



## How Quickly Do Older Adults Spend Their Wealth?

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The gradual substitution of defined contribution (DC) retirement plans for defined benefit (DB) plans is forcing all who save for retirement to become investment managers. Once people retire, they have the added challenge of preserving sufficient assets to support themselves if they live longer than expected. Annuities can provide protection, but very few savers convert assets into annuities. They are advantageous to healthy individuals who will live a long time but overpriced for the average person.

It would be worrisome if the lack of annuitization led retirees to overspend and become destitute if they live longer than expected. But recent research suggests that most retirees are extremely cautious when formulating their spending plans. Love, Palumbo, and Smith (2008) find that annualized wealth increases with age and Hurd and Rohwedder (2008) estimate that 87 percent of surviving spouses end up with some wealth when they die.

Retirees' conservatism can be explained in different ways. They may have a very strong bequest motive. Or they may be particularly cautious about future risks, especially those related to health costs. Or many may unnecessarily deprive themselves of consumption in their golden years.

### Retirees Spend Cautiously

Our research substantiates the notion that most retirees are, indeed, cautious. We used data from the Health and Retirement Study (HRS) to examine changes in asset holdings of older households (ages 60 and older in 2006) from 1998 to 2006, a time of turbulence in financial and housing markets. Stock values surged in the late 1990s before crashing in 2000. They began recovering in 2002 (in inflation-adjusted terms) and peaked again in 2007 before yet another crash. Housing prices grew rapidly until early 2006 and then fell abruptly.

A simple cross-sectional examination of the data shows that older households' net worth (total assets held outside DB pensions and Social Security) grew throughout the period except for a brief decline between 2000 and 2002 when the stock market crashed. For the typical older household in our sample, real net worth increased 20 percent between 1998 and 2006. Almost the entire net gain can be explained by the increase in housing values.

### Patterns Differ by Income

We also use regression analysis to examine how asset holdings vary by age and income group, controlling for family resources, health status, marital status, and year. These regression results show substantial differences in asset accumulation and rates of change by income group.

The net worth of those in the top quintile of the income distribution increased until age 85 (figure 1). For those in the three middle quintiles, net worth began declining after age 70, but only very slowly. Evidently, the vast majority in this portion of the income distribution will die with a significant amount of assets. Few older households, including those with little income, used home equity to finance retirement consumption.

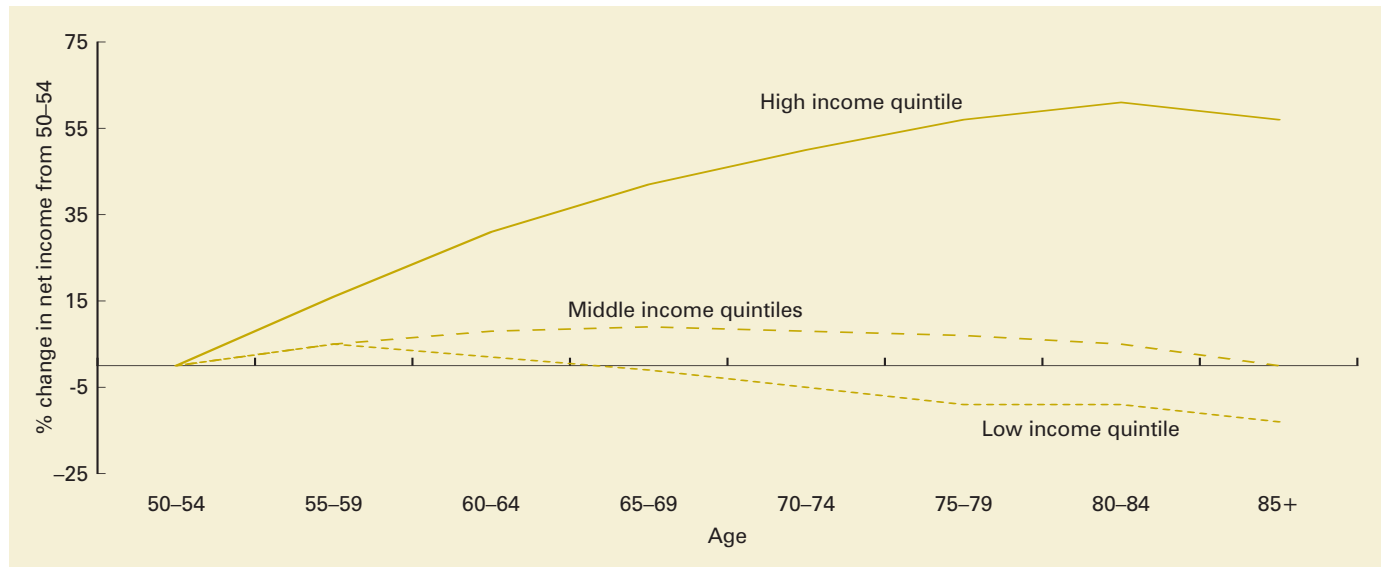
The bottom income quintile never accumulated much wealth and spent their assets quickly, leaving them dependent on Social Security and whatever DB pensions they had earned.

These findings refer to average households. Asset holdings and behavior vary widely within each income category. Some undoubtedly overspend, while others retain far more assets than are necessary by any standard.

It is clear that the older population did not spend the capital gains associated with the housing bubble or the surge in stock values between 2002 and 2006. It is less clear whether they wisely understood the gains were transitory or they were victims of inertia. In either case, older households' frugality left them in better shape to endure the crash that followed. Unfortunately, our HRS data did not cover the full effects of the housing bubble bursting or stock prices subsequently falling, so we cannot document the effects of the crash in detail. However, the 2008 stock market crash may ultimately appear as a minor blip in older households' asset accumulation, much like the 2000 crash.

Our results are reassuring for households in the top 80 percent of the income distribution, but the data indicate that the lowest income quintile quickly becomes almost wholly dependent on Social Security

FIGURE 1. Impact of Age on Net Worth by Per Capita Income



Source: Authors' calculations using the Health and Retirement Study (1998–2006).

Notes: Analysis is based on 40,250 unweighted person-year observations of subjects born before 1947. Net worth is the sum of net housing, retirement accounts, and other net assets including stocks, bonds, transaction accounts, nonhome property, and business equity, less unsecured debt. Per capita income quintile is based on the 2006 value by cohort. The age coefficients are based on a fixed-effect regression with dependent variable equal to the natural logarithm of net worth plus \$1,000.

after retirement. Social Security provides an adequate replacement rate for people who have worked for most of their careers, especially couples. Many others, however, have work histories interrupted by illness, unemployment, or other factors (Johnson and Mermin 2009). Further, replacement rates will decline for future retirees: Social Security's normal retirement age will slowly rise to 67, and Part B and Part D Medicare premiums are likely to rise inexorably. Further reforms of Social Security benefits are likely, because long-term budget deficits are exploding and the current Social Security system is not financially viable. Reformers must be sensitive to the heavy dependence on Social Security in the lowest part of the income distribution.

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