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ASSET CYCLES AND THE RETIREMENT DECISIONS OF OLDER WORKERS

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To determine how asset values of older workers affect their future retirement decisions, it is important to take into account how asset values change over asset cycles. This study uses Health and Retirement Study data from waves 1992 through 2008 together with restricted SSA data on geographic location to estimate a model of the age at first self-reported retirement for the subsample of married males. The model covariates include demographic variables, workplace variables (including wages of the two spouses), non-housing financial wealth, house value, housing equity and size of mortgage. The proportional hazard estimates are, for the most part, significant and of the correct sign. The estimated models replicate the decisions of the sample members for the period from 2000 to 2007. The models do not replicate the sharp drop in the aggregate retirement rate in the year 2008, the final year of the sample, which is also the first sample year in which non-housing financial wealth and housing equity both declined throughout the United States.

I try to modify the data in a reasonable way to try to gauge whether measurement error during the recession of 2008 could be the reason that the predictions of the model do not fit the actual experience in 2008. In the estimation data set a reported home value for the year 2008 is taken to be the correct value of the variable. I modify the home value using a MSA-level repeat home sales index to calculate a home-value growth rate for 2008 and apply it to a predicted or actual home value for 2007. Only if such a calculation is not possible for a given observation is the reported home value for the year 2008 taken to be the correct value of the home-value variable in that year. I modify the non-housing financial wealth variable by replacing the reported value of non-housing financial wealth for all households that reported no decline in the year 2008 by a value that applies the sample mean rate of decline, over all households the reported a decline, to the predicted or actual value of non-housing financial wealth for 2007. While the predictions move in the correct direction after these modifications are made, the improvement is small relative to the gap that remains.

I conclude that the under-prediction of the fall in the retirement rate may be due to different valuations of gains and losses in wealth, as put forward by Kahneman and Tversky in their famous paper “Prospect Theory: An Analysis of Decision under Risk,” published in the *Econometrica* in 1979. In this paper Kahneman and Tversky present an alternative to expected utility theory in a descriptive model of decision-making under uncertainty that they call prospect theory. Kahneman and Tversky suggest that people under-weight outcomes that are probable compared to outcomes obtained with certainty and also discard components shared by all prospects being considered. In prospect theory value is assigned to gains and losses of wealth rather than to the final total of wealth. The value function is defined on deviations from a reference point and is generally steeper for losses than for gains.

Using household wealth in 2007 as the reference point, the losses in wealth experienced by households were valued more highly than corresponding gains would have been. Therefore, even though the wealth position of a given household that lost wealth in 2008 may have matched the wealth position in an earlier year of a second household that had never previously lost wealth, all else equal, the utility of that wealth for the first household would be lower, and the first household would be less likely to retire.

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