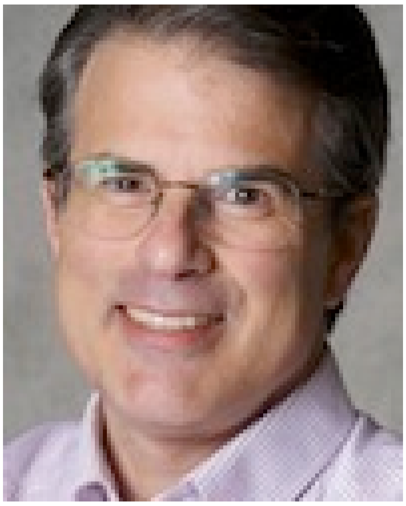
Retirement Income
JOURNAL

Where Defined Contribution Falls Short

By Kerry Pechter *Thu, Dec 7, 2017*

The defined contribution system, despite its standardized designs, regulations and contribution limits, reproduces (and may amplify) the economic disparities in the workforce it covers (or fails to cover).



Owning stocks and bonds is the most reliable way to achieve retirement security over the long run. That's what we're told and that's more or less what history has demonstrated. But what percentage of Americans actually holds a retirement-worthy portfolio? The percentage is surprising low.

A few days ago, I received a new research **paper** by economist Edward Wolff of New York University. According to his review of surveys of U.S. household wealth and income, stock ownership is broad but not deep. About half of Americans own stocks but a small minority owns almost all of it.

Age explains part of the story, but not all of it. Ownership of investments appears to increase with age, as expected. In 2007, pension accounts, corporate stock, financial securities, mutual funds and personal trusts represented just 10.2% of household wealth for those under age 35 but rose to 33.4% for those ages 65 to 74, according to the paper.

Defined contribution plans deserve much of the credit for that increase. Since the appearance of 401(k) plans in the early 1980s, financial assets have played a bigger role overall in personal wealth. The percent of households owning pension accounts, bonds, corporate stocks and mutual funds was just 14.7% in 1983. In 2016, it was 30.7%. Most of that increase (1.5% to 16.5%) came from the growth of defined contribution (DC) plans and IRAs. The share of all households with a DC plan more than doubled from 24% in 1989 to 53% percent in 2007.

"Among younger households, the share rose from 31% to 50%, and among middle-aged households it went from 28 to 64%," Wolff writes. "The average value of DC plans shot up more than seven-fold from $10,600 to $76,800 (all figures are in 2007 dollars). Among younger households, DC wealth rose by a factor of 3.3. Among middle-aged households, the average value of DC plans mushroomed by a factor of 6.5."

Unequal equity ownership

But only a minority of Americans has become wealthy as a result. Between 1983 and 2013, the top one percent received 45% of the total growth in net worth, while the top 20% got close to 100%. The share of income held by the top 20% rose to 61.8% in 2013 from 51.9% in 1982. The share of wealth held by the top 20% rose to 88.9% in 2013 to 81.3% in 1983.

The reality is that relatively few U.S. households today have a significant stake in the stock market. In 2016, only 36.8% had total stock holdings worth $5,000 or more, down from 40.1% in 2001; 32.0% owned $10,000 or more of stock, down from 35.1% in 2001; and only 24.6% had $25,000 or more of stocks, down from 27.1% 15 years earlier (all in 1995 dollars). Wolff's data isn't entirely consistent, but it all points to almost negligible average equity ownership among a solid majority of American households.

Ownership of stock is much more extensive and intensive at the high end of the wealth spectrum. According to Wolff, 94% of the top one percent of wealth holders own stock and 93% of households in the top 5.2% of income recipients ($250,000 or more) owned stock in 2016.

The top one percent of households (by income) still owns 40% of all stocks. The top five percent owns 71%, the top 10% owns 84% and the top 20% owns 93%. The paper notes that households earning $75,000 or more (the richest 35%) own 91% of all stocks and households earning $50,000 or more own 96%. In other words, only about half of households have any stocks at all.

What conclusions can we draw from this data? You might say, "So what?" Beauty contests and stock car races always have winners and runner-ups; for every population and every metric, there will be a top 20%, a middle 60% and a bottom 20%. Outside of Lake Wobegon, Minn., not every household can squeeze into the top quintile.

Alternately, you might invoke the 80:20 **"Pareto" principle** as a law of nature. This rule-of-thumb suggests that, in any population, 20% will account for 80% of performance. Or you might interpret the lop-sided data as evidence that the market justly rewards risk-takers. You could even argue that it's all relative: Even the poor in America are much richer than most people in the developing world.

But it's still a mystery why, even though DC plans have been available for 35 years, ownership of stock (even indirectly) remains so concentrated. My hunch is that the existing defined contribution system, despite its standardized designs, regulations and contribution limits, reproduces (and may amplify) the economic disparities in the workforce it covers (or fails to cover). If that's true, DC may not be the ideal path to broader retirement security.