In Brief

AARP Public Policy Institute

Boomers at the Bottom: How Will Low-Income Boomers Cope in Retirement?

This brief describes a new report which projects how boomers in the bottom fifth of the income distribution will fare in retirement in terms of income, wealth, poverty status, and replacement rates, and how they compare with earlier birth cohorts along those dimensions.

Experts have spent considerable energy assessing the financial preparation of the boomer generation, which will soon swell the rolls of Social Security and Medicare, as more and more reach the ages of eligibility for those two programs. While many express concern about the financial security of boomers, less attention has been explicitly focused on those at the bottom who will retire with low-incomes, struggle to make ends meet, and who will be the most vulnerable to cuts in government benefits.

This paper offers new evidence on how low-income boomers, defined as retirees at or below the 20th percentile of income at age 67, will fare in retirement.

What do we know about low-income boomer retirees? Who are they?

Low-income boomers are more likely to be members of a minority group (black, Hispanic or other groups), less likely to have a college degree, and more likely to be high school dropouts than higher-income boomers (boomers above the 20th percentile of income at age 67). On average, they are projected to work fewer years between the ages of 22 and 62 than higher-income boomers (only 22 years, compared with 33 years for higher-income boomers). As a result, their average lifetime earnings will be less than one-third those of higher-income boomers.

Low-income boomers are also much less likely to work when they become older (only 12 percent are expected to work at age 67, compared with 45 percent of higher-income boomers). Instead, they will depend on Social Security for 60 percent of their household income in retirement, while higher-income boomers will depend on Social Security for only 32 percent. In addition, low-income boomers are projected to have little more than one-quarter the wealth of typical higher-income boomers, and they are far less likely to own homes or to have pensions or retirement accounts.

Median income replacement rates (retirement income as a percent of average lifetime earnings) for low-income early boomers (born 1946-55) are projected to be 86 percent, compared with 71 percent for today's low-income older retirees (born 1926-35) and 81 percent for today's younger retirees (born 1936-45). But the median replacement rate will decline to only 71 percent among later boomers (born 1956-65). About 54 percent of early boomers but only 47 percent of later boomers will have replacement rates above 75 percent of average lifetime earnings.

The relatively high replacement rates of low-income boomers highlights a limitation of the replacement rate as a measure of adequacy. Replacement rates reflect how closely retirement income approximates pre-retirement wages, but reveal nothing about the adequacy of those wages. Public policy should be concerned about both retirement income levels and replacement of pre-retirement wages.

If low-income boomers had saved more over their lifetime or if they worked longer, their incomes in retirement would be higher, but the gains would not be spectacular. Increasing savings by one percent of earnings every year would boost median household income by about 9 percent, although it would raise the median replacement rate from 78 to 88 percent. Working up to five extra years or until age 67 would raise median household income by about 13 percent and would raise median replacement rates from 78 to 83 percent. However, these figures only show impacts on retirement income and adequacy at age 67. Another study by the lead author of this report estimated that more than two-fifths of retirees will have significantly less income at age 80 than they did at 67 due to changes in marital status, health status, living arrangements or work status.

Although most low-income boomers also have low lifetime wages, about one-third of boomers with low lifetime wages are expected to escape falling into the bottom income quintile at age 67 by continuing to work after retirement or sharing quarters with another individual, often an adult child or relative, who contributes financially to the household.

What should policy makers know about how Social Security reforms could hurt low-income boomers?

As the aging of the population and rising health care costs place an increasing strain on government resources, the future of those boomers at the lower end of the income distribution in retirement raises special concerns. Social Security will require changes in the coming years to make the trust fund solvent. Benefit reductions to improve trust fund balances could significantly affect the well-being of low-income retirees, forcing them to rely more heavily on private savings and increasing the risk that those savings will be depleted quickly.

Some options, including raising the maximum taxable Social Security earnings amount or reducing Social Security replacement rates for higher-wage workers could improve the fund's solvency without hurting low-wage workers or low-income retirees. Enacting a minimum Social Security benefit could also lessen the negative impact of cuts in Social Security benefits on low-income retirees.

Methodology

The Urban Institute used the Dynamic Simulation of Income Model (DYNASIM) to project wealth and income for boomers at the lower end of the income distribution at age 67. DYNASIM is a useful tool for understanding likely trends in the income of future retirees. It projects Social Security benefits and other important sources of income in retirement. DYNASIM, however, does not project out-of-pocket medical spending or health insurance and these ever-increasing costs could seriously threaten the economic security of retirees.

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