



Do Individual Retirement Accounts Increase Savings?

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Abstract

Do IRAs increase savings or are they merely a windfall for otherwise well-off taxpayers? A major objective of universal IRAs was to encourage saving for retirement. A spirited debate has ensued over the use of IRA tax deductions as a means of promoting private savings. The crucial policy issue is not whether IRA contributions were substantial; they clearly were, representing about 30 percent of personal savings from 1982 to 1986. Rather the important question is the source of IRA contributions. IRAs can be financed out of 1) tax savings themselves; 2) shifting existing assets into IRAs; 3) borrowing; 4) diverting new savings into IRAs; or 5) reducing consumption. The key question is how much of IRA savings comes from reduced consumption. For overall savings to increase, private savings must increase by more than the tax savings. Conventional economic theory and evidence strongly suggests that IRAs were not effective savings incentives. The challenge to this view rests largely on studies which have appealed to a variety of "psychological" factors not normally incorporated in economic analysis. This paper reviews both types of

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