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# THE IMPACT OF CHANGING EARNINGS VOLATILITY ON RETIREMENT WEALTH

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Over the last several decades, the volatility of family income has increased markedly, and own earnings volatility has remained relatively flat. Volatility in earnings may affect retirement wealth, depending on whether volatility affects accrued pension contributions or withdrawals or earnings credited toward future Social Security benefits. This project assesses the effect of the volatility of individual and family earnings on asset accumulation and projected retirement wealth using survey data matched to administrative earnings records. We consider different types of wealth (including financial assets, housing, Social Security wealth, and the combination of these) separately, and we contrast results for married people with those for never married people.

We use data from two separate matched surveys: The *Survey of Income and Program Participation* and the *Health and Retirement Study*. Using two separate surveys allows us to check the robustness of our results. This is important given that each survey has strengths and weaknesses for this application.

We find that higher earnings volatility over the relatively short term is associated with higher wealth for married people. When we decompose volatility into two components, the average volatility and the change in volatility, we find that the longer-term average drives the association. Effects for never married people are less clear, and typically do not differ statistically from zero. Considering different types of wealth, the effect of earnings volatility on Social Security wealth appears to differ from the effect on financial wealth and total wealth, with greater volatility sometimes negatively associated with the OASDI wealth. While our analyses have a somewhat different focus, these results are generally consistent with previous findings (Mitchell, Phillips, Au, and McCarthy 2007).

Supplemental analyses using an instrumental variables strategy have broadly consistent results as well, suggesting that our findings may be robust to the selectivity in, for example, the types of people who choose jobs with more or less risky earnings.

Overall, our findings support the idea that more volatile earnings prospects over the long run leads workers to increase precautionary saving but short-term volatility is associated with spending down wealth. If this is true, short-term increases in volatility of earnings, such as occur in major recessions, could leave individuals unable to retire when they would like to, or short of resources after retirement, but may also increase savings rates among younger workers who adjust their expectations of future earnings volatility.

The increase in mortgage debt exposure has affected the retirement preparedness of households. For the typical aged 50-62 in 2004, the extraction of home equity during the housing boom resulted in a 14 percent decline in net worth — accounting for the present discounted value of future rents — between 2001 and 2008. The fact that the extraction of home equity has been concentrated in about 30 percent of households means that a substantial portion of the population entering retirement will experience a much larger decline in net worth — a loss of about 35 percent in net worth. To these households, the housing boom provided some liquidity. But they will enter retirement with a fragile balance sheet in a time of depressed home prices and poor financial market returns.

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