LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

"$1,000 left to earn interest at 8% a year will grow to $43 quadrillion in 400 years, but the first hundred years are the hardest."
Sidney Homer

There is a serious flaw in today's workplace retirement system: too many working Americans save too little, with the risk that many will struggle financially in retirement. Forty or fifty years ago many workers joined companies that offered pension or profit-sharing plans. With forty to forty-five years of employment, the accumulated pension or profit sharing plus social security provided for a comfortable retirement. Today's worker is unlikely to find an employer-sponsored pension or profit-sharing plan. Instead, at best, a 401(k) plan is offered. To accumulate assets in a 401(k), the employee must contribute (i.e., reduce take home pay)—and many either contribute very little or nothing at all. The responsibility of providing for retirement has shifted from the employer to the employee.

It is important that employees get an early start saving for retirement. Today, the typical working life is from age twenty-two to sixty-two—or forty years—with approximately twenty years in retirement or a 2:1 ratio of working to non-working years. It is a little scary to think that every two years of work must finance one year of retirement.

Such a demanding task was not always so. In the original state sponsored retirement pension program instituted by Chancellor Otto Von Bismark for Germany in 1889, the retirement age was seventy. Adult life expectancy was about seventy-two. Work, on average, began at age sixteen, so that gave fifty-four working years to finance two years of retirement.

Then consider America in 1950. At that point in our country's history, work started on average at age twenty and retirement averaged age sixty-seven with life expectancy of seventy-six for about nine years of retirement. During that period, an employee had five years of work to prepare for each year of retirement.

Getting back to the present, we thought it would be helpful to give our readers an idea of the required savings rate needed over forty years of work to finance twenty years of retirement. Of course, the outcome depends on the assumptions you use. In an article in the September 5, 2005, *Barron's*, Alex J. Pollock made the calculation assuming one would need 70% of the final working year's salary during retirement (some would say this percentage should be 80% or 90%); that labor productivity and wages would grow at a reasonable 1.5% annual rate during the working career; that the savings would be in a tax-deferred account; and that we could expect returns during the accumulation and consumption periods of 6–7%. Using those assumptions, it would take a savings rate of 14% of pre-tax income during the working years to fund the retirement years. While the 14% savings rate includes the employee's contribution to social security and any contribution toward a retirement plan made by an employer, the additional amount a worker must save to get to the 14% level is quite substantial.

The savings rate in the U.S. has been negative since April 2005. A negative savings rate during a period when funds need to be set aside for retirement is an invitation for disaster. The 1950s example given in the earlier paragraph required a 6% savings rate, according to Mr. Pollock. And rather than being negative, as is the current experience, the personal savings rate from 1950–1990 was 7.7%. That generation, with savings, pension and profit-sharing plans, and social security funded a comfortable retirement.

As noted by Sidney Homer, the power of compounding is unbelievably strong. Today's young workers need to take advantage of that phenomenon and start saving early and aggressively to assure a comfortable retirement.

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