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Cohort Changes in Social Security Benefits and Pension Wealth

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The Health and Retirement Study (HRS) creates the potential to follow changes in retirement preparation through the introduction of new cohorts every six years. Along with private savings, Social Security and pension wealth form the famous "three-legged stool" of retirement security. Unlike private savings, however, Social Security and pension wealth cannot generally be measured well simply by asking people. For this reason the HRS has, from its beginnings in 1992, sought to obtain administrative records from the Social Security Administration (SSA) and pension plan descriptions from employers.

The 2010 HRS cohort also included an expansion of the minority sample. This 2010 group coincides with the recent availability of pension plan descriptions, improving the linkage over what was available in previous cohorts. The newly available information improves the respondent-plan linkage from what was available in previous waves and reduces the need for imputation. This allows us to better understand the financial preparedness for retirement among the Americans in the middle of the baby boom.

We show that, holding individual and job characteristics constant, there is substantial variation in plan wealth across and within sectors. Not counting contributions, public sector plans tend to yield larger wealth; among private sector plans, frozen plans and those taken over by the Pension Benefit Guaranty Corporation (PBGC) had lower level of benefits compared to the others. Hence, the newly available plan documents improve the quality of data in three dimensions: They reduce the need for imputation, they capture and preserve the variation in plan generosity, and they allow us to identify wealth in plans not reported by respondents in the HRS survey.

Nevertheless, even with these linkages, estimates of wealth must rely on some respondent-reported information, must use methods of projection, and must conduct imputations for households not successfully linked. We use these new data sources to measure pension and Social Security wealth, and to conduct sensitivity analyses of cohort changes and racial disparities to key assumptions used in their construction.

This paper answers three questions. First, how do the newly available sources of data enrich our understanding

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about the pension wealth held by HRS respondents and improve our assessment of retirement wealth? Second, how does the improved data inform about the financial preparedness for retirement among Americans from the middle of the baby boom? Third, how much does the estimation of retirement wealth depend on the assumption about earnings projection?

Among our major findings are:

- The near-elderly population in the most recent cohort is not as financially prepared for retirement as their peers in earlier cohorts. In relative terms, retirement wealth does not grow as fast as lifetime earnings; in absolute terms, retirement wealth declines among men and minorities since the turn of the century.

- There has been a stable shift from defined benefit (DB) plans to nonannuitized retirement wealth such as defined contributions (DC) or individual retirement accounts (IRA). The increase in DC and IRA was not enough to make up the loss in DB, which was reflected in the decline in retirement wealth. As a result, the proportion of Social Security benefits in total retirement wealth was increasing, especially among minorities.

- The HRS used different earnings projection methods to produce Social Security and pension wealth estimates. The earnings projection in Social Security wealth estimation requires administrative data linkage, but performs reasonably well for those who stay in the same job in 2010. The earnings projection in pension wealth does not require data linkage and is easier to implement, but pension wealth estimates in 2004 were affected by larger errors in earnings projection for the same group of respondents.

Our findings have implications for both policymakers and researchers. For policymakers, the increasing role of Social Security benefits in the retirement wealth of the near-elderly Americans underscores the importance of the Social Security system's solvency. To the extent that increase in DC and IRA wealth does not offset the decline in DB wealth, reducing Social Security benefits may have significant consequences on those at the lower end of earnings distribution. For researchers, the choice of earnings projection method depends on the context of research question and analytic strategy. There does not seem to be one, single best solution that fits all cases, and the decision has to be made on the trade-off of pros and cons among methods.

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