
Larry Kotlikoff to Receive RIIA's Academic Achievement Award

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Laurence J. Kotlikoff is a Harvard-trained economist who teaches at Boston University, advises policymakers, has written scholarly and popular books, created the well-known ESPlanner software, and has developed a rational approach to personal finance that he calls "consumption smoothing."

In recognition of those efforts, he will receive an Academic Achievement Award for Achievement in Applied Retirement Research at the Retirement Income Industry Association's third annual meeting in Boston October 6. The award is sponsored by Research magazine.

The gist of Kotlikoff's consumption smoothing idea is that a person's main financial challenge is to maintain roughly the same level of discretionary income throughout life, including retirement. It's the theme of *Spend Til the End* (Simon & Schuster, 2008), a personal finance book he wrote with columnist Scott Burns.

Last week Kotlikoff spoke briefly with RIJ. We asked him if there is a dominant thread that runs through his academic, popular, and public service work.

If there's one theme, he said, "It's being true to the science of economics, and to what we as economics have to say as a profession. That means trying to be consistent with what 100 years of research by economists has shown makes sense, both physiologically and logically."

"I say physiologically, because humans aren't built to consume everything every day. We get satiated. That's why Scott and I developed the concept of consumption smoothing. We're saying, 'You don't have to consume the maximum every minute.'"

Applying that philosophy to personal financial planning, however, requires more training than most people have, he said.

"I've come around to the view that personal economic problems are too complicated for people to figure out on their own with the tools they're using. So economists need to provide economic prescriptions. Unfortunately, economics are interested in studying the pathology. That's a tragic thing for us as a profession. We sit back and study people's behavior and decide that their actions are impaired. We observe that people aren't doing what our models say they should do.

"But, the fact is, nobody can do those things on his or her own. They're far too complicated. So we need to think about economics the way we think about medicine. Instead of just studying the pathologies, we have to prescribe solutions. That's why I developed ESPlanner software, which helps planners and individuals smooth their consumption."

He agrees with RIIA's philosophy of "first build a floor and then create upside." In other words, lock in a reliable retirement income stream before retirement, and take risks, if necessary, with the savings left over.

"Building a floor is the way people should go. If you decide to build a floor, and then you look at Monte Carlo simulations of the outcomes of that strategy, you'll see that there will much less variability in your future living standard. There might be less upside if you invest in things like TIPS, but there's also much less downside."

Kotlikoff has strong opinions about the financial services industry.

"When you're saving for retirement, the financial services industry tells you that you need to plan on having an income equal to 70% to 80% of your current income in order to maintain your lifestyle in retirement. In other words, they tell people that they'll need to spend the same amount, year in and year out. It's set high so that you'll save and invest more."

"Then when you hit retirement, they give you the 4% spending rule. It's set very low so that you'll leave more money with your financial planner. But there's no consistency between those two pieces of advice. There are lots of honest people in the financial services industry. But the industry is unfortunately full of highly paid con artists."

By the time you read this, Kotlikoff will have sent his latest manuscript off to his publisher, John Wiley & Sons. It's about "how economies evolve through time" and offers straightforward solutions to the big fiscal and monetary problems that the U.S. faces. It's titled, "Jimmy Stewart is Dead."

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