Economic Security in Retirement

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Most often, when we talk about retirement security, we focus on income security. But income is only one piece of the puzzle. To understand the role of income security, we need to place it in the broader context of economic security. We need to consider all of the means by which society's resources will be allocated to meet the necessities and indulgences of life. Economics is defined as "… *the science which studies human behavior as a relationship between ends and scarce means which have alternative uses*."[1] It is not limited to markets or resources with monetary value.

Individuals find value (or "utility") in economic security – they like to have confidence that their needs and wants will be met, not only for the moment but over their lifetime. They look to financial markets for long-term economic security, just as they look to other markets to buy the goods and services they consume from day to day. But this is only one place to look for economic security. The main sources of economic security in a modern society can be grouped into four broad categories. Think of them as pillars of one structure. All are essential to the entire structure and all bear part of the load. At times, the load shifts more onto one pillar or another.

Pillars of Economic Security			
Finance	Government	Community	Property
Investments, pensions, annuities and other financial products	Social Security, roads, parks, protection and emergency services, law courts	Family, neighbors, volunteer organizations	Home and cottage, furniture, tools, recreational equipment

Some of the necessities and indulgences of life can be met in more than one way. If you intend to play a lot of tennis after you retire, you can build up your retirement savings so you'll have the money you need to pay court fees. You can move to a town that has free municipal tennis courts. You can join a community tennis club. You can buy a lifetime membership in a private tennis club. You can even buy a home big

[1] Robbins, Lionel (1932). *An Essay on the Nature and Significance of Economic Science*. p. 15. London: Macmillan and Co., Limited. https://mises.org/library/essay-nature-and-significance-economic-science

enough to have your own tennis court in the back yard. The right choice for you might not work for other tennis aficionados.

A less frivolous example would be the way we prepare for our potential need for long-term care in our declining years. Will we count on family? Long-term care insurance? Government facilities? Will we sell our home to pay for a continuing care retirement community when the time comes?

Consideration of economic security in retirement must reflect the special needs of seniors with declining ability to be fully self-sufficient. Shopping, personal care, financial management, and mobility cannot be taken for granted. Private domestic services, public home care services, family and volunteer support can all help, but none is fully reliable in isolation.

The Financial Pillar

Money provides access to goods & services that can be purchased in retirement. Some financial products are designed specifically to provide retirement income while others are designed for wealth creation and preservation.

The main strength of these financial products is that money is fungible. You may think you'll want money to pay for vacations in your retirement but if it turns out your health or world events won't permit you to travel, you can use your money for home care or entertainment instead.

Relying on financial markets for economic security comes with a host of risks. Investment returns, inflation and longevity may be the ones most discussed and most easily quantified. Changes in taxation, failures of financial institutions and fraud are others. In extreme conditions, market shortages can lead to rationing of essential goods and services, so that having the money to buy what you need might not be sufficient, or even necessary.

The decline in real interest rates over the last three decades has more than doubled the price of a dollar of purchasing power to be delivered during a future retirement. The price of a nominal dollar has increased far more. The natural economic response to this price increase has been decreased reliance on the finance pillar and increased reliance on the other sources of economic security. From an employer perspective, this has meant that normal contributions to pension plans have not increased to keep pace with the cost of retirement income.

The Government Pillar

We expect some services to be provided by the public sector because they are natural monopolies or because society benefits from universal availability. Core public services such as the judiciary can only be provided by government. Without the ability to use law courts to enforce contracts and land titles, the financial and property pillars are unreliable.

Some social insurance programs are designed specifically to provide economic benefits during retirement. These entitlements are based on statutes, rather than contracts. Although current benefit levels may be the best indicator of future levels, demographic shifts or macroeconomic factors could make costs untenable and lead to legislated benefit changes.

Some financial planners might advise clients to make financial plans as if social security did not exist. They disparage the reliability of government income support programs and public health care. In contrast, they would not suggest pre-funding for highway maintenance, for example, on the presumption that this public service might be withdrawn. It could be argued that some government programs are more reliable than financial solutions because the government has the authority to confiscate financial assets or property if needed for the common good. Nonetheless, there are risks associated with relying too heavily on government and those who can afford to do so will seek other sources of economic security as well. The challenge is to anticipate which government programs and services will be deemed expendable in the face of an aging population, a shrinking workforce, climate change and mounting government debt.

If nothing else, the government responses to the pandemic of 2020 demonstrate how quickly governments can change course and how far they will go to intervene in the normal functioning of business, families and community groups and in the use of private property[2].

The Community Pillar

Historically, large families were the primary source of economic security. Even in developed economies, multi-generational households and family networks provide an exchange of services such as childcare, elder care and computer technical support. Community and family support can be particularly important for seniors with mobility difficulties.

In natural disasters and other crisis situations, family and social networks are the most responsive source of security. Faith communities, charities and local governments might also respond quickly, but markets and senior governments take longer. Ownership of property can be irrelevant.

One advantage of the community pillar is that it forms a non-taxable economy. It is not merely eligible for tax deferral or reduced tax rates: volunteer and family cooperation is beyond the capacity of governments to tax incomes, property and consumption.

The problem with the community pillar is that it is unenforceable. Even though you look out for your neighbor's children when they come home from school to an empty house, the neighbor still might not shovel their walk, or might move away when you need them most. Similarly, younger retirees in their 60s and 70s may be the most active volunteers in community social programs but when they are in their 80s and 90s and no longer able to take leadership roles, these programs may wither away.

The 20th century was a period of urbanization, increased mobility and, at least in North America, changing family structures and values. The changes emerging in the 21st century include online social connections and a return to working from home. These recent changes have the potential to restore reliance on community and family as a pillar of economic security.

[2] Humphries, Adrian. *Outrage, secrecy, confusion: Medical officer of health orders summer cottagers away*. National Post, May 1, 2020. Retrieved from https://nationalpost.com/news/outrage-secrecy-confusion-medical-officer-of-health-orders-summer-cottagers-away

The Property Pillar

Most seniors own their home. Shelter cost (mortgage principal & interest or rent) often takes up 30% or more of income so paying off a mortgage significantly reduces retirement income needs[3]. Ownership of property that will be used during retirement is risk free in the sense that, regardless of what happens to prices, the property remains affordable.

In an environment of negative real rates of return, hoarding becomes a viable retirement saving strategy. Choosing more durable furniture and roof shingles or stocking up on non-perishable consumables can be a relatively sound investment. The most important risk to relying on property arises from ongoing suitability. Durable goods can go out of style or become obsolete. The pre-retirement home may not continue to be appropriate as retirement progresses, and the relative cost of alternatives could change.

Extreme Risks

A discussion of economic security is not complete without consideration of the sorts of events that could barely be imagined before they occur. Of course, there is little we can do to prepare for the end of human civilization, whether it is caused by a comet, nuclear apocalypse or a 5˚ rise in global temperatures. On the other hand, there are things we can do to prepare for less severe catastrophic events such as plagues, revolutions or volcanic eruptions. The resulting death and destruction might be unprecedented and might severely damage some of the pillars of economic security, but individuals with well-prepared and well-diversified retirement plans will cope better than others.

The pandemic of 2020 illustrates how a single event can strain several pillars at the same time, and how quickly and dramatically priorities can change when necessary. These sorts of events cannot be anticipated in economic scenario generators calibrated to historical experience or addressed through margins of conservatism. We must be prepared to respond with changes to our lifestyles and institutions.

Other kinds of adverse events are predictable, if not fully understood. A continuing increase in the frequency of adverse weather events and a shift in our planet's habitable zones are virtually inevitable. What is unclear is the extent of property destruction, migration and conflict. Environmental, social and governance factors affect all the pillars of economic security, not just investments. As with all things, it is unwise to put all your eggs in one basket. The greatest economic security will come from a balanced approach.

Implications for Employers

As employers scale back the projected income replacement ratios in their retirement income plans, they need to prepare their employees for increased reliance on government, family and social networks to

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[3] In the United States, 79% of occupied housing units are owner-occupied. See U. S. Census Bureau, Quarterly Residential Vacancies and Homeownership, First Quarter 2020. April 220. Retrieved from https://www. census. gov/housing/hvs/files/currenthvspress. pdf. In Canada, 68% of households headed by seniors are homeowners and, of those, 80% are mortgage-free. See Statistics Canada, Home Ownership mortgage debt and types of mortgage among Canadian Families, August 2019 Census. Retrieved from https://www150. statcan. gc. ca/n1/pub/75-006-x/2019001/article/00012-eng. pdf. These statistics are not necessarily comparable, due to different sampling frames,

achieve an acceptable retirement lifestyle. Employees will be unwilling to give up secure employment until retirement is more appealing than continued employment. If they are unprepared for retirement, employers will find it necessary to dismiss long-service employees for cause, even though the cause is a natural consequence of aging or a failure to adapt to changing business needs. Pre-retirement planning seminars addressing all economic and social aspects of retirement can help prepare long-service employees for a secure retirement that is less reliant on financial solutions.

Employers can continue to provide their employees with access to wholesale financial markets (group insurance and savings plans). They would be well advised to structure these offerings in a way that avoids unconditional long-term financial commitments to employees, given the pace of change and societal disruptions in the 21st century. Targets and cost-sharing commitments make more sense than defined benefit guarantees.

Financial literacy has been identified as a focus area for addressing retirement well-being. It seems unlikely that improved understanding of compound interest and investment opportunities will be enough to overcome the dramatic increase in the price of retirement income, or to support retirement in a world with reduced reliance on the finance pillar. Indeed, when real interest rates are close to zero, compound interest mathematics is pretty much irrelevant. Perhaps a wiser focus would be on economic literacy – understanding how economic needs can be met in alternate ways and how investments in community and property can augment stocks and bonds. Work/life balance could be regarded as a retirement strategy.

The strength and resiliency of government and social institutions should not be overlooked. These factors should be considered by employers in the choice of business locations and supported on an ongoing basis through corporate citizenship and by facilitating employee involvement in civic affairs. Once it is understood that there is more than one way to play tennis or arrange long-term care, employees will give credit to their employers' long-term investments in their future, regardless of the form the investments take.

In an era of contract work and outsourcing, secure employment remains the key to obtaining a mortgage and purchasing a home. In turn, home ownership contributes to an employee's long-term commitment to a community and an employer. The ability for employers to provide permanent jobs is crucial. This should take precedence over fringe benefits. In some cases, examination of the full range of economic security options will lead employers to abandon employment policies and scale back benefit plans that cost too much or require inflexible commitments.

Reconsidering the balance between the pillars of economic security does not mean abandoning financial security or retirement income plans. These financial instruments remain important and may well attract just as big a share of the total compensation envelope as they have in decades past. The consequence of rebalancing is that the cost of retirement income will not be allowed to balloon along with rising life expectancy and falling interest rates when there are viable alternatives.

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