Retirement: Golden years or leaden years? (**Palo Alto Weekly**, June 26, 2002)

by Austin Lemoine

Are you saving enough for retirement?

A major issue raised by the Enron scandal has not gotten much press: millions of Americans will not have enough money when they retire.

In the past, Social Security and employer-paid pension plans have supported Americans in retirement. Social Security's still there. But employer-paid plans are disappearing. And 401(k)'s and similar accounts that replace them, are falling short. Many Americans are simply not saving enough.

That may sound contradictory, because American workers now put more money into employer-sponsored pension and retirement savings plans than their employers do. That milestone indicates just how far companies have moved away from the old-style pension system in which employers alone financed the retirement savings of their workers through "defined-benefit" plans, to the new-style 401(k)'s and similar "defined-contribution" plans financed mostly by workers.

The milestone is all the more remarkable because defined-contribution plans were intended to supplement defined-benefit plans, not displace them. But that's exactly what's happening. In 1998, the latest year for which the Labor Department has released data, company-sponsored retirement accounts had assets of $4 trillion. About half those assets were in defined-benefit pension plans with roughly 40 million employees enrolled, more than half of them still working. The other $2 trillion was in defined-contribution plans -- 401(k)'s, profit-sharing and stock-bonus plans (which provide no guaranteed benefits). Far more Americans were covered by those plans: 55 million, with 88 percent still working.

Roughly three out of every four new dollars invested in corporate retirement plans now go into 401(k)'s, and two out of three active workers who are covered by a retirement plan are responsible for directing the investment of their assets. New-style plans lack features of the old pension plans, like a guaranteed benefit and federal insurance to protect retirees if the company goes bankrupt. Debacles at Enron and other troubled companies have made painfully clear how easy it is for employees to lose their 401(k) savings, particularly if money is invested in company stock that crashes through the floor.

Congress is considering legislation that would mitigate such risk. What's not being considered is whether 401(k)-type voluntary savings programs are adequate. Labor Department data show that the average balance in such accounts is too meager to pay for more than a few years of retirement. Less than two-thirds of all working Americans are employed by companies that sponsor a retirement plan, and only 52 percent of all employees participate in retirement or pension plans. And if government employees, universities, and non-profit institutions are excluded, numbers are even lower -- only 47 percent of employees have anything other than Social Security awaiting them at retirement.

Under a defined-benefit plan, the typical company might pay an average of about 8 percent of its payroll into a pension account, with individual benefits based on a retiree's salary and tenure at the firm. But with a 401(k), the company could pay benefits anywhere between 3 percent of payroll (if it provides a match to employee contributions) to nothing at all.

By switching from defined-benefit to defined-contribution plans, companies have effectively cut worker benefits. But there's little evidence that they've simultaneously raised wages to offset that effect.

Since the first 401(k) accounts appeared in 1982 (and the stock market began an 18-year bull run), people now in their late 50's and early 60's have had more time to accumulate savings in their 401(k)'s than any other group. Some in this age group have built their accounts into rich nest eggs, but many others have not. By 1998, the average amount accumulated by this group in 401(k) accounts was only $57,000. That represents less than four years of monthly pension payments paid out in a typical defined-benefit plan. Failure to accumulate more can be attributed to factors such as inadequate incomes, imprudence, unlucky investments, college costs, alimony, layoff, debt and self-indulgence.

Evidence shows that as 401(k)'s have taken hold, employees have in fact lost ground in their retirement savings -- even during one of the greatest bull markets in history! Americans on the verge of retirement actually have less money saved now than 15 years ago, according to a recent study by New York University economist Edward Wolff. For those aged 47 to 64, inflation-adjusted median retirement wealth -- which includes defined-contribution plans, defined-benefit plans, and value of Social Security benefits -- actually fell 11 percent between 1983 and 1998. For the same age group, however, average retirement wealth rose 4 percent over that period. In other words, the more affluent gained retirement wealth but the less affluent lost it -- indeed, workers with $1 million or more of retirement wealth were the one group that gained.

Though Americans are generally confident about their financial futures, the financial acumen of the average worker is not what it could be. In a recent survey, 58 percent said they were behind schedule in planning and saving for retirement, and more than half expected their Social Security benefits to begin years before they actually would be eligible.

Some people may be betting that Social Security will come to their aid in retirement. Indeed, almost half of current retirees 60 and older say Social Security is the biggest share of their income. In the future, however, Social Security is not likely to be able to pick up the slack.

With the very structure of Social Security up for debate, it seems risky for younger workers to expect generous benefits when they reach old age. The future of Social Security notwithstanding, it's clear that many Americans haven't put enough money aside in their private retirement accounts, the other key component of retirement security.

The bottom line: the level of defined-contribution savings is not enough for many people to retire. A survey by the Employee Benefit Research Institute (EBRI) found than among workers aged 40 to 59, 39 percent reported 401(k) savings of less than $50,000; and less than one-fourth had saved $100,000 or more. In 2000, forty-four percent of 401(k) balances were less than $10,000; and ranking second, at 14 percent, was the $10,000 to $20,000 category. Fewer than 7 percent of 401(k) participants contributed the maximum amount that's allowed to their plans. While studies cited previously may underweight IRA's, the EBRI numbers clearly represent a lot of people.

Not everyone has lost out with defined-contribution retirement savings programs. Employees with high incomes, financial know-how and an interest in investments stand to benefit from a system of self-managed retirement accounts. But most people don't fit that profile. The likely consequence is a national retirement security crisis.

As this article goes to press, we note the recent publication of a new book on the same topic, "The Great 401(k) Hoax," by William Wolman, former Business Week chief economist, and Anne Colamosca.

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