Spending Trajectories after Age 65 and Implications for Economic Preparation for Retirement

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Starting Point for Financial Planning for Retirement: "How much will I/we need to finance our spending?"

Anticipate household's spending level and path

- Desired living standards at beginning of retirement years
- Anticipated onward trajectory

Some things difficult to foresee, sources of uncertainty:

- No longer able to work to compensate for shocks
- Increasing risk of health shocks, long-term care (informal, formal?)
- Elevated mortality risk
- Investment risk
- May lose ability to manage finances

→ Obtain guidance from (i) economic theory, (ii) observed spending patterns. Consistent with each other?

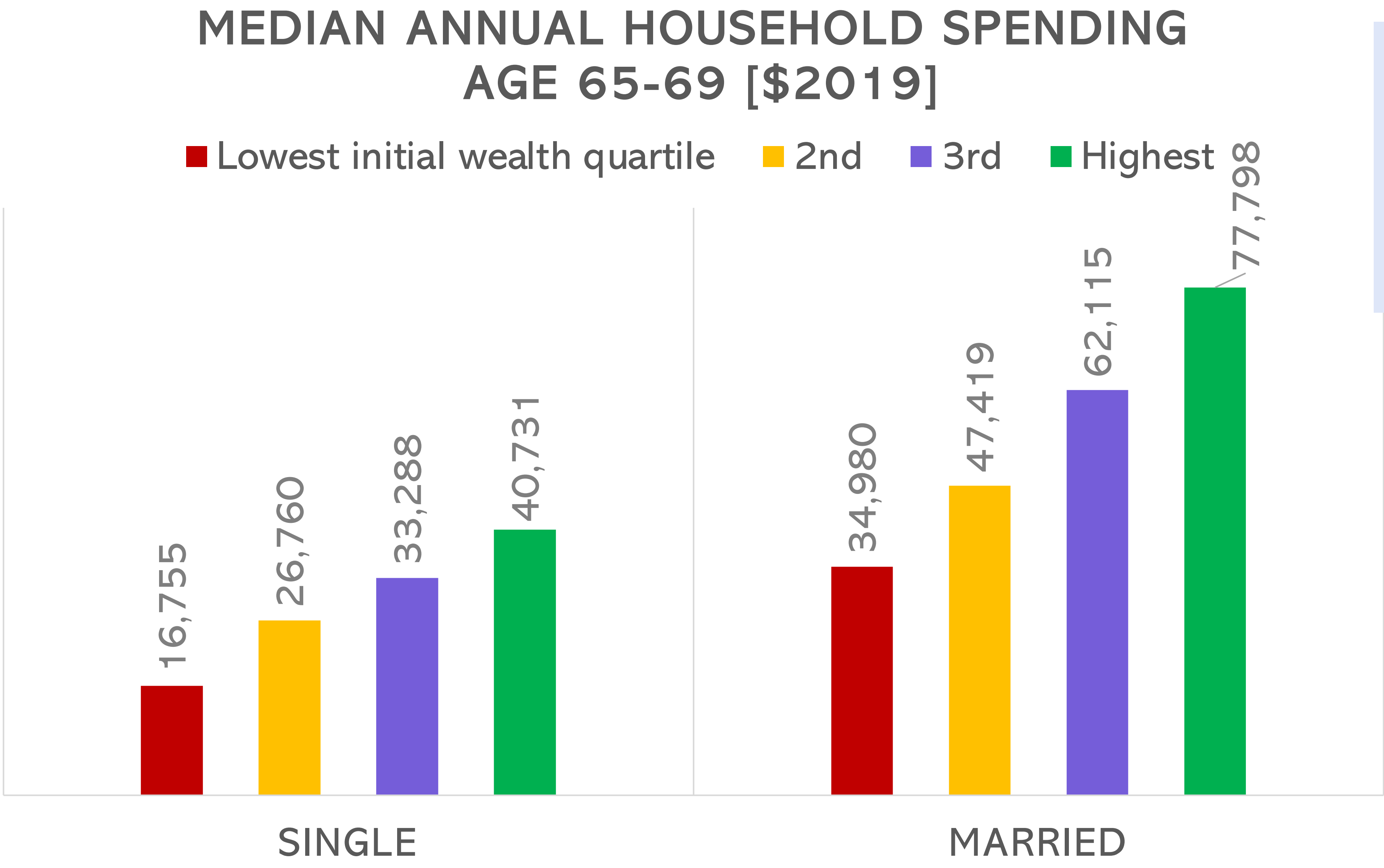
Spending Trajectory Implied by Lifecycle Model

- **During retirement: Spending declines** due to increasing mortality risk
  - Flatter path (smaller rate of decline conditional on age) if
    - higher life expectancy;
    - bequest motive
  - Widowing: one-time drop as single survivor spends less than the married household
- **Interaction with Health:**
  - If **health good, spend greater share on** goods & services **complementary to health**, less on health care; If health bad, reverse.
  - On average, health declines with age
    → spending composition changes with age, reduced enjoyment from spending.

Data: Health and Retirement Study and CAMS Supplement

- Representative of U.S. population over age 50
- Longitudinal: biennial, 1992 onward
- Spending supplement: biennial, 2001 onward
- Household spending elicited in 39 categories
- Total spending = sum of 39 categories
- Total compares closely to Consumer Expenditure Survey

Large Differentials in Spending Levels



Shown by initial wealth quartile (measured at or near age 65)

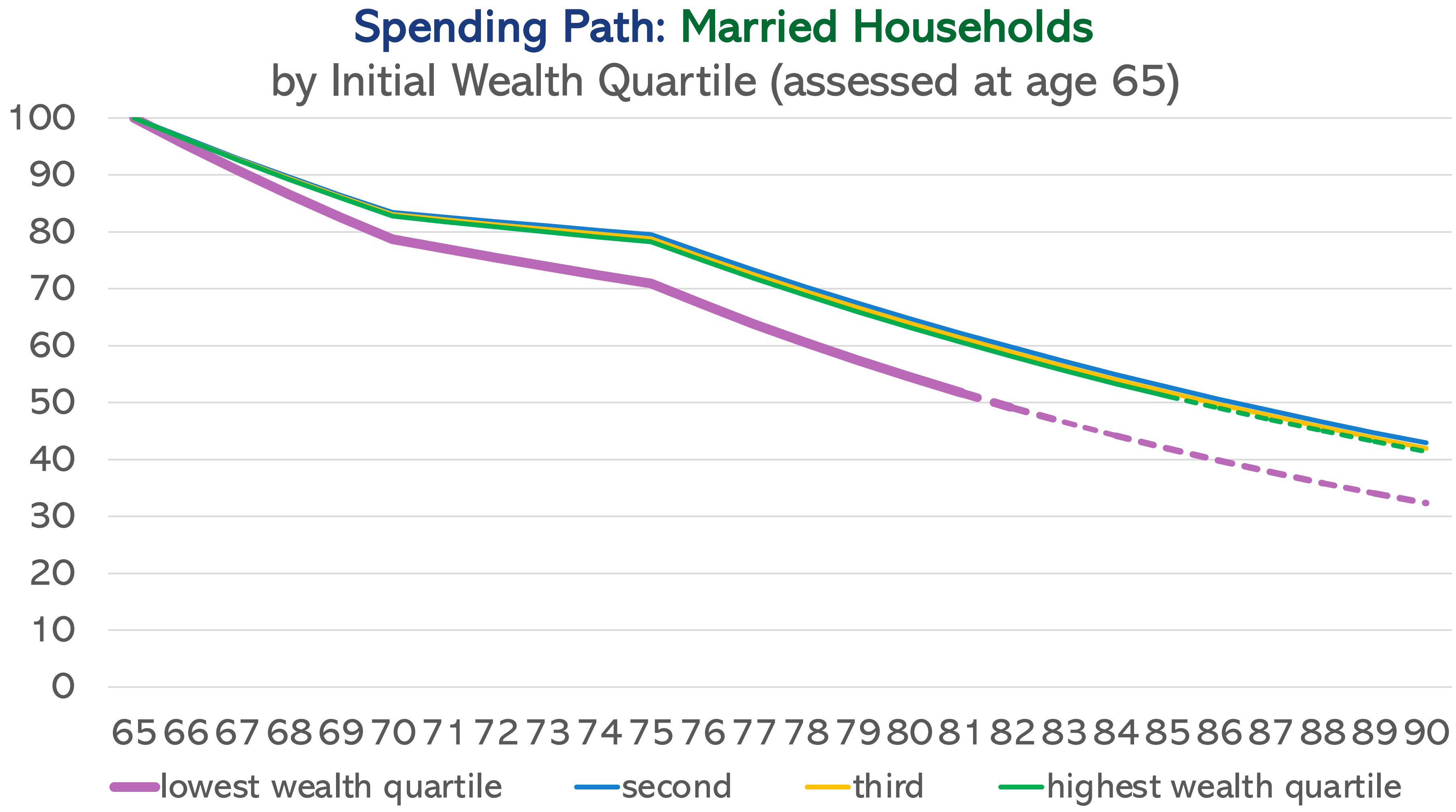
Source: Hurd and Rohwedder (2023), Journal of the Economics of Aging.

Spending Trajectories

- **Use longitudinal data on household spending** to
  - Estimate rates of change in spending by age, marital status and initial wealth (at age 65)
  - Construct spending trajectories based on rates of change
    (Note: cannot use cross-section data because of differential mortality and cohort differences)

- **Assess whether estimated trajectories useful guidance:**
  - Age pattern in households reporting
    - being financially constrained,
    - Dissatisfied with economic situation
  - Changes in enjoyment of spending on certain types of goods and services

Spending Declines across ALL Socioeconomic Groups



Overall average annual rate of change: **-2.7%**

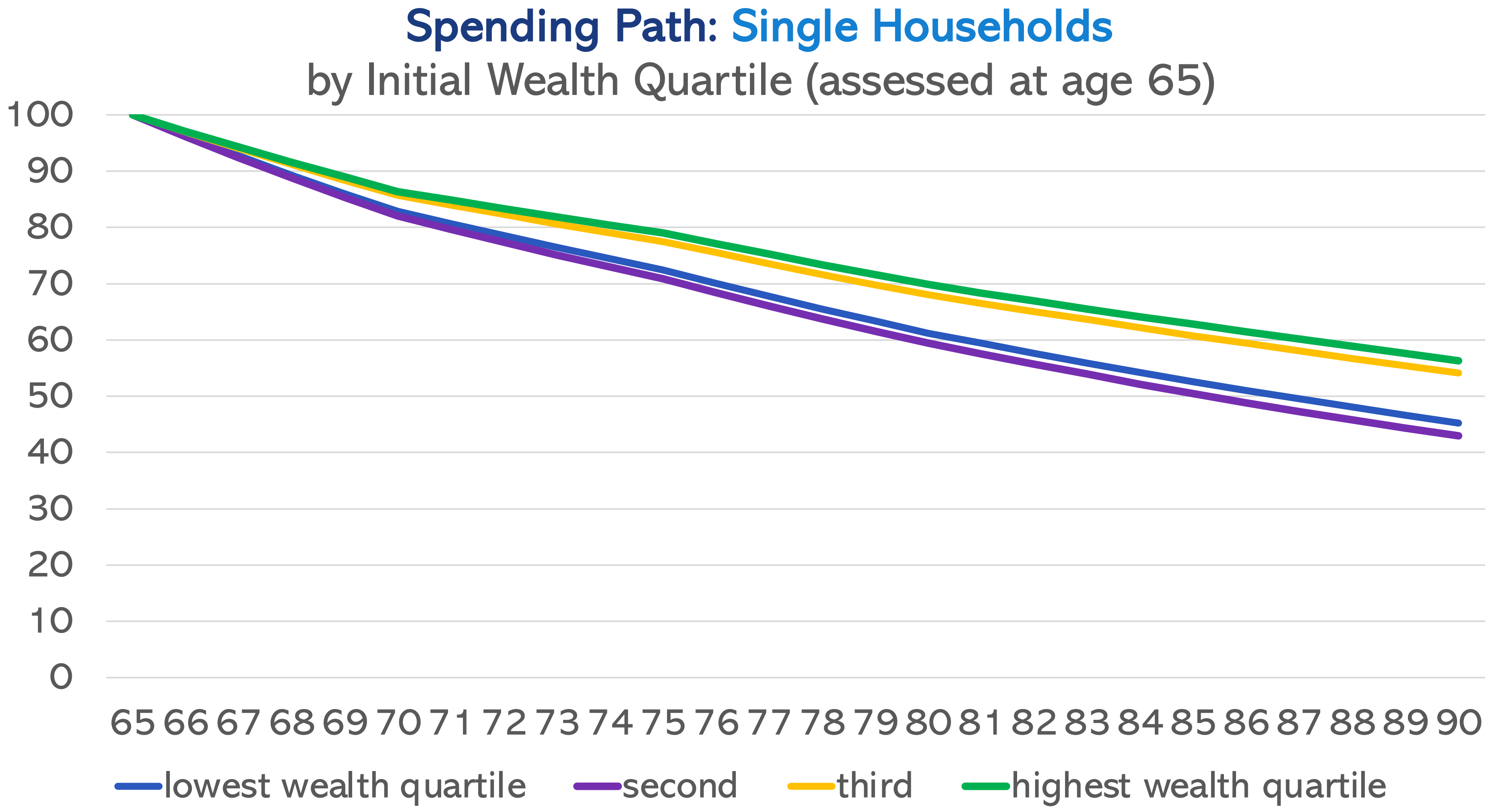
Largest rate of decline among lowest initial wealth group.

Flatter spending paths for all other groups with higher initial wealth; longer lived on average.

Similar patterns if stratifying by education.

Source: Hurd and Rohwedder (2023), Journal of the Economics of Aging. Updated.

Spending Declines ACROSS ALL Sociodemographic Groups



Overall average annualized rate of change: **-2.0%.**

Largest rate of decline among lowest two initial wealth quartiles.

Flatter spending paths for highest two initial wealth quartiles; longer lived on average.

Similar patterns if stratifying by education.

Source: Hurd and Rohwedder (2023), Journal of the Economics of Aging. Updated.

Interpretation of declining spending paths?

Are the declining spending paths …

… mostly chosen, that is, consistent with individuals’ preferences?

… or forced due to *unexpectedly* tightening budget constraint?

→ Study budget shares (composition of spending) and variation by age

→ Respondents’ own reports on:

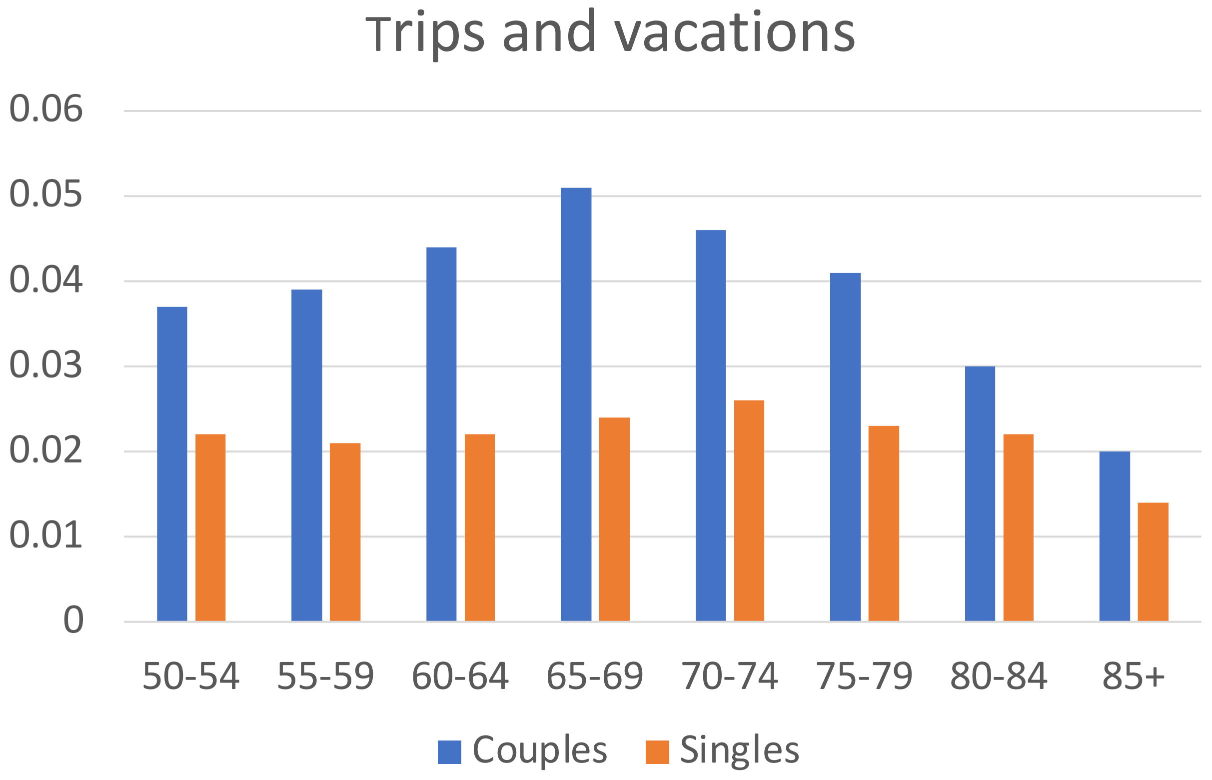
- Satisfaction with economic position
- Whether financially constrained (now, how it changed)
- Changes in enjoyment from some types of spending

How does composition of spending change with age?

- Budget share = fraction spent on good x / total spending

Spending Composition Changes with Age, as Health Declines

While health good, companionship:
Spend more on trips and vacations, leisure activities

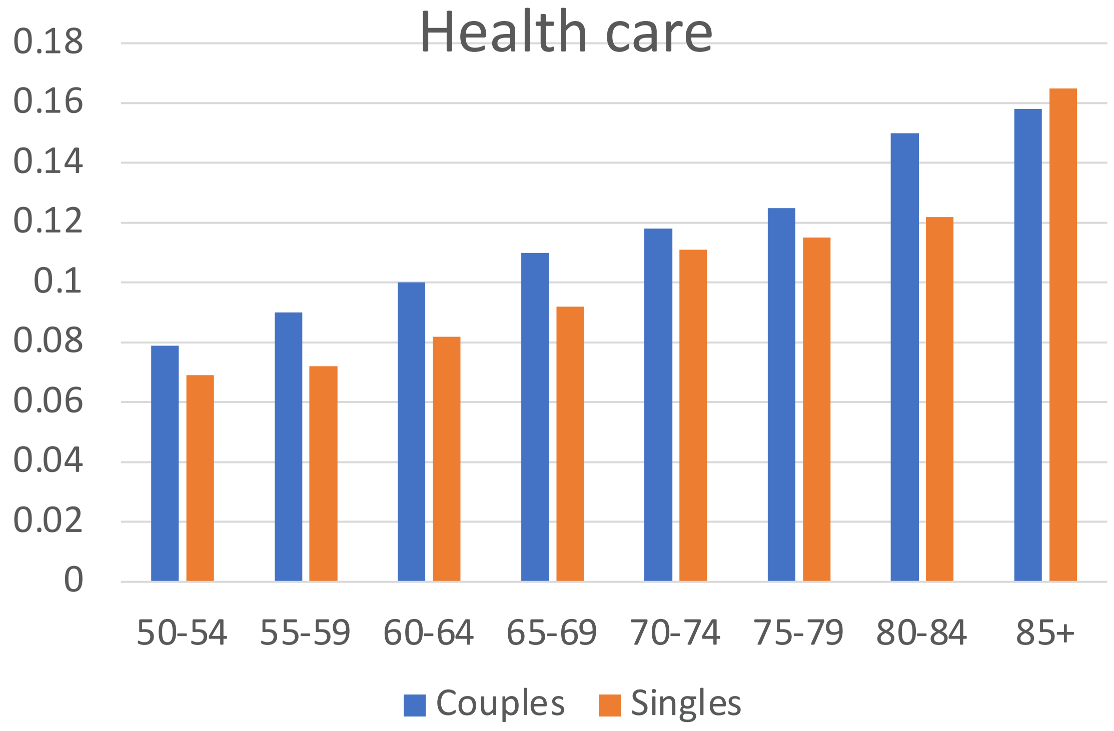


As health declines, spend less on transportation, clothing, durables, trips and vacations, leisure …

Spending Composition Changes with Age, as Health Declines

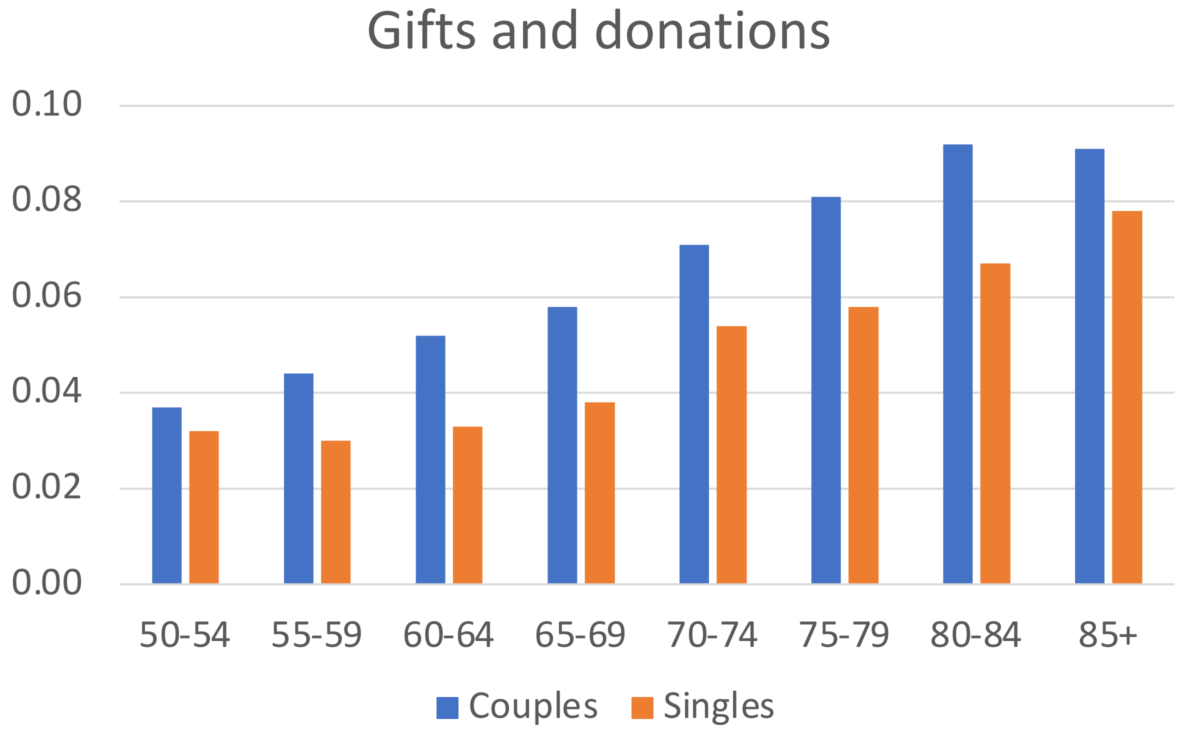
As health declines, spend higher fraction on health care.

Total spending still declines, except possibly in last year of life.



Gifts and donations: not health dependent

Increasing with age as household's time horizon shortens and mortality risk increases.



Is Prevalence of Financial Distress Higher at Advanced Ages?

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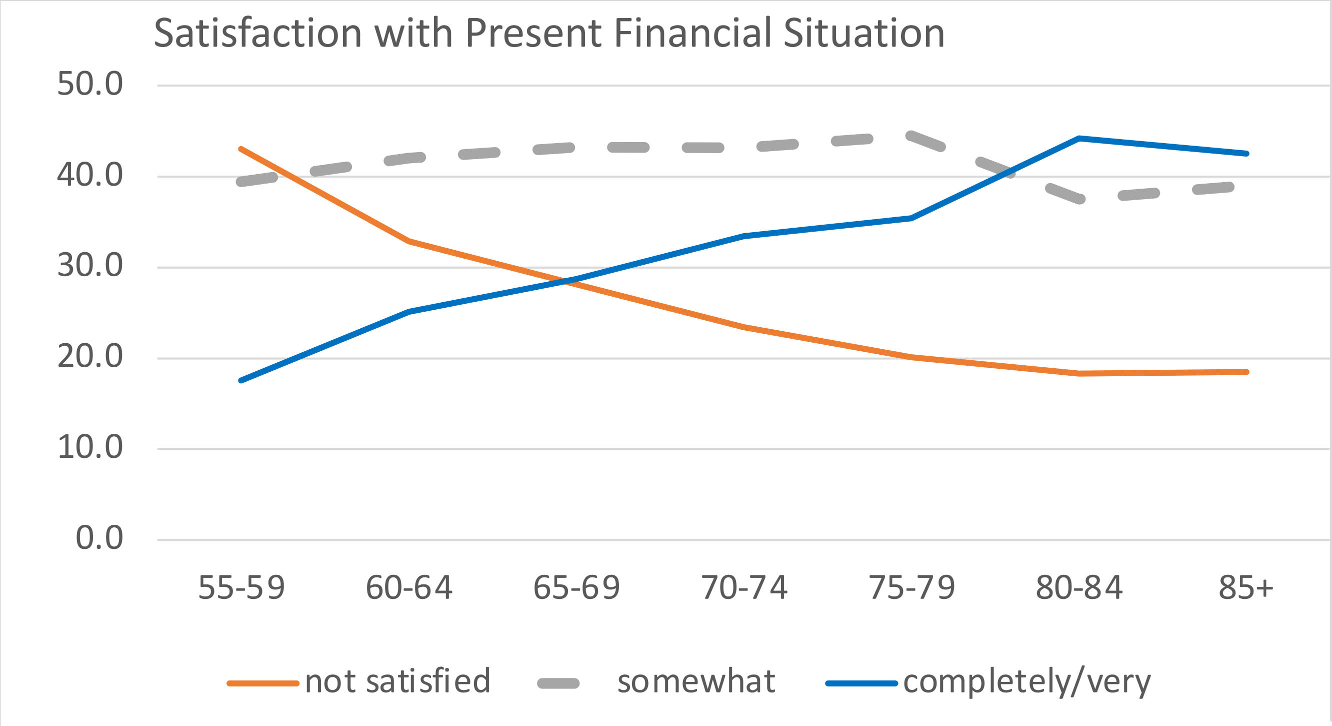
No.

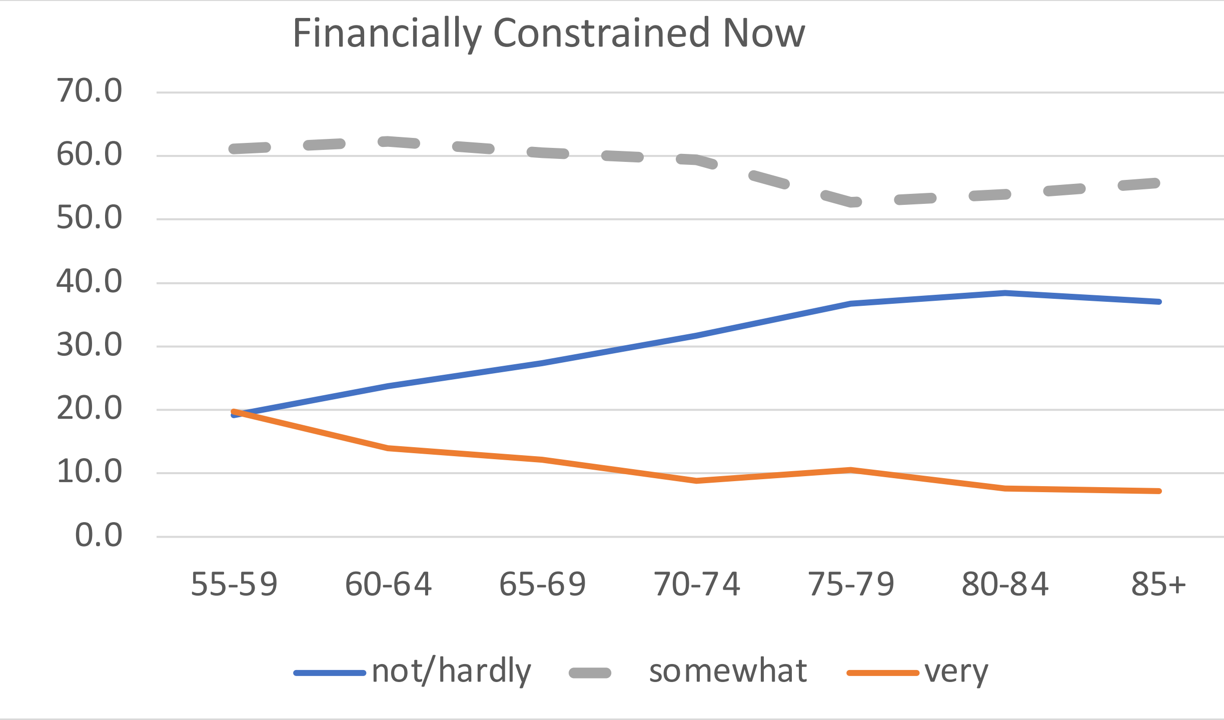
At advanced ages …

Larger fraction reports

(i) Satisfaction w/ finances



(ii) Little financial constraints



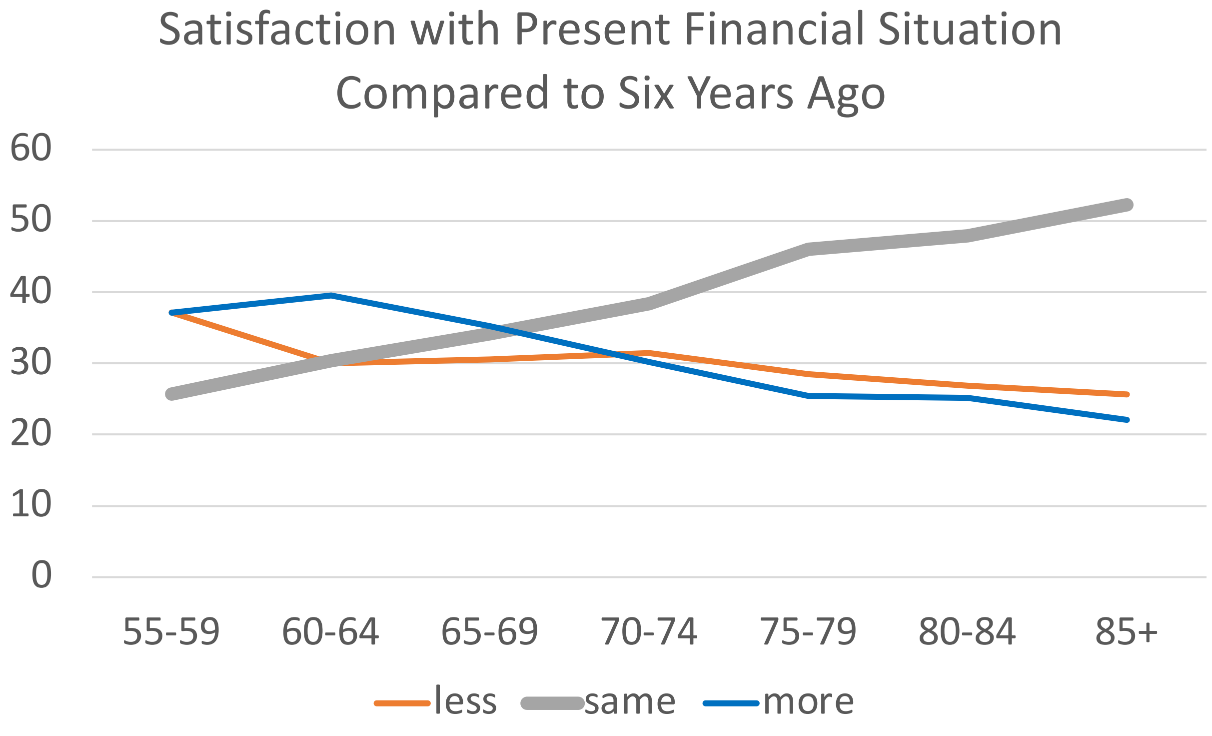
Within-person Comparison with Six Years Ago

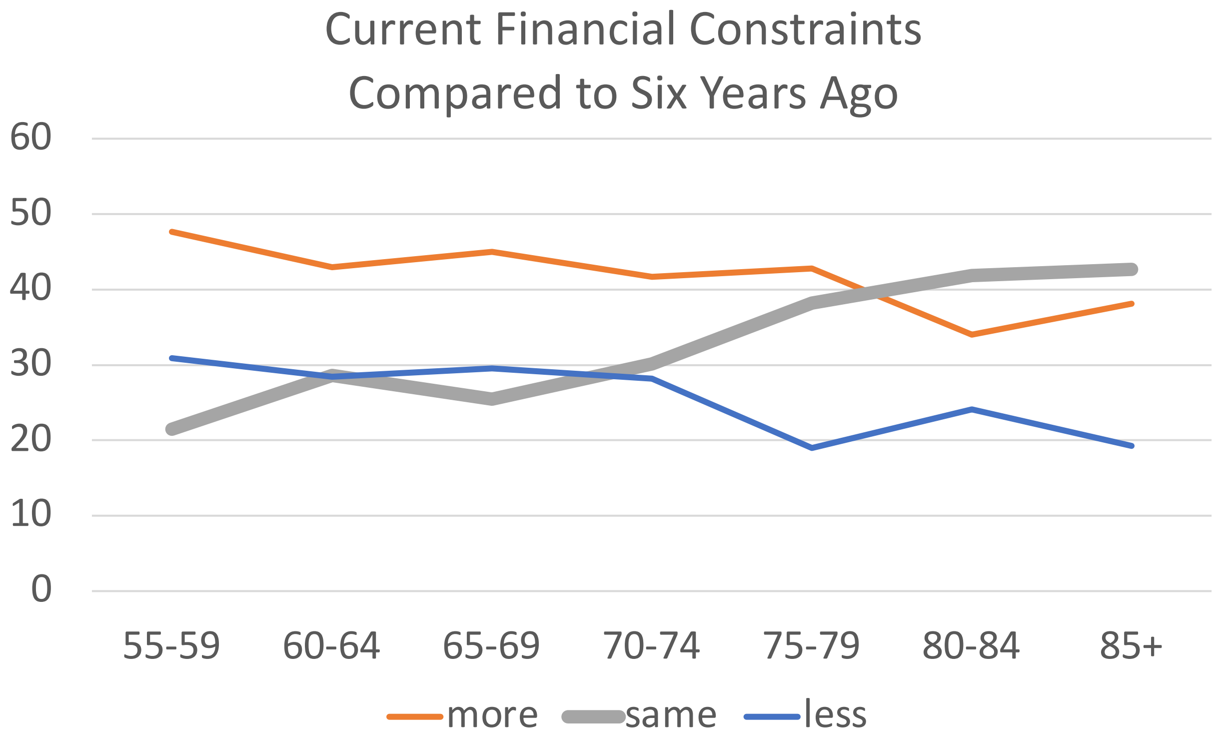
Satisfaction

- Percent reporting unchanged satisfaction increased with age
- Percent reporting less satisfaction decreased with age

Financial constraints

- Percent reporting “unchanged” increased with age
- Percent reporting “more” decreased with age





Changes in Enjoyment from Spending

Special Module in HRS-CAMS 2019

Change in enjoyment (marginal utility) of spending-related activities

Compared to six years ago, how much enjoyment do you (or would you) get today from traveling?

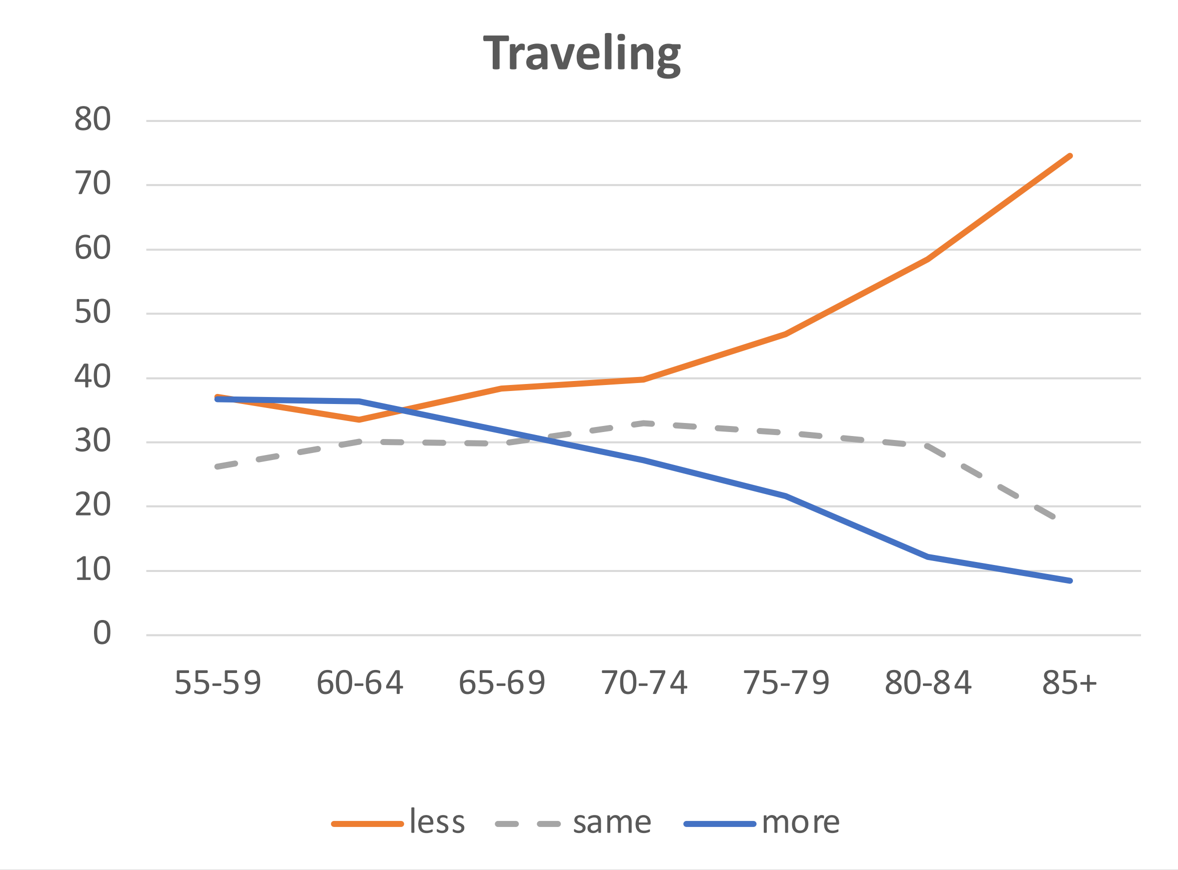
5-point response scale: 1. Much less … 3. Same … 5. Much more

Same question asked about spending on …

- Going out to eat
- Leisure activities
- Having new car
- Having new appliances

Empirical Evidence on Change in Enjoyment (CAMS 2019)

Compared to six years ago, how much enjoyment do you (or would you) get today from *traveling?*



At older ages

Higher percentage with **less enjoyment** compared w/ 6 years ago (within-person)

Lower percentage with more enjoyment

Results robust to inclusion of controls.

Similar results for:
- Going out to eat
- Leisure activities
- Having new car
- Having new appliances

Why does it matter whether spending declines?

→ Quantitatively important for finding necessary savings

- Social Security is a substantial fraction of economic resources
- Gap between Social Security and pensions and consumption needs to be filled by savings
- A moderate decline in spending translates into a larger decline in required savings
  - Example:
    1. Suppose
       - Flat spending path over retirement with expected present value of 100k
       - Social Security finances 50% of spending (→ 50k), savings to cover 50k gap.
    2. Suppose
       - Declining spending trajectory so that expected present value of spending is 10% lower (→ 90k).
       - Gap to be covered by savings: 40k, which is 20% less than in scenario with flat spending path..

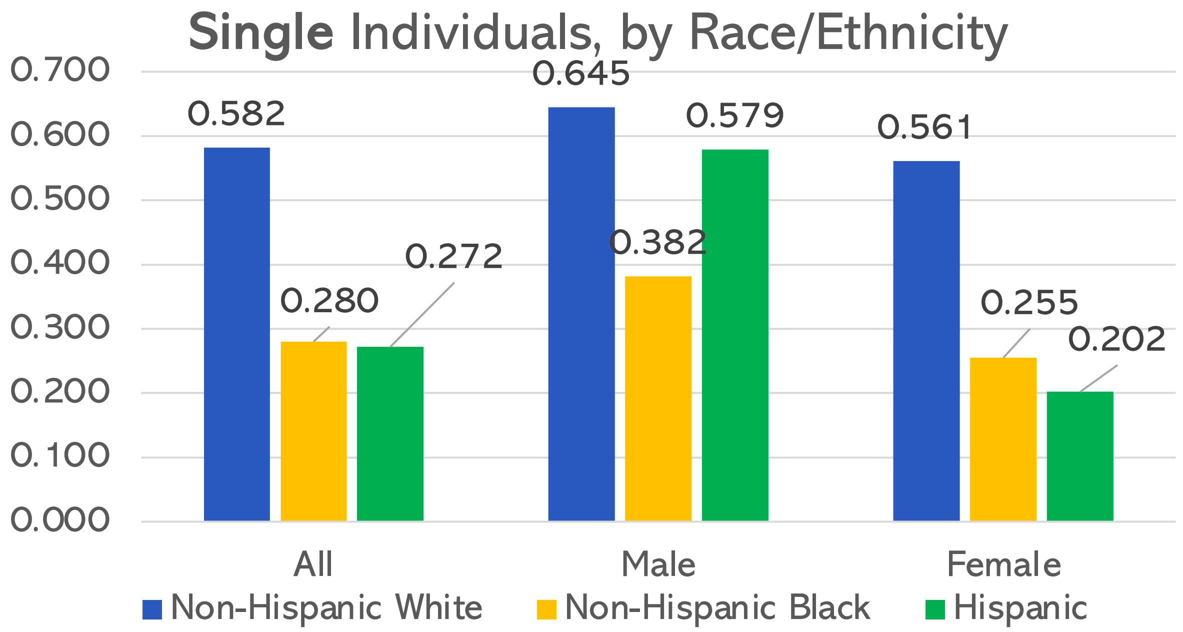
Application: Declining Spending Paths in Assessments of Adequacy of Retirement Resources

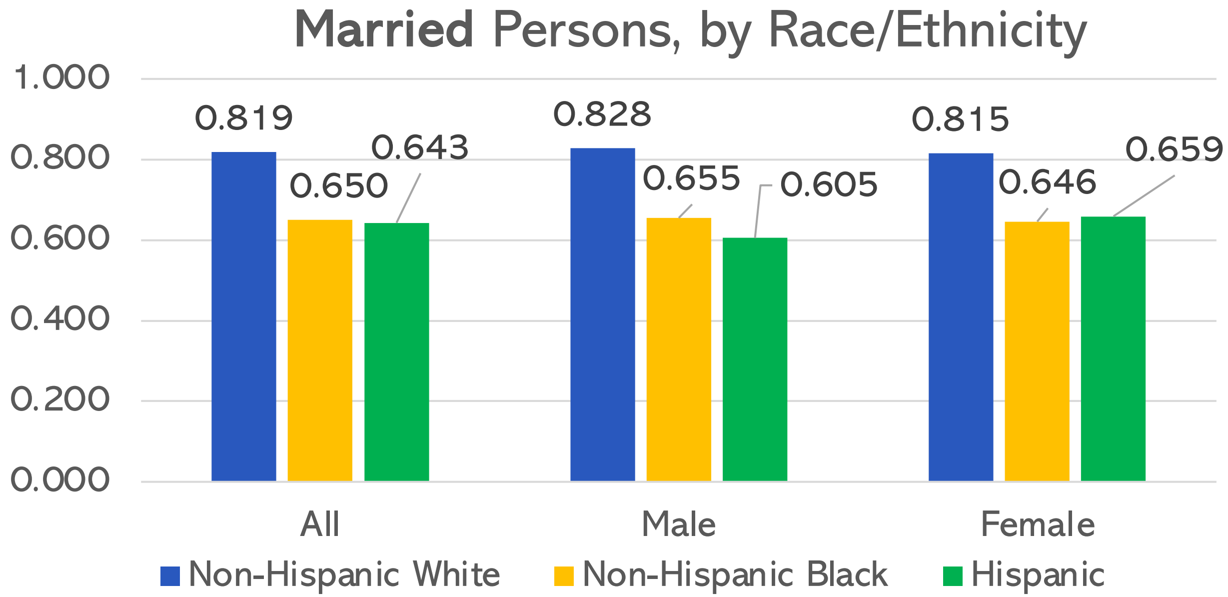
- **Microsimulation:** Do households have sufficient economic resources to finance – with high probability - consumption to the end of life without running out of wealth?

  - Single and married individuals observed in HRS around age 65-69; reported level of household's spending, income and assets
  - Simulate household's spending path, anchored to initial spending
  - Account for taxes, asset portfolio allocation (different rates of return and order of decumulation)
  - Stochastic length of life, OOP medical expenditure shocks, heterogeneity by marital status, sex, education.

PERCENT ADEQUATELY PREPARED: 65.8%

LOWER AMONG SINGLES, PERSONS OF COLOR





Source: Hurd and Rohwedder (2023), updated.

Conclusions

- **Spending declines at older ages** (not flat or increasing)
  - Accords with predictions of lifecycle model.
  - Observed for all socioeconomic groups → for most, not driven by tightening budget constraint.
  - Self reports: financial constraints not limiting factor for most households
  - Some explanations: Declines in health, reductions in enjoyment

  → Implications for resources needed in retirement

- **Overall assessment: For most, economic preparation adequate**
  - Simulations: most people adequately prepared

Conclusions - continued

- But some more economically constrained over time at older ages
- Found vulnerable subpopulations with only a minority having a low risk of running out of resources

→ **No need to encourage "people" to save more;**

Instead: Need to encourage (or provide for) "some people."

→ **Focus attention on causes and possible policy solutions.**

Thank you!

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