



Book Review: *Spend 'til the End*

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The Revolutionary Guide to Raising Your Living Standard (Today and When You Retire)

Laurence J. Kotlikoff and Scott Burns (Simon and Schuster, 2008)

Among the best attributes of a book are that it challenges conventional wisdom. *Spend 'til the End* attacks many of our financial planning and investment dilemmas, but not from the standpoint of the financial advice business. From Boston University economics professor Kotlikoff and nationally syndicated finance columnist Burns, this text adopts the economics perspective.

Summary:

This new work examines how we can “smooth out our consumption” to raise our standard of living—both in our working years and retirement.

The latest in a spate of financial pathology books, *Spend 'til the End* begins by plowing the mostly familiar ground of behavioral finance, neuro-economics and financial illiteracy. Much is blamed on the greed of the financial services industry and the need to sell expensive products (such as load mutual funds, those with high expense ratios and equity indexed annuities.)

But the authors introduce to the literature a discussion of the importance of an economic concept called consumption smoothing, critical to successful financial planning and which may be a remedy for many Americans to their financial maladies. In addition, we are treated to a fascinating discussion, from an economics perspective, of a litany of lifestyle decisions with an eye toward raising and maintaining our living standard. Examples run from career choice, home ownership (mortgage or not?), taxes, managing retirement plans, and dealing with social security (take it early or late?).

Smoothing out the Ride

Consumption smoothing is an antidote to the twin mistakes of overspending or under-spending during the accumulation phase. By definition, this contributes to either over or under-saving for retirement.

Moreover, these mistakes make us prone to falling victim to a pernicious phenomenon prevalent in financial planning circles—particularly in the planning software on the websites of the major do-it-yourself financial institutions. Induced by research funded by the financial services industry, the planning rule of thumb anticipates a replacement rate of 70-85% of pre-retirement income as the lynchpin of retirement planning.

There are five major infirmities in the replacement rate formulation:

- It assumes spending in retirement on the same items and same amount as before; such as children, a mortgage, etc. But these will end.
- However, different expense needs will arise; such as leisure, health care and caring for aging parents. It is naïve to assume these will be equal.

- There is a faulty demographic assumption, in that women live longer than men and needs can be reduced from those of couple to a surviving widow.
- It assumes no spending of principal.
- Finally, the conventional methodology assumes continuation of the current savings behavior, alteration of which will drastically change the outcome of the plan.

The authors recommend the use of much more sophisticated planning software to overcome these shortcomings, enabling the creation of a plan which allows for the attainment and maintenance of a much more stable standard of living.

Parts Three and Four of the book, entitled “Raising Your Living Standard” and “Pricing Your Passions,” are where the truly interesting discussions take place on economics of those topics mentioned previously—such as choosing a career. They reveal some interesting paradoxes, such as that it is more economical to become a plumber than a doctor. But you already knew that.

Several chapters in the last part of the book reveal the multi-dimensional problem presented by portfolio and spending choices, particularly in retirement. The key is to not focus on the portfolio in isolation or following a metronomic rule like the 4% solution. Rather, the authors suggest adding your human capital and non-financial assets—such as social security and pension income—into the analysis. By doing so, one can diversify your total economic resources, not just your portfolio. The result is an unusual equity allocation glide path recommendation that is sort of a roller coaster, rather than the conventional one that starts out aggressively and gets progressively more conservative as we age.

The book concludes with a brief discussion of some major public policy risks, about which the authors wrote in their earlier work, *The Coming Generational Storm* (MIT Press, 2004.) These include the massive under-funding of private and public pensions, Medicare and Social Security.

With a dose of good humor, *Spend 'til the End* covers a lot of territory and overall provides some interesting ways to think about the enormous challenges and the mysteries of personal financial planning.