



Save Your 401 (k) Before the Feds Replace it With the GRA

By Pamela Villarreal, OpEd Contributor

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When ideas emerge out of fear instead of facts, the consequences can be disastrous. Amid the tumultuous stock market and worries about the cost of federal bailouts, policymakers, politicians, and presidential candidates are focusing now on 401(k) plans.

At a recent hearing before the House Committee on Labor and Education, several experts testified about the effect of the financial crisis on these defined-contribution retirement plans, all but sounding the death knell for 401(k) plans.

Certainly, the balance sheets of those invested heavily in equities have taken a hit — although these paper losses are not cast in stone unless they are cashed out or transferred to another type of investment.

And most certainly, some who may have considered retiring in the next few years will want to work longer to recoup a portion of their nest eggs. But should 401(k) plans be subject to drastic rules changes that make them unrecognizable or virtually nonexistent?

Teresa Ghilarducci of the New School for Social Research has proposed a plan to let workers trade their current 401(k) plans in for a Guaranteed Retirement Account (GRA). This type of plan would pay a monthly amount at retirement, similar to an inflation-indexed annuity, at a guaranteed three percent real rate of return.

Moreover, every worker would continue to contribute a mandatory five percent of his earnings into a GRA (the employer would contribute half), with the government depositing \$600 a year, inflation-indexed, into the account of every worker.

Ghilarducci notes that the plan has many advantages: First, for those who are worried about fairness, the GRA plan, says Ghilarducci, would be fair. Since the current tax-deferred set-up of 401(k) plans benefits higher-income workers (uh...of course it does, since they pay most of the taxes), the GRA would eliminate the 401(k) tax subsidy to the “rich” in place of the \$600 tax credit given to every worker.

Another advantage, according to Ghilarducci, is that the accounts are pre-funded since workers are saving their own money.

The National Center for Policy Analysis, the organization for which I work, has long supported allowing workers to invest a portion of their payroll taxes into personal accounts and allowing them to select from a limited number of investment choices.

But, unlike some mandatory savings plans, GRAs are not personal, per se, as they do not allow individuals to pick from a limited array of funds like the federal Thrift Savings Plan (TSP) does. The money would instead be pooled and invested by the government as it sees fit.

Moreover, a GRA is no less immune to problems than a 401(k) plan. Although a guaranteed three percent real rate of return sounds good on the surface, in the fine print the government would have the right to reduce the guaranteed rate of return during economic down times and allow workers to access their funds during those times.

Even though the fund would be managed by an independent body (similar to the TSP), it could still be subject to political manipulation. Congress has numerous times attempted to require the TSP to invest in various funds of dubious value.

Finally, giving up on 401(k) plans because of a temporary market downturn is patently silly. Senator Barack Obama has also announced that as part of his tax plan, he proposes allowing 401(k) plan holders to obtain hardship withdrawals for this year and 2009 without the 10 percent penalty that is normally imposed.

While there is no doubt that hardship cases exist for some individuals and such a withdrawal may be necessary, politicians should not attempt to water down 401(k) retirement plans further.

In essence, instead of strengthening 401(k) plans which have served most workers quite well, the fear-based solution is to gut them to the point where they become unattractive to retirement savers and employers, leaving people even more unprepared for retirement and relying on government entitlements.

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