Inattentive Households and Consumption Declines During Retirement

Sheng Guo
Florida International University
Jonathan Skinner
Dartmouth College and NBER
Stephen P. Zeldes
Columbia University and NBER

The 19th Annual SSA Research Consortium Meeting, August 1, 2019
Funding from the Center for Retirement Research, Boston College, gratefully acknowledged

Do households save enough for retirement? One view

JULY 23, 2014

Half of Households Risk Inadequate Retirement Income

The average household must put away 15% of income toward retirement, a figure that falls dramatically through delayed retirement or an earlier start to saving

26,436 views | Oct 18, 2018, 09:01am

SEC Commissioner Warns: A Retirement Crisis 'Tsunami' Is Approaching

Elizabeth Bauer Contributor

Retirement

I write about retirement policy from an actuary's perspective.

National Retirement Risk Index (NRRI), based on the Center for Retirement Research (CRR) at Boston College. Thinkadvisor.com

Another view….

Memo to Trump: There Is No Looming 'Retirement Crisis'

Retirement incomes are rising. The president ought to rethink his pledge not to touch Social Security.

PHOTO: GETTY IMAGES

By Andrew G. Biggs

Aug. 24, 2017 7:30 p.m. ET

OPINION | COMMENTARY

The Phony Retirement Crisis

Contrary to the alarms, household savings are growing. But government plans are underfunded.

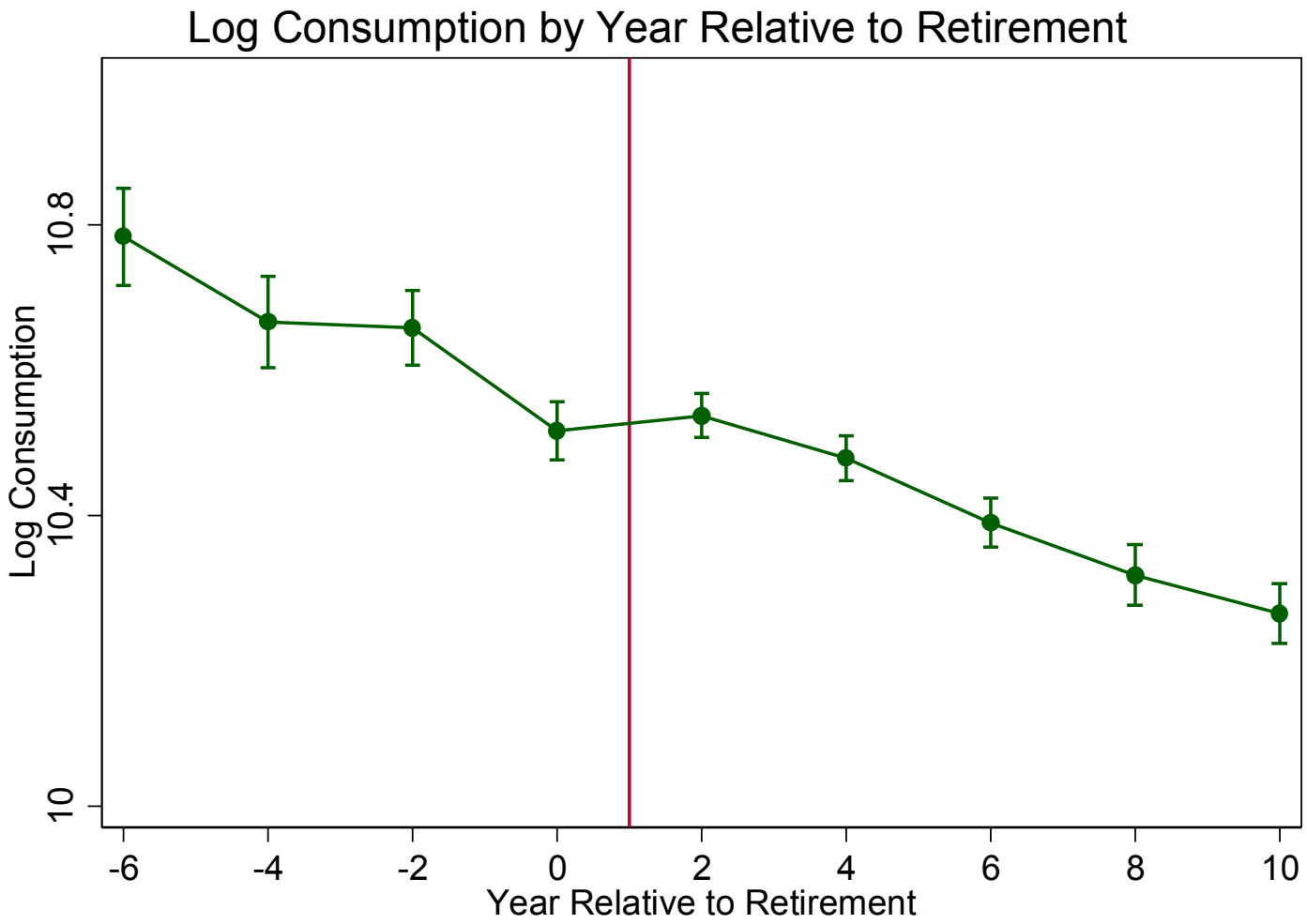
By Andrew Biggs

Feb. 28, 2019 6:56 p.m. ET

Measuring pre- and post-retirement consumption

- Health and Retirement Study (HRS); CAMS (Consumption and Activities Mail Survey) with RAND cleaned files, 2002-2015/16
- Retirement: Self-reported (in CAMS) with timing determined by search of HRS waves (forward and back). Priority goes to CAMS retirement report.
- 1,214 Households, 6,567 household-years
- Estimate household fixed-effects models with time-varying size of households

Declining consumption (adjusted for household size)

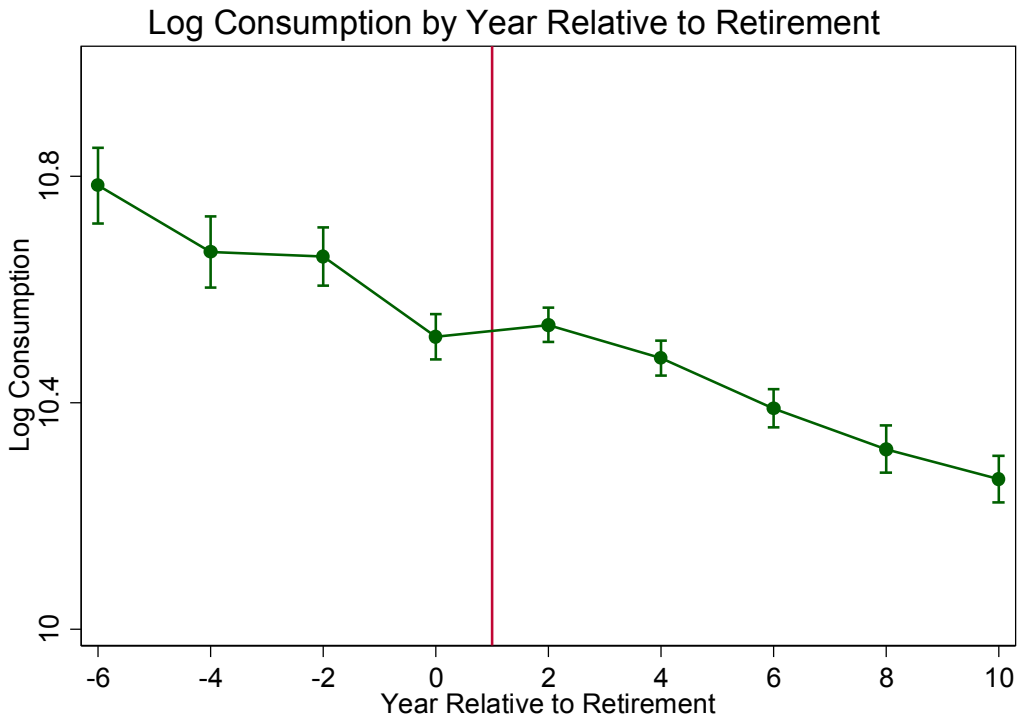


Rational reasons why consumption might decline

1. Shift into home production (cooking at home / shopping) rather than eating out (Aguiar and Hurst, 2005; Stephens and Toohey, 2018)
2. Bad health leads to both a decline in consumption and early retirement (Hurd & Rohwedder, 2013)
3. Time preference rates/optimally reduce consumption at retirement as children move out (Scholz et al., 2007)
4. Reduction in work-related costs (Aguila et al., 2007; Been et al, 2018)

An alternative explanation: “Inattention”

Intuition: People don’t always pay attention to looming income changes (e.g., retirement). So long as the utility cost of inattention isn’t too high, they don’t adjust their consumption (e.g., Gabaix, 2015)

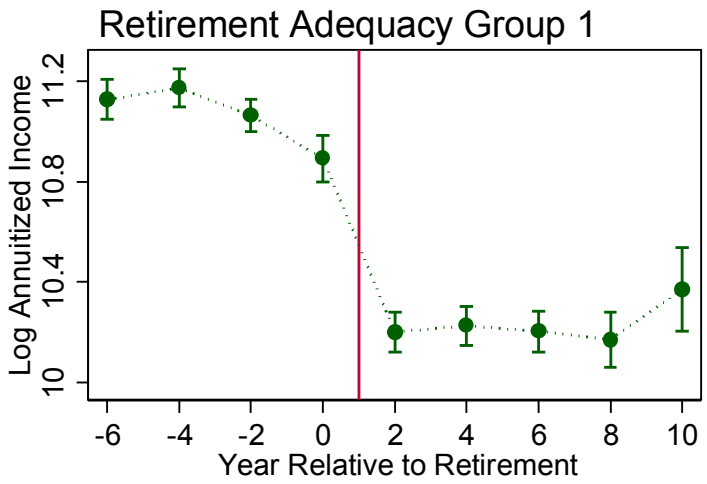


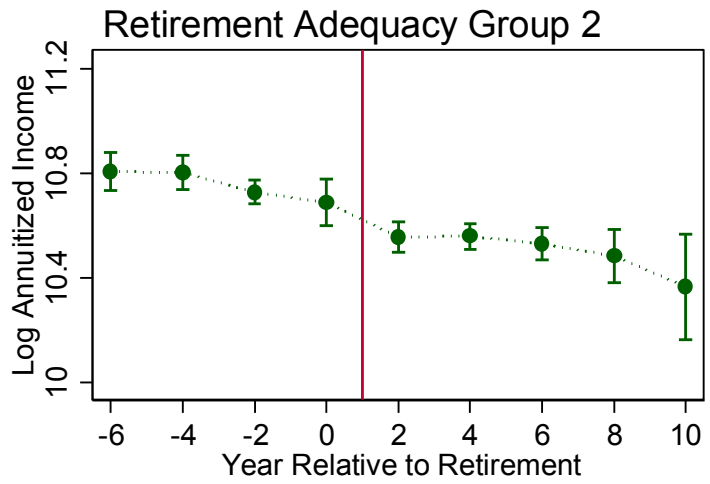
To test these hypotheses…

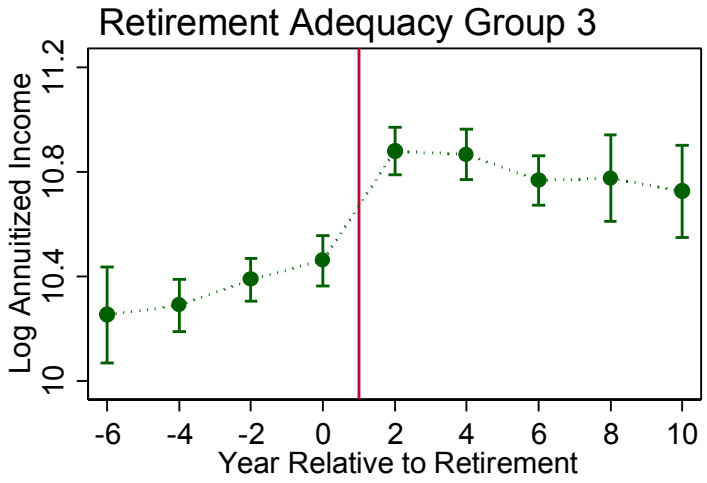
- Split households into terciles based on saving "adequacy" defined as:

- {Post-retirement income + "amortized" (1/15th) wealth} *divided by* {Pre-retirement non-capital income}

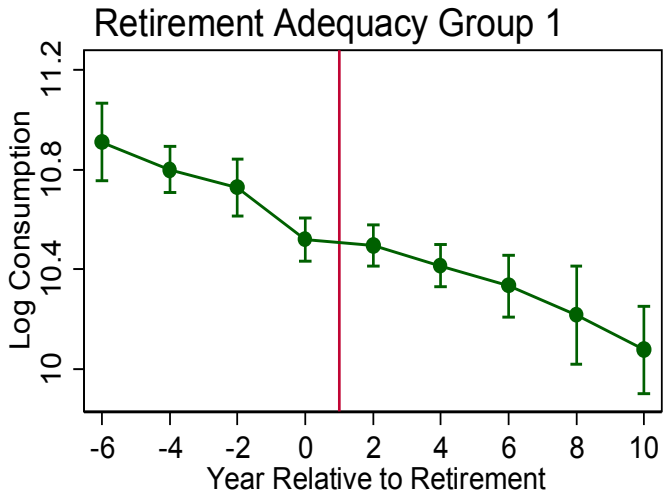
Annuitized income by tercile of retirement adequacy

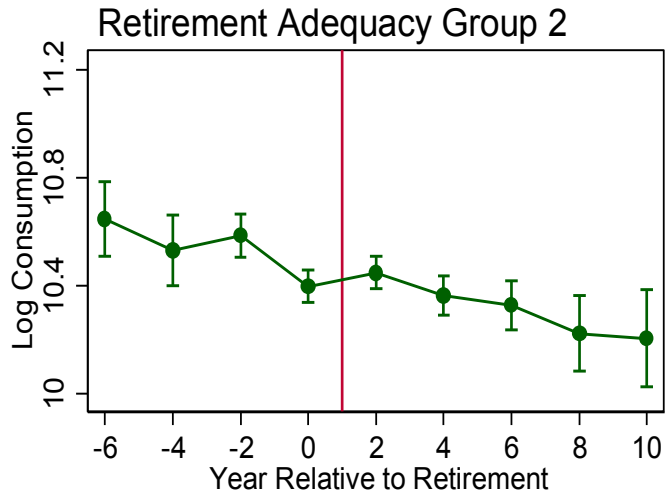






Consumption by tercile of retirement adequacy





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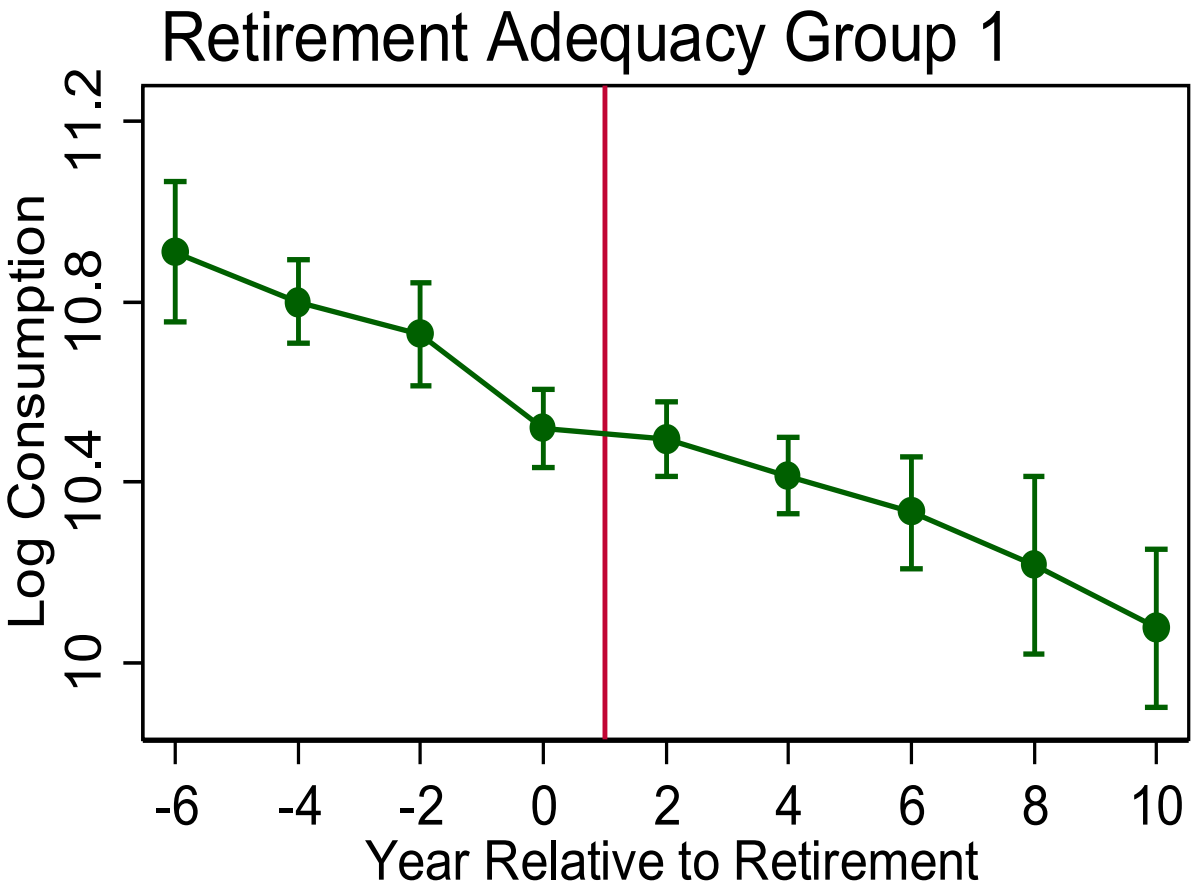

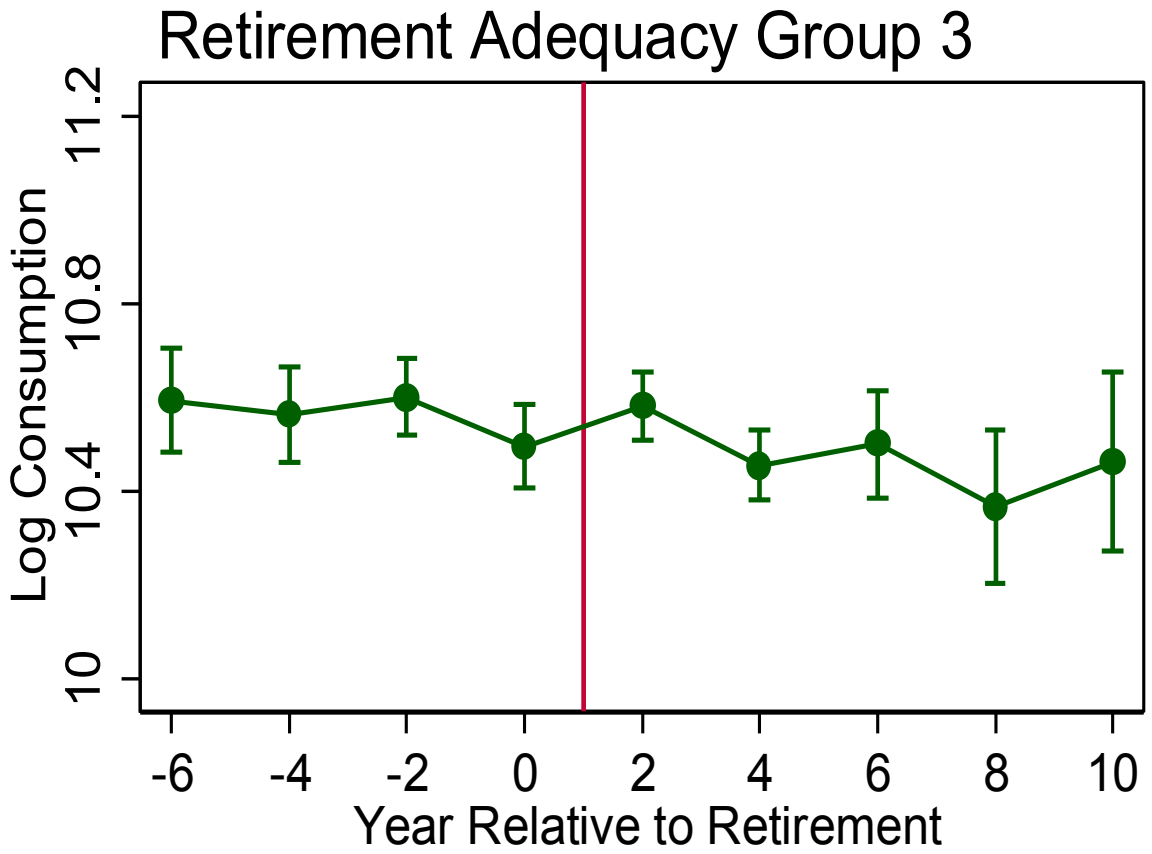

Checklist of hypotheses

1. Shift into home production (cooking at home / shopping) rather than eating out (Aguiar and Hurst, 2005; Stephens and Toohey, 2018)
2. Bad health leads to both a decline in consumption and early retirement (Hurd & Rohwedder, 2013)
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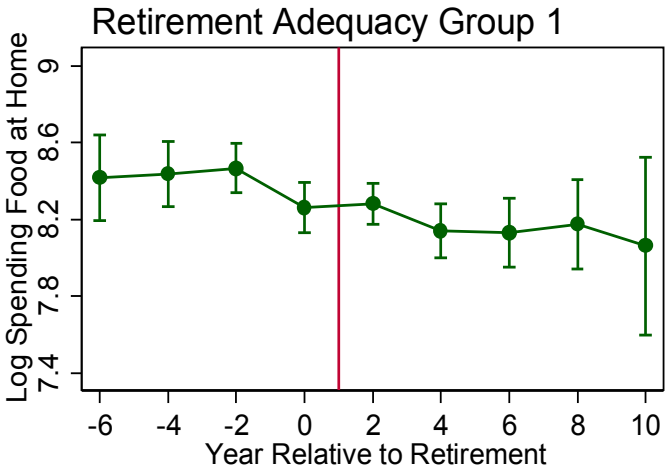
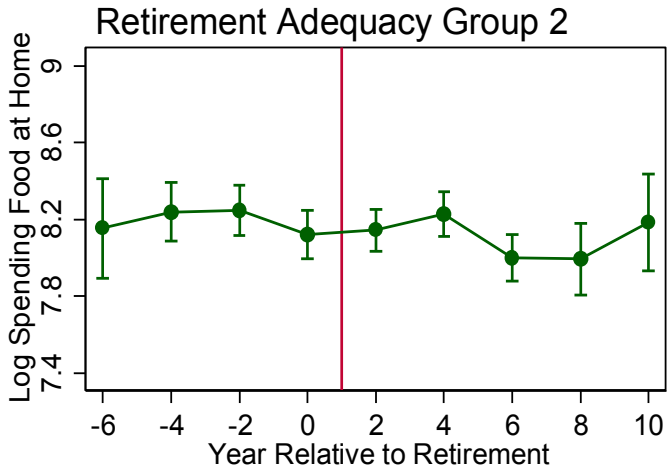
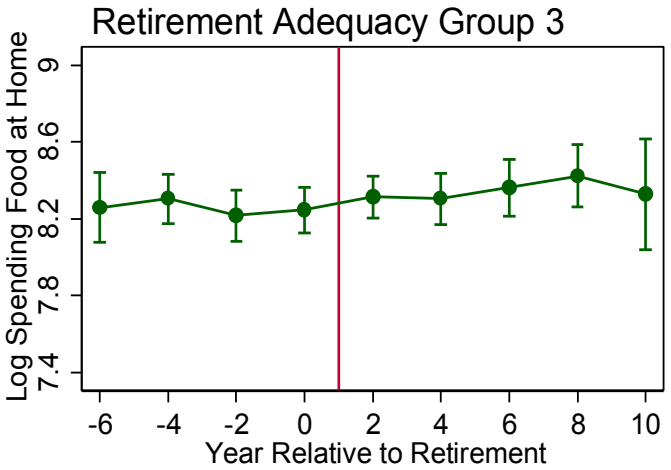
4. Reduction in work-related costs (Aguila et al., 2007; Been et al, 2018)
5. Inattention: People don't always pay attention to looming income changes (e.g., retirement).

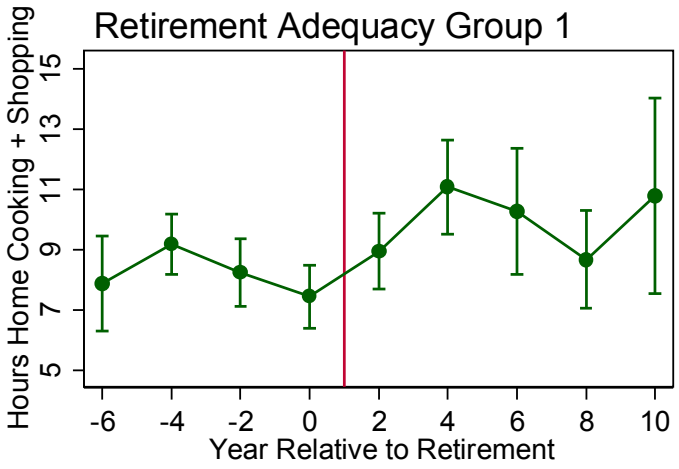
Log food at home by tercile of saving adequacy

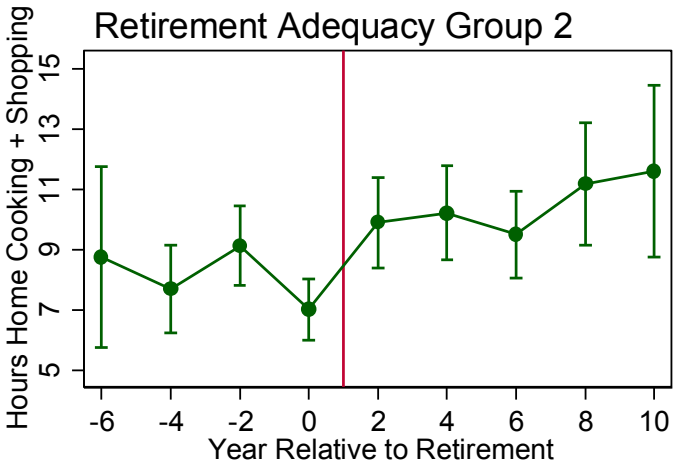


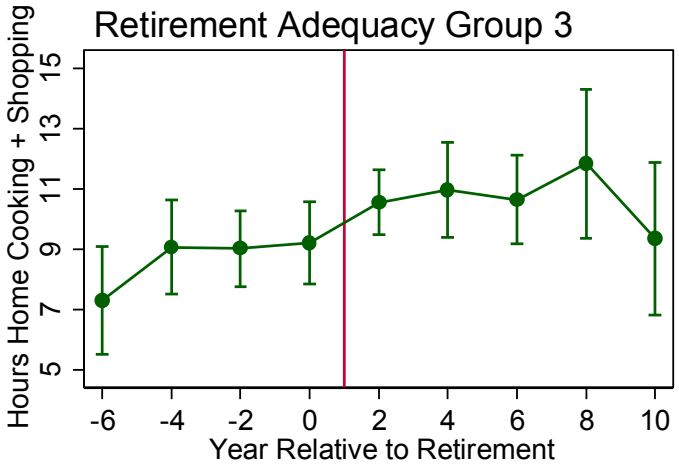




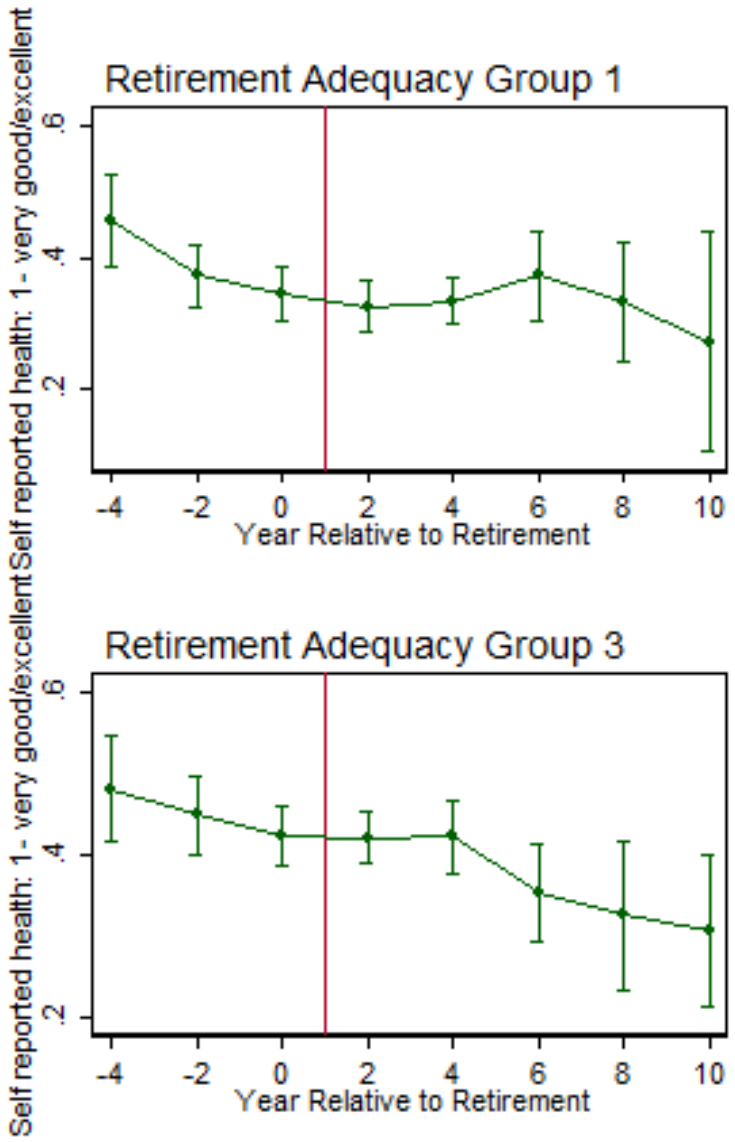
Hours cooking and shopping, by tercile

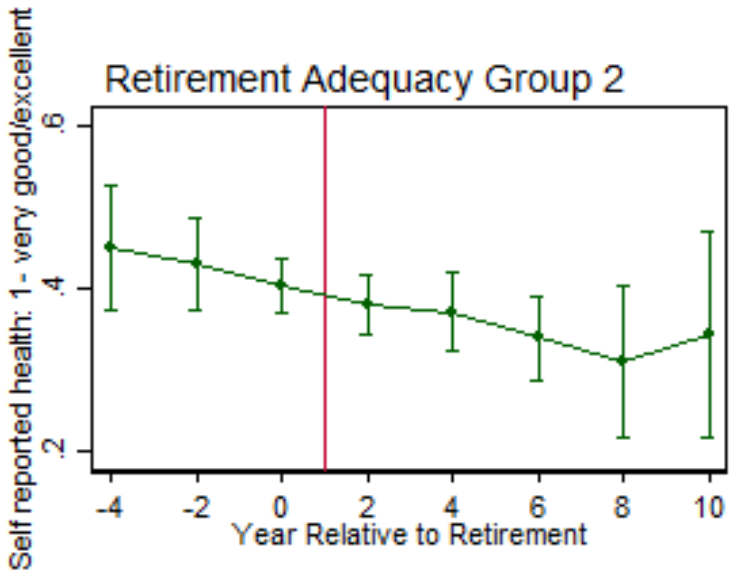






Self-reported health, by tercile





Anticipated consumption declines? (e.g., time preference)

- Mean % change for this question in CAMS: -26%
- Actual % change over 4 years: -22%

BOX B – Not Retired:

d. How do you expect your TOTAL spending to change with retirement?

_____ Stay the same ➔ Go to **f**

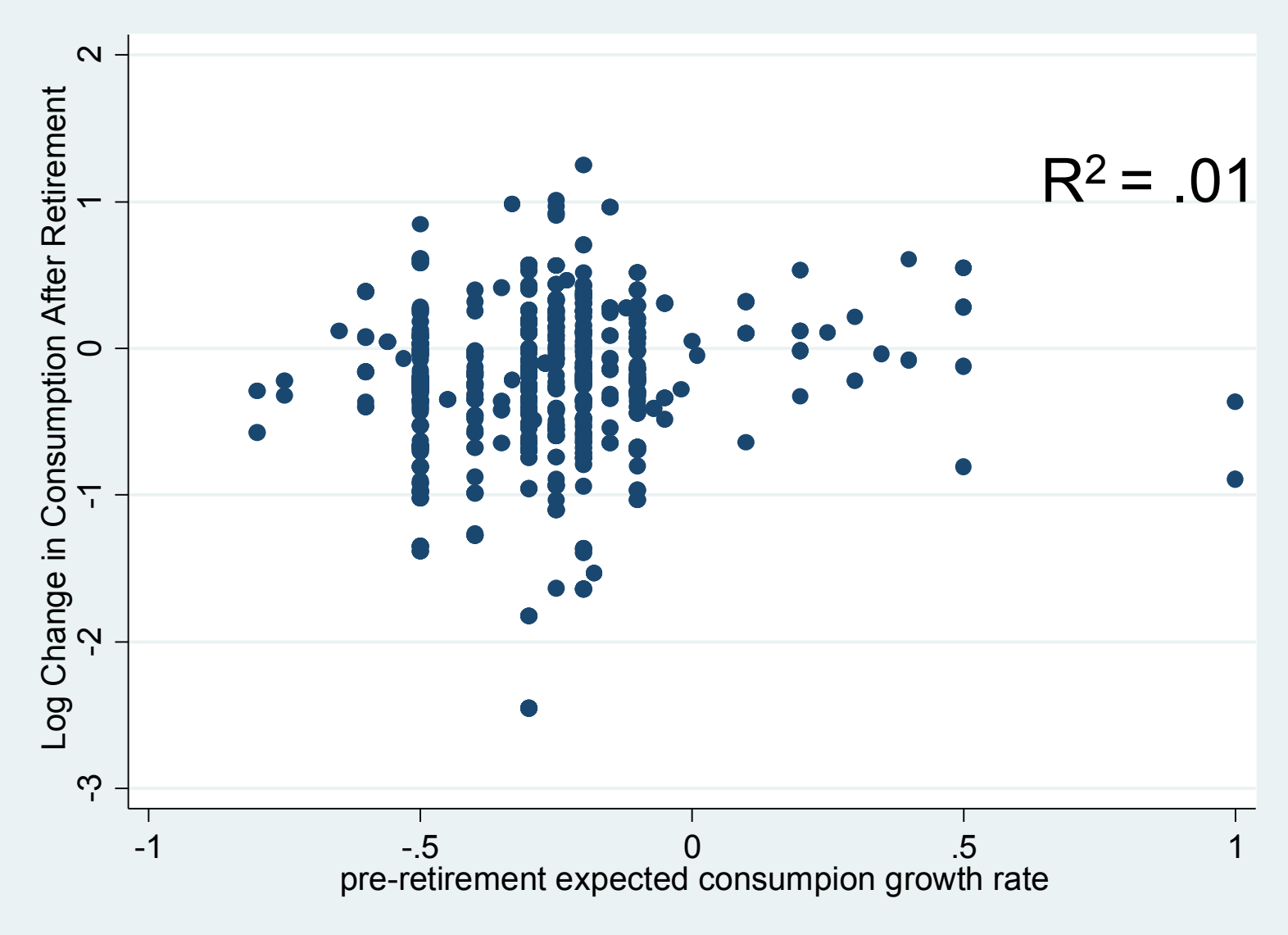
_____ Increase

_____ Decrease

e. By how much?

_____%

Yet expected consumption doesn't predict actual



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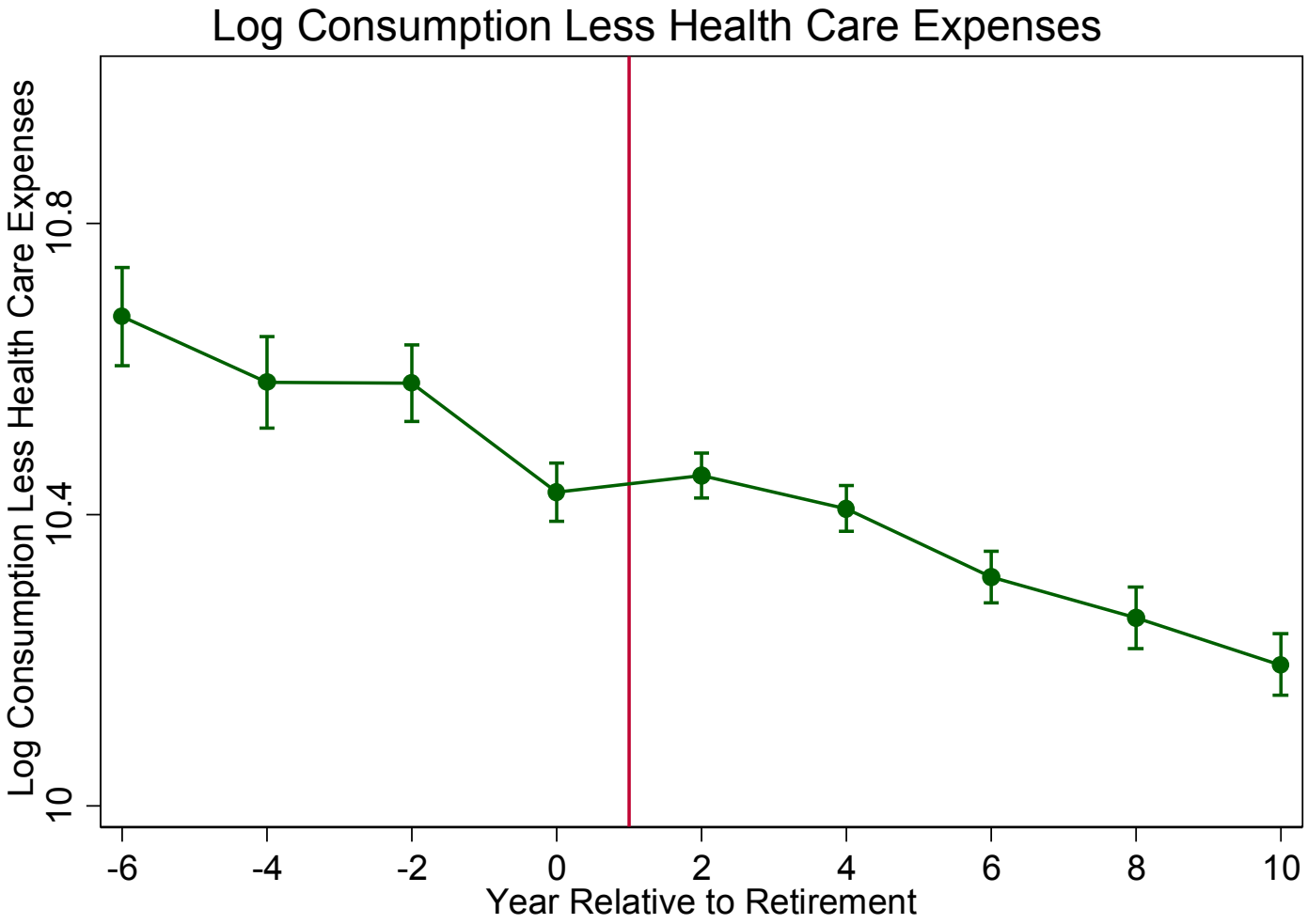
5. Inattention: People don't always pay attention to looming income changes; currently testing in a method of moments model (in progress)

Summing up

- Little agreement on the question of whether people are saving adequately for their retirement
- This paper considers a longer horizon around retirement and recognizes the heterogeneity of retirement adequacy in the population
- A model of inattention nested in traditional models could reconcile otherwise puzzling empirical patterns
- Ongoing: Test hypotheses formally in structural model

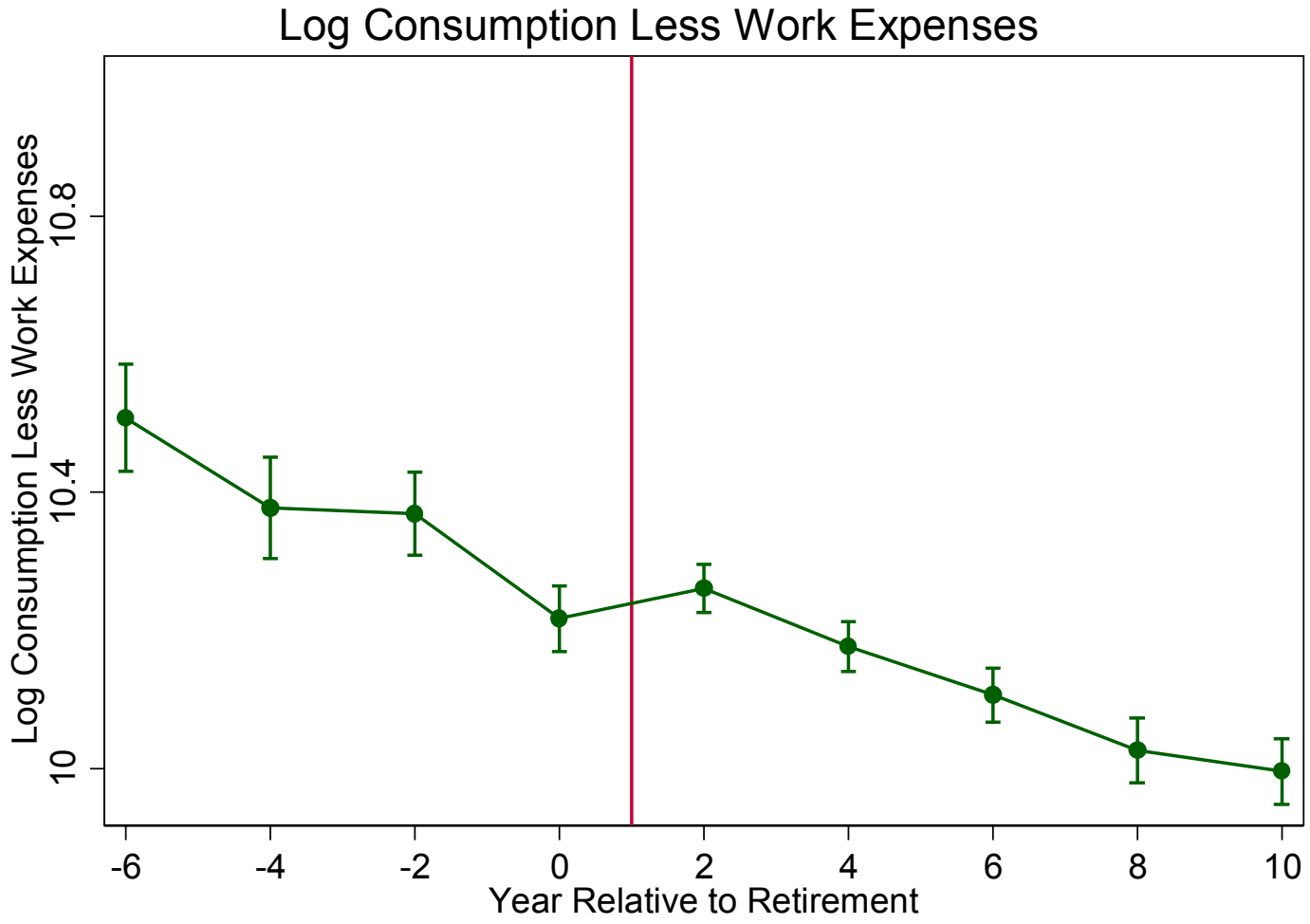
Extra slides

Consumption minus health expenses declines – similar pattern

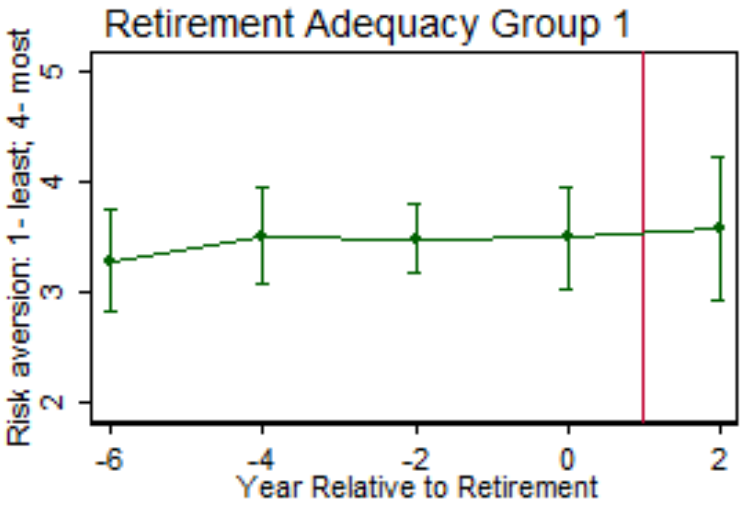


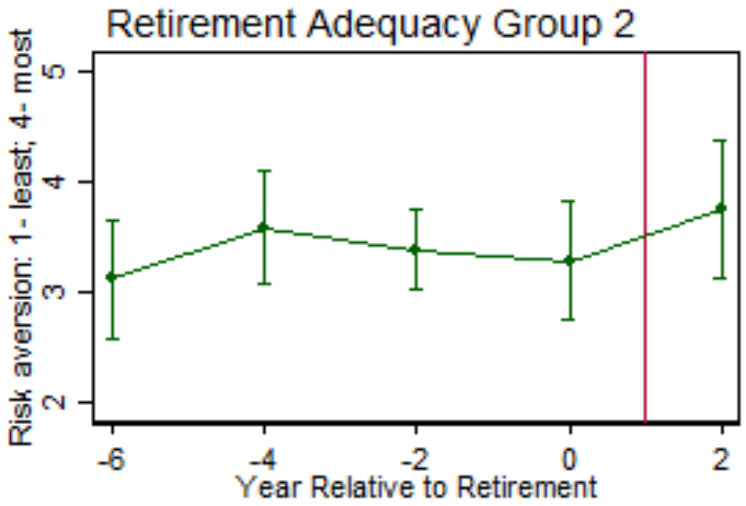
Declining consumption before and after retirement

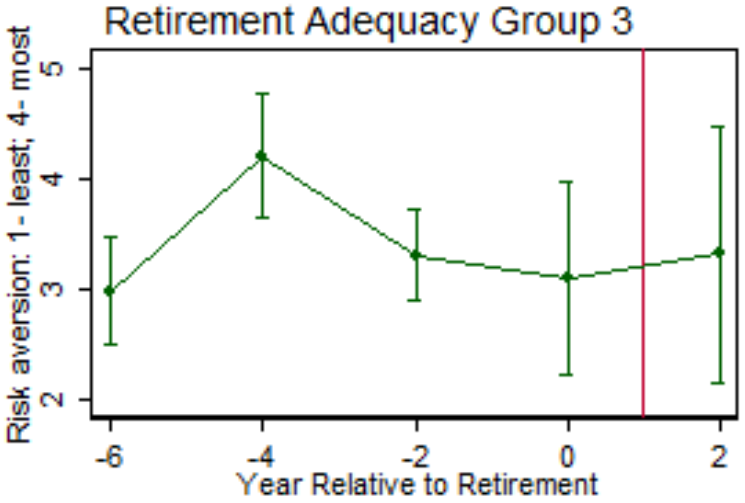
The pattern remains if net of work expenses…



Risk Aversion Prior to Retirement







Some statistics of tercile groups

	mean	std. dev.
	Retirement age (t=2)	
Tercile Group 1	64.88	7.65
Tercile Group 2	66.61	8.06
Tercile Group 3	65.96	7.64
	Health status (1: Very Good or Excellent)	
Tercile Group 1	0.35	0.42
Tercile Group 2	0.37	0.42
Tercile Group 3	0.41	0.44
	Anticipated post- consumption change	
Tercile Group 1	-25.7%	26.6%
Tercile Group 2	-24.4%	21.4%
Tercile Group 3	-27.9%	22.9%
	Pre-retirement non-capital income (log)	
Tercile Group 1	11.10	0.74
Tercile Group 2	10.76	0.79
Tercile Group 3	10.30	1.05
	Post-retirement annuitized income (log)	
Tercile Group 1	10.08	0.83
Tercile Group 2	10.37	0.70
Tercile Group 3	10.48	0.89