Comments for:

Low Returns and Optimal Retirement Savings

by David Blanchett, Michael Finke, and Wade Pfau

Getting More from Less: Three Levers for a Low-Return World

by Daniel W. Wallick, Andrew S. Clarke, Daniel B. Berkowitz, Kevin J. DiCiurcio, and Kimberly A. Stockton

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The Questions (and the Answers)

- Both papers ask:

  What is the optimal strategy for individual savers/plan sponsors given that we are in a low interest rate environment?

- Both papers effectively answer:

  Save more now!

  (or maybe work a little longer)

Approach and Answers are Sensible

- Starting Point: Moved from a “normal” return environment to a low return environment
- Analysis: Use stochastic representations of the two environments, simulate outcomes under various contribution and investment strategies
- Results: Evaluate income streams generated under various strategies, both expected and risk-adjusted

Comments

- A few requisite discussant quibbles
- Mostly focused on a bigger macro question: Should ***how*** future retirees react today depend on ***why*** we are in a "new" interest rate environment?
- One takeaway is that the "save a little more" versus "work a little more" decision may not be as much of a choice as papers presume

Quibbles 1: Interest Rate Environment

- It's not clear that we know what we need to know about the "new" interest rate environment
- Brookings Panel April 2017
    - Del Negro et. al. (and most, I think) believe in savings glut stories: If so, is "glut" permanent?
    - John Williams: could be other structural factors, focuses on low TFP growth, demographics
    - Other possible reasons as well (more later)
- Financial crisis taught us that statistical models based on recent returns data can be misleading

Quibbles 2: Life Cycle Paper

- Paper does a nice job thinking about realistic replacement rates, lifecycle trajectories
- Do historical saving rates or accumulated wealth look like model optimum in prior interest rate environment?
  - If not, tweak model? Effect of pre-paid housing, college and other child-associated costs?
- What is the role of health?
  - Ability to work and desire to spend (on non-medical consumption) in old age are correlated

Quibbles 3: DB Funding Paper

- Paper does a nice job thinking about fund manager's problem: have to meet targets
- Why aren't costs minimized now?
- Why assume the increased contributions will not be borne by workers?
  - Evidence from public pensions => underfunding has led to increased employee contributions
  - Makes the problem much more like the first paper, consumption now vs later (or work longer)

Deeper Question?

- Can the questions about optimal savings responses really be answered without knowing **WHY** we are in a low interest rate environment?

…and three ancillary questions:

1. What are the macroeconomic implications of *everyone* doing what the papers suggest?
2. Why aren't we having the same conversation about Social Security? (should we be?)
3. Why did Paul Samuelson develop the overlapping generations model in 1958?

What if everyone followed the suggestions?

- Prescriptions in the papers: more saving
- If we are in a savings glut/effective lower bound/insufficient aggregate demand/under employment equilibrium, situation worsened
- Think beyond savings “glut”: why is there such low *demand* for loanable funds now?
  - Policy: monetary, regulatory, trade, taxes, …
  - Demographics or other factors we can’t change?

Is Social Security Different?

- In the long run, it's the ratio of taxes collected to benefits paid that matters, not interest on trust fund
  - Right now, taxes ≈ benefits
  - In ≈ 2035, taxes ≈ .8*benefits
  - => cut benefits 20%, raise taxes 25%
- Raising taxes considered by most a work disincentive
- Cutting benefits would increase work or desired saving, but would adversely affect those who cannot work
- Note also that if low interest rates are associated with low productivity, funding math gets even harder

Samuelson (1958) OLG Model

- *An Exact Consumption-Loan Model of Interest With or Without the Social Contrivance of Money*
- The original OLG model, established the possibility of equilibrium negative interest rates
    - 3 period life; work in periods 1,2; no capital/storage
    - Middle age bargain with young
        - Middle age agents lend to young agents in period t
        - Young (now middle age) repay (now old) in period t+1
        - Negative interest rate equilibrium a real possibility
- Obviously unrealistic, but…
    - …we are moving towards a human capital economy
    - …distribution of agents across age groups changing

Taking Samuelson Seriously

- Demographics should have long run trend effect, why just now showing up?
  - Productivity/housing booms delayed inevitable?
- Samuelson was focused on money: inflation makes it possible to achieve negative (real) interest rates to balance supply and demand
  - Targeting 2% inflation is a key part of Fed strategy, in part to achieve negative real rates when needed
  - What if -2% real is not enough? What would even higher inflation => for investment strategy?

Samuelson ends with this quote…

When economists say that one of the functions of money is to act as a store of wealth and that one of money’s desirable properties is constancy of value (as measured by the constancy of average prices), we are entitled to ask: How do you know this? Why *should* prices be stable? On what tablets is that injunction written? Perhaps the function of money, if it is to serve as an optimal store of wealth, is so to change in its value as to create that optimum pattern of lifetime saving which would otherwise be established only by alternative social contrivances.

Alternative Social Contrivances

- Working longer may be the ONLY solution in the aggregate, if the additional saving is not going to increase future production
- And, we may also have to think "alternatively"
  - Are income taxes justifiable as a way to collect "returns" on public investment in human capital?
  - Are taxes (and not necessarily payroll, maybe a consumption tax) suddenly the lesser of two evils for Social Security and health program budgets?

Thanks!

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