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Explanations for the Decline in Spending at Older Ages

*Susann Rohwedder, Michael D. Hurd, and Péter Hudomiet**

In its simplest form, the leading economic theory about how spending changes as people age (the life-cycle model) implies that spending (or consumption) should decline at advanced age. The reason for the decline is that, absent a desire to leave a bequest, wealth held at death is wasted: It should have been consumed earlier. But the date of death is unknown, and too much early consumption brings risks that extended survival will require a later, large drop in consumption. Under this theory, the optimal balance between early and late spending requires that spending be somewhat elevated in the earlier retirement years, but then be reduced on surviving. Because the annual risk of dying increases sharply in old age, the consumption trajectory will be downward sloping at advanced ages. As an empirical matter we find that spending paths do decline with age as would be predicted by this simple model. In the case of a couple, the optimal consumption trajectory is considerably more complex because the couple has a "bequest motive" to the surviving spouse. But even then, the theory would predict a consumption trajectory with a negative slope at advanced old age, although the age at which the slope becomes negative depends on tastes and the environment.

The life-cycle model has been challenged by behavioral explanations: Individuals lack foresight; they spend too much earlier in life and then are forced to reduce spending at older ages. In this framework, the empirically observed decline in spending is interpreted to indicate that economic preparation was inadequate: Some individuals ran out of wealth causing an unsteady decline in their spending and so a decline in population spending. If people reduce spending because they overspent when young — possibly due to a lack of self-control or foresight — the decline in spending is not optimal, but rather signals under-saving.

It is difficult to distinguish empirically between these explanations. For example, the less educated exhibit a greater rate of spending decline at advanced ages, which is explained by higher mortality risk in the life-cycle model, but by a reduced use of forward-looking behavior under the behavioral interpretation.

Some aspects of the data, however, suggest an augmented life-cycle model, one that permits changes in the benefit or utility from some types of spending. As health declines with age people shift spending away from categories that are complementary to good health. An example would be spending on travel, which may become more of a burden than a benefit as health declines.

* **Susann Rohwedder** is a senior economist at RAND, associate director of the RAND Center for the Study of Aging, and an affiliate faculty member of the Pardee RAND Graduate School. **Michael Hurd** is principal senior researcher and director of the RAND Center for the Study of Aging. **Péter Hudomiet** is an associate economist at the RAND Corporation. This research brief is based on working paper MRDRC WP 2022-440, UM21-10.

Forward-looking individuals would want to shift such types of spending to earlier ages when health is good, amplifying the decline due to mortality risk. Support for this augmented life-cycle model comes from data on budget shares. Among those 65 to 69 about 20% of total spending is for trips and vacations and private transportation (almost all of the latter for automobiles). These categories are likely dependent on health because of, in the first case, the physical demands occasioned by travel and, in the second case, an increased risk of accidents as eyesight and hearing decline. At ages 85 to 89 such spending is about 10% of the total. An indication that this reduction is not solely due to the lifetime budget constraint is that budget shares for transfers and gifts, a luxury good which should be independent of health, increase with age. An implication is that the budget constraint is not an explanation for the overall reduction in spending.

Of course, some categories of spending are more beneficial when health is not good, the obvious category being health care spending. Indeed, the budget share for health care does increase with age, but the increase is not enough to prevent an overall decline in spending because most health care spending is insured.

This paper uses data from the 2019 Consumption and Activities Mail Survey, a substudy of the Health and Retirement Study, to shed light on the reasons for the spending decline at older ages. Respondents were asked about their satisfaction with their economic situation and how economically constrained they are. It is important to obtain a self-assessment because if the utility from spending varies with age, objective measures such as income and wealth do not accurately assess the age variation in individuals' economic situations. To find the variation by age in the utility produced by different types of spending, respondents were asked how much enjoyment they get from seven types of spending, such as trips and vacations, eating out, and having a car, and how their enjoyment from such spending has changed over a six-year period.

It does not appear that the decline in spending is due to financial constraints because the percentage of the population indicating a worsening in their financial situation over a six-year period is smaller at older ages. For example, 43% of 60 to 64 year olds said they were more constrained at the time of the interview (2019) than six years earlier (2013), whereas 34% of 80 to 84 year olds made that indication. Thirty percent of 60-64 year-olds said they were less satisfied with their economic situation than they were six years earlier versus 27% of 80 to 84 year olds.

It does appear that the utility from spending in some categories declines with age: We find that average scores on the enjoyment from seven activities declined over a six-year period and that the decline accelerated with age.

We interpret our results to indicate that at least part of the decline in spending comes from individuals and couples choosing to spend less on some activities because they get less satisfaction from spending on them. At least on average it is not necessary to invoke a behavioral explanation for the decline in total spending.

Overall, the level of satisfaction with the economic situation is quite high at advanced old age: 44% of 80 to 84 year olds are completely or very satisfied with their economic situation and 38% are somewhat satisfied. These levels are considerably higher than at younger ages. Nonetheless, some 18% are not satisfied, indicating potential room for policy intervention. ❖

Michigan Retirement and Disability Research Center
Institute for Social Research
426 Thompson Street, Room 3026
Ann Arbor, MI 48104-2321
Phone: (734) 615-0422 **Fax:** (734) 615-2180
mrdrcumich@umich.edu www.mrdrc.isr.umich.edu

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