Study: Financial windfalls hasten early retirement

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Older workers who get a jolt of cash out of the blue are more likely to cash in on early retirement, according to new research led by two University of Illinois finance professors.

Jeffrey R. Brown and Scott Weisbenner say the unique study shows that unexpected inheritances hasten retirement, lending new credence to widely held economic theory that people value leisure time and will parlay newfound wealth into less work.

"This study shows that at least some people approaching retirement work just for the money, not for love of the job," Brown said. "When unexpected wealth comes their way, a significant number respond by retiring early, not by continuing to work and buying a nice car or taking a vacation."

The findings, which will appear in the Review of Economics and Statistics, also could apply to the recent downturn in the stock market, shedding light on whether some workers might wind up on the job longer because of deep, recession-driven losses in stock portfolios and other investments, the authors said.

"A negative shock to wealth has just the opposite effect of what we have in this study, so I expect that those losses are going to lead some people to work longer than they expected," said Brown, a senior economic adviser to President George W. Bush in 2001-2002.

Weisbenner says retirement plans in households that were heavily invested in the stock market will be most affected by the economic crisis , which he says underscores the importance of maintaining a well-diversified portfolio.

"Over the past two decades, workers have become increasingly more responsible for making investment decisions as there has been a shift away from formula-based defined benefit pension plans to account-based defined contribution pension plans," he said. "The recent turbulence in the financial markets highlights the importance of thinking about how your retirement plan is invested and the risks to which you are exposed."

Brown says the study is unique because it gauges the impact of unexpected and larger-than-expected inheritances, using data from an ongoing survey that quizzes thousands of older workers every two years about their outlook for both inheritances and retirement plans.

Honing in on windfalls is important because workers factor expected inheritances into their plans, just as they do pensions, Social Security benefits and other known income, according to the study by Brown, Weisbenner and Wellesley College economics professor Courtney Coile, all of whom were doctoral classmates at the Massachusetts Institute of Technology.

"If you really want to understand how wealth affects retirement, you have to look for something that people didn't expect," Brown said. "The contribution that made this research special was the ability to follow the same people over time as they approach retirement, comparing their expectations to what actually happened."

The study found that nearly a quarter of workers who received a surprise or bigger-than-expected inheritance retired early, compared with 18 percent of total workers surveyed in the ongoing Health and Retirement Survey. The odds increased significantly as windfalls grew - about 8 percent for every $100,000 inherited.

"This supports the notion long held by labor economists that, all things equal, people prefer leisure over working," said Brown, the director of the Center on Business and Public Policy in the U. of I. College of Business. "What could be better than early retirement to ramp up your leisure time?"

He says the findings could help guide understanding of labor market decisions, including the effect of employer-provided incentives for early retirement or prospective Social Security reforms that could keep workers on the job longer if benefits are scaled back.

The study also could be a barometer for a long-debated question over what might happen as the massive Baby Boomer generation dies off, passing down trillions of dollars accumulated through stocks and other investments, Brown said.

"One of the effects it could have is driving people to retire earlier, which has implications ranging from tax revenue to the solvency of Social Security," he said. "Retirement is an important economic phenomenon because as people exit the work force they go from being producers and savers to drawing down both their own assets and the government's resources."

Source: University of Illinois at Urbana-Champaign (news : web)