Spending in Retirement: Policy Implications

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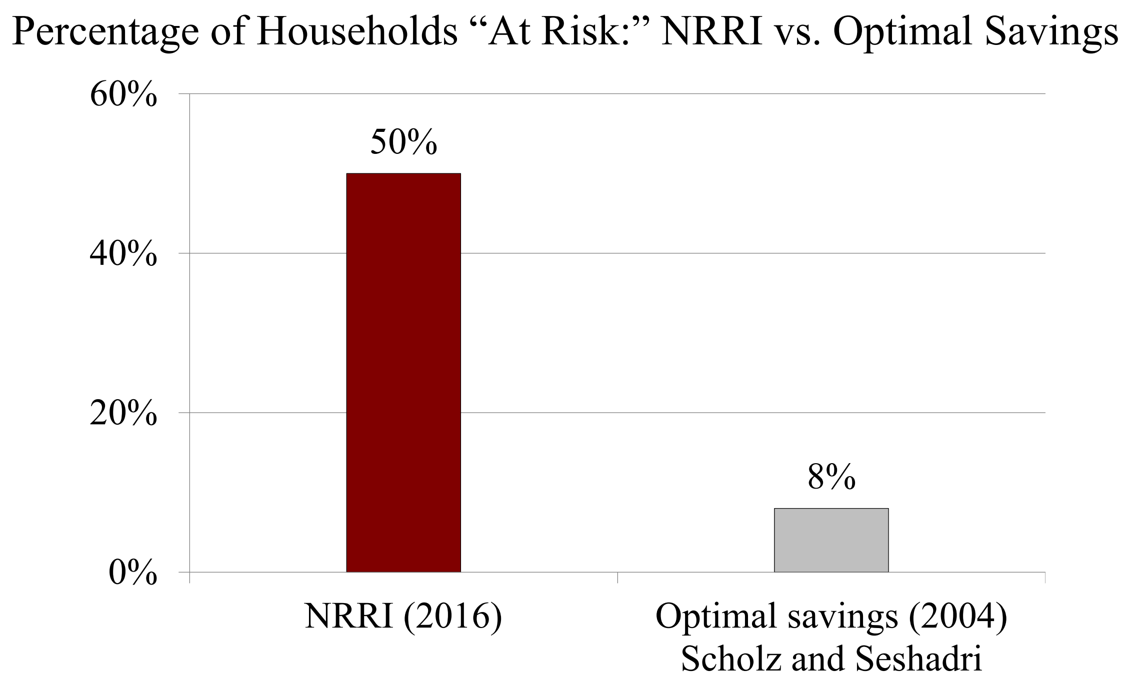
Households' desired pattern of retirement spending has implications for:

- retirement preparedness; and
- retirement income products.

Existing studies, which assume different spending patterns, offer conflicting assessments of preparedness.



Notes: The age range for the NRRI results is 30-59; the age range for the optimal savings results is 51-61.
Sources: Alicia H. Munnell, Wenliang Hou, and Geoffrey T. Sanzenbacher. 2018. "National Retirement Risk Index Shows Modest Improvement in 2016." *Issue in Brief* 18-1. Center for Retirement Research at Boston College; and John Karl Scholz and Ananth Seshadri. 2008. "Are All Americans Saving 'Optimally' for Retirement." Presented at the 10th Annual Retirement Research Consortium Conference.

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NRRI shows half of today's households are at risk.

- NRRI uses target replacement rates, derived from a life-cycle model that smooths spending.
- Households have steady spending over their work lives.
- Retirees purchase an inflation-adjusted annuity and annuitize the proceeds of a reverse mortgage to maintain steady spending in retirement.

Source: Alicia H. Munnell, Wenliang Hou, and Geoffrey T. Sanzenbacher. 2018. "National Retirement Risk Index Shows Modest Improvement in 2016." *Issue in Brief* 18-1. Center for Retirement Research at Boston College.

For the upcoming comparison, note that the NRRI has risen since 2004 (date used in Scholz & Seshadri) and risk declines by age.

Percentage of NRRI Households "At Risk" by Age Group, 2004, 2007, 2010, 2013, and 2016

Age group	2004	2007	2010	2013	2016
All	43%	44%	53%	52%	50%
30-39	49	53	62	59	56
40-49	44	47	55	52	52
50-59	35	32	44	45	44

Note: The 2004 results reflect slightly different age groups: the youngest group is age 32-39 and the oldest is age 50-58.
Sources: Alicia H. Munnell, Matthew S. Rutledge, and Anthony Webb. 2015. "Are Retirees Falling Short? Reconciling the Conflicting Evidence." *Issue in Brief* 15-5. Center for Retirement Research at Boston College; and Alicia H. Munnell, Wenliang Hou, and Geoffrey T. Sanzenbacher. 2018. "National Retirement Risk Index Shows Modest Improvement in 2016." *Issue in Brief* 18-1. Center for Retirement Research at Boston College.

Optimal savings model concludes that most Americans are "saving optimally."

- This model assumes households want to equalize *marginal utility* of consumption over their lifetimes.

- When applied to the *Health and Retirement Study* (HRS), the model shows how much households should have accumulated by their 50s.

- Comparing these estimated amounts to actual accumulations S&S conclude that, in 2004, only 8 percent of households in their 50s had less than optimal wealth.

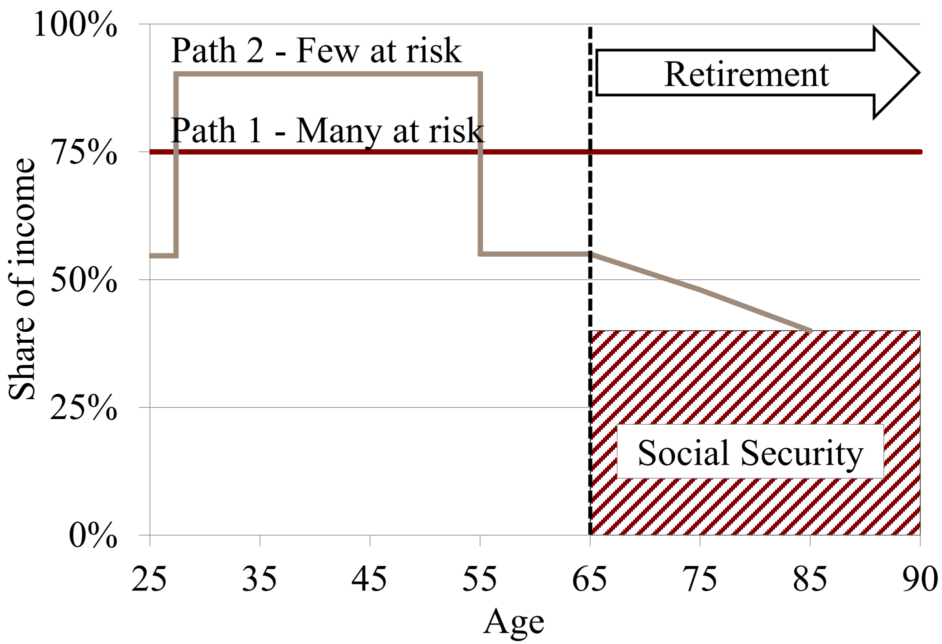
Source: John Karl Scholz and Ananth Seshadri. 2008. "Are All Americans Saving 'Optimally' for Retirement." Presented at the 10th Annual Retirement Research Consortium Conference.

The main differences between the NRRI and the optimal savings model are:

- how households adjust their spending when their kids leave home; and
- how households spend their accumulated wealth in retirement.

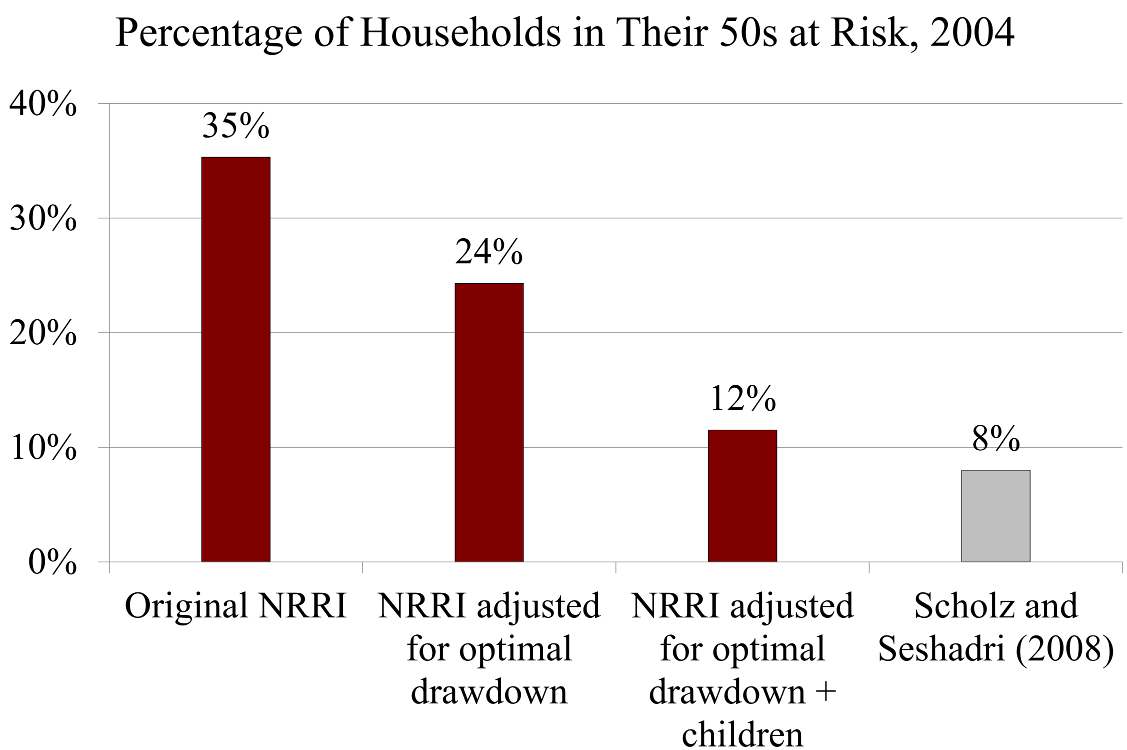
These assumptions produce dramatically different spending paths.

Illustrative Spending Relative to Income by Age for Households with Children



Source: Alicia H. Munnell, Matthew S. Rutledge, and Anthony Webb. 2014. "Are Retirees Falling Short? Reconciling the Conflicting Evidence." Working Paper 2014-6. Center for Retirement Research at Boston College.

Adjusting the NRRI for the differences in spending paths produces virtually the same share of households at risk.



Notes: The age range for the NRRI results is 50-58; the age range for the optimal savings results is 51-61.
Source: Alicia H. Munnell, Matthew S. Rutledge, and Anthony Webb. 2014. "Are Retirees Falling Short? Reconciling the Conflicting Evidence." Working Paper 2014-6. Center for Retirement Research at Boston College.

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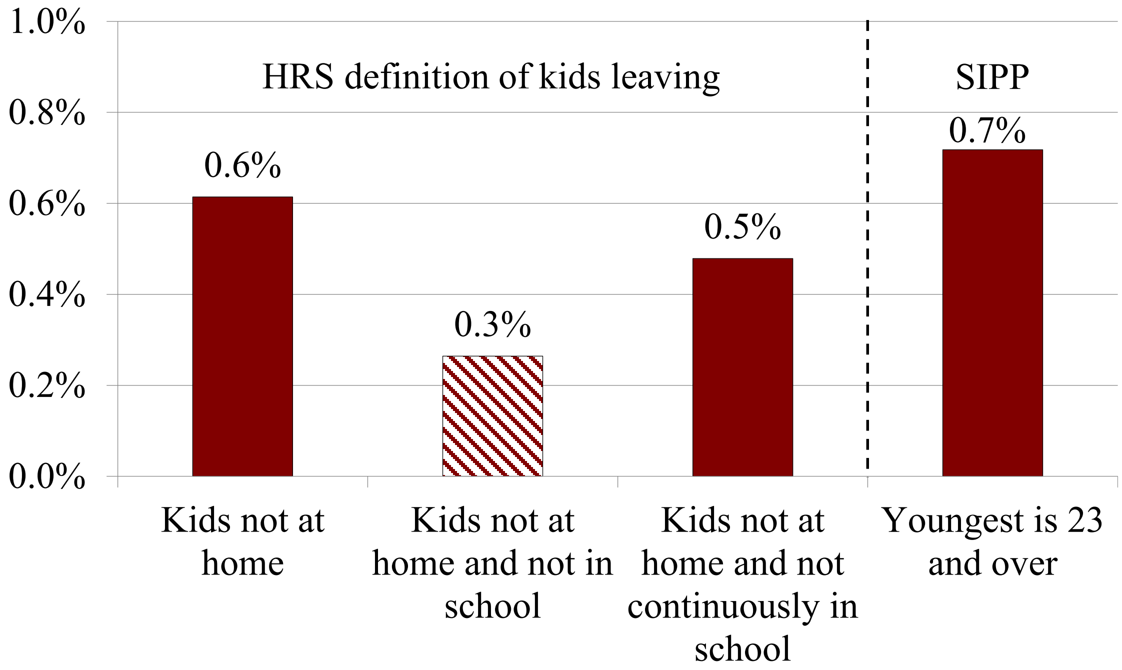
Which assumptions are right? Do parents reduce their spending when kids leave home?

- We looked at this question using HRS data linked to W-2 tax data from 1992-2010.
- The analysis focused on households married throughout the period, with at least one parent eligible for a 401(k).
- It also looked at younger households using the *Survey of Income and Program Participation* from 1992-2008.

The results showed a range of estimates for increased saving depending on the definition.

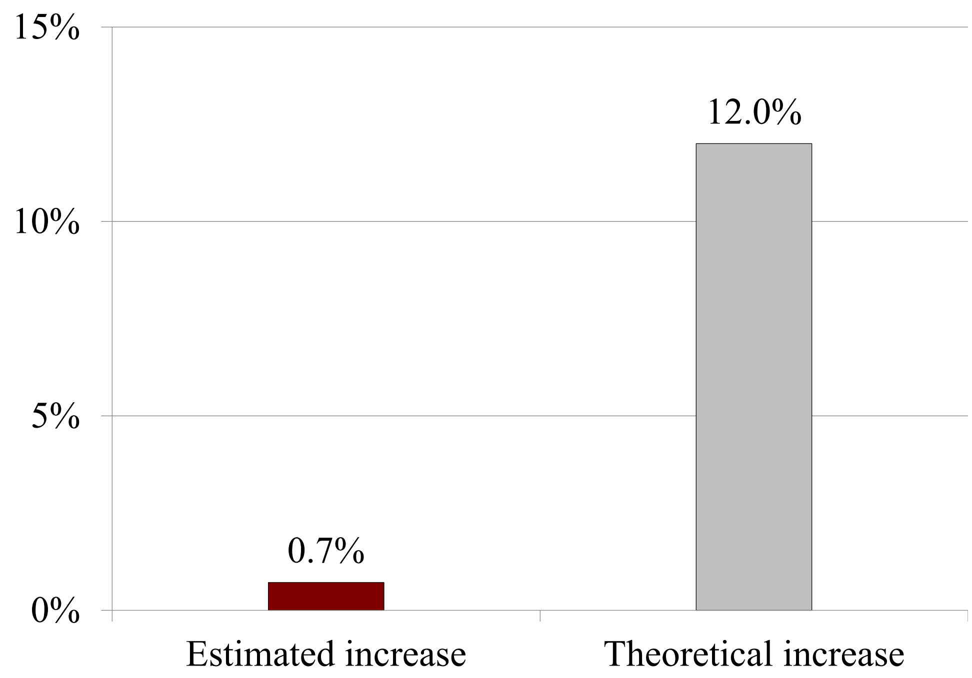
Percentage-Point Increase in 401(k) Saving for Households when Kids Leave



Source: Irena Dushi, Alicia H. Munnell, Geoffrey T. Sanzenbacher, Anthony Webb, and Anqi Chen. 2016. "Do Households Save More When the Kids Leave Home?" *Issue in Brief* 16-8. Center for Retirement Research at Boston College.

But even the largest increase in saving was miniscule compared to theory.

Percentage-Point Increase in 401(k) Saving for Households when Kids Leave, Estimated and Theoretical



Note: The estimated increase is for the SIPP definition (youngest child is 23+), which is the highest estimate.
Source: Irena Dushi, Alicia H. Munnell, Geoffrey T. Sanzenbacher, Anthony Webb, and Anqi Chen. 2016. "Do Households Save More When the Kids Leave Home?" *Issue in Brief* 16-8. Center for Retirement Research at Boston College.

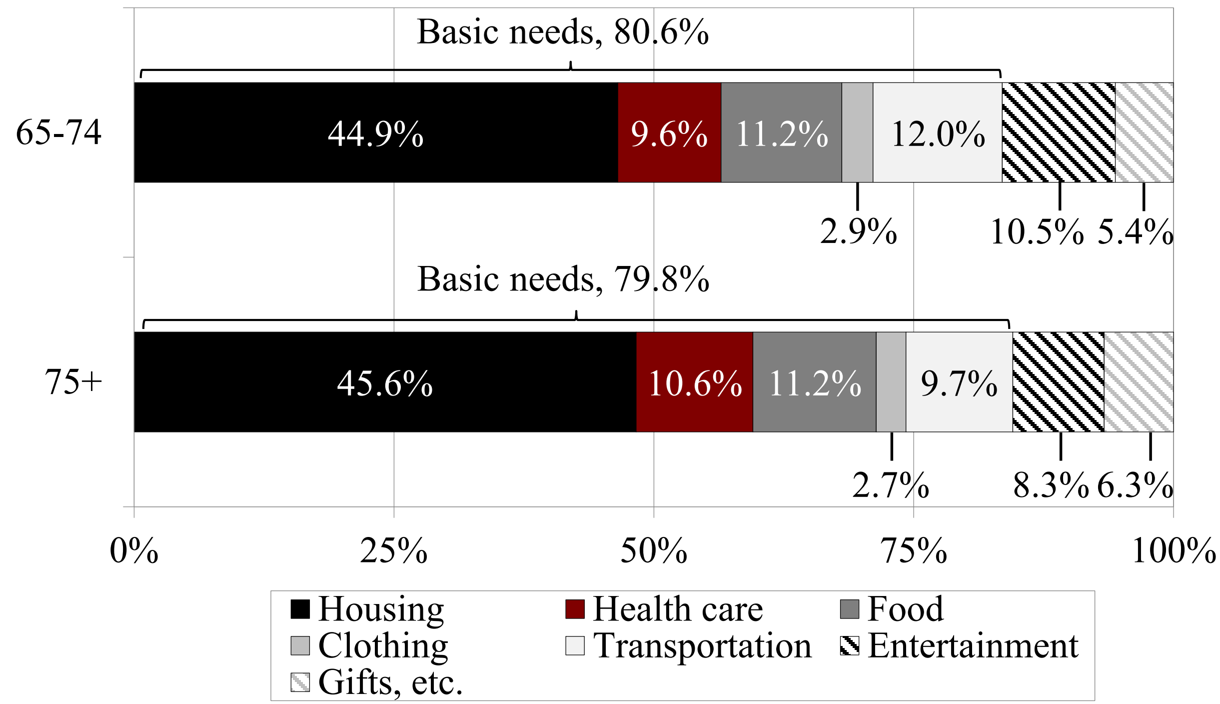
Which assumptions are right? Do people want declining or steady spending in retirement?

Evidence for steady spending:

- financial planners' framework;
- arguments for annuities (Gal's presentation today);
- structure of state/local defined benefit plans; and
- introspection!

In addition, Zahra's analysis indicates that most retiree spending goes for basic needs, which tend to be steady over time.

Share of Average Annual Household Spending on Major Components, by Age and Year



Notes: Numbers do not add up to 100 percent due to rounding.
Source: Zahri Ebrahimi. 2019. "How Do Retirees' Spending Patterns Change Over Time?" Issue Brief No. 492. EBRI.

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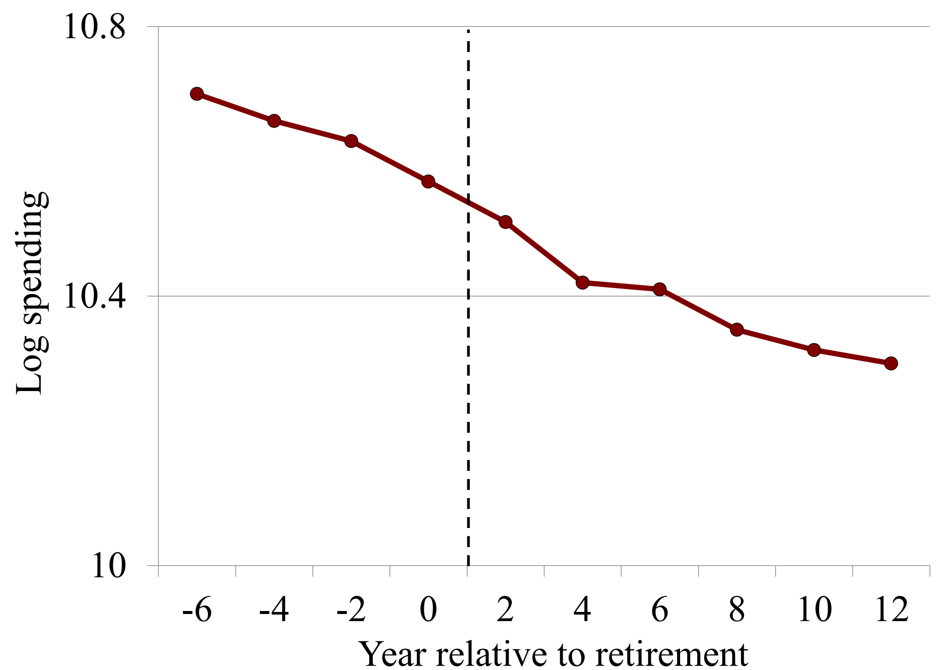
But many studies show that spending declines as people age.

Average Household Total Spending by Age, 2017



Source: Sheng Guo, Jonathan Skinner, and Stephen P. Zeldes. 2019 (forthcoming). "Inattentive Households and Consumption Declines During Retirement." Working Paper. Center for Retirement Research at Boston College.

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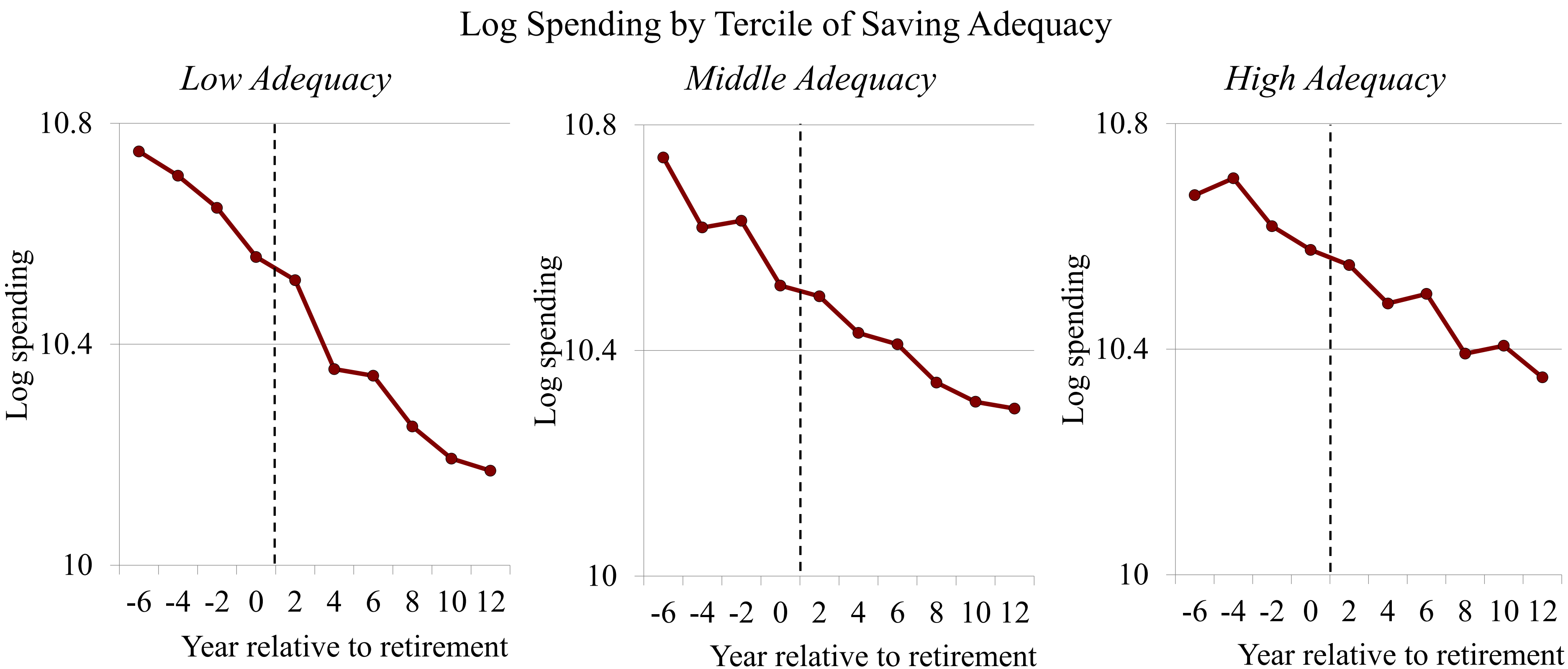
The key question is whether declining spending reflects declining income or a rational choice.



Source: Sheng Guo, Jonathan Skinner, and Stephen P. Zeldes. 2019 (forthcoming). "Inattentive Households and Consumption Declines During Retirement." Working Paper. Center for Retirement Research at Boston College.

Conclusion

- Retirement spending is a crucial topic.
- Whether people want steady or declining spending determines how many are at risk.
- If people want declining spending, then need to rethink arguments for annuities – especially inflation-adjusted annuities.
- If people want steady spending, then the share of households at risk is large.

Conclusion (cont.)

- But we have the tools to reduce the share at risk:
  - fix Social Security;
  - make 401(k)s fully automatic;
  - cover uncovered workers;
  - consider the house a retirement asset; and
  - inform people of the benefits of working longer.

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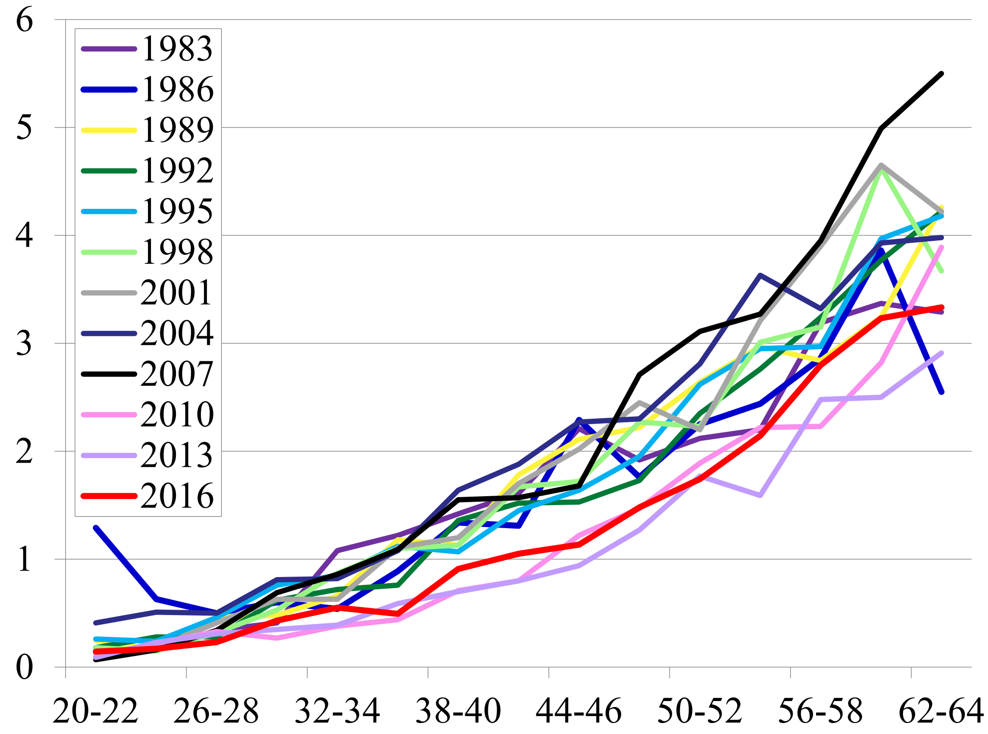
This figure shows that retirement preparedness has been declining.

Ratio of Wealth to Income by Age from the *Survey of Consumer Finances*, 1983-2016



Source: Author's calculations based on U.S. Board of Governors of the Federal Reserve System, *Survey of Consumer Finances* (1983-2016).

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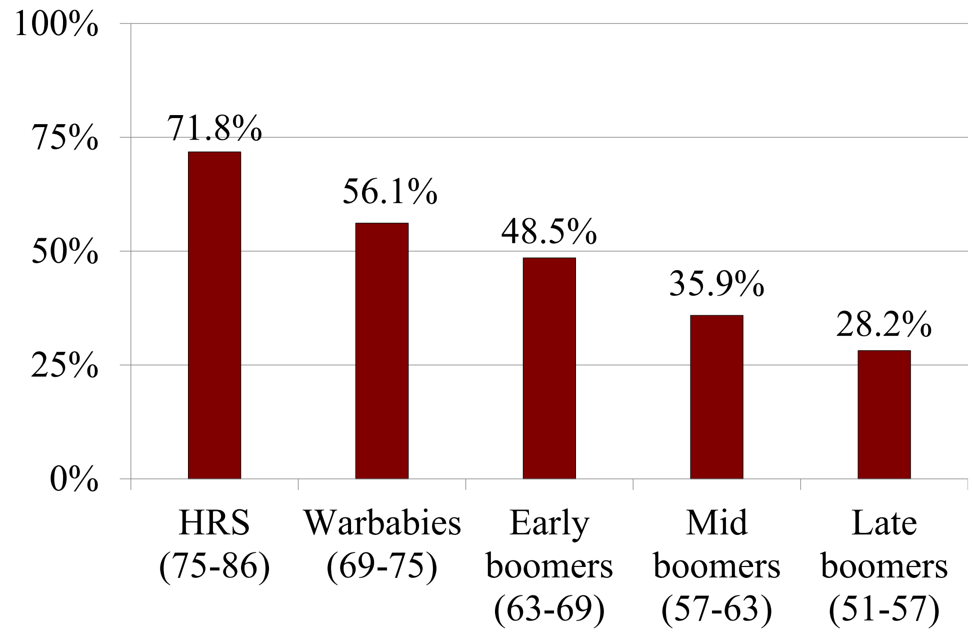
Income from defined benefit plans is falling rapidly due to shift to 401(k)s.

Defined Benefit Plan Wealth as a Share of Employer Plan Retirement Wealth
at Ages 51-56 for Middle Quintile Households by HRS Entry Cohort, 2016 Dollars



Source: Author's calculations from University of Michigan. *Health and Retirement Study,* 1992-2016.

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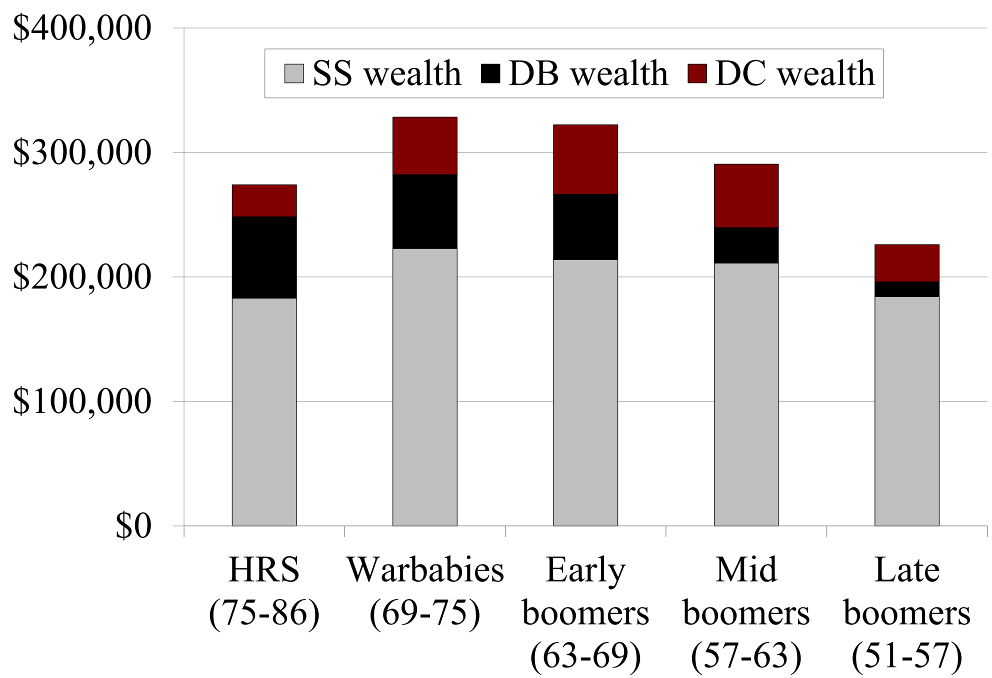
Retirement wealth is actually declining.

Retirement Wealth at Ages 51-56 for Middle-Quintile Households, by Type of Wealth and Cohort, 2016 Dollars



Source: Author's calculations from University of Michigan. *Health and Retirement Study,* 1992-2016.