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Risk Matters: Retirees Exposed to Growing Risks

Abstract –

The crisis of 2007 and thereafter led to a massive loss of household wealth in the United States. Data collected before the crisis in 2007 by the Federal Reserve through its triennial Survey of Consumer Finances show that U.S. retirees were already exposed to a number of risks. Retirees were exposed to market risk due to low levels of diversification and high levels of leverage, but only to a limited degree to labor market risk and longevity risks due to a comparatively good buffer from annuitized income. In all likelihood, the declining support from annuitized incomes for retirees, which started in 2004, continued thereafter as pension plans became underfunded, new retirees worked for a weak labor market for some time and thus earned fewer Social Security benefits than in the past, and benefit cuts to Social Security have been phased in. This means that U.S. retirees will increasingly have to rely on capital income exactly at a time when asset values have been hit hard, which could increase the risk exposure of retirees, lower their standard of living or both. Public policy will thus have to consider ways to help retirees rebuild their economic security and lower the risk exposure of retiree households. If public policy can reduce the risk exposure of individuals, it will require less wealth than otherwise would be the case to achieve the same level of economic security for retirees. Retirement risks can be reduced by encouraging more diversification and less leverage in individual accounts, increasing the annuitization of retirement savings, and creating more stable labor market options for older workers, among other policy steps.