Reimagining Pensions

The Next 40 Years

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Chapter 4

The Changing Nature of Retirement

Julia Coronado

Change is the only constant when it comes to retirement planning and income provision over the 40 years since the 1974 passage of the US Employee Retirement Income Security Act (ERISA). In 1979, most private sector workers (82 percent) who were covered by a pension plan had a defined benefit (DB) plan. By 2011, a minority (31 percent) had DB plans, while defined contribution (DC) plans, which did not exist in their current form when ERISA was signed, became the only retirement coverage for 69 percent of private sector workers (EBRI 2014*a*). Changes in benefit provision can only be partially linked to the passage of ERISA, since the public sector, not covered by ERISA, has also seen changes in the structure of retirement benefit provision, albeit more gradual ones.

Many of these changes in the retirement landscape were driven by demography. In 1970, an average man reaching the age of 65 could expect to live to 78.1 years of age, while a woman could expect to live to age 82. Forty years later, a 65-year-old man could expect to live to 82.7 and a woman to 85.3, an increase of 15–35 percent in the number of retirement years that needed to be financed, assuming retirement ages don't change (CDC 2014). But times have changed. Long-running surveys of people's retirement plans and experiences suggest a steady and substantial increase in their expected retirement ages as well as changing plans to work for pay in retirement. Yet these same surveys reveal a conundrum: large fractions of retirees, the majority in recent years, report retiring earlier than planned, and the fraction working in retirement is substantially below people's plans. Either individuals are so cautious that they oversave and find themselves in a surplus position at older ages (a view refuted by a large body of data and research), or there is something else afoot.

This chapter argues that older workers have had a difficult time executing their plans, owing to persistently weak labor market conditions for older employees. Many older workers have been forced into earlier retirement than planned due to job loss, and many who seek work are unable to find employment or can only find part-time jobs. While labor market conditions have been difficult for workers of all ages, older workers have a harder time finding another position once separated from a job. We conclude that people should be factoring uncertainty about labor market outcomes into their retirement planning decisions in addition to increased uncertainty from exposure to risky investments.

In what follows, we first describe key findings from the Retirement Confidence Survey, the longest-running annual survey of retirement attitudes, plans, and experiences. Next we corroborate these findings with evidence on older households from the Consumer Expenditure Survey. Results highlight the different experiences and future prospects of different generations. A third section looks at labor force outcomes and decisions using the Current Population Survey. Involuntary unemployment and underemployment are not unique to older workers, but these come at a vulnerable time in life. We conclude with some thoughts regarding implications for policy and research.

Watch What I Say, Then What I Do

Since 1993, the Employee Benefit Research Institute has surveyed a representative sample of US current workers and retirees about attitudes and self-reported decisions related to retirement in the Retirement Confidence Survey (RCS).[1] It poses a core set of questions to cohorts over time to reveal shifting trends in attitudes and decisions that can then be cross-checked with other data sources (EBRI 2014*b*). For this reason, the RCS captures the recent decline and partial rebound in Americans' confidence in their ability to afford a comfortable retirement. Indeed, confidence in retirement security has fallen in recent years: the share of current workers either very or somewhat confident in having the resources needed to live comfortably in retirement hovered around 70 percent in the 1990s through 2007; then it dropped sharply to just above 50 percent, before recovering to 55 percent in 2014. Among retirees, the high water mark was also in 2007 when 79 percent were very or somewhat confident they had enough money to live comfortably throughout their retirement years. This fell below 50 percent in the crisis, hitting a trough at 47 percent in 2013 before rising somewhat to 57 percent in 2014.

It is striking that today's retirees do not have much higher levels of confidence than do workers and that nearly half of them think their resources will not last throughout retirement. Arguably, the potentially depressive effect of the secular decline in DB pension coverage on retirement confidence was offset by rising equity and home values in recent decades. Even though the equity market has more than fully recovered losses registered during the financial crisis, and home values in most parts of the United States have also recovered well overall, the recent financial market volatility has tangibly revealed to workers and retirees alike the risks inherent in DC retirement vehicles.

The RCS captures a steady increase in the expected age of retirement among current workers. Figure 4.1 indicates that the fraction of workers expecting to retire after age 65 has risen steadily, from just over 10 percent in 1991, to roughly one-third of respondents in recent years. The rising trend has not been a function of business cycles or the financial crisis; rather, it likely reflects longer life expectancies, better physical health, and a more service-oriented economy, as well as the declining prevalence of DB pension plans with their strong incentives for earlier retirement. Nevertheless, Figure 4.1 also shows that plans for later retirement are not evident in the share of people retiring post-65 (about 15 percent).

Some reasons for the gap between retirement plans and retirement experience are provided in Figure 4.2. A fairly large proportion of retirees exits the labor force earlier than planned, and this share has risen notably in recent years, such that nearly half of all retirees report early exit from the labor force. The survey also queries respondents on their reasons for early exits, and many reasons cited in the 2014 survey suggest adverse consequences for standards of living. For example, 61 percent cited health problems or disability, 22 percent noted work-related reasons including firm

Figure 4.1 More workers expect to work longer, but retirement ages are not yet following

Source: EBRI (2014*b*).

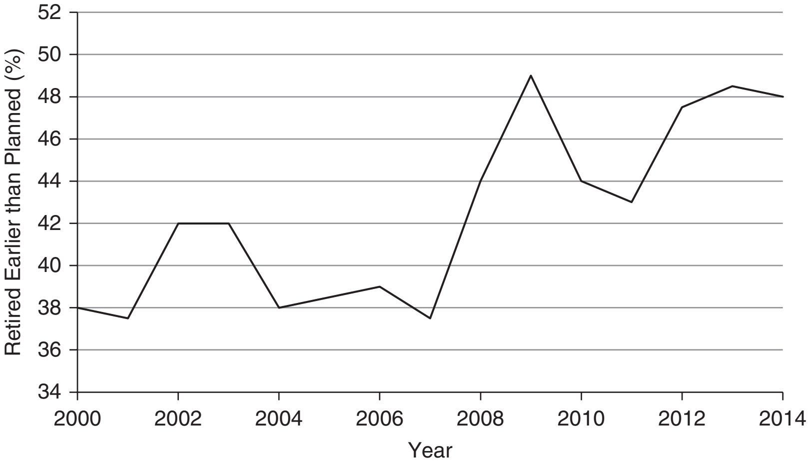

Figure 4.2 Workers are retiring earlier than planned (%, 2 yr avg.)
Source: EBRI (2014*b*).

downsizing and closure, and 18 percent cited having to care for a family member. In other words, many people do a poor job planning for the many contingencies that end up affecting their ability to continue working at older ages.

This poor planning manifests itself in an even larger gap between the share of workers reporting that they intend to continue working for pay in retirement and the share that actually does so. Figure 4.3 shows that roughly two-thirds of people currently working expect to continue working for pay in retirement, up from 55 percent in 1998. Yet the share of retirees that actually does work for pay has been relatively steady over time, at close to 25 percent. Reasons people cite for planning on working for pay post-retirement relate to their enjoyment of working, their desire to stay active, and their wanting extra spending money. Some people may find they simply do not need to work, or alternatively that poor health or care needs for a loved one can outweigh the benefits of working or make it infeasible. In any event, there appears to be a decline in the value of investments, as some cite the need for more money to make ends meet as a reason they plan to continue working.

Changing Generational Experience

Another explanation for the large gap between the share of people saying they will retire later and the share actually doing so is that the retirement

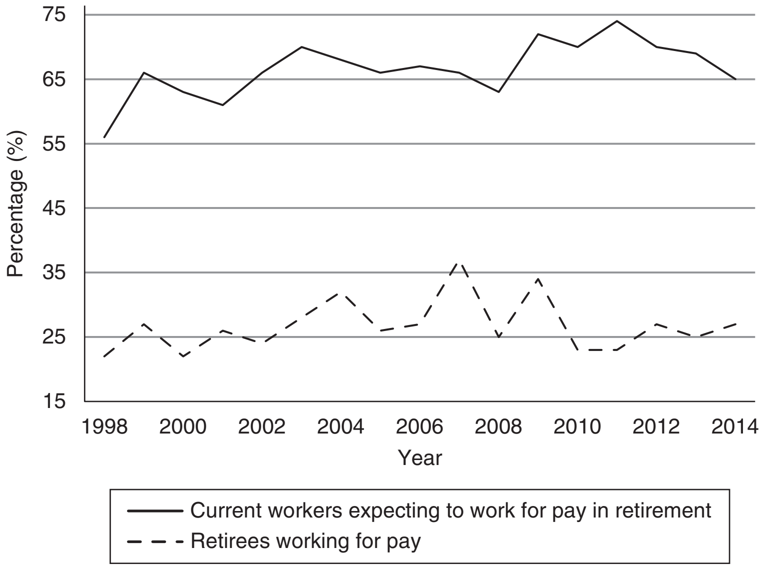

Figure 4.3 Most workers expect to work for pay, but few retirees do
Source: EBRI (2014*b*).

experience may be evolving rapidly across cohorts. Changes in pension coverage, asset returns, and labor market conditions may imply past retirees will be more financially comfortable and secure than future retirees, which is reflected in the plans of current workers. Ultimately, people save to smooth their consumption over their lifetimes, so data from the Consumer Expenditure Survey (CES) on per capita household spending across age groups can shed light on the well-being of current and future retirees (BLS 2014).

The CES confirms that there are important generational disparities, with older households realizing larger gains in their standards of living in recent decades compared to younger households, particularly in the aftermath of the Great Recession. Table 4.1 and Figure 4.4 show the evolution of average real per capita household consumption spending by age of the head of household between 1984 and 2012. All households saw an increase in average real levels of spending since 1984, but the largest gain (by a notable margin) was among households age 75+, who saw a 66 percent gain in real spending since 1984 versus a 6 percent gain for households age 35–44. In 1984, the level of per capita spending had a hump-shaped life cycle pattern rising between the ages of 25 and 64, then falling back as households aged and presumably engaged in more household production in place of out-of-pocket spending. This may also reflect gaps in consumption insurance

TABLE 4.1 Older households doing well

Real per capita spending				
Age of head of household	2012 vs. 1984 (% change)	2012 vs. 2007 (% change)	1984 level ($ 2009)	2012 level ($ 2009)
25–34	15	−4	14,550	16,691
35–44	6	−15	15,164	16,111
45–54	28	−2	16,916	21,697
55–64	46	−5	17,105	24,992
65–74	58	0	15,237	24,090
75+	66	1	12,703	21,086

Source: BLS (2014).

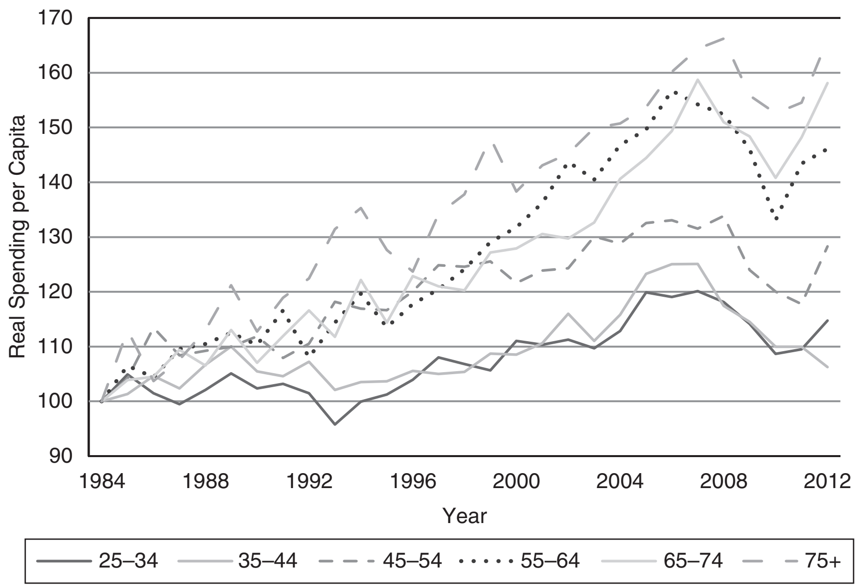

Figure 4.4 Real spending per capita by age of head of household. Older households have experienced the greatest increase in standard of living

Note: 1984 is 100.

Source: BLS (2014).

among the elderly. By contrast, in 2012, average per capita spending rose in a nearly linear fashion with age, falling back moderately for households age 75+. Disparities across age groups have also grown: in 1984, households spending the most were the 55–64 group who spent 17.5 percent more than the lowest spending cohort (age 25–34). In 2012, the biggest spenders

Figure 4.5 Income from public and private pensions by age of head of household (% of total household income). Pension support is fading for older households
Source: BLS (2014).

were still those age 55–64, but they spent 55.1 percent more than the lowest spenders (now age 35–44). Whereas the 1984 data suggest good but not perfect consumption smoothing across generations, the 2012 data are more suggestive of outright generational inequalities in living standards.

When it comes to financing consumption, CES data offer a different picture from some of the trends depicted by the RCS. Figure 4.5 shows the erosion of support from public and private pensions, even within already-retired cohorts. Households where the head is age 75+ continue to rely on pensions for two-thirds of their income on average; by contrast, households age 65–74 have seen that share decline from the late 1990s level of 60 percent in recent years. Given trends in pension coverage and the tendency of DB pensions to implement reforms that made the largest cuts to the youngest participants, the share of household income from traditional pensions is likely to continue to fall for future retirees. In contrast to the RCS, however, the CES shows a marked increase in the share of household income coming from work for pay among households age 65–74, from about 30 percent in the 1980s to almost 45 percent in recent years (see Figure 4.6). This could reflect later retirements among the younger tail of the age group, an increase in work for pay after retirement, or both. Thus the CES presents less of a tension between reported trends in worker expectations for retirement and the recent behavior of retirees.

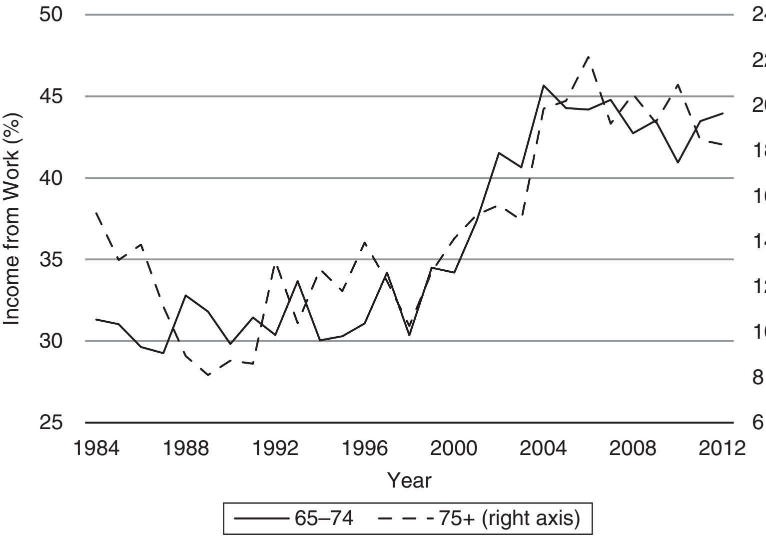

Figure 4.6 Income from work by age of head of household (% of total household income). More income support derives from work for older households
Source: BLS (2014).

Older households were not immune to the leveraging that brought the US economy to the brink of disaster in 2008–09. Traditionally, one of the simplest retirement plans had been for homeowners to pay off their mortgages prior to retirement, thereby lowering their income needs without changing their standards of living. Figure 4.7 shows that the share of households approaching or entering retirement age with mortgages was small and fairly stable through the late 1990s, but it jumped in the 2000s. For older workers, fixed mortgage obligations against falling home values likely impacted their ability to retire and downsize, and this implied more hardship and replanning for those who experienced job loss. Most recently, the CES showed a decline in the share of households age 55–64 with mortgages, likely reflecting a renewed emphasis on paying off fixed obligations. The fall in the share of households holding mortgages was also mirrored in the younger age groups, as both foreclosure and falling homeownership rates contributed to a decline in household leverage. In other words, retirement replanning seems to be underway, as households adjust to riskier economic realities than presumed prior to the Great Recession.

On balance, the CES results agree with the changing retirement landscape captured in the RCS. Additionally, they reflect that changes are already underway with a combination of later retirement and/or work for pay taking the place of declining pensions among the younger half of older households.

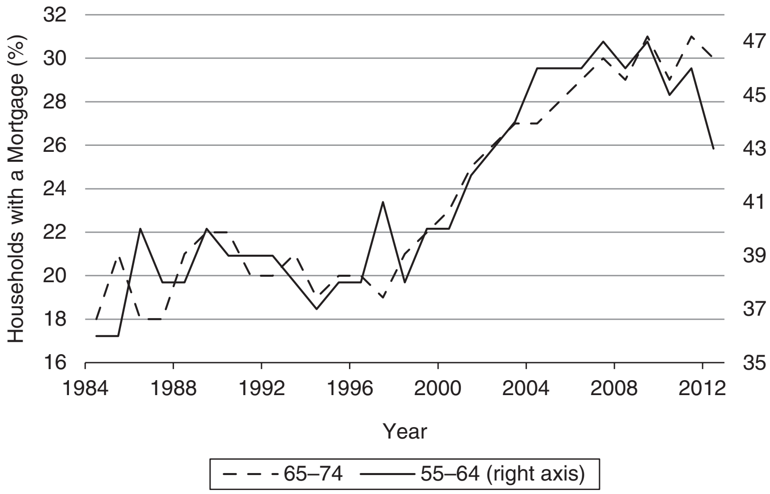

Figure 4.7 Households with a mortgage by age of head. Older households are taking on more leverage

Source: BLS (2014).

Shocking Experiences

Evidence from the RCS and CES also confirms that more people will want to continue working at their career jobs longer and work for pay in some capacity, even after they consider themselves to be retired from a 'main' job. Yet the RCS also highlights that people do not always have a choice about executing their plans and may be forced into early retirement. Another data source, the Current Population Survey (CPS), confirms that older workers have experienced considerable unemployment and underemployment in recent years. For instance, older workers who lose their jobs face greater difficulty finding employment than comparably qualified, or even less-qualified, younger workers. The implication is that workers must factor considerable uncertainty about their ability to work later in life into their planning process, rather than assume they can work as long as they want.

Also, older workers are not insulated from the business cycle. Figure 4.8 shows the unemployment rate for older men, which rises and falls with the rest of the economy. Indeed, in some respects, older workers arguably fared worse than others during the most recent downturn. The unemployment rate for all workers peaked at 10 percent in October 2009 at the height of the Great Recession, falling short of its prior peak in 1982 of 10.8 percent. However the unemployment rate for men age 55–64 set an all-time high of 8.0 percent in 2010, easily surpassing its prior peak of 6.2 percent in 1983.

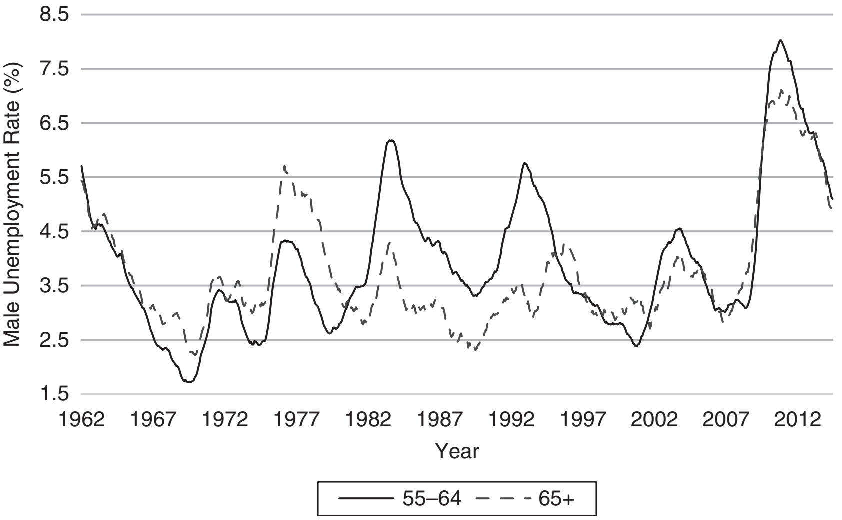

Figure 4.8 Unemployment rates by age for men. Unemployment is still elevated among older men

Source: BLS (2014).

The experience of men age 65+ relative to prior cycles was even worse; their unemployment rate peaked at 7.1 percent in 2012, nearly 3 percentage points above their 1983 peak of 4.3 percent. While the unemployment rate was consistently lower for older male workers than the population average, older worker groups had the worst unemployment experience during the Great Recession in post-WWII history. It is therefore unlikely that even the most prudent planners among this age group could have anticipated the likelihood of experiencing an unemployment shock. The story is much the same for older women (Figure 4.9); although their unemployment rates were lower than men's on an absolute basis, they experienced by far the worst degree of unemployment in the post-WWII period.

Fortunately, unemployment rates have been coming down rapidly in recent years, but for some groups, they remain at or above prior recessionary peaks. The persistence of unemployment among older workers highlights the difficulty older workers tend to experience in finding work once unemployed. Moreover, the unemployment rate understates the severity of underemployment among older workers. Figure 4.10 shows the degree of discouragement among persons age 55+: this is defined as the percent of the population that has given up looking for work and hence is not counted as unemployed, but wants a job and would work if one were available.

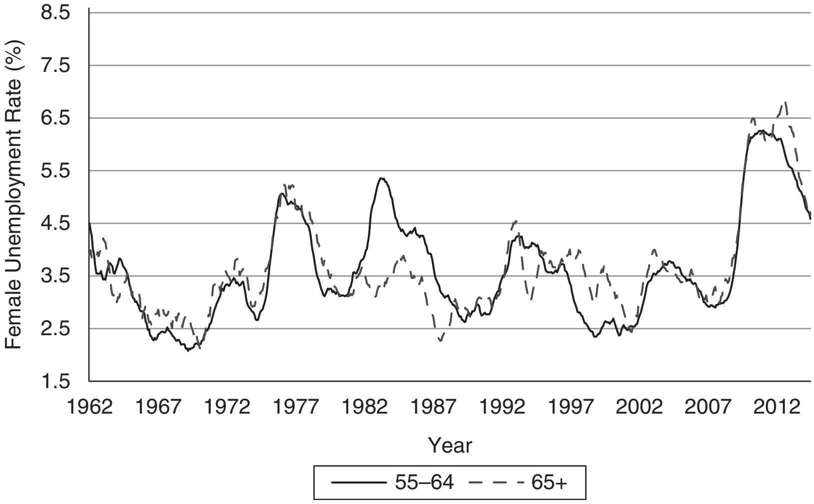

Figure 4.9 Unemployment rates by age for women. Unemployment is still elevated among older women

Source: BLS (2014).

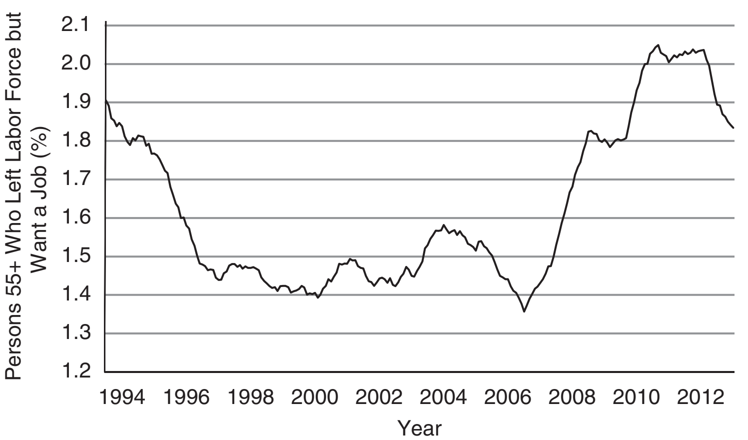

Figure 4.10 Percentage of persons 55+ who left the labor force but want a job. Some discouragement remains among older workers

Source: BLS (2014).

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Discouragement rates rose rapidly during the Great Recession and, like the unemployment rate, made progress but remain quite elevated.

Another group of under-employed individuals are people employed in part-time positions who would prefer full-time work. This 'shadow' labor force has been frequently cited by Federal Reserve Board Chairs as a headwind to the recovery and a reason the unemployment rate understates the degree of labor market slack. Workers of all ages have experienced large amounts of under-employment by this metric, and in fact older workers have fared relatively better in a cyclical sense as the share of involuntary part-time employment remains below prior recessionary peaks. Nonetheless, given that unemployment rates remain above the norms of prior expansions, the 0.5 percent of discouraged workers, and about 1 percentage point of involuntary part-time workers, suggests that a nontrivial minority of older households continues to experience reductions in consumption. Of course, younger workers too experienced shocks that will have long-term impacts on expectations and retirement plans. The good news is that households have developed prudence and are remaining less inclined to take on debt as the recovery has proceeded. The bad news is that this is a somewhat self-limiting process that has slowed down the recovery.

Conclusion

The retirement reality is changing rapidly because those close to retirement will enjoy less support from pensions and face greater investment and labor market risk to finance their consumption needs at older ages. As a result, current workers report plans to retire later and continue working for pay in retirement, and recent data confirm their plans.

More effective retirement planning will require that workers prepare better, rather than try and turn the clock back to a level of retirement support that the US economy can no longer afford. Saving and consumption decisions must acknowledge the possibility of economic downturns and unemployment, volatility in investment returns, and the vulnerabilities implied by entering retirement with fixed debt obligations. Some simple rules of thumb may be helpful in this regard, including paying off the mortgage prior to retirement, having a year of disposable income in cash to navigate unanticipated unemployment, and defining a certain multiple of household income that should be saved to finance consumption spending, depending on one's planned retirement age. US workers have shown an ability to adapt through the Great Recession, so we anticipate that retirement preparedness is not an impossible goal.

Endnote

1. For more detail on the Retirement Confidence Survey, see the Employee Benefit Research Institute's website: <http://ebri.org/surveys/rcs>.

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