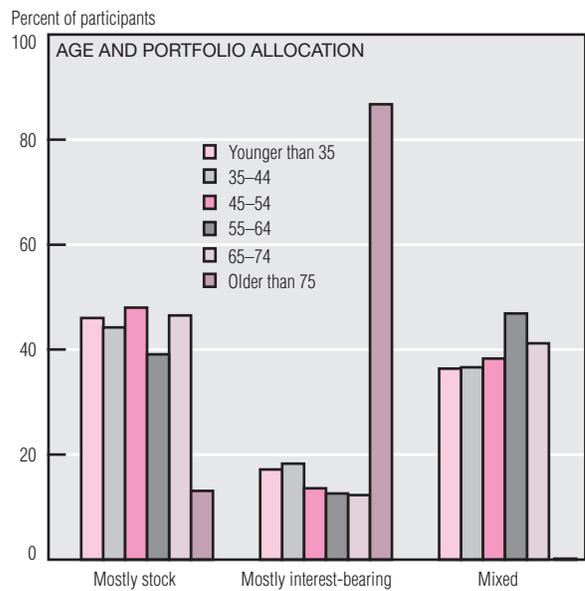
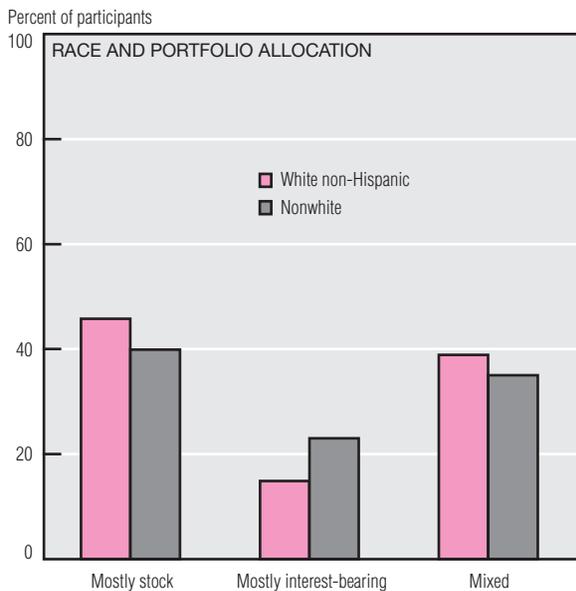
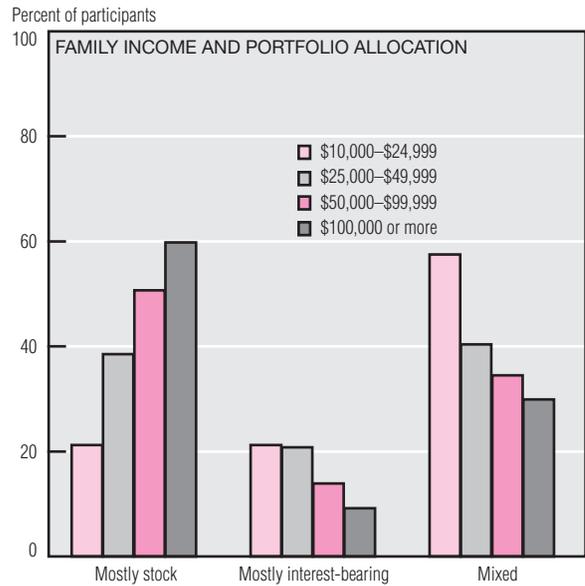
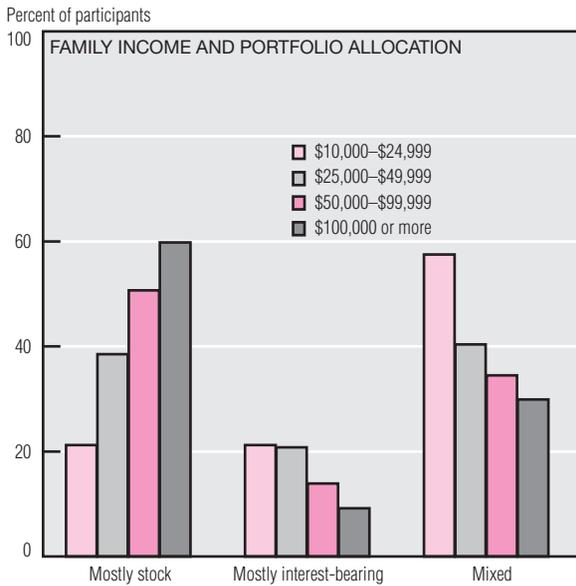


401(k)-Type Plans



NOTE: All data are for 1997. They combine 401(k) plans with 403(b) plans and supplemental retirement annuities.
 SOURCES: U.S. Department of Commerce, Bureau of Labor Statistics; and Employee Benefits Research Institute.

Redressing Social Security's funding shortfall by cutting benefits or hiking payroll taxes is likely to make returns on past contributions barely, if at all, positive. Workers with access to defined-contribution (DC) pension plans, however, might improve their retirement income by investing more in stocks than in bonds. Historical experience suggests that over investment horizons of 20 years or longer, stocks in general are likely to yield much higher returns than bonds with only modest (or no) increased risk of capital loss. How much an individual in a DC plan can

invest in stocks rather than bonds depends on the number and scope of investment choices the plan offers. Investment patterns among people with access to 401(k)-type plans show that a large fraction of those in low-income families invest primarily in bonds rather than stocks. The opposite is true for high-income families. One explanation is that low-income families are more risk averse or have less access to information about the risk-return trade-offs for stocks versus bonds over longer horizons. Alternatively, they may be aware that they are more likely to withdraw 401(k)-type

accumulations over shorter horizons and may rationally invest more heavily in bonds than stocks. Or high earners may work for larger firms that offer 401(k)-type plans with a sufficiently wide range of investment choices. This permits better portfolio diversification and therefore greater exposure to stocks. The data suggest that more educated individuals and whites tend to invest more heavily in stocks than others do. Except for those older than 75, there is little evidence that the fraction invested in stocks varies significantly by age.