Chapter 1

The Fractured American Retirement Dream

If I had known that I would have lived this long, I would have taken better care of myself.

—Jimmy Durante

A recent survey of some 2,500 adults ages 45 to 64 conducted by Action Research for Thrivent Financial Retirement indicated that many of the respondents plan to work after retirement. The question they responded to was "What income sources other than Social Security do you expect to have during your retirement years?" The top sources of income varied among the group. For example, some could rely on a 401(k) plan while others surveyed could not as evidenced by their responses. Some included savings and investments such as a 401(k) and stocks (52 percent); employment (43 percent); employer's pension (39 percent); individual retirement account (36 percent); and inheritance (16 percent).[1] Full-time retirement may very well be a thing of the past. Clearly, the notion of traditional retirement is dramatically changing and this is not limited to the United States alone. Pension reform has been on the national agenda for many countries for the last decade as each attempts to deal with their aging populations.

Longevity and High Costs Necessitate Pension Reform

One of the major and ongoing global initiatives of the previous decade was pension reform. In developed countries, the driving force was the recognition that economic and fiscal irresponsibility threaten existing retirement systems that will become unaffordable in coming decades given the demographic developments that present a staggering real risk. Countries that are evolving and making the transition to market economies are confronted with the challenge of introducing public pension systems that will provide social security in old age to its citizens and also support a market economy. There is hardly a country in the world where the reform of the existing pension system is not on the national agenda. The driving factors behind the need to reform are similar and common for all countries facing them.

The first are the short-term fiscal pressures that dictate immediate action while looming, larger problems resulting from an aging population and the insufficient, long-term resilience of retirement systems remain inadequately addressed. Second, socioeconomic changes demand a rethinking of the original and historical basic ideas that are the underpinning of the pension system design, some dating back to more than 100 years ago. Third, the challenges and opportunities of globalization have required countries to pay more attention to the broadening economic effects of pension plans, including creating a larger risk pool and offering portability to workers to carry their pension assets with them to the next employment opportunity that in some instances may even mean across national borders.

People around the world are living longer. "Longevity risk is a tremendous societal issue," according to Thomas Hess, chief economist of

Swiss Re, the world's largest reinsurer by premium income. "If you include also the health cost related to old age, I think it's definitely among the biggest risks we have today."[2] Attempting to add up the gap between the amount of money needed for funding retirees' pension systems and in addition to what they have saved is dizzying because it requires estimating a range of figures that include rapidly rising health care costs, increasing life spans, the unpredictability of potentially volatile market gyrations, and individuals' personal savings rates. Right now, no one has discovered the crystal ball to view and resolve all of these complications.

While it may be possible to hedge against stock or interest rate changes, there is no pure financial hedge for the varied dynamics of longevity. This is an unknown. Pension and health care costs are "the most volatile and unpredictable risks on companies' books at the moment" according to Stephen Hunnisett, an insurance analyst with Moody's in London.[3]

The Three-Legged Stool Approach to Retirement

If people have been and continue to openly acknowledge the problem, why are our pensions still in danger? There are numerous reasons that have contributed to retirement insecurity. It was not that long ago when the old adage of the *three-legged stool,* that is, the three-pronged formula, was the rule in preparing for a financially successful and rewarding retirement. Although that approach is still the answer to retirement security, it is rarely discussed today.

The three legs of the stool comprised a monthly government-guaranteed Social Security benefit, a solid independent pension plan, and one's individual savings. Today, all three of the legs are infact fractured. None of them is strong enough to sustain the weight of a robust retirement due to the varied economic burdens and conditions that exist for many Americans.

Let's look at the facts. Americans have had a very long and strange relationship, which I would categorize as a warped and uncontrollable love affair, with the assumption of debt. This personal savings leg of the retirement stool is being splintered by debt. We, as a society, have willingly accepted an extraordinarily high level of debt. It was encouraged and fostered throughout society at every level. Even within days of the horrific attacks of 9/11, Americans were supposed to be consoled in the midst of their shock and their collective grief by our president when he encouraged us to go out and lead normal lives and shop. Apparently, in his mind this is what most Americans were capable of doing in their hour of deep, incredible stupor of perplexity and pain. Over the last few decades, we have taken on more and more debt.

As far as the second leg of the stool goes, pension plans, we are well aware of the dramatic movement to shift the burden of retirement onto the shoulders of individuals and away from employers. This has been successfully accomplished by removing defined benefit plans from the private sector, replacing them with 401(k) or defined contribution plans, which are nothing more than forced savings plans for those who are smart enough or make enough money and have the foresight and discipline to set aside contributions from their weekly paychecks. For those who do not set aside this money, their futures are bleak.

The public sector pension arena is beginning to mirror what has taken place in the private sector over the last 25 years. There have been efforts to eliminate defined benefit plans for teachers, sanitation workers, firefighters, police officers, toll-takers, correctional officers, hospital workers, clerical workers, and other public workers. If these forces are successful, the pension leg for public workers will also fracture.

The Future of Social Security

Finally, the Social Security trust fund is not fully funded and cannot be trusted in the long-term to pay the benefit obligations to the millions of baby boomers who are anticipating retirement in the near future as well as the Generation X'ers who are following right behind. The so-called *trust fund* no longer exists. Today's Social Security surpluses are invested in U.S. Treasury bonds, which enable uncontrolled and wanton government spending on everything except future Social Security benefits. Future beneficiaries have no real security other than the hope that future workers will pay more payroll taxes and fund their retirement on their own. Conversations with Generation X employees reveal that they have little faith that the Social Security system will help them when they retire. They feel that the system has been squandered. Their discontent about the state of Social Security could well contribute to intergenerational warfare.

There are hard choices that will have to be made in order to maintain Social Security as a viable leg of the retirement stool to stand on. Decisions could include lowering the benefits or raising the payroll taxes to elevate the required contributions or borrowing the money from somewhere else. Each of these options takes a solid commitment from policymakers to initiate—and for the population to accept. Historically, there has been very little political will to accomplish serious policy initiatives when it comes to Social Security. It has, indeed, been called the *third rail* of politics. No policy solution can be accomplished without a determined political will by our nation's elected officials as well as a massive educational effort of the public in order to receive their tacit approval and the recognition that all Americans have to make some sacrifices. Failure to communicate the truth about this poor state of affairs has already contributed to suspicion among workers and, as already noted, caused intergenerational friction and led to a serious breakdown of our nation's social fabric.

David Walker, the Comptroller General of the United States, has publicly stated that Uncle Sam has developed some very bad money habits. He has said on TV and in public appearances on college campuses, at civic clubs, and many other venues, that our nation is saddled with debt to the tune of some $50 trillion. In fact, he said, "I would argue that the most serious threat to the United States is not someone hiding in a cave in Afghanistan or Pakistan, but our own fiscal irresponsibility."[4]

While Walker's testimony in Congress apparently fell on deaf ears, his remarks have struck a chord with some people. Walker maintains that issues such as Social Security, Medicare, and Medicaid and long-term health care expenditures are at a serious juncture and require that more severe controls be placed on federal government spending in order to preclude the nation from going into bankruptcy. He believes that a Congressional initiative must take place over the next 20 years in order to avoid financial disaster for Americans. Fiscal irresponsibility in Washington, D.C. is out of control and I posit that if history provides any clue, our leaders in Congress require a serious sit-down about their inadequate or nonapproach to dealing with our nation's fiscal problems. The signs in Washington point to the fact that neither political party gets the message.

Our nation's future fiscal soundness is in jeopardy and our elected leaders do not give a damn. What will focus them on the problems and convince them that their constituencies are concerned about our nation's well-being and are prepared to take some action? How many people have to be without health care insurance or have to work well beyond their normal retirement age before they get the message?

In Christopher Buckley's novel *Boomsday,* the first page is a prophetic, dire scenario of what happens if the facts mentioned thus far do not get addressed. Buckley's title was coined by economists to define the day that the first of the baby boomers began to retire with full Social Security benefits—and his story begins with a television news reporter who is communicating live on the ground from Florida. The commentator starts off, "In Florida today, another attack on a gated community by youths protesting the recent hike in the Social Security payroll tax." The reporter continues:

> Several hundred people in their twenties stormed the gates of a retirement community in the early hours this morning. Residents were assaulted as they played golf. Demonstrators seized carts and drove them into water hazards and bunkers. Others used spray paint and gardening implements to write slogans on the greens. One such message, gouged into the eighteenth green, read: "Boomsday Now!"[5]

Could this ominous albeit fictional account describe the world to come?

How many times have we thought of how close fact is to fiction and vice versa? How difficult it is to determine where the fine line exists that separates the real from the surreal? Perhaps buckley has shown us something like *virtual reality* and taken it to an eye-opening level. Reality is knocking and here fiction can clue us in on the seriously growing friction between the generations of boomers and those of the Generations of X and Y. Retirement practitioners, like our storytellers, have been thinking a great deal about this in the last decade. How dramatically and deep will that intergenerational tension grow?

How will it manifest itself as this reality of guaranteed entitlements to the elderly comes face-to-face with the cold hard fact that we cannot leave this enormous tab for the generations that are to follow us?

As the German theologian Dietrich Bonhoeffer said, "The ultimate test in moral society is the kind of world it leaves for its children."[6] Will gated communities truly be safe havens for retirees to live out their final golden years if they haven't given serious consideration to the generations coming up from behind? What kind of financial burdens will the younger generation inherit? Will we see the growing legions of the "sandwich" generation who have responsibilities both to their children and are now facing the issues of caring for their aging and ailing parents driving them to physical and financial exhaustion? Today some 33 million people are in that sandwich group. Most are women who provide care not only for their own parents but also their in-laws. That number is just the tip of the iceberg as the boomers begin to age and retire in large numbers and families do not have the financial wherewithal to make use of assisted living institutions. These are serious questions that appear to go unanswered because people lack either the resolve or the will to correct them. Politicians who make statements and call for reform seem like they are whistling in the dark.

Economic Revolutions

Humankind has witnessed three major historic economic revolutions that compare to climate change or tectonic shifts in the earth's crust. The first was the agricultural revolution, where mankind went from being hunters and gatherers foraging for their food and shelter and, ultimately, after centuries, moved to an agrarian society evolving gradually yet, steadfastly, over a period of some 3,000 years. The second economic convulsion was the industrial revolution, where society went from being a mostly rural, agrarian society to an industrial, urban one. This began over 300 years ago and introduced a totally new world order.

The current economic revolution is the globalization revolution, in which a society that might have been based on industry, with millions of workers in plants, factories, and related workplaces made things—steel, coal, rubber, aerospace, and shipbuilding industries, to name a few—have diversified into one that is less based on industry and increasingly based on the service sector. Facilitated by changes in finance and money management, the wonders of the information age—the Internet, personal computers, and the like—the removal of trade barriers (e.g., NAFTA), and outsourcing, the transition from an industrial- to a knowledge- or service-based economy has been both a beneficial challenge and entailed painful change. This is especially true in the United States as we have shifted from heavy industry and manufacturing over the past 30 years. The last surviving behemoth of the industrial age—auto manufacturing—is nothing more than the skeletal remains of a once-powerful industry that employed the heartland of America. The workforce has eroded dramatically over the last three decades. The once-powerful United Auto Workers (UAW) in 1970 had 1,619,000 union members. By 1990, the UAW was down to 952,000 members and at the end of 2006 it had shrunk to 475,000. In recent times, Ford, General Motors, and Chrysler have offered lump-sum payments to their workers in order to get them to leave the industry so that these automakers can get out from under the now-onerous, hard-won, and bargained work rules and legacy costs of health care and retirement that have been part of the industry's collective bargaining culture that today accounts for approximately $1,500 of the cost of an American-made car. During the preliminary stage leading up to the impending contract negotiations in 2007, the union's President, Ronald Gettelfinger, during a speech at the union's collective bargaining convention, warned the automakers against seeking too many concessions during the contract talks. He stated, "Collective bargaining is not collective begging. It would be a grave mistake to equate our actions to capitulations."[7] The ground rules and parameters are beginning to be defined and the final outcome regarding the workers and their employers will be hard to predict in this turbulent period going forward. Needless to say, the anxiety of workers is rising because of the unknowns.

The world does not stand still. What will the next economic revolution look like? How long will it take for the effects to dramatically change the landscape of mankind once again? We know that this is no time for complacency because the economic consequences are daunting. The extraordinary advances of science and technology, together with the rapid development of emerging countries and economies such as China, Brazil, India, Vietnam, and Russia to name a few in the borderless, globalized economy, should prompt all nations to reform fiscally in order to take advantage of the new state of the world.

Those of us who have been alive over the last 35 years have witnessed first-hand the fallout and spillover in society. It is still unfolding and will further change the world that we knew. The bright side is that when these economic and societal revolutions develop, they bring new opportunities and new and dynamic ways of working, thinking, communicating, and behaving toward significant change.

The Evolving Glossary of Finance

Let's review for a moment some of the new language that has entered our daily lives during this latest economic revolution: the language of finance and Wall Street as well as groupspeak of politics and those in charge of retirement administration and policy.

Over the past few decades, we have been introduced to such new terminology as *concession bargaining, portable workers, outsourcing, off shoring, maquiladoras, two-tier workers, give backs, downsizing, going postal, expendable workers, employee stock ownership plans, rust belt, plant closings, supply chain, job sharing, workplace violence, telecommuting, the Northeast industrial corridor, trade agreements, employee buyouts, and legacy costs* to name a few. The influence of these terms has had a profound effect on the way people function as well as the way newly designed work systems have evolved.

In the political world, the new vernacular includes terms like: *hanging chads, blue states and red states, free trade, the moral majority, opposition research, aggressive unilateralism, soccer moms, the third way, neoconservatives, neoliberals, family values, the blogosphere, triangulation, bundling of contributions,* and *mega-fundraising,* and *voter apathy* and *fatigue*—also to name but a few.

On Wall Street and in the world of finance, we have seen the *new barbarians* and their dynamics, their language and activities that include leveraged buyouts, day-trading, deregulation, junk bonds, shareholder activism, subprime mortgages, exchange-traded funds, structured investment vehicles, hedge funds, soft dollars, quarterly performance, stock options, privatization, merger arbitrage, proxy voting, derivatives, conduits, dot.com, sovereign debt, free markets, manager of managers, mergers and acquisitions, option adjustable-rate mortgages, securities litigation, currency exchange rates, economic imbalances, corporate governance, petrodollar investors, sovereign wealth funds, and *irrational exuberance.*

The world of retirement plan policy, investment management, and fund administration has developed its dynamics and language—some of which it shares with the Wall Street crowd—over the last two decades or so. Words such as *downshifting, asset allocation, baby boomers, pension reform, securities lending, vesting, fiduciary responsibility, pension protection, real estate investment trusts, popup options, timberland funds, surviving spouse options, actuarial assumptions, portable alpha, mutual funds, economically targeted investing, benchmarks, annuities, unfunded liabilities, self-directed plans, retiree health care, new asset classes, lifestyle funds, hedge funds, defined contribution plans, power boomers, private equity funds, halfback retirees, fullback retirees, emerging markets, global investing, leakage from 401(k) or defined contribution plans, alternative investments, commission recapture, risk shifting, defined benefit plans, value and growth, micro-, mid-, small- and large- capitalization stocks, transition management, cash balance plans, infrastructure investments, and socially responsible investing* come to mind.

Final Observations

Over the last 35 years, these massive changes in the U.S. economy and in world financial markets have largely condemned a great number of American workers and relegated them to lives of economic insecurity and misery. No longer can the worker count on a steady job for a single employer for his or her entire working life—a job that provides a paycheck and health and retirement benefits, too. Over the last three decades, workers' annual incomes have consistently increased while their aggregate income has stagnated. In the brave new economy of outsourced jobs, short-term gigs, and on-again, off-again health care coverage, American workers cannot rationally plan their economic futures. It is like being placed in a lifeboat without oars with the desire to row to a safe haven.

I find it amazing that as various injustices keep unfolding, the citizenry has responded with only momentary outrage that quickly evaporates. There is a widening restlessness that has spread throughout the United States. Perhaps this is due in part to the behavior and ineffectiveness of the two principal political parties. As H. L. Mencken said, "Under democracy one party always devotes its chief energies to trying to prove that the other party is unfit to rule—and both commonly succeed and are right."