Competing Demands: Saving for Retirement and Supporting Financially Dependent Children

Joanna Kling and Joan R. Kahn

Maryland Population Research Center and Department of Sociology
University of Maryland College Park

In 2011, the first of the 70 million baby boomers turned 65. Over the next two decades this largest cohort in U.S. history, born between the late 1940s and early 1960s, will enter retirement. How have the boomers' diverse and often disrupted family experiences contributed to their financial readiness to retire? Some studies have shown that disrupted marital lives put individuals at a financial disadvantage in terms of retirement wealth (e.g. Zissimopoulos, Karney, and Rauer 2013). This study builds on prior work by focusing on the diverse fertility experiences of the boomer generation. Saving for retirement and financially supporting children are often competing demands. In this study, we are specifically interested in the association between children's financial needs and their boomer parents' readiness for retirement.

We hypothesize that middle-aged parents (in their fifties) who still have dependent-aged children at home (or in college), or who are supporting their adult children by providing housing or financial support, have far greater financial obligations and will be less likely to save as much for retirement as parents whose children are older and who have established independent households. Obviously, parents who had children later in life will be much more likely to have dependent-aged children in their fifties; but what is less clear is how supporting children either at home or outside the home impact savings behaviors. We recognize that fertility decisions (especially about the timing of births) are closely related to education and other human capital considerations (e.g., better educated and career-oriented women tend to postpone first births and have fewer births overall). But net of education and work experience, do parents who complete

their childbearing at younger ages (and who successfully launch their adult children prior to their own retirement) do a better job saving for their own retirement than do parents who had children at later ages or whose older children are still depending on them for housing or financial support?

This research uses the Health and Retirement Study (HRS), a longitudinal study that interviews Americans aged 50 and older every two years. The original HRS cohort was first interviewed in 1992 at ages 51 to 61, though the sample was broadened to the population ages 50 and over in 1998. Spouses and partners within sampled households, regardless of age, are also interviewed at each wave. The HRS refreshed its sample in 2004 and 2010 with a new subsample of 51 to 56 year olds representing the early and mid-Baby Boom cohorts. Our initial analysis will use the 2004 data for early Baby Boomers who were born between 1945 and 1953 and who were between the ages of 51 to 59 in 2004. Our sample is further restricted to respondents who report having had at least one child and who do not report being retired. We use the 2004 wave of the HRS because of the availability of detailed retirement wealth information including a projected social security income and pension wealth based on restricted information obtained from the Social Security Administration and from individual pension plans. We plan to extend our study to the 2010 cohort once similar data become available.

Our analysis models the impact of having financially dependent children on accumulated pre-retirement wealth for the households in which sampled Baby boomers in their fifties live. We consider single and partnered boomers separately, under the assumption that partnered retirees will share their retirement wealth; therefore, we consider an individual's retirement wealth for single adults and the total retirement wealth accumulated by both partners for married or cohabiting respondents. We maintain a broad definition of children who may need parental support, and include biological, adopted and step-children.

We have two outcome measures that reflect components of wealth that we assume will be available upon retirement: personal savings and expected wealth in retirement. We define personal savings as liquid assets controlled by the individual such as money in checking, savings, or money market accounts, IRA or Keogh accounts, stocks, mutual funds, investment trusts, certificate of deposits (CDs), government savings bonds, or other bonds. We view personal savings as highly discretionary and therefore sensitive to competing financial demands which could either interrupt the pace of savings or force individuals to deplete their savings in order to meet pressing financial needs, including those of financially dependent children.

Our measure of expected wealth in retirement includes projected values of lifetime Social Security and pension income. Whereas many surveys rely on respondents to report how much they expect to receive in pension income, the HRS recognized that many individuals are unable to give accurate estimates; instead, the HRS has obtained administrative data from both the Social Security Administration and from individual employer pension plans, which allows us to estimate a measure of expected wealth in retirement. Access to the Social Security administrative data is restricted. However, the HRS has made publically available a measure of prospective Social Security total wealth for respondent households. The HRS calculation of Social Security wealth for partnered households assumes that spouses whose Social Security benefit is less than half of his or her spouses' benefit are dually entitled to his or her own benefit plus the difference between his or her own benefit and half of the spouses' benefit (see HRS documentation on Prospective Social Security Wealth Measures of Pre-retirees, 2010). Although individuals cannot alter their Social Security benefit, nor can families distribute this money to their children before they receive the benefit, we incorporate Social Security wealth into our analysis because parents might make other spending decisions (e.g., the amount of discretionary

money given to financially dependent children) with the expectation that Social Security will help finance their retirement.

Similarly, pension benefits are designed to be collected once people reach retirement age, although many pension savings plans allow people to invade their savings for emergency expenses, but not without substantial penalties. The HRS collects detailed information on pension plans (defined benefit (DB) and defined contribution (DC) plans), from respondents and when possible, match this to detailed pension plan information from employers. Using the HRS Pension Estimation Program, we will estimate a present discounted value of pension wealth at the full retirement age[1]. These estimates will reflect both the fixed income expected from traditional defined benefit pensions as well as an annuitized income flow generated from the savings accumulated in defined contribution pensions. We anticipate that the latter may be more vulnerable to periodic financial pressures than the former and we can test this empirically with our data.

Our main explanatory measures reflect the presence of children who are likely to be financially dependent on their parents and who may therefore inhibit their parents' ability to prepare for retirement. The HRS asks respondents about their children's characteristics, including the extent to which they rely on their parents for lodging or financial support. Although it would be informative to incorporate the prior history of financial support to children, we are unable to do so with the data for our sample because respondents were only first interviewed in 2004. However, we are able to distinguish different family configurations reflecting greater or lesser dependency on the part of respondents' children. We define financially dependent children as those who are either a) under age 22 (the earliest age one could

[1] The employer pension plan data is not publically available. In the event that we do not gain access to this data in a reasonable amount of time to use it for this project we will use only the respondent reported pension data.

expect to graduate from college), b) over age 22 but living in their parents' home, or c) are over age 22 and living outside their parents' home, but receiving at least $500 per year from their parents. We assume that these children are more financially dependent on their parents than are older children, those who live elsewhere, and those who do not receive such large financial transfers. The $500 cut-off for financial help comes from previous literature indicating this amount as a substantial amount of assistance (e.g. see McGarry and Shoeni 1997).

Our analysis will control for a wide range of demographic and socioeconomic factors including age, race, marital history, education, current earnings, and work history, In addition, we will also control for respondents' subjective retirement expectations of working after age 65. We recognize that the relationship between children and parents is much more than simply financial, and also involves emotional and instrumental support. Therefore, we include a measure of whether children are considered 'helpers,' meaning they help parents with daily activities.

As this project continues we hope to explore the impact of financially dependent children on an income replacement rate, comparing pre-retirement income to expected retirement income. A replacement rate would further the understanding of financial well-being of households in retirement because it is a relative measure of income comparing the likelihood of maintaining pre-retirement standard of living in retirement. We also plan to explore if expanding our definition of financial dependents to include grandchildren changes our estimates in our models.

References

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