

Executive Summary

Increasing the domestic saving rate has been a major policy concern for many OECD countries in the past decade because low saving rates can hinder investment, economic growth, the balance of payments and the financial stability of households.

Governments have therefore introduced various incentives, including savings accounts that offer tax advantages, called tax-preferred savings accounts. While much attention has been devoted to the study of tax-preferred pension accounts in the past 20 years, there has been relatively little research on whether tax incentives encourage other forms of saving. Consequently, this report focuses on tax-preferred savings accounts (not linked to pension or retirement savings) that enhance the financial well-being of households, such as education-savings accounts and life-insurance contracts.

The data for this report were derived from an extensive questionnaire answered by 11 OECD countries, and the aim of the report is to analyse the data received in light of the existing literature on tax incentives for savings. The report then presents a cross-country comparison useful to policymakers interested in designing or modifying tax-preferred savings accounts. This international comparison focuses on: account design features; the impact on the income distribution; the accounts' effect on saving; and government expenditure related to such accounts.

In particular, the analysis of the effects on the income distribution includes: the number of account participants by income class; the participation rate by each income class; and the average contribution by income class in total, and as a percentage of income. Distributional issues regarding tax-preferred savings accounts have received little attention in the literature. This is puzzling because it is generally believed that the effectiveness of tax-incentive programmes (*i.e.* an increase in saving at the lowest cost) depends crucially on whether the plans create new saving among low and middle-income households. The literature (Benjamin, 2003; Engen and Gale, 2000) agrees that the saving effect of tax-preferred incentive plans is greater on moderate-income households. Thus, the greater the share of low and middle-income households participating in tax-favoured accounts, the more likely it is that new saving is created. Additionally, since moderate-income individuals face a lower tax rate, the more they participate compared with high-income individuals, the lower the government's foregone tax revenues (Antolin, de Serres, de la Maisonneuve, 2004).

The report is organized as follows: Chapter 1 describes the various tax-preferred accounts analyzed for each country and presents a comparison of their design features, followed by an analysis of the effects on the income distribution, the savings effect, and government expenditures on tax-favoured savings plans. Chapter 2 then describes in more detail the design features of each tax-preferred plan. The Annex presents tables with data submitted by OECD countries.

Findings

This report shows that the tax-preferred plans analysed display some common distributional features. First, participation rates increase with income: the highest income classes display the highest participation rates.¹ For some accounts, higher participation rates for the richest classes are somewhat mitigated by the fact that a great number of participants come from moderate-income classes. This means that even if wealthier households profit from the savings plans to a greater extent, the participation of low and middle-income households is substantial. Regarding the level of contribution and/or investment in tax-preferred accounts, all the plans analyzed display contributions increasing with the holder's income. This result is partially mitigated by the fact that contributions as a percentage of income are highest for low-income earners.

Tax-preferred environments have been introduced with the aim of increasing personal and national saving. The relation between tax incentives and personal saving is one of the most investigated aspects of the academic work in this area. There is no general agreement in the literature, though. It is likely that the effect of tax-favoured accounts lies between the hypotheses of no new saving and the hypotheses that all the assets deposited in the plans represent new saving (Hubbard and Skinner, 1996). Most of the data sent by OECD countries support this view, indicating that tax-preferred accounts other than educational plans create new saving only when moderate-income households participate in them.

The last issue we investigate is the cost of tax-preferred savings accounts. As highlighted by Hubbard and Skinner (1996), it is not possible to understand whether tax-favoured plans are efficient (*i.e.* they increase saving at the minimum cost) without knowing something about the cost of the program in terms of foregone tax revenues.

This report shows that costs depend on whether incentives are granted through tax credits or through the exemption of accrued earnings. Expenditure features are also influenced by the capacity limits of the accounts and by the saving bonus granted to the investor. Unsurprisingly, the most expensive accounts are those granting a tax credit or paying a generous saving bonus in the account.

The overall conclusion is that it is important for the efficiency of tax-preferred accounts to involve moderate-income households: the latter are more likely to increase saving when given the opportunity to invest in tax-favoured accounts. Furthermore, since moderate-income individuals face a lower tax rate, the more they participate in comparison to high-income individuals, the lower the cost of foregone tax revenues. However, the evidence indicates that, in fact, wealthier individuals have the highest take up of tax-favoured accounts. This suggests that there is still room to improve the effectiveness of these plans by changing some of the design features in order to attract more moderate-income households.