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Analyzing Social Security and Tax Deferral Together Confirms: System Is Progressive, Provides Incentive to Save for All Workers

Washington, DC, January 20, 2016—A new book authored by Investment Company Institute Senior Economist Peter J. Brady details how the current structure of the U.S. retirement system is progressive and provides benefits to all American workers. The book, *How America Supports Retirement: Challenging the Conventional Wisdom on Who Benefits*, also dispels myths about tax deferral, a critical component of the employer-sponsored retirement plan system, which helps millions of individuals plan and save for retirement.

The Benefits of the U.S. Retirement System Are Progressive

“This book aims to tackle some of the pervasive myths about the structure of—and benefits provided by—the current retirement system in the United States,” said Brady. “When you look at the system as a whole, you find it is progressive, providing more in lifetime benefits through Social Security and tax deferral to lower earners as a percentage of their total lifetime earnings. Further, the book argues that tax deferral makes the tax system more—not less—fair, and illustrates that it equalizes the incentive to save by effectively taxing investment income at a zero rate for all workers.”

Brady’s book builds upon ICI’s long history of analysis and research on retirement and savings. The research counters critics’ attacks on the 401(k) system and other voluntary, employer-based retirement plans that, alongside Social Security, are helping millions of Americans achieve secure retirements.

“We are very excited to offer this groundbreaking research, culminating years of hard work by Pete Brady and our research team,” said ICI President and CEO Paul Schott Stevens. “This book provides important analysis and perspective to the growing conversation taking place on the future of retirement in America. It underscores the often-overlooked strengths of our voluntary, employer-based retirement system and is a must-read for anyone working in the public policy space on retirement and tax issues.”

Dispelling Myths About Tax Deferral

In addition to detailing the progressivity of the overall system, Brady’s book dispels key myths about tax deferral. First, Brady tackles the myth that higher-paid workers get more benefits from tax deferral because they face higher marginal tax rates. Instead, Brady asserts that the Social Security benefit formula causes workers with higher lifetime earnings to rely more on tax-deferred compensation—and thus to contribute more relative to their income—to prepare for retirement.

Additionally, Brady confronts the political narrative and myth that the current tax system provides an “upside-down” incentive to save, explaining that tax deferral actually eliminates the disincentive to save that is inherent in the U.S. income tax. The net effect is that tax deferral equalizes the incentive to save for workers with varying incomes and marginal tax rates.

Key findings from Brady’s work include:

- When evaluating the U.S. retirement system, it is important to assess both the Social Security system and tax deferral. In combination, the benefits of the two programs are progressive. In other words, lower-earning workers derive more benefit, as a percentage of income, from the government’s support for retirement through these two channels than do higher-earning workers.
- Policy discussions of tax deferral often focus on the up-front reduction in taxes enjoyed by workers and ignore the higher taxes these workers will pay during retirement. Contributions to retirement plans are tax-deferred, not tax-free. For higher-earning workers analyzed in this study, increased taxes in retirement offset more than half of the reduction in taxes while working.
- Contrary to conventional wisdom, the marginal benefits of tax deferral (the benefits of deferring an additional \$1 of compensation) are higher, on average, for the lower-earning workers analyzed in this study than they are for higher-earning workers.
- The benefits of tax deferral increase with lifetime earnings because of the design of the Social Security system, not because of the design of the income tax.
- The most prominent tax reform proposals to limit the up-front benefits of tax deferral would make the tax code less fair and more complex.

How America Supports Retirement is available at www.ici.org/whobenefits. A [summary](#) of the book is presented in the Institute’s *ICI Research Perspective* series.

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