

Family Status Transitions, Latent Health, and the Post-Retirement Evolution of Assets

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Since the advent of personal retirement accounts in the early 1980s, a great deal of attention has been directed to the accumulation of retirement assets in these accounts. Much less attention has been directed to the drawdown of assets under a regime in which personal accounts play an increasingly important role. When private retirement saving was dominated by employer-provided defined benefit plans, benefits were typically dispersed in the form of annuities. Under the personal account regime only a very small fraction of retirement assets are annuitized. The drawdown of assets is largely self-directed.

We consider the evolution of assets after retirement. We ask whether total assets--including housing equity, personal retirement accounts, and other financial assets--tend to be husbanded for a rainy day and drawn down primarily at the time of precipitating shocks. We give particular attention to the relationship between family status transitions and the evolution of assets, and the relationship between “latent” health status and the evolution of assets. The principle aim of this paper is to set out a data framework that allows us to address a series of questions related to how assets are managed in the drawdown phase following retirement. For example: What is the likelihood that families are unable to cover the cost of health and or family status shocks when they occur? How might alternative methods of managing asset drawdown affect financial well-being? In particular, how does the current largely “self-directed” system, in which account holders decide when and how much to withdraw, compare to a more “managed” system such as partial or full annuitization of personal account assets? Finally, how do recent and anticipated future developments, such as the recent sharp decline in financial asset values, rising retirement ages, and the anticipated growth in personal retirement assets in future decades, affect the ability of households to meet health and family status shocks?

Our analysis is based primarily on data from the Health and Retirement Study (HRS), including both the original HRS cohort (age 51 to 61 in 1992) and the original AHEAD cohort (age 70+ in 1993). An important feature of our analysis is that we organize the data so that we can observe the change in assets between each of the waves of the surveys, and we can observe how asset evolution is related to family status transitions. Thus, for example, we can observe the change in assets between waves for persons who continue in two-person or who continue in one-person households between

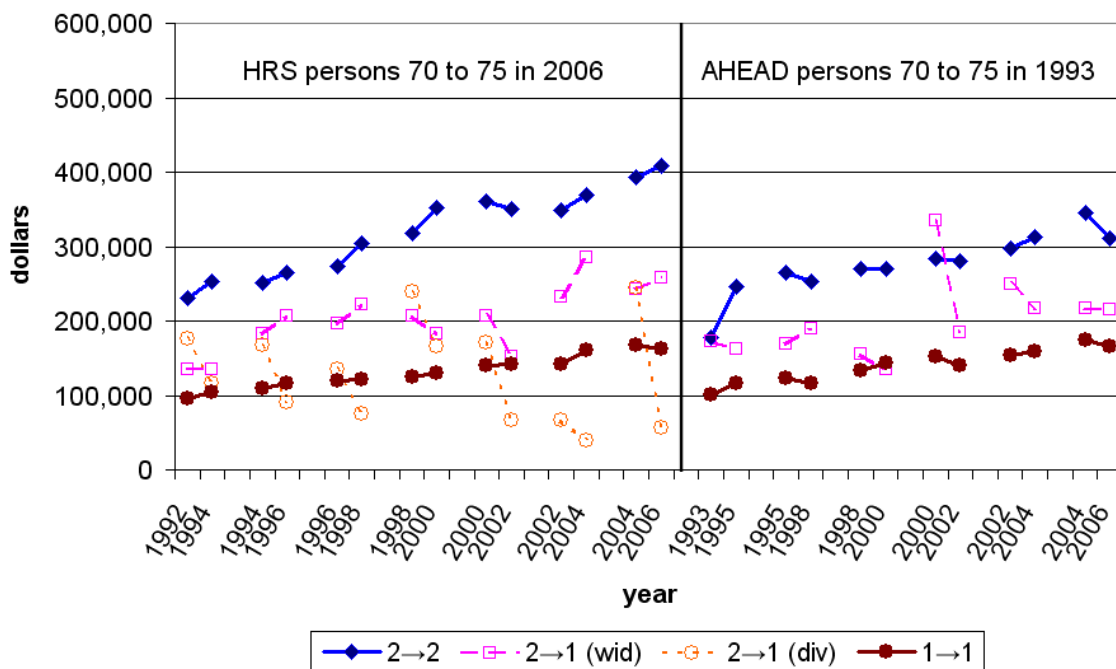
one wave and the next. We can also observe the change in assets for persons who experience a family status transition between waves, that is, persons who separate, divorce, become widowed or marry between the waves. In this way, we emphasize the discontinuous changes in assets that accompany shocks to family status, in particular the transition from two- to one-person households. For this analysis the unit of observation is the person rather than the household.

From the original HRS cohort we follow persons first surveyed in 1992 when they were age 51 to 61 and subsequently resurveyed every other year through 2006 (when they were age 65 to 75). From the AHEAD cohort, we follow persons aged 70 to 80 first surveyed in 1993 and then resurveyed in 1995, 1998, 2000, 2002, 2004, and 2006. For each of the data sources we consider assets at the beginning and end of each interval. For each person in each survey we categorize family status at the beginning of the interval as belonging to either a one-person household or to a two-person household. Over the interval between surveys a person initially in a one-person household may remain in a one-person household. We designate the family status transition for this person as 1→1 indicating that the person is in a one-person household in both years. Similarly, we classify persons initially in two-person households as 2→2 if the person remains in a two-person household, 2→1(div) if the person divorces or separates by the end of the interval and 2→1(wid) if the spouse dies by the end of the interval. To minimize the effect of apparent asset reporting errors and missing data we report trimmed means and medians in this paper.

There are several key results. First, the evolution of assets is strongly related to family status transitions. The total assets of persons in continuing two-person households increase substantially well into old age. For persons age 56 to 61 when initially observed in 1992 and age 70 to 75 when last observed in 2006 (shown in the left side of Figure 1) the average wave-to-wave increase in total assets is 6.3 percent for continuing two-person households. For the older cohort, age 70 to 75 in 1993 and age 83 to 88 in 2006 (shown in the right side of Figure 1), the mean rate of growth is 4.6 percent for continuing two-person households. For persons age 56 to 61 when initially observed in 1992 and age 70 to 75 when last observed in 2006 the mean wave-to-wave increase in total assets is 4.2 percent for continuing one-person households. For the older cohort, age 70 to 75 in 1993

and age 83 to 88 in 2006, the mean rate of growth is 1.4 percent for one-person households. The median estimates tend to be smaller, but still positive with the exception of the older continuous one-person households, for whom the average increase is not significantly different from zero. In contrast, persons in households that experience a family status transition during an interval—widowed or divorced—often experience a large decline or no increase in total assets. Substantial declines are associated with divorce, and the declines are statistically different from zero. The total assets of persons entering widowhood increase on average but the increase is not significantly different from zero.

Figure 1. Mean total assets for HRS persons age 56 to 61 in 1992, and AHEAD persons 70 to 75 in 1993 trimmed



Second, households that experience family status transitions during an interval—widowhood or divorce—have lower levels of assets than continuing two-person households. The mean beginning assets of persons who will experience a family status transmission are approximately 55 to 65 percent of the assets of continuing two person households. Further, these differences exist not just at the time of the transition, but are also evident long before the family transition and continue long after the transition. This finding underscores the need to account for differences in initial assets when estimating

the change in assets at the time of a family status transition. Otherwise, the effects of family status transitions are confounded with prior differences in assets.

Third, the evolution of assets is very strongly related to health, measured by a latent health index constructed from 28 indicators of health conditions, activity limitations, and health care usage. For example, for continuing two-person HRS households 56 to 61 (Figure 2) the ratio of assets of persons in the top health quintile to the assets of persons in the bottom quintile is 1.7 in 1992. The assets of persons in the top quintile increased more between 1992 and 2006 than the assets of persons in the bottom quintile. By the end of 2006 the ratio of assets in the top quintile to assets in the bottom quintile was over 2.2. For continuing one-person HRS households 56 to 61: The ratio of assets of persons in the top health quintile to the assets of persons in the bottom quintile is 2.8 in 1992. The assets of persons in the top quintile increased more between 1992 and 2006 than the assets of persons in the bottom quintile. By the end of 2006 the ratio of assets in the top quintile to assets in the bottom quintile was 4.1. Similar differences are found for older AHEAD households (Figure 3).

Figure 2. Mean total assets for persons age 56 to 61 in continuing two-person households in 1992, by evolving health quintile, trimmed sample

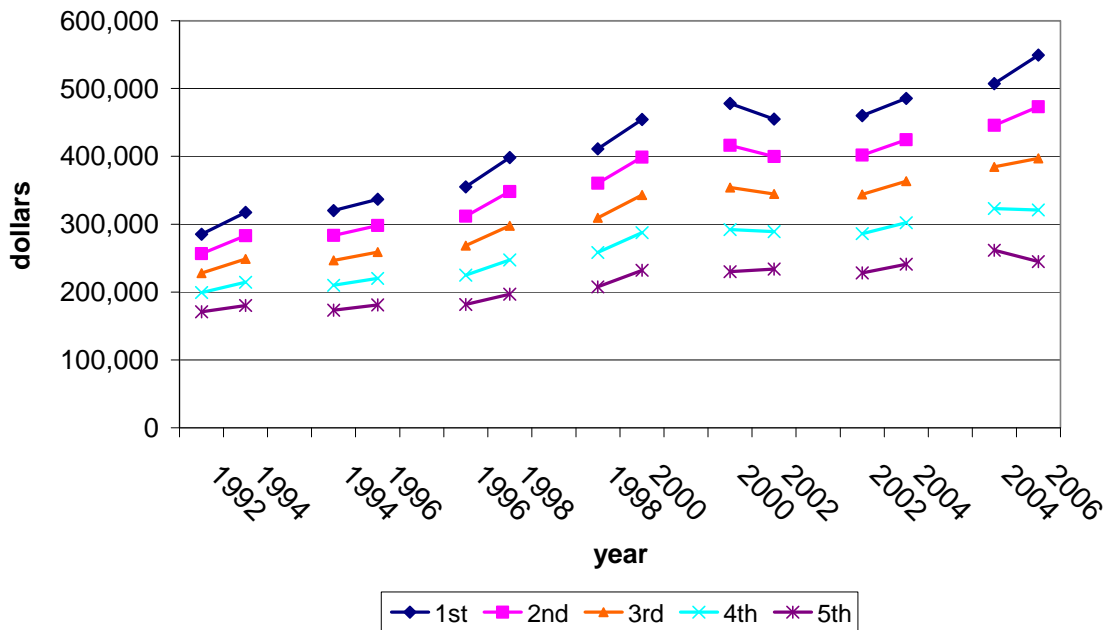
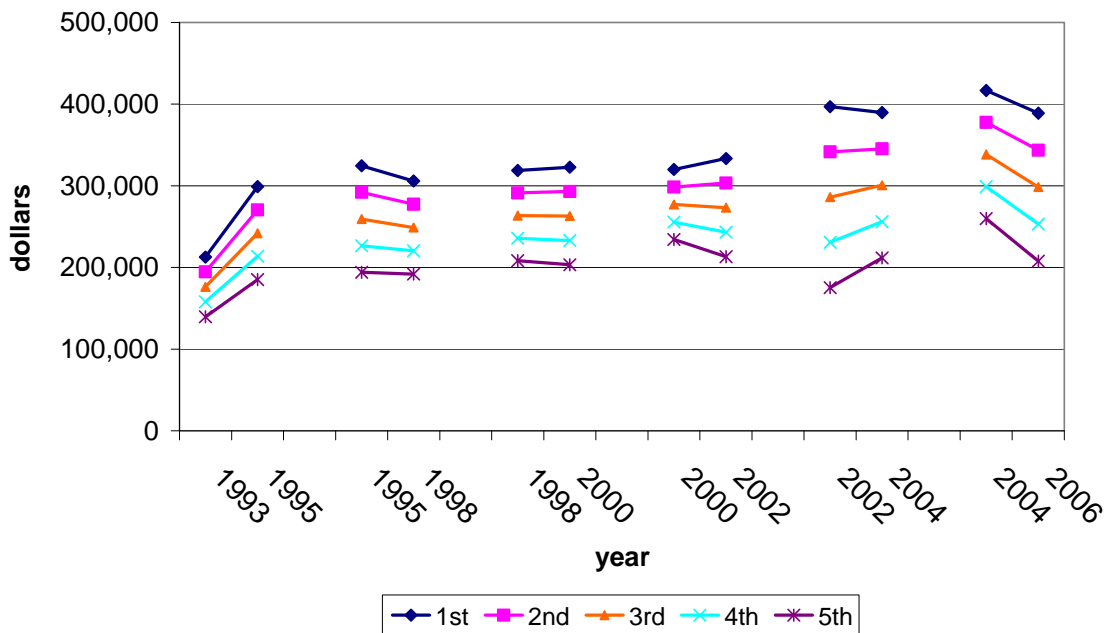


Figure 3. Mean total assets for persons age 70 to 75 in continuing two-person households in 1993, by evolving health quintile, trimmed sample



In future work we will address many of the questions raised in the second paragraph of the paper. A key issue that we faced in this paper, and will face in subsequent analyses, is the high incidence of apparent asset reporting errors and missing data. Details of these data problems are set out in an appendix. We use medians and trimmed means in this paper in an attempt to limit the effects of data errors. But as we proceed with further analysis we will have to give much more attention to “correcting” the data errors. This will be especially important when considering the distribution of assets and the likelihood that households will exhaust their assets

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