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Healthier and Wiser? Sure, but Not Wealthier

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BY many measures, today's older workers appear better equipped for retirement than any previous generation. Their homes are worth more than their parents' homes were. Their bank accounts are fatter. And study after study suggests that typical late-middle-age employees have accumulated more wealth than their counterparts did a quarter-century ago.

But virtually all of these studies have a flaw, a crucial asset that is left out of the equation. Add it back in, and the rosy picture suddenly darkens.

That asset is the traditional pension, an employee benefit that was widely available until the early 1980's but has been vanishing from the American workplace ever since. More than two-thirds of older households - those headed by people 47 to 64 - had someone earning a pension in 1983. By 2001, fewer than half did. The demise of the old-fashioned pension has been much discussed, but the effect on family finances has not. That is because the impact has been hard to measure.

New evidence suggests, though, that the waning of the pension has, imperceptibly but surely, stripped older workers of an immense store of wealth - much more than they probably guessed, if they thought about it at all. Retirement benefits today, particularly the 401(k) account, simply are not worth as much as the older kind of benefits. Some studies suggest otherwise, but they tend to rely on average balances of retirement accounts, and the averages have been skewed upward by the extraordinary gains of a few wealthy households.

When the holdings of more typical households are tracked instead, today's near-retirees turn out to be a little poorer, in constant dollars, than the previous generation was when it approached retirement in 1983. The sweeping change in employee compensation appears to be the reason, according to new research by Edward N. Wolff, an economist at New York University who analyzed 18 years of household financial data collected by the Federal Reserve.

Mr. Wolff found that the average net worth of an older household grew 44 percent, adjusted for inflation, from 1983 to 2001, to $673,000. But much of that growth was in the accounts of the richest households, which pushed the averages up. When Mr. Wolff looked at the net worth of the median older household - the one at the midpoint of the economic ladder, a better indicator of what is typical - the picture changed. That figure declined by 2.2 percent, or $4,000, during the period, to $199,900.

For a generation to emerge from two bullish decades with less wealth than its parents had "is remarkable," Mr. Wolff said. Based on economic growth and market returns over those 18 years, he said, their wealth "should be up around 30 or 40 percent."

The Fed's household-finance data also show that when pensions were more common, they served as a social leveler. Companies that offered them had to use the same pension formula, involving years of service and salary, for all workers in a plan; otherwise, the companies risked losing their tax break. The rich in those days bought big houses and invested in stocks and other assets that were out of reach for the middle class. But pensions would offset, to some degree, the difference between how these groups lived in old age. Traditional

pension plans were part of a system that reduced the poverty rate among the elderly to just 1 in 10 in 2002, the lowest in half a century.

The advent of self-directed retirement plans, by contrast, is giving rise to an elite minority who are well prepared for retirement, and a majority who are falling behind, the numbers show.

"The people at the top did better than they ever would have under the old system," Mr. Wolff said. "Basically, they made out like bandits."

JANE NOBILETTI, who sells long-term care insurance in Manhattan, has not done the math, but she senses some of this already. Earlier in her career, she earned a partial pension when she worked at a large insurance company. But after she had spent more than 20 years there, the company merged with another and began cutting costs, and Ms. Nobiletti felt compelled to leave.

By resigning, she walked away from the biggest part of her pension; traditional plans normally pay the maximum to those who stay 30 years. She said that she enjoyed her new job, and that she had never tried to calculate how much of a pension she forfeited by leaving her former employer.

"Once you've lost it, there's no point in thinking about it anymore," she said. Her current employer, a small insurance wholesaler, has a 401(k) plan, and Ms. Nobiletti, who is in her early 50's, is using it to supplement her reduced pension.

"The pension that I do have, I'm glad it's going to be there, but it's no big deal," she added, estimating that she will receive $1,000 to $2,000 a month when she is old enough to collect the benefit.

"I'm not set up, by any stretch of the imagination. I won't have the lifestyle that I now have. I will have to sell my apartment and move out of New York, and I don't want to do that."

Ms. Nobiletti's experience is just part of a much broader trend. Countless American workers have relinquished part of a pension by moving from one job to another over the last two decades, reducing the years of service that traditional pensions reward. Many more have stayed in place as their companies have merged or reorganized, but they have seen their benefits sheared off anyway because new corporate leaders decided to do away with the plans.

In some sectors, like commercial aviation, pension plans began falling like dominoes after deregulation, because companies could no longer build pension costs into the prices they charged for their products. Still other workers lost out because their industries - especially unionized ones like textiles or steel - died or moved offshore. The new industries that have grown up in their place, like technology, have tended to offer other forms of compensation, like stock options.

In 1985, about 115,000 American companies had traditional pension plans. As of last year, only about 31,000 did. Of those, many are thought to have frozen the benefits, pension specialists say, so that additional years of service no longer build a bigger pension. Others have closed their plans to new employees, or reduced their benefits formulas. Precise data on such changes are nonexistent, but Daniel L. McCaw, chief executive of Mercer Human Resource Consulting, said in Congressional testimony this year that as many as a quarter of surviving pension plans were either frozen or on the brink of a freeze.

As companies have moved out of the pension business, many have set up self-directed retirement programs instead, like 401(k) plans. Traditional pensions were paid out of a pooled pension fund, which was managed by professionals, but the new plans call for employees to set up their own accounts, deposit a portion of their earnings and manage the money themselves. Some companies make matching deposits. The old pension plans were automatic; the new ones are voluntary.

In 1983, only a tiny fraction of households had 401(k) accounts. But by 2001, about 62 percent of older households had one. Some analysts hail the new plans, saying that they ultimately may prove better than pensions. The new plans allow employees to change employers without forfeiting part of their benefit, as Ms. Nobiletti did, for example. And because they do not involve a fixed, predetermined benefit, as traditional pensions often do, they can be less vulnerable to inflation.

The new retirement plans also free workers from having to tie their fate to the fortunes of a single company.

Marcus Weaver, a manager at an industrial services company in Florida, said he was disappointed at first when his employer froze his pension during a merger in 1992. But then he saw a documentary on the collapse of the pension fund at Bethlehem Steel, in which many steelworkers lost part of their pensions. That made Mr. Weaver think that maybe it was just as well that he hadn't been relying on a pension.

"If somebody that huge could have imploded like that, it shows you that for the individual, it's probably better to go the 401(k) route," he said. "Then all your eggs aren't in one basket."

To many people, the 401(k) account simply looks bigger than a pension. Pensions are less tangible than other forms of wealth. Their value is hard to grasp, because it is usually expressed as a formula - some multiple of future salary and years of service, perhaps with other factors. For many workers, that is meaningless until retirement looms.

A 401(k) balance, by contrast, is expressed as a simple amount in dollars. It is easier to understand and therefore seems more substantial.

Philip Merten, who owns a small video production company in Miami, says he has been trying in recent years to make the most of the various self-directed retirement programs at his disposal. His company has a small-business retirement plan, called a SEP-IRA, and he contributes to that. He also continues to manage a 401(k) account that he built up in a previous job as a television cameraman. His wife has a 401(k) balance, too, from a past job at Telemundo, the Spanish-language television network. Through careful stewardship, these various retirement accounts add up to several hundred thousand dollars.

"We've been diligent," he said. The couple have also done well on other investments, particularly in real estate. They own their home, which they bought in 1999, and a condominium in Coral Gables, Fla., which they bought in 1989 when they were newly married.

"That's probably the best investment," Mr. Merten said. "Property values have just gone through the ceiling."

He said he thought that the condominium had quadrupled in value from the $50,000 they paid 15 years ago, and that their house had more than doubled in five years, to more than $500,000.

MR. MERTEN is happy with his decision to go into business for himself, he said. But it has forced him to go out and shop for health insurance on his own, and that process has given him doubts about retirement, and whether he is building a nest egg quickly enough. "My own gut feeling is that we need to speed up the rate a bit," he said.

His father spent his career at Bank of America and earned a substantial pension. He often urges Mr. Merten to set aside more. Mr. Merten does not think that there is any chance he will have retirement resources like his father's.

"Working for a big company like that, he knew exactly what he'd make, and he could plan," Mr. Merten said. "I think it's a lot harder now."

The Fed's household-finance data back Mr. Merten's impression that his family has done reasonably well with self-directed retirement benefits. The central bank has conducted regular, detailed surveys of the value of various assets held by households going back to 1983. Self-directed retirement accounts were just starting to appear in the workplace then, and, by the Fed's count, the average older household had about $8,000 in such a plan. By 2001, it had $96,600 - an impressively bullish increase.

Of course, households were losing access to pensions at the same time. But that side of things usually does not show up in the statistics. The Fed does collect detailed information about pensions in its surveys, but because the pensions are expressed as a formula, and other household assets are expressed in dollar amounts, it does not add the two together. Instead, it tracks most household assets - real estate, bank accounts, securities and so on - in its regular reports. The information on pensions is kept separate, in an appendix.

It is not impossible to convert pension values into dollars. Actuaries build their careers on doing precisely such calculations for their corporate clients. Mr. Wolff said he applied standard actuarial methods to the Fed's undigested pension data, and added the resulting values to the other household assets, for a complete picture of household net worth. That is how he arrived at the 2.2 percent decline in wealth for median older households.

Actuaries who were told about Mr. Wolff's research said the findings made intuitive sense to them. "The concept sounds right," said Steven G. Vernon, a vice president and consulting actuary at Watson Wyatt Worldwide.

People like Mr. Vernon calculate pension values routinely. They say that there are reasons traditional pensions hold more value than the newer benefits. For one thing, it is more efficient to run a pooled trust fund than a lot of individual accounts. In a pooled pension fund, employees who die before collecting much of a pension effectively pay for the benefits of those who live longer. Arguably, pooling the purchasing power of many participants reduces money-management fees and brokerage costs, as well. Mercer Human Resource Consulting estimates that for that reason, the performance of the typical pension plan is one to two percentage points better than that of the typical 401(k) plan.

Mercer and other retirement specialists say that complex federal regulations have driven many companies away from traditional pension plans, and that relaxing those rules might bring the companies back. So far in Washington, there has been talk about such a change, but no action. It took two years for Congress to make just a single modification in the pension rules, changing an interest rate that companies use when calculating pension values. Pension advocates say that Washington tends to react only in a crisis, and that this generation's unpreparedness for retirement won't be a crisis until people actually retire and feel the pinch.

As it dawns on workers that they don't have enough to live on, some are simply deciding to delay retirement. The Society of Actuaries recently reported that the number of people who say they will never retire, while small, doubled from 2001 to 2003, to 8 percent.

Pete Miller, 64, a computer program manager who lives in Northborough, Mass., recently did some of the calculations and discovered how important a pension can be. He taught at Boston University for many years, building up a large individual retirement account, and joined Lotus Development in 1993. Lotus had a traditional pension plan, "as good as you could get at that time," Mr. Miller said. I.B.M. took over Lotus in 1995 but brought employees like Mr. Miller into its own pension plan and gave them credit for their years at Lotus.

IN 1999, I.B.M. changed its pension plan, reducing some people's anticipated benefits and setting off a firestorm. Some employees sued; I.B.M. restored some of the benefits, but the controversy is still in court. Mr. Miller continues to work for the company.

Because he has his individual retirement account from his previous job, he said, the I.B.M. lawsuit is not a make-or-break issue for him. His wife also teaches and has a retirement account. With those assets, Social Security and the pension, he estimates that he and his wife will have retirement income of $4,000 to $5,000 a month, as long as they live frugally and do not draw down their principal. The I.B.M. pension will pay him about $500 a month, he said. He calculates that it would have been $1,000 a month if the terms of the plan had not changed.

"Five hundred dollars isn't that much, but it actually adds up," he said. His real estate taxes recently went up by about $500 a year. His two children are in high school, so they will need college tuition money just when he would normally retire.

"That $500 a month extra would have more than taken care of our property taxes," he said. "An extra $500 would have paid the property tax and the insurance on our home and auto."

Mr. Miller says that changes in retirement benefits have hit many American workers harder than him - and that he wonders how people who have no pensions at all will manage.

"There's no question that I've got to work as long as I possibly can," he said. "I don't make any secret of the fact that my aim is to maintain full-time employment until I am 69."

He's likely to find many of his generation working right alongside him.

J. Alex Tarquinio contributed reporting for this article.

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