

Extended Abstract

Changes in Consumption at Retirement: the Role of Income and Wealth Inequality

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Synthetic panel data based on successive cross-sections from the British Family Expenditure Survey and panel data on food consumption in the PSID document a drop in consumption shortly following retirement which cannot be explained by a reduction in work-related expenses (Banks, Blundell and Tanner, 1998). An interpretation is that the economic well-being of the newly retired is lower than they had anticipated, and that more saving before retirement would have led to greater lifetime utility. An extension of this interpretation is that the newly retired did not behave as predicted by the life-cycle model of consumption; otherwise, they would have smoothed consumption over retirement (Bernheim, Skinner, Weinberg, 2001).

An alternative explanation is that consumption and leisure are not separable in the utility function. In this framework theory predicts that spending should *change* as leisure increases discontinuously at retirement. However, whether it should increase or decrease is an empirical matter. For example, home-production can substitute for a number of market-purchased goods such as cleaning or gardening services; but leisure-related spending such as vacationing requires time input to produce utility.

In previous research we studied whether workers anticipate reducing consumption when they retire. Our analysis was based on the Consumption and Activities Mail Survey (CAMS) collected in Fall 2001, a mail survey of a random sample of respondents to the Health and Retirement Study (HRS). We found that two thirds of workers do anticipate reducing spending when they retire. The magnitude of the reduction is about the same as the reduction recollected by those already retired. Furthermore, comparisons between the time use of workers and the retired show that substitution of home-produced goods and services for market-purchased goods and services could plausibly account for part of the difference.

These findings do not support the interpretation that on average resources at retirement were a surprise forcing an unanticipated reduction in consumption. However, a criticism of these findings is that they are based on cross-section data. Much more convincing would be to find whether in panel data spending drops at retirement and whether the change was correctly anticipated.

This paper will use new data on consumption which was collected in CAMS wave 2. CAMS 2 was fielded in October, 2003 to the same respondents as the 2001 mail-out survey and so with CAMS 1 it constitutes a two-wave panel on spending. We observe the retirements of approximately 200 wave 1 respondents.

This paper has two main objectives. The first is to validate in panel the anticipation, as measured in CAMS 1, that consumption would decline at retirement. We will use data about anticipated changes in consumption at retirement, about actual consumption before and after retirement, and about time use. Should we find that actual

consumption declines as anticipated in CAMS wave 1 the results would provide additional evidence about the empirical usefulness of the life-cycle model, in particular about the interpretation of “mistakes” about retirement planning of the type put forward by Banks, Blundell and Tanner and by Bernheim, Skinner and Weinberg.

The second main objective is to relate the magnitude of the decline in spending to characteristics such as income and wealth. Our prior work showed that anticipated declines were greatest among those with the least wealth. If confirmed by actual declines in spending, these results would suggest that wealth dispersion is responsible for some of the decline.