Why Americans Don’t Face a Retirement Crisis

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There is no question that many Americans face challenges in preparing for retirement. Social Security is substantially underfunded, its long-term shortfalls are increasing, and policymakers have not made reform a priority. Nonetheless, analysts’ claims that Americans face a “retirement crisis” overstate what households will need in retirement, fail to account for how the presence of children in a household affects the need to save, and incorrectly point to households’ declining wealth-to-income ratios as a sign of deteriorating retirement saving. A careful review of data and retirement studies reveals that the state of retirement preparedness is in fact a more modest, manageable issue. A false sense of crisis risks enacting policies that could have significant costs for government budgets and ordinary Americans’ retirement security. In particular, government-run pension programs are the most poorly funded element of overall retirement saving. Policies that would make Americans more dependent on these programs could put their retirement income security at risk.

For years, it has been tacitly accepted that large numbers of Americans are significantly underprepared for retirement—a so-called retirement crisis. Only recently has research, including our own, questioned this view, arguing that purveyors of the crisis theme overestimate the income Americans will need in retirement and underestimate the income they are likely to have.¹

This is a healthy debate to have, as the policy stakes are high. On the one hand, if the retirement crisis viewpoint is correct, then policy action is needed to prevent large percentages of Americans from facing a sharply declining standard of living once they retire. But a false sense of crisis, on the other hand, risks enacting policies—such as the expansion of Social Security and the de facto replacement of private retirement plans by state-run or federally run savings plans—that could have significant costs both for government budgets and ordinary Americans’ retirement security.

A recent paper by Keith Miller, David Madland, and Christian E. Weller reviews some of the key points of disagreement behind different views of retirement preparedness. The authors contrast three main studies on retirement preparedness: a pessimistic study from the National Institute for Retirement Security (NIRS), which finds that up to 84 percent of Americans are underprepared for retirement; the Center for Retirement Research’s (CRR’s) National Retirement Risk Index (NRRI), which concludes that 52 percent of Americans are currently at risk of having inadequate income in retirement; and a study by economists William Gale, John Karl Scholz, and Ananth Seshadri, which finds that about 26 percent of American households are falling short in preparing for retirement.²

Miller, Madland, and Weller focus on several important questions, including:

- What do data from the Federal Reserve’s Survey of Consumer Finances (SCF) say about Americans’ retirement preparations?
• Should replacement rates be calculated relative to wage-indexed or inflation-indexed preretirement earnings?

• How should retirement income targets account for whether a household had children?

• Do even the optimistic studies show significant shortfalls in Americans’ retirement saving?

The authors note that the models they evaluate include a variety of assumptions about households’ behavior, and outline some of the issues of disagreement, stating “what is extremely important about all of these assumptions is that they remain unsettled in the academic literature.” They then conclude that the most reasonable course is to answer these questions in ways that find that Americans are falling significantly short in preparing for retirement.

For instance, Miller, Madland, and Weller interpret wealth-to-income ratios calculated from the SCF as showing that “households near retirement age were worse off in 2013 than they were in 1989.” They also conclude that replacement rates, which compare retirement income to preretirement earnings, should be calculated relative to wage-indexed average earnings, which produces significantly lower measured replacement rates at retirement than calculations relative to the inflation-adjusted average of career earnings. Likewise, the authors conclude that target retirement incomes should not be adjusted to account for whether a household did or did not have children. The lack of such an adjustment significantly increases the share of parents who are judged to have inadequate incomes in retirement.

Miller, Madland, and Weller conclude that while the NIRS study may overstate the retirement crisis, the more optimistic studies do not fully capture the degree of under-saving. Thus, they argue that the CRR’s NRRI presents the best estimates of retirement saving preparedness in the United States.

Miller, Madland, and Weller’s paper is a useful document, as it helps focus attention on a relatively small number of methodological questions that have large effects on the public’s perceptions of how well Americans will fare in retirement. They correctly note that expert opinion is divided on these questions. What they do not reveal, however, is that expert opinion is far from evenly divided. It seems clear to us that on each of these key points of disagreement, the authors opt for the demonstrably weaker side of the argument, which leads to their conclusion that a retirement crisis indeed exists.

Moreover, while there is merit in contrasting different views, there is also the danger of false equivalence: the NIRS study is far less sophisticated than Gale, Scholz, and Seshadri’s study and utilizes methods and assumptions that even Miller, Madland, and Weller acknowledge to be crude. At the same time, Miller and colleagues pay almost no attention to work from two highly respected retirement economists, Michael Hurd and Susann Rohwedder, who use different methods to reach conclusions qualitatively similar to those of Gale, Scholz, and Seshadri.

And Miller, Madland, and Weller entirely ignore work by Jack VanDerhei and Craig Copeland that analyzes retirement saving in greater detail than any of the other models and concludes that overall retirement preparedness is not in decline. The inclusion of the NIRS study and the exclusion of other studies biases Miller, Madland, and Weller’s analysis toward viewing the CRR’s NRRI as a happy medium. But in fact, the core disagreements are between the CRR’s index and the more optimistic studies. And in the areas in which the CRR disagrees with the more optimistic studies, the latter group appears to get the better of the substantive argument.

Thus, the most reasonable conclusion to reach is that the more optimistic analyses—such as Gale, Scholz, and Seshadri’s; Hurd and Rohwedder’s; and VanDerhei and Copeland’s—are the best currently available studies of Americans’ retirement preparedness. These studies do not conclude that all Americans are saving as they should. In fact, in certain cases they isolate significant saving shortfalls.

However, they do not present a rapid and significant decline in retirement security that demands dramatic policy actions that would radically change the American retirement saving system. A more reasonable conclusion is that government-run retirement programs should be reformed to maintain their solvency and improve their effectiveness and that private plans such as 401(k)s should continue the pattern of incremental reform seen over the past decade.

What the Survey of Consumer Finances Data Say about Americans’ Retirement Preparedness

Analysts who believe that Americans are undersaving for retirement often point to wealth-to-income ratios calculated using data from the Federal Reserve’s Survey of
from 576 percent in 2007 to 469 percent in 2013. The decline in the ratio of total household wealth to earnings, the most convincing evidence involves no modeling at all: a simple comparison of wealth-to-income ratios suggests we should be concerned.

But these basic data do not measure precisely what readers may think. Most retirement planners compare households’ retirement savings to their annual salaries. This makes intuitive sense, since retirement savings are intended to replace earned income once a household retires. Ratios of household wealth to household income, by contrast, do not necessarily capture the same relationship.

In the SCF, household income includes not just wages and salaries but also investment income, government welfare and disability benefits, and, for early retirees, pension benefits. Financial planners usually exclude investment income from their calculations, because part of it is simply returns on retirement savings that are reinvested to support future consumption during retirement and, thus, do not contribute to the living standards of workers while they are still employed. The inclusion of investment returns increases income and thus lowers wealth-to-income ratios.

Likewise, most government benefits do not cease at retirement, so households need not save to replace them. As a result of these factors, total household incomes in the SCF exceeded wages and salaries by 40 percent in 2013, up from 20 percent in 1992. This shift artificially makes households appear less prepared for retirement.

It’s a similar story with household wealth. SCF wealth figures include not just retirement savings but also other financial assets and, importantly, the value of housing. Changes in these other components of household wealth can skew our views of Americans’ preparedness for retirement and of how well the US retirement system is functioning.

Figure 1 illustrates these issues using data from households in the 45–54 age range, comparing the components of mean household wealth to household earnings. If we compare 2007 to 2013, there is a significant decline in the ratio of total household wealth to earnings, from 576 percent in 2007 to 469 percent in 2013.

Proponents of the retirement crisis viewpoint believe that such patterns demonstrate a significant decline in retirement preparedness.

But the components of wealth tell a different story. From 2007 to 2013, retirement savings rose slightly, from 124 percent to 128 percent of annual household earnings. Net nonretirement financial assets declined somewhat, from 152 percent to 133 percent of household earnings. The largest decline by far was in housing wealth, which fell from 300 percent to just 208 percent of household earnings.

The conclusion to be drawn from these ratios is straightforward: the United States had a housing bubble. Housing values rose beginning around 2001, peaked in mid-2006, and declined from early 2007 through early 2009. The collapse of the housing bubble, not declining retirement saving, explains most of the recent drop in wealth-to-income ratios. Had the housing market not collapsed, overall wealth-to-earnings ratios would have declined by just 24 percentage points from 2007 to 2013, and virtually all of that decline was attributable to the falling value of nonretirement financial wealth, not retirement savings.

This result raises two issues. First, it is not clear why retirement plans should be considered deficient because of the bursting of a widely recognized housing bubble. No one has argued that retirement plans were at the root of housing price declines. If anything, rising ratios of retirement savings to earnings offset a small part of the housing-induced decline in household wealth. So, from a retirement policy context, it is not clear what lessons are to be drawn.

Second, housing wealth plays an unusual role in the retirement savings context. Put simply, retirees have to live somewhere. For the majority of older workers and retirees who stayed in their homes during the 2001–09 era, the expansion and collapse of the housing bubble are of limited importance. The actual housing services provided by the home relate to its characteristics, not how its price was affected by unusual housing-price inflation during the bubble era. Retirees who did sell their homes might have experienced a financial loss if they bought at the height of the bubble, but they also could have bought or rented a new home at a lower price than at the bubble’s peak.

This is not to say that retirement savings did not suffer at all during this period. The stock market declined, individuals lost their jobs, and some employees who kept their jobs held off on contributing to their retirement plans. This third outcome, while unfortunate, was in many cases

Consumer Finances (SCF). Alicia H. Munnell, Anthony Webb, and Luke Delorme—as well as Miller, Madland, and Weller—present such data, showing that wealth-to-income ratios have declined in recent years. These “basic data,” state Munnell and colleagues, “reveal a significant decline in the level of retirement preparedness.” Munnell goes so far as to call such figures “The retirement crisis in one chart,” while Anthony Webb states that “perhaps the most convincing evidence involves no modeling at all: a simple comparison of wealth-to-income ratios suggests we should be concerned.”

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an entirely rational response. For instance, if a husband lost his job due to the Great Recession, his wife might have held off on contributing to her retirement plan until her spouse was re-employed.

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But the decline in wealth-to-income ratios, cited as evidence of a retirement crisis, is almost entirely a product of falling home values, with secondary contributions from declining net nonretirement financial assets and rising income-to-earnings ratios. The US retirement system had almost nothing to do with these declines, and—in many cases—rising ratios of retirement savings to earnings offset declines in other components of wealth.

It is also worth noting that the SCF does not contain data on benefits accrued under defined-benefit pensions or under Social Security. Many near-retirees still have defined-benefit pensions, and Social Security is a particularly important component of retirement wealth for low- and middle-income households. To better illustrate overall trends, we turn to aggregated data compiled by the Federal Reserve and the Social Security Administration.

Figure 2 shows the ratios of various forms of retirement assets to personal incomes, drawn from the National Income and Product Accounts. The oldest series, which shows the total financial assets for employer pension funds (both defined benefit and defined contribution, including state and local government plans), dates to 1945. The ratio of employer pension assets to personal incomes currently stands at 119 percent, and the patterns of increase over time are clear.

Beginning in 1981, the Fed began tracking household retirement savings, which include nonemployer savings, such as Individual Retirement Arrangements plans and insurance contracts. The series beginning in 1981 combines these household savings with the employer pension assets tracked in the bottom-most series. Again, the trend is toward increasing ratios of retirement assets to personal incomes, with the total rising from 72 percent in 1981 to 182 percent by 2013.

Finally, beginning in 1996, the Social Security Administration began publishing figures on the total value of Social Security benefits that have accrued but not yet
been paid out. The top-most series combines accrued Social Security benefits with household retirement savings and employer-run pension funds. This most comprehensive measure has increased from 269 percent of personal incomes in 1996 to 391 percent in 2013. These figures raise an obvious question: aren’t Social Security and state and local government pensions underfunded such that they cannot pay all the benefits they have promised? Absolutely, and this is highly relevant to the retirement policy debate underway. According to the Congressional Budget Office (CBO), over the next 75 years the Social Security program is underfunded by 22 percent. State and local government pensions, according to the Federal Reserve, are on average around 70 percent funded, leaving them 30 percent short of what they need. By contrast, Gale, Scholz, and Seshadri find that average actual household retirement savings—meaning savings outside of Social Security and defined-benefit pensions—exceed average optimal savings. Even looking at medians, multiplying the 25.9 percent of households that the authors project are falling short by the approximately 17 percent saving shortfall contingent on being underprepared results in a pseudo-net shortfall of 4.4 percent.

Yet, the policy prescriptions of many who argue that there is a retirement crisis are for Americans to rely more heavily on government-run plans, such as Social Security or proposed supplementary retirement-savings plans run by states or the federal government, and less on private retirement plans. This risks making households more dependent on retirement plans whose sponsors have shown a persistent inability or unwillingness to fully fund the benefits that these plans have promised.

**How Should Replacement Rates Be Calculated?**

A replacement rate expresses retirement income as a percentage of preretirement earnings. Replacement rates are designed to help measure how well a retiree is able to maintain his or her preretirement standard of living. A replacement rate of 100 percent is not necessary, as retirees face lower taxes and work-related costs and may have paid off their mortgages, but the ratio provides an intuitive reference point. However, there is a debate over how replacement rates should be calculated. The principal disagreement

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**Figure 2**

**Employer Pensions, Household Retirement Savings, and Accrued Social Security Benefits (Percentage of Personal Incomes)**

Sources: Board of Governors of the Federal Reserve System, Social Security Administration, and Bureau of Economic Analysis.
regards how the denominator of the calculation—preretirement earnings—should be measured. Some argue that past earnings should be indexed for the growth of average wages in the economy; others, including us, argue that inflation-adjusted preretirement earnings make more sense in a replacement rate calculation. Those wishing for a thorough review of the replacement rate issues should consult a paper by Andrew G. Biggs, Gaobo Pang, and Sylvester J. Schieber, which discusses both conceptual and historical issues in depth.\textsuperscript{16}

Figure 3 illustrates the differences using the Social Security Administration’s hypothetical “medium-scaled earner,” who is assumed to retire at age 65 in 2014. The bottom-most line represents the worker’s nominal earnings in each year, meaning the actual dollar values that would have appeared on his or her paycheck. Due to the effects of inflation, however, nominal dollars can be misleading. For this reason, the middle line represents the worker’s earnings in inflation-adjusted terms. These inflation-adjusted figures represent the real buying power that the worker’s prior earnings made available to him or her. The topmost line represents the worker’s earnings indexed for the growth of national wages. This process of wage indexing increases the worker’s past earnings by more than the rate of inflation, to represent the degree to which average wages for US workers of all ages and earnings levels have increased over time.

The wage-indexed average of a worker’s highest 35 years of earnings is generally around 20 percent higher than the worker’s inflation-adjusted average earnings. Wage indexing of prior earnings credits the individual with wages that individual never actually earned and a standard of living he or she never enjoyed, in the process raising the bar for what counts as an adequate income in retirement. As a result, replacement rates measured relative to wage-indexed average earnings will be substantially lower than when measured relative to inflation-indexed earnings (sometimes referred to as “price-indexed” earnings).

For instance, in a recent report the CBO estimated that Social Security will provide the average individual born in the 1990s with a wage-indexed replacement rate of 46 percent, versus a price-indexed replacement rate of 61 percent.\textsuperscript{17} The question is, which approach better represents how individuals think about retirement planning?

Price-indexed and wage-indexed replacement rates are representative of two broader economic perspectives. Price-indexed replacement rates are shorthand for a lifecycle approach in which individuals use borrowing and saving to turn income received at one point in
their life into consumption at other points. In general, individuals are assumed to derive more welfare (utility) from consuming roughly the same amount in each year versus following a pattern of feast and famine. There are reasons, discussed later, why actual consumption patterns may diverge from a simple pattern of consuming the same amount each year.

But assuming that individuals desire steady consumption is not an unreasonable simplification. For instance, Boston University Professor Laurence Kotlikoff’s financial planning program, ESPlanner, which applies mainstream economic principles to retirement planning, seeks to calculate the highest level of steady, inflation-adjusted consumption that an individual can maintain over his or her lifetime. A replacement rate calculated relative to inflation-adjusted preretirement earnings is a simple approximation of such an approach.

Wage-indexed replacement rates, by contrast, represent a relative-income approach in which individuals care about how their standard of living in a given year compares to the consumption of everyone else. In this relative approach, individuals want their consumption to rise along with wage growth in the economy so they can maintain their place in the overall distribution. This implies that individuals derive utility not so much from the amount of their consumption as from how that consumption compares to others. Munnell describes the idea in this way:

> When constructing the NRRI targets, my colleagues and I made a conscious decision to assume that households had a preference for a standard of living that increased during their working lives at the rate of economy-wide wage growth. This assumption reflected our belief that households care not only about their absolute standard of living, but also about their relative standard of living.¹⁸

One can think of this approach as “Keeping up with the Joneses.” Miller, Madland, and Weller illustrate wage-indexed replacement rates with a similar description, as do Stephen Goss and colleagues.¹⁹

Several initial points are warranted. First, the relative-income viewpoint does not presuppose a higher overall standard of living than the lifecycle approach. Rather, it assumes a higher standard of living during the later working life and during retirement, which is paid for via a lower standard of living from entering the workforce through middle age.²⁰ But since under both approaches lifetime consumption is constrained by the level of lifetime income, the average standard of living must be the same. Second, proponents of wage-indexed replacement rates apply their assumptions incompletely: they assume that individuals would like their standard of living to rise with economy-wide wage growth during their working lives, but in retirement desire a standard of living that rises only with inflation. Why? Logically, you either wish to keep up with the Joneses or you do not. So which of these two economic perspectives better captures mainstream opinion regarding how individuals think about saving and spending?

The answer to this question is quite clear: the lifecycle model is the textbook approach to considering these issues and makes no reference, either qualitatively or mathematically, to individuals calibrating their consumption to the standards of living of other households. It’s just not part of the model. Franco Modigliani won the Nobel Prize in economics in part for his work developing the lifecycle model, and Milton Friedman won the Nobel for his permanent-income hypothesis, which generates similar conclusions.

This is not to say that a relative-income approach is impossible or illogical, or that individuals never seek to keep up with the Joneses. And there are a number of economists who favor a relative-income approach over the standard lifecycle model.²¹ Nor is it to say that individuals’ consumption will not vary—sometimes considerably—from the smooth pattern predicted on a stylized lifecycle approach. For instance, in individuals’ early years when earnings are low, they might not be able to borrow; thus, they might consume less when young and more when older.²² Alternatively, they may be uncertain about how their earnings will evolve over time or how long they may live, which will affect how much they choose to consume today. Likewise, individuals’ ability to enjoy their consumption may be linked to their health status.²³ Thus, retirees might seek to consume more early in retirement than when they reach truly old age.

Yet if you must make a simplifying assumption, smooth consumption from one year to the next is a more reasonable one than assuming that individuals target their consumption to that of their peers. So the debate between wage- and price-indexed replacement rates isn’t between two equally accepted theories about how households want to arrange their consumption from year to year. It’s a competition between one idea that’s widely taught in textbooks and applied in research and another that most analysts working on retirement issues rarely consider. This isn’t to say that analysts shouldn’t consider these issues,
but such a strong assumption should not be built into models of retirement saving without prior discussion of the potential controversy of doing so.

Recent publications, spurred by the replacement rate debate, have clarified these points. For example, the CBO noted: “Indexing earnings to prices better captures the real amount of resources available to a worker over his or her lifetime, whereas indexing earnings to wages may overstate those amounts.” This echoes our statements that wage-indexed earnings credit the individual with wages that he or she never actually earned. Also in December 2014, the Organisation for Economic Co-operation and Development noted that inflation-indexed replacement rates are most consistent with the lifecycle approach to retirement planning, while wage-indexed replacement rates effectively compare the incomes of retirees with the incomes of working-age individuals at the time.

The question is not whether either wage-indexed or inflation-indexed replacement rates are perfect measures. Both are approximations with an emphasis on being understandable to nonspecialists. But of the two, replacement rates calculated relative to inflation-indexed career earnings are more consistent with theory and more understandable by practical users than are wage-indexed replacement rates.

**Should Retirement Income Targets Be Adjusted for Family Size?**

A second area of disagreement in retirement preparedness studies pertains to how children affect their parents’ need to save for retirement. In the lifecycle model, individuals with children would generally save less for retirement than those without children, because part of parents’ income during their working years is consumed by their kids. Economist Jonathan S. Skinner describes the logic in humorous terms:

Parents are already used to getting by on peanut butter, given that a large fraction of their preretirement budget has been devoted to supporting children, so it’s not difficult to set aside enough money to keep them in peanut butter through retirement. By contrast, childless households with the same income accustomed to caviar and fine wine must set aside more assets to maintain themselves in the style to which they have become accustomed. Simply put, parents don’t need to replace consumption they never had.

Research papers such as Gale, Scholz, and Seshadri’s and Hurd and Rohwedder’s adjust for family size and composition in setting retirement income targets. Specifically, such adjustments note that couples can live more cheaply than singles and that children consume part of the household income during parents’ working years, thus reducing parents’ preretirement consumption. A paper by Biggs focused specifically on these issues, showing that family size adjustments increase households’ median effective replacement rates by 16 percentage points. These adjustments result in fewer retiree households being considered unable to maintain their preretirement standard of living.

The CRR’s NRRI, by contrast, does not adjust for family size. There was no discussion of children in Munnell, Webb, and Delorme’s study, which outlined the NRRI methodology, but in subsequent writings the authors argue that once children leave home and no longer consume household resources, parents raise their consumption to make up the difference, and wish to maintain this higher level of consumption through retirement. This assumption sets a higher standard of living that the household must have the resources to maintain.

So who is right regarding adjusting retirement income targets according to family size? Simple theory points toward using family size adjustments. For parents to dramatically increase their consumption once kids leave home, and have sufficient savings to maintain that higher standard of living through retirement, they would need to consume substantially less when their kids are at home. This implies very different levels of individual consumption at different times in people’s lives, and the philosophy of the lifecycle approach is that people do not want that outcome and will manage their finances to avoid it.

Moreover, the weight of the research seems clearly on the side of using family size adjustments. Scholz and Seshadri show that wealth at retirement is distributed much as you would expect if parents saved to replace their own preretirement consumption, not to match the consumption of similar households without kids. They conclude that “children have a substantial effect on the level and dispersion of wealth and thus should be accounted for in typical retirement planning advice.” Other studies have found that consumption is higher when children are present in the household, and falls when they leave—for instance, Orazio Attanasio and colleagues use data from
the United Kingdom and US; James Banks and his coauthors as well as Martin Browning and Mette Ejrnæs use data from Britain; and Tulio Jappelli and Franco Modigliani use data from Italy.\textsuperscript{30}

Furthermore, Alexander Klos and Simon Rottke, using data from Germany, find that “household consumption drops and saving rises significantly within four years after a child moves out of a household. . . . Assuming that household consumption remains constant after a child’s move-out would overstate the problem of inadequate saving.”\textsuperscript{31} David A. Love, using a lifecycle model calibrated to US data, finds that households with children would hold substantially less wealth at retirement age than those without.\textsuperscript{32}

The creators of the NRRI justify omitting a household size adjustment by citing one study by two of Munnell’s colleagues, Norma Coe and Webb.\textsuperscript{33} This study followed households over the nine-year period from 2000 through 2008. The sample respondents were ages 52 to 74 at the beginning of the period, with an average age of 61. The sample had 833 households, but 743 never had any children living at home during the whole period, and 54 had children at home throughout the period. The authors’ conclusion that children had no effect on consumption patterns was based on only 36 households, whose parents were unusually old when their children moved out. Thus, this study has both a smaller and a less representative sample than any of the other studies cited. It is also possible that, in at least some of the households examined by Coe and Webb, elderly parents were living with their children rather than children living with their parents. This further complicates the picture.

Miller, Madland, and Weller state, “There is also no preponderance of evidence that shows that households cut expenditures after children leave the home; while some studies show that households can and do cut consumption, others find the opposite.”\textsuperscript{34} This strikes us as overstating the case; “preponderance” does not denote mathematical certainty, but rather the weight of the evidence. Even their use of “others” exaggerates the single study that the CRR and Miller, Madland, and Weller cite. Based on both the quantity and quality of studies that have examined these questions, adjustments for household size and composition appear amply justified.

But there is a further test we can make. As noted previously, Scholz and Seshadri find that households with children tend to accumulate less wealth by retirement age than similar households that do not have kids. This result allows us to draw one of two inferences.

Either

1. Households with kids are saving as theory indicates they would, and thus studies of retirement income adequacy need to account for household size and composition; or

2. Households with children are undersaving for retirement compared to similar childless households, and thus having kids is detrimental to parents’ retirement security.

Those who oppose household size adjustments must accept the second inference. But is it true?

One way to know is simply to ask: if households with children are less prepared for retirement than similar households without kids, the former group should express greater concerns regarding their financial security in retirement. But they don’t. Economist Suzanne Rohwedder used Health and Retirement Study data to analyze how individuals perceive their well-being in retirement. Retirees were asked questions such as these:

- All in all, would you say that your retirement has turned out to be very satisfying, moderately satisfying, or not at all satisfying?
- [Think] about your retirement years compared to the years just before you retired. Would you say the retirement years have been better, about the same, or not as good?
- Please tell me if you worry a lot, somewhat, a little, or not at all [about] not having enough income to get by.\textsuperscript{35}

If the CRR and Miller, Madland, and Weller are correct, retired parents should, all other things equal, be more likely to say that retirement is “not at all satisfying,” that their retirement years have been “not as good” as the years just before retirement, or that they “worry a lot” about not having enough income to get by. But Rohwedder’s research shows that there is no statistically significant difference in responses between retired parents and otherwise similar retirees who don’t have kids.

Thus, we judge that the weight of both theory and evidence points toward adjusting target retirement incomes for whether households had children. Once you do account for family size, the share of households deemed to be undersaving drops significantly.
Do Even the Optimistic Studies Show a Retirement Crisis?

Miller, Madland, and Weller argue that even the more optimistic studies—such as Barbara A. Butrica, Karen E. Smith, and Howard M. Iams’s and Scholz and Seshadri’s—“speak to the existence of a significant retirement savings shortfall that will affect millions of American families.” The authors are correct that even these studies lead to the conclusion that some Americans are underprepared for retirement. Where interpretation is needed, however, is in judging how many Americans are falling short, how large their saving shortfalls may be, and whether the overall level of retirement preparation is changing over time. Answering these questions is important in determining what policies may be appropriate to address retirement saving shortfalls.

With regard to Gale, Scholz, and Seshadri, the Miller, Madland, and Weller study focuses on two points: first, 25.9 percent of households are projected to be falling short in terms of retirement savings, and second, the median shortfall is $32,260 (in 2004 dollars). These figures are taken to imply a significant retirement saving problem. However, from these figures alone it is impossible to gauge the depth of saving deficits for those individuals who are falling short. Gale, Scholz, and Seshadri find that the median optimal wealth for the households studied was $188,835. They also find that the probability of undersaving is not strongly correlated with household earnings, which means that comparing the median deficit to the median optimal wealth goal is a reasonable, if crude, approximation of the extent of undersaving. On this assumption, the typical household that is underprepared for retirement falls around 17 percent short of its optimal wealth level.

However, Gale, Scholz, and Seshadri’s optimal wealth targets include only the wealth directly held and managed by the household and do not include the implicit wealth provided through Social Security and defined-benefit pensions. If we assume that Social Security and defined-benefit pensions together provide these households with half of their overall retirement wealth, this implies that the roughly one-quarter of households that are underprepared for retirement have total retirement assets that fall short by approximately 8 to 9 percent. This is not a problem to be ignored, but it is also one that appears to merit a tweaking of the retirement system rather than wholesale change.

Miller, Madland, and Weller also note that Butrica, Smith, and Iams’s study is “often cited by those seeking to paint a more optimistic picture of Americans’ retirement preparedness.” Miller, Madland, and Weller point out that this study projects that 43 percent of Generation X (those born from 1966 to 1975) will have retirement incomes equal to less than 75 percent of their preretirement earnings, which is taken to imply a substantial saving gap. But these replacement rate figures are relative to wage-indexed preretirement earnings and are not adjusted for household size or composition. Butrica, Smith, and Iams also publish projections relative to price-indexed replacement rates, which our earlier discussion showed to be a better approximation of a lifecycle approach. These figures show that only 25 percent of Generation X would fall below a 75 percent price-indexed replacement rate, an almost identical breakdown to that of earlier retiree cohorts.

The weight of both theory and evidence points toward adjusting target retirement incomes for whether households had children.

Moreover, Butrica, Smith, and Iams’s figures do not include a household size adjustment. Biggs—using a microsimulation model similar to that used by Butrica, Smith, and Iams—shows that adjusting for family size and composition increases effective median replacement rates by around 16 percentage points. If you assume that such an adjustment would increase replacement rates in Butrica, Smith, and Iams’s study by a similar amount, then about 15 percent of Generation X households are likely to have replacement rates below the 75 percent of real average preretirement earnings. If you accept a slightly lower target of 69 percent of inflation-indexed lifetime earnings, which converts the results of Scholz and Seshadri’s lifecycle model into target replacement rates, then the percentage of households falling short decreases to around 12 percent.

These shorthand calculations are at best approximations and are not intended to show that the retirement saving problem is de minimus. They do show, however, that one should not interpret the more optimistic retirement studies as implying anything close to a retirement crisis. Rather, using reasonable modifying assumptions, the numbers that Miller, Madland, and Weller point to can lead to very different conclusions.
Conclusion

Miller, Madland, and Weller highlight several issues of methodological disagreement between those who see a retirement crisis and those who see a more modest, manageable issue. This exercise is helpful, as it helps narrow the range of disagreements and focus on a smaller number of key issues that drive differing conclusions regarding the much broader question of how well Americans are preparing for retirement. Yet Miller, Madland, and Weller consistently opt for what appear to be the weaker sides of those arguments.

Proponents of the retirement crisis viewpoint also do not note the many ways in which private retirement savings plans are being improved. For instance, it took 401(k)-style plans just three years to recover their financial crisis losses, and today total assets are almost 37 percent above 2007 levels. State and local government pensions, by contrast, are currently less than 5 percent above their 2007 peak, despite benefit liabilities that have grown by 36 percent. Similarly, 59 percent of workplace pensions today automatically enroll employees, versus only 14 percent in 2001.43 Automatic enrollment can significantly increase participation in retirement plans.

Likewise, 41 percent of today’s employees invest their 401(k) plans in target-date funds that automatically reallocate their portfolios, versus just 19 percent of participants in 2006. Target-date funds are intended to help individuals who do not actively monitor their investment allocations. Administrative costs are also being addressed. More than 80 percent of today’s 401(k) plans offer low-cost stock index funds, which helped reduce fees by 20 percent in the past three years alone. And the Department of the Treasury recently enacted regulations making it easier for 401(k) plans to incorporate annuities, which convert lump sums into a guaranteed income that lasts for life.44

These improvements are important for two reasons. First, they show that whatever the past and current shortcomings of defined contribution retirement plans, such plans are on a trajectory to increase participation and saving rates while reducing management costs and improving the drawdown of assets in retirement. And second, the NRRI appears not to take these changes into account. As Vanderhei notes, the “NRRI relies on wealth-to-income patterns dating back to 1983 (a time period in which [defined contribution] plans have evolved from a secondary savings plan to the primary retirement plan in many cases, and 401(k) plans have changed for many eligible participants from voluntary enrollment to automatic enrollment).” Thus, “the NRRI projections appear to rely on an outdated perspective of 401(k)-plan designs and savings trends.”45

We believe that the most reasonable conclusions that can be drawn from the recent retirement preparedness research are as follows. Most of the decline in household wealth relative to incomes was a function of the collapse of the housing bubble, not falling retirement saving; replacement rates measured relative to career-average earnings adjusted for inflation provide a reasonable shorthand for how individuals tend to plan for retirement; household retirement income targets should be adjusted for whether households had children; and finally, the more optimistic retirement preparedness studies find that household retirement saving gaps are likely to be far smaller than those that exist in government-run retirement programs.

Proponents of the retirement crisis viewpoint do not note the many ways in which private retirement savings plans are being improved.

Challenges to retirement security remain. Social Security is substantially underfunded and its long-term shortfalls are increasing, yet neither Congress nor the president has made reform a priority. Even if solvent, Social Security often poorly serves low-income households, many of whom fail to qualify for benefits. And while private pensions are improving, more workers need access to retirement plans at work. These are all areas for potential bipartisan cooperation. But progress depends on an accurate view of the current state of retirement preparedness.

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Notes


4. Ibid.


7. For example, Jack VanDerhei and Craig Copeland observe that their estimates of people at risk of “not having sufficient retirement resources to pay for ‘basic’ retirement expenditures and uninsured health care costs” in 2010 “are generally much more optimistic than those simulated for the same groups seven years earlier.” VanDerhei noted further improvement by 2013. See Jack VanDerhei and Craig Copeland, “The EBRI Retirement Readiness Rating: Retirement Income Preparation and Future Prospects” (issue brief no. 344, Employee Benefit Research Institute, July 2010), www.ebri.org/pdf/briefspdf/EBRI_IB_07-2010_No344_RRR_RSPM1.pdf; and Jack VanDerhei, “What Causes EBRI Retirement Readiness Ratings to Vary: Results from the 2014 Retirement Security Projection Model” (issue brief no. 396, Employee Benefit Research Institute, February 2014), www.ebri.org/pdf/briefspdf/EBRI_IB_396_Feb14.RRRs2.pdf.


10. Authors’ calculations from SCF data.

11. Ibid.


20. Using the Social Security Administration's medium-scaled earner, consumption under the wage-indexed approach would be approximately 20 percent lower than the steady inflation-adjusted consumption path at age 30, would be even at age 53, and would be about 13 percent higher from age 65 onward.


22. Calculating replacement rates relative to the highest 35 years of inflation-adjusted earnings is one way to account for this issue.


34. Miller, Madland, and Weller, “The Reality of the Retirement Crisis.”


37. Miller, Madland, and Weller, “The Reality of the Retirement Crisis”; and Gale, Scholz, and Seshadri, “Are All Americans Saving ‘Optimally’ for Retirement?”


42. Gale, Scholz, and Seshadri, “Are All Americans Saving ‘Optimally’ for Retirement?”


45. VanDerhei, “What Causes EBRI Retirement Readiness Ratings to Vary: Results from the 2014 Retirement Security Projection Model.”