

Today's Research on Aging

PROGRAM AND POLICY IMPLICATIONS

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Older Workers and Retirement

The personal choices and financial decisions associated with retirement planning are challenging, and require a person to gather and analyze data on social security benefits and pension plans, inflation, and interest rates. Each individual must also consider factors such as personal health, a spouse's employment, and other family issues. Making the wrong decision by retiring too soon or not saving enough can have serious consequences for personal well-being in old age.

The Behavioral and Social Research Program at the National Institute on Aging supports analysis of how individuals make retirement decisions, the quality of these decisions, and their consequences. Knowledge gained from these analyses can help design programs to improve the choices people make. We discuss both NIA-sponsored and other research in this newsletter

Aging Workforce

From the 1970s to the mid-1990s, the labor force participation rate of older men declined in the United States and in many other industrialized countries. In a study of social security and retirement, Gruber and Wise (1999) were able to link much of older men's withdrawal from the labor force to incentives in social security systems. In many countries, regulations made it beneficial for individuals to

retire when they first became eligible for either old-age pensions or disability benefits.

Since the late 1990s, however, the labor force participation rate for men ages 50 and older has risen in the United States and has stabilized in several countries in the Organisation for Economic Cooperation and Development (OECD). This recent rise in older men's labor force participation may be attributed to both changes in public pension systems and to changes in private pensions. But older women have different work patterns than older men in industrialized countries. Since the 1970s, the proportion of adult women choosing to work has risen for nearly all age groups up to age 60. (See figure of labor force participation rates of older workers from a comparative perspective, page 2).

The Bureau of Labor Statistics has projected that the number of U.S. workers ages 55 and older will increase by 30 percent between 2005 and 2050. However, there are reasons to expect that older workers will not retire at as young an age as they are retiring now, which would lead to an even larger increase in older workers in the future. First, the Social Security eligibility age rises for the tail end of the baby-boom generation, potentially discouraging retirement. Second, many businesses have trimmed retirement benefits and replaced defined benefit plans with defined contribution plans (see box, page 3). In addition, research from the Health and Retirement Study (HRS) indicates that individuals in their mid-50s today are expecting to work longer than people of similar age did in 1992 (NIA 2007).

Retirement Decisions

The decision to retire can be a very complex one in which individuals take into account their health, a desire to spend more time on family activities or travel, and how they feel about work. Analysis from HRS data showed that more than one-third of those who retired between 2000 and 2002 said that spending more time with their families was a very important reason for retirement (NIA 2007). Poor health was a very important factor to many retirees between ages 55 and 59, but a smaller share of retirees in

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This review summarizes research related to the objectives of the National Institute on Aging, with emphasis on work conducted at the NIA demography centers. Our objective is to provide decisionmakers in government, business, and nongovernmental organizations with up-to-date scientific evidence relevant to policy debates and program design. These newsletters can be accessed at www.prb.org/TodaysResearch.aspx.

each successive age group considered health an important factor in their retirement decision. Less than 10 percent of respondents said they retired because of a strong dislike for their work.

When both husband and wife are working, the retirement decision may become even more complex because each spouse must consider the other's wishes and joint finances. Data suggest that unless one person retires involuntarily due to health problems, people are less likely to retire if their spouses are still working than if their spouses have already retired. A major reason behind the interdependence of the retirement decision of spouses is the high value placed on spending leisure time together (Gustman and Steinmeier 2004a).

For some workers, the loss of a job after age 50 is another factor in their decision to retire. One study examined the effect of job loss on older workers and found that two years after losing a job at age 55, 60 percent of men and 55 percent of women were employed or looking for a job

(Chan and Stevens 2001, 2004). Labor force participation rates were much higher for men and women who had not been displaced from their job, with 80 percent working or looking for work. Four years after a job loss, displaced workers were still substantially more likely to have withdrawn from the labor force.

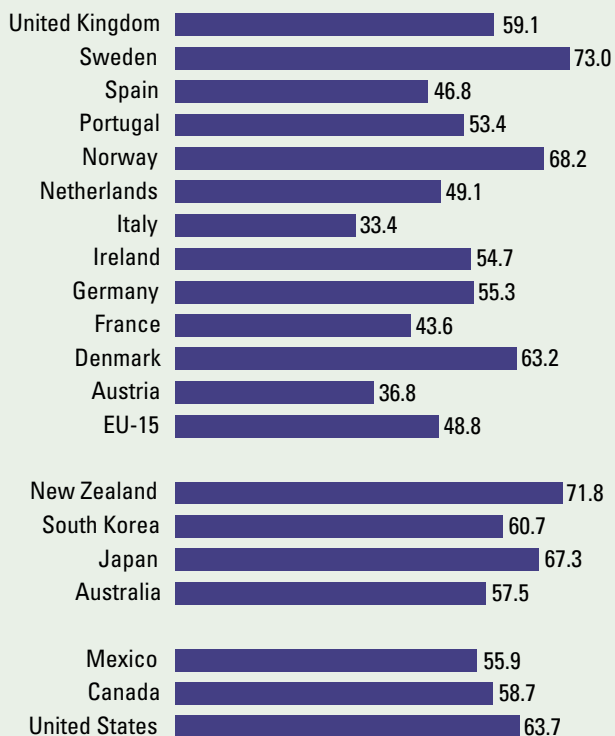
The question of whether financial or health factors are more important in the decision to retire is still being debated. Which factors are most important may be key to developing incentives to keep older workers in the labor force. One analysis of early HRS data found that subjective reports of health were more highly correlated with the transition to retirement than were changes in financial circumstances (McGarry 2004).

Concerns about how poor health affects the quality of life in retirement years are equally as important as whether poor health or financial reasons have more influence on retirement decisions. Some evidence suggests that retirees who left

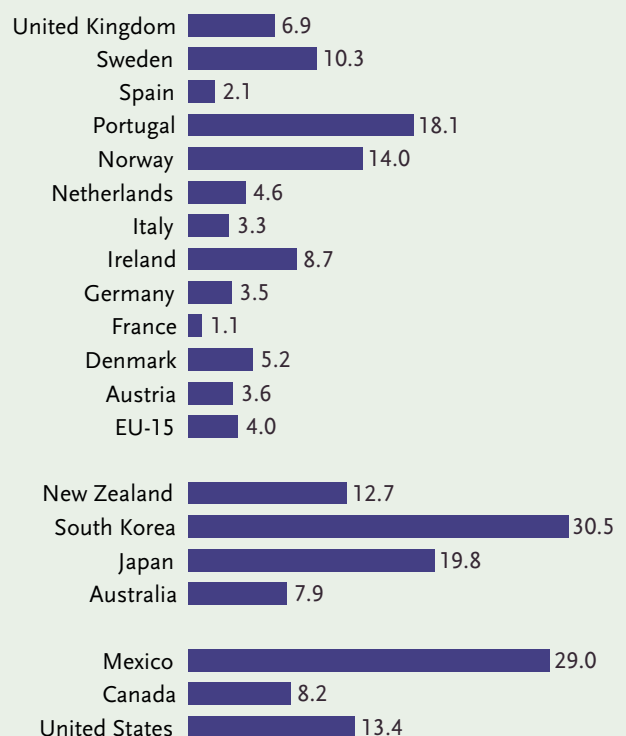
Labor force participation rates of workers ages 55 to 64 did not vary as widely across countries as the rate for those ages 65 and older.

Labor Force Participation Rates for Older Workers, 2006 (%)

Ages 55–64



Ages 65+



Source: Organization for Economic Development.

the labor force because of their poor health may face greater financial hardship. Because they may have planned to leave the work force after working more years, these retirees may be surprised by receiving lower Social Security benefits than they expected. In general, people do not appear to be well informed about their Social Security benefits, but retirees who say poor health was a very important reason why they retired overestimated their Social Security benefits by much more than other retirees (Rohwedder and Van Soest 2006).

Planning and Saving

Workers do not seem well informed about two of their major sources of retirement income: Social Security benefits and pensions (Gustman and Steinmeier 2004b). Many people report they will be eligible for full Social Security benefits sooner than the rules actually allow (prior to age 65), and many do not know what benefits are associated with

their pensions. In fact, many employees do not even know what type of pension they have.

The financial aspects of retirement decisions are complex because they require gathering and processing information about a wide range of factors, including Social Security and pensions, inflation, interest rates, and the future value of each of these components. Evidence suggests that on the whole, older women are not as financially literate as older men. In addition, women are also less likely to plan successfully for retirement (Lusardi and Mitchell, forthcoming).

Although the financial illiteracy of women is of particular concern because their longer lives increase their exposure to the risk of poverty in old age, financial illiteracy is widespread in the United States (Lusardi and Mitchell 2007, forthcoming). Such illiteracy has serious implications for retirement planning and other decisions. Recognizing the need to improve knowledge of basic financial and economic concepts, governments and several nonprofit organizations have started programs to improve financial literacy. These programs include a savings campaign in Japan and pension privatization in Sweden. Experiences from these programs can provide new information on roles for financial literacy and saving programs (Lusardi and Mitchell 2007).

In the United States, Title V of the Fair and Accurate Credit Transactions Act of 2003, known as the Financial Literacy and Education Improvement Act, created the Financial Literacy and Education Commission, comprised of 20 federal agencies, and charged it with coordinating federal efforts and developing a national strategy to promote financial literacy (GAO 2004). Among the major components of the commission's national strategy are targeting dissemination strategies to reach key demographics and conducting research and evaluation of financial education programs. The commission believes that broadening the research on financial education will assist policymakers and financial educators in improving the effectiveness of their work on financial literacy.

Wealth Effects of 401(k) Contributions

Since the Internal Revenue Code (IRC) Sec. 401(k) went into effect in 1981, there has been a fundamental shift in how workers save for retirement. The movement has been away from employer-managed defined benefit pensions to employee-controlled defined contribution retirement saving plans.

James Poterba, Steven Venti, and David Wise have studied how this change is likely to affect the financial well-being of future retirees. In a study published in the *Proceedings of the National Academy of Sciences*, they projected the future growth of assets in 401(k) plans. Their findings indicate that in 2040, 65-year-olds will have much more of their assets in 401(k) accounts than 65-year-olds will have in 2009. Even after assuming rates of return lower than the historical average and taking into account cash withdrawals before retirement and management fees, the average 401(k) balance for these older people in 2040 is expected to be \$345,000, compared with \$67,000 for 65-year-olds in 2009. The main reasons for the difference are: the number of years an individual contributes to the plan—less than 10 years for most retirees at the beginning of the 21st century but possibly their entire working lives for many retiring in 2040; 401(k) plans are expected to become available to many more employees; and wages are expected to rise.

In contrast, projections of the average value of an individual's defined benefit plan at age 65 show a real decline (in year 2000 dollars) from a high of \$73,000 in 2003 to about \$37,000 by 2040.

Source: Poterba, Venti, and Wise 2007.

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The NIA Demography Centers

The National Institute on Aging supports 13 research centers on the demography and economics of aging, based at the University of California at Berkeley, the University of Chicago, Harvard University, the University of Michigan, the National Bureau of Economic Research, the University of North Carolina, the University of Pennsylvania, Pennsylvania State University, Princeton University, RAND Corporation, Stanford University, the University of Southern California/University of California at Los Angeles, and the University of Wisconsin.

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Financial Literacy and Education Commission

www.treasury.gov/offices/domestic-finance/financial-institution/fin-education/commission/

Financial Security in Later Life Program

www.csrees.usda.gov/nea/economics/fsll/fsll.html

History of the 401k

www.ebri.org/pdf/publications/facts/0205fact.a.pdf



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