

# WORKING PAPER

## *Executive Summary*

MAY 2004, WP # 2004-16

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## EFFECTS OF STOCK MARKET FLUCTUATIONS ON THE ADEQUACY OF RETIREMENT WEALTH ACCUMULATION

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Several secular trends have led policymakers and researchers to question the adequacy of households' financial preparations for retirement in recent years. The baby boom generation is rapidly approaching retirement age. The need for retirement saving has increased as retirement ages have held constant or fallen, but life-spans have risen. Social Security and Medicare face long-term shortfalls that may require benefit cuts. Family networks, a traditional source of support in old age, are suspected to provide less support in the future. Private pension coverage has stagnated. Saving rates have hovered near zero and many households approach retirement with little in the way of financial assets.

On the other hand, the last two decades have seen a strong increase in equity values and in the share of households with direct and indirect ownership of equities. Equity values rose 50 percent relative to GDP from 1981 to 1990, and then tripled relative to GDP between 1990 and 1999. The dramatic, sustained rise in stock market values helped assuage some of the concerns about the adequacy of saving, but the decline since 2000 has led to renewed concerns about saving adequacy.

This paper examines the adequacy of households' saving for retirement and makes two contributions relative to the previous literature. First, using data from the 2001 Survey of Consumer Finances, we update previous work and provide more recent evidence on how well households are preparing for retirement. In contrast, most previous work uses data that are now 10 years old or older. The use of more recent data is particularly useful in light of the significant changes in the composition and level of wealth accumulation in the 1990s.

Our second contribution is to examine explicitly the role of the stock market in determining the adequacy of households' financial preparation for retirement. Although it may seem obvious that increases in the stock market help people save more for retirement, the overall effect on the adequacy of saving may be more complex. Households may adjust their other wealth or retire earlier in response to stock market fluctuations, and to the extent that stock holdings are concentrated among households that are extremely wealthy, variations in equity values will have little effect on how well the vast majority of households are faring with respect to retirement saving.

Despite the trends noted above, we find that many and perhaps most married couples, where the husband works full-time appear to be saving adequate amounts for retirement. Despite the popular linking of equity values and retirement saving, we find almost no link between variations in stock values and variations in the overall level or distribution of adequate saving. Historical variation in equity values and ownership does not correlate well with historical variation in the adequacy of saving. A simulated 40 percent decline in stock values – roughly the decline of broad market indices from their peak in 2000 to their trough in 2002 – has little effect on the observed adequacy of saving. The main

reason is that most households who hold stocks have significant amounts of other wealth and thus are deemed to be saving adequately even if their stock values fall. Despite the large increase over time in the share of households that hold some equities, the vast majority of American households hold very little equity or none at all, so that even substantial variation in equity prices has little direct effect on the wealth of most American households.

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