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Delaying Retirement an Additional Year Could Offset Stock Market Losses

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The sharp decline in the stock market in 2008 placed the retirement security of many Americans at risk. Although the market has rebounded this year after bottoming out in March 2009, as of mid-October 2009 the S&P 500 Index remained 30 percent below its peak level two years earlier. By delaying retirement one additional year, many mid- and late-career workers could increase their income at age 67 enough to offset some or all of their stock market losses.

Effects of the Market Crash on Future Retirement Incomes

We use projections from the Urban Institute's DYNASIM3 microsimulation model to show how the market crash might affect retirement outcomes under alternative stock market performance scenarios. This brief focuses on the most pessimistic "repeat-70s" scenario. It captures the 37 percent decline in stock prices in 2008 and assumes that real stock prices continue to decline an average of 0.3 percent per year (including price growth and dividends but subtracting a 1 percent administrative fee) through 2017, following the pattern observed from 1974 to 1982 (Ibbotson Associates 2008). The scenario assumes that after 2017 the market will grow at its long-term historical real rate of 5.5 percent. More detail, including descriptions of other scenarios, is available in Butrica, Smith, and Toder (2009).

If workers do not change their retirement plans in response to stock market losses, 20 percent of preboomers (born 1941–45), 28 percent of middle boomers (born 1951–55), and 22 percent of late boomers (born 1961–65) will see their age-67 retirement incomes fall at least 10 percent below the amounts they would have received if the stock market had not crashed (see baseline no retirement delay projections in figure 1). Middle boomers will lose the most because in addition to their initial stock losses, they will suffer further losses on new asset purchases as the market continues to decline while they near retirement. Late boomers will lose less than middle boomers because they had less wealth at stake when the market crashed and will have more time before retirement to recover some losses when the market starts improving. Preboomers have mostly stopped accumulating assets by 2008, so they will not suffer additional losses on new asset purchases.

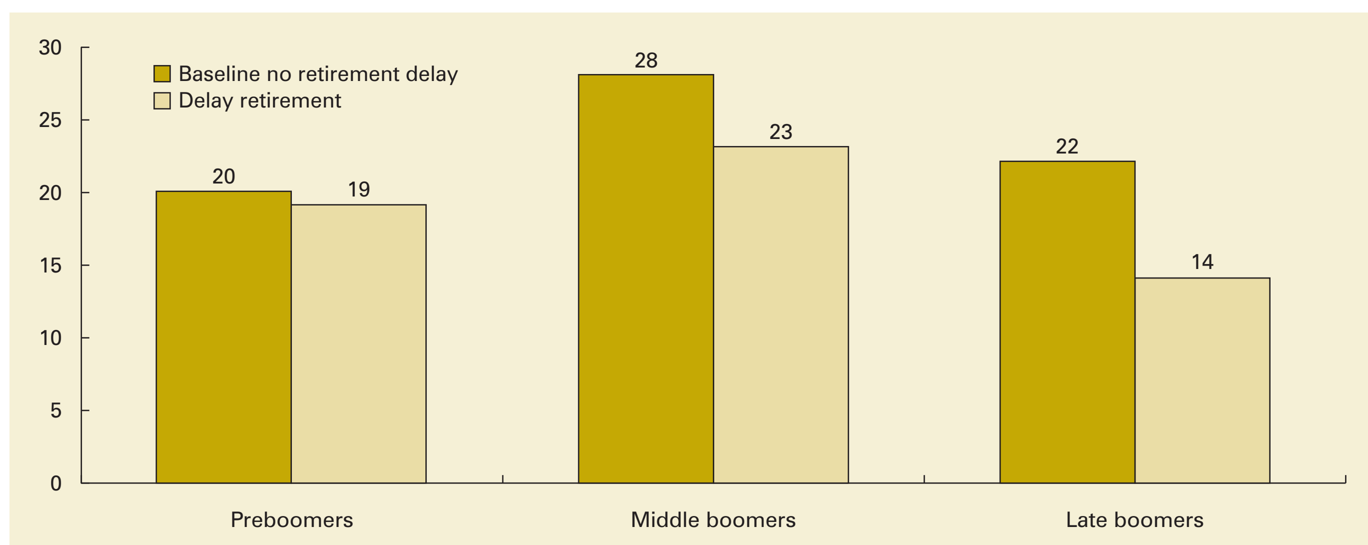
Working More Can Offset Market Losses

Working another year raises incomes at age 67 in various ways. Those who would otherwise have retired at age 66 would instead have earnings. Those covered by employment-based defined benefit plans on their current job would see their annual pension income increase because benefit formulas credit additional years of service. Those saving in defined contribution plans and other assets could contribute for an additional year, raising their account balance and the amount they could withdraw in retirement. Finally, additional earnings years would increase annual Social Security benefits for many workers. Consequently, if nondisabled workers with stock market losses delayed retirement one year, the share whose retirement incomes would fall because of the crash would shrink and some would even see their retirement incomes increase.

Delayed retirement would reduce income losses from the market crash most for late boomers, less for middle boomers, and least for preboomers. Late boomers have the best opportunities to delay retirement since they were still relatively young when the market crashed. Consequently, working an additional year reduces the share of late boomers who lose 10 percent or more of income at age 67 by 8 percentage points, from 22 to 14 percent (figure 1). In contrast, many preboomers were already retired when the market crashed in 2008. Delaying retirement would reduce the share of preboomers who lose 10 percent or more of income by only 1 percentage point, from 20 to 19 percent.

Delaying retirement one year offsets a larger share of losses among low-income retirees than high-income retirees. Low-income retirees had relatively few assets to lose when the market crashed and are more dependent on retirement income sources that rise with an additional year of work, such as Social Security benefits. In contrast, high-income retirees had relatively more assets at risk in the stock market. Delaying retirement one year reduces their market losses, but does not eliminate them.

FIGURE 1. Share of Individuals Who Lose at Least 10 Percent of Per Capita Household Income at Age 67 between the No-Crash and Repeat-70s Scenarios, by Retirement Assumption and Birth Cohort



Source: Authors' computations of DYNASIM3.

Notes: The baseline no retirement delay simulations assume that individuals continue to retire at the same age after the stock market crash. The delay retirement simulations assume that individuals delay their retirement and Social Security benefit take-up by one year in response to the stock market crash. The no-crash scenario assumes that the stock market had not crashed in 2008. The repeat-70s scenario incorporates the 2008 stock market crash and assumes it repeats the stock returns experienced between 1974 and 1982. Household income includes the annuity value of 80 percent of retirement and other financial assets, Social Security benefits, defined benefit pension benefits, earnings, SSI, and imputed rent (3 percent of housing equity).

Discussion

It's impossible to predict with certainty how the stock market upheavals of 2008 and 2009 will affect future retirement incomes. Much depends on how the market performs in coming years. Nonetheless, working an additional year would at least partially offset the projected loss in retirement income from falling stock prices. Of course, the weak labor market might prevent some older workers from staying in their current jobs or finding new ones. The unemployment rate in October 2009 was 10.2 percent—the highest rate in 26 years. Future retirement incomes could be lower than we project if the weak labor market persists.

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References

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