

RECESSION ON THE EVE *of Retirement*

Losses from the recession will cause some boomers to delay retirement, but many others will actually rush into it

BY RENEE HALTOM

The United States is home to roughly 78 million baby boomers, the generation born between 1946 and 1964. That's almost as many as the populations of California, Texas, and New York combined. Over the next two decades, this massive group will transition into retirement and draw upon the wealth its members accumulated over their working lives.

From that perspective, the boomers were hit with the 2007-2009 recession at arguably the worst possible point. Unlike younger workers, people close to retirement have fewer working years left in which to recoup wealth and income losses. And unlike the already-retired, many were afflicted by job loss and income stagnation in addition to damaged assets.

"I think their retirement plans and expectations are completely clouded with concerns and fears," says Cathy Weatherford, president of the Insured Retirement Institute, a nonprofit sponsored by the annuity industry that provides research and financial education targeted at the older segment of the population. "Over half of the people we talked to said they would be working for income in retirement. So maybe we're going to have to rename retirement."

Indeed, a big dose of pessimism about retirement prospects set in as soon as the economy turned sour. The fraction of 51- to 61-year-olds who said they expected to work past age 65 jumped from 38.6 percent to 46.4 percent in nine months during the recession. It took nine *years* for actual labor force participation to rise that much during the 2000s, according to a 2010 study by Michael Hurd and Susann Rohwedder for the Retirement Research Center at the University of Michigan. News media coverage has reinforced that pessimism, painting a dire picture of the fate of today's near-retirees.

On the surface, this pessimistic view makes sense. People within 10 years of full retirement age are more likely to own houses and financial assets than the population as a whole, so casual observers have understandably assumed that the problems in those markets would wreak havoc on their retirement assets. This view also matches perfectly with the principles that economists have long believed govern

people's saving and investing behavior as they approach retirement. The "lifecycle hypothesis" suggests that people will borrow at certain points in life and save at others in order to enjoy relatively "smooth" consumption overall. A major hit to wealth — such as the \$16 trillion decline in net worth that U.S. households and nonprofits experienced in just two years, according to Fed data — should drive older people to work longer in order to shore up income, savings, and ultimately consumption over the remainder of their lives.

But there are reasons we can expect the Great Recession to have a less severe effect on the average retirement age. Competing influences make for a complex picture of what the recession has done to the retirement prospects of the baby boom generation. While the number of near-retirees who expect to work past age 65 has gone up since the recession, quite a few boomers are somewhat insulated from housing-market and stock-market losses, and job loss has actually led some of them to retire earlier. Thus, for many boomers, their post-65 years may not track the postwar dream of stopping work altogether — hitting the golf course or the beach — but neither are they likely to face a reversion to the experiences of people from still earlier generations, who worked full-time for most of their expected lifespan. Instead, they may well create a new synthesis of the two prior retirement models, one that includes continued participation in the labor force, but less intensely than during their prime working years, combined with more leisure.

Measuring Loss

Boomers weren't as exposed to market swings as is widely assumed. More than half of the average boomer's wealth is held in Social Security and defined-benefit retirement plans (traditional pensions), assets that are virtually recession-proof. Using data from the Fed's Survey of Consumer Finances (SCF), Alicia Munnell, Francesca Golub-Sass, and Dan Muldoon at Boston College's Center for Retirement Research calculated that the average wealth of households approaching retirement was \$676,500 in 2007. About 44 percent of that was held in Social Security and 18 percent in defined-benefit pensions.

A smaller share of wealth was held in categories vulnerable to market swings: 20 percent in housing, and 11 percent in 401(k)s, IRAs, and other financial assets. (Economists argue that the country's massive shift away from defined-benefit plans and into defined-contribution plans since the early 1980s was gradual and recent enough to have limited the exposure of today's near-retirees.) A few smaller categories comprised the rest.

That's one reason the boomers' wealth losses appear small on average. An October 2011 study by Alan Gustman and Nahid Tabatabai at Dartmouth College, and Thomas Steinmeier at Texas Tech University provides an estimate of actual wealth losses from the Health and Retirement Study (HRS), a periodic survey sponsored by the National Institute on Aging. It sampled the same households in both

2006 and 2010 — that is, both before and after the financial crisis and recession. For the average household of “early boomers,” the cohort aged 58 to 63 in 2011, wealth fell by 2.8 percentage points in the four-year period. The researchers judge that to be modest based on the experience of previous generations at the same point in life. (Older cohorts gained 5.4 percentage points in wealth on average, but that was due partly to the housing boom. Thus, more “normal” economic conditions would produce a slight increase in wealth, in the researchers’ view, making the 2.8 percentage-point loss seem relatively modest.)

There’s another key reason average losses appear small: Gains for some groups cancel out losses for others, reflecting the wide divergence in what baby boomers experienced in the recession. The HRS sample was split almost 50/50 on whether households experienced a net gain or a net loss.

Those groups tend to divide by income. The greatest losses — both absolutely and in percentage terms — are concentrated among the wealthy, who tend to hold a greater proportion of wealth in assets that are vulnerable to recessions. In the HRS sample, four out of 10 early boomer households in the lowest 10 percent of wealth experienced some kind of wealth loss, whereas seven out of 10 in the wealthiest 10 percent reported it. The latter group was more than twice as likely to have lost more than half their wealth. The relatively poor, on the other hand, are less likely to own stocks, bonds, a home, or a pension — Social Security comprised almost 80 percent of wealth for the bottom quarter in the HRS sample. They lost just 1 percent of wealth on average.

While difficult to see in the data, there naturally are disparities even among households with similar wealth standings based on how they reacted to the market’s initial losses. Ric Edelman, chairman and CEO of Edelman Financial Services, a financial planning firm based in Fairfax, Va., that serves 15,000 clients, says that people who maintained their behavior through the financial market turmoil — stayed in the market and kept up retirement plan contributions — are the ones who emerged on the other side in better shape than they were in before it. Those who failed to do so tended to be those who lost their jobs or panicked and pulled out of the market when prices were low, missing the recovery that the market has experienced since.

Timing is Everything

The recent recession was a big one, its depth and breadth unmatched since before many baby boomers’ parents were born. But in some ways, its timing worked out favorably for boomers.

Housing is where many of their losses were concentrated. Roughly 80 percent of people within 10 years of retirement age own homes, according to the Census Bureau, compared to 67 percent for the nation as a whole. A potential saving grace, however, is that older people tend to be in a better position to withstand house price declines than younger people. They tend to be better diversified and have less

mortgage debt than younger households, which makes them less likely to be under water on a mortgage. Less than 5 percent of early boomers owe more on their homes than they’re worth, according to the HRS data analyzed by Gustman, Tabatabai, and Steinmeier. The number is many multiples of that for the nation as a whole.

There’s also a somewhat surprising observation to consider: People don’t rely on housing wealth for retirement consumption, contrary to what the lifecycle hypothesis would seem to imply. Instead, they tend to regard home equity as a rainy day fund earmarked for unexpected health expenses, late-life care, or bequests. This result comes from research by Steven Venti at Dartmouth and David Wise at Harvard University.

Perhaps the most important aspect of the housing market’s timing is that “it fed the boomers on the way up,” says Chip Case, a professor emeritus at Wellesley College, known for his research on the housing boom and bust with Yale University economist Robert Shiller. “If you got into the market before 2000, you’ve got a lot of equity,” he says. Even with housing losses, he argues that this equity has left boomers with plenty of flexibility now to take their next step in life: buffering themselves from financial losses, trading down into a smaller house, or moving into a rental or a nursing home. But if what Venti and Wise found holds true, then those steps won’t be necessary for a little while. Their work, and research that has followed, found that households tend not to exit homeownership unless a spouse dies or is moved into a nursing home, and even in those cases it’s rare until much later in life.

A similar argument can be made for equities. More recent research by Venti, Wise, and James Poterba at the Massachusetts Institute of Technology found a similar pattern for financial assets: Withdrawal rates in personal retirement accounts are low until age 70 1/2, when required minimum distributions tend to kick in, and even then withdrawals stay fairly low until age 85. The point is that many households close to retirement may have some years before they’re likely to realize market losses. With luck, markets will recover further in that period.

Is it Unemployment or Retirement?

Wealth losses and the extremely weak labor market have imposed competing forces on people close to retirement. Both could be expected to drive retirement behavior, but in opposite directions, and it’s not obvious which effect should

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be most visible at the aggregate level: Unemployment affects a relatively small group in a pretty severe way, while market losses are smaller in magnitude but hit a broader segment of the population.

According to Courtney Coile and Phillip Levine at Wellesley, the effect of the weak labor market will be greater this time around. In an October 2009 study, they predicted 50 percent more early retirements following the Great Recession as a result of the weak labor market than delayed retirements as a result of wealth losses. If their findings were updated to include the stock market's more recent gains, the number would stack up even more heavily in favor of increased retirements today, Coile says.

Coile and Levine used a separate study to put financial market losses in perspective: 75 percent of the households in a sample of near-retirees from the 2007 SCF held less than \$100,000 in equities. But for a household actually holding \$100,000 in stocks, a market decline of a full 50 percent would amount to just \$208 less in monthly retirement income, they estimate. That isn't nothing, they argue, but it's probably not enough to determine when someone will retire. Coile emphasizes that there certainly were people who lost serious sums in the market and were forced to put off retirement — just not on the scale that press reports have implied. “There has been a little bit too much energy in the media relative to the size of the problem,” she says.

By comparison, “the unemployment rate is a really underappreciated force,” she says. The labor market has been particularly unkind to older workers, who used to be less likely to lose their jobs, but have lost some of that edge in part because job tenure is a fading phenomenon in the workplace. They've had much more trouble finding reemployment than younger workers in this recession. Roughly 8 percent of jobless workers under 35 have been out of work for 99 weeks, but 16.3 percent of jobless workers over 45 have been out of work that long, according to a September 2011 analysis by Gerald Mayer at the Congressional Research Service. If older workers are able to find new jobs, they tend to experience sharper median wage declines than their younger counterparts: 20 percent for men aged 50 to 61, and 36 percent for those 62 or older. Men aged 25 to 49 experienced only a 2 percent to 4 percent median wage decline, according to Richard Johnson and Corina Mommaerts at the Urban Institute in Washington, D.C. (Many labor market studies focus on men since a plethora of hard-to-measure cultural changes over time have influenced women's decisions to work outside the home.)

That's why, when the years to retirement can be counted on one hand, getting laid off might be enough encouragement to just jump into it. Economists Gary Burtless and Barry Bosworth, both at the Brookings Institution in Washington, D.C., found little evidence that a weak labor market drives men between 55 and 59 from the labor force, but it does for men above 60, and especially above 65. Perhaps these individuals find job prospects weak and become “discouraged” workers who stop looking altogether.

Or perhaps they welcome the opportunity to enjoy a few extra years of retirement with relative youth and good health.

There's also a third possibility: They may choose to make ends meet by collecting Social Security. Benefits are available at age 62, roughly the threshold Burtless and Bosworth observed, although collecting early comes with a stiff penalty of up to 25 percent of the monthly payout. People who collect between age 62 and their full retirement age — 66 for most boomers, and 67 for younger generations — are subject to an earnings test that determines benefits. Bosworth and Burtless noted an uptick in the share of eligible boomers collecting Social Security at 62 after the financial crisis set in. For at least some of them, doing so was probably a matter of necessity.

Ultimately, early retirements might create a separate problem: People who claim Social Security early have to make do with permanently lower monthly payouts. That's because benefit levels are set so that total lifetime benefits are fixed regardless of how many months and years they're spread over. Coile and Levine found that households which are already less affluent are most likely to resort to early Social Security to make ends meet and experience that lower payout. Someone in the bottom third of the income distribution who became unemployed near retirement would experience lower income in their 70s by \$2,550, or about 25 percent, on average, they found. Since that group is likely to receive the vast majority of their wealth in retirement from Social Security as opposed to investments, the drop is likely to stem mostly from the reduction in Social Security benefits that would presumably result from collecting early, the authors argue. That's a much bigger hit to total income than households in the top third are likely to experience in their 70s due to a recession close to retirement; for them, income losses are likely to be driven largely by investments. Therefore, the effect of the weak labor market on less-wealthy near retirees should be of greater concern than the financial losses of those who are relatively wealthy, Coile and Levine argue.

The New Retirement

The concept of retirement may be evolving away from a binary choice — “retired” or “not retired.” In that evolution, economics is reinforcing cultural and demographic factors that were already in place. Boomers will live longer than any generation that preceded them. Many people are realizing that 30 years of retirement is a long stretch for which to prepare financially. Beyond that, while 30 years of leisure may sound attractive in concept, many people would find it profoundly unsatisfying. “Even if you're an avid golfer, it gets boring after a while!” Edelman says. “People are discovering that they want to remain fulfilled and productive and contribute to society.”

Edelman has observed that retirees — or whatever society eventually decides to replace that term with — are

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conditions. The typical weather derivative is based on the average temperature over a period of weeks or months; one party to the trade profits if the number of hot (or cold, depending on the contract) days is above the strike price, and the other party profits if the number is below. A heating oil company, for example, stands to lose revenue if a winter is warmer than expected, so it might place a bet that the number of hot days will be higher than the strike price. If the winter is warm, the decrease in revenue is offset by profits on the derivative contract. If the winter is cold, then the increase in revenue covers the losses on the derivative.

The Chicago Mercantile Exchange launched its first weather derivative product in 1999, and last year more than 1.4 million derivative contracts were written, for a total value of more than \$11 billion. In 2006, after Hurricane Katrina, the value of contracts was more than \$45 billion, according to the Weather Risk Management Association. The primary

users of weather derivatives are energy companies, but a growing number of construction, agricultural, and outdoor entertainment companies are entering the market. Unlike insurance, which protects only against catastrophic events, weather derivatives offer these companies a bulwark against more mundane occurrences.

Catastrophic or mundane, weather is beyond the control of the people it affects. As the models and technology improve, however, it becomes increasingly possible for individuals and businesses to use that information to arm themselves against whatever the weather might bring. Models aren't perfect; the residents of Vermont knew Hurricane Irene was coming, but they didn't expect that much of their landlocked state would end up under water. Still, as scientists keep trying to get better at predicting the unpredictable, businesses will continue to seek out every extra drop of certainty. **RF**

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increasingly opting to move into a less stressful line of work, take a part-time position, work a few months of the year, or pursue lifelong passions for which their careers never allowed time. Their reasons might be economic — but then again, maybe not. A recent survey by insurance company Allstate and the *National Journal* found that 68 percent of near-retirees planned to work in retirement, but only half out of financial necessity. Only 11 percent of current retirees

reported some form of work. For boomers, the concept of retirement is growing more ambiguous.

It would seem fitting for baby boomers to be the ones to set this trend in motion. "I think we're going to have to just watch them to see what happens," Weatherford says. "These are boomers. They have always been the hard-charging, hard-working generation. I really do think they're going to redefine it for us all." **RF**

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