University of Michigan Retirement Research Center

Key Findings

2010 Working Papers

I. Current Economic Crisis

The Effects of the Economic Crisis on the Older Population *by Michael Hurd and Susann Rohwedder* WP 2010-231

Using longitudinal data from the Health and Retirement Study and its supplemental surveys, we find:

- Average spending declined during 2007–2009 by eight percentage points more than during 2001–2007 for people aged 50–64.
- The population age 65 and older made smaller downward adjustments to spending, suggesting it was on average less affected by the crisis.
- Workers in their fifties expect to work longer: in May 2009, workers estimated the chances of working past age 62 to be 62%, which is 4 percentage points higher than in 2008.
- However, those who stopped working since 2008 revised their chances of working past age 62 downward from 45% to 40%, expressing pessimism about future job opportunities.
- On average, people expect to reduce their future bequests by 20%, but the reductions are concentrated among the well-to-do.
- Negative home equity rose substantially among older homeowners with a mortgage from about 1.6% to 7%.
- Respondents are pessimistic about economic recovery in the near future.

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The Effects of the Financial Crisis on the Well-Being of Older Americans: Evidence from the Cognitive Economics Study *by Matthew D. Shapiro* WP 2010-228

This paper uses the Cognitive Economics Study (CogEcon) — a panel survey of older Americans fielded just before and just after the financial crisis of fall 2008 — to assess the effects of the financial crisis.

Changes in consumption provide a comprehensive measurement of the effect of the crisis.

- Having financial losses is strongly associated with a decline in consumption. For a household with financial assets and mean percent losses, these losses reduce consumption by about 0.3 percentage points.
- Having little or no financial wealth is, however, associated with even larger drops in consumption.

The credit crisis had severe effects on many older households.

- A substantial minority of households report financial distress. Housing-related financial distress is rare in this population. Being denied credit or making a late payment is more common. Financial distress is much more common among households with little or no financial wealth. They are five times more likely to report more than one indicator of financial distress than those with positive financial wealth.

Many older Americans plan to delay retirement in response to the financial crisis.

- Reductions in leisure — in the form of returning to work and postponing retirement — are also common responses to the financial crisis and go hand in hand with the decrease in consumption.

High cognition individuals suffered less in the crisis.

- Even after controlling for the fact that high cognition individuals have higher wealth and education than average, and that high cognition individuals hold relatively more of their assets in stock than average, high cognition individuals were relatively well insulated from the effect of the financial crisis.

I. Current Economic Crisis, cont'd

Mortgage Contract Decisions and Mortgage Distress: Family and Financial Life-Cycle Factors *by Frank Stafford and Elena Gouskova* WP 2010-225

- Housing cash flow burden as of 2007 is a strong predictor of subsequent mortgage distress.
- Aggressive refinancing of homes was greatest in selected urban markets.
- Many of the problem mortgages were adjustable rate and second mortgages, common in these markets.
- Mortgage holding of those 65 and older rose from 20 percent in the early 1990s to 30 percent in 2007.
- All life-cycle groups have experienced adverse outcomes, less so for those over 65.
- Mortgage difficulties are predictors of reduced overall life satisfaction.

II. Social Security Disability Insurance

How Common is "Parking" Among Social Security Disability Insurance (SSDI) Beneficiaries? Evidence from the 1999 Change in the Level of Substantial Gainful Activity (SGA) *by Jody Schimmel, David Stapleton and Jae Song* WP 2009-220

- We estimate that 0.2 to 0.4 percent of disability beneficiaries "parked" their earnings below the $700 "substantial gainful activity" cap during 2002–2006.
- Those who park keep earnings low in order to retain disability benefits.
- The fraction of beneficiaries who park earnings is large relative to the number of individuals whose benefits are suspended because of work in a typical month (0.5 percent) or terminated in a typical year (0.5 percent).

Reconciling Findings on the Employment Effect of Disability Insurance *by John Bound and Timothy A. Waidmann* WP 2010-239

- Over the last 25 years, the Social Security Disability Insurance Program (DI) has grown dramatically. During the same period of time, employment rates for men with work limitations showed substantial declines in both absolute and relative terms.
- While these trends coincide, we find that the decrease in employment among those with work limitations during the early 1990s can only be partly explained by the growth of DI.
- For the period after the mid-1990s, we find little role for the DI program in explaining the continuing employment decline for men with work limitations.

The Social Security Early Retirement Benefit as Safety Net *by John Bound and Timothy A. Waidmann* WP 2010-240

- We use Health and Retirement Study data to analyze the health and economic status of those who apply for early retirement benefits and find that 1 in 5 of early retirees match the characteristics of Disability Insurance recipients.
- The pattern of using early retirement benefits as a response to poor health is most evident for men and unmarried women. Married women who retire early appear to weigh other factors in that decision.
- Early Social Security benefits likely provide a safety net for those in poor health, who are either not in poor enough health to be eligible for disability benefits or who, for whatever reason, did not apply for them.
- If the early retirement age for Social Security were to increase without an alternative safety net in place, it seems likely that this group of early retirees who are least able to work would either attempt to qualify for DI or face substantial income losses.

Does Disability Insurance Receipt Discourage Work? Using Examiner Assignment to Estimate Causal Effects of SSDI Receipt *by Nicole Maestas, Kathleen Mullen and Alexander Strand* WP 2010-241

- We match SSDI applicants to disability examiners, and use systematic variation in allowance rates by disability examiner that is uncorrelated with individual applicants' severity in order to estimate the labor supply effects of SSDI.
- The labor force participation rate of the marginal entrant would be on average 21 percentage points greater in the absence of SSDI benefit receipt. The likelihood of engaging in substantial gainful activity as defined by the SSDI program would be on average 13 percentage points higher, and he or she would earn $1,600 to $2,600 more per year on average.
- The disincentive effect of SSDI on labor force participation varies, ranging from 10 percentage points for those with more severe impairments to 60 percentage points for entrants with less severe impairments.

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Protecting the Household Incomes of Older Workers with Significant Health-Related Work Limitations in an Era of Fiscal Responsibility *by Jody Schimmel and David Stapleton* WP 2010-244

We consider three work-support options to encourage and help workers keep working, perhaps with reduced hours or lower pay.

- An expanded earned income tax credit (EITC)
- An employment support allowance (ESA)
- A health insurance subsidy comparable to that specified in the Affordable Care Act (ACA)

Work-support options, on average, would cost less per capita than SSDI benefits, especially if the ACA health insurance subsidy is already in place. The cost of these options is lower once the cost of Medicare for SSDI beneficiaries is factored in. These options would reduce poverty among the families of qualified workers — by 80 percent under the most costly option.

The Labor Supply Effects of Disability Insurance: Evidence from Automatic Conversion Using Administrative Data *by Nicole Maestas and Jae Song* WP 2010-247

- Surprisingly, labor supply increases when the strict DI work rules are abruptly relaxed as DI beneficiaries age out of the program at their Full Retirement Age (FRA) and are automatically converted to the OA program
- The increase in labor supply is pronounced for DI beneficiaries with recent work activity, and is evident in terms of both labor force participation and earnings
- An increase in labor supply at FRA is evident for beneficiaries with recent work activity in the six largest impairment categories, and particularly those with musculoskeletal or mental disorders

III. Social Security System Reform

The Growth in Social Security Benefits Among the Retirement Age Population from Increases in the Cap on Covered Earnings *by Alan L. Gustman, Thomas L. Steinmeier and Nahid Tabatabai* WP 2010-227

- Using data from the Health and Retirement Study, we find for the cohort born from 1948 to 1953 that, compared to cohorts 12 and 24 years older respectively, benefits were increased by 1.5 percent and 3.7 percent due to real increases over time in the maximum level of covered earnings subject to payroll tax.
- Tax receipts were increased by 5.3 and 10.6 percent over those that would have been collected under the payroll tax ceilings that applied to the cohorts 12 and 24 years older, respectively.
- Comparing the changes in benefits and taxes, about 22 percent of the additional tax revenues created by the increase in the payroll tax cap between the Early Boomer cohort and those 12 years older is used to increase benefits.
- About 27 percent of the additional tax revenues created by the increase in the payroll tax cap between the Early Boomer cohort and those 24 years older is used to increase benefits.

Financial Capability in the United States: Consumer Decision-Making and the Role of Social Security *by Annamaria Lusardi* WP 2010-226

- Financial capability is low among the U.S. population.
- Financial literacy can be linked to retirement planning, making provisions against shocks, high-cost borrowing, and making ends meet.
- A quarter of the population who acknowledged receiving the Social Security statement has used it to make decisions about when to stop working or when to claim Social Security benefits.
- Some demographic groups, such as African-Americans, those hit by shocks and older Americans, are more likely to use the Social Security statement.

The Joint Labor Supply Decision of Married Couples and the Social Security Pension System *by Shinichi Nishiyama* WP 2010-229

- The overlapping-generations model that consists of heterogeneous married couples predicts that removing spousal and survivors benefits from the current OASI program would increase female market work hours by 4.3–4.9% and total output by 1.1–1.5% in the long run.
- If the increased tax revenue due to higher economic activity after the policy change was redistributed in a lump-sum manner, a phased-in cohort-by-cohort removal of spousal and survivors benefits would make all current and future age cohorts on average better off.

Participation and Contributions in Tax-deferred Retirement Accounts: Evidence from Social Security Records *by Marjorie Honig and Irena Dushi* WP 2009-219

- Participation in tax-deferred retirement plans increased substantially from 1984 to 2003 for participants in the Health and Retirement Study.
- Contributions relative to earnings were nearly identical (5.5 percent) among three cohorts over this period.
- Those with earnings under than the median contributed less than $2,000 a year, while those in the highest income quartile tripled contributions from $2,000 to $6,000.
- Early Baby Boomers contributed less than their peers in the War Babies cohort, but more than their peers in the original HRS cohort.

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IV. Life-Cycle Model: Accumulation Phase

Borrowing from Yourself: The Determinants of 401(k) Loan Patterns *by Timothy Jun Lu and Olivia S. Mitchell* WP 2010-221

- People not only use 401(k) plans to save for retirement, but also draw on plan loans to make ends meet.
- People who are liquidity-constrained are more likely to take plan loans, while the better-off take larger loans when they do borrow.
- When a plan permits participants to take more loans, this boosts the probability of plan borrowing and loan size, whereas loan interest rates have only a small impact on participant behavior.
- Middle-aged people are more likely to take larger loans than those who are younger or older.

How Financial Literacy and Impatience Shape Retirement Wealth and Investment Behaviors *by Justine Hastings and Olivia S. Mitchell* WP 2010-233

- In a nationally representative survey of Chileans in 2009, we find that those with more patience in investing and a greater ability to follow through on plans are much more likely to have higher retirement savings and invest in their health.
- Those who are more financially literate also tend to have more retirement savings.
- Those with less financial literacy and less education are more sensitive to how information about investment fee funds is framed.
- People are more responsive to rewards versus losses when calculating fund fees and selecting plan types.

Occupational Learning, Financial Knowledge, and the Accumulation of Retirement Wealth *by Brooke Helppie, Kandice Kapinos and Robert J. Willis* WP 2010-237

- Using data from the Cognitive Economics Study, we find strong patterns of greater financial knowledge, as measured by financial literacy scores, for individuals who sort into occupations with at least some exposure to financial and investment content.
- We also find some suggestive evidence, which is stronger with the HRS data, that this occupational spillover (of financial concepts to one's financial knowledge) may translate into greater wealth accumulation.
- The policy implication is that individuals do seem to benefit from greater financial literacy.

Financial Knowledge and Financial Literacy at the Household Level *by Alan L. Gustman, Thomas L. Steinmeier and Nahid Tabatabai* WP 2010-223

- The more valuable the pension, the more knowledgeable are covered workers about their pensions. We argue that causality is more likely to run from pension wealth to pension knowledge than the other way around.
- Most measures of cognitive ability, including numeracy, are not significant determinants of pension and Social Security knowledge.
- Standardizing for incomes and other factors, a pension of higher value does not substitute for other forms of wealth. Counting pensions in total wealth, those with more valuable pensions save more for retirement, ceteris paribus.
- There is no evidence that wealth held outside of pensions is related to knowledge of pensions.
- Our findings raise questions about the avenues through which cognition and numeracy increase retirement wealth. Numeracy does not influence wealth in whole or in part by affecting financial knowledge of one's pension plan, where financial knowledge of the pension then influences other decisions about retirement saving.
- Accordingly, our analysis raises questions about whether the apparently robust numeracy-wealth relation provides a justification for designing policies that are aimed at increasing retirement saving by increasing numeracy or financial literacy.

Personality, Lifetime Earnings, and Retirement Wealth *by Angela Lee Duckworth and David Weir* WP 2010-235

- More conscientious and emotionally stable adults have higher lifetime earnings.
- Conscientiousness is comparable to cognitive abilities (processing speed and numerical ability) in the size of its relationship to lifetime earnings.
- Conscientiousness and emotional stability interact such that the effects of conscientiousness on lifetime earnings are greater among less emotionally stable adults.
- In couples, the conscientiousness of husbands and of wives has equal positive effects on wealth.

V. Life-Cycle Model: Family Line Networks

Intergenerational Transfers in the Health and Retirement Study Data *by John P. Laitner and Amanda Sonnega* WP 2010-238

- We analyze data from the Health and Retirement Study (HRS) on private intergenerational transfers between parents and children to assess the magnitude of such transfers and the possible motives behind them.
- We find that a household's financial respondent often seems to understate transfers from his or her in-laws. Thus, overall inheritances are substantially understated.
- About 30–40 percent of households eventually inherit.
- Inheritances are a mixture of intentional and accidental bequests, with the latter twice as prevalent.

Geographic Dispersion and the Well-Being of the Elderly *by Suzanne M. Bianchi, Kathleen McGarry and Judith A. Seltzer* WP 2010-234

The majority of care for the frail elderly is provided by family members. We describe proximity and co-residence of adult children and their mothers as a backdrop for understanding the availability of potential caregivers.

- Co-residence of adult children and widowed or divorced mothers is significantly more likely among Hispanics and non-Hispanic Blacks than among non-Hispanic Whites.
- Co-residence is less likely for married adult children, children who are themselves parents, and the highly educated.
- Adult children who live with a widowed or divorced mother are less likely to be employed full-time than adult children who live on their own.
- About one half of adult children and their mothers live more than 10 miles apart and do not move closer to each other over a two-year period. A little less than one quarter live within 10 miles of each other, and 8 percent share a household.
- Among the 17 percent of mother-child pairs whose proximity changes in a two-year period, about half of the changes bring the mother and adult child geographically closer to each other and half farther apart.

The Effects of Medicaid and Medicare Reforms on the Elderly's Savings and Medical Expenditures *by Mariacristina De Nardi, Eric French and John Bailey Jones* WP 2010-236

- We create a model to analyze the effects of recent changes in Medicaid and Medicare on out-of-pocket and total medical expenditures, and savings for retired single people.
- Households in the lower income quintiles are much more likely to receive Medicaid transfers, but the transfers that they receive are on average relatively small.
- Households in the higher income quintiles are much less likely to receive any Medicaid pay-outs, but when they do, these pay-outs are often very big and correspond to severe and expensive medical conditions.
- Reforms to make Medicaid more generous reduce the elderly's savings at all income levels, including the highest.
- Reforms that reduce Medicare copays that elderly people incur when consuming medical goods and services benefit higher income people more than poorer ones, because the poor are already well-insured by Medicaid.

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VI. Life-Cycle Model: Well-Being in Retirement

The Effect of the Risk of Out-of-Pocket Spending for Health Care on Economic Preparation for Retirement *by Michael Hurd and Susann Rohwedder* WP 2010-232

In prior work, we developed a framework to analyze economic preparation for retirement, taking into account the risk of living to an advanced old age and the concomitant risk of running out of resources. We augment our previous model to account for the risk of out-of-pocket spending for health care and find:

- The risk of out-of-pocket health care spending reduces economic preparation for retirement from about 72% of persons aged 65–69 to about 63%.
- However, the effects of taking into account health-related out-of-pocket expenditure risk differ sharply across the population.
- For example, among singles it reduces the fraction with adequate economic retirement resources disproportionately (from 57% to 44%). Among single women who did not graduate from high school, the percentage adequately prepared declines from 33% to 15%.
- The results suggest a role for better insurance: with perfect insurance, out-of-pocket spending would be at the mean level of our baseline simulations, resulting in an increase of about nine percentage points of persons adequately economically prepared for retirement.

Health and Wealth in a Life-Cycle Model *by John Karl Scholz and Ananth Seshadri* WP 2010-224

- We develop an economic model that allows us to examine the effects of hypothetical policy changes to social insurance on longevity. Our model assumes that households possess health stock and that investments in health stock prolong life.
- Our model is tested using real-life data. We find that it matches the distribution of wealth, total medical expenditures, and survival patterns of respondents in the Health and Retirement Study.
- Since most accumulation of health capital and wealth occurs well before retirement, and health status is largely fixed by age 60–65, we find minimal effects of repeal of Medicare on the health and wealth of the elderly in the short run. In the long run, however, we find Medicare repeal would have a large effect on survival probabilities, particularly in the lowest lifetime income quartile.

Cognitive Ability and Retiree Health Care Expenditure *by Hanming Fang, Lauren Nicholas and Daniel Silverman* WP 2010-230

- Those with less cognitive ability spend more on health care because they are in worse health.
- Using Health and Retirement Study records linked to Medicare data, we find no evidence that those with lower cognitive ability are differentially receiving unnecessary procedures or care.
- Much, but not all, of the relationship between cognitive function and health expenditure can be explained by observable health conditions, such as chronic conditions, physical limitations, and self-reported health.

Post-Retirement Adjustments in Defined-Benefit Pensions *by Charles Brown* WP 2010-242

- While annual inflation rates have been relatively low since 1992, those receiving fixed monthly pensions would have experienced a one-third reduction in the value of their pension benefits over this period.
- Annual increases in pension benefits reported by HRS respondents between 1994 and 2008 amount to about one third of the increase in the Consumer Price Index.
- The increases are concentrated among respondents who report that their benefits are adjusted for inflation.
- They are larger for workers in public administration than in other industries.

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About the MRRC

The MRRC promotes high quality research on retirement and Social Security policy; communicates findings to the policy community and the public; enhances access to relevant research data; and helps to train new scholars. MRRC serves the public and policy community as an authoritative source of information on a range of issues related to retirement income security.

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