

## Financial Preparation for Retirement

Data from 1989 Survey of Consumer Finances were used to examine the effect of socioeconomic variables on involuntary, voluntary, and other financial preparation of preretirees. Age, education, race, tenure, and employment status significantly influenced involuntary and voluntary financial preparation of preretirees which has implications for policy makers, gerontologists, retirement counselors, financial planners, and educators.

**Y. Lakshmi Malrouu, Queens College, CUNY<sup>1</sup>**  
**Jing J. Xiao, University of Rhode Island<sup>2</sup>**

Retirement is a complex social process through which people move during their lifetime. As 13% of Americans have already reached retirement ages and more approach the threshold of retirement, their responses to social forces affecting retirement will be determined by their experiences, expectations, and planning behavior. Although the elderly have higher per capita income, social and demographic changes such as increasing number of elderly, increased life expectancies, high divorce rates, changes in real wages, saving rates, and decreasing labor force participation may adversely affect their retirement incomes (Burns, 1990). One of the issues in retirement is the ability to finance it and the financial preparation for retirement is likely to vary among individuals.

Most current literature on retirement is based on people who are now older as preretirees are not frequently studied for retirement literature but this study attempted to fill that limitation. The purpose of this study is to understand the extent of financial preparation of preretirees and to examine the effect of socioeconomic differentials on their financial preparation for retirement.

### Literature Review

Several studies have focussed on the importance of financial status to both retirement preparation and satisfaction. While some studies measured the financial status of the elderly, financial planning for retirement requires evaluating the positions of preretirees relative to retirement needs. Many methods can be used and one of them is the life cycle hypothesis. The life-cycle economic approach implies that people try to vigorously save before retirement because they think they will be dissaving after retirement; although economists have shown that retired persons are less likely to dissave than was originally posited (Danzier, Van Der Gaag,

Smolensky, and Taussig, 1982; Ando and Modigliani, 1963; Kotlikoff, Spivak, and Summers, 1982; Hogarth, 1991).

An alternative interpretation of the inequalities of income distribution among the elderly is the cumulative advantage/disadvantage model. Those who are initially advantaged are more likely to receive a good education, leading to good jobs, leading to better health and better pension coverage, leading to higher savings and better postretirement benefit income (Crystal & Shea, 1990).

Leon (1985) identified a recursive model of economic status in retirement that pointed to a sequence of factors where previous conditions influenced later ones. He found that the family's socioeconomic and demographic characteristics determine to a large extent the educational attainment, which then influences occupational achievement.

In this study, task specific indices such as voluntary savings, and involuntary savings were synthesized to form an overall assessment of financial preparation. This study will try to overcome a major limitation of previous research. It will assess both voluntary and involuntary financial preparation to determine the overall financial preparation of preretirees. Some of the limitations of this study are: 1) Survey data of 1989 was used. Comparisons between years or longitudinal data could reveal a more thorough understanding of financial preparation of preretirees. 2) Imputed rent and home equity annuities were not considered for financial preparation. 3) It would be preferable to have more finely grained information on voluntary financial preparation including plans for saving, saving habits, and financial obligations.

## Methodology

### Data and Sample

Data from the Survey of Consumer Finances collected in 1989 by the Survey Research Center, University of Michigan, and sponsored by the Federal Reserve Board and several other federal agencies were used. The data replicates the first imputation from the public use tape (Kinneckell and Shack-Marquez, 1992).

Since the primary objective of this study is to examine the financial preparation of preretirees, employed respondents aged 65 years or younger were selected for the sample. The age delineation allowed representation of persons on the age continuum to compare those near retirement, 'the near phase' as well as those who have considerable time until retirement, 'the remote phase'. The sample size for the study was 1971 and included only full time workers, with the premise that full time workers were more likely to be eligible for pension plans and participate in contributing to them. Weighted samples were used to produce descriptive statistics and conduct data analyses.

### Variables

Dependent variables. Dependent variables for these analyses were grouped into involuntary financial preparation, voluntary preparation, and other financial preparation. Two involuntary financial preparation measures were considered, eligible for pension or retirement plan(s), PENSION, and contribution to pension or retirement plan(s), PENCON.

Voluntary financial preparation was measured using four indices, reported reason of saving for retirement (RETIRE), networth status (NETWTH), planning the time period for saving (PLAN), and saving habit (SAVEHAB). The first variable was a saving motive if one of the respondent's reason for saving was for retirement. The other three variables, networth status, planning the time period for saving, and saving habits are measures of saving behavior. Networth status is a cumulative index consisting of paper assets and cash value of whole life insurance, house, value of other properties, gross market value of vehicles, present value of private pension minus total liabilities. Planning the time period for saving is crucial for financial preparation. Saving habit measured if a respondent was saving at the present time.

The other financial preparation measures were financial obligations (FINOBLIG), private health insurance coverage (HEALTHINS), and adequacy of retirement income (ADEQ). The first two measures assessed if respondents had any financial obligations such

as educational costs, and health care costs, and if they had health insurance coverage. The perception of the preretirees was tested by asking if they felt they would have adequate retirement income.

Independent variables. The independent variables include socio-demographic factors: age, gender, race, marital status, and household size; human capital-related factors: education, health status of respondent and spouse/partner, and tenure; and work-related factors: employment status, and length of employment. Initially, income was included in the analyses as an independent variable, however, no income effect was found in seven out of the eight dependent variables. So the final analyses did not include income as an independent variable.

### Analysis

Since the dependent variables in this study were measures of retirement preparation which suggested the propensity of retirement preparation, the probit models were more appropriate for the purpose of this study (Maddala, 1992, p. 327).

## Results

The descriptive statistics of the weighted sample were presented in Table 1. The majority of the sample was male, white, with self reported good health, worked for an employer, contributed to a pension plan, and had private health insurance coverage. The mean household size was 3 members, with an annual household income of \$44,122.00.

The results of the socio-economic factors affecting the financial preparation of preretirees are presented in Table 2. Involuntary financial preparation was significantly influenced by socio-demographic and human capital factors. Whites, preretirees between 31-59 years and with higher education, and homeowners were more likely to have pension plans, whereas self-employed and married preretirees were less likely to have retirement or pension plans. Preretirees with higher education and having worked longer for their current employer were more likely to contribute to pension plans, while whites, married, respondents with good health were less likely to contribute to pension plans.

Voluntary financial preparation was influenced by some of the socio-demographic factors and human capital factors (refer to Table 2).

Table 1  
Descriptive statistics of the sample  
(N=1971)

	%	Mean (SD)
<u>Socio demographic variables</u>		
Age		
<31 years	20.2%	
31-38 years	23.6	
39-45 years	23.6	
46-52 years	13.1	
53-59 years	12.9	
60-65 years	6.6	
Gender		
Male	80.2%	
Female	19.8	
Race		
Whites	77.9%	
Nonwhites	22.1	
Marital Status		
Married	63.3%	
Nonmarried	36.7	
Household size		3.07 (2.8)
<u>Human capital variables</u>		
Income		44.1K (4.7K)
Education		13.34 (4.70)
Res health		
Excellent	45.2%	
Good	43.2	
Fair/Poor	11.6	
Spouse health		
No spouse	32.6%	
Excellent	28.2	
Good	29.9	
Fair/Poor	9.3	
Tenure		
Homeowner	64.7%	
Renter	35.3	
<u>Work related variables</u>		
Employment		
Employer	85.4%	
Self empl	14.6	
Lgth of empl		9.20 (1.49)

Whites, having higher education and a spouse with good or excellent health, and homeowners were more likely, and preretirees 52 years and younger, larger household size, and self employed were less likely to report saving for retirement. Whites, and homeowners were more likely to have positive networth status. Respondents between 53 and 59 years, having good health, homeowners, and self employed were more likely to have plans to save within the next five years, however, larger households planned to save after five years. Self employed and whites were less likely to save at the present time but higher educated, homeowners, and those having a spouse with good health were more likely to save.

Other financial preparation indices were significantly affected by socio-demographic, human-capital, and by self employment. Preretirees aged 59 years or younger, higher education, self employed, and those having a spouse with good health were more likely and males and those having good health were less likely to have financial obligations. Respondents aged 31-45 years, 53-59 years, whites, married, higher educated, homeowners, having good health, and having a longer work experience were more likely to have private health insurance coverage and the self-employed were less likely to have private health insurance coverage. Married, white, preretirees between 38 years or younger, having a spouse with good health, and self employed were less likely to perceive having adequate retirement incomes. This study presented some interesting and mixed results about the financial preparation of preretirees. Further research would help in clarifying some of the results obtained in this study.

### Discussion

Older respondents were more likely to report saving for retirement. Preretirees as young as 30 years indicated that one of the reasons for saving was for retirement. However, their networth status and saving habits were not reflective of this saving motive. Saving motives reported by preretirees may be a better indicator of perceived financial needs and may not exhibit immediate action (Xiao and Malroux, 1994). A matter of concern is the lack of contribution to pension plans for employed preretirees among all age groups. Social

Table 2  
Results of Probit Analysis of Financial Preparation for Retirement

	Involuntary		Voluntary Financial Preparation			
	Pencon	Pencon	Retire	Netwth	Plan	Savehab
Age						
<31	.12	.05	-1.3***	-.09	-.17	-.07
31-38	.53**	.11	-0.8***	-.51	.20	-.07
39-45	.71***	.36*	-.72***	-.09	-.09	.06
46-52	.40*	.05	-.39**	.11	.22	-.17
53-59	.40*	.30	.08	.90	.29*	-.01
60-65 <sup>a</sup>						
Gender						
Male	.03	-.12	-.03	-.01	.15	-.06
Female <sup>a</sup>						
Race						
Whites	.31***	-.21*	.28**	.45*	.11	-.19*
Nonwhites <sup>a</sup>						
Mar Status						
Married	-.41*	-.59**	.12	-.46	.26	.05
Nonmarried <sup>a</sup>						
Hhld size	.01	.03	-.19***	-.02	-.06*	-.03
Education	.09***	.06***	.05***	.05	-.01	.08***
Res health						
Excellent	-.04	-.25*	.04	.17	.44***	-.12
Good	-.08	-.36**	.08	.28	.34***	-.03
Fair/Poor <sup>a</sup>						
Spse health						
No Spouse	-.35	-.73**	-.05	-.39	.05	.35
Excellent	.69	-.20	.29*	.14	-.12	.64***
Good	-.16	-.17	.45***	.40	-.02	-.46***
Fair/Poor <sup>a</sup>						
Tenure						
Homeowner	.40***	.13	.43***	1.3***	.36***	.22**
Renter <sup>a</sup>						
Employment						
Employer	2.3***	1.4***	.21*	-.45	-.20*	.20*
Self emply <sup>a</sup>						
Lgth emply	.06***	.03***	.00	.03	.01	.01
Log likelihood	-967.3	-782.1	-933.1	-436.3	-1241.1	-1047.7

<sup>a</sup> reference category

\* p<.05

\*\*p<.01

\*\*\*p<.001

security is often described as a program which was never intended to be the predominant income source on which retirees should rely, but rather to complement savings, private pensions, and other private sources of income, sources which in fact account for a large share of the resources on which older persons depend. The suggestion that social security should be reduced in favor of expanded private systems is often recommended. In light of the present results, it is evident that even preretirees who are closer to retirement (60-65 years) were not significantly contributing to pension plans. When these preretirees retire they will have no other alternative but depend on social security as their primary source of retirement income.

Race was also an important factor in predicting the voluntary and involuntary financial preparation of preretirees. Nonwhites were in a precarious position of not having jobs that provide pension plans, and had no private health insurance coverage. Their reported reason for saving was not for retirement, had zero or negative net worth, and were not saving each month, but felt they would have adequate retirement income. These results are indicative of the structural arrangement of the society as well as the socio-demographic factors (Leon, 1985). Even though nonwhites were not included in pension plans and were not saving each month they felt they would have adequate retirement income. Perhaps, they may foresee little change in their living standards and subsequently, feel they have adequate retirement income.

In keeping with the cumulative advantage theory (Crystal and Shea, 1990), the results of this study indicate that education had a significant effect on involuntary and voluntary financial preparation. Better educated preretirees were more likely to be employed in jobs with pension plans, were contributing to them. Education also significantly influenced the preretirees' saving for retirement. Preretirees with higher education felt they had no financial obligations, and were covered by private medical insurance.

The longer the respondent was employed the more likely (s)he had pension plans and were contributing to these plans. Length of employment had a significant effect on medical insurance coverage.

As expected self employed respondents did not have pension plans and were not contributing to these plans. Although IRAs and Keogh plans encourage self employed persons to start saving for retirement, they are underutilized and often overlooked. Preretirees employed in government jobs and in private industry are compelled to contribute a certain percentage of their salaries towards a retirement plan. Herein emerges a picture where

preretirees lack the mental discipline to save for retirement unless involved in a mandatory retirement plan.

### **Implications**

Maintaining economic well-being among elderly persons is a major public policy goal and is the object of extensive budgetary outlays and transfer payments. Understanding how pre-retirement socio-economic characteristics influence post-retirement economic outcomes is important for policy formulation and, more broadly, in understanding processes of socio-economic stratification across the full life course.

The development of any kind of financial resources is preferable to no preparation. Pre-retirement programs offered either by employers, educators, or private providers should be geared toward those who are in financial need for retirement. Financial planning programs must also present realistic assessments of pension benefits and social security. Even small annuities and IRAs, with limited annual contributions and short time periods for development, provide some financial security. Pre-retirement programs should take into account a worker's age, financial position, and stage in the family life cycle to effectively appeal to workers.

Finally, anyone concerned with aiding the well-being of pre-retirees is probably troubled by the recurrent finding that minorities, those with less education, and the self employed are not as active in preparing for retirement. This research confirms the work of others, who point out that those might benefit most from such planning are among the least likely to pursue it. While intervention aimed at increasing participation in retirement preparation should continue to be vigorously supported, the recurrence of this finding infers that the problem is deeper and more systemic in nature than simply increasing an awareness for participation.

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#### Endnotes

1. Assistant Professor, Consumer Studies, Department of Home Economics.
2. Assistant Professor, Consumer Affairs Program, HSS.