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Will Boomers Redefine Retirement?

Olivia S. Mitchell

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Part I

Prospects for Baby Boomer Retirement

Chapter 1

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The number of retirees in the United States will double over the next thirty years, and similar if not larger age waves will also wash over other nations. As the unusually large cohort of individuals born 1946–66 known as 'Baby Boomers' moves into retirement, it is sure to have unprecedented effects on health care systems and private pensions, housing markets, national social safety nets, and indeed the entire economy. This volume provides a detailed and thoughtful assessment of how Baby Boomers will fare in retirement. Our goal is to generate new insights on this keenly important topic to guide future employers, employees, and policymakers, relying on new and never before exploited microeconomic data and modeling techniques developed for the economics of aging.

There is substantial disagreement about how well-off Baby Boomers will be during their 'golden years'. Some compare their financial and physical capital to a fixed consumption standard and deem them fit and ready for retirement. Other analysts assess Boomers as poorly prepared, particularly if one uses community standards such as the average earnings levels or poverty lines. And still others have proffered yet other thresholds such as incomes received by previous retiree cohorts.

The chapters of this book address these and related differences in a systematic and comprehensive manner. First, we take up the question of whether Baby Boomers will remake retirement, and what their financial capital will translate into in terms of later life command over resources. Next, we turn to the question of health capital: whether Boomers are living well longer, or whether they face more years in worse health than previous generations. The answer, as we show below, depends in part on their health insurance coverage. Then we focus on new roles for retirement assets and retirement planning. Of special interest is the way in which the new global economy is remaking pensions, requiring workers to shoulder the responsibility of making sensible portfolio allocation patterns. Finally, we turn to an exploration of how older persons intend to use their homes as a key source of retirement financing.

Will Boomers Remake Retirement?

Some 77 million strong, the leading edge of the Baby Boom generation is now crossing the age-60 threshold. In some very provocative research on past and future work patterns, Nicole Maestas concludes that Boomers are more attached to work than previous generations of workers at the same points in their lives. This change she partly attributes to the fact that Boomers are reaching retirement with markedly different family structures and socioeconomic status (SES) than prior generations of retirees, as well as different attitudes toward work. Her research uses a data-set that many in this volume employ and called the Health and Retirement Study (HRS). This is a nationally representative and very rich survey of individuals over the age of 50, for whom extensive financial, health, and expectations data have been collected and made available for research purposes.[1]

In her analysis, Maestas (Chapter 2, this volume) reviews the experiences of three different generations or birth cohorts, to show that the early members of the Boomer generation are better educated, more ethnically diverse, and less likely to be married than previous cohorts. The Boomers she studies also had significantly higher earnings, housing values, and net worth than their earlier counterparts, and they expect to continue working longer. She then notes a new phenomenon which she terms 'unretiring'; this refers to postretirement employment that Boomers anticipate doing as they move through their 60s. This new perspective on later-life employment cannot be fully attributed to poorer SES, suggesting that Boomers have a growing preference for working longer.

Turning to preparedness for retirement, Robert Haveman, Karen Holden, Andrei Romanov, and Barbara Wolfe (Chapter 3, this volume) compare retirees who retired during the early 1980s with those who left in the mid-1990s. The authors compute for each family annuitized net wealth (ANW) including the equity value of owner-occupied housing, drawing on the Social Security Administration's New Beneficiary Survey (NBS). The team's simulations indicate that mean retiree wealth is projected to rise substantially, for more recent cohorts. Nevertheless, in view of their longer life expectancies, wealth levels will not rise enough to generate more annual (annuitized) income than received by past cohorts. In fact, using the poverty line recommended by the National Academy of Sciences Panel on Poverty Measurement, 4 percent of prior retirees had inadequate resources; for more recent cohorts, they project the figure to rise to 7 percent. In addition, more than one-fifth of these retirees are slated to have ANW below twice the poverty threshold. Accordingly, one theme seen in this and other chapters is that Boomers are better off than their forebears in terms of wealth levels, but this wealth will not be enough to guarantee retirement security.

Another theme which permeates the studies in this volume has to do with the extraordinary diversity of individuals now reaching retirement age. That is, while averages may look attractive, there remain important pockets of vulnerability and these appear to be growing. For instance, Haveman et al. express concern that adequacy targets are less likely to be met by specific groups including women, nonwhites, unmarried persons, and those with less education.

A similar conclusion flows from the work of Barbara Butrica, Howard Iams, and Karen Smith (Chapter 4, this volume), who emphasize the fact that Boomers *on average* will head into retirement in better financial and physical health than prior generations of retirees, but this obscures changes in the *distribution* of income and wealth. These authors rely on a microsimulation model known as the Model of Income in the Near Term (MINT) which projects retirement adequacy at age 67 for cohorts born 1926–35, 1936–45, Early Boomers 1946–55, and Late Boomers born 1956–65. Their analysis concludes that the share of family income from nonretirement income sources is projected to increase due to the increased importance of asset income, which currently represents 4 percent of mean per capita retiree family income but is expected to grow to 20 percent for the Late Boomers. They also evaluate projected retirement replacement rates, comparing per capita family income at age 67 to average household earnings between age 22 and 62. By this measure, median replacement rates are projected to be 93 percent for current retirees, with only 80 percent rates for future retirees. Again, diversity is key: almost half of today's retirees can anticipate incomes that exceed their average lifetime earnings, but the figure drops to around one-third for Boomers. Thus, in absolute terms, Boomers will be better off in terms of higher income and lower poverty rates, but in relative terms, many will be worse off. Of course, all of these projections are tentative, since there is much uncertainty regarding costs of health care and uncertainty regarding the future of Social Security and defined benefit pension plans.

Are Boomers Healthier?

Financial capital is only part of the bundle of resources that older persons look to during retirement. Another resource is health capital, which David Weir (Chapter 5, this volume) compares across cohorts using the HRS. Older workers who are currently on the job tend to say they will work past age 62, but Weir is concerned that their health might not permit it. His data show a mixed picture: that is, for Boomers, smoking is less common than for their predecessors, but obesity is an increasing problem. Overweight persons are defined as having a Body Mass Index (BMI) of 30 or more, where the BMI refers to a calculation of an individual's weight in kilograms divided by height in meters. According to this measure, obesity rose 5 percent from 1992 to 2004; with this, there has also been a rise in the rate of diabetes, up 39 percent for cohorts reporting in 1992 versus in 2004. Some of the increase may be due to better diagnosis, of course. In addition, Weir notes only a slight increase in hypertension and stroke for those on the verge of retirement, but a substantial increase in self-reported pain, of 32 percent. The hypertension finding may be linked to increased use of medication to control the condition, a development he believes may provide insight into the future health of Boomers. He also suggests that there may be a better chance of developing medications or treatments for obesity than there are for smoking. Of course, even if Boomers do have more health problems than prior generations, this may not impact life expectancy; rather, it may presage more disability. Accordingly, Weir concludes that expectations of longer work lives are sustainable for most people, and pessimism about life expectancy is unwarranted.

In their chapter, Joyce Manchester, David Weaver, and Kevin Whitman (Chapter 6, this volume) also assess the relative position of Boomers as they head into retirement. This analysis, which relies on the MINT model, focuses on both the health and wealth of the Boomers. Unlike other analysts, they adopt the US poverty line standard set by the government as the amount of money required to purchase a constant basket of goods, and they compare Boomers to their parents' generations. They forecast a 40 percent more median income relative to the poverty line for Boomers versus older cohorts, and a 35 percent drop in the number of preretirement Boomers living in poverty, compared to their parents. Manchester et al. also find strong evidence of health improvements, noting that only 27 percent of Boomers report being in poor or fair health, 14 percent fewer than the parents' group. Also the fraction of Boomers reporting that it has a work disability fell by 11 percent compared to earlier respondents. The researchers then construct a measure of combined economic well-being and health status, and they conclude that Boomers will fare better than their parents, according to almost all measures of economic and physical well-being.

Health differences across cohorts on the verge of retirement are again the focus of Beth J. Soldo, Olivia Mitchell, Rania Tfaily, and John McCabe (Chapter 7, this volume), who devise a health index using Item Response Theory (IRT). Comparing three HRS cohorts, the authors conclude that Boomers are in poorer health than their counterparts a dozen year ago; in particular, women tend to report worse health (even if they live much longer!) In particular, Boomers indicate they have relatively more difficulty with a range of everyday physical tasks, and they also report having more pain, more chronic conditions, and more drinking and psychiatric problems than their HRS earlier counterparts. This trend suggests that Boomers have poorer self-perceived health than earlier groups.

Another way in which Boomers may differ from earlier retirees includes coverage against health shocks with health insurance. In the United States, of course, health insurance coverage is generally associated with one's workplace, but such insurance is not mandatory. Helen Levy (Chapter 8, this volume) reports that the fraction of Boomers lacking health insurance is slightly higher than for prior generations. Across the three waves of HRS age cohorts leading up to age 65, around 20 percent lacked insurance at some point in the period, which can be deemed substantial risk exposure. Yet only a very small fraction (3%) reported a hospitalization for self or spouse for which insurance paid nothing, and relatively little personal wealth was at stake. According to HRS data, median nonhousing assets of the uninsured totaled only $10,000, while the figure was close to $200,000 for insured persons. Thus median assets of the uninsured would not cover the costs of an average hospital stay of $17,000, suggesting that the uninsured are gambling that, if something happened, they could rely on charity care.

Understanding Retirement Assets

Turning to retirement financing, the discussion coalesces around pensions and private housing equity.[2] In their chapter, Leora Friedberg and Anthony Webb (Chapter 9, this volume) note the long-term shift from defined benefit (DB) to defined contribution (DC) plans over the last two decades, leading to important changes in the risks borne by workers in their retirement accounts. In DB plans, the employer must make investment choices and bear many of the risks associated with those choices; in DC plans, workers bear capital market and longevity risk. Of course, many DB pensions also carry the risk of a substantial loss in pension wealth resulting from an unexpectedly early exit from one's job or from termination and bankruptcy.

Focusing on HRS respondents, the authors assess the impact of these changes in pension structure on workers' investment choices *outside* their pensions. Their main results show significant and substantial differences in stock market investment among workers, depending on their pension characteristics. Specifically, employees covered for a long time in a DB plan holds riskier investments outside the pension. They also find that workers with DC plans invest more in the stock market overall, but there is no change in asset mix with job tenure. The inference is that workers having greater preferences for risk (who would invest more in the stock market anyway) might sort themselves into jobs with DC pensions. This research illustrates another of the consequences of the shift in pension structure that may alter patterns of job mobility at young and older ages, and retirement consumption.

Turning to pension wealth, the chapter by Chris Cunningham, Gary Engelhardt, and Anil Kumar (Chapter 10, this volume) points out that many workers have little or no idea what they can expect in pension benefits during retirement, which makes it difficult for researchers to gauge the adequacy of retirement savings (particularly as retirees move increasingly to DC plans). This team has developed a software tool they call the pension Calculator, which they then use to compute pension wealth measures for HRS respondents. They also compare their results to those produced from an earlier pension estimation program (PEP) developed at the University of Michigan. Based on more flexible assumptions, their model generates somewhat lower DC values than the ones produced by HRS; that is 401(k) pension wealth was some 40 percent lower, and overall DC wealth was 20 percent less. They also show that pension wealth resulting from voluntary saving (and accrued earnings thereon) comprises half of DC pension wealth.

The shift from DB to DC plans also drives analysis by Michael Hurd and Susann Rohwedder (Chapter 11, this volume). A key challenge in this arena is how to measure the value of pension wealth, inasmuch as many workers have no idea what their pension accruals are worth. The researchers rely on HRS data from respondents near retirement when they seem most knowledgeable about what their pension accruals are worth, and what they will have to draw on. The authors find a small increase in the amount of real 'bequeathable' wealth, from a mean of $304,000 for the oldest cohort, to $317,300 for the War Babies (WBs), to $382,300 for the Early Boomers (all in $2004). As a result, and assuming that financial risks in retirement faced by the different cohorts stay the same, they are not concerned that there is a critical pension shortfall facing Boomer near-retirees.

In a very interesting analysis of the Swedish retirement system, Anders Karlsson, Massimo Massa, and Andrei Simonov (Chapter 12, this volume) explore what happened in the year 2000, when Sweden required its workers to invest 2.5 percent of the 18.5 percent total pension tax in their own personal investment accounts. Initially, the government permitted participants to select from about 700 different funds, an unprecedented amount of investment choice. The authors show that having a pension account containing mutual fund investments does change investor incentives to participate directly in the stock market. Specifically, direct equity holding was not a close substitute for equity in the retirement accounts, suggesting that an individual account system will not crowd out direct equity market investment. In sum, they conclude that the new Swedish system helped inform investors of the benefits of stock market participation, boosting participation, and therefore saving.

This discussion dovetails nicely with Annamaria Lusardi and Jason Beeler's (Chapter 13, this volume) study on retirement planning and preparedness, which shows that those who say they plan for retirement do better than those who put little thought into their financial future. In the HRS, they are surprised to find that many Boomers—as many as one-third—had not devoted any thought to retirement prospects, even it is only a few years away. They also note that planning for retirement is positively associated with having more retirement wealth, and the impact is remarkably stable across cohorts. Nonplanners are concentrated disproportionately among the less educated, those with low income, and blacks/Hispanics, households which seem to have been largely unaffected by financial education programs instituted during the 1990s. They conclude that policies to stimulate saving might be best targeted to those groups least likely to plan.

The role of home equity in retirement saving is also crucial, since many older persons own their homes and the homes represent a substantial asset. Julia Coronado, Dean Maki, and Ben Weitzer (Chapter 14, this volume) use the HRS and other data to compare Early Boomers with cohorts older than they, and the authors find that Boomers are both better off and worse off. Thus they have more housing wealth, but they have borrowed more against their homes. As a result, Boomers have not acquired enough net worth to keep constant the replacement ratio of net worth to preretirement household income. Given Boomers' longer life expectancies, the authors conclude that the cohort may be worse off in old age. They also delve into the question of whether older people cash in on home equity to finance retirement. Interestingly, when they follow already-retired cohorts, they find that many who moved did downsize and therefore decreased their home equity/net worth ratio. In other words, they find evidence that retirees are tapping into their home equity and either spending it or putting it into financial assets. They also find that the decision to move does not appear to be related to changes in health, since both movers and nonmovers report similar health conditions. Boomers then may be expected to follow similar patterns, particularly if financial innovations such as reserve mortgages gain in popularity.

Discussion

The research in this volume offers key lessons for employers, workers, and policymakers looking ahead to the wave of Boomers as it moves into retirement. Evidently, many Boomers plan to keep working, certainly past conventional early retirement. Prolonging one's worklife where possible is a very effective way to add to and preserve retirement assets, which will in turn generate more eventual income for old age. Also, Boomers' expectations about working into retirement may be realistic, inasmuch as they are employed more often in knowledge-based jobs that do not require as much physical stamina as in the case of prior generations.

We also find that Boomer's health capital is about as good as it was for earlier cohorts, though results here are more nuanced. Many researchers conclude that Boomers will fare better than their parents with regard to work limitations and disability patterns. Yet Boomers' own self-reports indicate they have more difficulty with a range of everyday physical tasks, and they also report having more pain, more chronic conditions, and more drinking and psychiatric problems than their HRS earlier counterparts. Women seem particularly at risk, and the dangers of obesity are just beginning to be traced.

In sum, our findings paint a more complex picture than is often afforded by simple warnings of the 'impending retirement crisis' facing Baby Boomers. This is underscored by the fact that, while most Boomers are relatively well-off, there is much dispersion in the data. Some groups, particularly the nonmarried, the least educated, and many blacks and Hispanics, have very little in the way of retirement assets. Thus there will remain a need for a strong safety net in the years to come.

In addition, many people are still not planning adequately for retirement, and as a result, they are failing to save effectively. This could imply that many Boomers will be more vulnerable to old-age shocks and have few resources to cope. A related point is that Boomers have not shown that they can adjust their spending patterns to align these with changing circumstances. Compared to previous cohorts, Boomers have enjoyed lifetime economic prosperity, so that many have never had to scrimp and save as did their parents and grandparents during times of privation. Indeed, for many, the whole idea of retirement risk management is unfamiliar, a point underscored by their lack of retirement planning. This feeds into concerns regarding rising levels of household debt: some in the Boomer generation have shown a tendency to spend now and worry about tomorrow later, whereas retirees who experienced the Great Depression are reluctant to part with their savings.

Despite these cautionary flags, there is much we have learned and reason for excitement. Most importantly, we have confirmed that researcher and policymakers can reap invaluable rewards from long-term investments in rich and detailed data-sets such as the Health and Retirement Study. Indeed the HRS is used by many researchers for the first time here in this book to assess cohorts' retirement preparedness in a variety of new and interesting ways. We have also learned that there are ways to enhance the retirement experience. Innovative pension systems, such as the Swedish plan, are changing the way workers allocate their retirement portfolios. New products are being developed to help workers plan, save, and invest more effectively, manage their funds into retirement, and protect against longevity risk. Ready or not, Baby Boomers are transforming, and being transformed by, retirement.

Notes

[1] The Health and Retirement Study (HRS) is a biannual survey sponsored by the National Institute on Aging (NIA) along with the Social Security Administration (SSA) and administered at the University of Michigan. This survey of some 22,000 individuals has been conducted every 2 years since 1992, and it is an unusually important source for estimating the retirement readiness of prior retirees against Boomers. All the authors books compare distinct HRS cohorts, generally with the earliest termed the 'original HRS' who were aged 51–56 in 1992, the so-called 'War Babies' who were aged 51–56 in 1998, and the Early Boomers who were aged 51–56 in 2004. For more detail, see NIA (forthcoming) and http://hrsonline.isr.umich.edu/

[2] Public pensions and Social Security also are an important element of retirement income security, but are not our focus here. For further information, see Mitchell et al. (1999).

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