The 401(k) scam: How American workers have been robbed of their retirement benefits

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A retirement crisis of staggering proportions faces millions of American working people. The plunge in the stock market has profound implications in a country where most pensions and savings are not based on fixed benefits paid by employers, but instead are dependent on voluntary contributions made by workers to be invested on Wall Street.

The 401(k), as the plan is known, is literally a do-it-yourself retirement plan completely dependent on the vagaries of the market. With over $7.7 trillion wiped out in two-and-a-half years by the 44 percent fall of Standard & Poor 500, many face a shrinking pension or none at all. Unlike a high-powered executive, the average worker has no broker who is constantly following investments, giving tips or advising him or her on the wisest allocations. The 401(k) plan places the responsibility and burden entirely on the worker.

Instead, the most common scenario involves one's employer providing a packet of information with a number of funds from which to choose. Oppenheimer's Five Star Quest Balanced Value Fund, for example, tells the 401(k) participant that this particular portfolio has " **large, well established companies** that are undervalued by the market, and companies that fundamental analysis identifies as **well-managed, solid** businesses" (emphasis in original).

The company at the top of this portfolio's list is Worldcom, Inc.!

Today 401(k) is a household word, but it was nearly unknown 20 years ago. During the stock market boom of the 1990s the 401(k) was associated with the promise of easy wealth. With the rapid rise of high-tech stocks, many workers saw their contributions grow exponentially. William Wolman and Anne Colamosca, authors of *The Great 401(k) Hoax*, write, "it appeared as a device that made it easy for the average worker to participate in the biggest boom in history. It seemed the 401(k) would be a perpetual wealth machine for each and every member of the great American middle class."

A typical case is provided by Paul "P.J." Palambo, a long-distance truck driver who will be 62 next month. He started contributing to a 401(k) plan in 1982. He told *USA Today*, "I got in when the getting was good, and it grew from zero to almost $250,000. I said, that's great, I can retire when I'm 55." But with the two-and-a-half year fall in the market and the growing economic slump, 401(k)s are causing increasing concern, particularly for those in their 50s. Palambo lost close to $50,000 this year alone, and his predicament is like that of many others: "I've got thousands of shares of mutual funds, and if I sell now, I've lost it all."

Because they have seen their retirement savings wiped out, many people are being forced to work longer years than they ever expected. In the past year the number of people in the workforce 55 or older—the only age group that is growing—jumped 8 percent, to 20 million. These baby-boomers are facing a precarious financial future.

Millions have been forced to abandon their plans to retire in their 50s and early 60s to spend their remaining years enjoying an active lifestyle. Now many of these workers will have to work well into their 70s. Many in this age-bracket face the combined strain of paying for college tuition for their children and at the same time taking on the care of older parents.

A recent cover story in *Time* magazine, headlined "Will you ever be able to retire," noted that trends were leading to "a move backward to the historical norm—working until you drop—and away from the experiment of the past few decades, the only time in history when healthy people have stopped working for the last 20 or 30 years of their lives."

The story of Robert and Kyuja Kafka, recounted in *Time* magazine, is a common one. The family had saved diligently through a tax-favored college fund, while at the same time saving for their retirement. The Kafka's college and retirement savings have declined in value more than 50 percent. Such college savings plans, which came into wide use three years ago, are not providing much sanctuary. They appeared attractive because the earnings were exempt from federal and some state taxes; so long as the market was rising, assets grew. The problem is that most of these funds are in aggressive growth portfolios—those that have been hit the hardest, with losses of 30-60 percent. With a college bill of $37,000 for tuition, room and board due this month, the Kafka family is scrambling to find backup plans—refinancing their house to secure a line of credit, applying for student loans, and postponing a home-remodeling project.

While the fall in savings due to the stock market losses are causing a huge financial strain, many workers have no savings at all. According to a *USA Today/*Gallop Poll, more than one-third of adults say they have no money saved in any kind of retirement account and half of all households did not save a penny last year. "The average American household has virtually no chance to reach an adequate retirement savings in the next 50 years," commented Christian Weller of the Economic Policy Institute (EPI).

How retired people will live—pay for food, housing, medical care, not to mention expenditures other than the very basic requirements of daily life—is a very real question. According to an EPI study, retirees need to have 75 to 80 percent of their pre-retirement income available. Yet more than 40 percent of middle-aged households will not be able to replace even half of what they made on the job, and nearly 20 percent will have retirement incomes below the poverty line. The EPI study was based on federal data between 1989 and 1998 does not take into account the implications of the recent Wall Street plunge. Moreover, many workers have no access to 401(k) plans or do not make enough money to contribute to one.

The US pension system is entirely inadequate or nonexistent. Social Security, which came into effect in 1935, is to this day a very limited benefit and was never conceived as being more than a supplemental pension. Due to changes carried out by the US government, the age at which workers can qualify for Social Security benefits will soon rise to 67 from the current 65 years old. In addition, the Bush administration has been campaigning to open up Social Security to private investment, so that individuals can also put a portion of their benefits into the stock market.

The grim reality is that only a very small percentage of American workers have a fixed defined retirement pension plan sponsored by their employers. In fact, today only 16 percent of the population currently receives guaranteed-pension benefits that cover them for life. Even at its height, fixed pensions covered only a fraction of the workforce; mainly large manufacturing unionized industries such as auto and steel.

The 401(k) became the new model for pensions during the 1970s recession. Faced with the economic downturn, major corporations, with the collaboration of the unions, began severing long-term commitments to their employees. According to the authors of *The Great 401(k) Hoax*, "It wasn't the current cost of pension plans that most frightened corporate America. The real financial trauma was the implication of these obligations for the future of corporate balance sheets. Long-term pension liabilities were virtual black holes."

By 1980, less than half of the workforce was covered by traditional defined benefit plans. By 1996, this number grew by only 3 million, to a total of 41 million people. By contrast, the number of workers participating in defined contribution plans, such as 401(k)s, ballooned from 20 million in 1980 to over 50 million in 1996. The long-term financial interests of workers became directly tied to the fortunes of Wall Street.

Even when companies offered matching contributions to 401(k) plans, on average they only contributed 2 percent of pay, compared to the 6 to 7 percent of pay they typically contributed to traditional pension funds. Enron, like many companies, strongly encouraged employees to invest in the company's stock. Thousands of Enron's current, laid-off and retired workers lost most of their life savings when the company prevented workers from selling its stock held in 401(k) accounts, just as the stock price was plummeting.

Reports on account balances in 401(k) plans often give a more optimistic picture of retirement savings, because the assets of higher income workers skew the results. At the end of 2000, while the average account balance was $49,024, 44 percent of participants had balances of less than $10,000.

In contrast to the plight of working people, however, the top executives of companies engulfed in financial scandals have no retirement worries, even in those instances where their companies have collapsed. In the case of Enron, Jeffrey Skilling made $78 million. Laid-off Enron workers received a mere $4,500 severance payment, no matter how many years they had worked for the company.