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KidSave: An Innovative Step Toward Better Retirement Security

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A recent study of retirement savings plans shows that the most important step toward retirement security is the decision to save. This simple decision, according to the National Bureau of Economic Research, is even more important to an individual's retirement income than how the money is invested.

A new bipartisan proposal would make that decision much easier. S. 3200, authored by Senator Robert Kerrey (D–NE) and cosponsored by Senators Rick Santorum (R–PA), Daniel Patrick Moynihan (D–NY), Charles Grassley (R–IA), and John Breaux (D–LA), would create "KidSave" accounts to take a first step toward providing for future generations' retirements.

How KidSave Would Work. Under the Kerrey legislation, every American child would receive a loan of $2,000 at birth from Social Security. After 2005, that figure would be indexed annually for inflation. The money could be used only to open a KidSave account, and funds could be withdrawn only at retirement or if the owner of the account were to die before then. Even if no other money is ever added to the account, the $2,000 initial loan could grow to as much as $250,000 by the time the child retired. The nest egg could then be used for such things as increasing retirement income, sending a grandchild to college, starting a small business, or making a donation to a church or community organization.

These accounts would be invested through the Thrift Savings Plan (TSP), which helps federal employees invest for retirement. TSP currently offers three safe and low-cost investment options: a stock index fund, a corporate bond fund, and a government bond fund. Under the proposal, parents or legal guardians of under-age citizens could determine in which of these options the KidSave account would be invested.

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In addition to the base loan of $2,000 from Social Security, parents would be allowed to deposit up to $500 annually in each child's account until he or she reaches the age of 19. This money could be in cash or could come from various types of tax refunds. Part of that $500 could also come from grandparents, who would be allowed to roll over money, tax-free, from 401(k) or similar retirement plans.

When the account owner reached the age of 30, the initial loan would have to be repaid in five equal annual installments. Although the worker would not have to pay interest on the loan, he or she would pay back an inflation-adjusted amount. In other words, if the $2,000 initial loan had increased to $3,500 in inflation-adjusted dollars by the time the worker reached the age of 30, that would be the amount to be repaid. One-fifth of this adjusted amount would be deducted from the worker's account annually.

Positive Features of KidSave: In addition to enabling all individuals to build a retirement nest egg, the bipartisan KidSave plan has other benefits:

- **KidSave would be available for everyone.** Every child, regardless of family income level, would receive a KidSave account. Instead of attempting to redistribute income or targeting only a few specific groups, the program would help all Americans save for retirement. Lower-income workers would have the same opportunity to build assets as those in higher income brackets.
- **KidSave would be a loan, not a gift.** KidSave would teach children that while people may be willing to assist them, loans must be repaid. Unlike proposals to "seed" retirement accounts with government matching grants, KidSave would not divert other people's tax dollars into the accounts.
- **KidSave would help to reduce the gap between rich and poor.** Many lower-income individuals find it impossible to save because Social Security and other taxes leave them with nothing after rent, food, and other expenses. KidSave would enable low-income families to accumulate a nest egg for the family's future without cutting deeply into their paychecks. Also, since a KidSave account is owned by the individual and would become part of his or her estate, it would help the family if the worker died before retirement.
- **KidSave money would stay in the community.** Since KidSave accounts would be owned by the individual worker and would become part of his or her estate after death, the KidSave accounts of lower-income workers would tend to remain in their communities, giving these communities a greater opportunity to build wealth.
- **Because KidSave would be funded through Social Security, it would be harder to divert the money to other purposes.** A continuing problem with other types of retirement savings plans is that Congress allows workers to use that money for such things as educational expenses and purchasing a home. While these may be worthy goals, they do nothing directly to help a worker prepare for retirement. Because the KidSave accounts would be funded by a loan from Social Security, it would be politically very difficult for future Congresses to permit account holders to divert KidSave money to non-retirement uses.

Making KidSave Even Better. The proposal could be improved by allowing workers to divert a portion of their Social Security retirement taxes into their KidSave accounts in return for a proportional reduction in their individual Social Security retirement benefits. Because KidSave accounts can be expected to yield a greater rate of return than Social Security, the result would be to improve these workers' retirement income while also reducing Social Security's unfunded liability.

Conclusion. The bipartisan KidSave plan is an innovative step toward enabling every American to build a retirement nest egg. By permitting young Americans to have an account using funds loaned from their future Social Security benefits, KidSave would allow all income groups to build assets to supplement traditional Social Security. This means that all young Americans could look forward to a retirement that did not depend entirely on Social Security.

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