

Key Findings

*2009 Working
Papers*

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I. Social Security and Public Programs

Income, Material Hardship, and the Use of Public Programs among the Elderly. *Helen Levy.*

WP 2009-208.

- ▶ In 2006, ten percent of the elderly over 65 cut back on medications or food because of their cost.
- ▶ Three-quarters of elderly who cut back on food or medications are not considered poor and do not receive public assistance.
- ▶ Seniors who report poor health or more limitations on physical activity are much more likely to cut back on food or medications.

What Replacement Rates Should Households Use? *John Karl Scholz and Ananth Seshadri.*

WP 2009-214.

- ▶ Common financial planning advice calls for households to ensure that retirement income fall between 70 and 85 percent of pre-retirement income in order to maintain pre-retirement living standards.
- ▶ However, the common rules of thumb do not consider important factors that impact lifetime earnings and consumption, such as marital status, level of education, race, and number of children.
- ▶ We find that 48 percent of married couples have an optimal replacement rate of less than 65 percent of pre-retirement income.

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II. Macroeconomic Analysis of Social Security

Buffering Shocks to Well-Being Late in Life.

Matthew D. Shapiro.

WP 2009-211.

- ▶ Consumption by older Americans is fairly well-insulated from poor health or losing a spouse.
- ▶ Consumption falls 25 to 30 percent upon being widowed, dropping to the level of what a single individual consumes.
- ▶ Women and men experience similar declines in consumption following the loss of a spouse, yet women's income falls more than men's.
- ▶ Having an additional chronic diagnosis has no direct effect on the level of non-medical spending, even though it leads to a substantial increase in out-of-pocket medical expenses.
- ▶ However, self-reported poor health depresses non-medical spending noticeably, because poor health reduces the desire to spend.

Marking Social Security's Open Group Liability to Market. *Paul Anton Koehler and Laurence J. Kotlikoff.*

WP 2009-217.

- ▶ We find that the market value of Social Security's open group liability may be many times larger than the \$15.1 trillion stated in the Trustees' 2009 Report.
- ▶ The open group liability refers to what it will cost to keep the system operating as is indefinitely.
- ▶ We treat the growth rates of benefits and contributions as returns from a hypothetical security.
- ▶ We achieve mixed results—some show the unfunded liability to be much larger than the Trustees' Report, while some scenarios feature positive numbers.

Retirement in a Life-Cycle Model of Labor Supply with Home Production. *Richard Rogerson and Johanna Wallenius.*

Johanna Wallenius.

WP 2009-205.

- ▶ Existing models of retirement imply large labor supply responses to changes in the design of social security, but are not consistent with existing data on labor supply and wages.
- ▶ Home production time increases by only a small amount at retirement.
- ▶ We show that changes in home production time at retirement are important in assessing theories of retirement.

The Level and Risk of Out-of-Pocket Health Care Spending. *Michael Hurd and Susann Rohwedder.*

WP 2009-218.

- ▶ Health and Retirement Study data from 2004 and earlier overstates the average and the range in out-of-pocket spending on health care when compared to other studies.
- ▶ Very large out-of-pocket spending occurs less often than what is reported in the HRS.
- ▶ Much of the overestimation is due to how spending on prescription drugs is measured.

Social Security Literacy and Retirement Well-Being.

Hugo A. Benítez-Silva, Berna Demiralp and Zhen Liu.

WP 2009-210.

- ▶ Lack of basic knowledge about rules for obtaining Social Security benefits is widespread.
- ▶ Younger people are less informed than older people, however, only 70 percent of individuals aged 55 to 64 are aware of the minimum retirement age.
- ▶ Individuals who are reinterviewed show a large increase in knowledge about Social Security.
- ▶ Awareness could be increased by targeting messages pertinent to individuals based on their age or income.

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III. Wealth, Well-Being and Retirement

Extending Life-Cycle Models of Optimal Portfolio Choice: Integrating Flexible Work, Endogenous Retirement, and Investment Decisions with Lifetime Payouts. *Jing Jing Chai, Wolfram J. Horneff, Raimond H. Maurer and Olivia S. Mitchell.*

WP 2009-204.

- ▶ Access to annuities is important in the life-cycle context, as is labor market flexibility in the form of adjustable weekly work hours and retirement ages.
- ▶ People with flexible retirement and flexible work hours, in addition to annuitized saving, are better off. Their gain in well-being is worth more than 62 percent of their first-year earnings.
- ▶ As Baby Boomers move towards retirement, traditional fixed-payout annuities will gradually be replaced by investment-linked payout annuities.

How Do Pension Changes Affect Retirement Preparedness? The Trend to Defined Contribution Plans and the Vulnerability of the Retirement Age Population to the Stock Market Decline of 2008–2009. *Alan L. Gustman, Thomas L. Steinmeier and Nahid Tabatabai.*

WP 2009-206.

- ▶ The average person in their mid fifties is not likely to suffer a life changing financial loss from the stock market downturn of 2008–2009.
- ▶ Almost two-thirds of their pension wealth was held in defined-benefit plans (with only 15 percent invested in stocks) and one-quarter of pension wealth consisted of future Social Security benefits.
- ▶ If workers postpone retirement due to their stock market losses in 2008–2009, we estimate that 9 percent will delay retirement by 1–2 years, but the average person will delay it for only a few months.
- ▶ However, increases in the number of job losses may force some people to retire sooner than planned, which may result in more earlier retirements overall.

Mortality Contingent Claims: Impact of Capital Market, Income, and Interest Rate Risk. *Wolfram J. Horneff and Raimond H. Maurer.*

WP 2009-222.

- ▶ We explore how an investor can accumulate wealth and manage her assets effectively to meet the consumption and bequest liabilities that arise during her lifetime using pension annuities and life insurance policies with guaranteed payouts.
- ▶ We find a substantial impact of financial wealth with respect to the demand for life insurance policies, but we discover a considerably small influence of the short rate on the demand for life insurance if we reasonably calibrate our asset and income model.
- ▶ We find an analytical solution for the optimal demand for life insurance and pension annuities in the complete market case in which human capital is exactly priced, and derive numerical insight into a realistically calibrated case when uncertain income is unspanned.

The Displacement Effect of Public Pensions on the Accumulation of Financial Assets. *Michael Hurd, Pierre-Carl Michaud and Susann Rohwedder.*

WP 2009-212.

- ▶ The generosity of public pension systems affects both private saving rates and the timing of retirement.
- ▶ Our study of 12 countries shows that generous public pensions depress lifetime asset accumulation.
- ▶ For every dollar of pension wealth, financial assets are reduced by 23 to 44 cents.
- ▶ Higher public pensions also induce earlier retirement.
- ▶ Retirement comes one month earlier for every \$10,000 of pension wealth.

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IV. Financial Literacy

Financial Literacy among the Young. *Annamaria Lusardi, Olivia S. Mitchell and Vilsa Curto.*
WP 2008-191.

- ▶ Almost three-quarters of adults in their twenties lack basic financial literacy about calculating interest, inflation, and diversifying stocks.
- ▶ Financial literacy varies by demographic group and family background.
- ▶ Financial literacy programs should be targeted to those groups most lacking in financial knowledge.

How Much Do Respondents in the Health and Retirement Study Know About Their Tax-deferred Contribution Plans? A Cross-cohort Comparison. *Irena Dushi and Marjorie Honig.*
WP 2008-201.

- ▶ As employer-provided defined benefit pensions are replaced by voluntary contribution plans, it is increasingly important that employees understand the link between their annual contribution decisions and their post-retirement wealth.
- ▶ Health and Retirement Study respondents in 2004 were more knowledgeable about whether they were included in defined contribution pension plans than respondents in 1992.
- ▶ However, both groups of respondents were uncertain about whether they had actually contributed to their plans and overestimated their contributions.

The Efficiency of Pension Menus and Individual Portfolio Choice in 401(k) Pensions. *Ning Tang, Olivia S. Mitchell, Gary R. Mottola and Stephen P. Utkus.*

WP 2009-203.

- ▶ Most 401(k) plans offer efficient investment menus, measured by plan performance and diversification, when compared to market benchmarks.
- ▶ 401(k) plan participants had higher return losses and assumed greater risks than if they had used a naive allocation strategy.
- ▶ Poor investment decisions accounted for over three-quarters of the total losses sustained in the average portfolio.

Financial Literacy and Financial Sophistication in the Older Population: Evidence from the 2008 HRS. *Annamaria Lusardi, Olivia S. Mitchell and Vilsa Curto.*

WP 2009-216.

- ▶ Americans over age 55 lack a basic understanding of the stock market, risk diversification, portfolio choices, and investment fees.
- ▶ Lack of financial literacy is more evident among women, minorities, and those with less education and income.
- ▶ Americans would benefit from financial education programs targeted to their needs.

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V. International Research

Social Security Rules and Labor Force Participation of Older Workers: Evidence from Chile. *Alejandra Cox Edwards and Estelle James.*

Alejandra Cox Edwards and Estelle James.

WP 2008-202.

- ▶ Prior to its 1981 social security reform, Chile had early withdrawal from the labor force comparable to that of many European countries.
- ▶ Chile's 1981 reform increased labor force participation among older workers, especially pensioners and women, and postponed the age of pensioning.
- ▶ Reform included restrictions on early pensions, adoption of a defined-contribution plan, pensioner exemption from the payroll tax, and widows retained their pensions along with the survivor benefit.

Work Disability, Work, and Justification Bias in Europe and the U.S. *Arie Kapteyn, James P. Smith and Arthur van Soest.*

WP 2009-207.

- ▶ American workers are more likely to suffer from chronic conditions than their European counterparts.
- ▶ Overall, Americans are less likely to see themselves as work disabled than Europeans.
- ▶ However, to justify not working, nonworking Americans tend to classify health problems as more serious work limitations than do those who are working.
- ▶ In contrast, Europeans classify the work limitations of health problems the same regardless of whether they are working or nonworking.

Investor Behavior and Fund Performance under a Privatized Retirement Accounts System:

Evidence from Chile. *Elena Krasnokutskaya and Petra Todd.*

WP 2009-209.

- ▶ Low participation in the Chilean pension system, which is mandatory only for full-time workers in the formal sector, is due in part to the large informal sector of the economy.
- ▶ Regulation requiring that pension fund administrators deliver a return within 2 percent of the industry average encourages more risk taking than if portfolio risk were regulated.
- ▶ Fewer people participate in the pension plan because of the risk taking by pension firms.
- ▶ Older and younger individuals are more risk averse.

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VI. Demographic Research

Gain and Loss: Marriage and Wealth Changes Over Time. *Julie Zissimopoulos.*

WP 2009-213.

- ▶ Married people over age 50 save more out of their lifetime earnings than remarried, divorced, widowed or partnered individuals.
- ▶ Individuals who divorce experience a loss of wealth two to four years before the divorce and during the divorce, and they experience wealth recovery from increased savings after the divorce.
- ▶ Changes in wealth at older ages are similar for married couples and single men who do not change marital status, but divorced and widowed women save less.
- ▶ Divorced individuals who remarry accumulate wealth at higher rates than those who remain divorced.

Proximity and Coresidence of Adult Children and their Parents: Description and Correlates. *Janice Compton and Robert A. Pollak.*

WP 2009-215.

- ▶ While intergenerational coresidence has been declining in the United States, most Americans live within 25 miles of their mothers.
- ▶ Individuals are less likely to live near their mothers if they have a college degree.
- ▶ Adult women are more likely to live with their mother if she is older, in poor health, and unmarried.
- ▶ Black Americans are more likely than whites to live near or to live with their mothers.
- ▶ Hispanic Americans are no more likely to live close to their mothers than whites, but are twice as likely to live with their mothers.

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The Michigan Retirement Research Center is supported by a cooperative agreement with the Social Security Administration (10-M-98362-5-02).

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