

The Retirement Prospects of the Baby Boomers

The approaching retirement of the baby-boom generation has become a public concern—partly because of the budgetary pressures that will develop when baby boomers collect Social Security and Medicare benefits, but also because of claims that boomers are not accumulating enough private savings to finance their retirement. However, there is no widely accepted standard of what constitutes “enough” savings, mainly because retirement preparations are largely a matter of personal choice. Recent studies apply a range of different standards and provide a more complete picture of boomers’ finances.

Compared with their parents at the same age, baby boomers typically have higher income, are preparing for retirement at largely the same pace, and have accumulated more private wealth. On the whole, boomers are on track to have higher income in retirement than their parents and appear much less likely to live in poverty after they retire.

Within that overall picture, however, about a quarter of baby-boomer households have so far failed to accumulate significant savings. They appear likely to depend entirely on government benefits in retirement. At the other end of the spectrum, at least half of the households are expected to maintain their working-age standard of living during retirement (under the assumption that current laws governing federal benefit programs do not change). For the remaining quarter of boomer households, the evidence is mixed: under midrange assumptions about saving, rates of return, and retirement age, they appear set to experience moderate declines in their living standard during retirement, which could be offset by modestly increasing saving and by working for a few more years. For many boomers, a relevant issue is the degree to which they could be affected by—and plan for—any future changes in federal retirement benefits.

Concerns About the Baby Boomers’ Retirement

Baby boomers—people born between 1946 and 1964—make up one of the largest and most prosperous generations in U.S. history. As a group, boomers have enjoyed higher income during their working years than any preceding generation, and they have been accumulating substantial savings, in part to provide for their retirement. As they move out of the workforce and into retirement over the next 25 years, boomers will begin to draw on those savings, collect private pensions, and become eligible for benefits from government programs such as Social Security and Medicare.

That impending wave of retirements has become a source of concern for two reasons. First, the population of retirees will grow much more quickly than the taxpaying workforce, at a time when average benefits per retiree are expected to continue rising. Those developments will place severe and mounting budgetary pressures on the

federal government.¹ Second, some researchers have questioned whether many boomers are accumulating enough wealth to pay for an adequate retirement. Not only could inadequate saving leave boomers poorly prepared, but it could compound the government’s budgetary problems by limiting the growth of investment, productivity, and wages (which drive federal revenues).

The Congressional Budget Office (CBO) recently reviewed the research that has been conducted over the past decade on the retirement prospects of aging Americans.²

1. For more details, see Congressional Budget Office, *The Long-Term Budget Outlook* (December 2003), *A 125-Year Picture of the Federal Government’s Share of the Economy, 1950 to 2075*, Long-Range Fiscal Policy Brief No. 1 (June 14, 2002; revised July 3, 2002), and *The Looming Budgetary Impact of Society’s Aging*, Long-Range Fiscal Policy Brief No. 2 (July 3, 2002).
2. See Congressional Budget Office, *Baby Boomers’ Retirement Prospects: An Overview* (November 2003).

That review reveals a mixed picture of boomers' futures. Because retirement preparations are largely a matter of personal choice, there is no widely accepted standard of what constitutes an adequate or appropriate level of retirement income or consumption. In the absence of a single standard, researchers have used a number of different measures to assess the adequacy of retirement preparations; and the application of a variety of measures produces a variety of conclusions.

Boomers' Prospects Compared with Their Parents'

Some studies have compared boomers' finances with those of preceding generations; others compare them with the official poverty level. Those studies conclude that, on the whole, boomers will almost certainly be better off in retirement than their parents and will be much less likely to live in poverty.

Baby boomers have benefited greatly from productivity growth, rising real (inflation-adjusted) wages, and the increasing participation of women in the labor force. Although the benefits of prosperity have been distributed unevenly, boomers generally have higher per capita income than their parents did at the same age, are preparing for retirement at largely the same pace as their parents, and have accumulated more wealth. Boomer families have roughly the same wealth-to-income ratio that families of the same age nearly 20 years earlier had (see Table 1). Those observations suggest that boomers' saving behavior is much the same as that of their parents—and, furthermore, that baby boomers are not the source of the long-term decline in the overall personal saving rate in the United States.³

Boomers' Prospects Compared with Their Current Living Standards

Most studies of retirement preparation use a standard derived from economic theory suggesting that people

3. The causes of that decline are not fully understood. Some evidence suggests that it may be related to an increasing propensity to consume on the part of older people, combined with the government's redistribution of income to those older people. For more details, see Jagadeesh Gokhale, Laurence J. Kotlikoff, and John Sabelhaus, "Understanding the Postwar Decline in U.S. Saving: A Cohort Analysis," *Brookings Papers on Economic Activity*, no. 1 (1996), pp. 315-407.

Table 1.

Ratios of Family Wealth to Income, by Age of the Head of Household

	1983	1992	2001
Ratio of Median Family Wealth to Median Family Income			
Ages 35 to 44	1.5	1.2	1.5
Ages 45 to 54	2.2	1.9	2.4
Ratio of Average Family Wealth to Average Family Income			
Ages 35 to 44	2.7	2.9	3.4
Ages 45 to 54	5.2	4.7	5.2

Source: Congressional Budget Office using tabulations from Federal Reserve Board, *Survey of Consumer Finances*.

Note: These measures of family income include most kinds of before-tax income; the measures of family wealth include most kinds of private wealth (net of liabilities) but do not include expected Social Security and Medicare benefits.

will generally try to maintain roughly the same level of well-being throughout their lifetime. According to that standard, boomers are making adequate preparations for retirement if they are on track to accumulate enough resources during their working years to continue their working-age standard of living when they retire. That standard is relative because it depends on how much income people can expect to have over their lifetime. However, if the standard roughly matches how people actually behave, it may measure whether they are making sufficient preparations to meet their own perceived needs.

Taken together, the studies that apply such a standard suggest that roughly half of boomer households are on track to accumulate enough wealth to maintain their current standard of living if the heads of those households retire when they now plan to. At the other end of the spectrum, perhaps a quarter of the households—many of them low-income households with low-skilled workers—have accumulated very few assets thus far and are likely to find themselves largely dependent on government benefits in retirement. For some of those low-income households, Social Security benefits will be sufficient to let them maintain their working-age consumption (because Social Security benefits replace a larger share of previous earnings for low-income households than for high-income ones). Nevertheless, other households in the low-

saving group could face a decline in their standard of living in retirement.

For the remaining quarter of boomer households, the evidence is more mixed. Studies that use relatively optimistic assumptions about how much wealth those households will be able to accumulate before retirement—and that use broad measures of how much wealth they have—conclude that they are reasonably well prepared. For instance, if those households are projected to earn fairly high returns on their savings, to work until they qualify for full Social Security benefits, and to draw on their housing equity to finance some of their consumption in retirement, most of them should be able to maintain their current living standard. Conversely, studies that apply more-pessimistic assumptions or that use more-restrictive measures of wealth conclude that members of those households may face significant shortfalls: if they earn relatively low returns on their savings, retire before age 62, and never choose to draw on their housing equity, they may experience a significant decline in consumption during retirement. Under a midrange set of assumptions, many of those households appear likely to face relatively modest shortfalls that could be offset by increasing saving and by working for a few more years.

The Effects of Delaying Retirement

For households facing shortfalls in their retirement savings, relatively small changes in behavior can have surprisingly large effects. Because people who retire at 62 can expect to live another 20 years, each year they postpone retirement reduces their need for retirement savings by about 5 percent. An extra year of work also increases their Social Security benefits by several percent. Taken together, those effects lessen the total amount that people need to save, and the additional year gives them time to save more and earn returns on the assets they have already accumulated. As a result, households can make up for earlier shortfalls in retirement savings with surprisingly modest changes in behavior.

The Role of Social Security

Nearly all of the studies that CBO reviewed assume that Social Security and other government benefits will be paid as prescribed by current law. However, budgetary pressures could result in lower benefit levels for some recipients in the future. Because baby boomers in the lowest quarter of the income distribution are likely to depend

on government benefits for nearly all of their income in retirement, their current prospects depend heavily on the future of Social Security.

Furthermore, people's saving behavior is influenced by their expectations about future benefits. To the extent that baby boomers believe they will receive all of the government benefits to which they would be entitled under current law, that expectation may induce them to work or save less than they would otherwise. Conversely, to the extent that they recognize the looming difficulties in funding those programs, they may increase their saving or retire at a later age than they had originally planned.



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