Economist: ‘Retirement for most people is financial suicide’

Kerry Hannon
·Senior Columnist
Tue, April 5, 2022, 11:54 AM

Laurence Kotlikoff, the brash Boston University economics professor and Social Security expert, doesn’t mince words.

“We Americans are financially quite sick,” he writes in his new book, “Money Magic: An Economist's Secrets to More Money, Less Risk, and a Better Life” before listing all the financial gaffes we Americans make in our lifetimes.

“As a group, we undersave, underinsure, under diversify, pay for bad investment advice, rely on dying early, retire too soon, take Social Security at the first chance, free far too little trapped equity, borrow to invest in stocks, convince ourselves that stocks are safe long-term, live house poor,” he writes.

Marriage, divorce, college, and other lifestyle decisions we make irk him as well. But it’s a lack of savings — especially for retirement — that really gets under his skin.

“Most workers are saving bubkes,” he writes. “Half of today’s working families risk a major living-standard decline in retirement. The share would drop roughly in half were all workers to retire two years later.”

So, he offers his retirement advice in his book, which comes with a title that is a bit of a wink. It’s not abracadabra.

“It’s lifetime budgeting,” he told Yahoo Money. “It's the economics approach to financial planning … [it’s] not asking what you would like to spend, but here's what you can spend.”

Here’s what else he had to say in a conversation with Yahoo Money.

Kerry Hannon: Is conventional financial advice about retirement all wrong?

Laurence Kotlikoff: “The financial industry steers people looking for retirement planning advice into a fantasyland. Advisors ask them, how much would they like to spend in retirement? My answer is a billion dollars a day.

Then they ask them how much are you saving? ‘Not so much. Okay Let's put you into these high-yield funds.’ Your probability of success of not running out of money *is* higher. And your probability of success of failing is small –that *really* means the probability of starving to death.

So where you have financial planners kind of basically putting together a plan where the probability of starving to death is small. That doesn't sound like particularly good planning.

What are the biggest mistakes that people are making when it comes to their retirement?

A lot of people are just not planning for it. They leave it to somebody else. They're assuming that Uncle Sam and their employer are taking care of them. Then they are surprised when they hit retirement and find that they may not have enough money.

Second, there are lots of people that are not saving in 401(k)s, or are in 401(k) plans and aren't participating enough. They're not even putting in enough to get an employer match.

Taking advantage of the employer match is possibly the simplest money magic trick in the book. The average matching contribution to an employee’s retirement plan is over 4% of their pay. Yet a quarter of the workers eligible for this free money don’t participate in their employer’s plan. Let me proclaim this no-brainer:

If your employer offers to give you money for free, *take it.*

In my opinion, the whole 401k retirement account experiment in this country has failed.

Are people retiring too early?

Yes. They retire too early thinking they're okay without really looking at it carefully. The median wealth of Baby Boomers retiring is about $144,000, which is about three years of median spending, in a retirement that could last 35 or 40 years in some cases. So most boomers are retiring with too little money by a long shot for a retirement. That money could last longer if they worked longer.

I think retirement for most people is financial suicide. It's a decision to take the longest vacation of your life.

What is stopping people from saving in a retirement plan?

At least 32% of employers don't sponsor retirement account plans, period. And they're employing a good chunk of Americans.

And then we have a lot of people who have just got more pressing needs. They've got to pay for daycare. They've got to pay for the mortgage. They just don't feel they can contribute.

What are the biggest mistakes people make when it comes to Social Security?

They take Social Security too early at a much lower benefit. We have about 6% of people waiting until 70 to take their retirement benefit. My estimate is that about 85% should be waiting until 70 to take the benefit, when it’s 76% higher adjusted for inflation versus taking it at age 62.

That way, you're going to have more of your resources in an inflation-protected form. And then you've got this insurance if you keep living to a hundred. You've got this much bigger number year after year coming to you.

If you're disabled, and you can't work, and you don't have anything else, you're going to have to take it early, but there's lots of people that aren't and are taking it as soon as they can.

"Paying off household debts, starting with the highest interest-rate debts, is your best investment," said Laurence Kotlikoff, the brash Boston University economics professor.

What’s your best piece of financial advice?

I know a lot of people that have student loans at the same time are investing in stocks. It's a crazy thing to do. That was one of the things I am trying to get across in the book.

So what they've done in effect is borrow money to invest in the stock market. If you put less in the stock market, and you pay off that student loan, now you're getting probably a 5%, maybe 7% return.

Same with mortgages. Because of mortgage interest rate differentials, mortgages are financial losers. They're not nearly as bad as credit card balances, student loans, or payday loans, whose interest rates are far higher, but they're still something to be avoided when possible. Paying off household debts, starting with the highest interest-rate debts, is your best investment. It's entirely safe and it provides you a for-sure, above-market yield.

Parting thoughts?

Work on your financial health now, so you can spend your money 'til the end. That's the object. And if you've made a lot of money, if you're rich, you don't want to put it in the stock market. The stock market could drop 50%. It has.