University of Michigan Retirement Research Center

RESEARCH BRIEF

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Saving Shortfalls and Delayed Retirement

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Many older Americans have not saved enough to maintain their working life living standard in old age. We find evidence that, among singles, larger shortfalls do produce delayed retirement, though the effect is not large. For married couples, pre-retirement wealth shortfalls do not appear to delay retirement. Evidently couples have other means of handling saving shortfalls.

Much has been written in the economics literature about the determinants of household wealth accumulation, particularly regarding the question of whether households save adequately for their retirement. In this study, we measure and link the extent of retirement shortfalls to the decision to delay retirement. In particular, we ask whether older households which appear to lack the wealth to retire at a given age actually extend their working lives, so as to more readily pay for an adequate retirement income. Evidence on retirement wealth adequacy is of particular interest given the rapidly aging workforce and the expectation that Social Security faces financial insolvency.

We examine evidence on this matter using the Health and Retirement Study (HRS), a nationally representative panel survey of people age 51-61 in 1992 followed for several years in a panel. We use the data to project household retirement assets and to determine how much more saving would be needed to preserve post-retirement consumption levels. Our research then examines the links between derived saving shortfall measures and delayed retirement patterns. Among nonmarried persons, there is evidence that larger shortfalls do produce delayed retirement, though the effect is not quantitatively large. For married couples, pre-retirement wealth shortfalls do not appear to be significantly associated with delayed retirement. Evidently couples have other means of handling saving shortfalls.

Possible Responses to Retirement Shortfalls

We posit that a household could respond to prospective retirement saving shortfalls in several ways. For example, imagine that a worker planned to retire at age 62, but sometime in his 50's, he determined that he had not saved enough to provide for a smooth consumption path in retirement. One response might be to stick with the target retirement age but save more, a strategy that would require consumption cuts and increased work effort. Another response might be for the older worker to plan on cutting post-retirement consumption. Yet a third possibility might be to work longer, and indeed most people retiring at age 62 are apparently in good enough health to do so. Further, the results from Mitchell and Moore suggest that delaying retirement can substantially reduce the savings shortfalls.

We relate projected retirement savings shortfalls to observed retirement behavior in the HRS, to evaluate their association. We begin by assessing the claim that Americans undersave for retirement by examining the HRS, which contains exceptionally complete information on household wealth linked to administrative records on earnings and benefits from Social Security, including information on financial wealth, net home equity, and retirement pension wealth. With these data, we project and evaluate household retirement wealth, which we then compare to the level of retirement assets needed to smooth real consumption levels over the retirement period. We use this information to calculate the additional amount of annual earnings that would have to be saved to achieve consumption smoothing by the age of retirement. Finally we relate these shortfall measures to the probability of working at ages 62 and 65.

Findings

- The median older US household will be unable to maintain levels of pre-retirement consumption into retirement without additional saving, though delaying retirement by only three years would cut the saving burden by roughly half.

- Saving shortfalls are distributed unevenly across the older population, such that those with the highest earnings categories are also those with the largest shortfalls.

- Nonmarried households who face substantial saving shortfalls do tend to work somewhat longer.

- Among married couples, we find no relationship between shortfalls and work. One reason for the difference in results for the married and nonmarried samples may be that two earners can each work a bit longer, or consume a bit less, whereas nonmarried persons must bear the burden of the entire shortfall alone.

Conclusion

Though the current literature is, to some degree, divided on the extent of saving adequacy among near-retirees, our results suggest that individuals do respond rationally to saving shortfalls by extending their work lives and reducing the period they will spend in retirement. Future research can take into account differences in respondent knowledge regarding their anticipated retirement benefits.

About the Researchers

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About the MRRC

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