Whose Retirement Crisis Is It, Anyway?

By Kerry Pechter *Tue, Apr 8, 2014*

The thrust of last week's ICI Retirement Summit was that there's no broad retirement savings crisis needing government action. But that doesn't mean Boomers won't need help with decumulation.

Is there a retirement crisis? And, if so, what are the hot spots? Are we talking about a Social Security shortfall? Insufficient savings? A potential inability to decumulate rationally? A health care cost crisis? Declining fertility rates? Or do we just have a poverty problem that's ripening into a retirement crisis?

That's a lot of questions, and the mutual fund industry has a single answer: there is no crisis that's big enough to justify government intervention. Its trade/advocacy group, the Investment Company Institute, has worked hard recently to dispel a sense of alarm. In December, for instance, it published a white paper called, "Our Strong Retirement System: An American Success Story."

Last Friday, the ICI sponsored a Retirement Summit where, according to ICI chairman Paul Schott Stevens' (at left) op-ed in *The Hill* the day before, the ICI would "bring to light points of view that have not received much play in the media or the public discussion, where there continues to be a heavy emphasis on doom and gloom."

Despite this preview of the ICI's agenda—spin-sessions don't usually warrant news coverage—the quality of the speakers made this Summit difficult to pass up. Headlined by the unimpeachable James Poterba (below right) of MIT and the National Bureau of Economic Research, the roster included A-list retirement specialists who have made important contributions to the field.

What did they have to say? Over the course of the day, the speakers succeeded in replacing a picture of a forest with a picture of trees. Instead of a society-wide retirement problem, we saw a lot of personal retirement problems. It came down to this anti-climax: The more of the following factors that describe you (single, female, no high school diploma, African-American or Hispanic, bottom income quintile, poor health) the greater your chance of a wretched retirement. An interesting factoid: 95% of those who retire *voluntarily* are satisfied with retirement; only about half of people who retire *involuntarily* are.

But some troubling issues were minimized, glossed over or ignored by the speakers. For instance, ICI economist Peter Brady made Social Security sound progressive by emphasizing that the program replaces 77% of a low-income person's pre-retirement wages and only 28% of a high-income person's. But he didn't show that those replacement rates assume employment to full retirement age or that the benefits for upper-income retirees, who tend to live significantly longer than lower-income retirees, are much higher.

Optimism caucus

Similarly, Erik Hurst of the University of Chicago Booth School presented research showing how well most retirees are doing in the first few years of retirement. But he neglected an important question: what happens in extreme old age, when people run low on resources?

If there was an optimism caucus at the conference, Hurst was the chairman of it. "There's no such thing as suboptimal savings," he said. "People just have different preferences" over the life-cycle. "In so far as it's a public policy matter, I don't know how to deal with it."

Absent from the conference was much discussion of the public policy implications of the research data. That was by design: the ICI wanted the speakers to stick to the academic evidence for or (preferably) against the existence of a serious savings crisis. That left room for the unspoken but preferred policy implication: if we don't have a savings "crisis," then we don't need legislative interventions or higher taxes.

Several speakers testified to the existence of isolated, well-defined crises, like brushfires on an otherwise peaceful landscape. There's an Alzheimer's disease cost crisis already underway, said Kathleen McGarry, a UCLA economist. There's a financial literacy crisis, said Olivia Mitchell. And there's a Social Security funding crisis that continues to elude political consensus, said Stephen Goss, the Social Security Administration's chief actuary.

Mitchell (below left), the director of the Pension Research Council at the Wharton School, has been working on financial illiteracy. She has found that only 35% of American adults can correctly answer three out of three simple questions about compound interest, inflation, and investment diversification correctly.

Goss introduced the idea, not necessarily self-evident, that the lower birth rate in the U.S. in recent decades, not rising longevity, is what threatens Social Security's solvency. Therefore, it makes little sense to increase the full retirement stage.

To maintain currently promised Social Security benefits after 2033, he said, Americans will have to spend 6% of GDP on the program, or a third more than the current 4.5% of GDP. We have a choice: we can curtail benefits by about 25%, raise the payroll tax by a third, or require people to work longer. Or, we could start taxing the value of employer-sponsored health care benefits, which would eliminate 40% of the anticipated Social Security revenue shortfall.

Other presenters introduced data that tended to brighten the outlook for most retirees or defuse the darker predictions. Hurst of the Booth School argued that most people need less money as they get older, because they need less new clothing, spend less on commuting and use their extra leisure time to do things that they used to pay other people to do.

McGarry (right) said that health care costs in retirement tend to be highest for people with certain illnesses (like Alzheimer's patients) or at certain times (during the last year of life) or for people who choose to pay them (like people who opt for home health care). She seemed to believe that there are hot spots in health care costs, but that most people will be able to afford medical care in retirement.

'Complex and person-specific'

Poterba, the MIT economics professor, suggested that some analysts may be undercounting American's wealth by focusing on today's low median 401(k) balances. A lot of people have wealth beyond their 401(k)s. Ten percent of retirees will have an IRA, a 401(k) and a defined benefit pension, 72% have one or more of those types of accounts, and only 35% have only one, his data showed. The retirement picture is "more complicated and person-specific" than most people realize, Poterba said.

In a generally sanguine vein, Jack VanDerhei of the Employee Benefit Research Institute (EBRI) suggested that retirement savings *adequacy*—as distinct from *replacement* rates—is higher than people think.

If you include the potential cost of long-term care, that 57-59% of Americans are on track to meet 100% of their retirement spending needs, 67-70% are on track to meet 90%, and 81-84% are on track to cover 80% of their needs, VanDerhei said. If you exclude long-term care costs, 88-96% of retirees will have enough money to cover 80% of their needs.

For the retirement industry, of which the ICI represents the mutual fund sector, the Baby Boomer age wave is more of an opportunity—one that some companies will maximize and others will miss—than a crisis. Although last week's ICI Summit was about the retirement problem, not the opportunity, its drift was that the problem isn't really so awful. Or, if a problem exists, it's fragmented and concentrated among vulnerable populations.

The mysterious 30 percent

At the end of the day, figuratively and literally, Steve Utkus of Vanguard's Retirement Research Center summed up America's retirement prospects this way: About 50% of retirees will make it and about 20% will need government assistance. The mystery is what the remaining 30% are going to do.

Anthony Webb (below left) of the Center for Retirement Research at Boston College struck a dourer note. "The median household IRA and 401(k) balances for people ages 55 to 64 is only $120,000. That translates into a retirement income of about $400 a month. I can't convince myself that $400 plus Social Security can be adequate for anyone but the poorest people."

The director of the Rand Center for the Study of Aging, Michael Hurd, said, "Social Security is clearly important to most people. People who are divorced or widowed before retirement, or who are in poor health, are the most at risk. The question is: How can we do something for vulnerable groups without interfering with the incentives facing most people? But the problem isn't population-wide. We're not facing a systematic national shortfall in retirement savings."