are under 40 years old, and greater than 40 percent have household income of less than $50,000 per year.

We expect these families will save for college over an extended period of time, contributing approximately $1,600 per year to a child's account. Our savers are primarily parents, although we do find grandparents participating in providing funds to grandchildren. These families genuinely are small savers.

However, not everyone saves for college. Our marketing efforts have revealed any number of reasons for not saving. For example, one reason that many parents do not save is because they suffer from a phenomenon we call "enormity paralysis."

That is, when confronted with the high cost of college today, and projected future college costs, parents oftentimes are discouraged from beginning a savings plan because of the daunting nature of the problem.

The tax incentives provided by the Super IRA will increase the college saver's after-tax return on investment, thereby giving real hope to savers that their savings goals are attainable.

As affordability becomes apparent, sticker shock will diminish, and more families will start saving for college. The Super IRA is a well-designed savings incentive. The Super IRA permits college savers needed investment flexibility. It also encourages the private sector to develop appropriate college savings products and to stimulate thrift.

By effectively making a broad range of investment products tax advantaged to college savers, the Super IRA maintains a level playing field for all market participants, and avoids the market-damaging effects caused by exclusively placing subsidies on any one particular product.

It can provide savers with a wide range of investment choices, reach a broad spectrum of eligible families, and create a competitive and innovative marketplace that will maximize the nation's savings rate. The increased savings rate also will have a salutary effect on the stability of the banking industry.

Today's investment in this initiative will reap substantial rewards in the future, including a better educated, more productive work force.

College savings is one area where individuals can see the benefits of saving; an area where there is a shortage of savings. Therefore, it is an area where savings incentives are most needed and can be most effective.

The Savings and Investment Incentive Act of 1991 produces a dynamic partnership of Federal and private sector resources in order to encourage families to save and strengthen our future.

I urge the committee to approve S. 612, and I thank them for allowing me to testify today.

[The prepared statement of Mr. Roberts appears in the appendix.]

Senator DASCHLE. Thank you, Mr. Roberts. You must have timed that just perfectly.

Ms. Mohr.

STATEMENT OF MARY L. MOHR, PAST PRESIDENT AND MEMBER, LEGISLATIVE COMMITTEE, RETIREMENT INDUSTRY TRUST ASSOCIATION, DENVER, CO

Ms. MOHR. Good morning. I am Mary Mohr, president of First Retirement Marketing of Denver, CO. I am also a founding member and past president of the Retirement Industry Trust Association. Thank you for the opportunity to be here today. I would ask that my complete position paper be submitted for the record.

Senator DASCHLE. Without objection.

[The prepared statement of Ms. Mohr appears in the appendix.]

Ms. MOHR. In 1981 when the U.S. Congress voted to pass the Economic Recovery Tax Act, the expanded eligibility of the IRA represented a significant promise to American workers.

It was the Federal Government's promise to encourage and to assist those working Americans who wanted to accept responsibility for their own financial future, and it was a commitment the American public took quite seriously. They contributed over $170 billion to their IRA's from 1982 to 1986. Up to 80 percent of those contributions were new savings, not assets switched from other accounts.

More than two-thirds of the 1986 tax returns with IRA contributions showed adjusted gross incomes of less than $50,000. Americans had acknowledged the unreliability of future Social Security, Medicare, and pension benefits.

They understood the importance of long-term saving and recognized that for many of them the IRA represented their best—if not only—opportunity to save.

Now, 10 years later, the promise has been broken. The Tax Reform Act of 1986 curtailed IRA deductibility for the majority of plan participants, causing contribution levels to fall in 1987 by 62 percent, or $23 billion.

Working Americans who once hoped that the IRA would be their road to a comfortable retirement now find that they have fewer saving options and more constraints than ever before. For example: longer retirement. Retirees reaching age 65 can expect to live on average another 16.7 years. Inflation: at a 5-percent increase each year, in 20 years, today's dollar will be worth 38 cents. In 30 years, only 23 cents. Health care: it is estimated that health care costs are rising at close to 20 percent per year and fewer companies can afford to provide health insurance for retirees.

Aging parents: today, 60 percent of the elderly are dependent on their children for support. In 20 years, the number of people over 85 will have doubled to 6.6 million. Education expenses: many of today's families put off having children until they are in their thirties and forties. They will be paying for education expenses at a time in their parents' lives when their parents were saving for retirement.

More savings are needed. At least 80 percent of a worker's current income will be needed each year to maintain their standard of living during retirement.

Lower Social Security and pension payments: retirement benefits are expected to replace only 45 percent of the average married person's pre-retirement income. Surveys have shown that Americans know that they are not saving enough for retirement, and would welcome restoration of the IRA as a measure to promote personal saving.

The Retirement Industry Trust Association, on behalf of its clients and all Americans, endorses S. 612 as a measure to promote long-term saving and to meet the retirement, health care, and education needs of Americans.

The Retirement Industry Trust Association was founded 5 years ago in response to the curtailment of the IRA. It represents 12 corporate members that monitor assets in excess of $22 billion for close to 1 million taxpayers.

RITA members perform a unique function in the financial services industry. We are specialists in keeping track of retirement plan assets. Because we are independent of any financial company that generates products—as many of my fellows on the panel—our clients are able to invest their retirement funds in a wide variety of products; Stocks, bonds, mutual funds, CD's, public and private limited partnerships, real estate, and stock.

The Retirement Industry Trust Association's unique leadership role in the industry requires that it speaks out on key issues affecting our members and clients. That is why we are endorsing most of the provisions of S. 612.

However, our association would like to recommend that rather than allowing penalty-free distributions, the funds be loaned to IRA participants, similar to the way loans are already made available in qualified plans. The IRA could then be maintained as a long-term retirement savings vehicle, even when funds are made available for shorter term purposes.

Finally, there were 76 million people born in the United States between 1946 and 1964. In 20 years, these baby-boomers will be within retirement age. That leaves 20 years to save not only for retirement, but for all the other intervening expenses, including home ownership, children's education, and health care.

The urgent need to save is clear. It is time for Congress to renew its promise to the American people and restore the IRA as a savings incentive.

Thank you.

Senator DASCHLE. Thank you, Ms. Mohr.

Mr. Sebastian.

STATEMENT OF EDWARD JOHN SEBASTIAN, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, RESOURCE BANCSHARES CORP., COLUMBIA, SC, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION, WASHINGTON, DC

Mr. SEBASTIAN. Thank you. The American Bankers Association is pleased to support S. 612 legislation to restore the universal availability of the tax-deductible individual retirement account, to improve the IRA by providing the special IRA option, and to allow taxpayers to make penalty-free withdrawals for certain purposes.

From our experience, these new options will make IRA's a more attractive savings vehicle, and encourage a nationwide growth in savings that will benefit our economy.

At Resource Bancshares and Republic National Bank, our customers are conservative, hard-working, middle Americans. Although the average household income in the small communities we serve is less than $21,000, the pride of small-town America is stronger than ever; we have tapped that pride by encouraging savings with our "Steady Saver" account. The customer contracts with the bank to put aside a special dollar amount each month for a set number of years. Currently we have customers putting aside $25 or more per pay period for 2, 3, or 4-year commitments.

We have been surprised by the level of acceptance with our "Steady Saver" product. It took us 9 years to reach our current number of IRA accounts, but in less than a year, we have opened 20 percent of that number of "Steady Saver" accounts.

The customers in our smaller communities have signed up for this savings plan at a rate 35 percent greater than customers in our higher income markets.

The key to our success has been the simplicity of our "Steady Saver" account, primarily in the application process. Despite the success of our program, we have found that most Americans are out of the savings habit. Many Americans equate saving money with taking cash out of circulation, and so fear that saving is bad for the economy.

The way to counter this misunderstanding is to make savings a national priority, to re-educate Americans that savings is good for the economy. The Bentsen-Roth Super IRA, which provides tax incentives for savings, should be the cornerstone of this new campaign.

The Super IRA appeals to potential savers with varied goals and capacities to save. The up-front deduction for the traditional IRA will appeal to many taxpayers. The special IRA option, which converts earnings on contributions from tax-deferred to tax-free after 5 years, will appeal to new savers. The safety net exemptions provided will allow more middle Americans to save.

We believe that the penalty on withdrawals until age 59½ is a major barrier to IRA participation for the average wage earner who does not feel confidant that he can afford to lock up his hard-earned dollars for 20 or 30 years.

Bill S. 612 maintains the current $2,000 limit on contributions to IRA's. The $2,000 limit has proven to be high enough to make the IRA an attractive savings incentive for upper income taxpayers.

The new Super IRA program can also be promoted as a grass-roots, middle America savings plan. Marketing emphasis can be focused on saving smaller monthly increments, with a $2,000 annual cap. Under Republic's current "Steady Saver" plan, our customers can put in as little as $25 per paycheck and begin to help themselves and their community.

The timing could not be better for launching a national savings campaign. Enacting the Super IRA would assist in beginning another period of sustained growth for the U.S. economy.

Enacting the Super IRA legislation to restore IRA availability to all taxpayers while expanding its flexibility, and providing the option of the special IRA which converts tax deferred earnings to tax-free earnings after 5 years, should be the first step in launching a new national campaign to "Save America."

Thank you.

[The prepared statement of Edward John Sebastian appears in the appendix.]

Senator DASCHLE. Thank you for an excellent statement, Mr. Sebastian.

Ms. Rearick.

Ms. REARICK. I do not have a statement. I am accompanying Mr. Sebastian.

Senator DASCHLE. All right. Let me ask a question. Obviously there are two features here that encourage those who participate to save. One is the up-front feature, and the other is, of course, the tax advantage in drawing it out at the end. I would be interested in this panel's observations as to the value of each of those tax advantages.

Which, in your view. would have a greater impact on a prospective investor as he considers an IRA? Is it the up-front savings, the up-front tax savings achieved by deducting immediately, or would it be in drawing out the tax-free benefits after he has met the minimum requirements? Does anybody wish to express themselves?

Mr. Steffens.

Mr. STEFFENS. Senator, yes. We have done two surveys. One we did on our own, and one we did with the Gallup organization. And once it was explained—and I think a certain amount of education about the tax-free buildup piece would certainly be required—53 percent of the people that we surveyed felt that they would want to take advantage of the tax-free buildup.

I think that as people begin to understand the positives of that buildup, the average individual would see the benefit of building a pool of accessible retirement dollars that would come out tax free.

Senator DASCHLE. I suspect, judging from past experience, that the marketing of IRA's has been related very directly to the immediate gratification one obtains in tax advantages up front. But, as you say, if one would calculate the advantages over a longer period of time, if one could look that far—we are not oriented in that direction in this country very frequently—but one could see the obvious benefits over a longer period of time of the back-ended tax benefit. Anyone else have a thought on that? Yes, Ms. Mohr?

Ms. MOHR. In the Retirement Industry Trust Association, we conduct annual surveys to calculate 5498s, which is the method of making contributions, and we calculate those across member firms.

In 1986, 36 percent of our clients made contributions to their plans. In 1989, it fell to a little over 10 percent. So, in such a short period of time, we went from one out of three making contributions to one 1 of 10.

It is our belief—because we service not only stock brokers, we also service financial planners; a cross section of financial intermediaries—that the front-end deduction is by far the incentive that Americans need to save.

Senator DASCHLE. Mr. Sebastian.

Mr. SEBASTIAN. I think if we want to talk about starting a new campaign for savings, we need to go to the grassroots of America, and that is the small communities.

We want to attract all those people who, when they hear $2,000, think that is the level they need, instead of the $25 or the $30 per paycheck.

And the household income of these people in small town America—this is two or three people working per household—is less than $20,000.

They cannot afford $2,000, so they have to think in increments of $25. They are most concerned about getting that money if they have a hardship. They are not filing long form tax returns, they are taking standard deductions anyway So, their most important concern is can I get my money back in a short period of time, not 20 or 30 years. If they could get this money back in 5 years for hardship purposes, I think we would see a grassroots savings increase throughout the entire United States; something we have not had since the 1950's.

Senator DASCHLE. Do you have any recommendations on how one would define "hardship?"

Mr. SEBASTIAN. I think we could define hardship very similar to a 401(k) plan, or one of the defined pension trust plans.

Senator DASCHLE. Use the 401(k) definition of hardship?

Mr. SEBASTIAN. Sure. Medical, housing, unemployment.

Senator DASCHLE. Did you have a comment, Mr. Roberts?

Mr. ROBERTS. I had a comment on the preference of a back-end versus a front-end IRA. We speak to college savers, and one of the original attractions of an IRA was you got to take a deduction when you were in a high income tax bracket, and then withdraw the money when you were retired and in a lower income tax bracket. The reverse is true for college savers. They oftentimes start saving when they are in a lower tax bracket, and then withdraw the money when they are in their highest tax bracket.

So, although I agree with Mr. Steffens that a significant educational process would be necessary, the back-end IRA has a number of attractions to college savers.

Senator DASCHLE. Let me ask you one last question. Do you find that once they begin to develop a savings habit it continues; that these habits are sustained? Anybody wish to address that?

Mr. Steffens?

Mr. STEFFENS. Senator, yes. What we have seen is there has been a significant consistency in people putting money into IRA's. I think that consistency is a very important part of having a program such as this where they could depend upon it for a significant period of time.

Senator DASCHLE. Yes, Mr. Fink?

Mr. FINK. Senator, in my written testimony I quote from Professor Skinner, who studied the IRS tapes, and he found that the IRS data for 1982 through 1986 "suggests the probability of contributing to an IRA, given involvement in the prior year, was over 80 percent during the period of 1982 through 1986," which suggests that there is a habit. Once people start, there is an 80 percent probability of future year contributions.

Senator DASCHLE. Very well. Yes, Mr. Sebastian?

Mr. SEBASTIAN. I have to say from our experience, that is true in almost all types of savings plans. If you can get a person to commit to do $5 a week, or $25 a pay period, they will learn to budget as though that amount eliminated from their salary. That is why 401(k)s have been so great, but in small-town America, we do not have companies that can afford to have 401(k)s.

Senator DASCHLE. Well, this has been an excellent panel. I only wish many of my colleagues would have had the opportunity to participate, but I can assure you we will share this information with all of those on the Finance Committee. We thank you for your presentations, for your expert testimony, and for sharing your thoughts with us.

With that, the hearing stands adjourned.

[Whereupon, the hearing was adjourned at 12:26 p.m.]

APPENDIX

Additional Material Submitted

Prepared Statement of Paula G. Baker

Like many American families, my husband and I are concerned that we are not saving enough of our income. With frequent military moves, which always end up costing us $2,000-5,000 out of our pocket, and college tuitions for three children on the horizon, I felt I needed to go back to work at least part-time. Last year when our youngest child started preschool, I started teaching part-time at the same preschool. The salary was very small, $1200, but since we both went to the same location, I did not need to make day care arrangements. This situation enabled us to deposit each of my paychecks into our savings account. We were pleased to see the account grow, along with some other investments that we had made (a mutual fund, a money market fund, savings bonds and some stock, and a mutual fund and a C.D. designated as our IRA). All our investments were paid for by squeezing out what we could from our moderate income—there are no trust funds or family monies involved.

It was a shock to find out that since the $1200 I had made put us over the $50,000 limit to deduct our IRA, the tax consequences of this $1200 just about equalled my salary! My husband is a Lieutenant Colonel in the Air Force. With the Desert Storm emphasis on all aspects of military life, it was ironic to note that the salary he earned, which the country now realizes is far below that earned in a comparable civilian position, is considered too "wealthy" to claim an IRA deduction.

Nobody expects to get rich by serving their country in the military, yet suddenly we are considered too "wealthy" to provide for our own future. As the system stands now, there is no incentive to save. As we get older, what little we have been able to save on our own (and pay taxes on) will be rapidly depleted forcing us to rely more heavily upon already overburdened social programs in order to maintain a minimum standard of living.

Further, a military member is considered to have a vested retirement plan for the purposes of establishing the deductibility of the IRA. In actuality, if the member separates from the military before 20 years, he gets no military retirement with the almost yearly attacks on the military retirement system, there is no assurance that military retirement will remain intact when my husband becomes eligible for retirement.

In 1989, even before I began working part-time, our IRA was non-deductible. My husband received a small Aviation Continuation Pay (ACP, or the pilots' bonus) that year, which along with our investments, brought our income over the $50,000 limit. The bonus was paid in two installments in January and October of 1989. This spread the payments over two fiscal years, but left them in one tax year. Another example of maximizing our tax liability and minimizing our ability to save.

One doesn't have to be an economist to realize that saving money is good for our economy. If this country truly wants to increase the amount of savings in order to, among other things, generate cheap capital for businesses and stabilize the current economic downturn, we need to reapply the same incentives the original IRA legislation assured the American taxpayer.

In summary, I feel that we need to make the IRA universally deductible. Furthermore, we need to realize that some groups of people, such as the military, are not so easily labeled as "having a retirement plan" or "not having a retirement plan." Just as importantly, we need to find a way to eliminate the bookkeeping nightmare that alternating years of deductibility and nondeductibility have produced.

I would like to thank Senator Roth for this opportunity. What a valuable lesson to show my children, that even in a country as large as ours, a single citizen's voice can still be heard. I appreciate the opportunity to appear before this distinguished committee and welcome any questions you may have.

Prepared Statement of Judith N. Brown

The American Association of Retired Persons (AARP) appreciates this opportunity to comment on S. 612, the Savings and Investment Incentive Act of 1991. The Association is concerned about safeguarding the retirement income security of today's workers and retirees. Stagnating pension coverage and increasing longevity are making saving more critical than ever—both for individuals and for the nation as a whole.

BACKGROUND

Increasing saving and investment is critical to the promotion of sustained economic growth, without which our society cannot meet its diverse needs. It is especially critical for the U.S. during the next two decades as we prepare for the retirement of the baby boom generation, which will begin about 2012. During these upcoming years, the baby boom will be in its peak earning years, and its sheer size will present an unprecedented opportunity for boosting the nation's savings rate.

By whatever measure one chooses, the U.S. saving rate declined during the 1980s compared with the earlier post-war period. The personal saving rate (the saving done by households) declined from an average of 7.3 percent of disposable personal income during the 1960s and 1970s to 5.4 percent during the 1980s. This is attributable to several factors, in particular the stagnation in earnings during the 1980s, making any level of saving more difficult to achieve.

Between 1950 and 1980 national saving (the sum of personal saving, business saving and government saving) averaged between seven and eight percent of GNP, but since 1980 the rate has been about 5.5 percent. During the 1980s more than half of the decline in the saving rate was due to government "dissaving" at all levels. In particular, large federal government deficits averaged nearly three percent of GNP in the 1980s, compared with less than one percent in earlier post-war decades.

TAX INCENTIVES FOR SAVING

Government has long assumed a role in encouraging the act of saving by individuals and corporations. In recent years, some of these inducements have been weakened, either deliberately or inadvertently.

Individual Retirement Accounts (IRAs). Up until the Tax Reform Act of 1986 limited workers' ability to contribute to IRAs on a tax-favored basis, this form of saving was substantial. IRAs were introduced in the Employee Retirement Income Security Act of 1974, allowing workers who were not participating in pension plans to contribute and deduct from income the lesser of $1,500 or 15 percent of income.

The Economic Recovery Tax Act of 1981 expanded eligibility to all workers and raised the amount to the lesser of $2,000 or 100 percent of earnings. Within a year the number of taxpayers claiming IRA deductions nearly quadrupled, from 3.4 million in 1981 to 12 million in 1982. Over the following three years contributions and deductions continued to climb, reaching 16.2 million IRA participants and $38.2 billion in deductions by 1985.

The Tax Reform Act of 1986 curtailed the attractiveness of IRAs for many taxpayers. Workers covered by pension plans but with incomes below $25,000 (for single persons) or $40,000 (for couples) could continue to make fully deductible contributions of up to $2,000 and $2,250, respectively ($4,000 if both spouses work). The deductibility of IRA contributions was phased out between $25,000 and $35,000 of income for single persons, and between $40,000 and $50,000 for couples. However, workers not covered by a pension plan could continue to take the full IRA deduction. In 1987, the first year the restrictions became effective, the number of IRA contributors declined to 7.3 million and total deductions fell to $14.1 billion.

The income limits placed on deductible IRA contributions in the Tax Reform Act are not indexed for inflation, so the number of individuals eligible to make deductible contributions has declined since 1986 and will continue to decline in the future. According to an analysis by the Employee Benefit Research Institute, 65 percent of all workers were eligible for the full IRA deduction in 1987, 58 percent are eligible in 1991, and 52 percent will be eligible by 1995. The income class most affected earns between $30,000 and $50,000. Of this group, 75 percent were eligible in 1987, but only 43 percent are projected to be eligible by 1995.

Pensions. The tax code has played an important role in promoting national saving through the preferential treatment of employer-provided pension plans. As of the end of 1990, private and public pension fund assets in the American economy totaled almost $3 trillion, constituting the largest pool of capital in the world.

Tax incentives have played a major role in promoting employer-sponsored pensions. But after rising during the much of the post-war period, private pension coverage has stagnated in recent years. Coverage reached 50 percent in 1979, but the share of workers with a pension has not increased since then. In addition, new pension plans are increasingly of the defined contribution variety, whereby the individual—not the employer—assumes the risk for the plan's investment performance.

Some analysts attribute part of the stagnation in pension plan coverage to the fact that the U.S. has increasingly mixed retirement policy with tax policy. In the ceaseless search for new sources of revenue, pensions plans have been the focus of a number of tax law changes. Some employers—particularly small employers—have decided they are not worth the trouble. Thus, while the tax incentives have worked up to a point, many believe the cost and constant change are contributing to a leveling off of pension growth, and hence a relative decline in private saving.

MAJOR CONCERNS TO BE ADDRESSED

While recognizing the importance of increasing the national savings rate, the Association believes there are several questions that must be answered in assessing the virtues of reimplementing Individual Retirement Accounts or any other tax incentive savings vehicle.

Effectiveness of IRAs. While changes in the tax law unquestionably have caused the purchase of IRAs to plummet, the relationship between IRA contributions and net national savings is more problematic. Figure 1 shows the trend for 1981-1988 in the use of deductible IRAs and in the personal saving rate. IRA contributions increased steeply after 1981 and then declined sharply after Tax Reform in 1986, while saving declined steadily throughout the period. This does not necessarily mean that IRAs have been ineffective in increasing personal saving. It is possible that the declining personal saving rate in the early 1980s would have been even lower without IRAs. However, this data highlights an important question: whether expanded IRA's would be effective instruments to achieve increased savings.

IRAs can be financed from four sources: shifting existing assets, borrowing, diverting new savings, or reducing consumption. In all four cases there is a revenue loss for deductible contributions, but an increase in net national saving is assured only in the last case. Research findings are mixed on the effectiveness of IRAs in increasing saving. Some studies have concluded that net saving from IRA contributions have been as much as 50-60 percent of contributions, the rest coming from either reductions in other assets or reductions in taxes. Other studies have concluded that IRAs actually reduce saving if more than ten percent of the tax deduction is consumed.

Overall, the effectiveness of IRAs as instruments for creating new saving is unproven. The Association urges this Committee to explore further the effectiveness of IRAs in increasing saving.

Financing. According to the rules of the Budget Enforcement Act of 1990, any legislation that increases entitlement spending or reduces revenues must be fully offset by either spending cuts or additional revenue in the first year and over the full five-year period of the budget resolution. That raises the fundamental question of how to pay for the proposed expansion of IRAs. The Joint Tax Committee has estimated the revenue loss from the Savings and Investment Incentive Act of 1991 to be $25.8 billion over five years.

The Association must reserve any judgment about support for this legislation until the financing is in place and its impact on the deficit is assessed. The sources of financing will ultimately be a major factor in determining Association support for this measure.

Targeting Savings. A third concern is whether the IRA is capable of generating saving among those who are likely to be in greatest need in retirement. Data from the Internal Revenue Service show that a much greater percentage of upper-income persons have benefited from the IRA deduction (see Table 1). Upper-income Americans are the most likely to respond to improved savings incentives. But since the 1970s most other Americans have been just getting by, or even losing ground, so there may be little basis for assuming that more incentives to save will call forth greater saving among those most in need of improved prospects in investment. Perhaps coupling an expanded IRA with improvements in programs targeted to lower-income individuals would address the equity concern, but at yet greater budgetary cost.

IRAs versus other federal priorities. A fourth question is whether restoration of IRAs is the best use of scarce federal funds. In light of all the evidence available, does this policy provide the greatest "bang for the buck," or are there other higher priorities.

1. IRAs versus spending on other programs. In light of the very large demands that will be placed on society to support the baby boomers' retirement, should more resources be targeted primarily at improving the potential productivity of people in poverty, persons with disabilities, and the undereducated. Doing so would help keep down future spending on means-tested programs, while at the same time providing individuals with the opportunity to improve their earning power, tax contributions and ability to provide for their own retirement security.

2. IRAs versus other retirement savings vehicles. In terms of inducing saving specifically to promote retirement income security, would it make more sense to devote resources elsewhere, such as to expanding Simplified Employee Pensions (SEPs). SEPS may be a more effective way of improving savings for those workers who are least likely to be covered by a pension—those working in small businesses (fewer than 100 employees). Currently, only about 25 percent of small businesses have a pension plan. While small businesses are currently able to choose from a variety of tax-favored pension plans, including 401(k)s, profit sharing and Keogh arrangements, the minimal paperwork and reporting requirements of SEPS makes them more attractive to the small employer. Unfortunately, SEPS have not been widely or aggressively marketed, and thus demand has been low.

In addition, the Association believes that proposed liberalization of current IRA rollover rules in another piece of pending legislation will enhance savings. S. 1364, the Employee Benefits Simplification Act, will generally permit employees (or surviving spouses) to more easily roll over distributions from employer-sponsored pension plans to IRAs. In particular, the Association believes the direct trustee-to-trustee transfer provision contained in S. 1364 will significantly improve savings for those least able to save—lower income and younger workers. In general, this provision would *require* a plan, when an employee changes jobs, to transfer amounts above $500 directly to another employer plan or to an IRA.

This effort to promote pension preservation will help retain pension money until it is needed in retirement, thus fulfilling the basic purpose of a retirement plan. One of the major deficiencies with current pension distribution practices is the encouragement of direct cash-outs to employees, who most often immediately spend money that had been set aside for retirement. The Association believes the transfer requirement will significantly increase the pension amounts that will be saved, and will serve as a necessary incremental step towards greater portability of pension benefits. The minimal administrative overhead of this change pales in comparison to the potential for long-term pension savings that should result.

Multi-purpose saving versus saving for retirement. A final concern is whether early consumption of retirement funds undermines the goal of "retirement accounts." The Association generally opposes exceptions to the requirement that funds not be withdrawn without penalty until a specified age. The goal of adequacy of retirement income is diluted by exceptions that permit retirement funds to be consumed prior to retirement.

The Association strongly believes we must not undermine retirement savings, and should remain faithful to the goal of an individual retirement account. Should public policy see the need for additional areas for savings, we should address these areas directly, not raid retirement vehicles.

A number of exceptions are currently under consideration. These include: a down payment on a first home, educational expenses, and significant medical expenses. Particularly in the case of education, but also for medical expenditures, human capital improvements can result in heightened earning power and greater potential to save. In addition, many would argue that purchase of a home is an alternative investment, and that for most retirees the home is the asset with the greatest value.

Each of these uses of funds may be defensible, but what is to prevent the list from growing? A number of good arguments can be made for various legitimate needs. The broader the exceptions, however, the less remaining for retirement income security. We need to be clear about the true purpose of any saving incentive.

OTHER OPTIONS FOR ENHANCING RETIREMENT INCOME SECURITY

1. Increase penalties for cashing out pension funds prior to retirement. The large number of pension cash-outs has undermined the ability of some pension funds to fulfill the goal of retirement income security. Despite tax penalties for early withdrawals, more than one-third of workers who receive lump-sum distributions upon changing jobs spend the entire amount; only 11 percent save the entire amount, while the rest spend some and save some.

2. Encourage more small employers to make Simplified Employee Pension Plans (SEPs) available to their employees. SEPS are essentially IRAs established by an employer for all eligible employees, who are immediately vested in employer contributions. According to a recent Gallup poll about saving for retirement, nearly seven in 10 Americans would prefer for their employer to contribute to a retirement savings plan on their behalf rather than receive the money as current pay.

3. Reducing the Deficit. The biggest and most obvious bias against national saving remains America's large public sector deficit. Reducing the deficit would be a more effective instrument of saving than IRAs, because a dollar of reduced spending is more likely to come at the expense of consumption than is a dollar of IRA contributions. Trimming the deficit should be a savings priority. Efforts to make the American economy more productive at home and more competitive abroad are difficult and complex to pursue. But only by reducing debt will it be possible to begin making a dent in the myriad unmet needs whose persistence undermine the very goals we seek: improved productivity performance and opportunities for increased national saving. The focus should be on producing more in order to generate the higher incomes out of which high levels of saving and investment can be sustained.

CONCLUSION

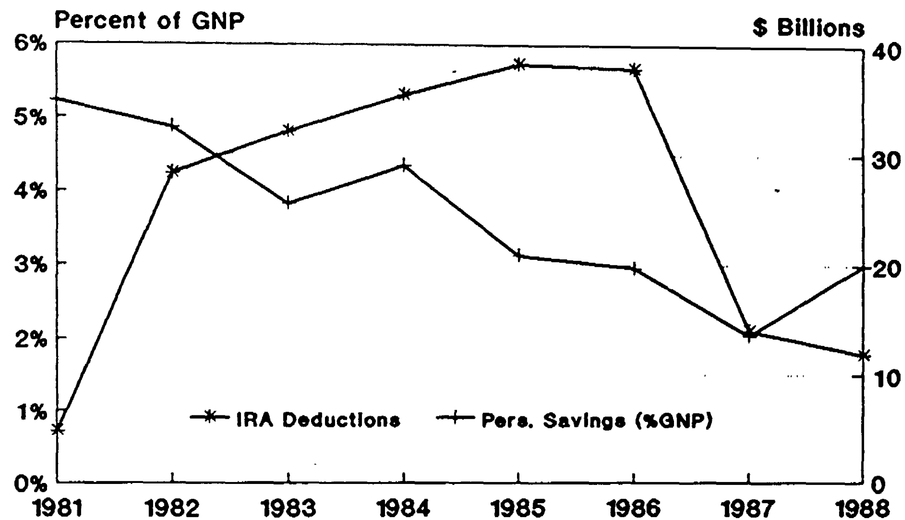
The Association believes savings is critical for both today's growth and tomorrow's retirement security. Tax incentives such as for IRAs can play an important role in improving savings. However, a number of questions remain for any new tax incentives for saving. Primary among these are how such incentives will be financed, and whether that new financing should be directed toward new savings incentives. The Association is pleased to take part in this important debate, and looks forward to further work with this committee to ensure an improved savings rate and particularly increased savings for retirement.

Table 1.—DISTRIBUTION OF IRA PURCHASES BY INCOME CLASS

Adjusted gross income class	Total number of returns	Number of returns with payments to IRAs	Percent of all returns with payments to IRAs
No adjusted gross income	113,354	37,039	33
$1 to $5,000	491,431	132,639	27
$5,000 to $10,000	1,539,403	435,137	28
$10,000 to $15,000	2,627,734	738,610	28
$15,000 to $20,000	3,336,967	1,030,570	31
$20,000 to $25,000	4,037,754	1,288,043	32
$25,000 to $30,000	4,297,779	1,423,249	33
$30,000 to $40,000	7,699,549	2,856,177	37
$40,000 to $50,000	5,922,386	2,486,702	42
$50,000 to $75,000	5,484,120	3,101,528	57
$75,000 to $100,000	1,290,038	971,558	75
$100,000 to $200,000	919,276	793,654	86
$200,000 to $500,000	217,410	190,442	88
$500,000 to $1,000,000	40,173	36,151	90
$1,000,000 or More	16,687	14,032	84

Source: IRS Statistics of Income—1986

Figure 1
Personal Savings as a Percent of GNP and Total IRA Deductions: 1981-1988



Source: Economic Report of the President and Employee Benefits Research Institute
Prepared by AARP Public Policy Institute

PREPARED STATEMENT OF WILLIAM J. BRYON

Mr. Chairman and members of the committee, I am William J. Byron, president of the Catholic University of America, in Washington, D.C. I am here today on behalf of the National Association of Independent Colleges and Universities (NAICU), which represents more than 800 independent colleges and universities, as well as the American Council on Education, the Association of American Universities, and the National Association of State Universities and Land-Grant Colleges. These organizations represent a diverse group of institutions of higher education, ranging from small liberal arts colleges to research universities.

I appreciate the opportunity to address the important role that federal incentives play in a family's decision to save for college, and the concerns colleges and universities share with parents and students about the increasing costs of higher education.

First, I would like to commend Chairman Bentsen and Senator Roth for their leadership in proposing to restore the deductibility of certain IRA contributions. This proposal would also create a new and innovative type of IRA; contributions into these accounts would not be tax deductible, but interest earnings would not be taxed either as earned of upon withdrawal so long as no withdrawals were made for at least five years.

By allowing penalty-free withdrawals from IRAs for college tuition, this plan would provide middle-income families with an effective and convenient mechanism for college savings. (In 1986, 87 percent of Americans who used the IRA deduction on their income taxes made $75,000 a year or less.) In addition, it would be an invaluable vehicle for meeting current tuition bills by allowing parents to use funds from their existing IRA accounts for college expenses without penalty. An important component of the legislation is the incentive provided to grandparents so that they also may contribute toward their grandchildren's college education. Complete restoration of IRAs would also stimulate growth in the personal savings rate among Americans—4.2 percent of disposable income in the first quarter of 1991, down from a post-World War II peak of 9.4 percent in 1973.

Families recognize the importance of sending their children to college. The National Institute of Independent Colleges and Universities (NIICU) and the Roper Organization have surveyed parents' on their attitudes toward planning for their children's college educations. The study revealed that more than three of every four parents with children of pre-college age expect, or at least hope, that their children will attend college. These hopes must be turned into reality. The gap between the incomes of high school graduates and college graduates continues to grow. For example, the difference between the earnings of men with high school diplomas and college degrees has more than tripled since the early 1970s. (In 1970, the median income of a man with a college degree was 39 percent more than a peer with only a high school diploma. By 1988, that gap had grown to 64 percent.)

Parents understand the importance of higher education and saving for college, but they need help in making the savings a reality. In the same Roper poll, fully two-thirds of the parents see themselves as having the primary responsibility for financing college. But when asked if they are currently saving for their children's higher education, only half of the parents with prospective college entrants said yes. And the average amount saved by parents was only $517.

The remaining half who are not currently saving said that they could not afford to do so at this time, but two out of three hoped to save later. Approximately 43 percent of the parents said that they would save more if the federal government provided an incentive for education savings.

In addition, the Roper poll showed that half of the general public would save for the education of someone other than their own child if a federal incentive was available. This broad interest within an extended family in supporting children in their academic pursuits is worth nurturing.

Indeed, students and their families have accepted the responsibility for paying the major portion of expenses at private colleges and universities. NIICU's analysis of the most recent data from the U.S. Department of Education shows that in 1986, 60 percent of all undergraduate expenses at private colleges and universities were paid by students and their families. In addition, even the 65 percent of undergraduates who received financial aid paid one-third or more of their education expenses. And this does not include the loans that they must repay after graduation.

A recent study by the American College Testing (ACT) program explains why more and more parents are asking themselves, "How am I going to afford college for my kids?" The ACT survey found that in the 1987-88 academic year, the average annual cost of a college education—including tuition, books, and room and board—

ranged from $6,000 at a two-year community colleges to $15,400 at private universities. Without financial assistance, the study noted, families need a median income of almost $50,000 to cover a child's expenses at a two-year community college, and a median income of approximately $95,000 for a private university. Comparing these estimates with Census Bureau data on family income, the study reported that only 18 percent of children aged 18 or younger live in families that can afford, out of current income, even the most inexpensive college education at a two-year public institution. Families simply must have help to save for the education of their children.

To assist parents in answering the question of how they can afford college for their children, private colleges and universities are increasingly devoting a larger portion of their institutional resources to assist financially needy and academically deserving students. In 1988-89, independent colleges and universities provided more than $2.6 billion to undergraduates from their own funds, an increase of 540 percent from the $397 million provided in 1970-71. Those schools also provided an additional $1 billion worth of assistance to graduate students that year.

These dramatic increases are a direct response to severe reductions in the availability of federal aid, particularly grant assistance, to students attending four-year colleges and universities. Pell Grant funds to students attending four-year colleges—public and private combined—declined significantly in the 1980s. In order to continue their efforts in reaching out to ever-larger numbers of economically disadvantaged students, these institutions made up the shortfall left by the federal government and directed more of their own money into financial aid. This, in part, has contributed to an increased in tuitions at private colleges and universities.

This commitment of institutional resources has enable students from a variety of backgrounds to attend private colleges and universities. Last year, 30 percent of our entering freshmen were the first generation in their families to attend college. Private institutions enrolled twice as many students from families earning less than $30,000 per year than from families earning more than $75,000 per year. In addition, independent colleges and universities have managed to enroll minority students at the same rate as public institutions—17.7 percent in private colleges and 17.5 percent in public colleges—in spite of our higher tuitions.

Not only has the erosion in federal assistance contributed to the rising cost of providing a quality education, but a host of other factors are involved. These include: skyrocketing employee benefit costs and institutional liability insurance; compliance with new state and federal regulations; rising faculty salaries; renovation of outdated facilities like classrooms and laboratories; and the purchase of expensive state-of-the-art scientific equipment and computer systems.

Financing college must be nationally recognized as a partnership among parents, students, institutions of higher learning, the private sector, and government on all levels. Savings proposals like the Bentsen-Roth plan are a vital element of this partnership.

There are many families that cannot afford to save for their children's college expenses. The federal and state governments must join with colleges themselves in providing financial assistance to these families. The government cannot do it all, however, and families must be encouraged to plan ahead for college expenses. The Education Savings Bond Act, passed during the 100th congress, will make a major contribution to this effort, and will particularly help families who can save a small amount over a long period of time through vehicles like their employers payroll deduction plans. The "Super IRA" plan that Senators Bentsen and Roth are proposing will fill the large remaining gap, and will also address the dreams and aspirations of parents for their children.

The colleges and universities that we represent will continue to seek private funds for scholarships, and we will continue to help needy students by providing financial aid. But we, and America's middle class, do need your help. With the kind of "Super IRA" Senator Bentsen has proposed, we will finally have the opportunity to work as a true partnership—the federal government and the family—to provide the kind of upward mobility and opportunity that many have considered beyond their grasp.

It is a true honor to testify before you today. We sincerely appreciate your leadership and your clear understanding of parents' aspirations for their children.

Prepared Statement of Mona K. Draper

Good Morning, Mr. Chairman and Members of the Committee, I am Mona K. Draper of Metairie, Louisiana. I am a member of the Institute of Electrical and

Electronics Engineers Inc. and currently serve on the Pensions Committee of the IEEE's United States Activities Board.

Since 1976 I have worked in engineering departments for public utility companies. I have experience in data and voice communications systems design; telephony circuit design; econometric, energy and load forecasting; and project management. I have also taught statistics at the University of New Orleans and have published several papers on forecasting I am currently employed in the quality management department of a major public utility.

I sincerely appreciate this opportunity to express IEEE-USA's views on S. 612, the Savings and Investment Incentive Act of 1991.

IEEE-USA'S INTEREST IN SAVINGS INCENTIVES LEGISLATION

The Institute of Electrical and Electronics Engineers, Inc. (IEEE) is a transnational professional technical society whose membership currently includes more than 320,000 electrical, electronics and computer engineers in 130 countries throughout the world. IEEE's United States Activities Board is responsible for promoting the professional careers and technology policy interests of IEEE's 250,000 U.S. members.

Personal savings are a critically important supplement to Social Security and employer sponsored pension plans as a source of income in retirement for middle income Americans. Private savings also represent a major source of the investment capital so urgently needed to increase the nation's industrial productivity and maintain our standard of living.

Unfortunately, Americans are currently saving much less than in the past and a great deal less than the citizens of most other industrialized nations. Over the past few years, personal savings have averaged less than 4 percent of disposable income, down from 6.5 percent during the early 1980s and 8 percent during the 1970's. Primary causes of this decline have been sharp increases in deficit spending by the Federal government and tax laws that encourage current consumption instead of stimulating savings.

IEEE-USA has long been concerned about the importance of personal saving as a source of retirement income for individual Americans as well as a major source of capital needed for productive investment in the nation's economy. For both of these reasons, IEEE-USA actively supported legislation to expand tax incentives for contributions to Individual Retirement Accounts in the late 1970's and early 1980's. We opposed the cut-backs in eligibility to make tax deductible IRA contributions contained in the Tax Reform Act of 1986.

IEEE-USA's current retirement income policy recommendations urge the 102nd Congress to enact legislation to increase pension coverage, particularly among small businesses; to improve the portability of pension benefits when workers change jobs, and; to increase national savings and help to ensure retirement security for all Americans by expanding personal savings incentives, including eligibility to make tax-favored contributions to Individual Retirement Accounts.

Supplemental savings programs, including Individual Retirement Accounts, have been particularly important sources of retirement income for the engineers and scientists who make up so large a part of America's increasingly mobile professional and technical workforce. Although most IEEE members are covered by employer sponsored pension plans, lack of pension portability, particularly from defined benefit plans, means that many of our most mobile members receive very meager pensions from former employers.

The Tax Reform Act of 1986 restricted eligibility to make tax deductible IRA contributions for workers (or spouses) with pensions and incomes over certain thresholds ($25,000 for single taxpayers and $40,000 for married couples). The effect of these restrictions on the general population has been to reduce IRA contributions by nearly 70 percent since 1987. In 1985, fully 25 percent of IEEE's U.S. members maintained IRAs; in 1990, less than 5 percent did.

We are especially pleased therefore, to offer the enthusiastic support of more than 250,000 electrical and electronics engineers and computer scientists for S. 612, the Savings and Investment Incentive Act of 1991.

In addition to support from IEEE-USA, I also bring the endorsement of the Engineers and Scientists Joint Committee on Pensions, a coalition made up of 33 major national engineering, scientific and technical organizations that operates under the auspices of the American Association of Engineering Societies. Collectively, ESJCP member organizations represent some 1.4 million engineering, scientific and technical personnel throughout the United States.

HIGHLIGHTS OF THE BENTSEN/ROTH SUPER IRA PROPOSAL

As introduced by Senators Lloyd Bentsen (D-TX) and Bill Roth, Jr. (R-DE), S. 612 will promote individual savings by permitting all taxpayers to make tax deductible contributions of up to $2,000 annually to conventional "front-loaded" IRAs under the rules in effect prior to the Tax Reform Act of 1986.

Alternatively, taxpayers would be permitted to make non-deductible contributions to a new "back-loaded" IRA under which earnings on contributions held for at least five years would not be taxable as income at withdrawal.

The Bentsen/Roth Super IRA proposal has the added advantage of indexing the $2,000 limit on contributions to IRAs for inflation.

In addition, the Bentsen/Roth Super IRA bill would provide exemptions from the 10 percent penalty tax on pre-mature withdrawals which are used to help pay for a first home, educational expenses or financially devastating medical costs.

ISSUES OF SPECIAL CONCERN

1. Deduction Eligibility Requirements

According to the Washington based Employee Benefits Research Institute, S 612, by extending IRA deduction eligibility to all workers, would increase the proportion of all workers who would be eligible for a $2,000 IRA deduction from 58 percent to 94 percent. It would expand IRA deduction eligibility for 37 percent of all workers in 1991 and for 43 percent of all workers in 1995.

Engineers and scientists, many of whom earn more than $40,000 a year, would be among the major beneficiaries of this change in tax policy. And by allowing penalty free withdrawals for first time home purchases, educational costs and major medical expenses, this bill should help to make IRAs much more attractive as a savings vehicle for younger, middle income Americans like myself.

2. Withdrawal Provisions

To discourage the use of tax-favored IRA contributions for non-retirement purposes, withdrawals prior to age 59½ death or disability are currently subject to a 10 percent income tax surcharge. IEEE-USA is generally supportive in principle of encouraging taxpayers to preserve tax-favored contributions to pension plans and other retirement savings arrangements for the purposes for which they are intended rather than permitting these savings to be spent for other purposes prior to retirement.

At the same time, we recognize the need to afford taxpayers some flexibility in access to as well as uses that can be made of their retirement savings.

As an alternative to penalty free-withdrawals for first time home purchases, educational expenses, and catastrophic medical costs, the Congress may wish to consider low interest loan provisions. Borrowers should be expected to repay principal plus interest, thereby creating additional tax-deferred savings for retirement. Borrowers who are unable to repay such loans would be subject to ordinary income tax on the principal plus a penalty tax

3. Revenue Implications

Preliminary revenue estimates from the Congressional Joint Committee on Taxation indicate that restoring pre-1986 IRA deduction eligibility rules, creating new back-loaded IRAs, and indexing IRA contribution limits for inflation as proposed by Senators Bentsen and Roth will cost taxpayers an estimated $4.4 billion in the first year and upwards of $25 billion over five years.

These costs are substantial, especially in times of spiralling Federal budget deficits and competing demands on limited financial resources.

It is our view, however, that the beneficial effects of the Bentsen/Roth Super IRA proposal far outweigh its adverse short term revenue implications. By stimulating economic growth, creating new jobs, and expanding the tax base this legislation should be viewed as a critically important investment in America's economic future.

Thank you, Mr. Chairman, for allowing me to present the views of IEEE-USA on this important legislation.

PREPARED STATEMENT OF MATTHEW P. FINK

I. Introduction

My name is Matthew Fink. I am Senior Vice President and General Counsel of the Investment Company Institute, the national association of the American investment company industry. The Institute's membership includes 3,288 open-end investment companies, more commonly known as mutual funds, 214 closed-end investment companies and 12 sponsors of unit investment trusts. Its mutual fund members have assets of about $1.185 trillion, accounting for approximately 95 percent of total industry assets, and have over 36 million shareholders.

II. The Institute's Support of the Bentsen-Roth IRA

Mutual funds traditionally have served as vehicles through which investors may channel their investment dollars into the nation's economy through diversified, professionally managed pools of securities. Mutual funds are increasingly provide the investment medium for all types of retirement income programs.

As an industry whose primary focus is on saving and long-term investment, our enthusiastic support of the Bentsen-Roth Savings and Investment Incentive Act of 1991 is not surprising. We do not need to be convinced of the benefits provided to both individual investors and the economy as a whole through long-term saving and investment. Moreover, our experience indicates that the universal IRA, the core of the Bentsen-Roth bill, is the best way to achieve these benefits.

III. The Twofold Benefits of Long-Term Saving

The benefits of long-term saving are twofold. On an individual level, long-term saving promotes retirement security. From a macro-economic prospective, long-term saving is essential to capital formation and economic growth.

While the need for long-term saving in the United States has increased, the rate of personal saving has declined. We share the belief of those in Congress and elsewhere that increased long-term saving through greater personal saving is critically important to our economy and the nation. Moreover, our experience has convinced us that one of the best ways to increase long-term personal saving is through the IRA.

A. IRAs Help Meet the Increased Need for Individual Retirement Saving

Individuals need personal saving to assure their retirement security. Two important trends -- one a change in the private retirement plan system and the other a demographic change -- indicate that the need for long-term personal saving for retirement is increasing.

The impact of these two trends can be described in the context of the symbolic three-legged stool, which is often used as the model to describe the components of individual retirement security. The three legs -- which consist of social security benefits, the private retirement plan system and personal saving are interdependent. To the extent one leg is reduced or weakened, the other legs must bear a greater burden if retirement security is to be assured.

1. The Changing Nature of the Private Retirement System Increases the Need for the IRA

The first factor affecting the stability of the traditional three-legged stool is the metamorphosis occurring in the nature of the private retirement plan system. Available data indicate a wide-ranging trend away from the use of defined benefit pension plans in favor of defined contribution plans as the primary method of providing employee retirement benefits.1/

This shift from defined benefit to defined contribution plans has been well-documented. A recent study by the Pension Benefit Guaranty Corporation (PBGC) states that "[d]uring the 1980s, among workers covered by a private pension, the portion covered primarily by a defined benefit plan fell substantially in favor of defined contribution plans."2/

In another study entitled "The Choice of Pension Plans in a Changing Regulatory Environment", Professors Clark and McDermed of North Carolina State University document the change in the private pension system from the mid-1970s to the present. In particular, they note the increasing reliance on defined contribution plans over the traditional defined benefit plans. According to figures cited by Clark and McDermed, in just the five-year period between 1980 and 1985, the number of primary defined contribution plans increased by 71 percent and the number of participants rose by 83 percent, while in the same period, primary defined benefit coverage showed virtually no growth. Moreover, the proportion of primary plans that were defined benefit plans declined in every sector of the private pension system and in plans of all sizes for this period.

Overall, the statistics showing the growth of defined contribution plans are dramatic. In 1975, only 11.2 million participants were covered by corporate defined contribution plans as compared to 27.2 million participants covered by corporate

---

1/ R. Clark and A. McDermed, The Choice of Pension Plans in a Changing Regulatory Environment, American Enterprise Institute (1990).

2/ R. Ippolito, Pension Plan Choice, 1979-1987: Clarification and Extensions, Pension Benefit Guaranty Corporation (Dec. 1990), p. 1.

defined benefit plans. By 1990, however, approximately 38.5 million employees were covered by corporate defined contribution plans, as compared to only 28.8 million employees in corporate defined benefit plans. Moreover, it is anticipated that by the year 2000, corporate defined contribution plans will have 52.3 million participants with assets of $2.258 trillion, while corporate defined benefit plans will have 29.7 million participants and assets of $1.847 trillion. (See Exhibits 1, 2 and 3 attached) In short, by the end of this decade it is expected that corporate defined contribution plans will have 22.6 million more participants than corporate defined benefit plans, and the assets of corporate defined contribution plans will exceed those of corporate defined benefit plans by more than $400 billion.3/

What is the impact of this trend from defined benefit plans to defined contribution plans? Under a defined benefit plan, employees are promised a fixed level of retirement benefits, typically based on their salary and years of service. The employer rather than the employee bears the risk of the plan's investment performance; annual funding is mandated by law;4/ and, generally, at least a portion of the benefits promised under the plan are insured by the PBGC.5/

By contrast, in a defined contribution plan, the employer promises only to contribute a fixed amount, typically a percentage of salary, to the employee's account each year. There is no specific level of retirement benefits promised or insured, and the employee bears the risk of investment performance. Unfortunately, experience has shown that even when participants can influence or direct the investment of their defined contribution plan accounts, workers tend to be conservative investors and accept lower long term returns in exchange for short term investment stability.6/

The growing dominance of defined contribution retirement plans creates a new uncertainty regarding the adequacy of the support provided by employer-sponsored retirement plans under the traditional three-legged stool model. This uncertainty is further compounded by the second factor affecting individual retirement security, the impact of current demographic trends.

3/ Statistics provided by The U.S. Department of Labor and Federal Reserve Board. Projections beyond 1990 are based on past trends and the outlook for the regulatory and economic environment, reflecting the views of Department of Labor economists. See attached exhibits.

4/ 29 U.S.C. Section 1082 (1985).

5/ 29 U.S.C. Section 1301 et. seq. (1985).

6/ See, e.g., J. Landes, "57% of Employee Savings Plan Assets in GICs", National Underwriter, November 12, 1990.

2. Demographic Factors Affecting Individual Retirement Security Increase the Need for the IRA

Two demographic trends indicate an increased need for individual retirement saving because of their potential strain on the social security leg of the three legged stool. First, future retirees will have a longer life expectancy and hence a longer retirement period than prior generations. Second, it is well known that the increasing cost of maintaining social security benefits must be funded by a shrinking workforce. When the so-called Baby Boomer generation reaches retirement, there will be a greater number of retirees, supported by a smaller workforce than ever before.

The Social Security Administration has warned that it will have a negative cash flow by the year 2015, as the Baby Boomers age.7/ Either future generations of workers will be burdened with higher taxes to support the nation's growing population of retirees or social security benefits will be reduced.

3. Current Retirement Saving Attitudes Are Not Meeting the Challenge

What are Americans doing in the face of this increased need for personal retirement saving? Unfortunately, statistics indicate that they are saving less than ever before. Even though, a decade after they retire, most retirees will need more income than they earned while working to maintain their standard of living,8/ few are meeting this challenge.

An Institute study conducted this year found that, compared to other generations, Baby Boomers seem to have done less financial preparation for the future than other generations. Despite a higher number of two-income families and a considerably higher per capita income than previous generations, their saving rates are lower than the two generations that preceded them. The study found that more than 6 out of every 10 Baby Boomers state that they are not saving for retirement, even though more than half expressed worry about meeting their financial needs during retirement. The financial goals of Baby Boomers tend to reflect short-term needs rather than long-term goals. For example, one-third of those surveyed as part of the study cited home ownership as their chief financial goal; another 14 percent cited education and only 17 percent mentioned retirement.9/

7/ "Retirement Plans That Could Fall Short", Edward H. Becker, New York Times, Sunday, May 27, 1991, p. F.11.

8/ Id.

9/ The Baby Boom Generation: A Financial Portrait, Investment Company Institute, Spring 1991.

4. IRAs Help Individuals Meet the Need for Increased Retirement Saving

The need for increased personal saving for retirement is undisputed. The change in the nature of the private retirement plan market and recent demographic trends reinforce this conclusion. The Bentsen-Roth IRA can help Americans begin to accumulate the retirement income they will need. As Professor Jonathan Skinner indicates in his recently completed study of IRA saving, the best justification for the IRA is its original one: to promote retirement income security. "For the large fraction of families with little wealth beyond their house, IRAs can provide a potentially large source of liquid wealth at retirement."10/

B. IRAs Benefit the Economy By Promoting Capital Formation

In addition to helping individuals meet their retirement needs, long-term saving and investment through the IRA promotes capital formation in the United States. Such saving also makes it easier to borrow domestically. As Professor Lawrence Summers noted quite simply:

> "[a]s a matter of arithmetic, domestic investment can only be financed from domestic saving or from foreign borrowing. Without increases in saving, any increase in investment must come from increased foreign borrowing which means a larger trade deficit. Conversely, any reduction in the trade deficit caused by a change in exchange rates or trade policies reduces the supply of capital to American firms dollar for dollar raising capital costs and choking off investment. Only by raising our national savings rate is it possible to reconcile the goals of increasing investment and reducing the trade deficit."11/

The importance of increasing domestic saving to finance growth in the United States is heightened by potential shortages of capital abroad. Eastern Europe is now beginning the long process of modernization, and Germany has been reunited. Both are likely to draw substantial amounts of new capital. Americans

---

10/ J. Skinner, "Do IRAs Promote Saving? A Review of the Evidence", Skinner/National Bureau of Economic Research, February 1991, p. 37, (hereafter referred to as "Skinner").

11/ L. Summers, "How Best to Give Tax Incentives for Saving and Investment?" Testimony to the Senate Finance Committee, September 29, 1989, p. 4. Hereinafter referred to as Summers.

must increase their saving for capital investment in response to potential reductions in capital investment from abroad.12/

No one denies the beneficial economic effects of increased domestic saving: increased personal saving reduces the cost of capital, contributes to the nation's productivity and thereby enhances international competitiveness. Because the Bentsen-Roth IRA will promote saving and investment, it would benefit the economy in these ways.

IV. The IRA Saving Habit

The mutual fund industry's substantial experience in the IRA market has taught us a very important lesson. Saving incentives work best if the rules are simple and permanent. Frequent changes in law create uncertainty and thereby reduce contributions. These considerations are not only important to consumers, but also to financial institutions when they are considering whether to make long term marketing and administrative commitments.

If investors are uncertain of the conditions under which contributions to a tax-favored arrangement may be made, they may simply opt to make no contribution. Similarly, a saving program which is not amenable to a simple, effective marketing campaign is not likely to be promoted by financial institutions.

The impact of an effective marketing campaign should not be underestimated. Professor Skinner notes that a number of economic studies on IRAs and saving have concluded that marketing plays a role in IRA purchases.13/ For example, Lawrence Summers in 1989 testimony before this Committee stated that "[i]t may well be that saving, like life insurance, is sold not bought."14/ Thus, an IRA saving program with universal coverage and simple, easy to understand rules is most likely to be successful. The Bentsen-Roth IRA has these characteristics.

Once put into place, a simple, universal IRA saving program has a substantial likelihood of producing contributions year

---

12/ See, e.g., The Hon. Alan Greenspan, Chairman, Board of Governors, Federal Reserve System, Oral Testimony to the Senate Finance Committee, May 16, 1991. "There is no question that over time, as these [Central European] economies become more and more oriented towards free markets as, indeed, they are fairly rapidly as privatization continues - there is going to have to be a very large amount of capital investment to bring the infrastructure, the standard of living - which is based on the productivity of assets - up significantly."

13/ Skinner at pp. 33-35.

14/ Summers at p. 7.

after year -- a saving habit. In his IRA study, Skinner reviewed the IRS tapes of tax returns for the period 1982-1986 to reexamine the economic evidence on the effectiveness of the IRA program. He concludes that IRA owners are persistent. Once individuals start contributing to an IRA, they tend to develop the saving habit and make contributions year after year. Skinner states that "[t]he IRS data suggests the probability of contributing to an IRA--given involvement in the prior year--was over 80 percent during the entire period 1982-1986. This finding suggests a core group of taxpayers who rely heavily on IRAs for their saving."15/

In addition to creating a persistent core of IRA contributions, Skinner's study concludes that, before its discontinuation, the universal IRA was increasingly attracting contributions from the lower income tax brackets. Again using the IRS tapes of tax returns, Skinner found differences between those who first contributed in 1982, and subsequent new contributors. In the period of 1982-1986, the median income of new contributors dropped an average of 24 percent, i.e., from $41,277 in 1982 to only $28,677 in 1986.16/ Thus, Skinner concludes that the more recent contributors tended to be more representative of the general population than those who first contributed in 1982.

The results of Skinner's study confirm the benefits of a simple, permanent saving program. Once adopted, such a program creates a recurring pattern of saving which, although most prevalent initially at the upper income brackets also develops rather quickly among lower income brackets as well. The Bentsen Roth IRA would establish the saving habit among all income brackets.

* * * * *

On behalf of the Investment Company Institute, I would like again to thank the members of this Committee for the opportunity to present this testimony. I would be glad to answer any questions you might have.

15/ Skinner at pp. 18-20.

16/ Skinner at p. 15

EXHIBIT :

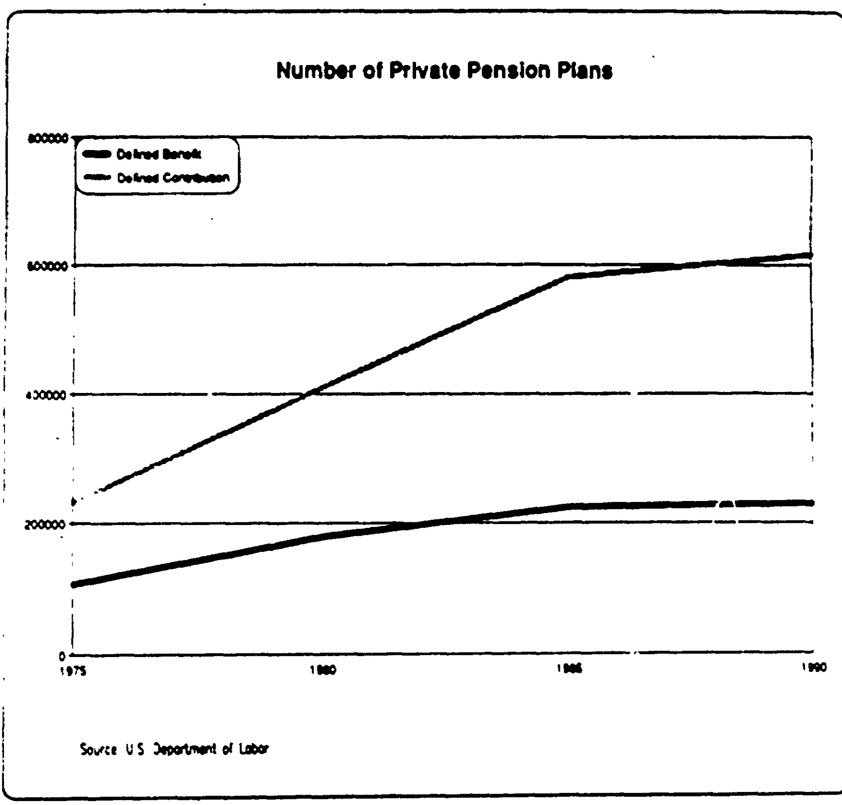
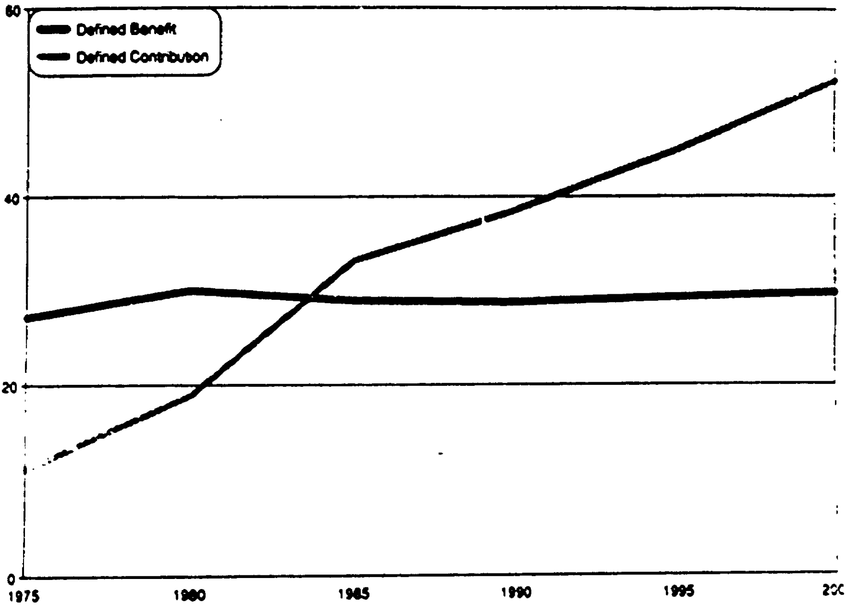

Number of Private Pension Plans
Defined Benefit
Defined Contribution
800000
600000
400000
200000
0
1975
1980
1985
1990
Source U.S. Department of Labor

EXHIBIT 2

Private Pension Coverage
(millions of employees)

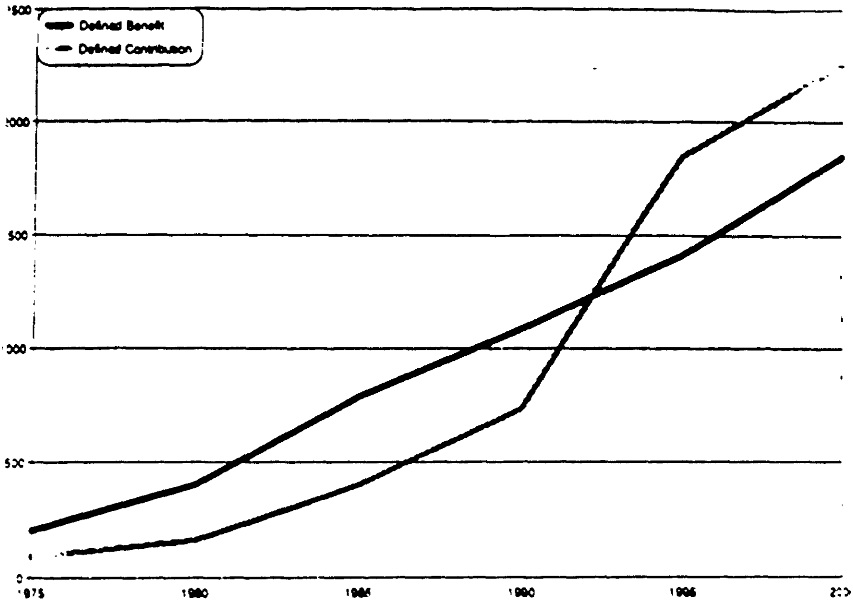


Source: U S. Department of Labor and Federal Reserve Board. Projections beyond 1990 were based on past trends and the outlook for the regulatory and economic environment, reflecting the views of Department of Labor economists.

EXHIBIT 3

Private Pension Assets

(billions of dollars)



Source: U.S. Department of Labor and Federal Reserve Board. Projections beyond 1990 were based on past trends and the outlook for the regulatory and economic environment, reflecting the views of Department of Labor economists.

Prepared Statement of Barbara Green

Good morning! My name is Barbara Green, and I live in Boston, Massachusetts. I am very grateful for the opportunity to appear before the Finance Committee and state why I believe that this bill should become law.

I would like to start by giving you a little of my personal background: I am a secretary and I am married to an electrician. We have been married three years and we have two sons, aged 9 and 10, from my previous marriage. Naturally, we would like to raise our family in a home of our own.

My husband began contributing regularly to the 403(b) plan provided by our employer before our marriage, and he has quite a bit saved up. These funds could provide a major portion of the downpayment on a house. Without the passage of this bill and with the responsibility of two children we may not be able to raise the amount of cash needed. This bill could provide some important relief for working couples like my husband and me who are working toward buying a home. Home ownership is something that Americans have come to expect. This is the way you are expected to live: when you grow up you get a job, you marry and raise a family in your own home. We grew up in homes owned by our families and we want our two sons to have that experience, too.

Real estate prices in the Northeast are quite high. The median home price in Boston according to a recent story in the Boston Globe is currently between $150,000 and $160,000. Most lending institutions require a 20% down payment. Add in the related costs such as mortgage application fees, home inspection fees, legal fees, points and closing costs and you will need between $30,000 and $40,000 in cash to buy that home.

Some lending institutions and government agencies have established first-time homebuyer programs. The catch to these programs is that they exclude families whose income exceeds $40,000.

Many couples like my husband and I didn't get married until we were in our 30s and in the meantime, put money in the 401(k) and 403(b) plans offered by our employers. If we were to withdraw the funds in those plans before we reach age 59½ we would have to forego 90 days' interest and pay a 10% penalty. A IRS form 1099 would be issued and those funds would then have to be declared as taxable income.

This bill would provide some much-needed relief for middle-class couples like us who are seeking a piece of the American dream. I ask that you will support this bill.

Prepared Statement of Vaughn Hobson

Mr. Chairman, no one wants me to save money.

I'm pestered at home by computerized recordings that call me up and tell me they've got a credit card reserved in my name.

Banks don't advertise the interest rates they will pay me for savings accounts; they tell me instead how easy it would be for me to get a home equity loan.

My kids don't hang out on street corners, for better or worse. They're down at the local shopping mall, learning basic consumer skills. I saw a great example of how our children develop their values just a couple of blocks from here—at Union Station. It seems that the station is one of the biggest places in the Washington area for kids to hang out.

Union Station is an architectural marvel and a wonderful place to catch the train. But it's basically a gigantic store, and teenagers who spend time there are eventually going to do what they're supposed to do: spend money.

Every direction I turn, there are people who want me and my family to buy something—preferably on credit. The President's economists tell us we can work our way out of the current recession, if Americans will just open up their wallets a little more and be a little less frugal.

There is no one (except their parents) telling Americans to think about what happens when they retire. We need a mechanism—and we need it soon—to encourage Americans to practice a little delayed gratification.

I don't expect the private sector to come up with the mechanism; they're the ones whose livelihood depends on separating me from as much of my income as possible. Congress and the executive branch are the only entities with the motive and the opportunity.

We need Congress to pass S. 612, which will make IRA's much more attractive. We need President Bush to sign it. And we need a massive publicity campaign to make Americans realize they ought to take advantage of the opportunities this law will give.

We've all seen the figures on our pitiful savings rate. The constant barrage of inducements to buy now and save later is one big reason for it.

But I don't think we're naturally any more profligate than the Germans or Japanese. Americans really do have less "savable" income than they did twenty or thirty years ago. We're strapped, and we need some help.

Congress, as we know, took a look at the savings picture in 1986, and decided to restrict the use of the main government-sponsored savings plan—IRA's. The restrictions generally don't pertain to couples whose combined income is less than $40,000 per year, but I am here today to tell you that the $40,000 ceiling is unrealistic, in the truest sense of the word. It doesn't have any connection with reality.

If both marriage partners are working and making a decent salary, chances are they're exceeding their $40,000 limit. If only one spouse, however, is working in a job that provides a pension, the couple will have to do some real belt-tightening when retirement time comes; they go from two incomes to a fraction of one (plus, in all likelihood social security).

These are just the people who need a IRA's—the hard-working middle-class single-pension worker bees whose combined incomes are between $40,000 and, say, $80,000. But the cards are stacked against them. These families should be putting aside money to supplement the single pension, but our government is discouraging (or at least not encouraging) them.

I've read the articles and columns that maintain IRA's don't encourage saving—they just let people switch their savings from one mechanics, to another. That might even be true.

But the federal government has got to do something to boost the savings rate, as well as counteract the factors that have made us, as an article I read the other day called us, a Nation of Spenders.

We've done IRA's before, and we know they can work. Common sense tells us that, with the new college-tuition and home-purchase provisions in S. 612, IRA's are going to be a lot more attractive for new savers than they were a few years ago.

I heartily endorse your efforts to enact S 612, and hope the House of Representatives and the President will join you in those efforts.

Prepared Statement of Frank Lalli

Good morning, Mr. Chairman My name is Frank Lalli, managing editor of MONEY magazine I am pleased to have the opportunity to appear before you today and present the results of the recent MONEY survey of public attitudes toward reinvigorating the Individual Retirement Accounts.

I'm here today, Senators, to deliver this mail—and the clear message it contains: A surprisingly vast number of Americans from all across this country would pour billions of dollars into savings each year if Congress added the proper incentives to IRAs.

MONEY, published by The Time Inc. Magazine Company, a subsidiary of Time Warner Inc., is the largest financial magazine in the country with a circulation of 1.8 million men and women. In June, MONEY published a one-page questionnaire inviting readers to give us their views on the Bentsen-Roth bill, S. 612, to reduce restrictions on IRAs. Based on several other similar polls of our readers—most notably one concerning the magazine's own proposal for a tax-deferred SAFE plan, the Savings Account for Future Educ tion—we anticipated a highly positive response. But nothing like this.

More than 23,000 readers have mailed us their answers so far. That's well beyond any survey we've ever taken in the magazine's 19-year history. Furthermore, an overwhelming 97% of those who responded said they would contribute to a revamped IRA. And most of the remaining 3% said they would not only because they are already retired. The pollsters who worked with us on the project say a virtually unanimous vote like that is extraordinary even for a self-selected survey such as this one.

Why such an outpouring for this retirement savings plan? I can only guess that our readers are seeing the same headlines as everyone else. They're reading that Social Security may eventually dry up, that giant insurance companies holding millions of workers' life savings are being seized by regulators and that corporations with underfunded pensions are going under. A new IRA that they control, with tax incentives for all, must look awfully good to a great many people right now. In that light, perhaps it's no wonder that our survey respondents under 40 years of age said they expect to depend more on their IRAs for their retirement income than Social Security or company pensions.

Taken overall, the results of our survey tend to rebut five of the most pointed questions IRA critics have raised.

Question No. One: Would the new IRA attract new money, or just siphon off existing savings?

Nearly four out of five of the readers said they would take their contributions *entirely* out of their earned income rather than from existing savings.

Question No. Two: Would restoring the right all working taxpayers had before Tax Reform—the right to deduct IRA contributions of up to $2,000 a year from their income taxes—stimulate much saving now that tax rates are so much lower?

The answer is yes. Despite today's comparatively low rates, tax deductibility remains a powerful lure. Our readers call it far and away the IRA's most attractive feature. Even more telling, 97% of our readers who have not put money into IRAs since deductibility was restricted in 1986 said they would start funding the new accounts.

Question No. Three: Would the proposal to allow early penalty-free withdrawals to pay for first homes, higher education or large medical bills actually undermine the IRA's primary purpose—that is, to build long-term saving for retirement?

Not among the people we surveyed. More than two-thirds of our readers over 40 years of age said they would not be inclined to withdraw any money before retirement.

By contrast, those under 40 were split pretty evenly on the question. However, one could logically argue that a number of those younger people might decide to open their first IRA with an eye toward tapping it early for a home or education only to end up focusing their savings on retirement as they grow older.

Question No. Four: Would the new IRA merely amount to a tax break for the rich?

Although nine out of 10 of our subscribers would call themselves middle-class, most make more than the average American. In this survey, the respondents' median family income was a little over $69,000. It's also true that among those with household incomes of $70,000 or more, virtually every person—99%—said he or she would contribute. So, yes, in that sense, the new IRA would offer a tax break for the relatively rich.

But not only for them. Our survey shows that it would also provide an extremely popular—and more valuable—break for the middle-class. Among those with household incomes of around $40,000 and $50,000—who are largely ineligible to fully deduct their contributions today—some 96% told us they would put money into the new IRA. For the truly rich, the $2,000 annual limit on contributions reduces their tax savings to a comparatively trivial amount of money. Contrast that with more average workers in the 28% bracket earning around $45,000. The $560 tax saving they can get on their $2,000 IRA contribution can make a welcome difference in any year. And in the long run, those contributions, year after year, plus earnings, can have a profound effect on the quality of a family's later life in a country where the typical family reaches retirement age now with a mere $7,000 in liquid assets.

And last, *Question No. Five:* How can this country afford the new IRAs?

Here, unfortunately, our survey does not provide an immediate answer about where the money can be found to finance a better IRA. Still, the respondents did offer up a wealth of potential targets, including eliminating or at least reducing mortgage interest deductions on second homes and on home equity loans. And that long list of tax targets suggests that many of those we polled believe the money can be found.

If I may, on behalf of MONEY magazine, I would add that the money *must* be found to encourage more personal savings, whether it be for the new IRA, our own SAFE proposal or some other idea. We need to take a long-range view and answer that last question with this question: In an age when the far superior savings rates enjoyed by our major economic rivals are sharpening their competitive edge, how can this country afford not to provide the tools to expand our savings pool, drive down interest rates, raise productivity and ultimately enhance our standard of living? Neither MONEY nor its parents take a position on your bill, Mr. Chairman. However, our survey results and our own common sense suggest to us that you're on the right track.

Finally, I would commend to you one other message from our survey on the cost of IRAs. In the thoughtful hand-written letters that many readers sent along with their polls, several suggested a way that the new IRA could help to pay for itself over time—even though it is impossible to quantify it. Emily Graham of Denver, for one, wrote—and I quote—"If Americans had consistent and more accessible tax-encouraged ways to save, I believe many of them would provide for themselves to a greater degree."

Senators, in the end, supporting the achievable self reliance that Emily Graham is describing could give this country the greatest boost of all.

Thank you for inviting me to testify. I would now be pleased to respond to any questions you may have.

PREPARED STATEMENT OF SENATOR FRANK R. LAUTENBERG

Mr. Chairman and members of this distinguished committee, thank you very much for the opportunity to testify today.

Let me begin by congratulating you, Mr. Chairman, for your outstanding leadership, along with Senator Roth, in efforts to expand the availability of individual retirement accounts. I am pleased to be an original cosponsor of your legislation, S. 612, and I fully agree with you about the need to increase our nation's savings rate.

I also want to express my appreciation for your efforts to address another important problem: unemployment, and the inadequacy of our nation's unemployment compensation system. As a supporter of your bill to expand the availability of unemployment insurance, I look forward to working with you for its prompt approval.

Today, Mr. Chairman, I'd like to discuss a proposal of mine, S. 693, that I hope you will see as a logical complement to your two initiatives. S. 693 would allow people who are laid off to withdraw funds from their IRA's or other retirement accounts, without the ten percent penalty that would otherwise apply.

Mr. Chairman, I know I do not have to tell you about the severity of our nation's unemployment problem. Seven percent of the American workforce is now out of work—the highest rate in almost five years. Nearly 9 million Americans cannot find employment.

In most cases, Mr. Chairman, these Americans have been laid off not because they're poor workers, or because they don't try hard enough. They're simply the innocent victims of a troubled economy—of forces larger than themselves.

For those unlucky enough to be laid off when business slows, the experience is often traumatic. There's a sense of rejection and betrayal. There's anger. And, perhaps most importantly, there's fear—fear for oneself, and for one's family.

The fear is understandable. Because, while their short-term employment prospects are often bleak, the unemployed face enormous financial pressures. As mortgage and rent payments come due, and bills pile up, millions of American families find themselves trapped by high fixed expenses, and without a paycheck to make ends meet.

Unemployment insurance can help, but it often falls far short of families' real needs, particularly in areas like New Jersey, where the costs of housing and other basic necessities are unusually high. Even if a family manages to survive on unemployment compensation, there may not be enough to overcome joblessness by relocating, or training for a new job. Compounding matters, in an increasing number of cases, the benefits of the long-term unemployed are expiring.

Yet in some cases, Mr. Chairman, the unemployed do have their own savings in an IRA or other retirement plan. These savings can provide a financial life raft to get through this unexpected financial storm. Unfortunately, it's a life raft with a large hole, because, for those under age 59½, withdrawals generally trigger a stiff, 10 percent tax penalty.

Mr. Chairman, Americans don't believe in hitting people when they're down. And I believe there's something fundamentally wrong with imposing a heavy penalty on those who want to gain access to their own money to cope with unemployment.

The bill I introduced, cosponsored by Senators Bingaman, Inouye, Kerry, Kohl, Levin and Lieberman, proposes to eliminate the 10 percent penalty for people who have been laid off and who are trying to find work. It's targeted to people who need it—those who have been eligible for unemployment compensation for at least 30 days.

I think that's only fair.

Mr. Chairman, while the bill's primary purpose is to provide relief to the unemployed, it also would provide at least two additional benefits.

First, it should increase the savings rate, by encouraging Americans to participate in IRA's and other retirement plans. Currently, many people, particularly young people, are reluctant to tie up their money for decades in a retirement plan. They're concerned, understandably, that their savings would be inaccessible in an emergency, such as an unexpected period of unemployment, without the imposition of a heavy penalty.

Allowing greater flexibility during periods of involuntary unemployment, Mr. Chairman, should reduce this concern. And that should lead to increased savings.

The bill also should provide another indirect benefit. By unlocking savings and injecting money into the economy during periods of high unemployment, the legislation would provide a modest countercyclical stimulus. This would help revive a slow economy to the benefit of all Americans.

Mr. Chairman, you have been an advocate for allowing early withdrawals from retirement plans for specific compelling reasons, such as to pay for college education expenses, first-time home purchases and high medical expenses. I hope you will agree that helping the unemployed is at least as important a goal.

I also want to point out that the cost of my bill is very reasonable. The Joint Committee on Taxation estimates that the proposal would cost $100 million in total over the next five fiscal years. considering the importance of the problem, Mr. Chairman, that's a modest amount. The estimate isn't higher in part because, while the bill would exempt eligible withdrawals from the ten percent penalty, money withdrawn would remain subject to ordinary income taxes.

In sum, Mr. Chairman, this bill would provide relief to the unemployed, increase our nation's savings rate, and provide an automatic stimulus to the economy during slow periods. All at a very modest cost to the Treasury. I hope you will give it serious consideration as the Committee moves forward with the "Super IRA" bill, and other related legislation.

Again, thank you very much for the opportunity to testify.

PREPARED STATEMENT OF DAVID A. LIFSON

Thank you, Mr. Chairman, for the opportunity to testify today on a subject that is of great importance to all American taxpayers. I am David Lifson, chairman-elect of the Individual Taxation Committee of the American Institute of Certified Public Accountants. Accompanying me today is Donald H. Skadden, Vice President - Taxation, of the AICPA. The AICPA is the national professional organization of CPAs, with over 300,000 members.

We compliment the Committee, and you, Mr. Chairman, for your desire to encourage savings and investment by the American public.

The AICPA is not taking a position on the policy question of whether or not the individual retirement account is the most appropriate mechanism for encouraging savings and investment. Rather, we come here today to offer our assistance on the technical aspects of the bill. We applaud your efforts and initiative in exploring ways to encourage savings and investment by Americans. Within the range of government policies influencing productivity and saving, the tax system is pervasive. It has proven an efficient means of providing economic incentives and, hence, can be used either to encourage or discourage saving and investment. However, tax laws are not the sole, or even perhaps the best, vehicle for influencing saving and investment. While non-tax methods would be worthy of discussion, the scope of our testimony is limited to the proposed changes in tax laws. We believe that our suggestions will simplify the legislation and make it easier for taxpayers to understand and easier for the IRS to enforce.

Mr. Chairman, there are problems with the current IRA system, including:

- The IRA is terribly complicated. Different rules apply to different taxpayers depending on the amount of the taxpayer's adjusted gross income and earned income, the amount of the spouse's adjusted gross income and earned income, whether the taxpayer's employer has a retirement plan, and whether the spouse's employer has a retirement plan. The system of deductible and non-deductible IRAs makes for cumbersome and costly recordkeeping, including extra forms to file annually. Those factors make the current system inefficient and very expensive to those who are currently eligible.

- The income limitation and pension plan participation disqualification work in tandem to deprive many who want to contribute to an IRA the opportunity to do so. For example, when both spouses work, if the couple earns $55,000 a year (combined) they may not make a deductible IRA contribution. Frequently, one spouse is an active participant in an employer plan while the other is not. The problem is that many employer plans are not adequate vehicles for saving for retirement. If the employer contributes only one dollar a year on behalf of the employee, or decides not to contribute any money to a profit-sharing plan, the employee and the spouse are prohibited from making a deductible contribution to an IRA.

- The earned income limitation discriminates against non-working spouses.

- Neither the $2,000 contribution limit nor the income phase-out for active participants in employer plans is indexed for inflation. Consequently, each year fewer taxpayers are eligible to participate in a deductible IRA and the real value of the deduction decreases.

- Other problems include a disincentive to save in an IRA because of harsh penalties assessed on early withdrawals, even when hardship requires access to the funds; loss of interest in the program by banks and other potential trustees because of limited eligibility; and a lack of resources to contribute to an IRA by those at whom the current system is aimed.

Your proposal would restore the deductible IRA for millions of Americans and would attack the problems in the current system in several ways:

- It simplifies the rules by applying one set of rules for all taxpayers.
- It eliminates cumbersome requirements to determine whether or not the taxpayer or his/her spouse is entitled to deposit funds into an IRA and claim a deduction.
- It re-establishes what the average taxpayer perceives as the best incentive to save, i.e., current deductibility of contributions.
- It indexes the amount deductible so that inflationary increases in the taxpayer's income will not erode the value of the contribution.

Your proposal also seeks to expand the scope of the nondeductible IRA and to relax the excise tax penalty provisions on early withdrawals.

Some specific comments on provisions in the bill follow.

Section 102 of the bill provides for a cost of living adjustment in $500 increments. We endorse this as an innovative way to simplify an indexation adjustment. It provides inflation relief without an annual change and odd contribution limitation amounts that usually accompany indexation provisions.

The AICPA takes no position on the policy question of whether there should be both deductible and nondeductible individual retirement accounts. If it is deemed desirable to have a nondeductible IRA, we believe the following suggestions would make the proposed system easier for taxpayers to comply with, and for the IRS to administer.

- Inasmuch as many taxpayers would use the nondeductible IRA for purposes other than retirement, it would be more descriptive to call the nondeductible account an "individual savings account" (ISA). This would also help keep the deductible and nondeductible accounts separate, which is absolutely essential for taxpayer compliance.

- The new section 408A(a) provides that the nondeductible IRA "...shall be treated for purposes of this title in the same manner as an individual retirement plan." This could be made more explicit with the addition of the words "under section 219 and section 408." It would be helpful if legislative intent could be made explicit on questions such as: Are the nondeductible IRAs to be (1) subject to the spousal rules at section 219(c)? (2) included in the calculation of excess distributions from qualified retirement plans at section 4980A? (3) included as income in respect of decedent? (4) included in the minimum distribution calculations at section 4974(a)?

- We recommend that the statute include in section 408A(d)(2)(C)(iii) the method for allocating earnings to contributions rather than leaving this decision to regulation writers.

- The definition of "eligible education institution" in new section 72(t)(7) cross-references IRC section 135(c)(3), which in turn cross-references the Higher Education Act of 1965 and the Carl D. Perkins Vocational Education Act, neither of which is readily available to taxpayers or most tax practitioners. It would be helpful if the legislation or the committee report included a more specific definition.

- The definition of a first-time homebuyer in new section 72(t)(6)(C) might provide the opportunity for abuse by taxpayers. One easy form of abuse can be illustrated in the case of a couple married at a time when one spouse owned a home and the other did not. They could then buy a new home in one spouse's name. After a year they would be able to sell the old house in the other spouse's name, therefore qualifying under section 1234 to roll the gain into the basis of the new house. Shortly thereafter, they could even transfer the title in the new home to both names. IRA funds could be used and a "tax free rollover" accomplished in the same transaction. We would suggest the following changes to minimize abuses in this area:

    - limit the use of this provision to a one-time only election to take a distribution from the IRA, similar to the once-in-a-lifetime election under section 121.

    - expand the two-year rule to four or six years, thus preventing many of the potential abuse scenarios for expatriates, recently married taxpayers and others.

    - limit the availability to those situations where neither the taxpayer nor the spouse have owned a principal residence during a qualifying period.

Again, thank you for the opportunity to speak. We hope that our comments prove to be useful. If you or your staff desire further assistance with technical matters in the bill, we would be happy to offer our expertise.

Prepared Statement of Mary L. Mohr

THE IRA PROMISE

With the passage of the Economic Recovery Tax Act of 1981 (ERTA), the United States Congress made a promise to the American people. The expanded eligibility of the Individual Retirement Account (IRA) was a promise to encourage and to assist those workers who wanted to accept responsibility for their own retirement future.

For their part, it was a commitment the American public took quite seriously. It contributed over $170 billion to IRAs from 19.2-1986 [1] and according to some studies,[2] up to 80% of those contributions were "new savings," not assets switched from other existing accounts. And the promise was not just made to the rich; in fact, more than two-thirds of the 1986 tax returns with IRA contributions, showed adjusted gross incomes of less than $50,000.[3]

The public's overwhelmingly positive reception to the IRA was in response to its deepening concerns over the unreliability of future Social Security, Medicare and pension plan benefits. Increasingly, Americans were aware of the importance of long-term saving and recognized that for many of them, the IRA represented their best opportunity to save.

TEN YEARS LATER, FEWER OPTIONS

Now, ten years later, the promise has been broken. The Tax Reform Act of 1986 (TRA), curtailed IRA tax deductibility for the majority of plan participants, causing a dramatic decline in annual contributions. According to the Internal Revenue Service, contributions fell by 62% or $23 billion during the one year period from 1986 to 1987.[4] More importantly, those working Americans who once hoped that the IRA

---

[1] Statistics of Income, 1982 through 1986 Internal Revenue Service.

[2] Steven F. Venti and David Wise "IRAs and Savings" and M. Feldstein (ed.), *Taxes and Capital Formation*, University of Chicago Press (1986a). "Tax Deferred Accounts, Constrained Choice and Estimation of Individual Saving," *Review of Economic Studies* (August 1986a). "Have IRAs Increased U.S. Saving?, *NBER Working Paper. No. 2217*, (April 1987). "The Evidence on IRAs," *Tax Notes*, (January 25, 1988).

[3] Statistics of Income, IRS.

[4] Statistics of Income, IRS.

would be their opportunity to secure a comfortable retirement, now find they have fewer saving options and more constraints than ever before. Over the next twenty to thirty years, they will be faced with a whole array of economic, social and demographic factors that will make saving even more difficult:

—LONGER RETIREMENT: Retirees reaching age 65 could expect to live, on average, another 16.7 years. This may mean living many years without salary income.[5]

—INFLATION: At a 5% increase each year, in twenty years today's dollar will be worth 38 cents, in thirty years only 23 cents.[6]

—HEALTH CARE: It is estimated that health care costs are rising at close to 20% per year and fewer companies can afford to provide insurance for retirees. Medicare is available only after age 65, and then typically covers only half of the health care expenses. Current demands on the nation's health care system also suggest a genuine concern about the future viability of Medicare. "We are confronting bankruptcy in the primary Medicare trust fund within 13 to 15 years unless we take effective action to change the situation," said Health and Human Services Secretary Louis W. Sullivan in April of 1990.[7]

—AGING PARENTS: Today sixty percent of the elderly are dependent on their children for support. In 20 years the number of people over 85 will have doubled to 6.6 million.[8]

—EDUCATION EXPENSES: Many of today's families put off having children until they are in their thirties or forties. These families will be paying for education expenses during their fifties and sixties, a crucial period for retirement saving.

A recent Money magazine article suggests that workers planning to retire should expect to save enough to generate at least 80% of their current income each year to maintain their standard of living. The article indicates that in 1993 Americans age 55 to 64 will have assets of almost $300,000 per household, while workers 35 to 44 will have only half that amount in 1993 dollars, by the time they retire. "The chief reason: because the average savings rate dropped from 7% to 9% of after-tax income in the '70s to as little as 3% during the '80s, though it has recently rebounded to 4.1%," says Clint Willis in the magazine's June 1991 issue.[9]

Social Security and pensions are expected to replace only 45% of the average married person's pre-retirement income.[10] This replacement figure reflects the fact that in just thirteen years existing law will begin to push back the normal retirement age at which Americans can receive full Social Security benefits. These cutbacks apply to all workers born after 1937 and increase for each later year of birth. Few Americans affected by the scheduled Social Security cutbacks are adjusting their personal retirement savings upwards to compensate for the reduction in benefits.

With individual saving declining and retirement benefits becoming less certain, the following analysis indicates just how crucial an effective retirement savings plan may be:

ASSUMPTIONS:

(1) 40 year old with 25 years until retirement

(2) $45,000 per year in current income, projecting a retirement benefit of $3,000 per month (80% of current annual income)

(3) 5% inflation rate

(4) 8% investment rate of return on all savings

(5) Retirement will last twenty years

Without Social Security or pension benefits, this individual would have to:

SAVE A TOTAL OF $1.8 MILLION or, $25,857 EACH YEAR FOR THE NEXT TWENTY FIVE YEARS[11]

---

[5] "Historical Statistics of the United States: Colonial Times to 1970," *Statistical Abstract of the United States 1988*, U.S. Census Bureau.

[6] David Thorndike, Thorndike Encyclopedia of Banking and Financial Tables, Third Edition, 1987.

[7] U.S. Department of Health and Human Services News Release, April 18, 1990.

[8] Statistical Abstract, 1988, U.S. Census Bureau.

[9] Clint Willis, "Starting Out Right," Money Magazine, June 1991, pp. 85-96.

[10] Bruce A. Palmer, "The Impact of Tax Reform on Wage Replacement Ratios," Center for Risk Management and Insurance Research (Georgia State University, 1988).

[11] Karen Meredith, My Generation newsletter, American Association of Boomers, May-June 1991.

A new survey conducted by the Gallup Organization on behalf of Fidelity Investments,[12] indicates that just 35% of the respondents know that it may take up to 80% of pre-retirement income to maintain their lifestyle in retirement and even when respondents underestimate those costs, only one-third feel financially prepared for retirement.

WHY RETIREMENT INDUSTRY TRUST ASSOCIATION ENDORSES S. 612

The Retirement Industry Trust Association (RITA) on behalf of its clients endorses Senate Bill 612 as a measure to promote personal saving to meet the retirement, health care and education needs of Americans.

RITA, a trade association for corporate trustees of self-directed retirement plans, with a concentration in IRAs, was formed in 1987. Our organization represents 12 corporate member firms that monitor assets in excess of $22 billion for close to one million individuals.

The majority of our members are classified as independent trustees, which means that they are not associated with a financial institution that offers investment products. Our members service the retirement needs of individuals as well as the securities industry, financial planners, mutual fund sponsors, banks and limited partnerships. Individual participants select investments, usually with the help of a financial advisor, that meet their long-term financial objectives for retirement. These investments include: stocks, bonds, mutual funds, certificates of deposit, public and private limited partnerships, real estate, promissory notes, privately offered corporate obligations and stock.

RITA conducts an annual survey of member firms to determine the number of contributions made to the IRA accounts that we administer. Our survey results support many of the national findings. Since IRA deductions were curtailed, RITA members have seen a dramatic drop-off in contributions. In 1986, 36.48% of our clients made contributions to their plans. In 1987, contributions dropped to 16.93%, held constant for 1988 at 16.80% and in 1989 fell to 10.47%.

Our members also have found that fewer workers are now eligible for IRA deductions. By 1995, the Employee Benefit Research Institute has projected that only 52% of all workers will be eligible to make tax deductible contributions.[13]

In addition to a decline in IRA participation, our industry has witnessed the demise of small employer qualified plans, due to the increased complexity and cost of plan maintenance and a substantial upsurge in small (Keogh) plan terminations. Ultimately, our clients, along with other working Americans, have found fewer and fewer opportunities to save for a secure financial future.

RITA has a unique leadership role in the industry and therefore, a responsibility to speak out on key issues affecting our members and clients. By offering our enthusiastic endorsement of Senate Bill 612, RITA and a growing coalition of organizations supporting the restoration of the IRA, want to send a clear message:

—We are heartened by the renewed interest of Congress to increase savings.
—We join in supporting efforts to encourage and assist those workers wanting to save for retirement.
—Finally, we ask that members of the Senate vote in favor of the passage of S. 612.

KEY FEATURES OF THE SAVINGS AND INVESTMENT INCENTIVE ACT OF 1991 (S. 612)

The members of RITA have reviewed Senate Bill 612 and are particularly interested in several of its key features:

We are in favor of Sec. 101 *Restoration of IRA Deduction* allowing individuals to make a $2,000 deductible contribution to an IRA without regard to salary level or coverage by other pension plans.

We also support Sec. 101(c) allowing front-end contributions to be deductible for taxable years beginning after December 31, 1990.

We consider Sec. 101(g) *Cost-Of-Living Adjustments* a positive addition. By adding an inflation index, future contribution amounts will allow individuals to keep pace with inflation while adding to their retirement benefits. The $2,000 contribution

[12] A national sample of 724 interviews of working adults age 25 or older, with household incomes of $25,000 or more who were responsible for making the household's financial decisions. Conducted by the Gallup Organization in January and February 1990 on behalf of Fidelity Investments, Boston, Mass.

[13] A new study by the Employee Benefit Research Institute, Washington, D.C. as reported in *Pensions and Investments*, p.26, May 13, 1991.

limit was initiated in January 1982. Today that contribution limit would be $2,700 if adjusted for inflation.

We recognize that the "back-ended" nondeductible IRA contribution provides a reasonable alternative for American savers and investors. This after-tax $2,000 contribution creates a long-term incentive for taxpayers by allowing the entire balance to be withdrawn tax-free upon retirement. Individuals would be able to "lock-in" the tax rate at the time of their contribution, rather than at the time of distribution, giving them a firm understanding of their future tax liabilities.

By giving individuals the flexibility to select between frontend deductible contributions and back-end nondeductible contributions, Congress is repositioning the responsibility for retirement savings to the individual. We believe this policy is favorable given the trend of the future needs of retirees.

The five year hold (Sec. 111(d)(2)) on tax free withdrawals of IRA earnings and contributions in an IRA in order to withdraw earnings tax-free is also a reinforcement of the long-term savings objective in this legislation.

We are not opposed to Sec. 201 that allows individuals access to their retirement fund for first time home purchases, payment of higher education, or financially devastating medical expenses. However, we feel that the savings incentive would be better served if individuals had the option to repay the account for such expenses (by structuring the initial transaction as a loan). Many trustees and custodians already have the infrastructure to handle loans, because they are currently allowed in qualified business retirement plans.

We would encourage an extension of the existing loan requirements to IRAs for the previously mentioned uses, with the IRA plan owner (not the trustee/custodian) verifying that the requirements to take the loan or penalty-free distribution had been met. Loans which are not repaid should be treated as deemed distributions, with the full tax consequences. These additional provisions will stimulate the United States economy and provide valid uses for savings in an IRA.

THE WINDOW REMAINS OPEN—BUT NOT FOR LONG

The economic, social and demographic factors making it so difficult for Americans to save must be addressed and soon. Americans are increasingly concerned that they will not have the income for future education expenses, medical emergencies, economic misfortunes, aging parents and most of all for retirement. Unless saving does increase quickly and substantially, our entire society will soon be burdened with the demands of old age.

There were 76 million people born in the U.S. between 1946 and 1964. In twenty years that segment of the population is projected to be within retirement age.[14] That leaves twenty years to save not only for retirement, but for all the other intervening expenses including home ownership, children's education and health care.

The urgent need for saving is clear. It is time for Congress to renew its promise to the American people and restore the IRA as a saving incentive. RITA appreciates the congressional intent of Senate Bill 612 and enthusiastically endorses efforts to help Americans prepare and save for a more secure financial future.

Exhibit I.—1991 MEMBER DATA

	Total assets	Total Accounts
American Trust Co., Honolulu, HI	$1,400,000,000	4,100
Delaware Charter, Wilmington, DL	8,000,000,000	300,000
EMJAY Corporation, Milwaukee, WI	800,000,000	2,400
First Trust Corp., Denver, CO	5,885,000,000	311,191
Home Fed Bank, San Diego, CA	857,159,228	69,592
Independent Trust Corp., Lombard, IL	115,072,744	5,100
Reliance Trust Co., Atlanta, GA	208,000,000	17,000
Resources Trust, Denver, CO	3,400,000,000	143,000
Retirement Accounts, Inc., Winter Park, FL	550,000,000	20,000
Sterling Trust, Waco, TX	300,000,000	16,000
Transcorp Pension, Laguna Hills, CA	470,000,000	30,000
Trust Co. of America, Boulder, CO	260,402,000	5,100
Total	**$22,245,633,972**	**923,483**

[14] "*Aging of America: Trends and Projections. 1987-88 Edition*, United States Department of Health and Human Services.

EXHIBIT II.—RETIREMENT INDUSTRY TRUST ASSOCIATION

[Member Companies as of July, 1991]

American Trust Company of Hawaii, Inc.
Davies Pacific Center
12th Floor
841 Bishop Street
Honolulu, HI 96813
(800) 367-5210
FAX (808) 523-8120

Bank of Beverly Hills
4005 N. Verdugo Road
Los Angeles, CA 90065
(213) 340-3900
FAX (213) 257-9826

Delaware Charter
P.O. Box 8963
1013 Centre Road
Wilmington, DE 19899
(302) 995-2131
FAX (302) 990-0449

First Trust Corporation
P.O. Box 173301
Denver, CO 80217-3301
(800) 525-2124 or 8188 (outside Colorado)
(800) 233-0407 (inside Colorado)
(303) 293-2223 (Denver)

Independent Trust Corporation
1910 Highland Avenue
Suite 105
Lombard, IL 60148
(800) 258-7878
(708) 916-5300
FAX (708) 916-5320

Reliance Trust Company
P.O. Box 48449
Atlanta, GA 30362-1449
(800) 235-4209
(404) 455-1907
FAX (404) 455-0989

Resources Trust Company
8051 E. Maplewood Ave.
Englewood, CO 80111
(303) 773-9993
FAX (303) 694-1582

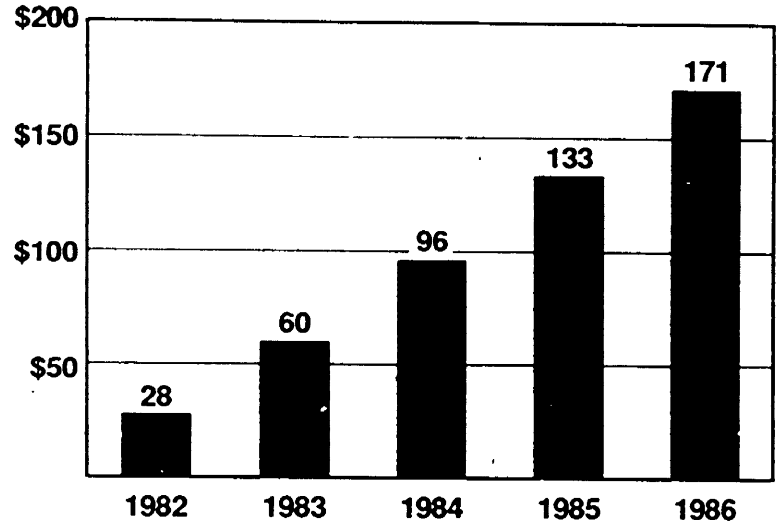
Retirement Accounts, Inc.
P.O. Box 3017
Winter Park, FL 32790
(407) 644-2002
(800) 325-4352
FAX (407) 740-5149

Transcorp Pension
22901 Mill Creek Road
Suite C
Laguna Hills, CA 92653
(714) 855-9105
(800) 228-0336
FAX (714) 855-8479

Trust Company of America
2025 Pearl Street
P.O. Box 8007
Boulder, CO 80306
(303) 449-3300
FAX (303) 449-0102

CHART 1

IRA CONTRIBUTIONS 1982-1986
(Cumulative)

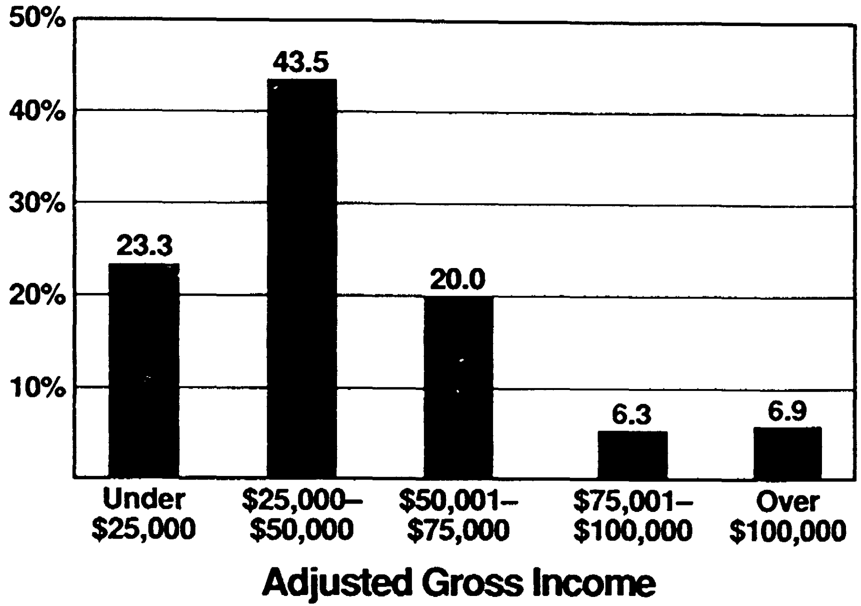


Contributions in $ Billions

Source: IRS Statistics of Income, 1982 through 1986

CHART 2

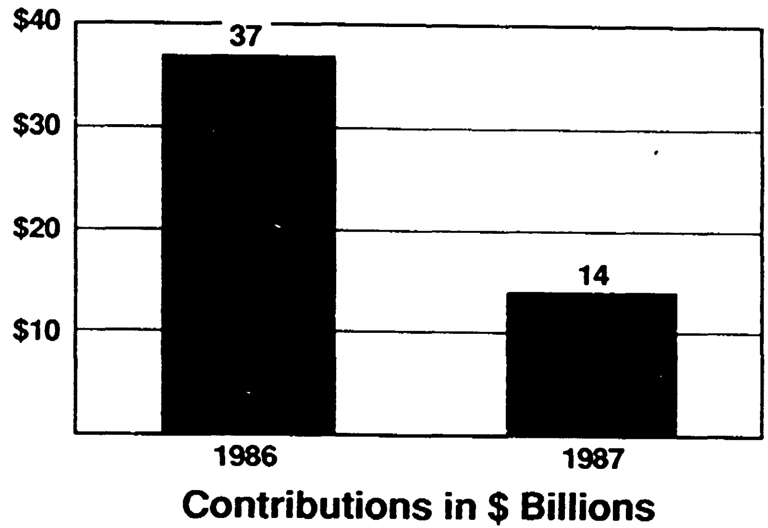
PERCENT OF 1986 TAX RETURNS WITH IRA CONTRIBUTIONS IN EACH INCOME RANGE



Source: IRS Statistics of Income

CHART 3

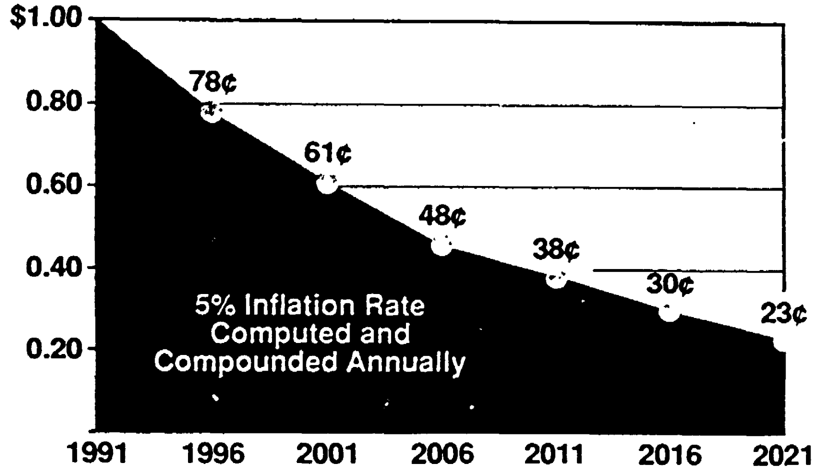
62% DECLINE IN IRA CONTRIBUTIONS FROM 1986 TO 1987



Source: IRS Statistics of Income

CHART 4

DECLINING VALUE OF TODAY'S DOLLAR OVER THE NEXT THIRTY YEARS



Source: The Thorndike Encyclopedia of Banking and Financial Tables, Third Edition, 1987

CHART 5a

SAVINGS REQUIRED TO RETIRE AT AGE 65 WITH $3,000 PER MONTH

For someone with current income of $45,000 per year, 80% or $36,000 per year at retirement will be required to maintain the current standard of living according to Money Magazine (June 1991).

CHART 5b

[illegible] NEEDED TO RETIRE AT AGE [illegible] $3,000 PER MONTH

Current Age	Years to Retirement Age 65	Savings at 65 to Last 20 Years	Amount to Save Annually
30	35	$3,079,245	$17,871
35	30	$2,412,708	$21,297
40	25	$1,890,195	$25,857
45	20	$1,481,007	$32,364
48	17	$1,279,482	$37,911

PREPARED STATEMENT OF PETER A. ROBERTS

I would like to thank Chairman Bentsen and other members of the Senate Finance Committee for giving me this opportunity to discuss the role that the private sector can play in concert with the Federal Government to increase the rate of saving for a college education.

Briefly, I am Chairman and Chief Executive Officer of College Savings Bank, a New Jersey-chartered, FDIC-insured savings bank located in Princeton.

College Savings Bank was formed for the primary purpose of originating and marketing the CollegeSure CD, America's premier college cost prepayment product.

I have provided testimony on college costs and tax incentives to save before the U.S. House Ways and Means Committee, Michigan Education Trust and other governmental bodies. I am the inventor of the patented CollegeSure® CD.

My comments today are directed to the Savings and Investment Incentive Act of 1991 (S. 612). This initiative is aimed at increasing the rate at which American families save. Encouraging saving and in particular encouraging saving for education expenses are critical to ensuring that our children will not be denied the opportunity to attend college due to a lack of financial resources. College Savings Bank endorses this initiative.

THE COLLEGE SAVINGS CRISIS

Most parents feel obligated to contribute toward the cost of their children's college education. [1] But only about half the families who plan to have one of their children attend college are currently saving for college, and the median savings level is under $700 per year. Even among families earning $30,000 or more per year, only 70% are saving for their children's college education, and the median total savings level (e.g. for college, retirement, home, etc.) is roughly $1,100 per year. Those who are not currently saving for their children's college education but plan to do so later expect to start saving when their child is 12 years old, which only leaves six years to save before the child matriculates. [2] Such savings programs are likely to leave families financially unprepared to pay for their children's college education

DIMENSIONS OF THE COLLEGE SAVINGS CRISIS

As college costs soar, more and more families are struggling with the task of planning how to finance the cost of their children's college education—a cost that threatens to escalate beyond their reach. The persistently high rates of college inflation present an imposing challenge. Based on data compiled by the College Board, college costs at private institutions have increased for the decade ended 1990 at an average rate of 9.4% per annum, versus a 5.6% average annual increase in the rate of inflation in consumer prices. [3] Even at the 7.83% rate of college cost inflation for 1990, direct charges (tuition, mandatory fees, room and board) for four years at the average private institution, currently $14,294 per year, would cost a member of the class of 2010 more than $225,000. [4]

Table 1 compares the rates of increase in direct charges at public and private universities to increases in the cost of various consumer goods and services and to changes in the average family's ability to pay for college, as measured by disposable personal income per capita and also by personal saving per capita. During each period, both private university and public university direct charges increased substantially faster than personal saving per capita. Table 1 indicates that the gap between college costs and family savings is widening at an alarming rate. Within the

---

[1] A recent survey found that 66% of the parents interviewed felt they had the primary responsibility for financing their children's college education. Roper Organization, "A National Study on Parental Savings for Children's Higher Education Expenses," National Institute of Independent Colleges and Universities, Washington, DC, August 1984, p. 5.

[2] *Ibid.*, pp. 4, 11. The study found an overall median saving level of $517 per annum and a median saving level of $904 per annum for families with incomes of $30,000 or more. Adjusting these figures based on the change in the consumer price index since 1984 indicates median saving levels of $657 and $1,149 per annum, respectively. Not surprisingly, the study also found that 74% of the individuals surveyed favored some form of tax incentive to promote saving for college.

[3] The college cost inflation figure is based on the annual rate of change in direct charges at private colleges as measured by the Independent College 500™ Index (the IC 500™), which is prepared annually by the College Board. The index is described in "Independent College 500™ Index," College Scholarship Service, New York, July 31, 1990.

[4] The enrollment-weighted average direct charges for 1990-91 at the 500 private colleges that comprise the IC 500 are $14,294.

past decade, public university and private university direct charges more than doubled, but personal saving per capita increased only 32%.

Table 1.—PERCENTAGE CHANGES IN UNDERGRADUATE DIRECT CHARGES, PERSONAL INCOME AND SAVING PER CAPITA, AND CONSUMER PRICES, 1959–1989

	Percentage Change		
	1959 to 1989	1969 to 1989	1979 to 1989
Tuition, Fees, Room and Board:			
Private Universities	791.5	419.3	157.4
Public Universities	500.3	288 3	112.7
Income and Saving Per Capita			
Disposable Personal Income Per Capita	669.4	362.3	94.9
Personal Saving Per Capita	460 9	231.7	31.6
Consumer Prices: [1]			
All Items	326.1	237.9	70.8
Food	321 2	237 2	56.6
Rent (Residential)	247.6	197.1	78.7
Energy	330 6	280 2	43.5
Medical Care Services	696 3	393 0	121.6
All Services	466.1	307.1	95.4

[1] Based on year-to-year changes

Sources *Digest of Education Statistics*, Center for Education Statistics, U S Department of Education, Washington, DC, various issues, and *Economic Report of the President*, U S Government Printing Office, Washington, DC, February 1991, pp 316-317, 351-353

The widening gulf between college costs and college savings is the result of two factors: the very high rate of college inflation relative to price inflation generally and the declining personal saving rate. Table 1 reports that university direct charges have increased substantially faster than consumer prices generally but more or less in line with the rising cost of medical care services, whose sharp rates of increase have attracted considerable public attention in recent years. The pattern of college costs relative to consumer price inflation depicted in Table 1 reflects the longer term historical trend in college inflation. A landmark study authored by William G. Bowen, former president of Princeton University, and presented to the Joint Economic Committee of Congress in 1969 reported that during the three "normal" peacetime periods between 1905 and 1966, direct costs per student increased at an average annual rate of 7.7% per annum, whereas an economy-wide cost index increased at an average annual rate of 1.9% per annum. [5] College educational costs rose more than four times as fast as costs did economy-wide.

Table 2 indicates the deterioration in the personal saving rate that has taken place since the early 1970s. The annual personal saving rate peaked at 9.4% in 1973 and has decreased more or less steadily since then to 2.9% in 1987 and a six-year average of only 4.4% for the period 1984-1989. Reliable direct data concerning saving rates for college are not available. However, because saving for a child's college education ranks first or second for most families who expect to send a child to college, the personal saving trend illustrated in Table 2 is probably indicative also of the trend in saving for college. [6]

A perspective on the seriousness of the deterioration in the college saving rate is provided in Table 2. If the average level of personal saving for a typical family of four were dedicated entirely to paying college costs for the two children, it would take 11.1 years' savings, based on the six-year annual average for 1984-1989, to fund direct charges at the average private university—more than double from the comparable period a decade ago—and 4.0 years' savings to fund direct charges at the average public university—up by 80% from the comparable period a decade ago. But savings are also required for other purposes and college costs include costs in addi-

[5] William G. Bowen, "Economic Pressures on the Major Private Universities," in *The Economics and Financing of Higher Education in the United States*, submitted to the Joint Economic Committee, 91st Congress, Washington, DC, 1969, pp. 399-439. Bowen's study goes on to explain why college cost inflation should persistently outpace consumer price inflation.

[6] The Roper study cited in footnote 1 found that saving for a child's college education ranked as the second most important reason for saving, behind emergencies, but ahead of retirement and other purposes. *Op.cit.*, p. 4.

tion to direct charges, so the situation is more serious than the one depicted in Table 2.

College costs are likely to continue outpacing consumer prices by a wide margin in the future and college savings, if present trends continue, will prove inadequate. Middle income families, who are to an increasing extent finding themselves with insufficient resources to pay the ever-increasing cost of college by themselves but with an overabundance of resources to qualify for financial aid, are likely to be most seriously affected. These families need effective college saving vehicles and appropriate saving incentives to help them reach their college goals.

Table 2.—NUMBER OF YEARS' SAVING TO FUND ONE YEAR'S DIRECT CHARGES

Period	Personal saving rate [1]	Direct charges as percent of disposable income per capita [2]		Numbers of years' saving to fund one year's direct charges [3]	
		Private universities	Public universities	Private universities	Public universities
1959-1963	6 3%	92.0	46.1	7.4	3.7
1964-1968	7.2	91.0	43 1	6.3	3.0
1969-1973	8.0	88.1	41.1	5.5	2.6
1974-1978	8.0	81.4	35.1	5.1	2.2
1979-1983	6 7	83.1	33.7	6.2	2.5
1984-1989	4.4	97.6	35.1	11.1	4.0

[1] Average annual value of personal saving as a percentage of disposable personal income

[2] Average annual undergraduate tuition, fees, room, and board as a percentage of disposable personal income per capita

[3] Average annual direct charges as a percentage of disposable personal income per capita divided by twice the average annual personal saving rate Calculation assumes a family of four with two children both of whom will attend college

Sources. ***Digest of Education Statistics***, Center for Education Statistics, U S Department of Education, Washington, DC, various issues, and ***Economic Report of the President***, U S Government Printing Office, Washington, DC, February 1991, pp 316-317

INCENTIVES HAVE TO BE CAREFULLY DESIGNED

One solution to increasing the rate at which families save for college is to provide tax incentives. However, the tax incentives have to be carefully designed so as to permit college savers sufficient investment flexibility and encourage the participation of the private sector. The Savings and Investment Incentive Act of 1991 (S.612) (the "Act") does just that.

The Act provides incentives for parents to establish Individual Retirement Accounts and Section 401(k) and 403(b) plans (collectively "Super IRAs") to save in part for their children's college educations. Moreover, the legislation encourages the utilization of the abundant resources of the private sector to cultivate thrift among savers.

A collateral benefit of the Super IRA is that it maintains a level playing field for all market participants and avoids the market damaging effects caused by exclusively placing subsidies on any one particular product. It can provide savers with a wide range of investment choices, reach a broader spectrum of eligible families, and create a competitive and innovative marketplace that is necessary to maximize the savings rate in this great Nation.

The Super IRA is a low-cost incentive that delivers an economically efficient savings benefit to the middle class. Today's investment in this initiative will reap substantial rewards in the future including a better educated and more productive workforce that consequently will contribute greater revenues to Treasury. In addition, it mobilizes the substantial resources of the private sector. One test of every initiative offered in the name of progress is whether it is in harmony with sound economic principles. The Super IRA meets and passes this important test with flying colors.

SUPER IRA WILL INCREASE COLLEGE SAVINGS POOL

One of the greatest impairments to saving for college for young parents is "sticker shock." Educators sometimes refer to this phenomenon as "enormity paralysis." When confronted with the high cost of college today and projected future costs, parents are often times discouraged from beginning a savings plan. Even through savings, the high cost of college appears unattainable. Many, rather than face the issue today, procrastinate and sometimes do not save at all. Eventually, they finance their child's college education through student loans. This can in fact further burden the Federal Government.

Tax incentives can help deflate this enormity paralysis. Both the front-end and back-end Super IRA options increase the after-tax return on investment. The higher rate of return makes achieving college saving goals that much more attainable. As affordability becomes more apparent, parents will overcome sticker shock and begin a college savings plan. The increased participation will increase the pool of savings.In addition, the average college saver, as observed by College Savings Bank, is younger and has less income than the average saver (see Exhibit). More than 50% of college savers are under 40 years old and greater than 40% have household income of less than $50,000 per year. These families save for college over an extended period of time (on average 10 years). Most save on a Christmas club-type program. Once an account is established, parents contribute on average $1600 per year. These families can be characterized as genuine small savers.

Tax advantages can be expected to stimulate savings. Most college savers are "entry-level" savers. Tax incentives will encourage more young parents to start saving earlier and contribute more towards their child's education. Furthermore, the Super IRA will be available through traditional delivery systems to the small saver such as banks, credit unions, payroll deduction, etc. In turn, Super IRAs will help financial institutions gather long-term funds, an important element in providing for the stability of the industry.

CONCLUSION

College savings is one area where individuals can see the benefits of saving and an area where there is a shortage of savings. Therefore, it is an area where savings incentives are most needed and can be most effective. The Savings and Investment Incentive Act of 1991 produces a dynamic partnership of Federal and private sector resources in order to encourage families to save and strengthen our future. I urge the Committee to approve S.612.

I thank the Chairman and the Committee for the opportunity to express my views today.

EXHIBIT

Who are College Savers?

Although only half the families with college-bound children save for college, those who do generally are younger and have less income than the average saver. Most are parents with young children. Many own homes.

College Savings Bank has surveyed and profiled its customers. The results were very similar to the results disclosed in a recently published survey on college cost prepayment plans. [7] The highlights of the published survey are detailed below:

	Percent
A—Age of College Saver	
Under 30	4.1
30-39	48 1
40-49	31.2
50-59	7.6
60-69	6 3
70 and over	2 8
Total	100.0
B—Age of Spouse	
Under 30	5.1
30—39	52.9
40—49	28.8
50—59	6 6
60—69	4 3
70 and Over	2.3
Total	100.0
C—Age of Child	
1—5 (Pre-School)	40 8
6—12 (Elementary)	47.4

[7] National Center for Postsecondary Governance and Finance, "Prepaid Tuition Survey," College Park, MD, December 1989.

	Percent
13—18 (Secondary)	11.4
Over 18 (Post-Secondary)	0.4
Total	100.0
D—Combined Income	
Less tnan $24,999	6.2
$25,000 to $49,999	37.4
$50,000 to $74,999	32.2
$75,000 to $100,000	11.9
More than $100,000	12.4
Total	100.0
E—Homeowners	
Yes	95.4
No	4.6
Total	100.0

PREPARED STATEMENT OF HARLEY ROUDA

INTRODUCTION

Good morning Mr. Chairman and Members of the Committee. My name is Harley Rouda. I am the 1991 President of the NATIONAL ASSOCIATION OF REALTORS®. I am a REALTOR® from Columbus, Ohio. The NATIONAL ASSOCIATION OF REALTORS® represents virtually every facet of the real estate industry, including REALTOR® brokers, developers, appraisers, syndicators and property managers. On behalf of the more than 750,000 members of our Association, I want to thank you for holding these hearings and for inviting the NATIONAL ASSOCIATION OF REALTORS® to testify on proposals to restore tax incentives for savings and investment in the Unites States by reinstating Individual Retirement Accounts (IRAs).

The NATIONAL ASSOCIATION OF REALTORS® (NAR) generally supports proposals that increase homeownership opportunities, particularly for those individuals kept out of the market by high interest rates and high downpayment requirements. Accordingly, NAR commends Senator Bentsen for holding these hearings, and commends him and Senator Roth and 75 others for introducing S. 612. The Super IRA legislation takes an important step toward solving the problem of housing affordability that faces our country.

SUPER IRA PROPOSAL

S. 612 is intended to increase the United States savings rate. We believe that the very low savings rate and the decline in the homeownership rate are linked together. Accordingly, we believe that it is critical to reinstate savings incentives into the tax code, and to permit tax-favored savings to be used for further investment in the first-time purchase of a home.

Only through bold leadership at the national level can the savings rate in the United States be improved. Two major components of any plan to enhance savings and investment in the United States are the adoption of broad tax incentives to foster a general climate of savings and tailored incentives that target particular areas of the national interest. We believe that S. 612 achieves both of those objectives. Reinstating IRAs for all taxpayers fosters a general climate that favors savings. The various withdrawal provisions, including the withdrawal provisions for the first-time purchase of a home, are targeted incentives that will have particular benefits for the nation. By reinstating the IRA, by creating a new type of IRA, and, most importantly for our members, by creating a new class of allowable penalty-free withdrawals, we believe that an environment will be created that will encourage young people to begin savings programs at a younger age, and provide them greater opportunities for investing in their futures though homeownership.

S. 612 permits a penalty-free withdrawal for the first-time purchase of a home. This provision not only permits a withdrawal by the purchaser, but also by the purchaser's spouse, parents and grandparents. This provision is critical to helping address the nation's serious housing affordability crisis. This withdrawal feature acknowledges that a home is the central element in the savings plan of most families. Today, more and more young people are being squeezed out of the housing market. This proposal will help these young people solve their most critical problem: amassing a downpayment.

THE HOUSING AFFORDABILITY CRISIS

The decade of the of the 1980s saw a steady decline in the nation's homeownership rate. This decline reversed the 40 year trend since World War II of rising homeownership. During the decade of the 80s, all segments of the population, measured by age groups, demonstrated declining homeownership rates. While the percentage of decline for entire population was fairly small, -- from 65.6% of households in 1980 to 63.9% in 1990 -- this statistic itself translates into more than 2 million families who are unable to realize the American dream of owning their own home. Table 1 presents the aggregate homeownership rates by decade since 1930, and by year since 1980.

The largest declines in home ownership were among those under 25 and, more importantly, among those in the prime family formation years of 25 - 34. Homeownership among these age groups declined by roughly 15% during the 1980s. Today, fewer than half the people in each of these age groups own their own homes. In 1980, more than half of them owned their homes. Table 2 graphically illustrates this decline by age group, and by income levels. As this table shows, every age and income group experienced a decline in ownership.

The National Housing Task Force issued a report in 1988 identifying several factors that have contributed to this precipitous decline in homeownership, especially among younger Americans. These factors included a scarcity of mortgages at affordable rates, rising home prices, (particularly in certain regions), and most importantly, the inability of prospective homeowners to accumulate sufficient savings to make a downpayment on the first-time purchase of a home.

Studies conducted by the NATIONAL ASSOCIATION OF REALTORS® and various industry groups have consistently shown that the single most compelling problem preventing young people from buying a home for the first time is the inability to save enough money to make a downpayment. Price is, of course, a considerable barrier for many individuals. In California, the median price of a home has now exceeded $200,000. In 1970, the median price of a home in California was $24,300. In the first quarter of 1991, the median rose to more than $207,000. This approaches a ten-fold increase in 20 years. Obviously, few parts of the country are as extreme as California, but it is true that family median income has grown much more slowly than housing prices. Throughout the 80s, home prices nationally rose about 115%, while the national median family income rose only about 75%. More significantly, the median incomes of first time homebuyers rose by only 52.3%. All of these statistics carry with them one message: new sources of capital are critical to young families attempting to purchase a home for the first time.

At the same time that housing prices are escalating, rental payments for prospective homeowners are consuming ever-increasing portions of family income. This is most critical for single parent families. Rent for many of these families consumes 60% of family income. During the 1970's, rents for all households consumed about 23 - 25 percent of family income. In the 1980's, this increased to about 40 percent, and is slightly higher today.

The largest pool of capital available in the economy is comprised of pension funds, IRAs and deferred compensation plans. It therefore makes sense to permit first-time homebuyers access to that pool of capital, and to provide incentives to encourage them to expand that pool, as well. Thus, reinstating the IRA is crucial to expanding the pool of available capital, and permitting access to that pool of capital is crucial to expand the class of first-time homebuyers. To assess the need for capital, the NATIONAL ASSOCIATION OF REALTORS® compiles a first time homebuyer affordability index. It is based on a 10% downpayment on a median-priced starter home. While the plight of first time homebuyers has improved since 1982, their incomes are still about <u>20% less</u> than what is currently needed to purchase a starter home and support a mortgage. A new capital source is essential for them.

Tax policy debates in recent years have emphasized income distribution. Table 2 shows the rates of home ownership by income class. Note that in all income classes, the rate of ownership has declined. We can also draw a few conclusions about the distribution of home ownership from IRS statistics of income. In 1987, the last full year for which published data are available, 28 million returns claimed mortgage interest deductions. Two-thirds of those returns were filed by individuals with less than $50,000 in adjusted gross income. About one-fifth of these returns were filed by individuals with adjusted gross incomes below $25,000. Those with less than $50,000 of adjusted gross income accounted for more than half of all mortgage interest deductions as measured in dollars. These 28 million return filers do not represent the entire universe of homeowners, but we believe their performance to be representative. Thus, the benefits of homeownership appear to be experienced in substantial measure by those with less than $50,000 in income.

It is notable, too, that during the years before 1986 in which IRA deductions were universally available, the heaviest usage was among individuals with less than $50,000 adjusted gross income. In 1983 - 1984, over 70 percent of individuals contributing to IRAs had income below $50,000, and more than half (52%) had incomes below $40,000. By contrast, in 1987, NAR research shows that utilization of IRA deductions had declined even among eligible taxpayers with less than $50,000 of income.

WHY A WITHDRAWAL FEATURE?

Some theorists and commentators object to any rule that would permit IRA funds to be used for any non-retirement purpose. We believe it is time to expand the availability of IRA funds, and to make those funds available for the purchase of a home. We believe that using IRA funds to purchase a home makes sense for everyone.

A home is the center of the savings plan for most American families. If the tax code is to be used to encourage savings, we believe that a broad class of incentives should be provided. Accordingly, we wholeheartedly support the reinstatement of the tax deductible IRA, the creation of the new nondeductible IRA, and, most importantly for our members, the withdrawal features that permit individuals to make important investments in their future. An IRA can be a comparatively liquid form of savings. An investment in a home is very illiquid, but is a very tangible form of savings, and is a long-range savings plan that contributes to present stability and to long-term economic growth.

Investing IRA funds in a home is a very prudent savings investment. The data that the NATIONAL ASSOCIATION OF REALTORS® has compiled reveals that the average annual after tax rate of return on housing over a recent 8 year period was 12.2%. Thus, we would strongly contend that the use of an IRA account to acquire a residence is totally consistent with savings objectives. IRAs are intended to operate as savings vehicles. Investing in a growth asset such as a house is consistent with a personal savings plan that focuses on long-term growth.

Earlier this year, the Administration offered a proposal as part of its fiscal year 1992 budget that would permit limited withdrawals of $10,000 from an IRA for the first time purchase of a home, so long as the home price did not exceed 110% of the area median home price. While we believe that the Administration proposal has merit, we find S. 612 superior for several reasons. First, S. 612 does not limit the amount that can be withdrawn from an IRA. Second, S. 612 imposes no limitation on the purchase price of the home that can be acquired with IRA funds. The absence of a restriction on the purchase price improves the effectiveness of this proposal, especially in high-cost-of-living areas. Third, the Administration proposal permits withdrawals only from IRAs. S. 612 permits withdrawals not only from IRAs, but from section 401(k) plans that have been amended to permit withdrawals. The inclusion of 401(k) plans opens yet another avenue of savings to individuals who are fortunate enough to work for an employer who provides such a plan.

We support a withdrawal provision as providing access to capital and as consistent with long-term savings objectives.

WHY PARENTS AND GRANDPARENTS?

S. 612 includes a feature that the NATIONAL ASSOCIATION OF REALTORS® recommended in 1989 and 1990 when similar proposals were debated. We commend the authors of S. 612 for making this important change. The Association recommended that the IRA proposal be expanded to include penalty-free withdrawals by the spouse, parents and grandparents of prospective purchasers. Our studies, together with other research data, have consistently shown that the IRA account balances of prospective homebuyers are small when contrasted with those of their parents and grandparents. Often, the assistance of other family members is required when individuals purchase their first home. Owners of IRAs tend be in age groups older than the principal household formation group under age 35. The typical individual who owns an IRA through a mutual fund, according to the Investment Company Institute, is 50 years old, married and already a homeowner.

The NATIONAL ASSOCIATION OF REALTORS® holds as a fundamental tenet that it is appropriate to expand the class of persons who are homeowners. If older persons tend to own IRAs, and if they tend to already own homes, as well, then they can make the most significant contribution to expanding the class of homeowners. Parents' and grandparents' IRAs should be made available to contribute toward the housing costs of younger family members.

Use of family wealth for the benefit of other family members is acknowledged elsewhere in the Internal Revenue Code. Section 213 permits individuals to deduct allowable medical expenses not only for themselves, but also for their children and dependents. During 1987, following the Tax Reform Act of 1986, mortgage interest deductions were permitted when the taxpayer used mortgage proceeds for medical or education expenses for family members. The personal exemption provisions contemplate that some family wealth should be excluded from taxation as contributing to the support of the family. In addition, tax credits are permitted for the care of children and other dependent family members. Therefore, the NATIONAL ASSOCIATION OF REALTORS® believes that the use of family funds to benefit family members is not inconsistent with current tax policy.

This is especially true if the withdrawn IRA funds will be subject to the income tax. A parental contribution to a child's downpayment would, in effect, be made with after-tax dollars, and should, therefore, be viewed as a legitimate use of family wealth. This is even more true in the case of older persons. About 80 percent of individuals between ages 65 and 69 own homes, while only about a third of the individuals in the 25 - 29 year old age group own homes. Individuals over age 55 receive substantial tax benefits when they sell their homes. If those same older persons made an IRA withdrawal to help a younger family member, the Government would derive some revenue from the transaction. Moreover, there will be an important expansion of the savings rate for the entire family as the first-time home purchaser acquires a home. We believe it is in the national interest to enlarge the pool of homeowners, and believe that homeownership should be widely available to all age groups.

Young people who already have IRAs will not have accumulated large sums in them. Today, given the high cost of housing, large sums are needed to meet the expenses of a downpayment, closing costs, transfer taxes, points and other costs that go along with a purchase. In 1989, the average price of a home nationally was $72,117. A 20% downpayment for such a home would be over $14,000. Even in a state with relatively low closing costs, the first time purchase of a home would require about $15,000 in cash. Young persons thus often require the assistance of family members in making their first home purchase. Accordingly, we believe that it is altogether appropriate for family wealth to be used for this important purpose.

CONCLUSION

We believe that the purchase of a home is one of the most important savings events in the life of any family. Accordingly, we wholeheartedly support the tax incentives embodied in S. 612, particularly those provisions that would permit individuals to make penalty-free withdrawals from their individual retirement accounts for the first time purchase of a home. This proposal, we acknowledge, is not a panacea, but it will make a significantly contribution to helping a large number of Americans begin to participate in the American dream.

Table 1
U.S. HOMEOWNERSHIP RATE
(Percentages)

Previous Decades		The 1980s		The 1980s Cont.	
Year	%	Year	%	Year	%
1930	47.8	1980	65.6	1986	63.8
1940	43.6	1981	65.4	1987	64.0
1950	55.0	1982	64.8	1988	63.8
1960	64.2	1983	64.6	1989	63.9
1970	64.6	1984	64.5	1990	63.9
1980	65.6	1985	63.9	1991	63.9

Source: U.S. Bureau of the Census

Table 2
HOMEOWNERSHIP RATE BY SELECTED HOUSEHOLD CHARACTERISTICS: 1980-1988
(Percentage Distributions)

	1980	1983	1988	Percent Change 1980-1988
All Households	65.6	64.6	63.8	- 2.7
Age				
Under 25	21.3	19.3	15.5	-27.2
25-34	52.3	47.0	45.0	-14.0
35-44	72.3	69.6	67.1	- 7.2
45-64	78.5	78.8	77.8	- 1.0
65 and over	72.3	74.8	75.0	- 3.7
Income				
Under $5000	49.4	43.3	39.5	-20.0
$5000-$9999	56.8	50.3	48.6	-14.4
$10,000-$14,999	59.1	55.8	52.7	-13.9
$15,000-$19,999	66.5	59.7	57.6	-13.4
$20,000-$24,999	73.7	65.7	61.4	-16.7
$25,000-$34,999	82.0	74.1	68.0	-17.0
$35,000-$49,999	88.5	81.6	77.6	-12.3
$50,000 +	91.9	89.1	86.9	- 5.4

Sources:

- "All Households" data from U.S. Bureau of the Census, Current Housing Reports, Series H-111, Vacancy Rates and Characteristics of Housing in the United States, Nos. 76-5 through 86-5.
- Age data from American Housing Survey, 1980; U.S. Dept. of Commerce, Current Population Survey, 1983 and 1988.
- Income data from U.S. Bureau of the Census, Current Population Reports, Series P-60.
- Tabulations by the Economics and Research Division, NATIONAL ASSOCIATION OF REALTORS®

PREPARED STATEMENT OF EDWARD JOHN SEBASTIAN

INTRODUCTION

Mr. Chairman and members of the Committee, I am Edward John Sebastian, Chairman of the Board and Chief Executive Officer of Resource Bancshares Corporation. I am testifying today on behalf of the American Bankers Association. The member organizations of the American Bankers Association range in size from the smallest to the largest banks, with 85 percent of the members having assets of less than $100 million. The combined assets of ABA members comprise about 95 percent of the total assets of the commercial banking industry.

The American Bankers Association (ABA) is pleased to support S. 612, legislation to restore the universal availability of the tax deductible Individual Retirement Account (IRA). Senator Bentsen, as you noted in your statement in the Congressional Record on March 12, 1991, S. 612 would improve the IRA by providing taxpayers the option to contribute to a special IRA that would not be deductible, but all interest would be tax free if held for five years. The bill would also allow taxpayers to make penalty free withdrawals from their IRA for college education, first home purchases and large medical expenses. From our experience, these new options will make IRAs a more attractive savings vehicle and encourage a nationwide growth in savings that will benefit our economy.

RESOURCE BANCSHARES SAVINGS PROGRAM

Resource Bancshares is a multi-state bank holding company with total assets of $700 million. Resource owns Republic National Bank of Columbia, South Carolina, a $470 million dollar national bank with 18 banking offices. Our niche is retail banking in small town America. This is traditional community banking. We provide the services our customers need. Our managers know the customers by name, they see them at the grocery and hardware stores on Saturday and at church on Sunday. Five of our banking offices are in Columbia, the state capital with a population of 101,208. We serve 36,789 other potential customers through thirteen offices. The largest office outside of Columbia serves a population of 6,700. Three banking offices serve towns with less than 1000 people.

Our customers are conservative, hard working middle Americans. It does not take high income or high savings to live in small town America. The average household income for 1990 in the thirteen small communities we serve was $20,997. There's a "pride of small town America" that drives our customers, a pride that they have worked for everything they have and do not rely on handouts. I believe our customers are representative of Americans living in small communities across the country.

At Republic National Bank we have tapped into that pride and seen great success with our savings products. Our focus is to develop a stable supply of customer deposits, and then to invest those funds wisely to earn a good return. To implement this philosophy we have created a savings product that we call a "Steady Saver" account. The customer contracts with the bank to put aside a specific amount each month for a set number of years. Currently we have customers putting aside $25 or more per pay period for two, three or four year commitments.

We have seen a surprising level of acceptance with our Steady Saver product. It took us nine years to reach our current number of IRA accounts. In less than a year we have opened 20 percent of that number of Steady Saver accounts. The customers in our smaller communities with annual income of less than $21,000 have signed up for this saving plan at a rate 35% greater than customers in our higher income market. The key to our success has been the simplicity of our Steady Saver account, primarily the simplicity of the application. It was a struggle to keep the application to one page that would not overwhelm our customers with all the regulatory requirements, but it was worth the effort.

At this time we are generating consumer interest by offering attractive rates. Rates are enough to encourage traditional savers, but they are not enough to encourage new savers to begin saving.

NATIONAL PRIORITY NECESSARY TO ENCOURAGE NEW SAVERS

Despite the success of our program, we have found that most Americans are out of the savings habit. Credit has provided an alternative means for customers to make large purchases through small payments over time, an alternative that provides immediate gratification. The widespread availability of credit has left generations of adults unfamiliar with the concept of saving first.

A 1989 study published by the Public Agenda Foundation concluded that "many Americans equate saving money with taking cash out of circulation and so, fear that saving is bad for the economy." This belief is perpetuated by news reports today that spending drives the economy and the reported fear that recovery from this recession will be slow because of reluctance on the part of consumers to spend.

The way to counter this misunderstanding is to make savings a national priority, to re-educate Americans that saving is good for the economy. The Bentsen-Roth Super IRA which provides tax incentives for savings should be the cornerstone of this campaign. The Super IRA appeals to potential savers with varied goals and capacities to save, a crucial element of encouraging new savings.

The numbers show that when the IRA was universally available from 1982 to 1986 Americans responded. However, as Senator Roth stated in his introductory floor statement for S. 612, Dr. Lawrence Summers' figures demonstrate that since IRA eligibility was cut back in 1986, there has been a 40 percent decrease in participation by those who remain eligible. Certainly at our banks the only IRA deposits we see today are rollovers from employer plans. Despite the fact that most of our customers are still eligible for deductible IRAs because of their income level or because they are not covered by employer plans, they still do not participate.

THE SUPER IRA WILL ENCOURAGE SAVINGS BY ALL AMERICANS

Restoring IRAs to all taxpayers will again encourage the spirit of saving by sending the message that saving is important to America. The upfront deduction for the traditional IRA will appeal to many taxpayers. The special IRA option which converts earnings on contributions from tax deferred to tax free after five years will also be an incentive for new savers, particularly among people like the customers at Republic National Bank. These customers are less motivated by effective tax rates, tax deductions and tax deferrals than more financially sophisticated taxpayers. They are motivated by the desire to help themselves build their own future, and the future of their community and their country.

SAFETY NET EXEMPTIONS WILL ALLOW MIDDLE AMERICA TO SAVE

The "safety net" exemptions provided in S. 612 will allow middle America to increase their savings. We believe that the prohibition on withdrawals until age 59 and a half is a major barrier to IRA participation for our customers. The average wage earner in our small communities does not feel confident that he can afford to lock up his hard earned dollars for twenty or thirty years; he does not have enough financial cushion to feel that confident.

LOW THRESHOLD FOR ENTRY ENCOURAGES MIDDLE AMERICA TO SAVE

The bill S. 612 maintains the current $2000 limit on contributions to IRAs. The $2000 limit has proven to be high enough to make the IRA an attractive savings incentive for upper income taxpayers. Furthermore, S. 612 improves on prior law by indexing the limit for inflation. Indexing the dollar limit will preserve the value of the incentive to encourage savings in the face of erosion by inflation.

However, we must remember to promote the fact that IRAs have a low threshold for entry to encourage taxpayers to save any amount they can in the Super IRA program. We believe that too much emphasis on the maximum contribution has also "scared" off many lower to middle income taxpayers from participating in IRAs. Two thousand dollars is ten percent of the annual household income in the thirteen small communities Republic National Bank serves—a seemingly unreachable savings goal. But $25 per pay period is more practical. Under Republic's current Steady Saver plan our customers can put in as little as $25 per paycheck and begin to help themselves and their community.

TIMING IS RIGHT

The timing could not be better for launching a national savings campaign. Congress is on a path to enact deposit insurance reforms before the end of the year that will correct the misguided practices such as "too big to fail" that have placed a greater burden on the FDIC than it was ever designed to bear. The reforms being considered right now should restore the Bank Insurance Fund to its proper function of protecting the deposits of the average American. With these reforms in place to restore the faith of depositors, banks will be looking to expand their deposit base. A program to encourage new savers will increase the pool of funds available to banks.

The economy is coming out of a recession. New funds flowing into banks will provide banks with the dollars and the confidence to make loans to consumers and businesses. These funds will go to productive investments in plant and equipment and the production of more goods. Enacting the Super IRA now could launch another period of sustained growth for the US economy. We have seen how tax a favored savings plan buttressed the economic growth and development of other nations, like Japan. Let us learn from that experience.

Enacting the Super IRA legislation to restore IRA availability to all taxpayers while expanding its flexibility, and providing the option of the special IRA which converts tax deferred earnings to tax free earnings after five years, should be the first step in launching a national campaign to "Save America."

PREPARED STATEMENT OF JOHN L. STEFFENS

Mr. Chairman, and members of the committee, I am John L. Steffens co-chairman of the Tax Policy Committee of the Securities Industry Association (SIA) and Executive Vice President, Merrill Lynch and Co., Inc. Mr. Chairman, SIA commends you for your leadership in the effort to restore tax incentives to increase personal saving. We agree with you, Senator Roth, 75 of your colleagues in the Senate and 250 House co-sponsors that it is time to "bring the IRA out of retirement."

SIA's membership accounts for more than 90% of securities activities in North America. Its roughly 600 firms range from large firms engaged in a full spectrum of domestic and international securities and securities-related activities to small or local firms engaged exclusively in retail brokerage. The securities industry manages over $247 billion of client IRA assets - about 44% of all IRA assets.

SIA shares your concern that the United States is not saving enough to remain globally competitive as a Nation or financially secure as individuals.

Our personal saving rate is among the lowest in the industrialized world. Although recovered from 1987's near historic low of 2.9%, the personal saving rate at a 4.6% average in 1989 and 1990 was hardly robust -- nor close to that of our foreign competitors. Currently, the rate has dropped to 3.7%, the lowest rate since 1987. We must take steps to improve the saving rate if the U.S. is to remain a leader in the world economy.

The public recognizes this necessity. A variety of national polls and studies consistently confirm the importance of saving to Americans.

A Merrill Lynch-commissioned Wirthlin Group Poll (1990) showed that 91% of Americans feel it is important for them to increase their personal saving rate. Wirthlin and The Merrill Lynch Retirement Surveys (1989, 1990 & 1991) found that between 66% and 78% of Americans would save more if the government provided tax incentives. Both polls found that between 60% and 84% of Americans believe that increasing personal saving should be made a national priority.

Why IRAs Make Sense

As America moves through the nineties and beyond, two issues should be at the forefront of public policy concerns: (1) Is America focusing its resources in a direction that will stimulate economic growth and global competitiveness, and (2) Are Americans adequately focusing their individual resources on their own future economic needs?

America has an aging infrastructure, low productivity, a shortage of domestic investment capital and faces large trade and federal budget deficits. Virtually all economists will agree that increased national saving is essential to ensure America's long-term economic growth.

Since 1950, the U.S.'s net capital stock has increased by only 3.6% annually in the United States, compared to 12% in Japan, 7% in West Germany and 5% in France. Human capital, as reflected in test scores and numbers of graduates in such fields as engineering, science and mathematics, shows the U.S. lagging behind other industrial nations well before the 1980s.

Investment as a percentage of GDP averaged 9% during the 1960s, 7.8% during the 1970s and 5.2% during the 1980s. Saving and investment rates also declined in most major countries in the 1980s, but remained considerably above the U.S. rates. For example, the Japanese invest more than three times the U.S. rate, on average, and the Germans save at almost three times the rate of Americans.

As saving and investment dwindled, debt soared. In 1980, federal debt amounted to 37.2% of GNP. By 1990, this percentage had risen to nearly 73%. In absolute terms, government debt quadrupled over the decade, from $1 trillion in 1980 to nearly $4 trillion by year-end 1990, with interest payments soaking up 15% of federal revenues. In the same period, corporate debt tripled. As a percentage of GNP, it rose from 18% in 1980 to 29% in 1990. Corporate interest expense between 1983 and 1989 was equal to 18% of cash flow on average, compared to an 8% average during the years 1950 to 1982. The U.S. entered the decade as a international lender and left as an international debtor.

Over the next few decades, declining growth in the working age population, increasing growth in the retirement population and spiraling debt service costs will place a tremendous financial strain on the U.S. economy. Low saving and investment rates will make it even more difficult to overcome these demographic and budgetary facts of life and may defeat any gains in productivity the country may be able to muster. Without increased saving, the result will be a lower standard of living for all Americans.

Though low national saving stunts the economy, low personal saving has the doubly negative effect of both limiting the economy and diminishing a person's quality of life.

In the 1990's we have an opportunity rare in the field of public policy. We still have the gift of time - time to make the investments necessary today for a better life tomorrow. We must make time our ally. But time isn't something we can save and use later. We use it now, or lose it forever.

For these reasons SIA believes it is urgent for Congress to pass the Bentsen-Roth Super-IRA. Americans need all the encouragement they can get to increase their saving. Bringing the IRA out of retirement will help ensure that the resources for tomorrow do exist.

Saving and the Costs of Retirement

The aging of America adds a new sense of urgency for saving. More Americans will be living longer than ever before. If current trends continue, the next century will see many Americans confront the reality of spending as much time in retirement as they did working.

The amount of retirement income considered adequate is increasing due to early retirement, longer life expectancies and escalating medical costs. Americans must save more in a shorter period of working time for a longer period of retirement.

Individuals of all ages are not prepared to meet the increasing costs of living longer. The extreme lack of personal saving in the U.S. is evidence of this.

49-352 - 91 - 4

According to the most recent Survey of Income and Program Participation of the Commerce Department, families headed by individuals aged 45-54 have median financial assets of only $2,300. Excluding those families with income less than $30,000, the median financial assets increase to only $12,500. This is hardly an adequate source of future security or income.

Merrill Lynch's own consumer research found a large gap between pre-retirees' beliefs and the reality of who will pay for future retirement costs. They continue to regard the government and their employer as the major sources of retirement income. Only 11% of the surveyed pre-retirees believe any type of personal savings will be their most important source of retirement income. Thirty percent (30%) of today's pre-retirees believe an employer pension will be their most important source.

According to the Treasury Department, Office of Tax Analysis, retirees from all income levels receive 38% of their total income from Social Security; it is the largest single source of retirement income for the majority of retirees. Pensions, however, account for only 14% of post-age 65 income. Personal savings and other sources of income exceed Social Security retirement benefits.

Retirees living on $20,000 or more a year currently receive only 20% of their total income from Social Security and 15% from pension income. According to the Department of Commerce in 1988 36.5% of households 65 and over had incomes greater than $20,000. Equally alarming is the recent Census report indicating that 24 million workers are not covered by any pension, 401(k) or IRA plan.

We calculate that today's average 35 year old can expect to need at least $504,000 (in current dollars) in savings to retire by 2020 on 60% of his or her pre-retirement salary.

Both Social Security and employer pensions are likely to play an even smaller role in the future, resulting in a lower proportion of the elderly population who will be able to maintain their pre-retirement standard of living without other sources of income. Savings must be increased to fill the void.

The need to prepare for health care costs associated with living longer is also being neglected. Today, the health care costs of Americans over age 65 account for 37% of the nation's total health care bill. This proportion is expected to grow as the baby boom generation ages. Expenditures for nursing home care alone have increased more than 200% in the last ten years and the population needing long-term care is expected to triple in the next century. Nursing home costs alone are projected to reach $150,000/year for individuals by 2010 (in current dollars).

Merrill Lynch's 1991 Retirement Survey indicates 73% of preretirees accept that they have primary responsibility for retirement support and 80% feel prepared. Yet 28% are saving less than they did last year. 43% are concerned about outliving the money they have put away for retirement. The paradox between attitudes and behavior is evident. The reality is that behavior must change.

<u>Saving and Foreign Reliance</u>

Mr. Chairman, there is another reason for Americans to increase savings. The sagging U.S. saving rate of the 1980s was fortunately offset by a surge of foreign capital inflows. In effect, foreign saving bolstered domestic investment. The price tag for our borrowing is reflected in the current account deficits of recent years. While the U.S. economy benefits from such borrowing, reliance on foreign capital is neither a sustainable nor desirable long-run solution to a low national saving rate.

Many foreign countries, like Japan and parts of Europe, are expecting their own demographic shift - sooner than the U.S. When their baby boomers retire, saving may decrease, and the flow of capital to the U.S. may diminish or turn into a net outflow.

The U.S. and its people should not rely on "the kindness of strangers" to fund the economy and retirements. By increasing personal saving at home, we secure future sources of income and reap the double reward of spurring the economy at the same time.

We have learned from the recent experience in Iraq that a reliance on foreign resources may inevitably be costly for America. As with other natural resources, a strong domestic capital supply will increase our economic strength and reduce our future vulnerability.

IRA Myths and Realities

While there is general agreement on the individual and economic need to save more, the balance of my testimony documents SIA's conviction that the Super-IRA will, in fact, increase saving.

Efforts to "bring the IRA out of retirement" have been questioned due to the belief that IRAs may not be effective, or that the low personal saving rate is not really a problem. SIA members' experience with IRAs, and our interpretation of studies published to date, lead to the conclusions that:

- The IRA, from 1982 through 1986 worked; it increased National saving, and will provide additional retirement security to a broad cross section of people.

- Without IRAs, saving from 1982 through 1986 would have been lower than it was.

- Well-designed saving incentives, like the IRA will stimulate additional personal saving.

- Well-designed saving incentives have appeal to Americans at all economic levels.

- Public policy, through the use of tax incentives, can positively affect personal saving behavior.

- The saving crisis is real.

- Regardless of statistical differences, our foreign competitors simply save more as individuals, and thereby invest more in their Nations' futures than do we.

A few SIA members have initiated consumer and primary research to test the efficacy of IRAs. Some studies have specifically attempted examined the questions: (1) what were the past effects of IRAs on personal saving; (2) what effect did changes in IRA legislation have on saving behavior; and (3) what effect could new IRA tax incentives have on future saving behavior and the U.S. economy?

In addition to corroborating the academic research, the results and analyses systematically refute a number of myths regarding tax incentives in general; myths that seem to continually perpetuate themselves regardless of the weight of evidence to the contrary:

Myth #1: Tax incentives do not increase personal saving - they merely promote the shifting of funds from other saving vehicles.

Findings: Most contributions to IRAs have been new private savings. A 1989 Lewin/ICF analysis found no indication that people shifted funds out of other forms of savings in order to contribute to an IRA, or contributed funds that they would have saved anyway in another form. After controlling for various other factors that might affect saving, IRA contributions were found to be positively related to other saving. This means that, generally, individuals who contributed to IRAs saved more in other forms, not less. They neither shifted nor reduced other savings nor borrowed to contribute to their IRAs.

Lewin/ICF also investigated the effects of IRAs on aggregate household saving by analyzing data relating household acquisition of financial assets (excluding IRAs) to IRA contributions, disposable income, the rate of interest, unemployment, change of GNP, change in stock market values, inflation, and pension plan contributions. Again, it was found that IRA contributions saved more in other forms as well as in IRAs.

Myth #2: IRAs only provide tax incentives for the wealthy.

Findings: The majority of IRA contributors are middle income! In 1978, 75 percent of IRA contributors were persons with family incomes of less than $40,000. In 1982, 55 percent of the persons contributing to IRAs had family incomes lower than $40,000 and in 1985 71% of IRA contributors had adjusted gross incomes of less than $50,000.

Myth #3: Public policy, through the use of tax incentives, cannot affect personal saving behavior.

Findings: When IRAs were curtailed in 1986, annual contributions dropped from nearly $38 billion in 1986 - almost one-third of personal savings - to only $14 billion in 1987. The personal saving rate fell to 2.9 percent in 1987, the lowest since 1939. The personal saving rate has averaged 4.0 percent since 1986, compared to an average of 5.3 percent saving rate when full IRA eligibility existed. About 3.5 percent of the population aged 21 and older contributed to IRAs in 1978. This increased to 17 percent in 1982, after the expansion in eligibility, then fell to 13.8 in 1987, after eligibility was limited. About 44 percent of this decrease in participation was accounted for by persons with family incomes between $30,000 and $50,000.

Prominent researchers such as Glenn Hubbard (Columbia Business School), Steven Venti and David Wise (Dartmouth and Harvard, respectively), Lawrence Summers and Chris Carroll (Harvard), Jonathan Skinner (University of Virginia) and Daniel Feenberg (National Bureau of Economic Research) have had similar findings.

The Super-IRA

I would now like to specifically address the viability of the Bentsen-Roth Super-IRA.

One of the most attractive and compelling features of the Super-IRA proposal is that it provides real choice in designing a personal saving program. In SIA's judgement, the Super-IRA has the necessary flexibility to address all major lifecycle saving needs. Though the Super-IRA is economically neutral -- deductible and nondeductible options are present value equivalents -- the ability to choose either option, or both, allows each person to decide which type of IRA best matches their view of the future.

The securities industry also sees the flexibility of the Super-IRA as an opportunity to provide advice and guidance to their clients on how to prudently invest to meet long-term saving goals and objectives.

Some policymakers have questioned whether a saving vehicle that does not solely rely on an up-front tax deduction will provide enough incentive for new saving. Based on the evidence, we believe the answer is a definite Yes.

A number of national polls have been conducted to test the viability of the IRA and the timing of tax incentives. The combined results of a 1990 Merrill Lynch-commissioned Wirthlin Poll, 1990 Gallup Poll and 1990/1991 Merrill Lynch Retirement Surveys indicate that about half of Americans would prefer a "back-end" IRA and half the deductible IRA.

The Role of Financial Institutions

Finally, it should be noted that the success of IRAs does not depend solely upon the features of the account. Financial institutions will be very aggressive in marketing the Super-IRA to their clients. It is clear that the Super-IRA contains features that will benefit a large majority of individuals. Institutions will be quick to point out the advantages and offer advice and guidance regarding what options to choose. The institutions will also be bolstered by the resurgence of contributions into IRAs.

As with the IRAs in 1986, advertising will be diverse and prolific. This will bring many clients who formerly contributed annually to IRAs back into the IRA habit and will entice new savers to open Super-IRA accounts. This educational/marketing clout cannot be underestimated. The ultimate result will be steady, increased flows of new savings into IRAs to the benefit of both the savers and the economy.

Conclusions

For America to maintain political and economic leadership, we must rebuild our personal and National self-reliance by rekindling National saving.

We do face a crisis of insufficient National saving. U.S. savings has been too low for a decade or longer. The cost of this crisis is reflected in stagnant real earnings, unmet needs for more and better public and private capital. These problems will become more severe, especially when the time comes that foreign lenders revere the international flow of capital and the elderly population begins to grow rapidly in the next century.

As Federal Reserve Board Chairman Greenspan testified before this committee (May 16, 1991) regarding Super-IRAs, "Inadequate domestic saving is impairing our economic prospects for the long run ... " The gamble "might be worth the chance." He strengthened this comment before the House Banking committee

(July 16, 1991) noting that IRAs should be reinstated because low national saving rates are the nation's biggest long-term problem.

The Wall Street Journal recently noted that "a new mood is apparent" among the baby boomers The "aging population is worried and more cost conscious;" they are recognizing the need to save for the future. The inference drawn from this small bit of anecdotal evidence is that many Americans are concerned about their ability to meet the needs of tomorrow. They should be concerned. Though the mood has changed, behavior has not.

The government needs to create saving incentives for individuals to put resources aside. Public policy can have a positive impact on both sides of the saving equation. The impact can be immediate, significant and enduring. All parties must educate Americans on the need to prepare for their financial future and the value of saving, both personally and for the economy.

Productivity tends to increase with the influx of capital. A growing pool of savings, funding public and private sector investments, in human and economic capital will result in an improved standard of living and renewed economic expansion through the balance of the decade and especially in the new century.

PREPARED STATEMENT OF DAVID WILLIAMS II

Mr. Chairman, and other distinguished members of the United States Senate Committee on Finance, let me first thank you for the opportunity to testify on Senate Bill 612, the Bentsen-Roth IRA Bill. My name is David Williams, II and I am an Associate Professor of Law at The Ohio State University College of Law. Having completed a Masters of Business Administration, a Juris Doctor, a LL.M. in Taxation, coupled with six years of teaching tax related courses has positioned me to speak to you today as a tax educator. Having worked in a law firm, an international accounting firm and as a tax and financial consultant to businesses and individuals, I can speak to you today as a tax practitioner. However, I would like to structure my comments from another of my professions. In my opinion, my most important and enjoyable one—that of a parent. As a parent and a college graduate, I truly want to provide my children with at least the same opportunity I had—that of obtaining a good, solid college education. With the rising cost of education and the decreasing amount of financial aid, the financing of a college education, for many of us, has become more of a dream and less of a reality. It is for this reason, and in the capacity of a parent, that I strongly endorse the concept of the special IRA for education and Senate Bill 612.

A couple years ago, I published an article entitled *Financing A College Education: A Taxing Dilemma,* in which I analyzed, and in some cases, criticized the efforts made by the states and the federal government in helping us, the parents of today, finance a college education for our children. At one point in the article, I actually suggested that Congress create an IRA-type vehicle to help meet higher education costs. While I am sure no one on this Committee read my article and thus I cannot take any credit for the drafting of this bill, I can express my deep appreciation and sincere gratitude for the wisdom of the sponsors of this bill for bringing us this needed help.

Presently, planning to finance a child's college education is, at best, a confusing, hit or miss, type of endeavor. Parents can attempt to save money in a bank account or other investment, only to see the earnings generated by the savings or investment eaten up by federal, state and in some cases local taxes. Of course, one can seek a greater rate of return on an investment, thereby minimizing the damage of the tax cost. However, greater risk comes hand in hand with greater expected return. I am sure most parents would agree that their child's education fund is not the one to be subject to great risk, or any risk at all. The search for greater returns by seeking risky investments can lead to the actual depletion of the principal amount of the investment, as well as the earnings.

Many states have attempted to assist us in this important task by developing prepaid tuition plans, college savings bonds, or early purchase college credits. While these devices have afforded some relief, there are problems connected to each of these programs. In some cases, the success of the plan is linked to the sponsor obtaining a somewhat uncertain rate of return. In some cases, the child is only allowed to attend a certain school or certain schools in a given state. In some cases, the availability of the guarantee is contingent on acceptance into a certain group of schools. In some cases, the financial stability and survival of the sponsor controls the future. In all cases, the hidden tax consequences make the options less desirable in practice than advertised. When my children are ready to attend college, I want them to be able to choose a University near or far, one that meets their needs, not one that a contract dictates they attend. I also want to know that the money will be there and not subject to offset by taxing authorities or bad investment judgments of the sponsors in their quest for higher yields.

In 1988, Congress provided us with partial relief with the enactment of the Technical and Miscellaneous Revenue Act. In this Act, Section 135 entitled "Income from United States Savings Bonds Used To Pay Higher Education Tuition And Fees" was created. In short, it allows certain purchasers of Series EE Savings Bonds to avoid taxation on the earnings of those bonds, when redeemed, if the proceeds are used for qualified higher education expenses. While this was a step in the right direction, the phase-out provision (based on increased income) serves as a disqualification for many of us. If I am saving today by this method, when it is time to redeem the bonds and pay my child's higher education expenses, my income, *hopefully* will be over what is presently considered this Section's threshold amount. The reasoning that a married couple with AGI of $95,000 and five children needs less help than a married couple with AGI of $60,000 and one child is ludicrous.

Finally, we can hire a tax and/or investment professional to search and devise a creative vehicle to help us reach our objectives. However, this individual's fees would erode most of the advantage we would gain from their efforts. Anyway, the education of our nation's youth should not be subjected to the same efforts we employ to determine the proper entity to hold a piece of investment property.

Finally true help has arrived. It is in the form of this bill, the Bentsen-Roth IRA Bill. By allowing us to contribute up to $2,000 a year in a special IRA, the parents and the grandparents, of our nation can more successfully plan to help fund their children's and grandchildren's higher education. While no deduction is allowed for the contribution to this special account, the money will grow tax-free and withdrawal from the account, if done to pay qualified higher education expenses, will escape inclusion into gross income and taxation. This will allow us to apply *every dollar* to higher education expenses. This exclusion from taxation forms the partnership between the government and the people that continues to make this country strong. This provision, coupled with the removal of penalties for early withdrawal from certain other retirement plans (if used for higher education) is the kind of help and relief that is needed to secure the continuing education of many of our nation's youth.

The enactment of this bill will give parents the flexibility to choose a proper method to successfully save for college educations, without the former confusion. The flexibility that this bill provides is outstanding. Let's say I have $3,000 a year to put away after meeting my yearly needs. I can put $1,000 in a regular IRA and receive a $1,000 tax deduction. I can put $1,000 in a special IRA for the education of my children and purchase two $1,000 savings bonds (cost $500 each). The earnings on all three accounts grow tax-free. When it is time for my child to go to college, I will have a number of options. If my yearly income has increased, I can use the special IRA to pay the college expenses and receive the total funds without additional tax cost. If I need additional money for the educational expenses, I can cash the savings bonds or withdraw cash from the regular IRA account (without penalty), pay tax on the earnings and use the remaining proceeds. If these funds are not needed, I can leave the funds alone to support my retirement. On the other hand, if my yearly income has decreased, I can cash the savings bonds, receiving the proceeds tax free, and use them for my child's college education. If additional funds are needed I can withdraw cash from either of the IRA accounts. If I use the regular IRA, the special IRA could be used for my child's graduate school, my grandchildren's education, for the first purchase of a home by my child, or for my medical expenses as I grow older. While I personally would like to see the contributions to the special IRA deductible, the definition of higher education expense include room and board and the 5-year contribution rule modified, I still think this is a great assistance in this important area. This bill is evidence that our elected officials are interested in helping us to obtain our goals in our everyday life.

While many will state that this bill will be costly because of the loss of revenue, I must disagree. It is a fact that college educated individuals make many times the income of non-college educated individuals. Therefore, the revenue loss on the front end will be recaptured later. In fact, the revenue is just deferred and will actually be enlarged. But there is a bigger argument against the foregone revenue cry. This must be viewed as an investment by our country and the return can be measured in other than money or cash revenue. The better educated our population, the more competitive our nation will be in solving international and domestic problems. I would hate to think that the individual, or individuals, who can help solve the homeless problem, find the cure for cancer or AIDS, devise a solution for famine in Africa or merely help us live more peacefully will never get to do these things because his, or her, parents are unable to finance their college education. This bill will help stop that awful occurrence from happening. In addition, a more educated citizenry will be a more involved and informed citizenry and a more involved and informed citizenry will create a better world for all of us to live in.

In closing, let me return to my law school professor profession for a moment. In a few weeks the students will be returning and my basic federal tax class will begin. I will start by asking them what are the purposes of a tax system in modern society. All will immediately respond "to raise revenue." As I ask them to focus beyond that many will struggle, but a few will state that the tax system can be an element of social legislation that provides incentives and disincentives to encourage or help us reach certain goals or overcome certain obstacles. If graded after the first class these would be the "A" students. The United States tax code is, and should be, one of the greatest examples of social legislation. In a society as strong and as great as ours, the government, which is the collective people, must provide incentives and help for us to continue to do the things that have made this country what it is today. Helping parents provide for education of their children is certainly one of those things. I commend the authors of this bill and I urge you all to pass this bill and give many of today's youth the same opportunity that you and I had—to get a good college education. Thank you.

COMMUNICATIONS

STATEMENT OF HUGH J. CAMPBELL, JR.

I understand that two goals of the SUPER IRA BILL are to:

(1) Jumpstart savings, and
(2) Ease Americans' concerns about home ownership, health care, college education and a secure retirement.

These worthwhile goals are to a certain extent being achieved through the impressive growth in the 401(k) plan area. Based on the introduction of The Employee Benefits Simplification and Expansion Bill of 1991 (S. 1364) I understand that there is support for increased participation in 401(k) plans.

I am concerned that the passage of (S. 612) as introduced may threaten continued growth in the 401(k) plan area. The success and in some cases the survival of many 401(k) plans is dependent on the participation of non-highly compensated employees. To non-highly compensated employees, THE SUPER IRA will provide an investment vehicle that is superior to a non-match 401(k) and offer them greater accessibility to their money. With approximately half of all 401(k) plans estimated to be non-match, passage of (S. 612) could threaten both the past and future growth in this area.

A possible solution would be the employee's portion of 401(k) plan be at least as attractive as THE SUPER IRA. To limit revenue lost THE SUPER IRA could be available to only those taxpayer not contributing a certain amount into a 401(k), 403(b), SEP IRA or similar plans. I see no reason to allow a taxpayer to take advantage of THE SUPER IRA if the are taking the maximum advantage of the 401(k) or similar plan limit. Indexing the maximum loan amount from a 401(k) to inflation would encourage more taxpayers to use it as a vehicle for accumulating savings especially for education.

CHESHIRE COUNTY SAVINGS BANK,
Keene, NH, August 3, 1991.

Mr. WAYNE HOSIER,
U.S. Senate,
Committee on Finance,
Washington DC

Re: Hearing on Super IRA—Bill S. 612 (Statements for hearing record)
Date of Hearing: July 31, 1991

Dear Mr. Hosier: I hope the comments in this letter will be used to encourage Congress to pass the Super IRA Bill S. 612.

There has been a lot of talk during the last couple of years regarding pension reform. That is good—however action in the form of a beneficial and understandable retirement program is what is needed.

As the Retirement Accounts Officer of Cheshire County Savings Bank, and having been involved with IRAs, SEPs, and Keogh Plans since 1975, I would like to attest that at no other time have my customers been so confused, and contributions been so low. In spite of all our efforts since 1987 to re-educate our customers, we still have people who either didn't realize they were eligible for deductions; or customers who make contributions, only to come back months later to do contribution corrections because they just found out they did not qualify for deductions. Our bank does not track deductible versus non-deductible contributions. However, conversations with customers lead me to believe that less than 1% of contributions being made are non-deductible. After they find out about the recordkeeping involved in making non-deductible contributions they *run* in the opposite direction.

Other concerns the public has expressed is the tax base they may be in when they do start withdrawing from their IRA. It may appear now that they will be in a lower tax bracket when they retire, however they don't know what Congress may pass for tax brackets in the next 5, 10, or 20 years. They repeatedly ask me "What guarantee do I have that I won't be in an even higher tax bracket when I start withdrawing from my IRA?"

People are concerned about their retirement years, and the quality of those years. Some are more willing to plan for it than others. To help those that are willing, and to encourage those that are hesitant, they need something that will be beneficiary and understandable. In all the publications I have read regarding the current proposals before Congress, I believe the Bentsen-Roth IRA proposal would satisfy the needs of the greatest number of consumers. Both the deductible and backended versions will have their place with the consumer. Many banks, including mine, offer investment programs for the smaller saver to contribute amounts on a periodic basis. For these people, the immediate tax savings of a deductible contribution, along with the ability to make penalty-free distributions for first home purchases, educational expenses, or devastating medical expenses will be extremely attractive.

Many people have become exasperated when they hear IRA deductions were taken away because it was only being used by the rich! These people in the higher income brackets are those who are more settled (40's and older), have their own home, kids out of college—and have not had a chance to put much away until their 40's or 50's. Their income is higher, but how much have their really saved? Now they are in a rush to set aside as much as possible in the working years they have left. In planning for the future, as well as at the moment, this segment is also concerned about the best way to go about their retirement planning. These people are worried about putting money away now, only to be charged more to use it in the future. The backended IRA would resolve this conflict. They also have the security of knowing they may use this money for certain medical expenses.

Members of Congress have expressed concern over how much in IRA funds is "new" savings. Much of it is. The periodic savings program we offer sees transfers from customers' checking account into their IRAs weekly or monthly. this money is now being saved in a restricted manner—not available for any spending spree a person may have. Monies transferred from existing savings or term certificate accounts now have even more permanence because of the IRA withdrawal restrictions.

These retirement funds will continue to build and strengthen the economy. When a person reaches retirement, he or she will be able to enjoy their leisure and spend their money on trips or other luxuries. They will also be less of a burden on relatives or social services in "surviving" their retirement.

I understand that economic times make it difficult to provide any form of *tax* savings. However, will there ever be a good time? Hopefully both the House and Senate will take a look at the overall picture of savings—and from this provide a retirement program that can be used with confidence by the average person.

Sincerely,

PATRICIA A. HATCH, *Retirement Accounts Officer.*

DOMINION BANKSHARES CORP.,
Roanoke, VA, August 8, 1991.

WAYNE HOSIER,
U.S. Senate,
Committee on Finance,
Washington, DC

RE: Super IRA Bill (S. 612), July 31, 1991

Dear Mr. Hosier: Dominion Bankshares Corporation is a multi-bank holding company operating in Virginia, Maryland, Tennessee and the District of Columbia. We serve as Custodian for 87,000 Individual Retirement Accounts (IRAs) which represent 64,000 customers and $800 million in IRA balances. Our management strongly supports the Bentsen-Roth Super IRA bill (S. 612) and especially the restoration of fully deductible retirement accounts. We wish to have our written comments included in the hearing record.

The options offered by the Bentsen-Roth bill address those issues which not only concern most Americans but many of our customers. Skyrocketing medical expenses, affordable home ownership, educational expenses, and a secure retirement are foremost on our customers' minds. If our nation is to remain vital and competitive, we must encourage savings for long-term economic growth.

According to the Employee Benefits Research Institute, if we continue to save under the current tax guidelines for IRAs, only 52% of single Americans and 38% of two-earner households will be eligible for full deductions on their IRA contributions by the year 1996. Given our current economic environment and the growing population of retirees, we feel it imperative to encourage saving at a higher level by reinstating full deductibility for eligible contributions.

The Bentsen-Roth bill not only reinstates full deductions for IRA contributions but offers the option to allocate savings contributions to nondeductible accounts. This provides consumers with a choice in planning and meeting their savings goals. By offering alternatives, not all contributions made will be deductible and therefore, not all contributions will produce a revenue loss. Certainly the $2,000 cap for nondeductible contributions is more acceptable than the $5,000 limit offered through the proposed Family Savings Accounts.

The deductibility rules of the Tax Reform Act of 1986 have caused continued confusion and frustration for our customers. We frequently receive inquiries about whether or not full deductibility will be reinstated. We also receive questions regarding the use of IRA funds for educational expenses and first-home purchases.

Reducing or limiting deductibility has taken away the incentive for many to invest in IRAs. In addition, confusion over how to calculate deductions and how to file Form 8606 deters many customers from contributing. Some avoid funding IRAs altogether because of the misunderstandings surrounding the withdrawal of nondeductible contributions. Our experience with CPAs and tax accountants indicates that many do not understand the rules regarding nondeductible contributions and are advising their clients incorrectly. The lack of deductions, compounded by additional calculations and filings, prevent many customers from making IRA contributions. The large national decrease in IRA deposits from $38 billion in 1986 to $14 billion in 1989 reflects this consumer concern.

The Bentsen-Roth bill addresses the apprehensions voiced by our customers. Tax deductible contributions and tax deferred earnings are powerful and needed tools for retirement savings. By restoring full deductibility for all those eligible to make IRA contributions and by making IRA distributions more flexible, we believe the IRA deposit rate will grow. Increasing IRA contributions will provide two key benefits. It will insure financial security at retirement and assist in long-range national economic growth.

We believe this bill is extremely beneficial to all Americans. IRAs are a national resource which are not being fully utilized because of the Tax Reform Act of 1986 changes. The Bentsen-Roth proposal reinstates the advantages of having an IRA. We encourage your support.

Thank you for your consideration.

Sincerely,

BETTY F. STANLEY, *Vice President, Retail Retirement Services.*

STATEMENT OF ERIC J. KLIEBER FACCIANI & CO.

I first want to express my support for increased availability of tax-favored savings for individual Americans, as provided for in the proposed "Super IRA" legislation, S. 612, currently under consideration by the Senate Finance Committee. I particularly support making such savings available for purposes other than retirement, such as first-time home purchases, higher education expenses and extraordinary medical expenses.

Two things concern me regarding this proposed legislation:

> No allowance is made for tying availability of tax-favored savings to the savings needs of individuals and families. The proposal allows the same deductible contribution amount for all workers, $2,000 per year. An unmarried worker whose employer sponsors a 401(k) plan can make a deductible salary-deferral contribution of about $8,000 per year to that plan, while a worker supporting a family on one income cannot contribute more than $2,000 to a super IRA regardless of the size of his family. When a married couple without children are both eligible to participate in a 401(k) plan, the deductible salary-deferral contribution rises to about $16,000 per year. Not only is this unfair, it is a terribly

inefficient allocation of tax incentives at a time when severe budget deficits demand that such resources be judiciously deployed.

Increased opportunities for tax-favored savings would reduce Federal tax revenues while providing no offsetting source of additional revenue.

These two concerns can both be addressed by modifying the proposed legislation as follows:

Increasing the amount that can be contributed each year to a super IRA to $2,000 per family member, defined as the number of family members claimed as dependents for income tax purposes in the previous tax year. This limit would apply on a family basis, not separately to each working family member.

Changing the limit on income exclusion for elective deferrals to 401(k) and similar plans, contained in IRC 402(g), to be the same as the limit described above on contributions to a super IRA.

Coordinating these two limits, so that any contributions by a family member subject to the IRC 402(g) limit would reduce the maximum super IRA contribution, and any super IRA contribution would reduce the IRC 402(g) limit on elective salary deferrals for family members.

These modifications would have the following effects:

Availability of tax-favored savings would be allocated according to need, as indicated by family size.

Lowering the limit on tax-favored savings for small families with members participating in 401(k) or similar plans would provide additional tax revenues to help offset revenue losses resulting from expanded savings opportunities for larger families.

Making the same savings opportunities available both inside and outside employer-sponsored salary deferral plans would reduce the need for cumbersome non-discrimination testing in employer-sponsored plans, such as the average deferral percentage test for 401(k) plans, clearing the way for simplification proposals in this area currently before Congress.

For these reasons, I hope the Committee will give serious consideration to these suggested modifications to S. 612.

Statement of Cheryl Marro

August 12, 1991.

Mr. Wayne Hosier,
U.S. Senate Committee on Finance,
Washington, D.C.

Re: Hearing for Bentsen-Roth Super IRA

Dear Mr. Hosier: Lately I have been reading about proposals by Senators Roth and Bentsen to change the ridiculously restrictive and confusing regulations regarding contributions/distributions for Individual Retirement Accounts (IRA's). I understand that the Bush administration is basically opposed to such proposals because of the loss of revenue that would occur as a result of restoring the deductibility of IRA contributions to the average citizen.

I'm afraid that such opposition demonstrates a lack of foresight on the issues involved. Restoring full deductibility initially may result in significant losses, as feared, but what are the ramifications for the future if it is not? What is going to happen when the once prosperous "baby boomer" generation retires and finds itself below the poverty level? When it finds that many of the companies that employed it over the years are bankrupt or out of business and pension assets are gone with the wind? When Social Security is stretched to the limit? When it has no nest egg to fall back on for medical expenses, or even living expenses?

In my lifetime I have seen a member of my family who has been forced to give up her home, even though the mortgage was paid off. Social Security does not give her enough income to even pay the taxes on the property. I don't want the same thing to happen to me!

We constantly hear that the low savings rate of Americans has reached crisis proportions yet there is nothing realistic being done about it. We have to be progressive, look beyond the tips of our noses and plan for the future of this country. Give "Middle Americans" the much needed tax deduction and encouragement to save. **Bring back the IRA!**

I don't care what shape it takes, but keep it simple. People who are struggling to save for the future cannot afford to hire attorneys, accountants, or financial advisors merely to interpret complex and confusing government regulations and legal mumbo-jumbo. Mr. Hosier, most Americans are not as fortunate as you and your family. We do not have the financial resources, political connections, or big special interest groups to help us achieve the "American Dream." We are counting on you and the other members of Congress to hear our plea, to share in our concerns about our future, and to demonstrate that you do understand and care about our plight.

If Congress does have a vision for America, it must include the IRA.

Sincerely,

CHERYL MARRO.

MORTGAGE BANKERS
ASSOCIATION OF AMERICA

Warren Lasko
Executive Vice President

Tel. (202) 861-6501
Fax (202) 429-1672

August 14, 1991

The Honorable Lloyd M. Bentsen
Chairman
Committee on Finance
United States Senate
205 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

The Mortgage Bankers Association of America (MBA)[1] appreciates the opportunity to present our views with respect to the Committee's hearing on the Expanded Use of Individual Retirement Accounts (IRA), and to express our support for S 612, the "Savings and Investment Incentive Act of 1991." Specifically, our comments will focus on the use of IRA funds for the downpayment on a home.

Overview. The quantity, quality, and affordability of housing in America is influenced as much by Federal tax policy as by any other Federal action. Federal tax policy should affirmatively support the production and maintenance of housing if America is to remain one of the best housed nations in the world. In addition, Federal tax policy should aim to lower real interest rates, promote homeownership and affordability, and thus benefit all sectors of the economy, including housing.

---

[1]The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of residential and commercial real estate finance. MBA's membership comprises more than 2,300 mortgage originators and servicers, as well as investors, and a wide variety of mortgage industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, selling, and servicing real estate investment portfolios.

Members of MBA include:

- Mortgage Banking Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Mortgage Insurance Companies
- Life Insurance Companies
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

Background. MBA believes that allowing penalty free withdrawal of funds from an IRA or 401(k) plan for the purchase of a first home is sound tax and housing policy. There is a need for the Federal government to reemphasize its commitment to stabilizing and expanding the number of homeowners in the country.

In terms of homeownership, America is increasingly becoming a Nation of haves and have-nots. Government statistics show homeownership rates have declined since 1980 for all age groups under 45. According to a report issued by the Department of Housing and Urban Development, entitled, "Annual Housing Survey," homeownership rates for households headed by those age 25 to 29 fell from 43 percent in 1980 to 34 percent in 1990, for those age 30 to 34, from 61 percent down to 52 percent, respectively.

Under current law, when a taxpayer with an IRA or other retirement account withdraws money before reaching the age of 59 and one-half years, they must pay a 10 percent penalty plus income tax at their tax rate on the money withdrawn. This penalty is so severe that it discourages individuals from utilizing these resources.

MBA believes that IRA funds used for a downpayment should be considered "invested" in the home purchase. Thus, in addition to being exempt from a withdrawal penalty, the funds should also not be taxable until the house is sold or funds otherwise withdrawn from the investment. Homeownership is America's best investment.

MBA believes that allowing taxpayers to utilize IRAs for the purpose of buying a home would not cause significant loss of revenue to the Federal government. Such a change would not alter the amount of money that may be deposited in benefit plans, nor the income limits or other conditions on tax-deferred deposits--limitations that have reduced the revenue impact of new IRAs. Taxes are already deferred on the appreciation of a home, so there would be no incentive to invest IRA funds beyond the minimum level needed to qualify for a home. Above that amount, the homebuyer would, in effect, be losing the benefit of tax deferred appreciation and earnings that would otherwise be realized in a retirement account.

While we believe that withdrawals invested in a home purchase should not be taxed, we are aware of the tight fiscal constraints under which the Congress must operate and the continuing need to offset any tax expenditures with other sources of revenue. The IRA proposal contained in S 612 attempts to balance the needs of prospective homeowners with that of the need for deficit reduction. Therefore, MBA supports S 612.

Use of IRAs for First-Time Homebuyers. To most Americans a house is their single most significant investment. Many young prospective homebuyers are faced with the choice of accumulating tax-deferred savings in an IRA or keeping their savings in taxable accounts in order to purchase their first home. MBA believes that allowing the use of IRAs for home purchase would motivate young people to increase their savings rate.

S 612, the "Savings and Investment Incentive Act of 1991." MBA commends you and Senator Bill Roth (R-DE) for introducing S 612, which would allow young couples, or their parents or their grandparents on their behalf, to make penalty-free withdrawals to pay for a first home. At a time when overall homeownership rates are declining and the Federal role in stimulating affordable housing is diminished, the Bentsen-Roth IRA bill is a needed shot in the arm to encourage and increase savings for homeownership.

The Administration's Fiscal Year (FY) 1992 budget submission would allow individuals to make penalty-free withdrawals of up to $10,000 from their IRA for the purchase of a first home. Eligibility would be restricted to individuals who have not owned a home in the last three years. In addition, the taxpayer must be purchasing or constructing a principal residence at a price not higher than 110 percent of the median home price in the area. Individuals would, however, be required to pay taxes on their withdrawals. The Administration estimates that the bill would cost $0.1 billion annually, and approximately $0.4 billion over five years.

MBA commends the Bentsen-Roth bill for providing more flexibility to the taxpayer. The Bentsen-Roth proposal re-establishes the IRA as a viable home purchase tool by setting no arbitrary limits on the amount of a withdrawal or the price of a home.

Moreover, S 612 does not place any restrictions on the financial creativity of donors or recipients. S 612 would allow taxpayers, who have not owned a home in two years, to utilize their IRAs for a downpayment, closing costs, or rehabilitation expenses. MBA supports your proposal to allow a parent or grandparent to withdraw IRA funds to assist a child or grandchild with a downpayment on a starter home. Your proposal provides the flexibility and creativity needed to address the financial complexities consumers encounter. MBA strongly supports the Bentsen-Roth bill and urges its prompt passage.

Once again, MBA commends you and the Members of the Committee for your efforts to foster affordable housing through creative use of the Tax Code. MBA appreciates the opportunity to submit a statement in conjunction with your July 31 hearing.

Please contact Michael J. Ferrell, MBA's Legislative Counsel at (202) 861-6509, Larry Parks at (202) 861-6977 or Jim Freeman at (202) 861-8184, if you have further questions or need additional information.

Sincerely,

Warren Lasko

Warren Lasko

Statement of the National Council of Savings Institutions

Introduction

Mr. Chairman and Members of the Committee, thank you for providing this opportunity for the National Council of Savings Institutions to present testimony for the record, with respect to S.612, the "Savings and Investment Act of 1991," introduced by Chairman Bentsen and Senator Roth.

The National Council of Savings Institutions is a trade association of approximately 350 BIF-insured savings banks, cooperative banks, and savings and loans associations. National Council members have over 4,000 branches nationwide.

The National Council applauds the introduction of the "Bentsen-Roth Super IRA" legislation as an effective way to encourage increased retirement savings. Increased retirement savings, in addition to reducing the strain on the social security fund and creating badly needed investment capital, will also provide a source of liquidity for financial institutions.

Description of the Bentsen-Roth Super IRA

S.612 includes the following principal features. Individuals would be permitted once again to make $2,000 deductible contributions annually regardless of their compensation and whether they are active participants in another pension plan. The $2,000 deduction limit would be adjusted for inflation. An exemption would be provided, as well, from the 10 percent premature distribution penalty for first-time home purchases, higher education tuition, and financially devastating medical expenses. In addition to the traditional front-end loaded IRA arrangement, S.612 would create a back-end loaded "special IRA." Contributions to a special IRA would be made from after-tax dollars, but earnings on contributions that are held in the account for at least five years could be withdrawn tax-free.

The National Council believes that giving individuals a choice between front-end and back-end loaded plans creates a flexibility that will enable them to tailor their retirement saving to their needs and preferences. We believe that many small savers who would otherwise invest in an IRA are reluctant to put their money where it will be subject to a 10 percent penalty if they use it before age 59 and a half. The special IRA, however, combines liquidity and tax savings in a way that will encourage saving. We also believe that making it possible to use IRA funds for first-time home purchases will bring home ownership within the reach of more Americans. At the same time it should provide a stimulus to the home building industry. Permitting IRA funds to be used to pay for higher education amounts to a capital investment in greater human productivity. Finally, with medical costs steadily increasing permitting IRA funds to be made available for medical emergencies represents sound social policy.

The Need to Encourage Retirement Savings

The fundamental purpose of the IRA is to encourage retirement saving. Chairman Bentsen noted in his floor statement introducing S.612 that an analysis of the data indicates that the restrictions placed on IRA eligibility and deductibility by the Tax Reform Act caused a 60 percent drop in enrollment and a 70 percent drop in contributions. It has been reported that pension plan participation has been flat or even may have declined in recent years. It has been reported further that employers are increasingly turning from defined benefit plans, which require the employer to provide a fixed pension, to defined contribution plans, where the employer contributions are fixed and the ultimate benefit depends on the investment return of the employee's account. (See Ippolito, Pension Plan Choice, 1979-1987: Clarification and Extensions, Pension Benefit Guaranty Corporation (December 1990).) Even when employees do participate in pension plans, lack of portability often makes the benefits of participation illusory for the more and more workers who change jobs with relative frequency.

On the other hand, increasing life expectancy necessitates an increase in retirement saving and this short-fall is not being made up with private savings. The inability or unwillingness of Americans to save as compared with the citizens of competitor nations has been well-documented. (See, e.g., Harris and Steindel, The Decline in U.S. Savings and Its Implications for Economic Growth, Federal Reserve Bank of New York Quarterly Review (Winter, 1991).) Thus, if nothing is done, the short-fall will inevitably have to made up from the social security fund and that, in turn, will require further increases in social security taxes.

The Super IRA Will Stimulate A Saving Psychology

The National Council believes that the Bentsen-Roth Super IRA is one way to help make up the short-fall. Chairman Bentsen noted in his floor statement introducing S.612 that those who say that IRA contributions are only a shift of existing savings are looking at old data. More recent studies, as he points out, indicate that before the cut-backs made by the Tax Reform Act, people, in fact, did increase their savings to take advantage of increased IRA eligibility. Equally significant, in the Chairman's view, is the fact that many individuals who remained eligible for IRA participation after the Tax Reform Act changes stopped making IRA contributions. He cites data indicating that there was a 40 percent decrease in participation by individuals who were still eligible to participate.

In the Chairman's view, which we share, the link between these disparate facts is advertising. IRAs are currently subject to restrictive and complicated rules and, thus, are difficult to market effectively. Before tax reform, everyone could make deductible IRA contributions and the rules were simple. This kind of IRA was easy for financial institutions to advertise and widespread participation resulted from successful advertising. (See Skinner, Do IRAs Promote Savings? A Review of the Evidence," National Bureau of Economic Research (February 1991.)

Encouraging individuals to save for their retirement serves another important goal. The key to our continued prosperity is increased domestic capital formation. As Chairman Bentsen points out, we are facing a "real capital crunch" in this country. Through the decade of the 1980's, we were able to finance our deficit and meet our capital needs with foreign borrowings. The cost of foreign funds is now being bid-up. The emerging economies of eastern Europe and the Pacific rim can be expected to soak up German and Japanese capital, respectively. Likewise the devastation in the Persian Gulf may keep its capital at home for some time.

The Super IRA Will Help Thrifts And Banks

The advantages to our economy of increased domestic savings are apparent. Capital becomes cheaper and inflation will be lower. There is another advantage, however, that is less apparent. The

National Council is working with the Banking Committees to create legislation that will restore profitability and depositor confidence to the thrift and banking industries. The single most important need of financial institutions is for an infusion of capital.

Increased savings will make lower cost capital available to all businesses, including financial institutions. Secondly, if depositor confidence is restored and a strong incentive to save in the form of a universal IRA is created, deposits in thrifts and banks will increase.

Much has been written about the existence of a "credit crunch" -- the inability of small and medium businesses to obtain bank loans -- exacerbating the current recession and hindering a recovery. (See the Statement of John P. LaWare, Member, Board of Governors of the Federal Reserve System, before the Committee on Small Business, U.S. House of Representatives, June 6, 1990.) The causes of the credit crunch include misguided, overly restrictive regulatory policies, but there can be no doubt that new deposits would create new loans that would help to restart the economy.

Conclusion

The National Council urges the Congress to pass this important legislation. As Chairman Bentsen has said, "It is time that we took the IRA out of retirement and put it to work helping Americans to save for the future." We believe that enactment of the Bentsen-Roth Super IRA will create a useful tool for deficit reduction and the restoration of American economic pre-eminence.

Once again, thank you for this opportunity to present testimony. We hope that our comments are helpful. If the National Council staff can provide further assistance to you or your staffs, we would be happy to do so.

NATIONAL FEDERATION OF INDEPENDENT BUSINESS,
Washington, DC, May 23, 1991.

Hon. LLOYD BENTSEN, *Chairman,*
Senate Finance Committee,
U.S. Senate,
Washington, DC.

Dear Mr. Chairman: On behalf of the over 500,000 members of the National Federation of Independent Business (NFIB), thank you for introducing S. 612, legislation to restore the tax deduction for contributions to an individual retirement account (IRA).

When asked in an NFIB survey in February whether or not Congress should restore the deduction for contributions to an IRA, the response from NFIB members was an overwhelmingly favorable—78% to 16%. NFIB members view IRA accounts as a simple, inexpensive way to save for their retirement.

Your legislation would restore one of the best ways to assist all Americans in planning for retirement—individual retirement accounts. In addition, restoring the IRA deduction will also increase national savings and will lower the cost of capital in this country. As a result, business owners who need to borrow money to start a business or expand their current business will have easier access to the funds they need.

Future generations are going to have a very hard time affording retirement. The current personal savings rate in this country is dismal, and it is unlikely that Social Security will be able to contribute much to the retirement needs of the post-baby boom generation. By providing tax advantages for individual retirement accounts, your legislation will assist individuals who want to provide for their own retirement, instead of relying on the federal government.

Again, thank you for introducing S. 612. NFIB looks forward to working with you on this issue.

Sincerely,

JOHN J. MOTLEY III, *Vice President, Federal Governmental Relations.*

STATEMENT OF THE NON COMMISSIONED OFFICERS ASSOCIATION OF THE U.S.A.

Mr. Chairman. I am retired Army Sergeant Major Michael F. Ouellette, Deputy Director of Legislative Affairs for the Non Commissioned Officers Association of the USA (NCOA). The Association is a congressionally-chartered organization with a membership in excess of 160,000 noncommissioned and petty officers serving in every component of the five (5) Armed Forces of the United States; active, national guard, reserve, and retired; or in a veteran's status. The Association advocates the early passage of S. 612, a bill to amend the Internal Revenue Code of 1986 to improve the Individual Retirement Account (IRA).

Proponents of S. 612 know there are far too many restrictions included in the current program. These limitations have deterred many taxpayers from participating while others have been unable to open an IRA because they are alleged to be covered by another "pension plan." The military retirement system, for example, is considered a "pension plan" although the Supreme Court of the United States has ruled otherwise.

In reviewing the history of IRA the Association recalls that prior to 1976 no military personnel were eligible to participate in the plan. Military reservists were included later in its infancy after proponents for the Reserve Forces of the United States Armed Services made three convincing arguments:

(1) The Reserve retirement system offers no vested interest to the participant until he or she attains age 60.

(2) The amount of retired pay can be so limited that reservists may not be interested in reserve retirement; many drop out of the reserve program before completing 20 years of creditable service.

(3) In the event of a national emergency reservists will constitute the principal and immediate source of trained military manpower; therefore, it is essential that our military reserves attract and retain high quality personnel, and by ending this form of discrimination, Congress will do much to keep strong and able reserve forces at the ready.

Later, in convincing Congress to add eligibility for active duty servicemembers, NCOA and other advocates for improvements in military personnel programs, offered strikingly similar arguments:

(1) The regular retirement system offers no vested interest to the participant until he or she serves a minimum of 20 years of honorable active duty.

(2) Military retired pay for the average servicemember reaching retirement eligibility is currently less than $1,000 monthly. For those entering the military on or after August 1, 1986, the amount (in current 1991 dollars) will be less. At present, only about 15-to-20 of every 100 persons entering the armed forces will remain long enough to qualify for retired pay.

(3) In the event of a conflict between the United States and an aggressor nation, active duty military personnel will be the first to fight. Maintaining a strong and ready force of active duty servicemembers is a necessity and a principle concern of our nation's elected legislators. By amending the current code to allow active duty military personnel to fully participate in the IRA plan, as authorized military reservists, such action will play and essential role in attracting and retaining the highest quality men and women for the Army, Navy, Marine Corps, Air Force, and Coast Guard.

In 1986, Congress for whatever reason deleted active duty military personnel from participating while continuing to authorize entitlement to reservists. This, again, brought to the surface the same question that presented itself in the 1970's: Is the active duty military retirement program a "real" retirement plan? NCOA submitted that it isn't.

Other governmental retirement systems have deferred retirement programs should an employee be terminated prior to attaining retirement eligibility. In the case of active duty personnel, not only do they not have a vested program but are treated discriminately, in law, when seeking unemployment compensation. Ex-servicemembers must wait for a longer period before they can make application, and are entitled to half the benefits available to former federal civilian employees.

There are other comparisons of federal governmental plans, particularly those of the Civil Service Retirement System (CSRS), and Federal Employees Retirement System (FERS), with that of the Military Retirement System (MRS). The broad disparities in the comparison, as noted below, lend validity to NCOA's charge that the latter is not a true retirement program.

	CSRS	FERS	MRS
Vested at	5 yrs.	5 yrs.	20 yrs.
Thrift Savings Plan	Yes—Up to 5% of pay earns 8. 75% interest..	Yes—Up to 10% of pay; matching gov't. contribution of 5 percent.	None
Optional loan program	Yes	Yes	No
Lump sum payments	Yes	Yes	No
Involuntary early retirement	Yes	Yes	No
Employment	Permanent	Permanent	For enlisted personnel 6 year enlistments at most. Retention dependent upon approval by superiors after each enlistment.
Deferred annuity	Yes	Yes	No
Contributory	Yes	Yes	No
Restrictive	No	No	Yes
Refund option	Yes	Yes	No
Entitlement	Legal	Legal	None

In conclusion, NCOA avers unequivocally that the military retirement plan is more of an incentive for retention than one designed to provide an annuity or a pension for military personnel when they retire from the armed forces. If for no other reason, and there are other good and sufficient reasons therein, NCOA welcomes the introduction of the Super IRA bill and urges this distinguished Committee to adopt S. 612 at the earliest. It will address what NCOA and others believe to be an inequity in the treatment of active duty military personnel in the current IRA program.

Thank you.

Statement of Lyndon L. Olson, Jr.

I am pleased to have this opportunity to submit written testimony in support of the Bentsen-Roth bill, S. 612, the "Super IRA" plan. I am President and Chief Executive Officer of Primerica Life Insurance Company and Vice Chairman of one of its sister companies Primerica Financial Services.

EXPERIENCE GAINED ACROSS THE KITCHEN TABLE

The Primerica Financial Services sales force consists of 150,000 life insurance agents, of whom 27,000 are also licensed to market mutual funds, making PFS the largest financial services marketing organization in the United States. I offer this testimony on behalf of both our agents and customers; the knowledge that we have gained over the years comes not from polls, surveys or focus groups, but rather from the experience we have gained meeting hard-working Americans across the kitchen table. Primerica Financial Services representatives visit approximately 200,000 households monthly—that is where people tell it like it is.

Our company has achieved success by marketing term life insurance and mutual funds in support of the "buy term and invest the difference" concept—the cornerstone of our company. We carried our philosophy to the forgotten middle-American market and they embraced our practical approach to personal finance. As a result, we now have more than 2.2 million life insurance policyholders and 645,000 mutual fund customers.

Primerica Financial Services has always advocated "investing the difference" by saving for retirement through systematic contributions to a mutual fund IRA. We have approximately $2 billion in assets under management in our Common Sense Trust family of funds as proof of our success in communicating the need to save to our customers. We have contracts to market 100 additional fund groups, such as American Capital, Pioneer and Templeton funds.

SUPER IRA PLAN WILL ENCOURAGE DISCIPLINED SAVINGS

Although we continue to recommend IRA's as a good way to save for the future, there is little doubt that the restrictions currently in place regarding contribution limitations and early-withdrawal penalties have made many Americans reluctant to commit to IRA's. We have found that the hardest part about establishing the discipline necessary to save is starting to save.

Unfortunately, people are concerned about maintaining some liquidity in their savings for home purchases, college expenses and emergencies. What happens to these people? Tragically, many do not save at all because they do not have the incentive. They feel a certain sense of futility—that their financial future is out of their control. If we do not provide this incentive, these people will be much less likely to save for retirement.

NEGATIVE IMPACT OF CURRENT IRA RESTRICTIONS

Our records indicate that although customers are still interested in IRAs, they are not opening as many new accounts and have reduced contributions to existing ones. The company's mutual fund brokerage subsidiary statistics show that about 60% of all invested funds are contributed to IRA plans. This percentage has remained relatively static for the past six years, however total contributions peaked in 1986 and 1987 and have since sharply declined. It should be noted that 1987 figures were bolstered by a rush of IRA contributions before April 15 in order to take advantage of the more favorable tax treatment of IRAs prior to the 1986 tax reform.

The negative impact of the restrictions imposed by the 1986 tax reform were immediately felt as sales started declining in the third quarter of 1987, down 30% from the second quarter and 15% from the first quarter of 1987. Initial contributions to new accounts and additional contributions to existing IRA accounts have remained flat ever since.

Obviously, the market crash in October, 1987, had a profound impact on the 1987 fourth quarter and beyond. Still, evidence supports our contention that the loss of certain IRA benefits has contributed to reduced participation and lower contributions to mutual fund IRA's with our company.

WE BELIEVE IN INVESTING IN AMERICA

Primerica Financial Services markets mutual funds as long-term investments, that is why so many of our mutual fund accounts are IRAs. Our agents educate consumers that by systematically investing in mutual funds, they are able to take advantage of diversified, professionally managed pools of securities. This allows people not normally disposed to invest in individual securities to share in the growth of the stock and bond markets. Not only is this great for personal retirement savings, but it also helps the nation's economy by providing capital necessary for economic growth. We believe in this country's future, and we can help its future by encouraging more people to invest in it long-term. The Bentsen-Roth bill would do just that.

PRIMERICA FINANCIAL SERVICES PEOPLE SPEAK UP

In May, we explained the Bentsen-Roth bill to our agents and asked that they write letters of support to their Congressmen and Senators. They wrote the letters so they could better serve their customers. They wrote the letters so they could help themselves and their families. But mostly, they wrote because they feel strongly that the Super IRA is right for America and all its citizens.

We asked our agents to mail copies of their letters to our home office so we could keep track of their efforts. Thus far, I am extremely proud to say that we have received approximately 15,000 copies of letters sent by our agents to their Congressmen and Senators.

Primerica Financial Services representative Sheila Gamberdella of California, wrote the following to Senator Alan Cranston, "It is my hope that you will support the "Super IRA.". . . Throughout the day I consult with families on their financial matters, I am amazed at how little is contributed to their savings accounts for the long term . . . their debt continues to consume them and control all their financial decisions. In a wonderful country like the United States, why do benefits go to those who borrow rather than save?"

Representative Nelson Schoon of Indiana expressed his views to Senator Richard G. Lugar, "I see many of my friends and neighbors being encouraged to create debt for themselves. They are told it will solve their cash flow problems and make their businesses more profitable. In reality, just the opposite occurs. The government needs to encourage savings. This should be done through tax incentives and by example (stop deficit spending). This country needs to become a nation of savers, not debtors. All debt has ever done is create bondage to the creditor and devour resources through high interest rates. We need the Super IRA!"

J. Larry Grant of Oregon stated the following to Congressman Bob Smith and Senator Packwood, "Under current law, if both spouses work and earn over $50,000 per year, they are penalized. With the current economy and steady inflation, can $50,000 a year be considered rich? As people contribute to their individual retirement accounts, they will have funds at retirement time to finance their own needs and not burden the already over burdened welfare and Social Security programs. If Americans are given that extra incentive to save . . . they will respond and fund their IRAs and at the same time, fund our nation's economic recovery."

These comments from our representatives show how frustrated they are about a tax system that encourages spending but provides little incentive for saving. Although these people might be frustrated, they are optimistic that things can be turned around if programs such as the Bentsen-Roth plan are implemented now. These people, and their customers, are the backbone of America.

Our agents did not stop with writing their own letters; they also went to their customers, told them about the "Super IRA" plan and encouraged them to write letters. Our agents have told us that their customers responded with great enthusiasm; many of these current and potential customers wrote letters to their legislators asking them to help pass the plan.

CONCLUSIONS

The U.S. National Savings rate for the past decade has been worse than at any time since World War II. This is already costing our nation valuable working capital that would stir growth in the public and private sectors of the economy. The baby boom generation is aging, and will live longer on average than prior generations. If they are not adequately prepared for retirement, how will the nation support them? The answer is, we must begin supporting them by helping them help themselves. The Bentsen-Roth "Super IRA" will do just that.

By simplifying the IRA by making it available to all Americans, while eliminating early-withdrawal penalties for first-time home purchasers, education expenses and catastrophic medical expenses, more people will contribute more money. We know from experience that people are now paying attention to their finances and "tightening up" on credit purchases. They have seen what harm deficit spending has done to both their household "economy" and to this nation's economy. Americans want to stop this cycle and help themselves save for the future and simultaneously help their country become stronger. The time to do it is now; the Super IRA will lead the way to a better financial future for this nation and its hard-working citizens.

STATEMENT OF JOHN RATLIFF

ADLER, RATLIFF & ROHLFS, LTD.,
Northbrook, IL, July 30, 1991.

Mr. WAYNE HOSIER,
U.S. Senate,
Committee on Finance,
Washington, DC.

Dear Mr. Hosier: I have been a practicing CPA for approximately 20 years. Most middle-class people who established a deductible IRA account and for whom I have prepared income tax returns, have stated to me that this was a tremendous incentive to save for the future. They would say the "government" finally did something for middle-class Americans. When this benefit was eliminated, so was the incentive to save.

Please allow deductible IRA contributions, even if it means a slight tax increase.

Very truly yours,

JOHN RATLIFF, *C.P.A.*

STATEMENT OF THE UNITED STATES LEAGUE OF SAVINGS INSTITUTIONS

The U.S. League of Savings Institutions* welcomes this opportunity to provide its views on the Savings and Investment Incentive Act of 1991 (S. 612). This measure would restore the universal eligibility for IRA contributions that prevailed prior to the 1986 Tax Reform Act, introduce a new variant of the IRA and make significant adjustments to the rules governing penalty-free withdrawals. The U.S. League strongly supports this return to universal IRA eligibility.

Over the years, our thrift member institutions have aggressively marketed the individual retirement account (IRA). IRA/Keogh retirement savings (a separate IRA breakdown is unavailable) currently held at 96 percent of our member institutions totals $81.2 billion. Savings is unquestionably the most important ingredient for a smooth functioning financial system. It is also essential for a productive national economy. Without an adequate level of national savings, domestic economic investment becomes too dependent on foreign investment. It is time to break the hold of foreign capital over our economic future by bolstering our deficient national savings pool.

IMPACT ON SAVINGS RATES AND SAVINGS SUBSTITUTIONS

Econometric analysis has not produced any definitive conclusion on the impact of the previous "universal" IRA on national savings rates in the early to mid-1980s. Economic theory and common sense both indicate that the availability of this savings option had an impact on new savings (savings generation) and existing savings balances (savings substitution) although the exact proportionate mix is unknown, and perhaps unknowable.

It is also clear that the impact on new savings will grow over time as the supply of funds for switching is exhausted. This argues for the introduction of these new rules and their maintenance for a prolonged period.

As the Joint Tax Committee's study of this legislation notes, one of the aspects of the universal IRA that would be revived by this measure is the heavy promotional effort undertaken by anxious providers and its beneficial impact on saver psychology.

Depository institutions are acutely aware of the decreasing role of private, consumer saving from discretionary income. Contractual savings under pension arrangements have comprised an increasing share of our private savings pool. This inflow is certainly welcome, but its availability may have reduced consumer willingness to save in other, more traditional ways. The familiar

---

* The U.S. League of Savings Institutions serves the more than 2,000 member institutions which make up the $1.05 trillion savings association and savings bank businesses. League members include all types of institutions -- federal and state-chartered, stock and mutual. The principal officers include: Donald B. Shackelford, Chairman, Columbus, Ohio; Robert B. O'Brien, Vice Chairman, Morristown, New Jersey; Frederick L. Webber, President, Washington, D.C.; J. Denis O'Toole, Executive Vice President for Governmental Affairs. League headquarters are at 1709 New York Avenue, N.W., Suite 801, Washington, D.C. 20006. Telephone: (202) 637-8900. The Chicago office is located at 111 East Wacker Drive, Chicago, Illinois 60601. Telephone: (312) 644-3100.

sources of retirement savings -- social security, employer pension and employee savings -- will vary widely from employee to employee.

Although currently accumulating vast paper surpluses, the social security system will ultimately suffer from an increasingly adverse ratio of beneficiaries to workers. Anything that can be done to relieve the pressure from that component of retirement income will be extremely helpful, even at the cost of some current revenue.

The private pension system remains in flux. In a separate effort, the tax-writing committees are addressing the ongoing problems of complexity, fairness and financial stability of this system. Achieving any one of these objectives within the existing private pension system could adversely effect the other two.

Restoring the full scope of the IRA would automatically address, in part, the problems of funding, vesting and portability that so bedevil the private pension system. Although progress has been made in each of these areas since the passage of the landmark ERISA legislation, individuals who have been employed all their lives but who have changed jobs every five years or so may still reach retirement age with essentially zero accumulation from the standard defined-benefit pension plan system.

(In that regard, while we enthusiastically support the provisions of S. 612, we would suggest that some additional thought be given to yet more generous IRA contribution/deductibility treatment to those persons covered by a defined-benefit plan but who leave employment with no addition to retirement savings because of vesting rules.)

Furthermore, much attention has been paid recently to the plight of beneficiaries of such plans who have been made reliant on annuities from insurers that have encountered financial difficulties. At a stroke, the IRA solves the funding, vesting and portability problems and, at the option of the beneficiary, can obtain federal insurance of principal and interest by selection of an insured depository as the custodian of the funds. Return of the universal IRA will be a timely boost to stable and secure retirement savings.

One point should be stressed heavily in the debate on savings generation versus substitution. Whatever the relative percentages on that score, it is clear that 100 percent of the balances in the IRA accounts have been locked up as long-term savings.

These funds become part of the "deep-end" of the savings pool -- dependable sources of long-term capital for financing all types of long-term investment.

As the demands for available capital are increased by the expanding economies of Eastern Europe and the Soviet Union, the transformation of existing savings into more stable, long-term savings balances takes on even greater significance, particularly for long-term mortgage lenders.

EXPANDING PENALTY-FREE DISTRIBUTION ELIGIBILITY

Other features which broaden the appeal of this legislation would permit early withdrawals from IRA, 401(k), 403(b) or

501(c)(18) plans without imposition of the 10 percent penalty tax provided the money is used for the purchase of a first home, certain educational costs or catastrophic medical expenses. The increased access to savings without penalty makes the new IRA considerably more attractive to all savers than its predecessor. Catastrophic illness can occur at any time or age, so young and old are benefitted by this change. The cost of education and the purchase of a first home are usually concerns of the young, but older savers are increasingly facing these expenses either directly or as helpful parents.

DEDUCTIBLE VERSUS TAX-FREE INTEREST IRAs

One valuable benefit of the 1986 Tax Reform Act was the reduction in the top marginal tax rates. Other things being equal, however, such a reduction automatically decreases the incentive to contribute to the "traditional" deductible form of the universal IRA. Therefore, pre-1986 experience may be misleading as a guide to future savings behavior.

The new special IRA has the feature that interest earned will be tax-free if left undisturbed for five years. The League believes that this type of account will be a valuable bridge between the pure retirement account and long-term, fully taxable savings. Individuals will be more likely to commit to savings if such funds remain within reach without substantial penalty.

Similar vehicles exist today via insurance products, but these new IRA accounts will offer lower transaction costs and more transparency to savers.

INFLATION ADJUSTMENT FEATURE

The measure makes a sensible and long-overdue adjustment of the contribution limits through indexing in $500 increments. The real value of the $2,000 ceiling has been substantially eroded since 1981. This inflation adjustment will retain the future value and identification of IRA contribution limits by making the adjustment in significant $500 steps.

ADMINISTRATIVE BURDENS

The elimination of the eligibility phaseout rules for deductible IRAs will actually simplify administration for that class of accounts. Obviously, however, the introduction of the tax-free, term IRA and the expansion of penalty-free distributions will modestly increase the reporting burden.

We do not believe that these changes will be an unmanageable burden on the information reporting system. The distribution reporting is part of the regular system for depository institutions. Matching to loan documents and reports for home purchase transactions should be feasible at low cost. Matching to educational or medical expenses will remain outside the regular information reporting system, but such data are already required within the regular taxpayer audit system and should not represent any significant additional abuse potential.

CONCLUSION

The retirement objective should continue to be the primary purpose for this new expanded IRA. The need to supplement social security and employer retirement income with private savings is becoming more apparent with the prospects of a much reduced future work force, longer life expectancy, spiraling medical costs and early retirement. For thrift institutions which invest heavily in mortgage loans, long-term IRA savings provides a much better asset-liability match. Even the negative aspect of increased IRA withdrawals from the viewpoint of depository institutions should be far outweighed by the increased savings volume generated by such an attractive account. Indeed, the U.S. League believes that S. 612 will transform the once popular IRA retirement account into a much needed national savings account with universal eligibility as well as universal appeal. The League would be happy to cooperate with the Finance Committee and the Treasury to craft the appropriate changes to our existing system.

* * * *

This concludes the U.S. League's statement. Any desired clarification or amplification of the League's position can be obtained from our Washington office.

49-352 (128)