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ANNUITIZED WEALTH AND CONSUMPTION AT OLDER AGES

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In the past, most retirees with employer pension plans received their benefits in the form of lifetime annuities, and few people entered retirement with large stocks of accumulated funds. With the growth in Individual Retirement Accounts (IRAs) and employer-sponsored defined contribution (DC) plans, increasing numbers of older Americans are now entering retirement with large account balances. Most employers do not offer annuities to their DC plan participants, and few retirees use their account balances to purchase annuities. Little is known about how quickly retirees will spend down their IRA and DC assets, or how these funds affect consumption patterns. People who enter retirement with little of their wealth annuitized run the risk of spending too quickly and depleting their assets before they die. Or they might spend too slowly, out of fear of running out of money, and not enjoy as comfortable a retirement as they could afford.

This analysis examines the impact of annuitized wealth on household spending for retired adults ages 65 and over. The study compares consumption patterns for older Americans with and without significant financial assets. It computes the level and composition of total retirement wealth, including annuitized Social Security, pension, and Supplemental Security Income (SSI) wealth, by demographic group. Finally, it examines how retirement consumption varies by the degree of annuitization and simulates the impact of workers arriving at retirement with less of their wealth annuitized. Data are from the Health and Retirement Study (HRS), a nationally representative survey of Americans over age 50, and the Consumption and Activities Mail Survey (CAMS), a recent supplement to the HRS.

The study finds that those with little annuitized wealth spend more, even after controlling for personal characteristics, income, and wealth. The results imply that the shift from DB pensions to DC pensions and IRAs and any privatization of Social Security that does not require annuitization may promote even further spending of retirement resources.

Retired adults ages 65 and over with greater financial wealth spend more than those with less wealth, and a greater share of their spending is for discretionary purposes.

- Older adults with more than $100,000 in financial assets have per capita expenditures that are nearly twice as high as for those without assets.
- Typical married adults with more than $100,000 in assets devote similar budget shares to basic and discretionary expenditures, while those with zero or negative financial assets spend 76 percent of their budgets on basic needs and 24 percent on discretionary items.

On average, more than half of retirement wealth comes from annuities and less than a fifth from financial assets.

- Among married adults with typical expenditures, total wealth is $377,365 of which 41 percent is from Social Security, 26 percent from housing, vehicles, and businesses, 19 percent from financial assets, and 14 percent from pension annuities.
- Among unmarried adults with typical expenditures, total wealth is $330,084 of which 48 percent comes from Social Security, 26 percent from housing, vehicles, and businesses, 14 percent from financial assets, 10 percent from pension annuities, and 1 percent from SSI.
- Annuitized wealth represents 55 percent of total wealth for typical married adults and 59 percent of total wealth for unmarried adults.

Retired adults ages 65 and over with little annuitized wealth spend more.

- For typical married and unmarried adults, annual expenditures are almost $27,000 for those with less than one-quarter of their wealth annuitized. In contrast, expenditures are less than $14,000 for those with more than three-quarters of their wealth annuitized.
- Even after controlling for demographics, income, and wealth, adults with little annuitized wealth spend more. Pension wealth has a bigger effect on the expenditures of married adults, while Social Security wealth has a bigger effect on the expenditures of unmarried adults. Also, discretionary spending is more responsive to the degree of annuitization than is basic spending.

If all of their DB pension annuities were converted into unannuitized DC retirement accounts, discretionary spending could increase by as much 3 percent for married adults and 11 percent for unmarried adults. By comparison, if Social Security was completely privatized, and retirees did not annuitize, discretionary spending could increase by as much as 22 percent for married adults and 38 percent for unmarried adults.

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