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In order to better understand the state of household finances, the Federal Reserve has recently conducted a special survey called the Survey of Household Economics and Decision making, or SHED. This is in addition to the tri-annual Survey of Consumer Finances. Key findings from the SHED include the following: (a) most families indicate that they are "doing okay" or "living comfortably," (b) still, about one in three families felt they were financially worse off than they were five years ago, (c) only about half of the respondents were putting some of their income away in savings, and the median savings rate of the savers was 10% of income, and finally, (d) only about one in four households was actively preparing for retirement. While not worrying about retirement is somewhat understandable for young people, it is eye-opening that less than half of people over the age of 50 are not preparing for retirement.

There are certainly valid reasons for not thinking about, nor preparing for, retirement. One reason is that you really enjoy your work and do not plan to retire. Another is that you have a terrific pension plan at work; one that enables you to maintain your consumption levels indefinitely (for an example, see below). But my guess is that most people do not fall into either of these categories. Instead, most people will be forced to downsize spending ("retrench") during their retirement years.

Financial advisors are generally supportive of the retrenchment strategy. After all, they say, family expenses tend to peak and then decline once children are out of the house and on their own. In fact, the data do show that older households spend less. But is this because expenses are lower or because resources are constrained? My guess is the latter.

The fundamental problem is that most people do not save enough during their working years. The facts that only half of households have saved at all, and the median savings rate for them is 10%, suggest that 75 percent of households have savings rates below 10%. Of course, some people can get away with no or low savings. For example, consider our Vice President.

VP Biden

According to a recent Bloomberg News report, Vice President Joe Biden is proud of the fact that he has no savings account, nor does he own a stock or a bond. Presumably, he is pleased to be able to make these claims inasmuch as it appears to place him clearly in the majority 99% instead of the affluent 1%.

But, can this be correct? No savings account? No mutual fund? This seems weird for a man that has had a very long and successful career; not only weird, but also somewhat irresponsible. Once you get to the point that you are making a decent income, it is incumbent upon you for the sake of your family to forego consumption and build up some savings.

Of course, in Joe's situation there is no need to do this. After all, as of 2016 Vice President Biden will have had a forty-plus year career in Congress and eight years as Vice President. For this, he earns a substantial salary and an even more impressive pension (which is adjusted for inflation). Given this salary and pension, he really doesn't need to save (assuming he does not intend to leave a financial legacy for his children). So maybe it is understandable that he has created no savings or investment account.

Yet from another perspective this is troubling.

The primary source of capital for new ventures is savings, and their ultimate placement in equity securities or debt securities or mutual funds. The fact the Vice President Biden views it as a positive that he has not saved is unfortunate. It reflects a view from one of the preeminent members of the Democratic Party that building up a savings account is a bad thing. What happened to Benjamin Franklin?

This sends a bad message. It is through savings that capital is cumulated. Along with knowledge, accumulation of capital is a primary source of improved productivity and improved standards of living. We want to promote savings, not denigrate it.

Bottom line: Don't Retrench, Ratchet!

I think people would be better off if they adopted a plan that allowed them to spend more as they age. To accomplish this is easy: just estimate your total economic resources (including future earnings power) and keep annual spending to a modest fraction (1% or 2%) of total resources. For most people, implementation of this plan will mean lowering the amount of current consumption. But the good news is that, barring disastrous investment performance, the implication of this strategy is that your wealth will rise over time and so will your spending. Not only that, but the economy's overall performance will be better as well.