Opinion | Allison Schrager, Columnist

Your 401(k) Will Be Gone Within a Decade

The intellectual case for getting rid of tax-advantaged retirement plans is strong, and the political case is catching up.

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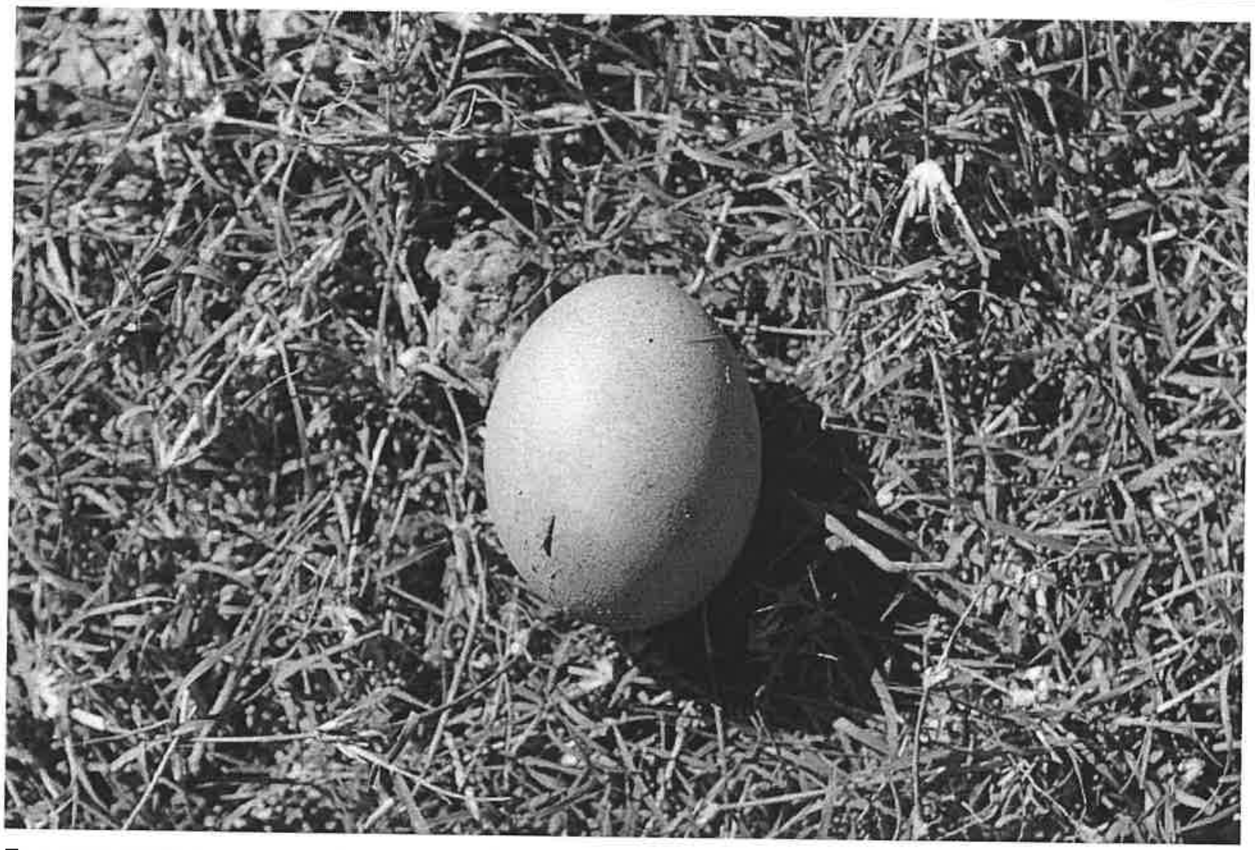

Everyone needs a nest egg. *Photographer: Mary Kang/Bloomberg*

If you are among the 56% of US workers with a retirement plan, I have some bad news for you: Your 401(k) will be gone in 10 years, tops. Not the money, thank goodness – Americans have trillions of dollars in these accounts, and there is an entire industry built around them – but the plans themselves.

There has been a brewing intellectual movement to get rid of the 401(k) for several years, with scholars on both the right and left questioning its value. And as the federal government gets increasingly desperate for new sources of revenue, the tax treatment of

401(k)s is a likely target. There are good policy reasons to end it, but the question remains: Will Americans still save for retirement?

The 401(k) is not tax-free but what is known as tax-advantaged. Contributions made while working are not taxed, but participants pay taxes when they withdraw the money during retirement. Whether there is a big tax savings depends on the tax rate in retirement – which is usually lower because retirees tend to have lower earnings. Savers also avoid capital gains taxes on returns.

All of this cost the government an estimated $185 billion in 2019, or 0.9% of GDP. That's not nothing. And in theory it's justifiable because it creates a powerful incentive to save for retirement. More retirement savings have a triple benefit: for the economy overall, since they fuel growth; for the government, since retirees with income are less likely to be a burden on the state; and, of course, for workers who might not save enough today and regret it later.

Then again, maybe not. The first rumblings that the benefits of the tax breaks may be overstated came in a 2014 study of Danish savers. Without tax-advantaged accounts, it found, people just put their money in another kind of account. People did save more in retirement accounts, but that's mostly because of automatic paycheck deduction. Subsequent research in other countries found similar results. Not only did the tax incentive fail to encourage more saving; the biggest beneficiaries tended to be the wealthy.

To review: Neither conservatives nor liberals are particular fans of tax-advantaged retirement accounts, and savers appear to be indifferent to them. So what's the point of a 401(k)? Expect more scrutiny in the coming years as more revenue is needed to fund entitlement programs and interest on the national debt. Eliminating the favorable tax treatment of the 401(k) is much less painful politically than increasing taxes directly.

This doesn't mean employer-sponsored retirement accounts – and even employer contributions to them – will go away. But no one will get any tax benefits. Removing the special tax treatment, however, raises a deeper question: If you are a worker, why bother with a retirement account at all? Especially if there is a penalty for early withdrawals?

Enter the employer-sponsored liquid account. Like a retirement account, it is funded by payroll deductions, but unlike a 401(k), it allows employees to withdraw money without a penalty when needed. As these accounts grow in popularity, they may displace the 401(k). More liquid accounts, similar to a Roth IRA, have been become popular in Canada, and Canadians are saving more in them than in the tax-advantaged retirement accounts.

Still, there is a case for the 401(k). The saving rate is not the only metric to judge the value of these accounts. There is a justification, for example, for the penalty for early withdrawal: It prevents people from spending their savings too soon. If you think that's a valuable social goal, then you may also support preferential tax treatment of accounts with an early-withdrawal penalty.

Replacing the 401(k) with more liquid saving accounts will mean less money saved for retirement, simply because they make it much easier for people to spend their savings. I asked Andrew Biggs, co-author of a recent report on using subsidies for retirement plans to fix Social Security, if he was concerned that the lack of a tax advantage would result in more early withdrawals. He told me that retirement savings could be encouraged by tinkering with the capital gains tax rate. Besides, what if people truly do value spending today over saving for retirement tomorrow? In that case, the nudges are misguided.

It's worth pointing out, finally, that nudges – misguided or not – can work on governments, too. Retirement accounts also require the government to defer consumption, because it forgoes some tax revenue today in exchange for future revenue. Perhaps 1% of GDP is too much to pay for this one modicum of spending discipline imposed on the government – a discipline that, in a higher-rate environment, is more expensive and harder to justify. But it is pretty much the only way the government is saving. That, too, is not nothing.

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