

What Replacement Rate Do Households Actually Experience in Retirement?

Alicia H. Munnell and Mauricio Soto
Boston College

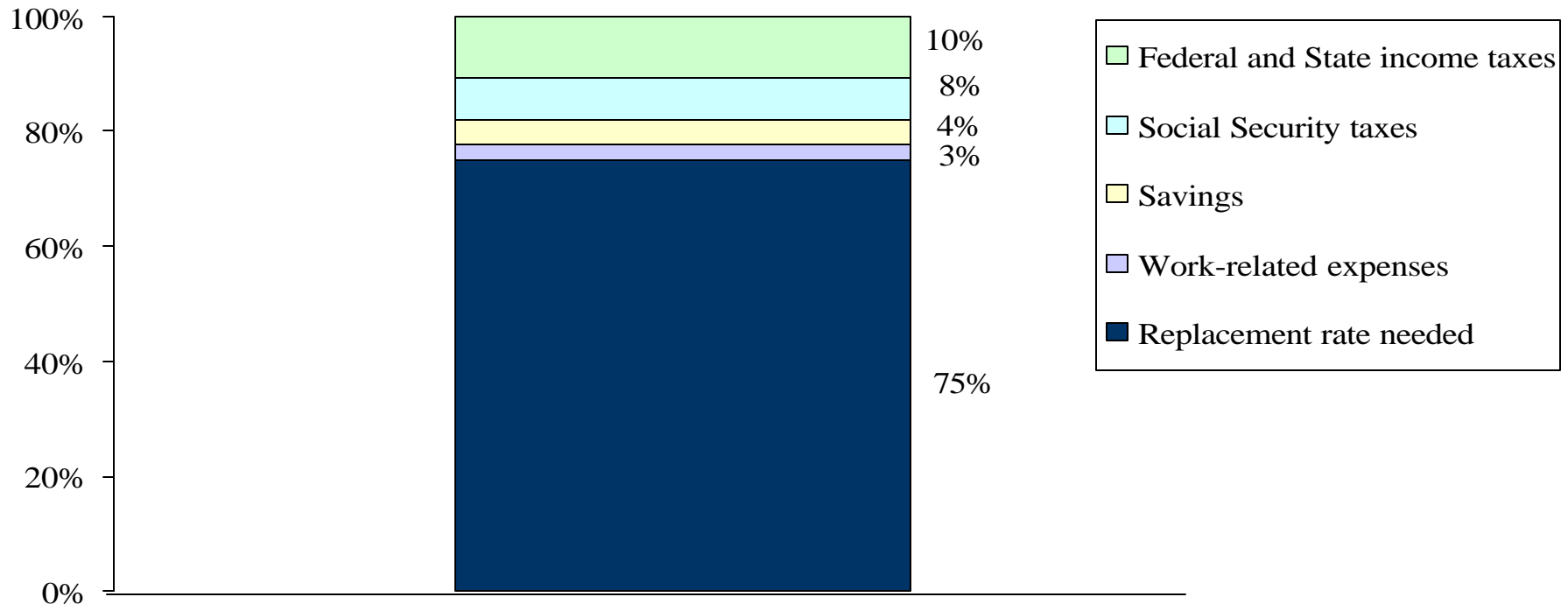
Prepared for the 7th Annual Joint Conference of the Retirement Research Consortium
“Towards a Secure Retirement System”
August 11-12, 2005
Washington, D.C.

1. Study presents increasingly comprehensive measures of “Replacement Rates” (RR).

- Individuals:
 - Social Security
- Households:
 - Social Security
 - Pensions and financial assets
 - Housing

2. People need less than 100 percent of pre-retirement income.

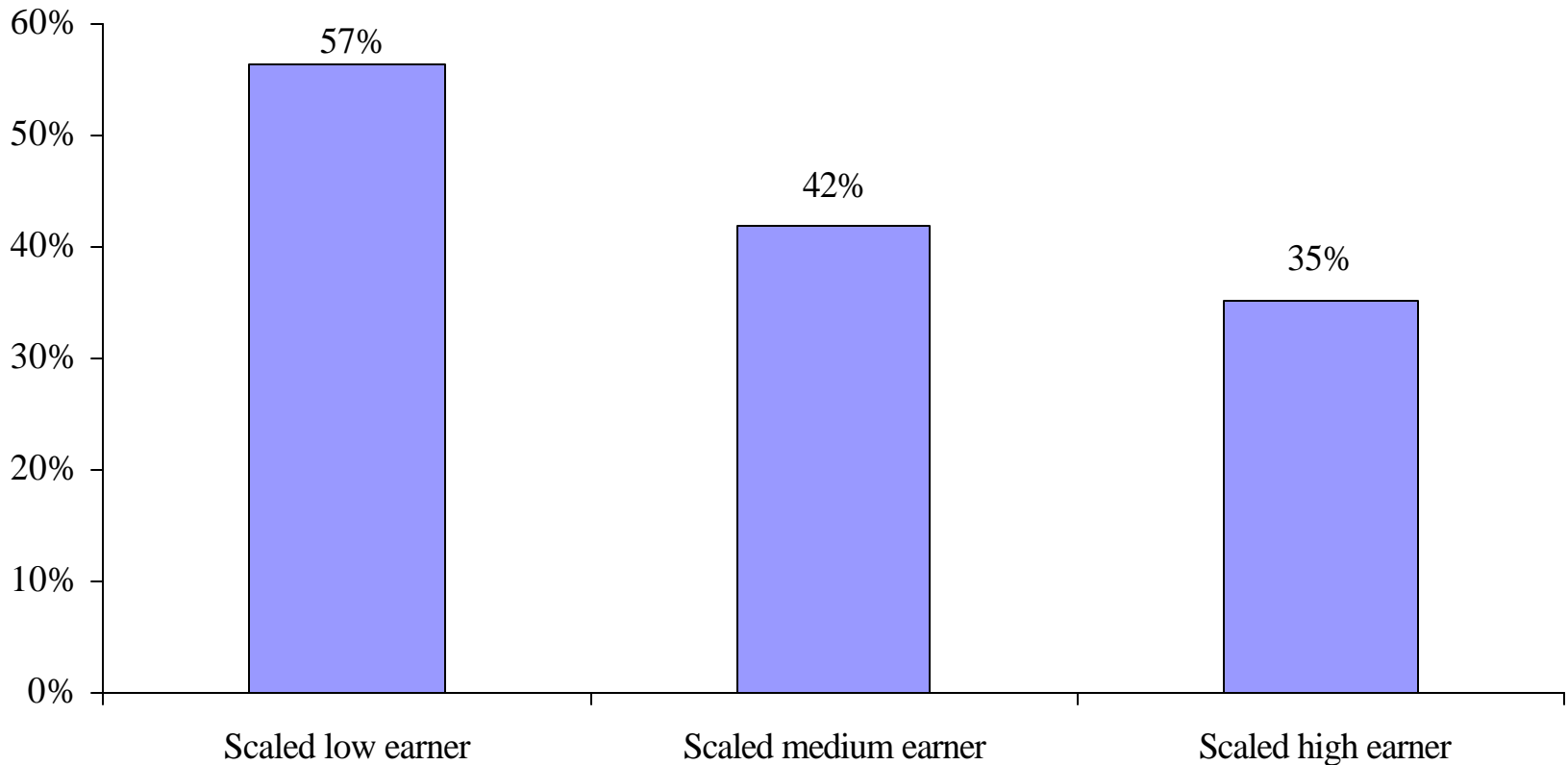
Percent of Pre-Retirement Income Required to Maintain Living Standards



Source: Bruce A. Palmer. 2001. "2001 GSU/AON RETIRE Project Report." *Research Report Series*. 01(1) (June).

3. Calculating RRs should be easy; SSA already publishes numbers.

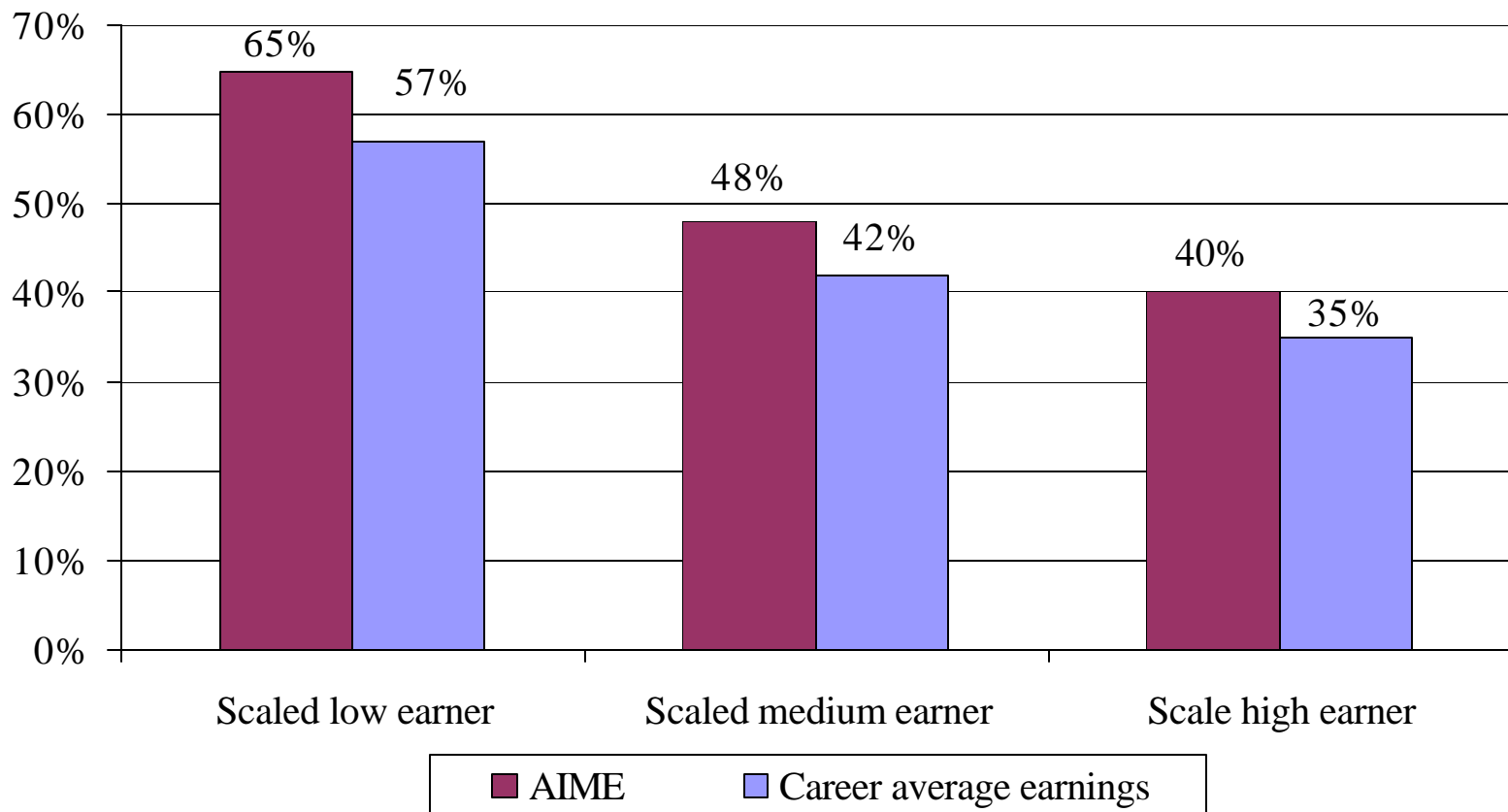
Social Security RRs for Hypothetical Workers at 65, 2004



Source: U.S. Social Security Administration. 2004. *2004 Social Security Trustees Report*. Table VI.F11. Washington, D.C.

4. The first complication – the denominator matters.

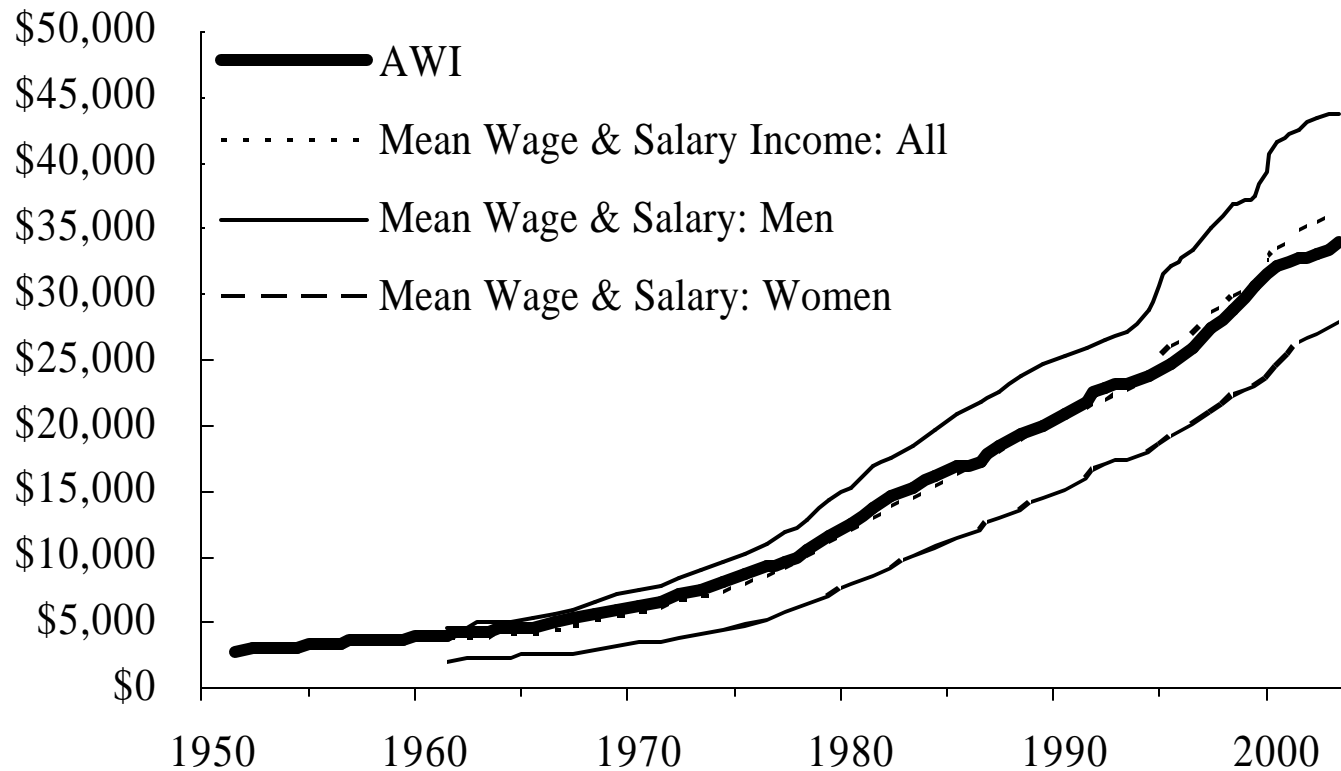
Social Security RRs for Hypothetical Workers at 65 Based on AIME and Career Average Earnings, 2004



Source: U.S. Social Security Administration. 2004. *2004 Social Security Trustees Report*. Table VI.F11. Washington, D.C. and authors' calculations.

5. And SSA numbers assume steady earnings.

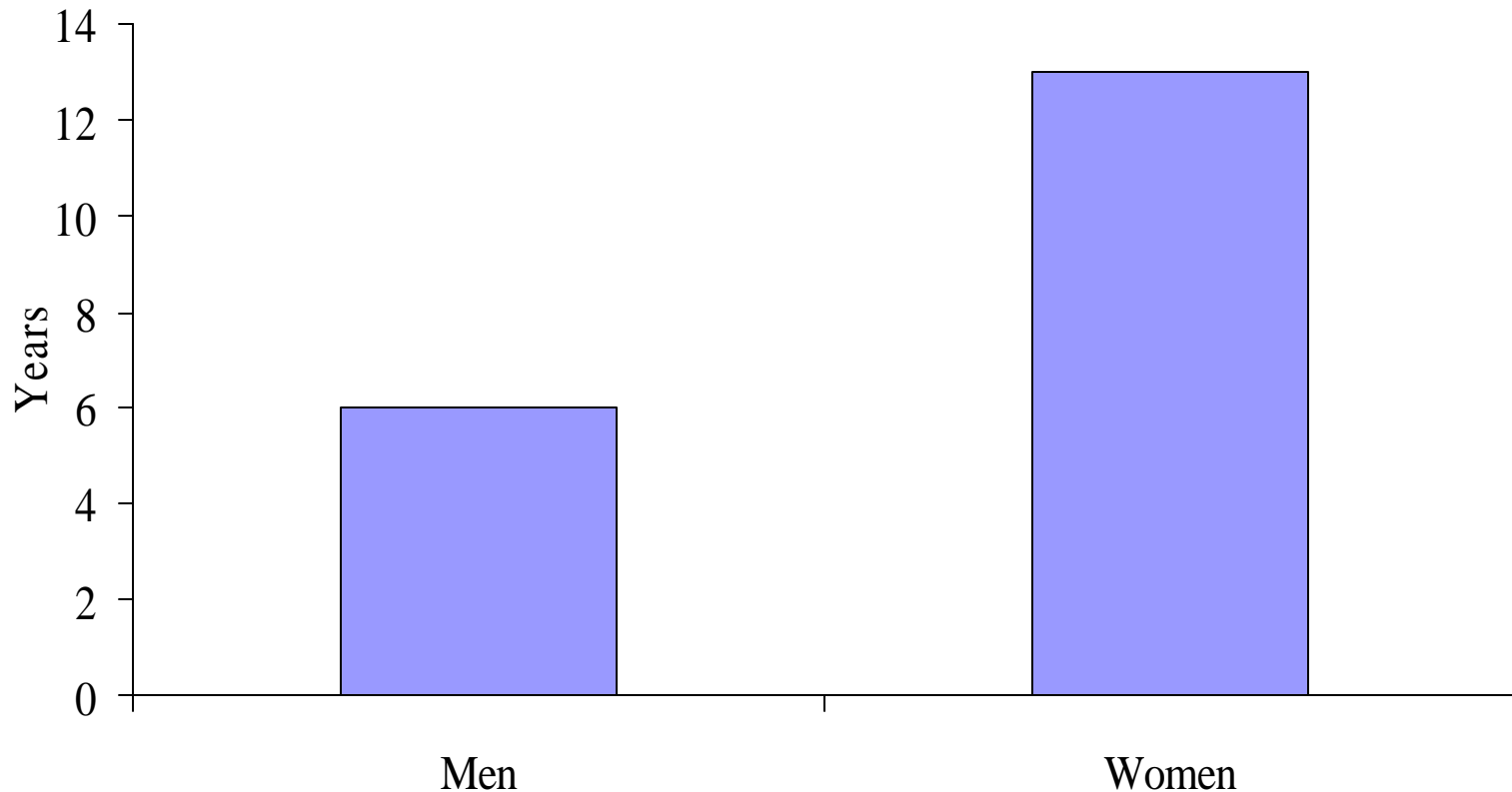
Mean Wage and Salary Income and Average Wage Index, 1950-2003



Source: Authors' calculations based on U.S. Census Bureau. *Current Population Survey* (various years); Social Security Administration. 2005. Washington, D.C.

6. In fact, people have interrupted careers.

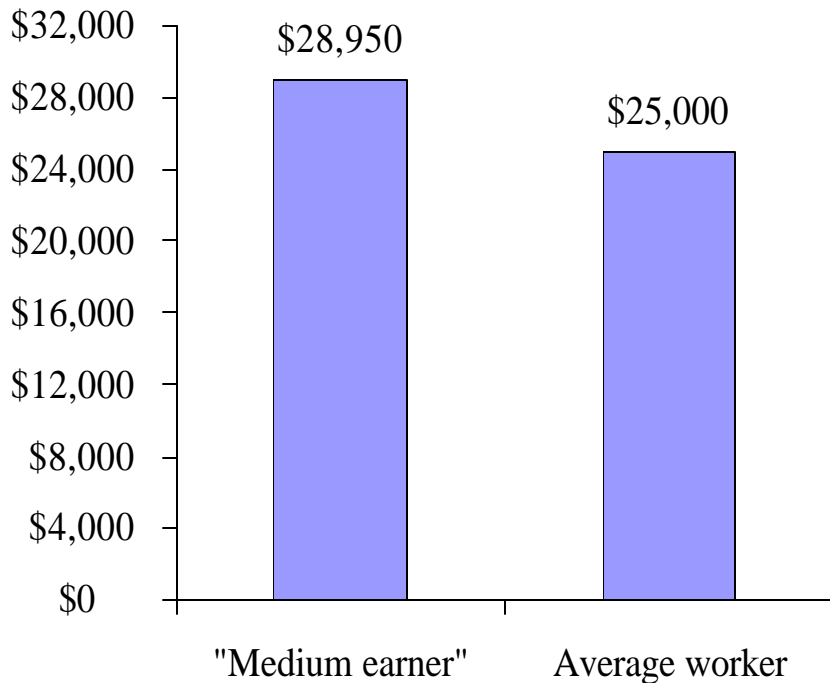
Average Number of Years with Zero Earnings of New Retired-Worker Beneficiaries, 2002



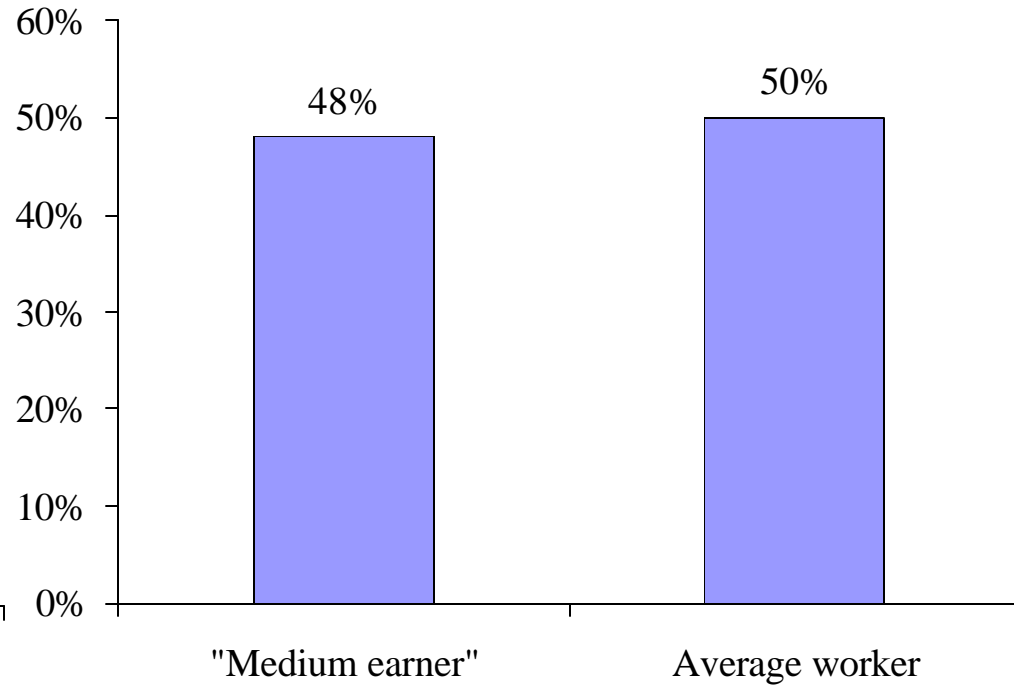
Source: U.S. Social Security Administration. 2004. *Performance and Accountability Report, FY 2004*. Washington, D.C.

7. Therefore, actual AIMEs at 65 are lower and RRs should be higher.

AIME at 65, 2003



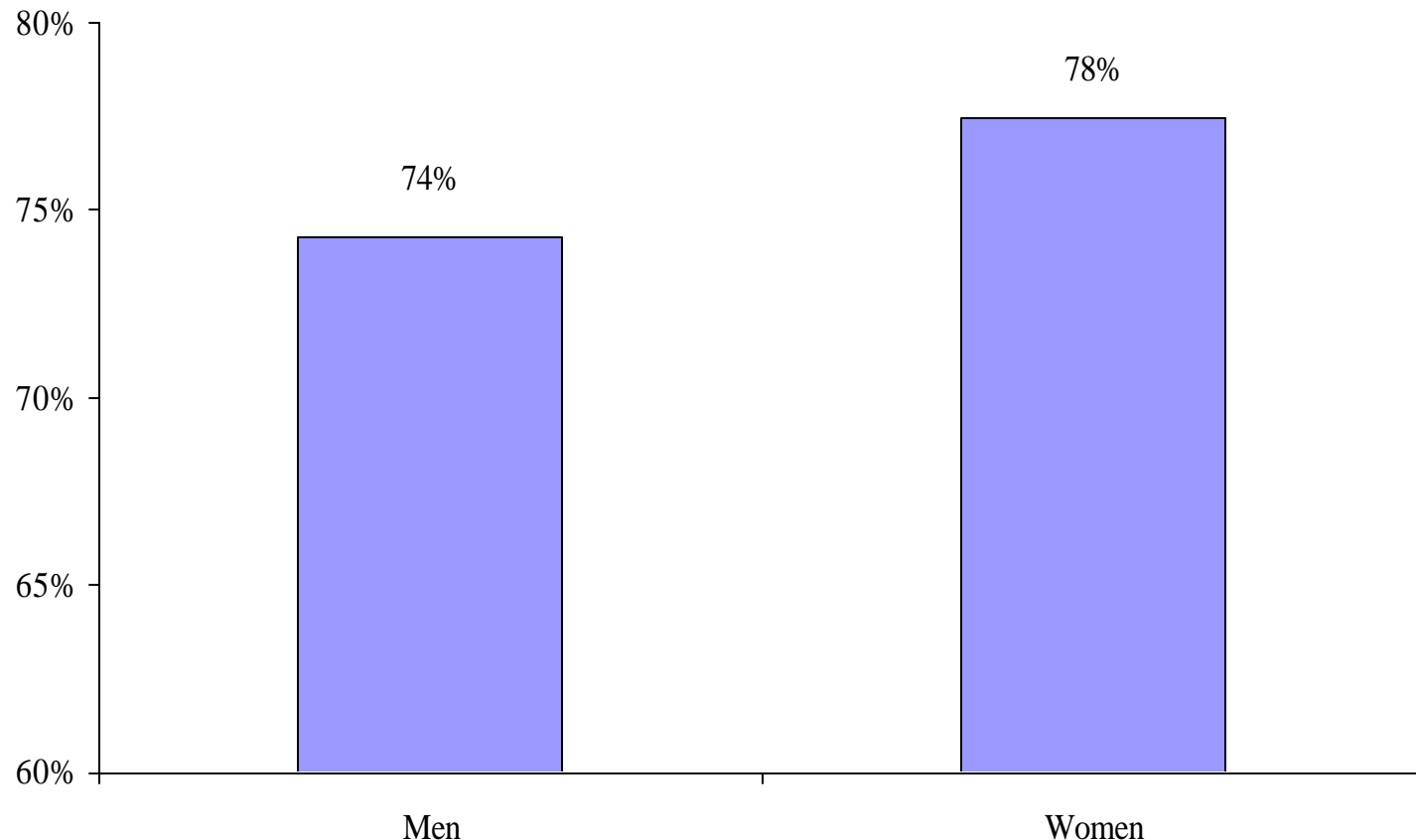
Social Security RR as a Percent of AIME, 2003



Sources: Authors' calculations based on the U.S. Social Security Administration. 2004. *2004 Social Security Trustees Report and Annual Statistical Supplement 2004*. Washington, D.C.

8. But people retire early, reducing monthly benefits and RRs.

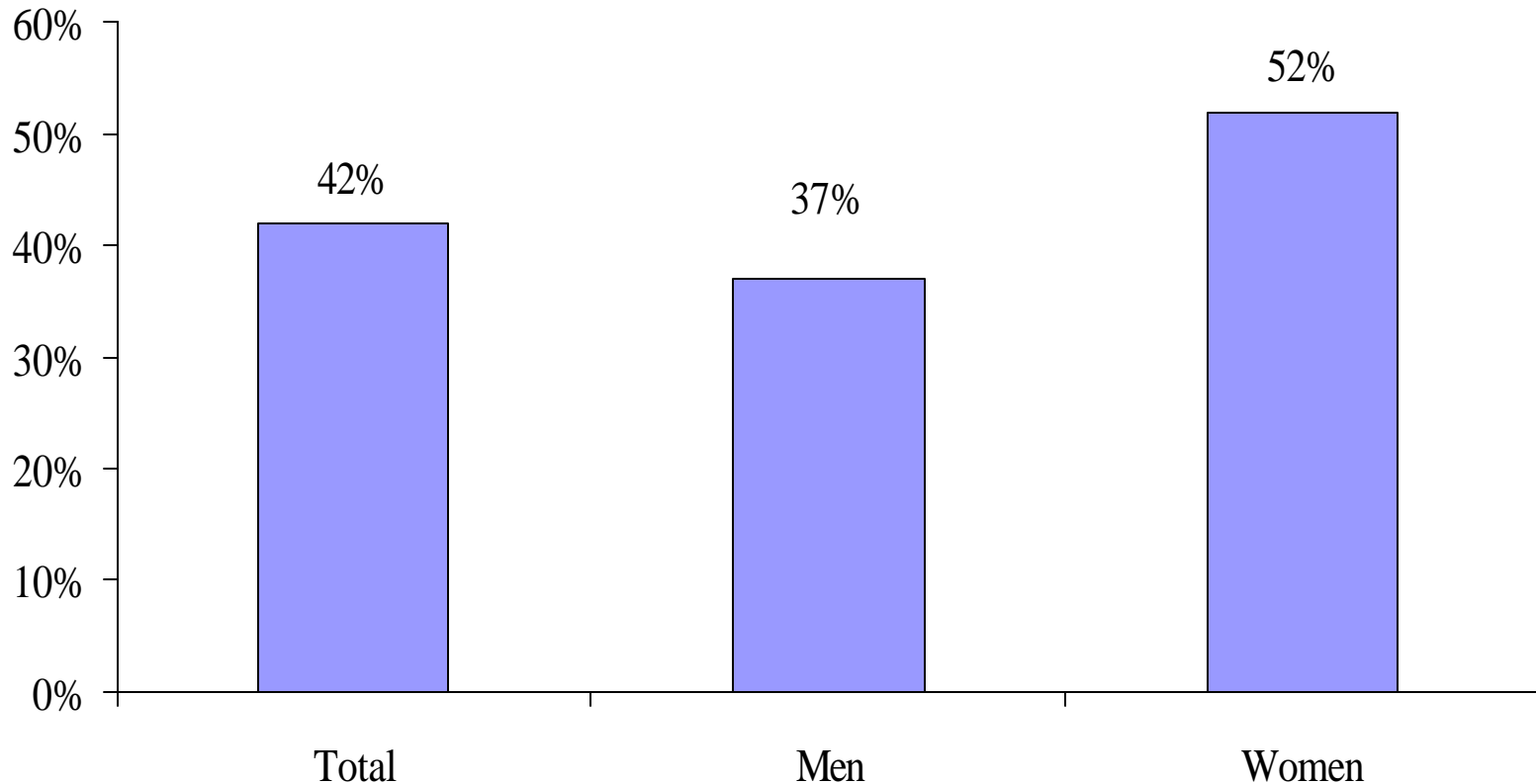
Percent of Workers Receiving Initial Social Security Benefit Before 65, 2003



Source: U.S. Social Security Administration. 2004. *Social Security Bulletin, Annual Statistical Supplement 2004*. Table VI.BV. Washington, D.C. and authors' calculations.

9. *By coincidence*, early retirement lowers median RR to reported number.

Ratio of Social Security Benefits to AIME of New Retired-Worker Beneficiaries, 2002

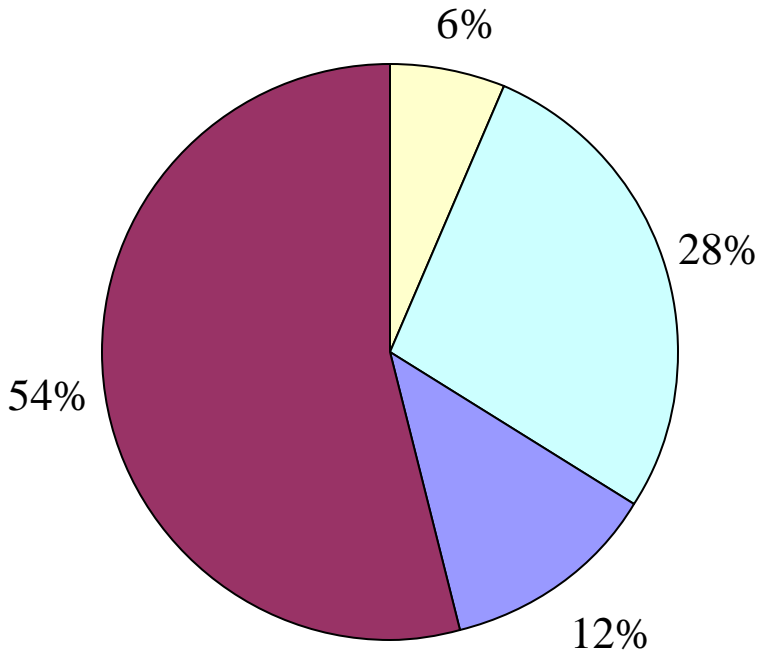


Source: U.S. Social Security Administration. 2004. *Performance and Accountability Report, FY 2004*. Washington, D.C.

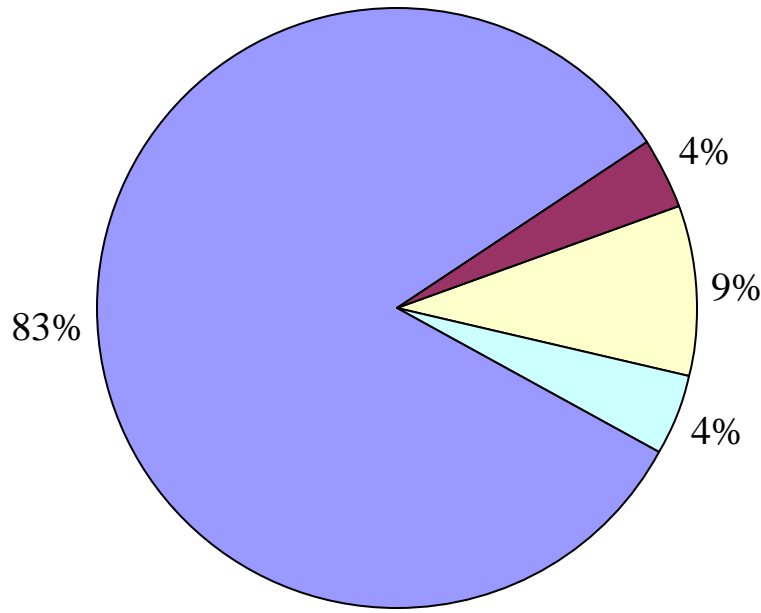
10. Married women have the highest RRs; married men have the lowest.

RR Recipients by Marital Status and Gender

RR > 75 Percent



RR < 30 Percent

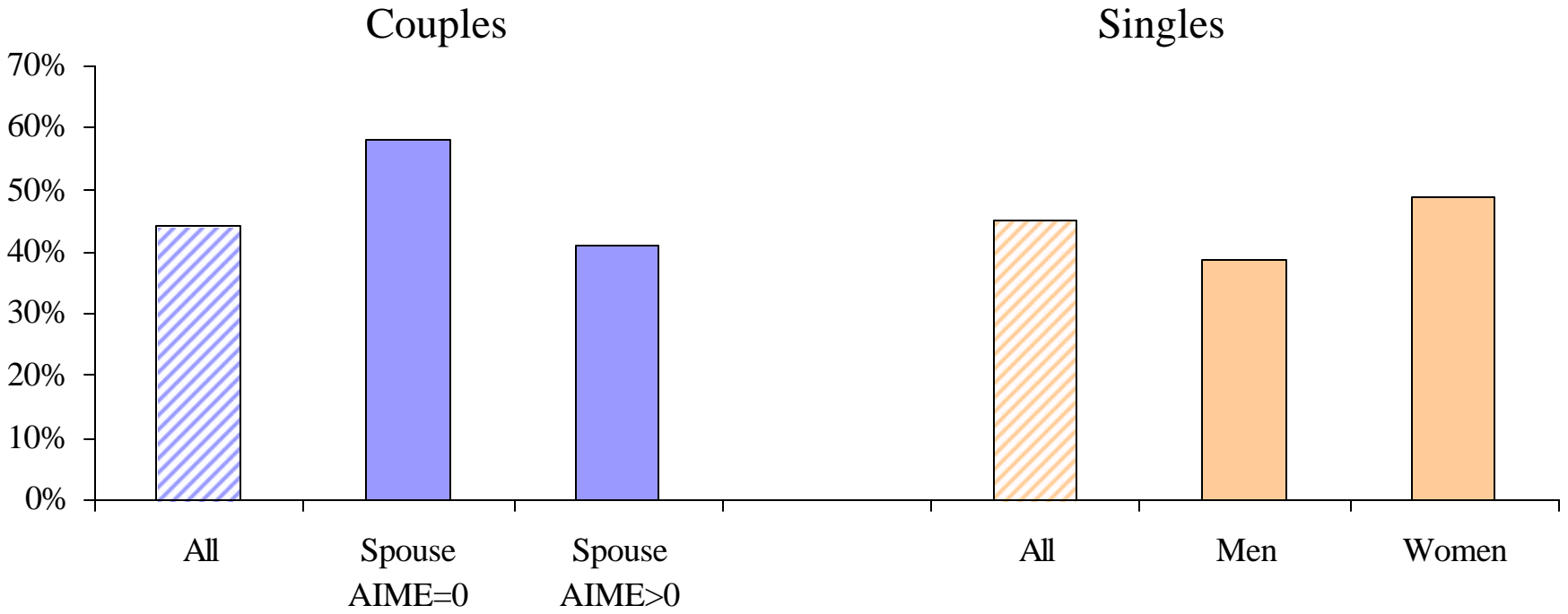


- Single men
- Single women
- Married men
- Married women

Source: Authors' calculations based on the *Health and Retirement Study (HRS)*.

11. *Household* Social Security RRs show distinct patterns by earnings and gender.

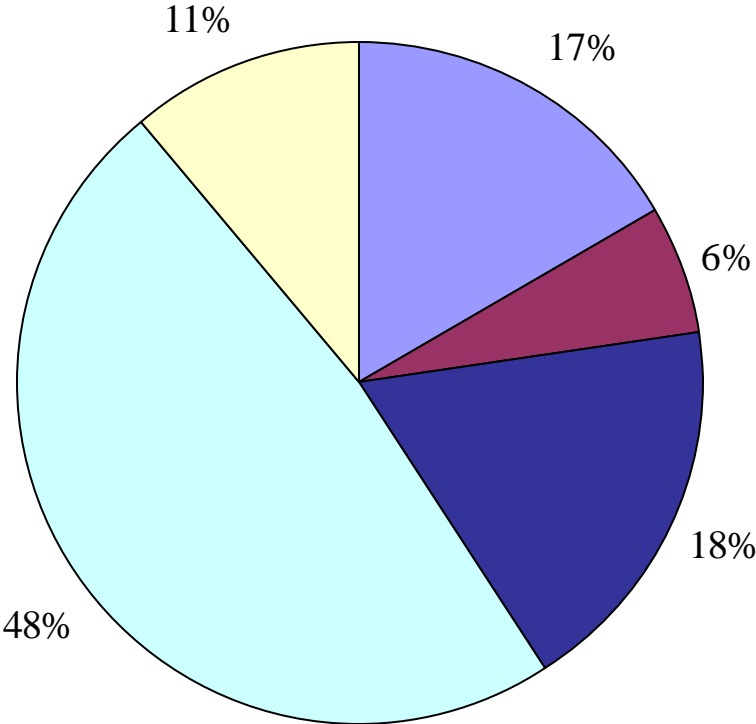
Median Social Security RRs for HRS Households



Source: Authors' calculations based on the *Health and Retirement Study (HRS)*.

12. People have more than Social Security.

Wealth Holdings of the Middle Ten Percent of Households at Retirement



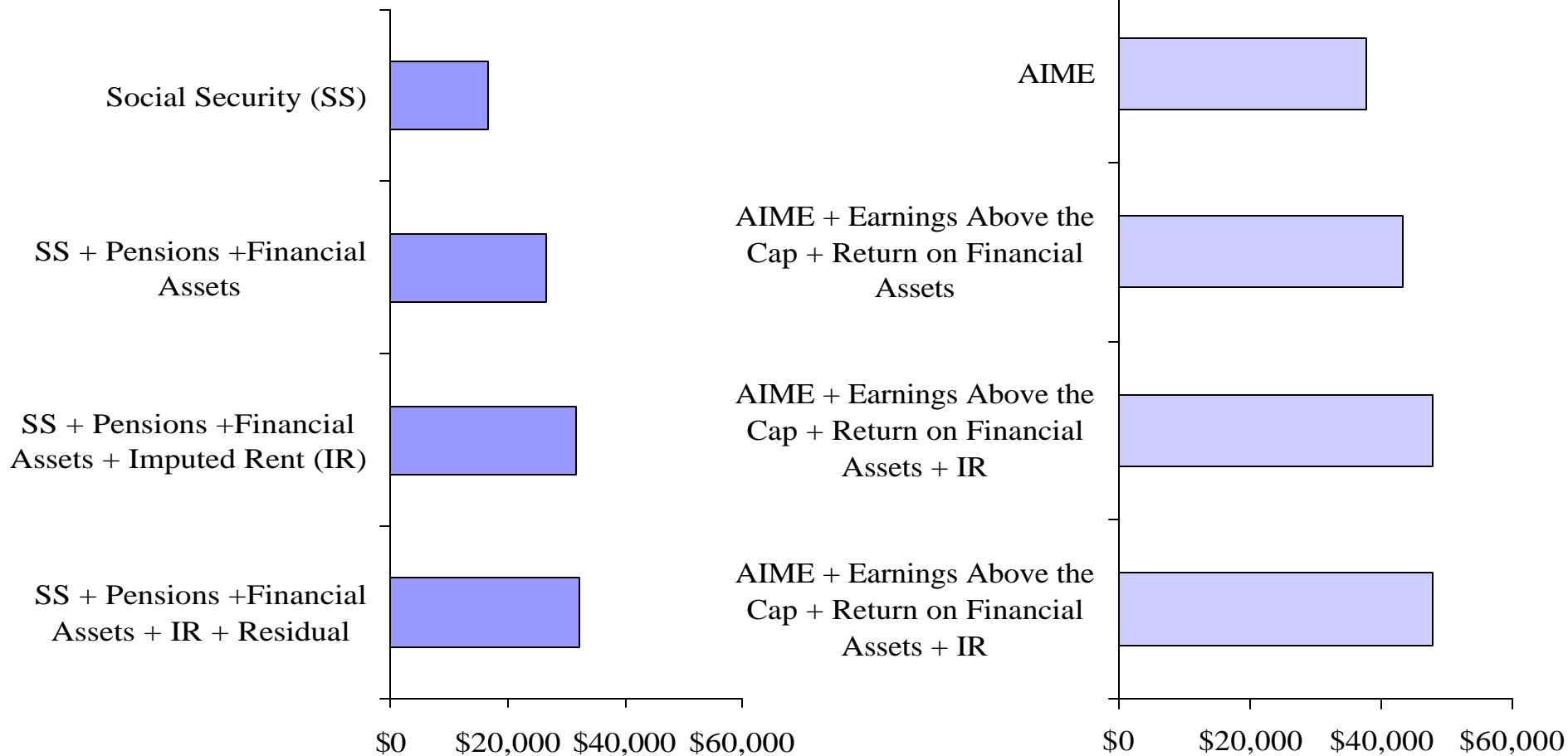
| | | |
|-----------------|----------------------|-----------------|
| Primary housing | Defined contribution | Defined benefit |
| Social Security | Other assets | |

Source: Authors' calculations based on the *Health and Retirement Study (HRS)*.

13. But expanding retirement income requires expanding *pre-retirement* income.

Retirement Income

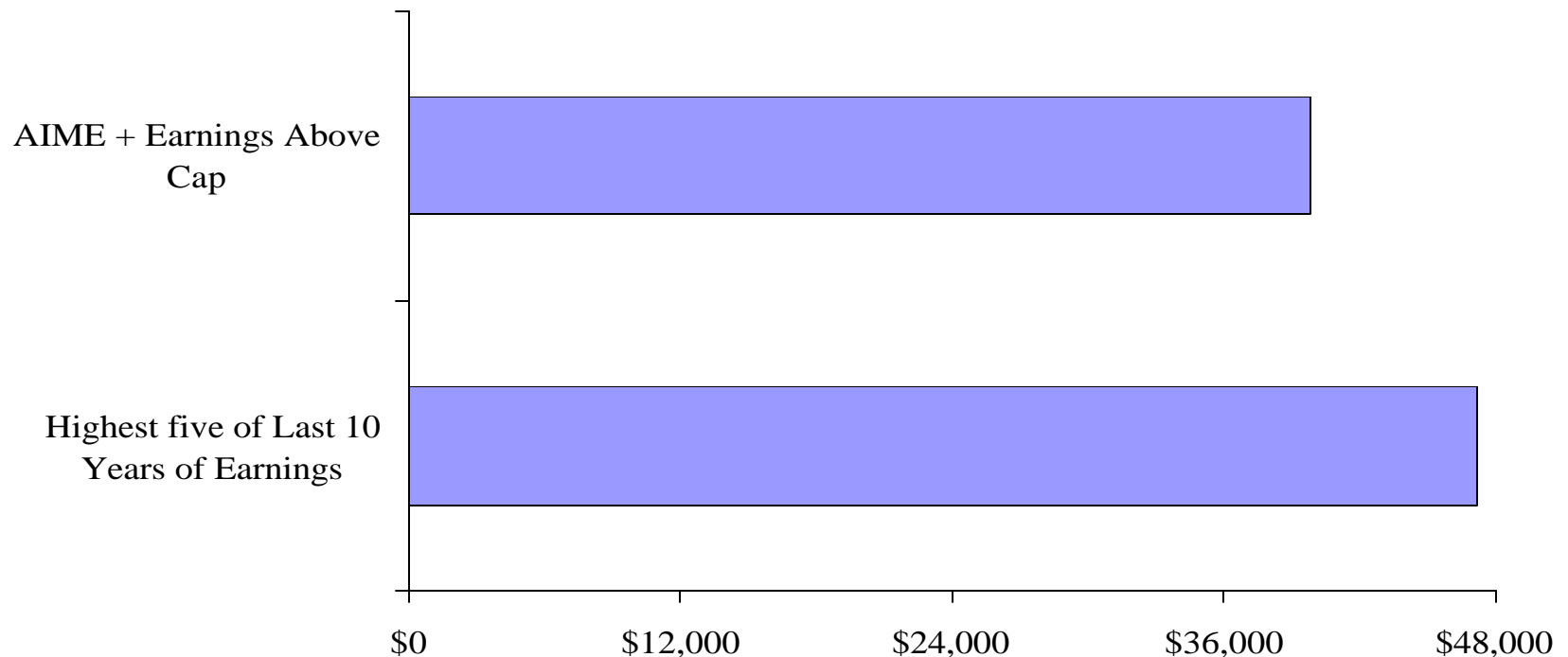
Pre-Retirement Income



Source: Authors' calculations based on the *Health and Retirement Study (HRS)*.

14. RRs also depend on whether replacing lifetime earnings or recent earnings.

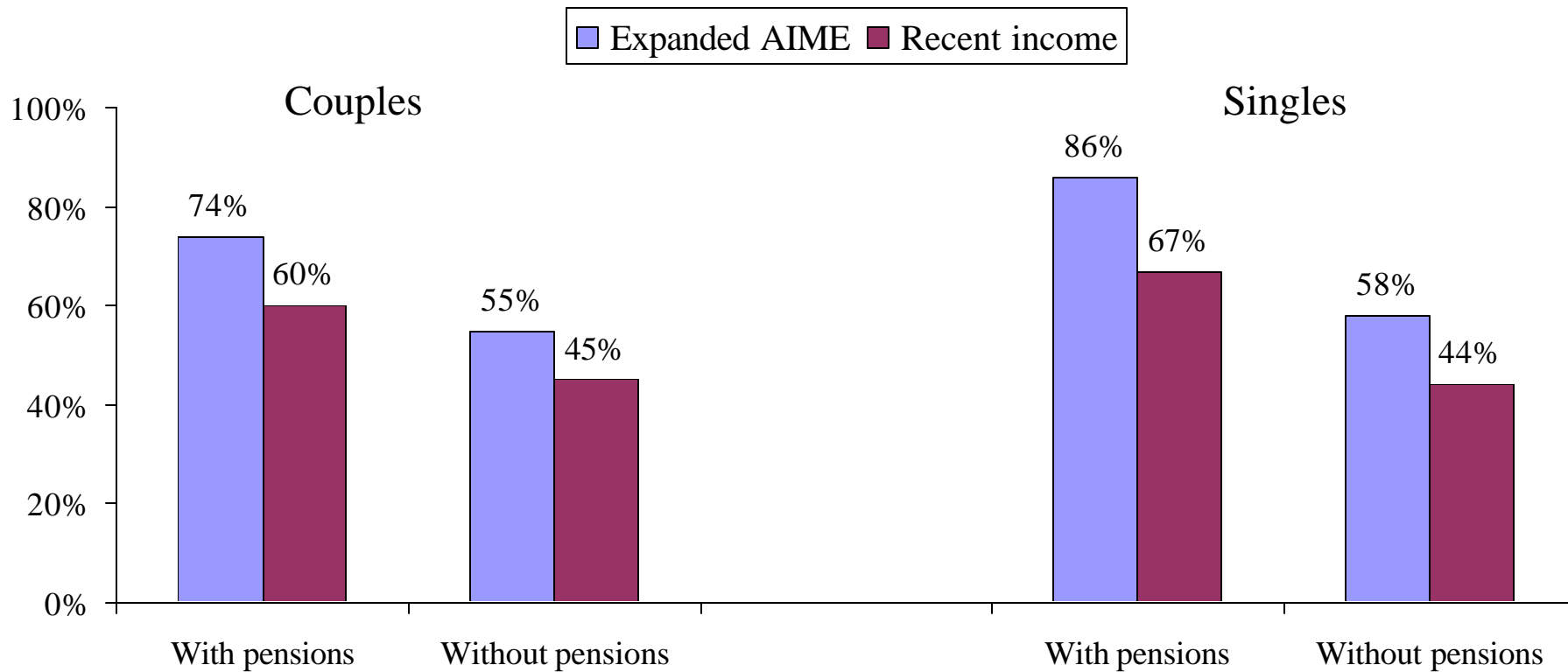
Median Expanded AIME and Median Highest Five of Last Ten Years



Source: Authors' calculations based on the *Health and Retirement Study (HRS)*.

15. Pensions and financial assets increase RRs.

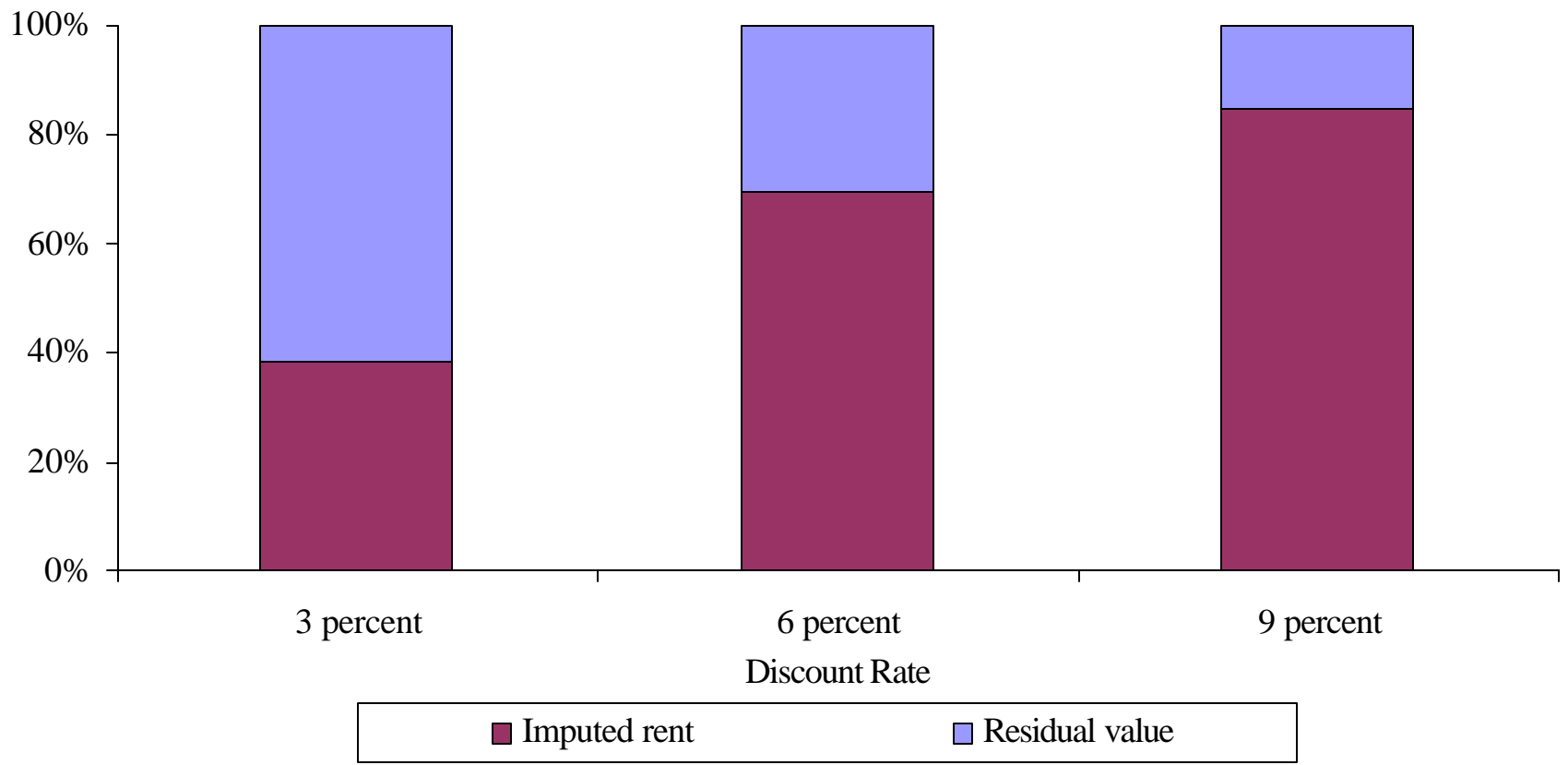
Median RRs for Couples and Singles by Coverage and Pre-Retirement Earnings



Source: Authors' calculations based on *Health and Retirement Study (HRS)*.

16. Housing also provides retirement income through imputed rent and residual value.

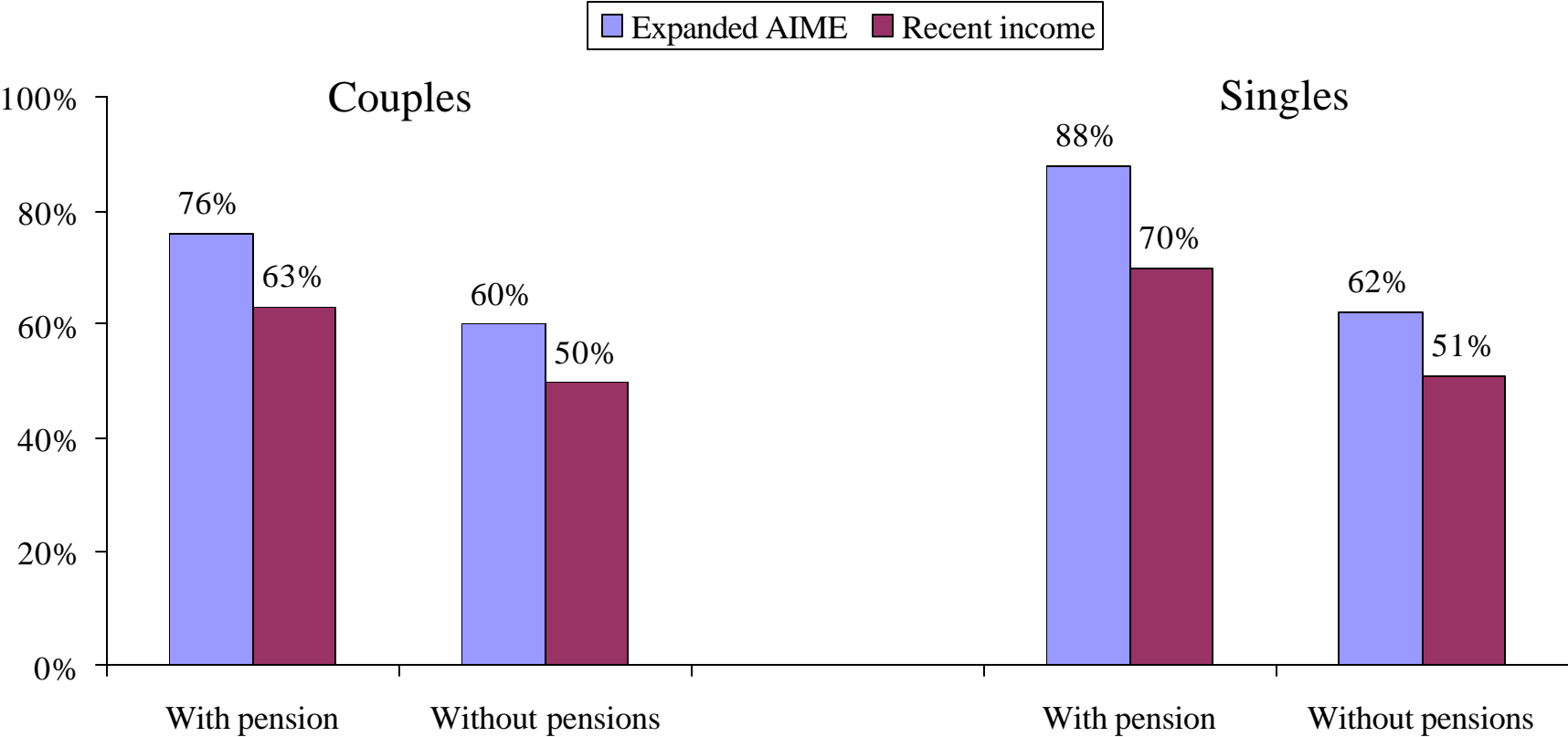
Present Discounted Value of Imputed Rent as a Percent of Total House Value



Source: Authors' estimates.

17. Including imputed raises RRs, but patterns persist.

Median RRs Including Housing for Couples and Singles by Pension Coverage



Source: Authors' calculations based on *Health and Retirement Study (HRS)*.

18. Summary

- Individual worker Social Security RR is 42 percent.
 - Interrupted careers reduce lifetime earnings.
 - Most workers retire before 65.
- Household Social Security RRs vary by earnings and gender.
 - Single women > single men.
 - One-earner couples > two-earner couples.
- Pensions and financial assets raise RRs.
- Housing should be included, but has modest impact.

19. Conclusion

- Today most workers have adequate RRs.
 - Pensions matter.
 - “Pre-retirement” earnings matter.
- But, the future will be less secure.