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Don't Reform 401(k) Accounts Out of Existence
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In recent weeks, as the country has watched multiple corporate goliaths felled by Chapter 11, many small investors who once banked on a cushy retirement are feeling much less secure. Voices in Washington are calling for "safety measures" and "protections." But what purpose does Enron's fallout serve if the effect is to limit workers' access to stock ownership through pension plans?

There is room for improvement, but by moving too quickly and emotionally, we risk overcompensating and curtailing a trend that has been both a boon for workers and a driving force in our recent period of economic prosperity. To avoid repeats of the collateral damage from recent bankruptcies, we must have the sort of pension reform that protects workers' retirements without mistakenly discouraging wealth accumulation.

President Bush has proposed just such a reform package. His pension proposal would allow diversification of 401(k) portfolios after three years in a plan; preclude corporate officers from selling company stock when workers are unable to trade; require quarterly 401(k) statements from employers to workers; and encourage employers to make investment advice available to workers.

Private, employer-provided pensions are, after all, a key component of retirement security for many Americans as is described in The Economic Report of the President, released today. Over the past two decades, the U.S. pension landscape has undergone a dramatic shift, moving away from traditional defined-benefit plans and towards participant-directed, defined-contribution plans like 401(k)s. Today, over 40 million workers have 401(k) accounts, with assets of over $1.8 trillion and representing over 20% of total household pension reserves.

These plans are often the best thing that has happened to the average investor. They provide millions of Americans with an opportunity to accumulate substantial retirement wealth in a tax-preferred manner. The plans are also portable, meaning that individuals who change jobs or move in and out of the labor force keep their retirement security.

Getting involved with these sorts of investments through company plans also helps investors better understand the movements of the market, making them smarter about managing their money. Recent research by Prof. Scott Weisbenner of the University of Illinois suggests that workers with a 401(k)-type plan are more familiar with equity investments and invest more in equity outside of their 401(k) plans.

For these reasons, employer-provided, participant-directed plans should be encouraged, not discouraged, by public policy. Recent research by Profs. James Poterba of MIT, David Wise of Harvard University, and Steven Venti of Dartmouth University suggests that 401(k)s could rival Social Security as a source of retirement wealth in the next three decades.

The president's proposal would give all plan participants the right, but not the obligation, to diversify their 401(k) portfolio. Many employers currently make generous contributions to their employees' accounts, and should be encouraged to continue to do so.

The freedom to diversify ought to be accompanied by independent investment advice so employees understand the benefits of diversification. Up to now, companies have been discouraged from taking on that role for their employees by the threat of liability. The president is now calling on the Senate to

join the House in passing the Retirement Security Advice Act, which would encourage employers to make investment advice available, along with quarterly benefit statements.

These proposals would substantially strengthen retirement security without discouraging firms from sponsoring 401(k) plans. But they have come under attack both from those who say that they do not do enough to protect retirees, and from those who say that they meddle in agreements between employers and employees.

The major disadvantage of additional regulation is that it would discourage employers from sponsoring 401(k) plans. Approximately half of all workers are currently covered, and the president wants coverage to be extended to others. Some other, more regulatory proposals have come forth that run the serious risk of harming long-run retirement security.

Sens. Barbara Boxer (D. Calif.) and Jon Corzine (D., N.J.) have called for a reduction in the tax deduction for employer matching contributions when made in employer stock. But by raising taxes on company contributions, employers would be less likely to contribute, leading to lower wealth accumulation for retirement.

They have also called for caps on the fraction of plan assets that can be held in employer securities. But such caps limit individual investment choice, potentially force plans to sell company securities in periods that the company is outperforming the market, and run the risk that some companies will decrease the generosity of their employer match in order to comply. This type of regulation works against retirement security over the long run.

Does this mean that we should have absolutely no additional regulation? The problem with this approach is that it may leave the retirement assets of many workers and retirees exposed to excessive risk. As the president said in his State of the Union address, "A good job should lead to security in retirement . . . Employees who have worked hard and saved all their lives should not have to risk losing everything if their company fails." The administration has developed policies that will provide strong protections to workers, while continuing to encourage employers to sponsor pension plans.

Mr. Hubbard is chairman of President Bush's Council of Economic Advisers.