Study sees U.S. retirement wealth up sharply by 2040

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The average value of Americans' 401(k) plans will be substantially higher in real terms by the year 2040 even if stock market returns fall short of their historical values, according to new research by a team of economists from MIT, Harvard and Dartmouth.

In a study published this week in the online early edition of the *Proceedings of the National Academy of Sciences*, James Poterba of MIT, Steven Venti of Dartmouth College and David Wise of Harvard University looked at how changes in types of pension plans and in demographic structure will affect the wealth of future retirees.

They found that if the average return on stocks for the next 35 years is three percentage points below its historical value, then the average value of 401(k) plan balances would increase from $29,700 in 2000 to $269,000 by 2040. If equity returns continue at their historical level, the average plan balance in 2040 would be even greater: $452,000 by 2040.

All dollar values are measured in constant 2000 prices. The findings challenge some bearish projections that retirement assets will drop in value in coming decades as baby-boomers cash out their holdings. The team accounted for the discrepancy by noting that their research takes into effect the continuation of pension plan shifts away from traditional defined benefit plans toward 401(k) plans--a trend that has been under way for some 30 years.

In short, because most current retirees who have assets in 401(k) plans were covered by these plans for only a fraction of their working careers, the balances at retirement for future retirees are likely to be substantially greater than those of current retirees.

This is true even if the trend toward a growing fraction of the workforce covered by 401(k) plans slows or stops, said Poterba, head of MIT's economics department and the Mitsui Professor of Economics.

"The key touchstone here is that if in fact people are in these 401(k) retirement plans for three or four decades, they will have a lot more chance to build up their assets than the current crop of retirees--many of whom have only been investing in 401(k) plans for part of their careers," Poterba said.

The paper uses data on historical participation rates in, and contribution rates to, 401(k) plans to project the future evolution of 401(k) balances for retirement-aged households.

Poterba noted several important caveats to the research, chief of which was the difficulty of trying to make accurate projections of what will happen more than three decades from now.

He also said certain demographic groups may cash out their 401(k) plans prior to retirement, meaning they will not benefit from the projected large increase in their nest eggs.

Source: MIT