Half of Americans will see their standard of living fall in retirement

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With roughly 10,000 boomers retiring every days, the U.S. retirement crisis is no longer an easily dismissed distant concern. Whether we choose to pay attention or not, American workers' savings shortfall is a slow-moving hurricane that's going to hit many of us where we live.

By some measures, Americans are less prepared than ever to retire comfortably. A recent brief by the Center for Retirement Research at Boston College examined workers' wealth-to-income ratios from 1983 to 2013. Tracked by the Federal Reserve, this metric plots workers' accumulated assets over their income—the higher the ratio, the bigger their financial cushion.

Researchers found that workers' wealth-to-income trajectory has held steady over the 30 years ending in 2013 when various factors, including the drop in workers covered by pensions, meant it needed to increase in order for workers not to lose ground. "They should have more wealth to compensate, and they don't," said Anthony Webb, senior research economist at the Center for Retirement Research.

In 2013, the average 62-to-64-year old had accumulated wealth equal to about three times his income, slightly below the level of 1983. Wealth includes all financial assets, such as 401(k) balances and home equity; income includes wages plus earnings and returns on financial assets. This metric excludes the future value of employer pensions and Social Security.

There's no magic ratio to guarantee that people will meet their retirement goals, Webb said. Wealth-to-income adequacy depends on a number of factors, including lifetime earnings, health status, and willingness to economize. The Center for Retirement Research simply highlights a disturbing trend: today's workers should be accumulating more than prior generations, yet they aren't.

Today's workers should be socking away more for retirement because the decks are stacked against them in ways that they weren't 30 years ago. In 1979, 28 percent of all private-sector workers had pensions as their sole retirement plan benefit; by 2011, that number had dropped to 3 percent, according to the Employee Benefit Research Institute. Back in the early 1980s, double-digit interest rates meant that it was possible for many retirees top live comfortably off of bond income.

Social Security

Changes to Social Security mean that boomers will receive a lower replacement rate—that is, the percentage of pre-retirement income that the benefits replace—than current retirees. And yet, people are living longer than ever before, so future retirees will need to stretch their nest eggs longer than prior generations.

What’s more, out-of-pocket health-care costs are eating up an increasing share of retirees’ incomes at a time when fewer workers have employer-sponsored retiree health-care benefits to make up the difference between what Medicare covers and what they owe.

A recent analysis by HealthView Services, a Danvers, Mass.-based provider of health-care cost data and planning tools, projected that for a 55-year-old couple retiring in 10 years at age 65, health-care costs will gobble up approximately 90% of their lifetime Social Security benefits.

This sobering state of affairs won’t be immediately obvious to the couple, who at 65 will likely still be in relatively good health. But health care costs typically rise at around 5% to 6% a year, and most people consume more of these increasingly pricey services as they age.

Meanwhile, Social Security’s annual inflation raise, based on a broad basket of goods and services known as CPI-W, won’t keep pace. The gap grows over time, to the detriment of older Americans. Between 1985 and 2014, the CPI-W lagged the inflation experienced by households aged 62 and older by 6.5% on a cumulative basis, according to the J.P. Morgan Guide to Retirement’s analysis of Bureau of Labor Statistics data.

Standard of living to fall

The Center for Retirement Research uses Federal Reserve data as the basis for its National Retirement Risk Index. This index measures the likelihood of households to achieve the same standard of living in retirement as they had while working.

Their analysis found that about half of American households will be unable maintain their standard of living in retirement. This will mean a series of trade-offs at best and sacrifices at worst. It’s one thing to accept a slightly reduced standard of living—say, to be forced to downsize to an apartment when you’d rather remain in the family home. It’s quite another to have to choose between keeping the lights on and buying medicine or food.

To be sure, rosier predictions exist on Americans’ retirement readiness. But these typically rest on rosy assumptions. Studies projecting that Americans are saving enough for retirement typically assume that people will reduce their spending after their children leave home, according to the Center for Retirement Research brief.

Under these projections, parents do not spend more on themselves when their children become financially independent. Instead, they sensibly plow the money they used to spend on their offspring into their retirement fund. Then, when they retire, they continue to spend less than they did when their children were at home. Some retirees will surely follow this prudent pattern, but plenty won’t.

Nitty-gritty

By contrast, the wealth-to-income ratio is a neutral gauge that doesn't assume a specific behavior. And what it shows is troubling, according to the Center for Retirement Research.

Harold Evensky, a financial planner and professor of practice at Texas Tech University, said he gets into nitty-gritty retirement planning once clients get within five years of that milestone. Before clients reach that stage, his standard advice is to save as much as they can.

Evensky, who is 72, worries about the coming retirement crisis and the country that his children and grandchildren will inherit. "One of the nice things about being my age is that I'm not going to have to see a lot of things," he said. "It's scary."

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