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Solving the Retirement Crisis: Q&A With Alicia Munnell

The veteran economist weighs in on how to make Social Security, 401(k)s and the rest of the retirement safety net work better for seniors.

By J. ALEX TARQUINIO

Economist Alicia Munnell has headed the Center for Retirement Research at Boston College since its inception in 1997, studying everything from retiree health-care to the role of older Americans in the job market. (She's also a regular contributor to SmartMoney.com's Encore blog.) In two conversations with SmartMoney magazine staff writer J. Alex Tarquinio, Munnell weighed in on the finance and policy issues that have transformed retirement into a source of anxiety for so many Baby Boomers; those conversations are edited together below.

SmartMoney: How can we fix the Social Security system?

Alicia Munnell: Social Security is the backbone of our retirement system, so we should be careful about cutting benefits significantly. We need benefit cuts and tax increases to balance the program. We can postpone the full retirement age, linking it to increases in life expectancy. That wouldn't take effect until after 2020, so anyone retiring within the next decade wouldn't be affected. As a one-time thing, we might delay the cost-of-living adjustment for current retirees by six months. We did that in 1983, and the world didn't come to an end.

SM: How should the system deal with higher earners?

AM: We can raise the cap on wages that are covered by Social Security, currently at $106,800, to around $180,000. So high-wage earners would pay more Social Security taxes now and receive larger checks when they retire. I am opposed to trimming future benefits for high-income workers. If you do that, then you miss the collegial sense of Social Security. Most of the proposals involve capping the payroll tax around 90 percent of all wages and salaries in the United States, which was what we aimed at in 1983. It has slipped since then because of the increasing difference in incomes. Once you say that you want Bill Gates to pay Social Security taxes on the full value of his earnings then you have to think about whether you want to provide the full benefits [on the same scale], and it gets sort of crazy.

SM: What do you say to younger Americans who don't think that Social Security will be there when they retire?

AM: First, I tell them they're incorrect. The exhaustion of the trust fund has been [described as] equivalent to the end of the program. But once the trust fund is gone, the payroll tax money coming in would still cover 75 to 80 percent of promised benefits. The current argument is over whether we should cut benefits now or later. It's a shame that the issue has been confused with the exhaustion of the trust fund. I also think it is dangerous. If you really don't think that something is going to be there, then you don't care about it.

SM: How should retirees and folks near retirement cope with the recent wild swings in the stock market?

AM: I feel their pain. But the markets are clearly over-reacting. Even the downgrade of U.S. debt wasn't really news. The whole scene over the debt limit in Congress was shocking, and this was a catalyst to recognize that we are not managing our fiscal house very responsibly. However, investors shouldn't make an adjustment in the midst of the volatility. Wait until the markets return to a more stable level. Then it's a good time to think about how much volatility you can stand.

SM: Many target-date funds keep a large portion of their portfolios in stocks after shareholders have reached retirement. Should the financial industry reconsider this strategy?

AM: Individual investors may decide they don't want to be that heavily invested in stocks. I am probably on the cautious side of conservative. I keep 25 to 30 percent of my investable assets in stocks. I don't think retirees should go any lower than that.

SM: The Employee Benefit Research Institute recently said that some workers won't be able to afford to retire until they reach their 80s. Do you agree?

AM: That's not a helpful statement. Maybe to get the very last person to the 90 percent confidence level that they won't outlive their money, they'll need to work into their 80s. But the vast majority of Americans would help their circumstances by working four years longer than average. I'm afraid if you tell them they'll need to work 20 years longer, they'll throw up their hands and give up.

SM: But there are more than 2 million unemployed Americans over 55 years old. Is it reasonable to lecture older workers about staying in the workforce when it is so tough for them to find jobs?

AM: Fifty-year-olds are not malleable, so it takes longer for them to find a job match in the best of times -- and these are not the best of times. I'd like to see a Roosevelt-style job-creation program, because sprinkling a little stimulus here and a little stimulus there isn't working. We need a program that gets [older workers] back into schools and hospitals and construction sites and libraries.

SM: How are older Americans supposed to pay for their health care?

AM: Many people should buy insurance to cover long-term care, unless they are so rich that they can afford to pay $75,000 a year, which is the average price for a full-time-care facility. The best time to buy insurance is probably when you are about 10 years away from retirement.

SM: Lately, annuities have been pitched as a way to guarantee retirement income, especially for retirees who don't have traditional pensions. Is this just a sop to the insurance industry?

AM: Annuities are very hard to understand, and expensive. Only 1 percent of people buy them, and they tend to have long life expectancies. So annuities are priced for them and not the average guy. Also, because they are complicated, you really need to sit across the kitchen table from an insurance agent who explains them to you. So the marketing costs are high. But I think more retirees are going to need annuities if they don't have pensions. Social Security provides you with a steady stream of inflation-adjusted income, but that might not be enough. By the way, if you can use some of your savings to delay taking Social Security as long as possible to age 70, you get a big increase in your monthly checks. It's like using that money to buy an annuity, only cheaper.

SM: What else can retirees do if they are worried about outliving their savings?

AM: There is one product that could be key to the financial security of many retirees, but it has a bad rap: reverse mortgages. In the past, many retirees didn't tap their home equity because they didn't have to. I think that going forward more of them are going to need to. Here again, reverse mortgages can be complicated to understand. They have been criticized as expensive, but the costs have fallen. You can't shift all of the risks to the banks, though, or they aren't going to want to be in this business.

SM: You don't support an extension of the so-called payroll-tax holiday -- which reduced the amount of Social Security taxes that workers pay by 2 percent. If it expires, won't that be akin to a tax hike in a lousy economy?

AM: It wouldn't be viewed that way in a rational world. But in this world, any time you restore a tax, it is seen as a tax increase. I think the payroll-tax holiday was a terrible idea. It was on the employee side, so it couldn't stimulate job creation. It put some money in the hands of workers, but most of them didn't even notice.

SM: There's a recent trend to auto-enroll workers in 401(k)s. But you think employers should go even further, right?

AM: Inertia is an enormously potent force, and automatic enrollment is a way to get inertia to work for us. The Pension Protection Act of 2006 made automatic enrollment easier, but still, only half of companies with 401(k) plans do it. And they usually only enroll new employees, often at very low contribution rates. We need to redefine the 401(k) plan. We can't mandate that employers offer one. But if they do, we can require them to automatically enroll workers. And while we're at it, we should sweep all employees into it, not just new hires.

SM: If it's such a great idea, why don't more employers do it?

AM: I think it comes down to money. The boards of directors are sitting around their conference tables and saying, "You're proposing that we bring more people into the plan, and we have a 3 percent match. What's in it for us?" That's a reasonable question. If your workers aren't adequately prepared for retirement, then they're going to be hanging on to their jobs by their knuckles, even though they're tired and unproductive. If employers want an orderly retirement process, they need to make sure that all of their employees have enough money to support themselves by the time they reach retirement age.

SM: Many companies with auto-enrollment only default 3 percent of an employee's income into the 401(k), far below what experts say you should save for retirement. How could we get employees to save more?

AM: Instead of telling people how much money they have in their accounts, which can seem like an enormous sum to many people, translate that into how much income that's going to produce when they reach 65. That would be undeniably helpful, by focusing them on the idea that eventually they will need to convert the money in their 401(k)s into an income stream.

SM: You're turning 70 next year. Any plans to retire?

AM: I'm going to work as long as it feels good. [Then] I'll go to Paris for six months. Then I will come back and sit in an office and write. Financially, I will just ride what I have into the sunset.

Social security's trust fund could run dry if laws aren't changed, but Alicia Munnell says that's unlikely and that taxes would still cover most benefits.