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MONEYVOICES: SCRAP 401(K) FOR GOV'T ACCOUNTS



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Editor's note: Teresa Ghilarducci's testimony before Congress on a proposal to replace 401(k) plans with guaranteed retirement accounts attracted widespread attention in the fund industry as well as subsequent criticism from 401(k) proponents. Ghilarducci explains the reasons behind her proposal in this column.

The nation's economic recession has many victims, including tens of millions of people who will never recover the losses in their 401(k) plans before they die or retire. The nation's major 401(k) managers revealed two disturbing pieces of news at the end of January:

- Account holders have increased their withdrawals from the funds before retirement. Such withdrawals bring on hefty tax penalties and reveal a psychological tendency to treat these accounts as piggy banks, not retirement funds.
- Account balances are down by more than 25%. This means workers with \$100,000 on Jan. 1, 2008, had \$75,000 at the year's end. If the worker did nothing and returns on the remaining account matched inflation, it would take 21 years to get back to 2008 levels.

Already older people are returning to work, fearing layoffs and cutting consumption. At some point, President Barack Obama will have to face the retirement crises by turning his back on his campaign promises. As a candidate, Obama proposed that all workers without a traditional employer-pension plan enroll in an IRA account or 401(k)-type plan (everyone would have the option of not participating in a pension plan). The government would induce low- and middle-income workers to stay in a plan by offering a 50% match up to \$1,000 per year in the form of a contribution to a retirement account at a bank or mutual fund.

The problem is that the 401(k) system is fatally flawed and expanding it would simply magnify the retirement crises we face. Clearly this is not the time to give more 401(k) business to Wall Street. When the last depression caused American financial systems to be rewritten, we got Social Security. I propose Guaranteed Retirement Accounts (GRAs), which are a cross between a traditional pension and a 401(k)-type plan. Workers in a GRA would continue to save 5% of their income with a guaranteed rate of 3% above inflation. In addition, the government would give everyone in a GRA \$600 indexed to inflation to offset the mandated 5% contributions. The account balance would be converted into a lifetime pension. This retirement plan will replace roughly a quarter of an average worker's pay if the investor retires at 65 after 40 years of work. Combining that with Social Security, the typical worker will then have a guaranteed pension equal to 70% of what he or she earned before retirement.

The GRAs can be a long-term solution in insecure pensions and serve as a Social Security supplement. Mandatory and voluntary savings could be parked in a safe, guaranteed government program, similar to federal employee retirement plans. The GRA plan gives workers and employers what they both want — a retirement plan they don't have to worry about. Workers get a guaranteed pension they can't outlive, and employers avoid taking on long-term pension liabilities.