

The Boston Globe

June 14, 2007

When a penny saved is taxed

Editorial

SAVING MONEY is supposed to help Americans afford their own futures. But a new study shows that poorer, younger people are often punished for saving by kinks in the tax code and in federal program rules. To fix the problem and encourage saving at all income levels, Congress should change the rules and seek out innovations.

Low-income people often have the least money to save. But if they don't start early, they risk being poor in retirement. The study, written by Boston University economics professor Laurence Kotlikoff and released by the **National Center for Policy Analysis** in Dallas, points to a classic example of people hurt by obstacles to saving: families on welfare. In Massachusetts in 2005, welfare recipients could not have more than \$2,500 in assets. If they did, they lost their welfare checks, creating a disincentive to save.

Similarly, some people who receive food stamps must have less than \$2,000 in savings, or else lose the benefit.

Calculating taxes and government benefits is a complex process. The end result is that most people face some disincentive to save - but the system tilts in favor of the rich. For example, the report says that a 30-year-old single mother earning \$15,000 a year could lose \$2.60 for every \$1 she saves because of additional taxes and lost benefits. But if she instead earned \$250,000 a year, she is effectively penalized only 31 cents for every extra dollar she saves.

Fixing this system would give people a fighting chance to save. A key step is to adjust the tax code. One quirk is in the Earned Income Tax Credit, a helpful program that rewards low-income workers. But in the past, some EITC filers couldn't qualify for another program that offers tax incentives to save. Such inconsistencies need to be cleared up. Similarly, officials should have more room to discount or disregard retirement savings when assessing eligibility for benefit programs.

People also need help with an identity problem: Americans are shoppers. According to the US Department of Commerce, the personal savings rate in 2006 was minus 1 percent of disposable income. But with the right incentives Americans can overcome their profligate ways. This was done in a 2005 study released by the National Bureau of Economic Research. Researchers set up an experiment in 60 H&R Block tax preparation offices in low- and moderate-income neighborhoods in St. Louis. Tax filers at these offices were asked to contribute to IRAs. Some were offered a 50 percent match of funds - if they put in \$300, another \$150 was added. Others were offered 20 percent, and others weren't offered any matching funds. Not surprisingly, the higher incentive, the more people saved. Another contributing factor was the ease of the program.

Better policies and leadership can help people save for themselves.