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The Survey of Consumer Finances (SCF) shows that median net worth for baby boomers (households with head of household aged 55-64 in 2010) was \$179,000 in 2010, down from \$226,000 in 2007. The median is defined to be the lowest of the top 50% (or the greatest of the bottom 50%). At first glance, it is surprising to me that the median net worth is that low. By definition, boomers have had 30 years to build up assets for retirement. A majority of boomers would have had access to a 401K savings plan at their work. Had they fully participated over a thirty year period, even without a company match, and earned a 7% return their retirement account alone would be \$500,000 today. Evidently, at least half of the boomers either worked for employers that did not offer such plans or they chose to not fully participate.

Not to denigrate my fellow boomers, but it seems to me that they (many of them) have missed an obvious and important opportunity.

To be fair, there are important components of wealth that are not included in the SCF. Most obviously, these include the after-tax value of social security and defined benefit plans. Unlike defined contribution plans like 401Ks, defined benefit plans are not counted in the SCF because the plan assets are owned by the sponsoring entity, not the plan participant. So, to the extent that boomer retirement spending objectives are satisfied by social security and pensions from defined benefit plans, there is little need to build up additional stocks of assets. However, a long-term decline in the percentage of workers covered by defined benefit plans means that many if not most boomers will find retirement income well below their expectations.

In my view, boomer savings rates have been way too low. Consequences of low savings include high levels of consumer debt, inadequate net worth and, most fundamentally, restricted choices. Had they saved more in the past boomers today would have more options – to retire early, to support charitable giving, to launch a new business, to assist family members, etc.

What is the “right” savings rate? Suppose we adopt the economic theory of consumption smoothing, whereby every household aims for a stable real consumption stream over time. Earned income, of course, tends to be quite volatile over time – zero during school years, rising rapidly during the early working years, peaking out in middle age and gradually declining, and then plummeting to zero in retirement. The economic objective of smoothed consumption entails negative savings when young, positive savings during middle age and then negative savings again in retirement. Applying this model to the US today, I estimate that an average savings rate of 15% would be consistent with consumption smoothing (this is an average rate; different age/income/net worth cohorts have quite different target savings rates, ranging from below zero to above 30%). One of the assumptions underlying this calculation is that the after-tax real rate of return on investment is constant at 3%. While this rate is fairly conservative in historical terms, in today’s market the risk free real rate is well below 3%. To achieve 3%, you will have to take on investment risk. Once you take return uncertainty into account, prudence would require a yet higher savings rate.

Some people do save a lot, even more than my calculation would suggest. For example, in his book “Millionaire Teacher,” high school English teacher Andrew Hallam describes a disciplined program of saving and investing that enabled him to create a seven figure net worth while still in his 30’s, even though his income was below the U.S. median. His program is pretty simple – be very frugal and invest in low cost passively managed index funds. Simple but not easy; Andrew’s savings rate appears to be about 50%.

Is it likely that many people will follow Andrew's example? It does require a lot of focus and commitment. Also, many people simply have lesser income (perhaps no job) and/or greater financial obligations than Andrew. For them it would be even harder to ramp up savings. Still, Andrew is a lesson plan in what can be done, while the boomers in the aggregate are, like Greece, a lesson plan in what not to do.

Suppose for the sake of argument that many people attempt to increase their savings rates. What would be the economic fallout? In particular, would higher savings rates impair economic growth? Well, in the short run there would be dislocation as demand for consumer goods shifted to demand for capital goods. But in the long run, GDP would be higher thanks to a larger capital stock and greater economic productivity.

¹Andrew Hallam, "Millionaire Teacher: The Nine Rules of Wealth You Should Have Learned in School," 2011.