# RETIREES: DOING BETTER WITH LESS

BY DAVID BLANCHETT

Personal financial plans and national retirement readiness studies typically assume that households seek to maintain a constant standard of living (i.e., after-tax spending, or consumption) throughout one's lifetime. The idea is that *any* reduction in spending is problematic, or more formally, that the utility (or satisfaction) of consumption is constant over time. The lack of savings more generally for Americans has resulted in growing concerns of a potential national retirement crisis. However, the story is more nuanced.

Leveraging data from the Health and Retirement Study (HRS), I find that financial wellbeing increases markedly for older Americans holding consumption levels constant, which suggests the utility of consumption changes across the lifecycle (i.e., retirees do not need to maintain the same standard of pre-retirement consumption throughout retirement to maintain the same level of financial wellbeing, on average). For example, while only about 45% of respondents consuming between $20,000 and $30,000 per year between the ages of 50 and 54 are satisfied with their financial situation, approximately 84% of those age 80 or older consuming between $20,000 and $30,000 per year are satisfied with their financial situation (or roughly double). Additionally, financial wellbeing declines[1] for only approximately 7% of households moving in retirement, despite the fact consumption declines by approximately 20%, on average.

This analysis suggests that reductions in spending during retirement are likely to be significantly less cataclysmic than suggested by many existing models. However, the current generation of Peak 65 retirees, many of whom are retiring without a defined-benefit pension plan, might require more protected income later in life. Regardless, we need to approach the implications of these potential spending reductions in later retirement with more nuance to better reflect how people experience retirement and adjust to situations over time.

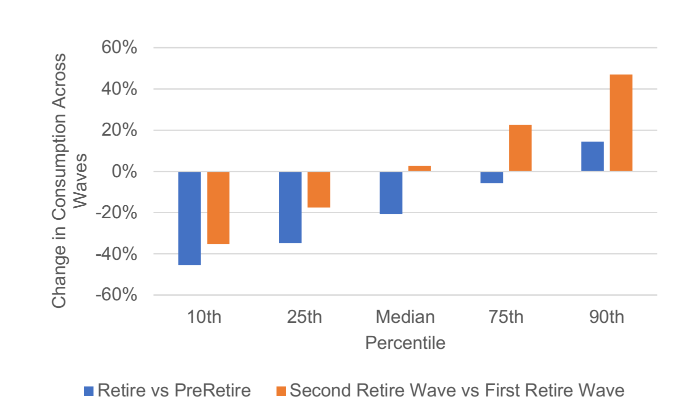
## RETIREMENT SPENDING

Savings allow a household to transfer consumption, or spending, over time. In other words, by not consuming income today, the household is enabling itself to consume those monies at some point in the future. There are a variety of economic theories that exist to explain this behavior, the most prominent is the "life-cycle hypothesis" (LCH), which was introduced initially by Modigliani and Brumberg (1954).

The LCH implies that individuals maximize utility by using savings to make lifetime consumption as smooth as possible. Risk is defined as the variability of consumption and savings allows to smooth this variation over time. Optimal decisions will vary based on a host of household preferences, such as the elasticity of substitution through time, risk aversion, the discount rate, mortality risk, etc.

1. These would be people who were doing well financially while working, then not well financially after they retired. This excludes households who were already not doing well financially preretirement and also report not being well during retirement, which is approximately 12% of households.

*Exhibit 1: How Consumption Changes Into Retirement*




*Source: Health and Retirement Study, Author's Calculations*

Consumption smoothing is relatively simple if wages are constant, in today's dollars, over time. For example, a household that spends (or consumes) $50,000 a year would generally be assumed to target the same amount in retirement. That household would likely need to save money (i.e., underconsume) today so that they could achieve the same level of consumption in retirement, although the optimal savings among would need to be balanced against a number of factors (e.g., subjective discount rate, risk aversion levels, elasticity of intertemporal substitution, etc).

When estimating a retirement income goal (e.g., for a financial plan) the most common assumption is that a given household will want to maintain the level of spending in retirement. We can explore the accuracy of this assumption using data from the Health and Retirement Study (HRS)[2]. The HRS is a longitudinal household survey conducted by the Institute for Social Research at the University of Michigan that surveys a representative sample of approximately 20,000 people in America over the age of 50, supported by the National Institute on Aging and the Social Security Administration. It has been administered on a biennial basis since 1992.

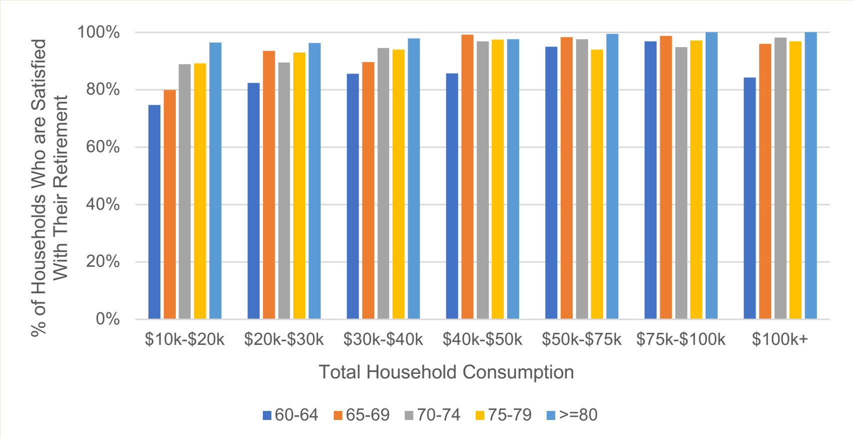
This analysis uses income, assets, and demographic data specifically from the RAND HRS Longitudinal File and spending (i.e., consumption) from the RAND Consumption and Activities Mail Survey (CAMS) Spending Data. The RAND HRS Longitudinal File is a user-friendly version of a subset of the HRS and the RAND CAMS is a user-friendly version of Part B of the CAMS survey.

The analysis considers HRS waves five (2000) through 14 (2018). The HRS wave five was conducted in 2000 and the first CAMS survey wave was conducted in 2001. When matching the spending from the CAMS dataset to the income and assets data from the HRS, the previous year is used (i.e., the 2001 consumption values would be matched against the 2000 HRS values). The last year of available RAND CAMS consumption data is 2019 (which is accessed through the 2021 RAND CAMS dataset), which is why the 2020 HRS data is not included. Each wave is effectively considered as an independent observation for the analysis (i.e., the panel aspect of the HRS is not). If a household appears in multiple waves the last observation for that household us used.

Economic theory suggests that consumption more directly measures the well-being of the family than current (or total) income. Current income can be misleading due to temporary fluctuations such as layoffs of changes in family status. Additionally, income is somewhat ambiguous value in retirement, when a large portion of consumption may be based on withdrawals from saving versus more traditional income sources (e.g., Social Security retirement benefits). Therefore, consumption is used as the proxy spending in this analysis.

2. Access the HRS data here: https://hrsdata.isr.umich.edu/data-products/rand

*Exhibit 2: Retirement Satisfaction (Among Retirees) by Age and Household Consumption*




*Source: Health and Retirement Study, Author's Calculations*

## HOW THINGS CHANGE IN RETIREMENT

The notion that households should target a consistent level of consumption during retirement seems reasonable when we look at how consumption changes moving into retirement. Exhibit 1 includes the distribution of changes in consumption for households entering retirement (i.e., comparing inflation-adjusted consumption in the wave before the retire to the first wave they are noted to have retired) and the distribution of changes in consumption comparing the first two years of retirement.

We can see that while there is some noise in the HRS around spending (i.e., some significant changes in consumption at the individual household level), households typically experience a relatively larger reduction of consumption entering retirement, with a median decline of approximately 20%. However, changes after retirement are relatively constant with the initial retirement spending level and is actually slightly higher.

One potential reason for the drop in consumption at retirement is the realization that households simply cannot spend (or consume) at pre-retirement levels due to lack of savings. This reduction in consumption, as well as the overall lack of retirement savings, though, has given rise to the notion that we are in, or at least headed towards, a national retirement crisis. For example, in a nationally representative online survey of 2,203 adults conducted by Morning Consult between Feb 26-28, 2024, commissioned by Prudential Financial, 58% of respondents somewhat or strongly agreed with the statement that "a national retirement crisis exists.[3]

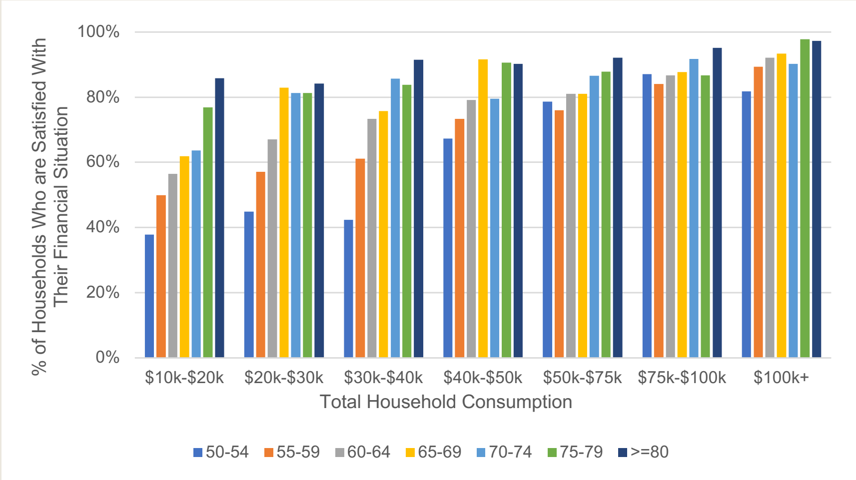
The effect was notably higher among workers compared to retirees, where approximately two thirds of those age 65 or younger believed there was a national retirement crisis. However, only approximately 26% of retirees described their personal situation as a crisis, and only about 10% of retirees with $50,000 or more in total savings described their personal situation as crisis.

There is a clear disconnect between perceptions of a national crisis (what other people are experiencing) and the reported situation of retirees, where retirees are far better off when asked about their situation. This is consistent with retiree perspectives in the HRS. For example, there is a question in the HRS which asks "All in all, would you say that your retirement has turned out to be very satisfying, moderately satisfying, or not at all satisfying?" Exhibit 2 aggregates the responses by respondent age and household consumption level.

Overall, roughly 90% are moderately or very satisfied with retirement, where satisfaction increases with age and consumption levels. These responses strongly suggest that despite perceptions of a retirement crisis, retirees are relatively content.

3. https://www.pgim.com/article/retirement-crisis-perception-vs-reality

*Exhibit 3: Financial Well-Being by Respondent Age and Household Consumption*




*Source: Health and Retirement Study, Author's Calculations*

One potential explanation for the disconnect in the relative satisfaction of retirees and the widely noted lack of retirement savings (i.e., inability to replace pre-retirement spending) could be retirees don't actually need to replace the same standard living in retirement as pre-retirement to be financially content.

The HRS asks a selected subset of respondents "How satisfied are you with your present financial situation" in its leave-behind questionnaire. There are five possible responses: completely satisfied, very satisfied, somewhat satisfied, not very satisfied, and not at all satisfied. Unlike the retirement satisfaction question, this question is asked to both those who are working and retired, so it's possible to contrast how perceptions of financial wellbeing by age and total consumption level.

For the analysis, we assume respondents who reply they are completely satisfied, very satisfied, or somewhat satisfied are financially well, while those who reply they are not very satisfied or not at all satisfied are not financially well. Exhibit 3 aggregates the levels of financial wellbeing for different respondent age groups and levels of total household consumption.

There is relatively clear evidence that financial wellbeing increases with consumption levels, which is not surprising; however, there is also notable improvement by age (holding consumption constant). For example, while only about 45% of respondents consuming between $20,000 and $30,000 per year between the ages of 50 and 54 are satisfied with their financial situation, approximately 84% of those age 80 or older consuming $20,000 and $30,000 per year are satisfied with their financial situation (or roughly double the amount).

While it's possible retirees could be over reporting financial wellbeing, there are other potential drivers as well. For example, retirees are going to have significantly more free time than workers, which may offset lower potential consumption levels. Regardless, the exhibit provides relatively powerful evidence that households likely don't actually need the same level of consumption to maintain the same level of wellbeing in retirement.

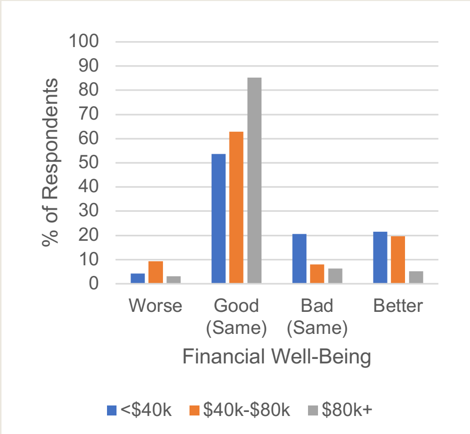
For robustness purposes, Appendix 1 includes a similar analysis leveraging data from the 2023 Survey of Household Economics and Decisionmaking (SHED), where financial wellbeing is broken out by age and income level (spending and/or consumption is not available). The results are remarkably similar to the previous exhibit. Note, income can be relatively incomplete metric for retiree households, which is why the primary analysis focuses on consumption.

## MOVING INTO RETIREMENT

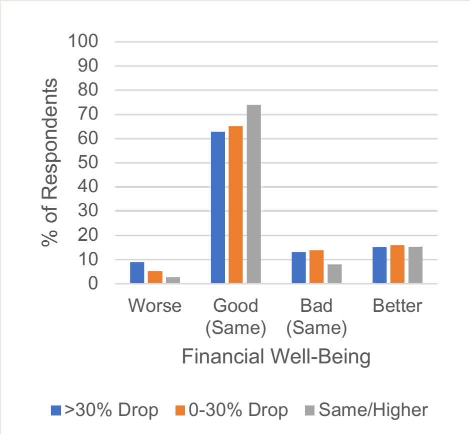
So far, the analysis clearly suggests that retirees are relatively content and that required consumption to maintain a given level of financial wellbeing declines into retirement. Next, we explore how perceptions of

*Exhibit 4: Change in Financial Well-Being Moving Into Retirement*

PRERETIREMENT CONSUMPTION




CHANGE IN CONSUMPTION




*Source: Health and Retirement Study, Author's Calculations*

financial wellbeing change moving in retirement. For the analysis we group households up into three consumption groups (less than $40,000, $40,000 t0 $79,999, and greater than or each to $80,000) and how the consumption changes from the first to the last observation for that household (decline of 30% or more, a decline from 0% to 30%, the same or higher). Only those households who are between the ages of 55 and 65, have a gap of at least eight years in observations (i.e., from pre and post retirement), and all available data are included. A total of 411 households met with criteria.

Exhibit 4 aggregates whether the financial wellbeing gets worse (i.e., the household was financially well while working, and then was financially unwell in retirement), stays the same (i.e., report the same level of financial wellbeing before and after retirement, either good bad), or gets better (i.e., the household was financially unwell while working and then was financially well in retirement).

We are most interested in what percentage of households who report their financial wellbeing gets worse in retirement. Approximately 7% of households report that their financial wellbeing gets worse in retirement (i.e., it was good pre-retirement and then is bad in retirement). In contrast, financial wellbeing improves for approximately 16% of households, stays bad for 12% of households and stays good for the remainder (approximately two thirds).

The households who report a worsening financial wellbeing tend to experience the largest changes in consumption. For example, households roughly 9% of households experiencing a consumption decline of greater than 30% of more report a worse situation versus only 5% for those who report a drop between zero and 30%. Even approximately 3% of households that report higher consumption in retirement report a declining financial condition. Therefore, while changes in consumption are clearly related to perceptions of wellbeing, there are other factors at play.

## CONCLUSIONS

While targeting the same level of consumption in retirement seems like a reasonable goal for American workers, this analysis suggests that those who may not achieve this target are likely to fare far better than commonly assumed in retirement models. More specifically, the satisfaction (or utility) derived from a given level of consumption appears to increase with age in retirement. This means that even retirees who may have to eventually live off less in retirement may actually end up better off from a satisfaction standpoint as compared to how satisfied they were doing while working.

Many people retiring today are doing so without a traditional pension plan, and may require additional protected income in retirement, either from an annuity or by facilitating delayed claiming of Social Security retirement benefits. However, these results suggest we need to revisit retirement income models, especially those that suggest we are headed towards (or in) a retirement crisis, since these models do not appear to accurately reflect how Americans actually experience retirement.

## AUTHOR

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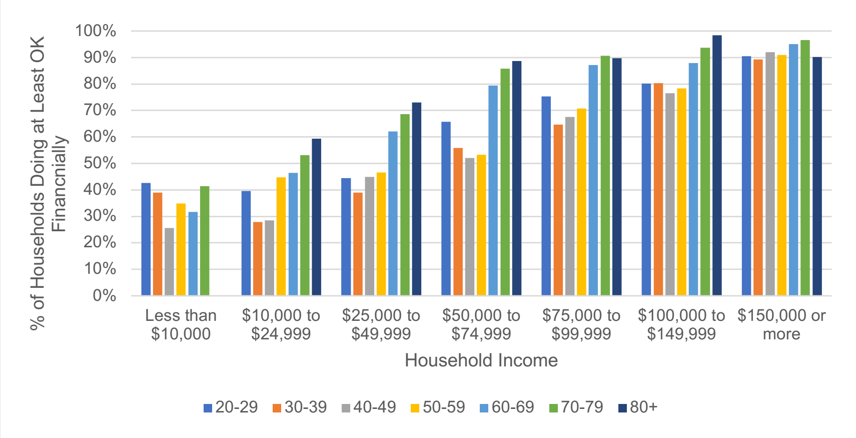
## APPENDIX

The Federal Reserve Board has conducted the SHED since 2013, which measures the economic well-being of U.S. households and identifies potential risks to their finances. The survey includes modules on a range of topics of current relevance to financial well-being including credit access and behaviors, savings, retirement, economic fragility, and education and student loans.

For our analysis, which leverages the 2023 version, we focus a question which asks "Overall, which one of the following best describes how well you are managing financially these days?" where there are four possible responses "finding it difficult to get by", "just getting by", "doing ok", and "living comfortably". For the analysis we combine the top two responses ("doing ok" and "living comfortably") to better understand how age and income are related to the overall financial condition of the household. The results are included in Exhibit 5.[4]

There is clear effect where respondents with higher income levels are more likely to report they are doing at least ok financially. Additionally, there is a notable age effect, whereby older respondents are more likely to report being financially well at the same income level. For example, among respondents with total household income levels between $50,000 and $74,999, approximately 52% of those between the ages of 40 to 49 are doing at least ok compared to approximately 89% among those 80 years or older with the same income level.

*Exhibit 5: Households Doing at Least OK Financially by Age and Income*




*Source: 2023 Survey of Household Economics and Decisionmaking, Author's Calculations*

4. There are only six respondents age 80 or over with a total income of less than $10,000, so this group is excluded.