State Wage-Payment Laws, the Pension Protection Act of 2006, and 401(k) Saving Behavior

Gary V. Engelhardt

Syracuse University

Overview

- 401(k)s dominant form of retirement saving

- In 1990s, plans began adopting automatic enrollment (AE)

  » Default is to participate and defer salary, but may opt out

- Despite research, AE still less than 5% of 401(k) plans in 2005

Overview

- IRS rulings in 1998 and 2000 that AE was permissible for new hires and existing employees

- Oft-cited reason for reluctance to adopt AE

  » Default ran counter to state-level wage-payment laws that forbid wage deductions without written permission of employee

- No evidence though that this was a binding constraint on firm pension choices

Overview

- This paper part of a larger research project examining impact of PPA2006

- Presents evidence that wage-payment laws significantly deterred the expansion of 401(k) participation via AE prior to 2006

Methodology

- HRS panel sample of 703 mid-career individuals (EBB)

- Working in both 2004 and 2008

- Eligible for a 401(k)

- Non-federal employers

  » Federal workers exempt from state laws

- No self-employed

Methodology

- Sample consists of individuals in

    » 40's and 50's

        - Young enough for AE to have an impact
        - Old enough that retirement is not a distant prospect

    » Primarily white, married, with a college education

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Methodology

- Natural experiment framework

- Compare participation/contributions of workers

  » Residing in states with wage-payment laws outlawing deductions without written consent

    vs.

  » Residing in states without such laws

  » Before (2004)

    vs.

  » After PPA2006 (2008)

Summary of State Laws

- 26 states have laws outlawing wage deductions without written employee consent

- 8 exempt state employees

- 7 exempt local public sector employees

- Wide variation in administrative, criminal, and civil penalties

Table 2
States with Wage-Payment Laws Requiring Written Permission

	(1)	(2)	(3)	(4)	(5)
State	State Employees Exempt	Local Employees Exempt	Other Exemptions	Penalty ($) Per Employee	Lump-Sum Penalty ($)
Arizona	No	No		0	0
California	Yes	Yes		100	0
Connecticut	No	No		5000	0
Delaware	Yes	Yes		5000	0
Hawaii	Yes	Yes		10000	0
Iowa	No	No		0	500
Idaho	No	No		0	500
Illinois	Yes	No		0	500
Kansas	No	No		0	0
Kentucky	No	No		0	0
Louisiana	No	No	Less than 10 employees in Oil, Manufacturing, and Mining	0	500
Maryland	No	No		0	1000
Michigan	No	No		0	0
North Carolina	Yes	Yes		250	0
North Dakota	No	No		0	0
Nebraska	No	No		0	0
New Hampshire	No	No		0	200
New Jersey	No	No		0	1000
New York	No	No		0	500
Oregon	No	No		0	0
South Carolina	No	No		100	0
Texas	Yes	Yes		0	1000
Utah	Yes	Yes	Agriculture	0	0
Virginia	No	No		1000	0
Vermont	No	No		500	0
Washington	Yes	Yes		0	1000

Estimation Framework

- State variation requires the use of restricted-access geo-code data

- Cannot be merged with pension SPDs

- Use self-reported measures of 401(k) participation and contributions in the employment section

- Unfortunately, HRS does not have complete, direct measures of AE in the employment section

Estimation Framework

- However, a number of studies have documented a strong link between the passage of PPA2006 and substantial subsequent growth in AE plans

  » Utkus - Vanguard
  » VanDerhei – ICI/EBRI

- Therefore, I take a reduced-form approach

Estimation Framework

- *i* indexes individual, *s* indexes state, *t* indexes calendar year

- Estimate

$$C_{ist} = \alpha \mathbf{x}_{ist} + \beta \kappa_{ist} + \delta_1 y_{ist} + \delta_2 y_{ist}^2 + \gamma D_{ist}^{Pension} + \theta D_{is}^{Written} \times D_t^{After\,2006} + u_{ist}$$

- Control for earnings (*y*), other pension coverage, demographics (**x**), employment characteristics (**K**)

- Interaction term

Estimation Framework

- Disturbance term is modeled as

$$u_{ist} = v_i + \psi_s + \xi_t + \varepsilon_{ist}$$

- Panel data: treat v as a random effect

Estimation Framework

- Primary objective is to estimate θ

$$C_{ist} = \alpha x_{ist} + \beta \kappa_{ist} + \delta_1 y_{ist} + \delta_2 y_{ist}^2 + \gamma D_{ist}^{Pension} + \theta D_{is}^{Written} \times D_t^{After\,2006} + u_{ist}$$

- Measures differential impact of working for an employer subject to wage-payment laws requiring written permission, before vs. after PPA2006

- Akin to a D-D estimate, identified primarily by state-by-year variation

Empirical Findings for Participation

Table 3
Random-Effect Probit Estimates of the Determinants of 401(k) Participation, Standard Errors in Parentheses, Marginal Effects in Brackets

Explanatory Variable	(1)	(2)	(3)	(4)
Dummy if State Requires Written	0.387	0.375	0.276	0.166
Permission×After PPA2006	(0.192)	(0.191)	(0.192)	(0.196)
	[0.097]	[0.094]	[0.069]	[0.042]
Dummy if State Requires Written				0.000680
Permission×After PPA2006×Penalty				(0.000306)
per Employee				[0.000180]

- 6.9 p.p. higher 401(k) participation rate
- On base of 68%, 10% increase in participation rate

Other Empirical Findings for Participation

- Differential impact by size of penalty

- Differential impact by firm size

- Robust to alternative estimators

Empirical Findings for Contributions

Table 4
Two-Limit Random-Effect Tobit Estimates of the Determinants of 401(k) Contribution Amounts,
Standard Errors in Parentheses

Explanatory Variable	(1)	(2)	(3)	(4)
Dummy if State Requires Written Permission×After PPA2006	363.2 (508.3)	391.5 (507.2)	119.8 (506.4)	21.28 (517.3)
Dummy if State Requires Written Permission×After PPA2006×Penalty per Employee				0.584 (0.623)

- Average contribution $3,800
- Little impact on contributions

Summary

- Complements work by others documenting expansion of AE since 2006

- PPA2006 had differential impact

- Expanded 401(k) participation in states with these wage-payment laws

Summary

- State wage-payment laws were a binding constraint on firm pension choices prior to 2006

- Little impact on contributions

- Growth in AE from PPA2006 has broadened, not deepened 401(k) saving among mid-career workers