New Study Confirms 401(k) Limits Not Constraining

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MarketWatch Blog by Alicia H. Munnell

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Catch-up provisions had only a modest impact on saving.

Under current law, individuals can contribute up to $18,000 per year to a 401(k) plan and those 50 and older can make an additional catch-up contribution of $6,000. Despite the fact that less than 10 percent of participants are constrained by these ceilings, many suggest that the answer to the retirement income crisis is raising the contribution limits.

A **recent study** by my colleagues shows that raising the limits would do little to increase retirement saving. These researchers looked at the impact of changes that Congress enacted in 2001, which increased 401(k) limits for all ages and established a new catch-up provision for workers age 50 or older, allowing them to contribute much more.

This study uses the *Survey of Income and Program Participation*, a panel survey of households over a two- to five-year period that includes demographic and economic variables, linked to the Social Security Administration's Detailed Earnings Records. The sample includes any individual ages 46-53 between 1999 and 2005, just before and after the adoption of the catch-up provision.

The 2001 legislation increased the tax-deferred limits on 401(k) contributions between 2001 and 2005 from $10,500 to $14,000 for individuals under age 50, and from $10,500 to $18,000 for individuals age 50 and over.

The researchers estimated the impact of these new limits on contributions along three dimensions: 1) workers who were under age 50 versus 50 and older, because older individuals had a higher contribution limit; 2) participants who were near the contribution limit in any prior year versus workers who had never approached the limit, because the latter group's tax incentives remained unchanged; and 3) workers before and after the adoption of the catch-up provision.

The results showed that the increase in 401(k) limits and introduction of catch-up provisions did not have a statistically significant effect on contributions of those workers unconstrained by the deferral limits – both those under 50 and those over 50.

As expected, the story is different for constrained workers. Constrained workers under age 50 contributed a statistically significant $917 more after 2001 than non-constrained contributors in the same age group. Constrained workers over age 50 – those now eligible for the catch-up provisions – contributed a statistically significant $1,697 more after 2001 than their non-constrained counterparts. This increase was about half of the amount by which they could have raised their contributions.

Thus, the only group of 401(k) participants sensitive to a change in tax incentives was workers who were constrained by the tax-deferred limits. Less than 10 percent fell into this category, and these people had much higher income and wealth than the unconstrained.

The bottom line is that further tinkering with the contribution limit for 401(k)s would likely affect only a very small group of people; it does not appear to offer a broad-based solution for low saving rates in the United States.