Better Information on Income Replacement Rates Needed to Help Workers Plan for Retirement

What GAO Found

Household spending patterns varied by age, with mid-career households (those aged 45-49) spending more than older households. For example, according to 2013 survey data from the Bureau of Labor Statistics (BLS), mid-career households spent an estimated average of around $58,500, while young retiree households (those aged 65-69) spent about 20 percent less. While the share of spending was consistent for some categories, other categories had larger variations across age groups. For example, housing expenses comprised the largest share of spending regardless of age, while older households spent more out of pocket on health care than mid-career households. Spending was less variable across age for low-income households compared to other households. For example, there was not a significant difference in average spending between mid-career and young retiree households in the lowest income quartile, compared to an approximately $20,000 difference for the highest income quartile. These variations in spending patterns have implications for the resources households need to maintain their standard of living in retirement.

Researchers and financial industry professionals develop target replacement rates—the percentage of income to aim for in retirement—based on certain key factors, including spending, household characteristics, and pre-retirement earnings. GAO’s analysis of the literature found that calculating an appropriate replacement rate can be complex. For example, there is debate over whether households that have raised children should target a lower replacement rate than households that have not. In addition, a worker’s pre-retirement earnings could be defined as earnings at the end of the worker’s career or as average earnings over the course of the career. Despite these complicated considerations, target replacement rates cited in the articles and reports GAO reviewed typically range between 70 and 85 percent. Some financial industry professionals told GAO that they develop customized targets that take into account workers’ assets and expected spending, while others questioned the usefulness of replacement rates.

The information and tools on replacement rates that the Department of Labor (DOL) provides may be too limited to help workers understand how to use such rates for retirement planning. DOL’s Employee Benefits Security Administration’s (EBSA) website provides information and tools to help American workers better plan for retirement, including a tool to help workers calculate their retirement income needs as a percentage of preretirement income. While EBSA’s materials note that a target replacement rate can vary based on individual circumstances, they do not include specific examples of demographic groups that research indicates can result in higher or lower income replacement needs, or how much a replacement rate might need to be adjusted for those groups or for other individual circumstances. Without additional information, workers may not understand how to adjust target replacement rates when planning for retirement. Further, EBSA’s worksheet and online tool for calculating how much to save use a default replacement rate with no opportunity for a user to adjust the rate based on individual circumstances. Without the ability to adjust the replacement rates used in planning tools, workers may over- or under-estimate how much they need to save for retirement.