The Financial Well-Being of American Retirees

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Comments on Feinschreiber and James Laiosa

In this paper, the authors use The National Financial Well-Being score to indicate the proportion of total planned retirement expenses the median household is on track to afford. The numerator represents retirees' household income and the denominator represents their planned expenses. A score above 1.00 signifies that pre-retirees will have enough money to continue their current spending levels into retirement, while a score below 1.00 means that pre-retirees will not be able to maintain their current spending levels. Based on a survey of 1,026 retired households whose respondents were between ages 57 and 85, the authors find that the typical household is on track to afford 1.31 times its planned expenses assuming average market conditions and 1.20 times its planned expenses assuming poor market conditions.

Numerous studies have examined the adequacy of retirement income to protect economic security. Many of these studies paint a bleak picture of retirees' prospects (Moore and Mitchell 2000; Wolff 2002). Using their National Retirement Risk Index, Munnell, Webb and Delorme (2006) show that 43 percent of American households are at risk of being unable to maintain their standard of living in retirement, even after financial and housing wealth are factored in. When health care costs are considered, the share of households at risk increases to 61 percent (Munnell, et al., 2008). And a McKinsey report suggests that 60 percent of boomers will need to continue working in retirement in order to maintain 80 percent of their pre-retirement consumption in old age (Court, Farrell and Forsyth 2007).

Other studies are more optimistic (Gustman and Steinmeier 1999; Haveman, et al., 2006; Haveman, et al., 2007; Keister and Deeb-Sossa, 2001). For example, Scholz, Seshadri, and Khitatrakun (2006) find that over 80 percent of pre-retirees born between 1931 and 1941 have accumulated *more* wealth than their optimal savings targets. And that for the fewer than 20 percent of households who are not meeting their targets, the deficits are relatively small. Scholz and Seshadri (2008) find similar results for other birth cohorts. The Feinschreiber and Laiosa study is also fairly optimistic. It finds that 75 percent of retirees are on track to affording their planned expenses under average market conditions and that 69 percent of retirees are on track even under poor market conditions. There are a couple of reasons, however, why these results may be as positive as they are.

First, it is not clear whether the authors use a random sample of American retirees or a select sample of Fidelity investors. The answer will influence how we should interpret their results. For example, if their sample includes only Fidelity investors then their results may be optimistic only because investors are probably wealthier than the average American.

According to data from a nationally representative survey, about 41 percent of households ages 65 and older have pension benefits or annuities and 25 percent have earnings (SSA 2009, table 2.A1). In contrast, around 80 percent of the Feinschreiber and Laiosa study sample have pension benefits alone and the proportion with earnings, including those under age 65, is less than 10 percent. In addition, median income from pension benefits or annuities is significantly lower in the nationally representative study than in the Feinschreiber and Laiosa study. These differences suggest that their sample may not be nationally representative and their sample respondents may actually be better off than the average American.

Despite the issue of their sample's representativeness, household expenditure shares in the Feinschreiber and Laiosa study are very similar to those reported in Butrica, Goldwyn and Johnson (2005) using the Health and Retirement Study and Fisher, et al., (2008) using the Consumer Expenditure Survey—both nationally representative surveys. For example, these studies find that typical older adults spend about 33 percent of their household expenditures on housing and only about 10 to 20 percent on health care, depending on age. Although health care spending accounts for smaller shares of expenditures and income than housing, these shares increase with age and poor health.

The second reason why the Feinschreiber and Laiosa results may be more optimistic than most studies, and why studies evaluating retirement savings adequacy often reach differing conclusions, is because of differences in how studies define adequacy and measure wealth or income, as well as differences in their analysis methods.

Although expenditures shares in the Feinschreiber and Laiosa study are similar to Butrica and coauthors, median dollar expenditures are almost double for each age group. This difference would arise if their sample was richer than the sample used by Butrica and coauthors. But it would also arise if the Feinschreiber and Laiosa study did not adjust for household size. Butrica and coauthors present per capita household expenditures. Considering only total household expenditures could be misleading because spending tends to increase with household size. Ignoring household size could particularly distort estimated age differences in spending because older households tend to be smaller than younger households. The same is true for total household income.

Another methodological concern is the use of projected household expenses. The authors note that financial well-being scores are calculated using *projected* household expenses that are based on *reported* current expenses. This could be problematic if current expenses, as well as current income, ends up being very different from future expenses and future income. Although the resources available at retirement may be sufficient to maintain living standards initially, they may not be enough to support consumption throughout retirement. Life-changing events during retirement can cause unexpected shocks to wealth, income and expenses. Johnson, Mermin and Uccello (2006) find that 87 percent of adults ages 51 to 61 and 75 percent of adults ages 70 and older experience or have a spouse that experiences at least one negative event over about 10 years, including divorce, widowhood, job loss, disability, and other adverse health events. Not properly accounting for these events could overstate income and understate expenditures later in retirement.

In projecting future household expenses, the authors assume that food, transportation, entertainment, and other expenses increase at the current inflation rate of 2.3 percent. However, this inflation rate is based on the Consumer Price Index for All Urban Consumers (CPI-U), which may not represent the spending patterns of older adults. An experimental consumer price index for the elderly, known as the CPI-E, may be more appropriate. This index has substantially larger weights for housing and health care than the CPI-U. Consequently, between 1982 and 2007, the CPI-E rose 126.5 percent compared with only 115.2 percent for the CPI-U (Stewart 2008).

In conclusion, there is no shortage of answers when it comes to the retirement prospects of future retirees. Therefore, it is important for purveyors of this information to clearly communicate the assumptions and methodologies of their analyses so that consumers can make informed decisions about their ideal retirement savings strategy.

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