

How do U.S Households Perceive Their Preparedness for Retirement? Perception Versus Objective Retirement Adequacy of U.S Households

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Introduction

Retirement adequacy of current workers is still a significant issue in policy debates about Social Security reform and in proposals for restructuring of public and private defined benefit plans, as well as for income tax incentives for retirement saving and penalties for early withdrawal of funds from tax sheltered retirement accounts. However, retirement planning is becoming increasingly challenging because workers face economic uncertainty, Social Security benefit insolvency, and increased life expectancy. Choi, Laibson, and Madrian (2004) noted that over the last 20 years, defined benefit pension plans have continued to replace defined-contribution pension plans so that workers are more responsible for their own retirement savings. Therefore, more accurate self-assessment of an individual's financial status would be a salient factor in retirement planning. The main purpose of this study is to assess the projected retirement adequacy of U.S households having different perceptions of being adequately prepared for retirement.

Methods

Data and Sample Selection

The dataset analyzed in this study is the 2010 Survey of Consumer Finances (SCF), a cross-sectional dataset sponsored by the Federal Reserve Board. The analytical sample is composed of households with a head and/or spouse/partner who is age 35 to 70, employed full time, and indicated the age at which s/he planned to stop full-time work; similar to previous retirement studies such as Yuh, Montalto, and Hanna (1998) and Chen (2007). Of the total sample, 2,636 households met the sample criteria.

Objective and Subjective Measurement for Retirement

The calculation of resources during retirement follows the retirement income stage method reported by Chen (2007) and Kim, Chen and Hanna (2012). To determine adequacy of retirement resources, benchmark replacement ratios from the published income categories from the 2010 Consumer Expenditure Survey published by BLS are estimated. If the replacement ratio is equal to or greater than the benchmark replacement ratio, the household would have an adequate retirement resources to sustain desired retirement needs. The SCF has a variable for the retirement perception, with five levels – totally inadequate, inadequate, enough to maintain living standards, satisfactory and very satisfactory. Though little research has focused on the SCF retirement perception variable, it would plausibly reflect respondent's perception of having an adequate retirement. For the purpose of this study, the subjective measurement is a dichotomous indicator of households' perception of having an adequate retirement with value equal to 1 if the value of indicator is 3, 4, or 5 (adequate), otherwise the value is 0 (inadequate).

Result

As shown in Table 1, from the 2010 Survey of Consumer Finances, only 42% of working households were adequately prepared for retirement based on an objective measure while 47% rated their future retirement income adequate. About 53% of households had consistency between subjective and objective assessments described as realists having adequate resources. 21% were pessimists (only objective adequacy) while 26% were optimists (only subjective adequacy).

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Table 2 indicates financial characteristics of four different groups above. In order to examine financial situation of each group, four socioeconomic variables such as mean and median net worth, educational attainment with bachelor degree or higher, having defined contribution (DC)/ benefit (DB) pension, and use of financial planner for saving and investment decision are employed. Realists with adequate resources have the highest proportion in all variables except the mean net worth while similar households (realists) with inadequate resources have the lowest percentage in all categories. Households with enough retirement resources were more likely to use a financial planning service than households having inadequate preparedness. Almost a half of households have defined contribution pension in both the pessimists and optimists group.

Table 1

Proportion of households meeting subjective and objective retirement adequacy

	Objective Measurement ^b		
	Adequate Retirement	Inadequate Retirement	Total
<u>Subjective Measurement ^a</u>			
Perceived Adequate retirement	20.7%	26.4%	47.1%
Perceived Inadequate retirement	21.1%	31.8%	52.9%
Total	41.8%	58.2%	100%

^a For the purpose of this study, the perceived retirement adequacy variable is coded as a binary category. When the response is coded less than 2 (totally inadequate and inadequate), it is defined as having perception of inadequate retirement. Otherwise, response more than 3 is recoded as having perception of adequate retirement.

^b See the method section

Table 2

Selected Descriptive Patterns for Retirement Perception Categories

	Mean net worth (median) ^a	Education of head (bachelor or more)	Having DC (DB) plan	Use of financial planner
Realists having adequate resources	924,197 (234,050)	58.8%	64.18 (28.48)	35.6%
Realists having inadequate resources	293,369 (58,740)	40.1%	35.88 (9.64)	22.5%
Optimists (only subjective adequacy)	347,506 (110,300)	37.3%	52.54 (15.96)	28.6%
Pessimists (only objective adequacy)	1108,217 (209,900)	49.7%	56.15 (15.23)	34.6%

^a Thousands of 2010 dollars

Discussion

Future researchers need to improve my analysis of individual's retirement assessment and perception. I will examine factors related to the divergence between objective and subjective assessments by employing four groups, categorized as "Realists having adequate resources", "Realists having inadequate resources", Optimists (only subjective adequacy), and Pessimists (only objective adequacy). In order to test the empirical result, a multinomial logit model will be used, which is

appropriate for analysis of alternatives that are neither hierarchical nor ordered. Policymakers should recognize the role of self-assessment and perception to improve retirement saving of U.S. households.

References

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