Will Enron Lead to Enhanced Retirement Security?

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- *A good job should lead to security in retirement. I ask Congress to enact new safeguards for 401(k) and pension plans. Employees who have worked hard and saved all their lives should not risk losing everything if their company fails.*

-- President George W. Bush,
State of the Union Address,
January 29, 2002

The collapse of Enron brings out many tales, but none motivate action more than images of workers who now are left with little or nothing in the way of retirement plan benefits. In response, President Bush has requested legislation that would essentially remove some bars that prevent workers from selling their company stock, improve information, and limit the extent to which company officials could diversify their employer stock holdings when other workers are barred from doing so.

Whatever the merits of these proposals — and, in general, I applaud their direction — it leaves two disturbing questions on the table. First, didn't we just have a major pension reform enacted last year and why wasn't anything done then? Second, when all is said and done and legislation is passed, are many more workers in the economy likely to go into retirement with at least a moderate amount of private retirement benefits? The answer to the first question helps us understand why the answer to the second likely will be "No" — that despite the wishes of the President and the Congress, many good jobs in the future still will not "lead to security in retirement."

The scandal behind the scandal is that this nation's policy-making system, from Executive Branch to Congress, has for years been unable to really fix up most governmental systems and programs. Interest groups and lobbyists now crowd out other public agendas so much that, except for an emergency such as a terrorist attack or an Enron collapse, many of the public's basic needs are not examined in depth by executive branch agencies and the committees of Congress. Thus, it was that in preparing reform of retirement plans in the months and year leading up to last year's reform, the problems of the average person were largely ignored.

Many important issues — ranging from inadequate coverage for the majority of the population to contradictory rules that trap the unwary to the Enron problem of being stuck mainly in one stock — got so little attention that they were excluded altogether from that reform. By "coverage" here, I am using a lay person's and an economist's definition of having moderately adequate pension benefits when going into retirement, not the strictly legal definition of being "covered" under some plan that might provide anything at all by time of retirement.

Last year's agenda was set mainly by interests with lobbying influence in Congress — in this case, often executives and small business persons who wanted to be able to tuck away more tax- deferred retirement saving and corporations who wanted the law to be flexible enough to allow for the types of plans they were offering. I want to be clear: There is nothing wrong with those interests being expressed and sometimes met, it is the exclusion of wider and more fundamental issues that is the concern.

Given this recent history, there's a strong possibility that outside of some rules making diversification easier for employees, nothing much will be done about increasing retirement plan coverage this year either. The combination of a status quo mentality about retirement plan design, revenue constraints, and the narrow focus on Enron itself likely will deter much more from happening. When the aggregate data are examined, this reform likely will make at best a slight increase in the adequacy of pension coverage among employees. One proof will be in the revenue estimate: If there is not much additional revenue loss, then few additional

deposits on net will be made to retirement plans, much less the retirement plans of those individuals with little or nothing in the way of assets.

Modern portfolio theory shows clearly that diversification of a portfolio can allow one to achieve the same expected return with a lower level of risk. It does not, however, prove that it is wrong to concentrate substantial investment in one place. Some people may want to take on more risk, partly on the chance of receiving greater reward. Most importantly, in the case of employment, it has long been accepted that partial ownership of one's own company can lead workers to become more productive. Whatever the evidence for this last bit of conventional wisdom, it does make at least intuitive sense that some stake in a company makes one more concerned with its overall well- being.

Accordingly, the tax laws have long given tax benefits such as deferral for some types of plans with substantial investment in employer stock, just as it does for more traditional pension and diversified 401(k) contribution plans. At one time, many policy makers thought that plans holding employer stock were add-ons to more secure retirement and pension plans. This "myth" is a bit misleading, since the majority of employees have always gone into retirement with very little in the way of any benefit — whether from a pension plan, 401(k) plan, or any other plan. Regardless of the history, today many covered employees will have their assets mainly in some form of 401(k) or other "defined contribution" plan where they — and sometimes their employer — direct investments narrowly into employer stock. This entails additional risk relative to a situation where the employer stock would be an add-on to a core and less risky retirement plan.

What, then, is the Enron problem to be fixed? Is it merely greater opportunity for diversification for 401(k) plans? Or is the goal real pension reform, defined, as the president's State of the Union Address as "security in retirement" for those "holding good jobs" and maybe even for those holding not-so-good jobs? If it is the latter, then we must admit up front that inadequate coverage derives from a variety of sources, perhaps the least important of which is that some employees lose out because of concentrated investment in employer stock. The most serious problem of all is that many employees make few deposits or have few deposits made on their behalf into any type of retirement plan, and in many pension plans they lose out dramatically if they move from job to job during their careers. A related problem is that even when these deposits are made by employee or employer, these funds are often withdrawn and spent by employees when they switch jobs and decide not to roll the money over into other retirement accounts.

Today, if you're going to guess at what retirement plan reform is likely to take place, think small. Retirement plan reform in recent years has represented mainly patches onto an already complex system. Even the moderate amount of moneys that were spent in last year's tax bill largely were directed at increasing deposit limits for those already well covered, and little effort was made to deal with the common person's problems — whether it be diversification, inconsistent rules that can penalize people haphazardly, or, most importantly, adequate coverage by the time of retirement. Can we expect a lot more this time? I hope I'm wrong, but outside of some modest diversification options, probably not.

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