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HOW SECURE ARE RETIREMENT NEST EGGS?

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Introduction

Life's uncertainties can upend the best-laid retirement plans. Health can fail as people grow older, or their spouses can become ill. Older people can lose their jobs, and often have trouble finding new ones. Marriages can end in widowhood or divorce. Health, employment, and marital shocks near retirement can have serious financial repercussions, raising out-of-pocket medical spending, reducing earnings, disrupting retirement saving, and forcing people to dip prematurely into their nest eggs.

This *brief* examines different types of negative events that can strike near retirement. It reports the incidence of widowhood, divorce, job layoffs, disability, and various medical conditions over a 10-year period, and estimates their impact on household wealth. Data come from the Health and Retirement Study (HRS), a nationally representative survey of older Americans conducted by the University of Michigan for the National Institute on Aging. The survey interviewed a large sample of non-institutionalized adults ages 51 to 61 in 1992 and re-interviewed them every other year. The analysis uses data through 2002, the most recent year available.

The results show that many people in their 50s and 60s experience negative shocks that threaten retirement security. Job layoffs, divorce, and the onset of work disabilities near retirement substantially erode retirement savings. The findings highlight the limitations of the safety net when things go wrong in late midlife.

Pre-Retirement Years Are Crucial Yet Risky Period for Saving

People typically accumulate much of their retirement savings in the decade or so before they stop working. Most people cannot afford to devote many resources to retirement savings at younger ages, when they are raising their families and putting their children through school. Once they have reached their late 50s, many people have completed their child rearing responsibilities and are earning higher salaries than they did at younger ages, leaving them with more funds to invest in 401(k) plans, IRAs, and other retirement savings vehicles. The value of future retirement benefits paid to workers in traditional employer pension plans also tends to grow rapidly for those in their 50s, because benefits are typically tied to years of service and salary earned near the end of the career.[1] Further, working late into one's 50s generally maximizes future Social Security benefits, which are based on earnings received in the 35 highest-earning years.

Health Problems

Health problems that force people to retire early can deal a serious blow to retirement preparations. The loss in earnings limits the ability to save. Although only about 20 percent of private-sector workers now participate in traditional employer pension plans,

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participants forego substantial future benefits when forced to separate before they can begin collecting their pensions.[2] Most people forced to stop working in their 50s also lose future Social Security retirement benefits (although Social Security disability benefits can cushion the impact for those who qualify). Even when health problems force people only to reduce their work hours, instead of dropping out of the labor force completely, the financial consequences for retirement can be severe.

Retirement savings can also suffer when workers' family members become ill. For example, if spouses are also employed, the households' earnings and credits toward future retirement benefits fall when the spouses' health problems force them to curtail their employment. Some people must also cut back on their own work hours to care for ill family members.[3] In 2001, 35 percent of those bankrupted by medical problems curtailed their employment, often to care for someone else.[4]

Health problems can also trigger out-of-pocket medical spending, forcing people to dip prematurely into retirement nest eggs or to tap money earmarked for saving. In a recent survey, 39 percent of terminally ill patients reported that health care costs caused moderate or severe financial problems.[5] Medical costs were a contributing factor in at least 17 percent of individual bankruptcies in 2001.[6] Unlike Americans age 65 or older, nearly all of whom receive health insurance coverage through Medicare, 13 percent of adults age 55 to 64 were uninsured in 2004, compounding the financial risk from serious illness or injury.[7]

Health problems so severe that they require people to obtain help with such basic daily activities as eating, bathing, and dressing pose special financial challenges. Home health aides charged $19 per hour on average in 2004.[8] For the typical user of paid home care services who receives 60 hours of paid care per month, annual home care costs total nearly $14,000.[9] Nursing home care is much more expensive. In 2005, the average daily private pay rate for a semi-private room in a nursing home was $176, or more than $64,000 per year.[10] Because private and public insurance for long-term care services is limited, many long-term care costs are paid out of pocket, until people have exhausted their financial resources.

Widowhood and Divorce

Widowhood and divorce in late mid-life can also disrupt retirement savings. The second paycheck, along with at least some of the spouses' benefits, disappears when marriages end. Consumption needs generally fall when a household shrinks, but not by much, at least according to the assumptions underlying the official poverty threshold.[11] In 2000, 17 percent of widowed women and 20 percent of divorced women age 65 or older received incomes less than the federal poverty line, compared with just 4 percent of married women.[12]

Job Loss

Job layoffs in the years just prior to retirement can have long-lasting financial consequences. People in their 50s who become unemployed frequently have trouble finding work.[13] Long spells of unemployment reduce pension and Social Security credits and leave people with less money to put aside for retirement.

Health, Employment, and Marital Shocks Strike Often

About 7 in 10 adults who were age 51 to 61 in 1992 develop health problems, lose their jobs, or lose spouses to death or divorce during the 10-year period ending in 2002 (see Table 1). More than 4 in 10 are diagnosed with major new medical conditions,

Table 1. Incidence of Shocks 1992-2002, by Baseline Marital Status

Negative events	All	Married	Single
Major medical condition	41.3%	40.2 %	44.3%*
Health-related work limitation	33.7	33.0	35.8 *
Severe disability	6.9	5.6	10.5 *
Enter nursing home	3.4	2.7	5.7 *
Laid off from job	18.7	18.2	20.0
Divorced	2.3	3.1	-
Widowed	7.3	9.8	-
Any negative shock for individual	**69.0**	**69.1**	**68.6 ***
Any negative shock for individual or spouse	**82.3**	**86.9**	**68.6**

Source: Authors' calculations using data from the 1992 and 2002 waves of the *Health and Retirement Study*. See endnote 14 for more details.
* Indicates significant difference (p<.05) from married group.

including heart problems, cancer, serious lung problems, diabetes, strokes, and psychiatric problems.[15] About one-third develop work disabilities — health problems that curtail employment — and about 7 percent develop disabilities severe enough to limit bathing, dressing, or eating. Nearly one-fifth are laid off between 1992 and 2002. More than 3 percent enter nursing homes. Nearly 10 percent of married adults become widowed; another 3 percent divorce.

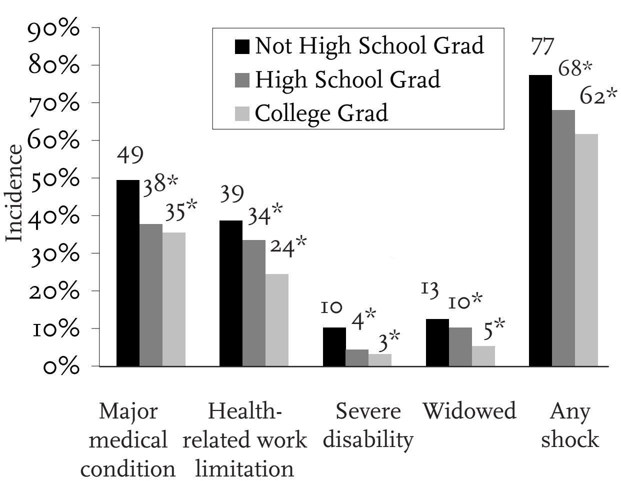
Health problems at late mid-life are more common among single people, who lack the financial and emotional support of a spouse, than married people. For example, unmarried adults ages 51 to 61 are about 4 percentage points more likely to develop a major medical condition than married adults, and about 5 percentage points more likely to become severely disabled.

Married people, however, face the added risk of divorce and the risk that their spouses could die, become ill, or lose their jobs. When things go wrong for spouses, the financial consequences can be just as serious as when one's own health fails or other misfortune strikes. With spousal health problems and job loss factored in, the share of married people ages 51 to 61 experiencing negative events over a 10-year period jumps to 87 percent, compared with 69 percent for single people.

Negative shocks at older ages are especially common among people with limited education, who generally have fewer financial resources to help them weather adversity (see Figure 1). For example, at ages 51 to 61, about half of married adults without high school degrees develop new medical conditions over a 10-year period, compared with only about one-third of married college graduates. Health-related work limitations strike nearly 40 percent of married people during the period who did not complete high school, but only about one-quarter of those with college degrees. Married high school dropouts are more than twice as likely to become widowed as married college graduates and more than three times as likely to develop severe disabilities. Negative events in late mid-life also strike single people with limited education more frequently than those with college degrees.[17]

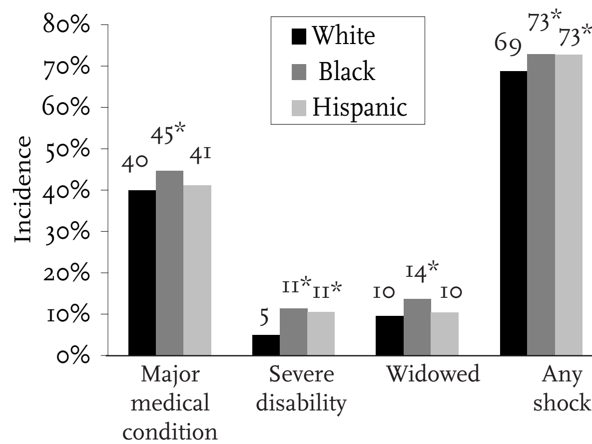
Negative shocks are also more common among blacks and Hispanics than whites (see Figure 2).

Figure 1. Incidence of Selected Shocks 1992-2002 for Adults Married at Baseline, by Educational Level



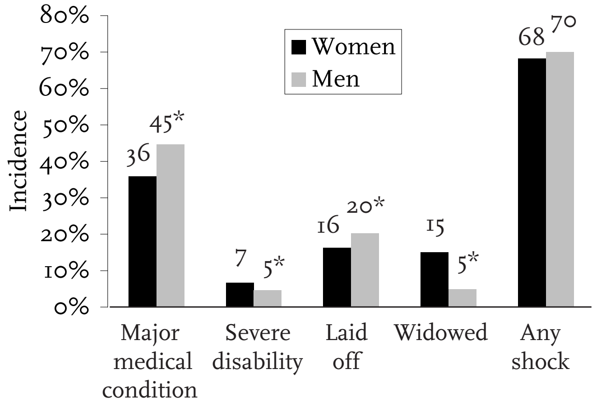
Source: Authors' calculations using data from the 1992 and 2002 waves of the *Health and Retirement Study*. See endnote 16 for more details.
* Indicates significant difference (p<.05) from group without high school degree.

Figure 2. Incidence of Selected Shocks 1992-2002 for Adults Married at Baseline, by Race



Source: Authors' calculations using data from the 1992 and 2002 waves of the *Health and Retirement Study*. See endnote 16 for more details.
* Indicates significant difference (p<.05) from whites.

Figure 3. Incidence of Selected Shocks 1992-2002 for Adults Married at Baseline, by Gender



Source: Authors' calculations using data from the 1992 and 2002 waves of the *Health and Retirement Study*. See endnote 16 for more details.
* Indicates significant difference (p<.05) from women.

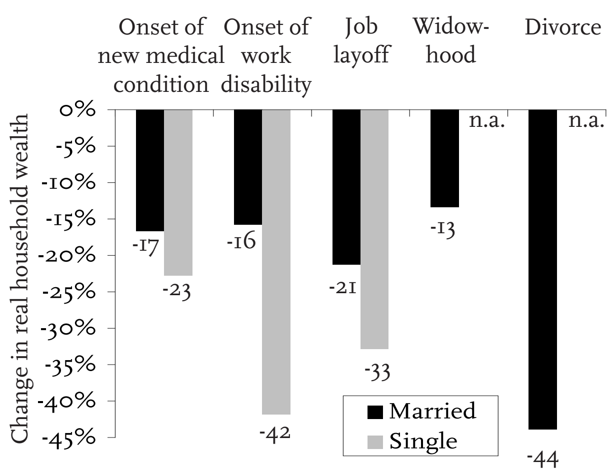
The greatest difference is in the incidence of severe disabilities; married blacks and Hispanics are more than twice as likely as married whites to develop limitations in bathing, dressing, or eating.[18] Married blacks are also significantly more likely to receive new diagnoses of major medical conditions, especially diabetes, than married whites, and are more likely to become widowed.

Married men are just as likely as married women to experience some type of negative shock in late midlife, but women are more likely to become widowed or severely disabled (see Figure 3). For example, 15 percent of married women age 51 to 61 become widowed over a 10-year period, compared with only 5 percent of married men. Married men, however, are more likely to develop medical conditions than married women. Over a 10-year period, 45 percent of married men ages 51 to 61 are diagnosed with major medical conditions, compared with 36 percent of married women. Gender differences are especially dramatic for heart problems, which begin to afflict 20 percent of men but only 12 percent of women. Layoff rates are also higher for men than for women. There are no significant gender differences among unmarried people in the likelihood of experiencing health problems or job layoffs in late midlife.

Shocks Reduce Household Wealth

HRS estimates show that health problems, job layoffs, and marital dissolution in late mid-life significantly reduce household wealth. For example, the onset of work disabilities among people in their 50s and 60s reduces wealth by 42 percent for single people and 16 percent for married people, holding constant such other personal characteristics as education, race, gender, age, and baseline health status (see Figure 4).[19] Median 2002 wealth is about $9,000 lower for single people who develop work disabilities than for similar people who do not report any work disabilities. The onset of medical conditions that do not necessarily limit work has smaller but still significant effects, reducing household wealth by 23 percent for single people and 17 percent for married people. Job layoffs shrink wealth by 33 percent for single people and 21 percent for married people. Health problems and job loss are especially serious for single people, because they cannot fall back on the economic resources of their spouses when adversity strikes.

Figure 4. Estimated Impact of Shocks on Real Household Wealth 1992-2002, by Baseline Marital Status



Source: Authors' calculations using data from the 1992 and 2002 waves of the *Health and Retirement Study*. See endnote 20 for more details.
n.a. = not applicable

Widowhood and divorce in late mid-life significantly reduce wealth, even factoring in reduced living expenses resulting from the loss of a spouse. People who become widowed experience a 13 percent decline in household wealth, and those who become divorced experience a 44 percent decline.

Household wealth includes financial assets (such as bank accounts, Individual Retirement Accounts, stocks, and bonds) and the value of housing (net of outstanding mortgage debt), other property, and businesses. It excludes the value of future benefits from Social Security and traditional employer pension plans.

Conclusion

Health problems and job layoffs are common as people approach retirement, though most Americans lack adequate protection when such disaster strikes. Inadequate health insurance exposes people to high out-of-pocket costs when serious medical conditions develop. The safety net is meager for people who lose their jobs or are forced to retire early because of declining health. Unemployment benefits generally last no more than 26 weeks, and only those who satisfy Social Security's strict eligibility requirements receive disability benefits. Health problems, job losses, widowhood, and divorce in the years immediately prior to retirement can rob people of financial security later. Workers need to consider these risks as they develop their retirement plans. Those who wait until their 50s to begin saving seriously, as many do, may find it too late to protect themselves against unexpected setbacks and the financial consequences.

Endnotes

1 Workers who leave their employer before age 50, who have not generally built up many years of service and whose earnings on the job tend to be lower than older and more experienced workers, do not usually receive large pensions. Inflation also erodes future pension benefits for workers who separate before they begin collecting benefits, because employers do not adjust the initial benefit for price changes.

2 Costo (2006).

3 Coile (2003); Johnson and Favreault (2001); and Johnson and LoSasso (2000).

4 Himmelstein et al. (2005).

5 Emanuel et al. (2000).

6 Dranove and Millenson (2006).

7 U.S. Census Bureau (2005).

8 Metlife (2005).

9 Johnson and Wiener (2006).

10 Metlife (2005).

11 The official poverty thresholds imply that a married couple needs only 26 percent more income than an unmarried person living alone. A National Academy of Sciences panel concluded that a married couple needs between 57 percent and 68 percent more income than an unmarried person (Citro and Michael 1995), confirming that two people can live much more cheaply than one.

12 Social Security Administration (2002).

13 Chan and Stevens (2001).

14 Estimates are for those age 51 to 61 at baseline. Major medical conditions consist of cancer, stroke, heart problems, lung disease, psychiatric problems, and diabetes. Individuals are classified as severely disabled if they report limitations with two or more of the following activities of daily living: bathing, dressing, and eating.

15 Heart ailments are especially common. Over a 10-year period, 16 percent of adults ages 51 to 61 at baseline develop serious heart problems. About 10 percent contract diabetes, 10 percent develop cancer, and 9 percent experience psychiatric problems. Only 5 percent have strokes and 6 percent contract lung disease.

16 Estimates cover years 1992 to 2002, for married adults age 51 to 61 at baseline. Major medical condition includes cancer, stroke, heart problems, lung disease, psychiatric problems, and diabetes. Individuals are classified as severely disabled if they report limitations with two or more of the following activities of daily living: bathing, dressing, and eating. Estimates do not include spousal health or employment shocks.

17 See Johnson, Mermin, and Uccello (2005).

18 The incidence of severe disability is also about twice as high for single blacks and Hispanics as for single whites. See Johnson, Mermin, and Uccello (2005).

19 Estimates are based on median regressions of real household wealth in 2002 or at death for those who do not survive until 2002. The analysis measures shocks between 1992 and 2002 or death. Regressions control for education, race, age, baseline medical conditions, and baseline work disabilities. Regressions for married people also control for spousal health in 1992 and spousal shocks after 1992. The analysis adjusts for household size by dividing household wealth for married people by 1.62. For more information, see Johnson, Mermin, and Uccello (2005).

20 Estimates are based on median regressions of real household wealth in 2002 or at death for those who do not survive until 2002. The analysis measures shocks between 1992 and 2002 or death. The sample consists of adults ages 51 to 61 in 1992, and models were estimated separately by 1992 marital status. In cases where both members of a married couple were age eligible, we randomly selected one spouse for the sample. Regressions control for education, race, age, baseline medical conditions, and baseline work disabilities. Regressions for married people also control for spousal health in 1992 and spousal shocks after 1992. Wealth includes financial assets and the net value of housing, other property, and businesses, and is expressed in constant 2002 dollars. The analysis adjusts for household size by dividing household wealth for married people by 1.62. For more information, see Johnson, Mermin, and Uccello (2005).

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About the Center

The Center for Retirement Research at Boston College was established in 1998 through a grant from the Social Security Administration. The Center's mission is to produce first-class research and forge a strong link between the academic community and decision makers in the public and private sectors around an issue of critical importance to the nation's future. To achieve this mission, the Center sponsors a wide variety of research projects, transmits new findings to a broad audience, trains new scholars, and broadens access to valuable data sources. Since its inception, the Center has established a reputation as an authoritative source of information on all major aspects of the retirement income debate.

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