

Hey, low-income people! Here's one retirement savings strategy, while government thinks about how it might help.

By Karl Polzer

U.S. retirement policy hurts you because it leaves you out. Don't wait for that to change. Congress cares more about the middle class than you. That's because more of them vote. State governments are gouging you by selling you lottery tickets. Here's a strategy for retirement that's better than a lottery ticket.

Think tanks in Washington, DC are busy cranking out policy proposals to address the “looming retirement savings crisis” spurred by the fact that more than half of American households have virtually nothing saved for this purpose in their defined contribution (DC) accounts or otherwise.

As is custom, while Congress takes its time, the idea people in the Capital environment ask the usual questions and round up assumptions to fill in around what they know. So, why aren't more poor people stuffing money into tax-favored IRAs and 401(k) plans? There must be something morally amiss with them. After all, some studies show that poor people are spending up to 10% of their income on lottery tickets. If only we, the wise planners, could get them to act more rationally (that is, like us) and think ahead!!

Among the reasons that low-income people don't have much in retirement plans are the following:

- Poor people don't have much money to save in the first place.
- They are less likely to invest retirement funds in stocks, which earn much more than bank accounts over long periods of time. Because they might need their savings for food or shelter, they can take less risk than people with more money. Less risk can mean less reward, which can result in dramatically lower retirement savings over decades of investment.
- They are far less likely to have access to a retirement plan at work and an employer willing to put money in the account. For those without an employer plan, many financial institutions make it difficult to start small individual retirement accounts or charge fees that are steep relative to small balances.

- They are less likely to afford financial advisors or representatives. Meanwhile, federal government employees and many former federal government employees working for think tanks, who are pondering why their countrymen aren't well prepared for retirement, still have traditional defined benefit plans run by investment professionals, alongside their DC plans.
- Poor people also get less of a tax break for money they put in qualified retirement plans than people with higher tax rates do.
- Many don't feel comfortable with financial issues, financial planners, or retirement planners.
- They don't see retirement plan options that make sense to them and they don't have time to hunt through the haystack to find them.

When the factors above and other circumstances are taken into account, it's no surprise that the DC retirement system isn't helping poor people very much to save for retirement and why the majority can expect to rely almost exclusively on Social Security. The DC retirement system is stacked against them, and, in fact, tends to magnify differences in asset levels between those at the top and those at the bottom over time. (See working essay "How the New Retirement System Magnifies Wealth Inequality," also on this web site.)

Under this type of retirement system, each worker is expected to be an accomplished saver and investor. Their investment risk is not pooled. Each person is on her or his own. Unfortunately, most people are not financially or vocationally equipped for this task.

While policymakers play ping pong with various options – including mandatory savings accounts with an opt-out option (hey, do you understand this?); government organized pensions that could be accessed by workers or small business (what about this?) – poor people and young people needn't wait for help. They can start saving and investing for the long term either within a government qualified retirement account like an IRA or by buying stock or mutual funds through a broker. Yes, there is a risk of failure. You could lose your investment entirely. Where would you be then? Probably not far from where you are now.

Many policy planners shudder at the idea of low income-people taking investment risk with small amounts of money that they might possibly lose. But, if our society's predominant retirement system expects each individual to act as an investor, there's an argument that people need to learn how to invest by "doing it" -- that is, by having skin in the game. There's a case that this needs to happen early a person's work life.

Like primitive people teaching kids to use sharp knives to clean and skin animals and make tools, people going into the workforce need to be taught the basics of saving and investing. People entering the DC system need to see their asset levels go both up and down in price and get used to the idea that risk involves loss as well as gain. They need to fail and learn to get up and try again. Small amounts of money are ideal for experimentation and learning how to invest. It also could be argued that poor people are used to living amidst a great deal of uncertainty and risk. Many face a lot of risk getting through each day. Who knows – "they" might be very good at handling investment risk if it was demystified... Even better, the government could organize a retirement system including a way to pool investment risk under the guidance of experienced professionals held accountable for helping money grow without excessive risk.

Enter the lottery. Studies show that many low-income people spend significant percentages of their income on state sponsored lotteries. While the odds of winning the lottery big time are infinitesimal, the proposition appears to be clear: this is a ticket to lifestyle that is otherwise out of reach for the majority of U.S. workers. However, if a person plays repeatedly, odds are they will end up losing about half the money invested over time. While spending this kind of money on entertainment (the lottery could be considered that) is a personal choice, it's a poor type of long-term investment.

Expected Return on Lottery v. Return on Stocks over 40 Years

Average Amount Spent or Invested per Month (2006 Dollars)	Total Spent or Invested over 40 Years	Expected Return from Lottery (a) (Nominal Amount at End)	Expected Return from Lottery (a) (2006 Dollars)	Expected Return from S&P 500 (Nominal Amount at End)	Expected Return from S&P 500 (2006 Dollars)	Increased Retirement Savings from Investing Rather than Playing Lottery (2006 Dollars)
\$5	\$3,806.85	\$2,017.63	\$890.72	\$18,372.49	\$8,110.85	\$7,220.13
\$10	\$7,613.70	\$4,035.26	\$1,781.44	\$36,744.98	\$16,221.69	\$14,440.26
\$25	\$19,034.26	\$10,088.16	\$4,453.59	\$91,862.44	\$40,554.23	\$36,100.64
\$50	\$38,068.52	\$20,176.31	\$8,907.18	\$183,724.88	\$81,108.46	\$72,201.29
\$100	\$76,137.03	\$40,352.63	\$17,814.35	\$367,449.77	\$162,216.92	\$144,402.57
\$300	\$228,411.10	\$121,057.89	\$53,443.05	\$1,102,349.30	\$486,650.77	\$433,207.72

Note: Calculations assume a constant 2 percent inflation rate, 7 percent return on S&P 500 average, and monthly compounding. Lottery spending is not adjusted for life cycle or income cycle.

- (a) Based on a 53% cumulative payout rate for all lotteries from 1964 through 2003. These figures represent the average lottery player's winnings; of every dollar spent by consumers, lottery agencies have returned 53 cents in the form of prizes. Payout rates vary by state, type of game and year. See Teresa LaFleur and Bruce LaFleur, *LaFleur's 2003 World Lottery Almanac* (Boyd's, Maryland: TLF Publications, 2003), 19.

Source: Tax Foundation

An analysis by the Tax Foundation makes the case that money spent on the lottery is in effect a tax that diverts income away from retirement savings, particularly for low-income people.ⁱ **See table on the previous page.** The study shows that money spent on lottery tickets would shrink almost in half over 40 years. Spending \$50 dollars on the lottery each month would come to about \$38,000 over four decades. At the end of that time period, the person would have about \$20,000. This drop in value is consistent with the observation that state lotteries cumulatively returned 53 cents in the prizes for each dollar consumers spent over a 40-year period ending in 2003, just before the study was done. The same amount of money (\$50 a month) invested in a stock index fund would yield about \$184,000 over four decades.

If playing the lottery is important to a person for psychological reasons, including entertainment or simply trying to bet against poverty and help motivate the effort to keep a job with little or no promotion potential,ⁱⁱ one strategy could be taking half the money usually spent on lottery tickets and, instead, investing that in a stock fund in a Roth IRA or through a brokerage account or annuity. As a result, the odds of winning a big lottery jackpot wouldn't change much, while you would be acquiring real assets in your new account. You would have the entertainment value of watching the ups and down of your investment. Even if service charges would be relatively high for small accounts, they probably would be lower than the massive overhead costs that the government is charging you (about 50%) to play the lottery. Instead of buying a tiny chance at winning entrance to a capitalist fantasyland, you would be accumulating real assets like shares in real estate and companies producing value in the economy. At set intervals, you could take a look at how your lottery investment is doing compared with your investment in working assets and consider changing how you split your investment dollars going forward.

If the government ends up creating a retirement system that includes you in the meantime, that's fine. But don't expect that to happen in the near future.

And don't forget to vote. People struggling to make ends meet may soon be the majority. Think of what your elected representatives might do for you if they knew there were consequences for not fighting for your interests.

ⁱ “Lottery Taxes Divert Income from Retirement Savings,” Gerald Prante and Alicia Hansen, Tax Foundation, 2006.
See: <http://taxfoundation.org/article/lottery-taxes-divert-income-retirement-savings>.

ⁱⁱ See “Lotteries: America’s \$70 Billion Shame,” The Atlantic, May 15, 2015.
<http://www.theatlantic.com/business/archive/2015/05/lotteries-americas-70-billion-shame/392870/>