Too Much of a Good Thing? /// An economist says you may be saving more than you need to for retirement

BY LAURENCE KOTLIKOFF

Your ten-year-old will get this right. Put him in front of twenty cupcakes and invite him to eat as many as he wants. He'll inhale the first, gobble down the second, and take his time with the third. Suggesting he go for a fourth will elicit the following response: "Let's save some for tomorrow." In squirreling away cupcakes, your ten-year-old is engaging in consumption smoothing: trying to maintain his living standard not just over time (today and tomorrow), but also

ILLUSTRATION BY HARRY CAMPBELL

across times — good ones (sweet-tooth dad did the shopping) and bad ones (sensible mom did the shopping).

That's a basic premise of the life-cycle model, an economics-based approach to personal financial planning developed over the last century. Leading economics journals are full of studies that use sophisticated mathematics and lots of computing power to solve ever-more-elaborate life-cycle, consumption-smoothing problems. These studies also show that household financial decisions deviate widely from what the models predict — and that households routinely make major financial mistakes.

This is not surprising. None of us has a Pentium IV chip implanted in his brain. In recent years, behavioral economists have been teaming up with psychologists and neurologists to understand more precisely how our neural circuitry affects our financial judgments. That's intellectually intriguing, but it's of little practical help to households in making complex consumption-smoothing decisions. What they need are the tools required to get these decisions right — the same tools that economists use.

The financial planning industry doesn't help. Conventional planning software makes you set your own future spending targets for retirement, something that's nearly impossible for most households to do. Think about all the interconnected factors — your age, your spouse's or partner's age, your children's ages, labor earnings, mortgage payments, regular assets, federal and state taxes, Social Security benefits, pensions, 401(k) accounts, college tuition, estate plans, housing plans, retirement dates, and Medicare premiums, to name several. Get any of these factors wrong, let alone their interplay, and you'll set the wrong spending target. Even small targeting mistakes, since they are being made for forty or so years of potential retirement, can lead to very bad saving and insurance decisions.

WEB EXTRA
Through the end of October, Professor Kotlikoff will answer questions about retirement planning at www.bu.edu/bostonia.

Confused? The financial industry is quick to the rescue. It has developed a rule of thumb for setting the "right" target: you should plan to spend each year in retirement about 80 percent of your preretirement earnings. Unfortunately, this advice is designed to sell mutual funds and insurance products. It's not designed to help us achieve a stable living standard.

For almost all households, following this rule will have you saving far too much and buying far too much life insurance. That may seem safe. In fact, it's risky. If you save too much when you're young, you run the risk of dying before you get around to enjoying your money. And if you buy too much life insurance, you run the risk of never collecting because you live to a ripe old age. Worse yet, you can easily be talked into investing in highly risky assets in order to raise the chances of meeting *your* target.

Economics is focused on living standard balance; it's focused on making you happy, not enriching your financial advisor, retirement-account provider, or insurance agent. So what do you really need to do to plan for retirement? My first piece of advice is to steer clear of rules of thumb and conventional financial advice. Do not go to your mutual fund's Web site and use its five-question calculator to figure out how much to save or how much life insurance to buy. These tools and the thousands like them elsewhere on the Web represent forms of financial malpractice. No physician would last long giving you a two-minute checkup and then selling you drugs. But this type of behavior goes on 24/7 in the financial services industry.

What consumers need are economics-based tools that use the life-cycle model to help you raise your standard of living. (Full disclosure: With the support of Boston University, the National Institute on Aging, and other economists, I developed a program called ESPlanner, Economic Security Planner. It's the first of what I hope will be many such tools to come.) These tools won't ask you what you'd like to spend in retirement. Instead, they will tell you what you *can* spend in retirement, and every year leading up to it, if you'd like to have a smooth ride — a stable living standard per household member. They find the right spending targets for you. Once you've set up a basic plan, you can determine in

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short order whether to contribute more to a retirement account, which retirement account to use, when to take Social Security, whether to repay your mortgage, whether to switch jobs, whether to move to New Hampshire, and so forth. In each case, the answer depends on whether making the particular decision will raise or lower your living standard.

My next proposal is to price your lifestyle decisions in terms of their living standard impacts. Whether it's buying a boat, sending your child to private school, having another baby, or retiring early, there's always a living standard price to pay. We can't make the right set of decisions in these spheres until we know what each decision costs. And with today's software, you can learn these prices almost instantly.


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My final instruction is to protect your living standard. That means saving the right amount year in and year out. It also means holding the right amount of life and other forms of insurance. And it means investing in a way that limits your living standard risk. The new software can help you here as well. It shows you how different investment strategies affect the level, but also the spread, of your living standard through time.

After a century, economists are realizing that they have a responsibility not just to study financial pathology, but also to try to cure it. Their new medicines aren't panaceas, but they can go a very long way to helping you smooth, raise, price, and protect your living standard.

LAURENCE KOTLIKOFF *is a College of Arts and Sciences professor of economics. His latest book is* Spend 'Til the End: The Revolutionary Guide to Raising Your Living Standard — Today and When You Retire *(Simon & Schuster), written with Scott Burns. For more information about ESPlanner (Economic Security Planner), visit www.esplanner.com.*

Free Radical ///

The digital revolution is on, says blogger Markos Moulitsas

BY BARI WALSH

Markos Moulitsas Zúniga (LAW'99) is the founder of the influential political blog Daily Kos, credited with giving rise to a new generation of progressive online activists, the so-called netroots. Using emerging digital tools like blogging, podcasting, social networking, and video-sharing, these activists are shaking up old ways of building consensus, doing politics, and shaping culture. In *Taking on the System: Rules for Radical Change in a Digital Era* (Celebra), Moulitsas has written a love letter to these pioneers and a call to arms to the rest of us: understand the power of technology, wield it effectively, and you can change the world, right from your living room. He spoke to *Bostonia* about the new rules of engagement.

What does radical change mean in 2008?

There is an entrenched gatekeeping elite that strives to maintain the status quo. Their lofty status requires it. Whether it's the music labels or the Hollywood studios or Microsoft or the political elite — these people have it pretty good, and they'll do anything to protect their status.

Radical change means subverting that ruling elite. In politics, the netroots have given rise to a new generation of politicians, while technology allowed Barack Obama to slay the vaunted (and gatekeeping) Clinton political machine. YouTube is giving rise to a new generation of video mavens who bypass the Hollywood studios. MySpace and iTunes are making it possible for musicians to build large fan bases without help from record labels. Hackers all over the world have used the Web to create and disseminate software as complex as entirely new operating systems.

WEB EXTRA
Read an excerpt from *Taking on the System* at www.bu.edu/bostonia.

In looking at why protests leading up to the Iraq War failed to change policy, you write, "This is not an era for street protests."

The antiwar protests failed to sway opinion because they were such a tired concept, in message and execution, that the media felt free to ignore them. No matter how much those protesters might think otherwise, "a bunch of people marching in the streets" is not a compelling story. Some may blame the "corporate media," but that same media feel free to ignore the thousands of antiabortion protesters who regularly hit the streets.