

ICI VIEWPOINTS

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Let's Set the Record Straight on 401(k)

As states and localities struggle to control their budgets, more and more policymakers are considering fundamental changes in the retirement plans offered to public employees. This year, [at least eight states have taken up legislation](#) to change part or all of their public retirement plans from traditional defined benefit (DB) pensions to defined contribution (DC) plans similar to the 401(k)s that are now the most common plans in the private sector. Many more public employers are likely to consider such changes in coming years.

Unfortunately, debate over public employee pensions has been clouded by a serious misconception: the myth of the “failed” 401(k) system. As debate has focused on the sustainability of public workers’ DB pensions, a [backlash](#) has been evident against 401(k)-style DC plans. And too many [commentators](#) take it for granted that 401(k) plans are reducing the retirement security of America’s private-sector workforce.

That’s not true. In fact, Americans’ resources for retirement have grown rapidly since 401(k) plans were introduced. DC plans are improving the retirement security of America’s private-sector workers. As savers and investors, 401(k) participants manage their accounts well. And 401(k) plans enjoy [strong support](#) among America’s workers.

All Americans, whether in the public sector or private, need to know that they can prosper and enjoy a secure retirement with 401(k)-style DC retirement plans.

Since 1980, the year before 401(k)s were born, [the number of retirees receiving income from private-sector retirement plans](#), including both DB and DC plans, has grown—and so has the amount they received.

Since 1980, assets earmarked for retirement, whether in employer plans or personal savings, have grown three times as fast as the U.S. economy, to [\\$17.5 trillion](#). More than half of those assets—\$9.2 trillion—are in DC plans and individual retirement accounts (IRAs).

On an individual level, independent studies show that DC plans are a better deal for most workers than traditional DB pensions. [Andrew Samwick and Jonathan Skinner of Dartmouth](#) found that 401(k) plans “are as good or better than DB plans in providing for retirement...Our results suggest that the trend toward 401(k) plans has strengthened the retirement security of current workers.” As [noted recently on Viewpoints by Sarah Holden](#), ICI’s Senior Director for Retirement and Investor Research, economists James Poterba of MIT, Steven Venti of Dartmouth, and David A. Wise of Harvard have also found that [401\(k\)s will increase wealth at retirement](#) for future retirees across the lifetime earnings spectrum.

DC plan balances do move with the market. However, 401(k) savers who participated [consistently](#) from 2003 through 2009 saw their accounts grow at a 10.5 percent average annual rate over those six years, despite one of the worst bear markets since the 1930s. One key factor was that 401(k) savers did not panic. [ICI's monitoring of DC plan participants since 2008](#) shows that workers kept contributing, maintained their investment plans, and avoided withdrawals. That is consistent with other data showing that 401(k) participants save responsibly, invest responsibly, and manage their account balances responsibly at [job changes](#) and at retirement. Investor education and such innovations as [automatic enrollment](#) and default investments are helping 401(k) plan participants succeed.

America's private-sector workers recognize the value of their 401(k) plans. We know they do—because [we have asked them](#). In surveys over the past three years, nearly eight in 10 households that own DC accounts or IRAs indicate they are confident that such accounts can help people meet their retirement goals. Clearly, America's workers believe in the 401(k) system.

The rapid adoption of DC plans and public support for them demonstrate that 401(k)s offer significant advantages for both employees and employers. Workers appreciate the portability of DC account balances and the security of ownership, particularly in a mobile workforce. For public employers, DC plans could solve the moral hazard posed by DB plans—the temptation they offer for employers to solve immediate labor problems with promises that will not come due for decades. With DC plans, by contrast, the costs are clear and up front.

Finding the best ways to attract and compensate public employees, given the fiscal problems of the states, will not be easy. But debate over pension reforms should not be based on myths and misconceptions. The facts are clear: 401(k)s work.