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Defined Benefit vs. Defined Contribution Plans: Only 45 Years to Retirement: What a Recent College Graduate Needs to Know

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DEFINED BENEFIT VS DEFINED CONTRIBUTION PLANS: ONLY 45 YEARS TO RETIREMENT. WHAT A RECENT COLLEGE GRADUATE NEEDS TO KNOW. 2010

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Abstract

This paper defines and explains the terms essential for understanding retirement planning. It then describes the types of plans involved, defined benefit and defined contribution plans, and discusses the debate surrounding the privatization of Social Security. This paper provides statistics and facts about each of these options to better prepare a person in his or her 20s who is about to graduate from college and enter a career. Finally, the paper supplies tips on what a young person can do now to ensure a financially stable life upon retiring.

Introduction

The general structure of the retirement system has shifted from the common pension plan to contribution plans like the 401(k). Employers want to bear minimal risk, so instead of offering defined benefit pension plans, they have turned to defined contribution plans, most notably 401(k) plans. The employee, therefore, has become responsible for contributing additional funds if the value of the retirement plan assets decreases. Also, because of this change in plan structure, the average retirement age has increased. Defined benefit pensions are known for offering large monetary accruals after 25 or 30 years of employment, whereas defined contribution plans offer a portable account. This flexibility allows an employee's benefits to increase at a constant rate even after the 25 or 30 years of service. In addition, the debate on whether or not to privatize Social Security has impacted retirement planning. Because of the nearly 80 million retiring baby boomers, the funding for the once reliable Social Security system is becoming scarce and unstable. This paper will define terms and supply further details regarding defined benefit plans, defined contribution plans, and the Social Security system, and suggest what people early in their careers need to do from this point forward to prepare for retirement.

Developing an Understanding

In college, students are taught the skills to make them more knowledgeable in their area of study, but upon graduation, they lack the necessary skills that will prepare them for retirement. Recent graduates begin the job search in hopes of finding a lucrative career. They fail, however, to plan for the future. Planning for retirement must begin on the first day in the work force. In order to begin this process, it is good to understand all the possibilities of retirement, most notably, defined benefit plans and defined contribution plans. It is remarkable how few of the younger generation know and care about the facts regarding retirement.

The Financial Accounting Standards Board defines the defined benefit pension plan as,

> A pension benefit is part of the compensation paid to an employee for services. In a defined benefit pension plan, the employer promises to provide, in addition to current wages, retirement income payments in future years after the employee retires or terminates service. Generally, the amount of benefit to be paid depends on a number of future events that are incorporated in the plan's benefit formula, often including how long the employee and any survivors live, how many years of service the employee renders, and the employee's compensation in the years immediately before retirement or termination. [FASB715-30-5, ¶4]

Regarding the defined benefit plan, in most cases, services are rendered over a number of years before the employee retires and collects or begins collecting the pension. Even though the services rendered by the employee are complete and the employee has retired, the total amount of benefit that the employer has promised and the cost to the employer of the services rendered are not precisely determinable. These costs can only be estimated using the benefit formula and estimates of the relevant future events, many of which the employer cannot control. [FASB715-30-5, ¶5]

An alternative excerpt from the Financial Accounting Standards Board explains the defined benefit plan's distributions as follows:

> Defined benefit pension plans provide a promise to pay to participants specified benefits that are determinable and are based on such factors as age, years of service, and compensation. A plan's net assets are the existing means by which it may provide benefits, therefore, net asset information is necessary in assessing a plan's ability to pay benefits when due. [FASB960-10-5, ¶4]

The American Institute of Certified Public Accountants (AICPA) summarizes the defined benefit plan as one that provides benefits in terms of final average compensation or career average compensation, or as a flat dollar benefit per year of service.

The other concept that a recent graduate must understand is the defined contribution plan. The Financial Accounting Standards Board describes the defined contribution plan as,

> A plan that provides postretirement benefits in return for services rendered, provides an individual account for each plan participant, and specifies how contributions to the individual's account are to be determined rather than

> specifies the amount of benefits the individual is to receive. Under a defined contribution postretirement plan, the benefits a plan participant will receive depend solely on the amount contributed to the plan participant's account, the returns earned on investments of those contributions, and the forfeitures of other plan participants' benefits that may be allocated to that plan participant's account. [FASB715-70-20]

Because the defined contribution plan is more prevalent among younger employees, it deserves further discussion about the specific types of plans. There are three general types of plans, according to the AICPA: profit-sharing plans, money purchase pension plans, and stock bonus plans. The profit sharing plan is not a pension plan or a stock bonus plan, and employer contributions can be discretionary or based upon a fixed formula related to profits, compensation, or various other factors. With a money purchase pension plan, employer contributions are based on a fixed formula that is unrelated to profits. And a stock bonus plan is a defined contribution plan in which distributions are normally made in stock of the employer ("Types of Defined Contribution Pension Plans").

The defined contribution plan is considerably more common, so further explanation may help to better understand the specialized plans. In the cash deferred arrangement, or 401(k) plan, a participant is permitted to elect to receive amounts in cash or have them contributed to the plan as employer contributions on the participant's behalf. A thrift plan, also called a savings plan, is a profit sharing or stock bonus plan in which the participants make after tax contributions that are, in turn, matched, in whole or in part, by employer contributions. A Keogh plan, or HR 10 plan, is any defined benefit or contribution plan that covers one or more self employed individuals. Another common plan is the simple plan or saving incentive match plan for employees. This plan is tax-favored and available to employers with no more than 100 employees who earned $5,000 or more in compensation during the preceding calendar year ("Types of Defined Contribution Pension Plans").

Now that a better understanding of defined benefit plans and defined contribution plans has been established, a recent graduate's next question should be, what about Social Security? Social Security is funded from payroll taxes. This means that a specific percentage of a worker's paycheck goes directly to a Social Security fund to provide benefits to current recipients, or retirees. "Social Security is a safety net that keeps retirees out of poverty. Between 1960 and 2004, Social Security helped cut the poverty rate among seniors by more than two-thirds, from 35 percent to 10 percent" (AFL-CIO America's Union Movement). This guaranteed income has been and is obviously essential to the lives of current retirees, but complaints are arising that the system is unsustainable. After paying into this system for an entire working life, a recent graduate may not have anything to collect from the Social Security fund when his or her time for retirement comes. An American Union Movement website notes, "Social Security is a sound system that can meet 100 percent of its obligations until 2042 (some projections say 2052). After 2042, if no changes are made, funds from Social Security payroll taxes will be sufficient to finance nearly 70 percent of the payments to beneficiaries" (AFL-CIO America's Union Movement).

It is also important to realize that there have been talks of privatizing the system, which means that workers would be permitted to invest their own contributions in the stock market, changing Social Security from a defined benefit system to a defined contribution system. While Social Security does face problems in the near future, privatization will make the issues worse: "The average worker would lose $152,000 in guaranteed retirement benefits. Guaranteed benefits would be cut by 40 percent even for workers who don't choose to have a privatized account. For workers who do choose privatized accounts, the government will take back 70 cents in Social Security benefits for every $1 in their accounts. That's on top of the 40 percent guaranteed benefit cut" (AFL-CIO America's Union Movement).

Concerning the development of a greater awareness of retirement terms, a recent college graduate should also know how the Employee Retirement Income Security Act of 1974 (ERISA) protects retirement assets when, for example, a company files bankruptcy. With the recent demise of many previously profitable companies, many workers have been left with questions regarding pension plans and the employer's misuse of plan assets. "The Employee Retirement Income Security Act of 1974 (ERISA) is a federal law that sets minimum standards for most voluntarily established pension and health plans in private industry to provide protection for individuals in these plans" (http://www.dol.gov/dol/topic/health-plans/erisa.htm). In addition, ERISA requires that participants be made aware of important plan information, and it requires a grievance and appeals process for participants to recover benefits from their plans, and sue for these benefits if the terms have been breached (http://www.dol.gov/dol/topic/health-plans/erisa.htm).

With the instability of market conditions, it is beneficial to understand the plans in place to protect current investment assets. It is also important to recognize the modernization of retirement plans.

Pension Structure and Retirement Age

It is no secret that the employer- provided pension has changed over the last 20 years. College graduates can look to their own parents to see that the retirement age has increased, approximately two years on average. With the shift from defined benefit plans to defined contribution plans, the absence of age related incentives has created this change. A spring 2005 article entitled, "Retirement and the Evolution of Pension Structure" in *The Journal of Human Resources* indicates that defined benefit pensions encourage workers to stay in a job in order to gain access to large pension accruals late in the career and then to leave, typically after 25-30 years of tenure. In contrast, the shift to defined contribution plans allows these pension contributions and returns to accumulate in a portable account. With this, the timing of the pension wealth accruals is not tied to the timing of retirement as it is in defined benefit pensions. In this same article, Friedberg and Webb state that "workers with defined contribution plans retire substantially later. Retirement patterns begin to diverge at around age 55 and accelerate around age 60, when most workers with defined benefit plans begin to experience negative accruals. Workers with defined benefit plans retire almost two years earlier, on average, compared to workers with defined contribution plans and holding other characteristics constant (Friedberg, Webb 306)." These observations are valuable because they stress the importance of retirement planning in one's twenties or thirties, or rather, on day one. The sooner one begins thinking about investments, the better prepared he or she will be for all the possible shifts and changes in pension structure. If a recent college graduate builds a strong financial foundation from the first day on the job, he or she has the ability to take greater risks, and in turn, reap more benefits than someone who fails to save.

The value of the pension may depend on the retirement date in one of several ways. According to Friedberg and Webb, delaying retirement may substantially raise long-term benefits, so pension wealth accrual is large at some future date, though small today. This concept encourages later retirement. In defined benefit plans, this pattern arises at younger ages. Sometimes, delaying retirement may have little or no effect on future pension benefits. Then, the foregone income makes pension wealth accrual small or negative, encouraging immediate retirement. This pattern generally arises in defined benefit plans after eligibility for early or full benefits. On the other hand, future pension benefits may increase at a constant rate when retirement is delayed. This pattern occurs in defined contribution plans. Here, the incentive to retire depends on factors like the employer contribution rate (Friedberg, Webb 283).

Now that a young careerist has accepted there is an increased probability that retirement will occur at a later age, he or she should question why this shift from defined benefit plans to defined contribution plans has occurred.

Transferring the Risk

The most prominent reason for the shift involves investment risk, or market risk. It is common knowledge that the stock market fluctuates. Recently, these fluctuations have not been favored by the majority of investors. In other words, the value of stocks has been declining; therefore, investors have been forced to contribute more and more money to their retirement plans to recover the lost funds. If the employer is not "bearing the risk," it is the investors' responsibility to shovel additional funds into the plan. When one puts money toward retirement, the dollars are invested in income producing assets like stocks, bonds, and real estate to generate adequate income necessary to support life during retirement. When a downturn in the market occurs, such as the one we have been experiencing in previous years, who bears the risk for the money invested? In regards to defined benefit plans, the employer assumes the market risk. "During periods of economic growth and rising asset values, the cost of funding (i.e., contributing money to the plan and investing it to accumulate funds necessary to pay the pensions when employees retire) a pension decreases as the rising values of the investments enables the employer to contribute less out of current revenues and still build the value of the plan to cover the future pension obligations ("Market Risk")." On the other hand, when markets go down or asset values decrease, it is the employer's responsibility to contribute more money to the plan to ensure there is funding for future obligations to the retirees.

As discussed earlier, retirees in defined benefit plans receive a constant dollar amount each month regardless of the changing market conditions. Therefore, if the markets decline, employers suffer because they must "divert more money from current revenue into the pension plan thereby increasing its costs at the expense of its profit. When markets rise, the employer reaps the benefit of the rising values and can reduce its pension contributions and increase its profits while the retiree continues to receive the same promised income ("Market Risk")." From another perspective, the retirees are not harmed by the effects of the market, but their pension income also does not benefit from the growth. When inflation drives market values up, the employers benefit because they can maintain the monthly pension income by contributing fewer dollars. The retirees, however, lose purchasing power because although inflation has occurred, their pension income remains constant, usually resulting in a decreased standard of living ("Market Risk").

In contrast, with defined contribution plans, the retirees assume the majority of the risks and garner the benefits. "When economic growth causes investment values to increase, the retirees see their wealth and income increase while employers are unable to adjust their contributions downward ("Market Risk")." Inflation was just discussed in terms of the defined benefit plan. In terms of defined contribution plans, the employers are unable to adjust contributions when inflation occurs, thereby retirees notice the dollar value of their pension funds rise. In this situation, all prices in the economy are increasing due to the inflation, but the rise in the pension values offsets this so that the standard of living usually remains unchanged.

Social Security: Baby Boom or Bust?

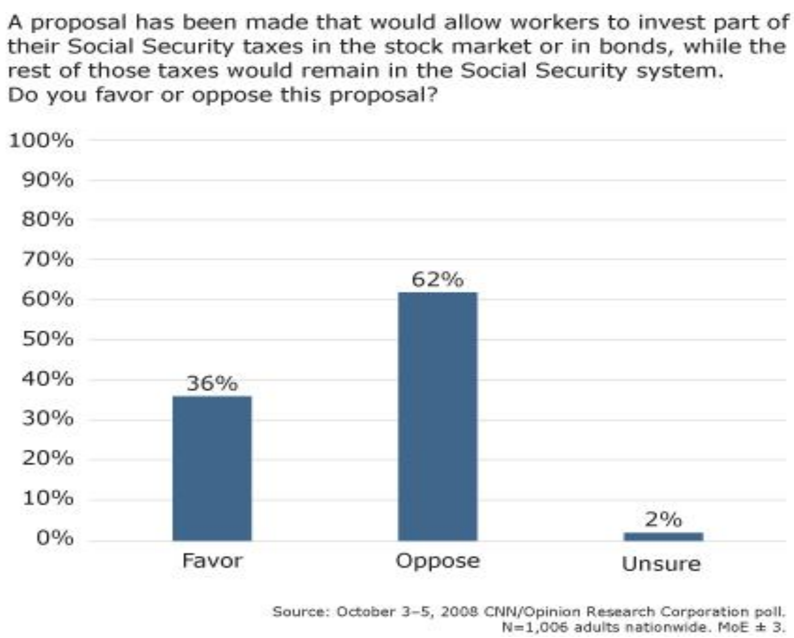
As mentioned earlier in the paper, there have been talks about privatizing Social Security, giving an individual the option to invest these dollars in the stock market. Social Security is known for its guaranteed benefits, a paycheck once a month, every month, so why this shift toward a risky defined contribution arrangement? Americans are unsure as to the future of Social Security, so they are weighing every possible option to increase the available funds. One thing they can be sure of is that if the system continues as it exists now, Social Security will not exist by the time one in his or her 20s is ready to begin collecting.

An article from the National Public Radio website discusses the impact the retirement of America's baby boomer generation will have on Social Security. The statement from 2008 was that that would be the year in which the first of the baby boomers would turn 62 and become eligible to claim early retirement benefits. In addition, the current recession has also caused larger numbers of retirement. With this, the Social Security Administration projected that about one million of those baby boomers would opt to take early retirement. Nearly 80 million Americans were born between 1946 and 1964, making them the baby boomer generation. They have obviously had a major influence on American culture with their vigorous work habits, but they will also have a big impact on Social Security finances. Because of the low fertility rate of baby boom females, having at least one child less on average than women of previous generations, there will be fewer workers paying into the system to support each retiree. This baby bust means that instead of three workers per retiree, there will only be two. John Ydstie, NPR correspondent and host who has covered the economy for two decades remarks,

> As a result, in 2017 the payroll taxes flowing into the Social Security system won't be enough to cover promised benefits. But the system will remain solvent because the Social Security Trust Fund will be able to cover the shortfall until 2041.
>
> Then, if nothing is done to shore up the system, payroll taxes will cover just 75 percent of promised benefits. To bring the system back into financial balance

Congress and the president will have to agree on tax increases or benefit cuts, or both. If they decided to just raise taxes to solve the problem they could make the system solvent for the next 75 years by boosting the payroll tax 1 percentage point for workers and 1 percentage point for employers, according to the Social Security Trustees annual report for 2007 ("Baby Boomers Begin to Claim Social Security").

The current American is feeling doubtful, to say the least, about the retirement situation, but the consensus remains against privatization. The following poll was from a 2008 article entitled "Just Say No to Social Security Privatization" from The Century Foundation website:



Defined Contribution: 401(k) plans

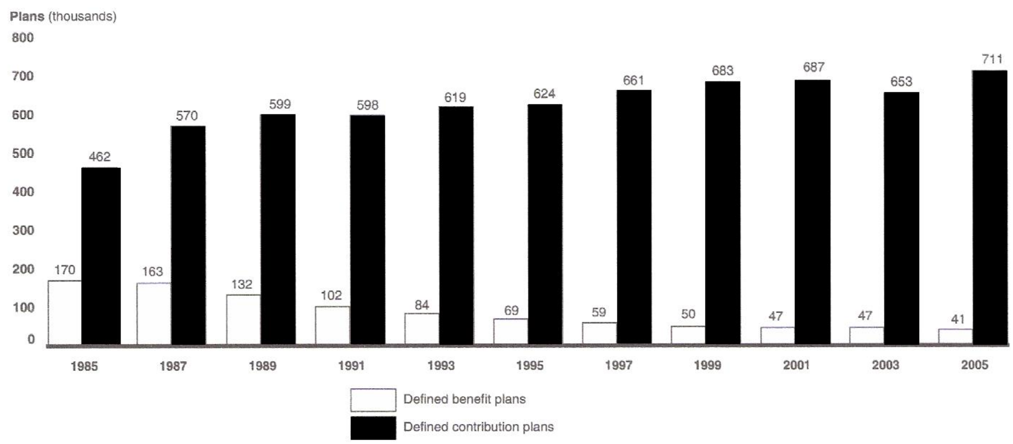
The mobility of defined contribution plans provides a unique opportunity for the younger generation. Specifically, 401(k) plans are crucial to the retirement planning of recent college graduates. Whereas their parents were accustomed to the constraints of the defined benefit pension plan, these 401(k) plans are portable, meaning they move with a worker from company to company. A recent graduate is more likely to hold various positions throughout his or her career, so this plan is effective in terms of savings. The problem, however, is that the younger generation is choosing not to invest. The lack of participation among twenty and thirty year olds is remarkable as the 401(k) plan becomes more popular.

In a United States Government Accountability Office article entitled "Private Pensions," director Barbara Bovbjerg argues that,

> There are an increasing number of active participants in 401(k) plans than in other types of employer-sponsored pension plans, a trend that has accelerated since the 1980s. Now, 401(k) plans represent the majority of all private pension plans; they also service the most participants and hold the most assets. These plans offer a range of investment options, but equity funds—those that invest primarily in stocks—accounted for nearly half of 401(k) assets at the close of 2005. Most 401(k) plans are participant-directed, meaning that a participant is responsible for making the investment decisions about his or her own retirement plan contributions (Bovbjerg 2).

Figure 1 displays the changes in the number of defined benefit plans and defined contribution plans from 1985-2005. Note the drastic growth of the defined contribution plan relative to that of the defined benefit plan.

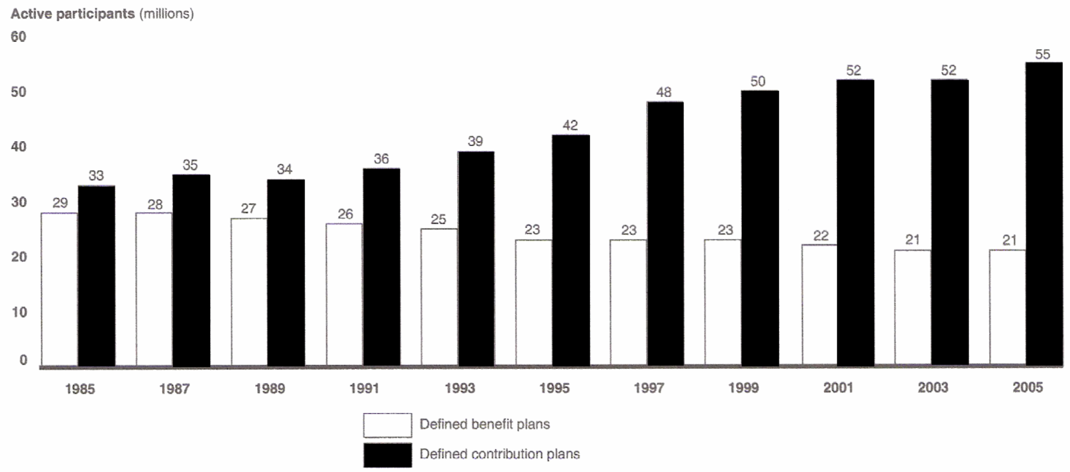
Figure 1: Changes in the Number of Defined Benefit Plans and Defined Contribution Plans, 1985-2005



Source: U.S. Department of Labor (1985 - 2003 data); Investment Company Institute (2005 estimates).

Note: The Investment Company Institute's estimates for 2005 are based on the Department of Labor, Form 5500 Annual Reports, and other information.

Figure 2: Changes in the Number of Active Participants in Defined Benefit Plans and Defined Contribution Plans, 1985-2005



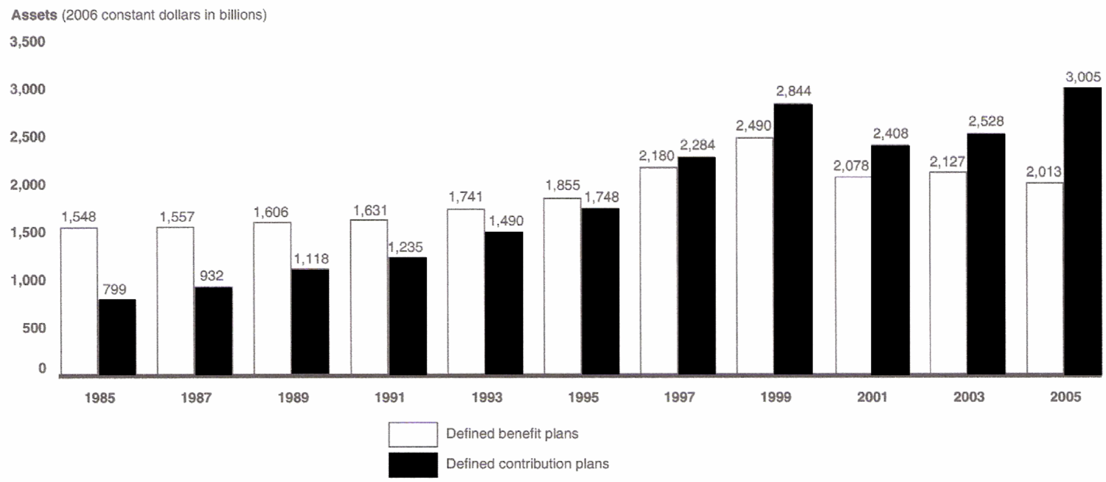
Source: U.S. Department of Labor (1985 - 2003 data); Investment Company Institute (2005 estimates).

Note: The Investment Company Institute's estimates for 2005 are based on the Department of Labor, Form 5500 Annual Reports, and other information.

According to a source from the United States Government Accountability Office, in 1985, defined benefit plans covered approximately 29 million active participants, compared to 33 million active participants in defined contribution plans. As shown in Figure 2, by 2005 the difference in these statistics had become more pronounced, with approximately 21 million active participants covered by defined benefit plans and 55 million active participants in defined contribution plans.

"With the growth in plans and participants, the majority of private pension plan assets are now held in defined contribution plans (Bovbjerg)." Figure 3 illustrates the shift in the late 1990s to a greater percentage of defined contribution plan assets.

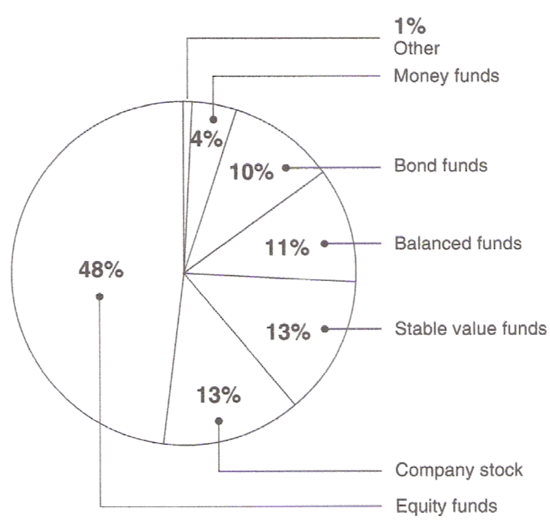
Figure 3: Changes in Defined Benefit and Defined Contribution Plan Assets, 1985-2005



Source: U.S. Department of Labor (1985 - 2003 data); Investment Company Institute (2005 estimates).

Note: The Investment Company Institute's estimates for 2005 are based on the Department of Labor, Form 5500 Annual Reports, and other information.

Figure 4: 401(k) Plan Average Asset Allocation in 2005



Source: Investment Company Institute.

Note: The Investment Company Institute's estimates for 2005 are based on the Department of Labor, Form 5500 Annual Reports; and other information

“Similarly, the number of 401(k) plans grew from less than 30,000 in 1985, or less than 7 percent of all defined contribution plans, to an estimated 417,000 plans, or about 95 percent of all defined contribution plans in 2005. During this same time period, the number of active participants in 401(k) plans increased from 10 million to 47 million, and plan assets increased from $270 billion to about $2.5 trillion in constant 2006 dollars (Bovbjerg).” Figure 4 displays the average asset allocation within the 401(k) plan according to 2005 data.

In this same article from the United States Government Accountability Office Bovbjerg explains 401(k) plan statistics and average contributions.

> With the growth in 401(k) plans, more workers now bear greater responsibility for funding their retirement income. According to the most recent data from Labor, the majority of 401(k) plans are participant-directed, meaning that a participant makes investment decisions about his or her own retirement plan contributions. In 2003, about 88 percent of all 401(k) plans—covering 93 percent of all active 401(k) plan participants and 92 percent of all 401(k) plan assets—generally allowed participants to choose how much to invest, within federal limits, and to select from a menu of diversified investment options selected by the employer sponsoring the plan.
>
> While some participants have account balances of greater than $100,000, most have much smaller balances. Based on industry estimates for 2005, 37 percent of participants had balances of less than $10,000, while 16 percent had balances greater than $100,000. The median account balance was $19,328, while the

> average account balance was $58,328. Participants' account balances also include any contributions employers make on their behalf (Bovbjerg 11-12).

With any investment plan, there are risks involved. Although there are obvious benefits of investing with a 401(k) plan, market fluctuations can cause accumulated wealth to be wiped out. The current recession has caused people who retired last year to be a lot poorer than they had planned to be.

> About 50 million Americans have 401(k) plans, which have $2.5 trillion in total assets, estimates the Employee Benefit Research Institute in Washington. In the 12 months following the stock market's peak in October 2007, more than $1 trillion worth of stock value held in 401(k)s and other "defined-contribution" plans was wiped out, according to the Boston College research center. If individual retirement accounts, which consist largely of money rolled over from 401(k)s, are taken into account, about $2 trillion of stock value evaporated ("Big Slide in 401(k)s Spurs Calls for Change").

In this same article from *The Wall Street Journal*, 401(k) plans are described as being born in 1978 with a designated role of supplementing company- funded defined benefit plans and Social Security, and a way for executives to stash some of their compensation in tax-deferred accounts. Big employers began to recognize that 401(k)s are substantially cheaper than defined-benefit plans, so the employee-managed accounts transitioned from supporting role to center stage. The problem is that an individual's investment choices and market fluctuations drastically change account balances ("Big Slide in 401(k)s Spurs Calls for Change").

> While 401(k) participants have been through stock slides before, now they are also grappling with declines in home values and tighter consumer credit. What's more, health-care costs are rising fast, and people are living longer. These converging pressures are prompting many 401(k) savers to postpone retirement and adjust to a lower standard of living ("Big Slide in 401(k)s Spurs Calls for Change").

This *Wall Street Journal* article also provides profiles of middle aged individuals who lost nearly half of their retirement savings due to the current recession and poor investment choices. Many amateur investors do not have the proper time or financial knowledge to manage their accounts. With proper investment guidance and a stronger economic time, these 401(k) plans can be beneficial to young careerists.

401(k) Profile

After examining the obvious benefits of investing with a 401(k) plan, a recent college graduate may be curious as to who is using this plan and what kind of benefits those individuals will be receiving. The following data comes from an analysis of 21.8 million participants in 56,232 employer- sponsored 401(k) plans done by the Employee Benefit Research Institute and the Investment Company Institute, as of the end of 2007. This article was featured in the Money and Business section of usnews.com.

Retirement may seem like something only parents or grandparents need to discuss, but for an early twenty year old about to graduate from college, retirement is anything but a distant dream. In fact, according to the Money and Business article, "employees in their 20s make up only 12 percent of all 401(k) participants." The money that is invested, however, has plenty of time to grow, so any contributions are well worth the effort. The following is a profile of accounts held by 401(k) participants in their 20s:

401(k) Account Balance

Job Tenure	Average Account Balance
0-2 years	$4,491
2-5 years	$10,748
5-10 years	$18,564

Average 401(k) Asset Allocation

Type of Investment	Share of Account Balance
Equity funds	48.1%
Lifecycle Funds	13.8%
Balanced funds	9.2%
Bond funds	6.6%
Money funds	3.7%
GICs*/stable value funds	5.9%
Company stock	8.4%
Other	1.3%
Unknown	2.7%

401(k)'s and Job Tenure

Salary Range	Median Account Balance
$20,000-$40,000	$6,759
$40,000-$60,000	$15,510
$60,000-$80,000	$33,155
$80,000-$100,000	$49,002
More than $100,000	$52,268

Another profile is that of 401(k) participants in their 30s. By this time, one has hopefully transitioned from the job search to finding a stable career, but now other factors affect savings, such as a mortgage on a first home, or a newborn child. Data from the Money and Business article states that "25 percent of all 401(k) participants are in their 30s." This section's profile is as follows:

401(k) Account Balance

Job Tenure	Average Account Balance
0-2 years	$11,502
2-5 years	$23,024
5-10 years	$42,861
10-20 years	$62,207

401(k)'s and Job Tenure

Salary Range	Median Account Balance
$20,000 - $40,000	$21,187
$40,000 - $60,000	$37,578
$60,000- $80,000	$64,611
$80,000 - $100,000	$100,995
More than $100,000	$150,678

Average 401(k) Asset Allocation

Type of Investment	Share of Account Balance
Equity funds	56.8%
Lifecycle Funds	9.3%
Balanced funds	7.4%
Bond funds	6.9%
Money funds	3.0%
GICs*/stable value funds	4.9%
Company stock	8.9%
Other	1.7%
Unknown	1.0%

Time to Plan

This same edition of Money and Business summarizes that about 33 percent of retirees get a monthly check from a pension, 28 percent receive health insurance from a former employer, and only about 7 percent of retirees' income is from savings, including a 401(k). It is predicted, though, that only 10 percent or fewer of people in their 20s will get a monthly pension check or receive health insurance in retirement from an employer

(Brandon). So, the bottom line is that one needs to begin saving now because no one else is going to plan your retirement.

The facts surrounding a typical person in their 20s are astonishing. At this age, one is in the best position of life to start saving, but, continuously, young people choose to spend every dollar they make. The president and CEO of the Employee Benefit Research Institute, Dallas Salisbury, states, "The earlier you start, the less you have to save every month. Start at 20, and set aside 15 percent of every dollar you earn, are gifted, or inherit, and you will be in good shape at retirement age. Wait until 40, and it will have to be 25 percent or more of every dollar earned. Wait until 50, and it will be 45 percent of every dollar earned." The idea of "compound interest" is the key to saving. Let the money put into savings make money on its own. The longer it is in a retirement plan, the more interest money that will be made. It really is simple, yet only 4 percent of those 25 and under max out contributions to these retirement plans (Brandon).

Another tip that the younger generation needs to be aware of is the instability of Social Security. Andrew Eschtruth, associate director of external relations at Boston College's Center for Retirement Research claims,

> Anyone born after 1960 will not qualify for full Social Security benefits unless retiring after turning 67. If you retire earlier, the amount you get in each check will be reduced. So you will either have to wait longer to claim your full benefit, or receive a reduced benefit compared with your parents. So, although Social Security may still be around to help fund retirement, it should not be counted upon as an exclusive source of income.

Even with this knowledge, only one third of workers 25 and under choose to contribute to employer sponsored retirement plans. But even among the 26 to 40 year old age group, only around 40 percent contribute to a tax advantaged IRA (Brandon). The following chart from a Money and Business article shows another break down of 401(k) contributions:

401(k) participation				
	Participate	% of pay	Avg. balance	Median balance
18-25 (Gen Y)	31.3%	5.6%	$3,200	$1,280
26-41 (Gen X)	63.1%	7.2%	$31,240	$14,730
42 and up (boomers)	72.0%	8.3%	$93,190	$44,330

So, to answer the question on every investment agency's mind, why are young people choosing not to contribute? "Many cite a lack of money or awareness to take advantage of these plans. Yet with a few minor adjustments, younger investors can make the necessary changes to ensure they are doing everything they can to save for the future," says Rande Spiegelman, vice president of financial planning for the Schwab Center for Investment Research. It turns out that there is no real quantifiable explanation for why 20 year olds choose not to participate in 401(k) plans. They are simply ignorant about the issue of retirement. Many are focusing on their current paychecks and fail to think ahead about the benefits of deferring income. They see deferred income as fewer dollars that will appear on their next paycheck, not a tax break that will contribute to greater future benefits.

A 2005 article in *The Wall Street Journal* puts saving in a perspective that most 20 something year olds can relate to. The idea is called the "Starbucks Effect." The average mocha or latte and a muffin cost about 5 dollars, so that is roughly 150 dollars a month. If this money is instead invested regularly and allowed to compound at 10 percent in a tax free vehicle starting at age 25, this person would have about $1 million dollars in savings when retiring at age 65, even though actual contributions would be only $72,000. The idea of compound interest for the long term is the key to saving.

The well known target of saving $1 million dollars for retirement may be easy to remember, but "longer life spans, the threat of inflation and the uncertain future of Social Security benefits make this long- touted savings advice inadequate for most" ("$1 Million Doesn't Cut It for Retirement"). This article, sponsored by Fidelity Investments, provides advisers' opinions on average investment goals in today's dollars for various generations:

> Generation Y (ages 18 to 26) needs to save at least $2 million, according to 77% of advisers. Forty percent put the figure at $3 million. Nearly half of advisers (46%) said Generation X (ages 27 to 42) should at least double the $1 million goal. Twenty-two percent suggested more than $3 million. For Boomers (ages 43 to 64), 35% recommended $2 million to $3 million. Thirty percent suggested $1.5 million to $2 million. According to Scottrade's analysis, seniors are the only generation that may come close to needing only $1 million. Forty-four percent of advisers said $500,000 to $1.5 million is sufficient for average families in that age bracket ("$1 Million Doesn't Cut It for Retirement").

Bill Smith, the president of an Ohio- based retirement group who is among the advisers that took part in this survey concludes this article by stating, "I've never been a big fan of planning to earn less in retirement than you are making now. I'd like to see an individual continue making the same amount of retirement as when he was working.

Who wants to set themselves up in retirement to make less?" ("$1 Million Doesn't Cut It for Retirement")

Conclusion

Planning for retirement must begin on day one of entering the work force. Young people early in their careers should save about 15 percent of their pre tax income to be on the proper financial track for retirement. This saving can be as simple as avoiding purchasing a cup of coffee every morning or even having one less drink after work in the evenings. Also remember, the well known $1 million mark for retirement falls short of the actual cost of comfort. The next essential step is taking full advantage of employer offered defined contribution plans. By establishing a 401(k) plan, young careerists can benefit from compound interest and deferred compensation. The important thing to remember is that simply contributing is not enough. One should make sure enough dollars are put in the 401(k) to receive the full employer match. In addition, most young careerists are known for "job hopping." These 401(k) plans are portable, so people early in their careers must remember to take the accumulated plan money with them. Many young workers tend to pay the tax penalties and keep the cash from their plans, but after doing this a few times, they are sacrificing large sums of money when they enter into retirement. Lastly, a young careerist must not rely on Social Security. This paper has discussed the debates and controversies surrounding the possible privatization and the instability of the Social Security system. Funding might be available to help today's young careerists at the time of their retirement; however, Social Security alone will not provide sufficient financial support.

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