Retirement Consumption: Insights from a Survey

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Retirement Consumption Puzzle

- **Consumption falls in retirement**
  - Hammermesh (1984), Mariger (1987), others

- **Recent focus on “Negative surprises”**
  - Banks, Blundell, Tanner [1998]: “the only way to reconcile fully the fall in consumption with the life-cycle hypothesis is with the systematic arrival of unexpected adverse information”
  - Bernheim, Skinner, Weinberg [2001]: “many retirees. . . take stock of their finances only to discover that their resources are insufficient to maintain their accustomed standard of living.”
Do Findings Invalidate LCH?

- Key is expected vs. unexpected changes
- Need to better understand expectations
- We use survey methods to gauge pre-retiree expectations and retiree outcomes
  - Roots in Juster [1966]
Four Findings

1. Pre-retirees generally expect significant falls in spending/consumption at retirement.

2. Many retired households appear to be consuming more than expected.

3. Households are profoundly uncertain about how consumption will change in retirement.

4. Those who do not plan tend to underestimate retirement spending needs.
Our Data

- **Two surveys mailed to a sample of TIAA-CREF participants**
  - Non-random: wealthier and more educated
- **Detailed data on asset holdings and income**
  - High quality (high item response, and self-reported balances closely match TIAA accounting data)
- **Financial preferences, expectations, attitudes**
  - Many with incomplete total wealth data, but no apparent bias in questions of interest
Key Qualitative Question

“For many households, overall spending changes dramatically upon retirement. Please indicate below what your experience has been (if you are retired), or what your expectations are (if not retired):

- My household had (or expects to have) no change in spending at retirement
- My household has spent (or will spend) more after retirement than before
- My household has spent (or will spend) less after retirement than before”
Key Quantitative Question

- “About how much more or less (as a percentage of your pre-retirement spending)?”
- “Because of the uncertainty that is inherent in any question about your financial future, we ask you to provide three estimates:
  - a **LOW** estimate, where you are 90% sure that the correct answer is above this number,
  - your **CLOSEST** estimate of the most accurate number,
  - a **HIGH** estimate, where you are 90% sure that the correct answer is below this number”
Finding 1: Pre-retiree $E[\Delta c]$ Is Negative

- 90% responded to both questions
- Qualitative responses:
  - 55% expect to spend less
  - 35% expect to spend same
  - 10% expect to spend more
- Quantitative responses (average):
  - $-10\%$
OLS Regression for Pre-Retirees

Expected change in spending (log points) vs. Net Worth-to-Income for different D/Y ratios:
- D/Y = 0.00
- D/Y = 0.25
- D/Y = 0.50
- D/Y = 1.00
- D/Y = 2.00
Finding 2: Retiree $\Delta c$ Less Negative than $E[\Delta c]$

- **Frequencies**
  - 44% spent less
  - 36% spent same
  - 20% spent more

- **Arithmetic mean change in spending:**
  - $-4\%$
Finding 3: High Uncertainty in $E[\Delta c]$

- Average range from High to Low is 27.8% for pre-retirees
- Not significantly impacted by equity shares or years to retirement
How is Uncertainty Resolved?

“If you are currently retired, how do your spending needs in retirement compare with those you expected before you retired:

- About what you expected
- Higher than you expected
- Lower than you expected”
Finding 4: Non-Planners Underestimated Needs

- Question: “I have spent a great deal of time developing a financial plan.” (1-6 scale response)

<table>
<thead>
<tr>
<th>Planning Response</th>
<th>Spending Needs vs. Prior Expectations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>At</td>
</tr>
<tr>
<td>Disagree (1-2)</td>
<td>67.0%</td>
</tr>
<tr>
<td>Equivocate (3-4)</td>
<td>76.8</td>
</tr>
<tr>
<td>Agree (5-6)</td>
<td>76.0</td>
</tr>
</tbody>
</table>
Conclusions

- No evidence for wealth shocks
- Still some indication of poor preparation
  - Great uncertainty
  - Possible bias in expectations regarding needs
  - Planning may have an important impact
- While techniques need to be refined, survey data on expectations has great potential for research.