A Great New book on America's Coming Retirement Crisis Helps Us Highlight the Need for Comprehensive Retirement Risk Management

by

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Introduction

In *Falling Short: The Coming Retirement Crisis and What to Do About It* (Oxford 2014), the authors (Charles D. Ellis, Alicia H. Munnel, with Andrew Eschtruth) have written a book that deserves to be read by all adults whose incomes rely on debt-based economic systems around the world. The evolution of the United States retirement income system presents some features and challenges for pre-retirees that are likely to be found in many countries as we go forward into this new century.

This book is about the income inadequacy that potentially awaits future retirees in America. Thus, its conception of retirement crises faced by individuals or an aging cohort seems unduly narrow. A more comprehensive and useful conceptualization of retirement challenges is presented in Chapter 3 of *Key Demographics in Retirement Risk Management,* written by two co-authors who have between them over 30 years of experience in financial and retirement planning. Their work places a clear focus upon variables beyond income adequacy. (Click on this link to get *Key Demographics …* http://www.springer.com/us/book/9789400740433 also in a Kindle edition at http://www.amazon.ca/Key-Demographics-Retirement-Risk-Management/dp/9400740433)

I do not blame Ellis and his co-authors for carefully defining the particular niche in which they have made a brilliantly clear and cogent synthesis of major ideas that have been in the literature in recent years, among them some are innovations of the work at Boston College. This book provides several important 'take-aways' at different levels -- personal, familial, and societal. But it would be unfortunate if one of those 'take-aways' seems to boil down to the idea that by and large our major retirement challenges are those arising from income inadequacy.

One reason that this would be unfortunate is that it inhibits appropriately broad thinking about our major risk management challenges and opportunities, including the opportunities to address income inadequacy through systems of human cooperation that do not rely on financial markets as heavily as do the institutions, strategies, and culture that are the focus of the discussion in the book.

Core of the retirement crisis

After stating that the book is about "America's impending retirement crisis", they go on to describe the core of the crisis as follows: "our retirement problem is simple: we need more income [and] we will get less from traditional sources." They go on to outline its elements and possible solutions with great clarity, providing basic education in English that should be accessible to all persons with good high school education. This is a great public service.

However, for us older folk to limit our horizon in thinking about our retirement challenges to the question of income adequacy would be a serious mistake. Why?

It would be a serious mistake because there are some other very important challenges associated with non-economic dimensions of our future later life transitions. They and the economic issues present us with a concert of linked risk management questions. Indeed by attending to these linkages, we can reach for contributions to solving the *economic* issues that the authors have not addressed.

"New" contributions to solving the problem

The essence of these contributions involves reducing our need for cash by the way that we manage our lifestyles and build social capital, as I show below. Moreover, our inevitably limited resources are best deployed when we take into account as much as feasible the full spectrum of risk management questions that are pertinent in our lives.

Let us take as examples the topics of our mental and physical fitness, and that of the interconnectedness and resilience of sources of mutual support in our local communities. These are matters that involve variables that can be 'managed' so as to create a great reduction in many persons'need for cash, speaking collectively (since the realities are sensitive to individual circumstances). (Notice the word "reduction", please. I do not mean to suggest elimination of the need for cash.)

The good value of thinking about multidimensional risk management (i.e., that which goes beyond income adequacy) comes out clearly when you look at the elements of the problem that the authors lay out. Here are the elements. Our aging cohorts need more money or more subsidized access to services enabled by cash payments to the service deliverers. However, the sources of money or of the said subsidized services are declining. These declines involve interest rates falling to historic lows, Social Security eventually becoming less potent as a source of income, and weakening of employer supported pensions and post retirement health care payments.

A key aspect of this reduced employer support is that of placing on the shoulders of individuals enhanced levels of responsibility to achieve effective money management connected with earned pensions (a matter about which there is now a ton of literature, with Andrew Hacker's *The Great Shift* being an early outstanding entry). It is also worthwhile to keep in mind the focus that the authors placed on the fact that close to one-half of retiring workers have no employer related pension program.

Systemic troubles ahead?

Let's add to those factors an elephant in the room to which the authors have not paid enough attention. That is the fragility of our financial system, which is charged, in a sense, with delivering reliable flows of investment income along with acceptable purchasing power in each unit of currency. We on Main Street could save until we are blue in the face, and yet have little impact on the influence that financial-market traders have upon what will become the valuation of our pensions and savings in the months and years ahead.

This, in effect, means that the question of how much to save might have largely gone into the realm of "the unsolvable" for a very large number of people. And let us add to that black box the uncertainty about health breakdown risks, as well as pertinent behavioral variables that they will alter as they age further.

The upshot is that our aging cohorts are now confronted with an enormous economic-risk management challenge, and for a high percentage of us the issue isn't the maintenance of a hoped-for standard of living. It is that of survival in a state where we avoid being charity cases or placing an enormous burden upon whatever family resources we may have.

Where are the resilient local communities where services can be exchanged?

In speaking of family resources, we bring into the story a huge dimension that the authors have discussed inadequately. Where there is a lack of a culture that suitably values interdependence and sharing within extended families as well as across families within communities, a huge issue exists. Relying on this interdependence might take us back to a bygone age; but there is already much talk going on about building personal and familial self-reliance and strengthening local communities to organize exchanges of services.

This cannot be the whole solution; but it can be a great help where many older people do not need high-tech health care to survive and enjoy themselves within their limitations.

What if we brought proactive caring back into health care?

Now let's identify another elephant in the room. It is how well we adjust our lifestyles to better manage and promote the battle against the physical and mental declines that come from allowing our bodies, our minds, and our social capital to go to waste from our neglect of best practices in mental physical and social fitness promotion. Major figures in the field of alternative medicine have been advocating the position that herein exists an important route toward moderating the rate of rise in global healthcare costs.

It is worth emphasizing that none of these non-economic variables comprise individually or collectively the solution to the problem that the authors describe so well; but they contribute to the multifaceted solution that we need. And we get into those variables by defining our risk management challenge more broadly than is done in the book.

Have we only three options?

Thus, when the authors tell us that we have only three options in trying to address the problem that they describe, we should raise some questions about definitions of terms in three key phrases they use: "poor in retirement", "save more while working", and "work longer". On the surface what the authors mean to convey with these phrases seems absolutely clear; but it becomes less clear when we wonder about the words "poor", "save", and "work".

To these words, we can attribute reasonable meanings which when articulated would bring us to a different construction of what the existing options are. For example, setting aside cash for a rainy day is not the only meaningful way to think about saving; because one way to save is to build up social capital upon which can one can draw in later life to obtain free services for which one would need cash in the absence of that social capital. As another example, unpaid work can deliver to the recipients of the outputs values that allow them to reduce their need for cash.

There is another important part of the book where non-economic dimensions of risk management are not sufficiently recognized. To get into this area properly, we need to describe components of the problem in broader terms than have been done above.

The authors very neatly summarize America's retirement problem in the following terms. Due to the combination of (1) extension of the average length of life, (2) the tendency of a substantial proportion of workers to avoid delaying their retirements beyond the early 60s in age, and (3) rapidly rising health care costs, our society is a scene of rising "retirement needs". While these needs are growing, the capability of income sources to deliver the resources required to satisfy them is declining. This decline comprises (1) lowered investment returns, (2) employer-sponsored plans yielding inadequate balances in terms of supporting suitable income flows in later life, and (3) forecasted reduction of income flow per payee coming from the Social Security system.

The authors say that "these changes would be expected to lead to substantially higher wealth to income ratios if people were aiming to preserve their standard of living in retirement. Instead, the pattern of wealth accumulation has remained virtually unchanged so people are increasingly less prepared for retirement". This remark seems both correct and powerful. However, it is appropriate to call for the definition of two crucial phrases -- "standard of living", and "preparation for retirement".

We do not have to go to any distance to support the assertion that there are very reasonable definitions of these phrases that lead to major adjustments to the risk management step that the authors are advocating. Here are a couple of examples.

Suppose that I decide to leave my Manhattan high-rise apartment to live in a small community where people focus upon self-reliance at the individual and the family level and inter-family sharing of services, as well as frequent participation in community activities. Also, I would focus more effort upon expanding my cognitive fitness with a whole variety of brain-centered activities that are free or cheap. Whether I thereby reduce my standard of living depends on how you define "standard of living".

Secondly, it is arguable that our society is in a state of crisis regarding the way that we think about wealth. In a nutshell, it seems that the vast majority of us think that wealth is either financial capital or non financial assets that are readily converted into financial capital. In this line of thinking, wealth is all about global (for a person) purchasing power. It seems our society has largely failed to acknowledge that there exist other absolutely vital dimensions of well-being that are legitimately forms of wealth, given a broader definition of "wealth" than the one we usually use.

We need no elaboration here; because everybody knows what I'm talking about. However, they will quickly say that only the financial wealth matters -- that's the wealth that can bring you significant prestige in society! Yet, when we arrive in the Third and Fourth Ages of life, it becomes quickly evident that ignoring the other forms of wealth can bring catastrophic consequences no matter how much financial wealth is on hand.

This last thought brings us to the idea of preparedness for retirement. If we follow the line of thinking laid out above down to this idea of preparedness for retirement, it seems that preparedness involves far more than the kind of preparedness that the authors seem to have in mind when they focus on income adequacy. To put this point somewhat crassly: $1 million may seem to do you little good when you are a lonely old man/woman to whom few people want to talk. A million-dollar wheelchair does you little good when the condition of your feet prevents you from engaging in the independent mobility needed to effectively promote physical and mental fitness. Everybody knows these things; but you have to get old to appreciate their importance!

Is wise investment good enough?

Finally, it seems worthwhile to delve somewhat deeply into the realm of financial risk management to point out a major problem that the book has not exposited adequately. We find the problem in the section entitled "Make your 401(k) plan work for you". To put the problem in a nutshell, except for the arrival of flows of money into the capital markets from debt expansion or from the growth of financial resources that are accumulated by converting output of real goods and services into financial assets, the search for returns on investments in the financial markets is often a zero-sum game. This means that inevitably there is a class of winners and a corresponding class of losers.

This fact becomes very bad news when a small proportion of the winners walk away with extremely large gains; because then we must add to the losers a subset of winners whose gains are essentially negligible relative to the maintenance of their standard of living.

Even when there are inflows of capital to the financial markets, they have to be large relative to the preexisting size of the capital already there if they are to allow a high percentage of investors to *all* show substantial positive investment returns.

The implication is that for a substantial proportion of market participants investing successfully is often a true impossible mission. That does not mean that they have not invested wisely.

The obvious objection to the foregoing remarks is that we have to look long-term, and then we will see that along with the growth of total output in the economy will come a corresponding growth of capital in financial markets. That's so; but there are a caveat and a warning to state here.

The caveat is that when capital in financial markets is expanding because of real national economic growth, that expansion needs to outstrip in its rate the rate of growth of investments being placed in that market. If the rate of growth of investments is too fast, we may still find an inherent tendency for a substantial fraction of participants to be unable to obtain decent positive investment returns, and that would reflect systemic forces that are independent of how wise investors are.

Thus, endless vibrant growth of the real economy, i.e., growth of the production of real goods and services, may be a prerequisite for successful investing by a high percentage of investors. Looking backwards to the 1960s and 70s, it is easily argued that such growth has taken place. However, the capability of our ecosystem to maintain vigorous growth moving forward indefinitely is an issue that many are raising.

The warning I mentioned can be summed up as follows. When the global digital money supply is being pumped up with no sustained ties to the rate of expansion of real goods and services, much of the apparent wealth associated with this money growth may not be convertible into consumption of real goods and services when large numbers of people attempt that conversion on a massive scale within a short time period. Thus, the more the rate of this kind of money growth outstrips that of goods and services in the real economy, the less will it be possible for a high fraction of us to successfully convert our financial wealth into consumption of real goods and services.

To see what's involved, imagine 500 millionaires invading the grocery stores to buy emergency loaves of bread as a big storm approaches, and they find there are only 50 loaves on the shelves. Some of these persons will find their millions of dollars useless to get the bread they need. This is why it is so important to conceptualize wealth in much broader terms than we normally do, and to set about building these alternative kinds of wealth so that we can draw upon them in times of need.

Summary

To summarize, the authors have done a brilliant job of dealing with the issues surrounding retirement income inadequacy. For many people, effective risk management around that inadequacy inevitably brings us to a broader conception of the retirement challenges than that provided by the authors. This broader conception leads us to variables in life domains not discussed by the authors.

Having said that, we should acknowledge a point that every good marketer will tell you: one of the biggest mistakes you can make in a business venture is to fail to develop your particular niche within a broader field and in the process you try to 'please everyone'. The authors of have clearly identified their niche, and within its confines they have produced a very helpful book. Click on this link to buy *Falling Short: The Coming Retirement Crisis and What to Do About It* at:
http://www.amazon.com/Falling-Short-Coming-Retirement-Crisis/dp/0190218894/ref=sr_1_sc_1?s=books&ie=UTF8&qid=1435436148&sr=1-1-spell&keywords=Falling+Short+Munnel