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From the Special Issue Editor

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It is my great pleasure to have served as Special Issue Editor for Volume 9, Number 1 of the *Financial Services Review* and to offer you eight outstanding articles covering a variety of issues related to retirement. The topic of this issue "Ensuring Retirement Income Adequacy in the Next Century" is quite timely and has implications for all of us, whether or not we are doing research in retirement investment, pensions, or social security.

The retirement of the baby boom is fast approaching and, despite the strength of the economy in recent years, there is much concern among policy-makers that this generation is financially ill-prepared for retirement. This is not an insignificant problem in light of the demographic changes facing this country and others worldwide. The aging of the population is predicted to place great strain on financial markets as the flow of investment funds reverses direction, and retirees gradually liquidate asset portfolios to fund cash flow in retirement. The social security administration predicts that, although we can expect many more years in which payroll tax inflows exceed benefit outflows while the baby boom enjoys their peak earning years, their retirement which begins in 2008 will eventually bankrupt the social security trust fund in the absence of significant reform, and this will occur sooner if politicians continue to look for ways to spend the surplus. In recognition of the "three-legged stool" concept of retirement planning, this issue of the *Financial Services Review* addresses problems and solutions in all three areas: private pensions, social security, and individual savings.

How will individuals respond to a shortfall of financial resources as retirement approaches? A large percentage of U.S. workers do not have access to employer-provided pensions, and some cross-sections of individuals, most notably women, have significantly lower pension sponsorship and participation rates. Furthermore, U.S. savings rates are low relative to other developed countries and studies have reported that the average household in the U.S. has too little retirement wealth accumulation. Individuals approaching retirement under these circumstances have few choices. Two of the articles in this issue address the timing of retirement. In "Determinants of Planned Retirement Age," Catherine Montalto, Yoonkyung Yuh, and Sherman Hanna use the Health and Retirement Study dataset covering older households to consider the factors that influence planned retirement age. Although individuals may have plans to retire earlier while they are young, planned retirement age increases with age, perhaps an indication that inadequacy of retirement wealth is forcing

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longer working periods. Walt Woerheide takes a different approach to this question in his paper, “The Impact of the Pension on the Decision to Work One More Year,” in which he estimates the net benefit to be received by working an additional year (salary plus additional pension accruals less foregone retirement benefits).

In “Beliefs and Actions: Expectations and Savings Decisions by Older Americans”, Harold Elder and Patricia Rudolph explore the interesting question of the inter-relationship between savings behavior, pension plan participation, and expectations with respect to retirement standard of living. Their finding that individuals consider personal savings and pension plan savings to be substitutes is an important explanation for low savings rates in light of the increasing numbers of defined contribution plans and their financial performance over the last decade. However, the fact that individual saving, but not pensions, is found to have an affect on expected standard of living in retirement may imply that individuals do not fully understand the value of private pensions.

In light of social security reform proposals that suggest creation of individual investment accounts and/or investment of social security trust fund in equities, several papers in this issue are particularly interesting. Although previous studies have suggested that stocks generally have outperformed bonds in the long run, common wisdom has argued in favor of reducing equity exposure as retirement nears. In “The Asset Allocation Decision in Retirement: Lessons From Dollar-Cost Averaging,” Premal Vora and John McGinnis consider the retirement consumption effect of stock versus bond investing during the retirement period. Employing a “dollar-cost disinvesting” methodology, they show that retirees over that last several decades would have consistently done better by investing in stocks.

However, it is clear from the other papers in this issue that actual investment decisions by individuals may not produce optimal retirement outcomes. Jack VanDerhei and Kelly Olsen use a unique database which includes information on nearly thirty thousand 401(k) plans and more than six million participants in “Social Security Investment Accounts: Lessons from Participant Directed 401(k) Data” and apply their findings to an analysis of the advisability of giving investment control over social security accounts to individual participants. Based on recent investment decisions by 401(k) participants, they conclude that a large percentage of individuals are very conservative in their investment choices, a finding that is consistent with that of Doug Waggle and Basil Englis who examine Individual Retirement Account investments in their article “Asset Allocation Decisions in Retirement Accounts: An All-or-Nothing Proposition.” Their results, based on a large survey sample of consumers, suggest that many individuals are totally undiversified and that a large percentage have their IRAs invested entirely in cash.

Whether or not individuals can be expected to optimally invest their individual social security accounts, there are potentially large macroeconomic spillover effects from shifting payroll taxes to equities. In “Social Security Reform: The Effect of Investing in Equities,” Erick Elder and Larry Holland provide a convincing argument that shifting social security funds from government securities to equities implies a decrease in the return on equities, an increase in bond yield and ultimately an increase in general income taxes.

The final paper in this issue provides an interesting analysis of an alternative retirement savings vehicle. In “An Analysis of the Medical Savings Account as an Alternative Retirement Savings Vehicle,” J. Tim Query suggest that, while the medical savings account is not a substitute for traditional retirement savings vehicles and pensions, individuals with low expected medical expenditures could accumulate significant account balances by the time of retirement.

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