Are You Spending Too Little in Retirement?

By Meir Statman

Article Highlights

- Useful mental tools such as distinct accounts and rules regarding saving and spending can turn into obstacles in retirement when it's time to dip into capital.
- Concern about running out of money is regularly exaggerated in inflated estimates of life expectancy. Plus, older people spend less.
- We need not feel guilty about spending our hard-earned savings on ourselves or sharing "over-saved" money with family and the needy.

An elderly couple moving into an assisted-living apartment calls their son in another state for help with moving their belongings. A widow in her 90s finds it difficult to clean her home, yet refuses to hire help.

These people are not wealthy, but neither are they poor. Each has more than enough money to pay a moving company or a cleaning crew, without the risk of running out of money before running out of life. Yet they resist, insisting that they cannot afford these services. Why do people behave this way?

I was intrigued by that question, especially given that I research and teach behavioral finance—a field that combines finance and human behavior. I also wanted to know what we could learn about how people change—or fail to change—their attitudes about saving and spending as they go from work to retirement. So, I set out to try to answer them in my latest book, "Finance for Normal People: How Investors and Markets Behave" (Oxford University Press, May 2017), in recent presentations to financial advisers and in an article I've written for The Wall Street Journal ("The Mental Mistakes We Make With Retirement Spending," April 24, 2017.)

The responses have been fascinating in their own right. I have learned much from the many stories of financial advisers and readers of The Wall Street Journal. Here is one: "I've been a dedicated saver and investor for 40 years, always practicing self-denial to the point that it's extremely difficult to spend money. I honestly get uptight about small purchases that are insignificant. The difficulty is changing a mindset that has gripped my thinking for four decades."

To bring readers of the *AAII Journal* into the conversation around this area, here's a look at some basic points I've put forward in the book to answer that first question: Why do people behave this way? Additionally, I include stories from people who agree—or who push back.

Hard to Grasp Tasks

Let's start with the feeling of financial well-being, a feeling that we have as much money as we need. Some people with high financial well-being are wealthy, but many more are middle-class people who earn adequate incomes throughout their working years, save enough and spend their savings judiciously in retirement. Low financial well-being afflicts the poor, but it also afflicts spendthrifts who spend more than they earn and frugal people who slip into stinginess by excessive fear—depriving themselves, their families and the needy. One reader wrote: "Since I retired, every withdrawal from savings has been painful. So many articles are about the fear of not having enough … This article gave me hope and the thought to pursue joy with my money, not stew in fear."

Pensions promote financial well-being. Those lucky enough to have them typically do not need to save much for retirement and do not fear running out of money. My parents were among the lucky. They left us their house, some mementos, precious memories and deep gratitude. I have the menorah that held the candles my mother would light every Friday night, and a painting that hung in the kitchen since I was a small child.

Fewer have pensions these days, and more have retirement savings in IRAs and 401(k) accounts. We bear the difficult task of saving enough during our working years and the equally difficult task of spending the right amount in each retirement year. These tasks are difficult, because spending needs and temptations abound during working years, while fear of running out of money haunts us in retirement.

Social Security provides some, even if insufficient, income to most retired people; mortgage-free houses provide shelter to those fortunate to have them; and Medicare and Medicaid pay much of medical expenses. But many are justifiably concerned about the cost of long-term care, reluctant to accept assistance from Medicaid and adamant about maintaining their dignity. My father would say, "When parents give to children, all smile. When children give to parents, all cry." One retired parent wrote to me about "maintaining a certain amount of that capital to cover the possibility of long-term care expenses. One of the 'gifts' I intend to leave my children is never to be in a position where my wife or I do not have the resources to adequately take care of ourselves. If we never need it, great, the kids/grandkids can have it and use it however they want and I won't be around to cringe."

Our Mental Toolbox

We tackle the tasks of saving and spending with the mental tools of framing, mental accounting and self-control. We frame our money into distinct mental accounts, mainly "capital" and "income," and set self-control rules of saving and spending. Income includes salaries, pensions, interest and dividends, among other sources. Capital includes houses, bonds, stocks and other investments. Self-control tools include automatic transfers from income such as salary to capital such as IRA and 401(k) accounts, automatic reinvestment of interest and dividends into mutual fund accounts and following the rule to "spend income but don't dip into capital."

People who are fortunate enough to earn good incomes during their working years—and employ these mental tools successfully—accumulate substantial savings. But these useful mental tools can turn into obstacles in retirement when income diminishes and it is time to dip into capital. One extremely wealthy man, a retired insurance company executive, wrote: "I've struggled with boundary issues between income and capital. I've actually taken on a couple of board of director assignments so that I feel justified spending for what I consider extravagant."

Self-Control Helps

Self-control is not easy to muster. Some fail to muster it at all. Wants for spending it all today overwhelm wants for saving for tomorrow when self-control is weak. National Football League (NFL) players enjoy very large income spikes that amount to substantial wealth, but wants for spending today often overwhelm wants for saving for tomorrow. Bankruptcy filings of many NFL players begin soon after the end of their careers.

Circumstances, especially poverty, can undermine self-control, breeding scarcity and narrowing options. These overload people's cognitive and emotional resources and hamper saving, job performance and decision-making. Poverty is regularly exploited. For credit card companies, the most profitable American consumers are those on the verge of bankruptcy.

Some people are savers by nature and nurture. The "Big Five" personality traits that psychologists discuss are conscientiousness, neuroticism, extraversion, agreeableness and openness. Conscientiousness is the trait most closely associated with self-control. The retired insurance executive wrote: "The points on conscientious saving hit the nail on the head. I grew up as one of nine children of Depression-era parents. They always stressed education, achievement, savings and marital happiness over satisfying urges for material things."

Excessive Self-Control Harms

Self-control can be excessive. Indeed, excessive self-control is as prevalent as insufficient self-control. Excessive self-control is evident in the tendency to spend less today than our ideal level of spending, driving us to extremes beyond frugality. The prospect of spending money inflicts emotional pain on tightwads even when it might otherwise be in their interest to spend.

The interplay between emotion and cognition is evident in functional magnetic resonance imaging of people who see a product followed by its price and then are asked to decide whether to buy it or not. Seeing the price caused greater activation in the brain's insula among people who decided not to buy the product than among people who decided to buy. (The insula is the region associated with painful sensations such as social exclusion and disgusting odors.)

One person wrote: "What if the enjoyment is in the saving and the pain is in the spending?" Another wrote: "Every so often there are articles about people who have accumulated vast wealth relative to their lifetime income. When they pass at an old age and people find out, they feel sad for them—that they lived frugally and never spent it on anything. I sometimes think that they are missing the point. The total enjoyment for that person was in the saving and living miserly and frugally, well below one's means. To a certain degree, I am that person."

Moreover, excessive self-control can induce a mindset where spending is what irresponsible people do, reflected in this statement: "I'm saving now because good, admirable, upstanding people sacrifice their current standard of living to save, save, save for the future."

We Spend Less as We Age, and We Die Sooner Than We Hope

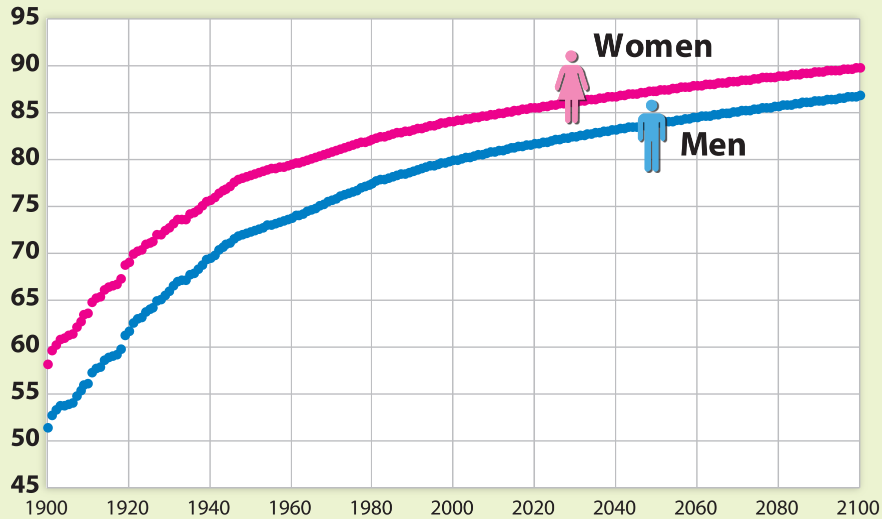
Concern about running out of money is regularly exaggerated in inflated estimates of life expectancy. Social Security tables indicate that, on average, only one in 10 of today's 65-year-old men will live to age 95. [Figure 1 shows a chart of Social Security's life expectancies for men and women over time.] Yet one respondent wrote: "With discoveries in biotech rolling out of labs in droves, we may have reached a technological tipping point regarding life expectancy. I think today's 60-somethings will easily live to be 100, maybe 110—and their children will probably make it to 150." Reality, however, is still some distance away from the labs. The oldest-in-the-world woman, an Italian, died in April 2017 at age 117, followed by the oldest-in-the-world man, an Israeli, who died in August 2017 at age 113.

Moreover, older people spend less, in large part because physical limitations make them less able to spend and because they are less inclined to spend for personal reasons. Spending at age 84, adjusted for inflation, is 23% less than it was at age 62 among college-educated American couples. Spending on movies, theatre, opera and concerts declines by more than 50% between the ages of 60 and 80. Spending on hearing aids, nursing homes and funeral expenses increases by more than 50%.

Another respondent wrote: "Lots of people lose a spouse and do not travel or vacation much because they are by themselves. They have enough money but just do not go anywhere or do much. They have lost their best friend and have not found a second life after losing their spouse. So, they sort of mope around and just do not do much. It is really sad. I know a few people in this situation and have tried to help, but there does not seem to be much you can do. We lose not only spouses, but friends … Suddenly we're left to do things alone, or to not do them. Balance, while we have the resources to seek balance, is important to a fulfilling retirement."

Figure 1. Life Expectancy From Year of Birth

Life expectancy at age 0, by sex and calendar year, based on the Social Security Administration's period life tables. Though life expectancies have increased over time, the life expectancy for a child born in 2018 is 81.6 years for males and 85.5 year for females.



Source: "Life Tables for the United States Social Security Area 1900–2100," Felicitie C. Bell and Michael L. Miller, Social Security Administration.

Spend Here Now

We need not feel guilty about spending our hard-earned savings on ourselves. As one reader wrote: "During my career I was a very conscientious saver and investor. I always maxed out my 401(k) contribution and put a large percentage of my salary and bonus into a deferred-compensation program. I have had a difficult time changing my mindset from a saver to a spender. This article helped me make that mental transition. The first thing I did was to go out and get fitted for a new set of golf clubs and I didn't feel guilty about it!"

Some people derive no pleasure from spending on themselves. One wrote: "If one has never derived pleasure from material things, why would that change in retirement? A cup of coffee and a walk on the beach at dawn and I'm happy. The psychic income from being over-saved has value."

I empathize with this person. I, too, like a cup of coffee and a walk on the beach, even if not at dawn. But why not share "over-saved" money with family and the needy? Someone who understands this wrote: "I learned from my mom that the greatest joy in life is giving to your family. She would give something to all six of her children, the grandchildren, the great grandchildren and all of their spouses on their birthdays, anniversaries, St. Patrick's Day and Valentine's Day, for no reason at all. If you want the closest thing to eternal life, try this."

Another wrote about balancing spending on himself, his family and the needy: "I am deriving pleasure from assuming the strategy of 'I am through saving. Now I am spending.' Judiciously, to be sure, but nevertheless with a view to obtaining satisfaction. Thus, my wife and I have made some long-desired renovations to our home, schedule at least two major overseas vacations a year and supplement our children's financial needs at a time when they need it and when I can see the result. I devote more time and financial support to charitable work. I continue to spend time exercising at a local athletic club, now free thanks to SilverSneakers. I read more and indulge in my love of classical music. All of this gives me significant satisfaction."

Observations on Saving and Spending

- Saving is difficult for the young; spending is difficult for the old.
- The mental tools of framing, mental accounting and self-control help us save when we are young. The same mental tools harm us when we are old, as they can be obstacles to prudent spending.
- If you derive no pleasure from spending on yourself, why not spend on your family and the needy?
- It is better to give with a warm hand than with a cold one.

Better Warm Than Cold

One reader faulted me for failing to "address preserving capital for the next generation, which is a priority for some of us octogenarians." But why not give money to the next generation with a warm hand rather than with a cold one?

Some months ago, I was speaking to a large group of financial advisers about the difficulties that face well-off people when transitioning from work to retirement and from saving to spending. Several advisers walked over to me as I stepped off the stage to ask questions and share experiences. One stood aside, waiting until all the others have left. "I burst out crying when you said, 'It is better to give with a warm hand than with a cold one.'" Indeed, she was crying when she spoke to me. It turned out that she lent her son some $27,000 for college tuition and now demanded that he pay her back by the agreed schedule. She reasoned that paying by schedule would benefit her son, teaching him financial responsibility. But the son was now financially squeezed, at the beginning of his career, lacking even money to buy his girlfriend an engagement ring, and his mother's demand had soured their relationship. The mother had more than enough money to forgive the loan without imposing any hardship on herself, giving with a warm hand rather than with a cold one. I hope this is what she did that day.

One last story with a lesson: "My husband was reared by extremely thrifty parents who survived the Great Depression and World War II, and through hard work and frugality bordering on stinginess (all Christmas gifts came from the Salvation Army) they accumulated a very comfortable nest egg. They passed on to him their fiscal philosophies and my husband absorbed them like a sponge.

"My husband handled our finances. Once he died and I took over the finances, I was amazed at how much money we had. I shall have to work very hard to spend all of it, but I plan to give it my best effort. In the two-and-a-half years since my husband died, I have been to Africa and made three trips to Europe. I have already booked trips to see lowland gorillas in Rwanda and Uganda, snow monkeys in Japan, penguins in Antarctica and ride a horse across the Mongolian steppes. These trips were booked after my doctor told me that based on her patients, 80 is the age at which people lose their energy and enthusiasm for traveling. I am attempting to get in as many trips as I can before hitting that mile marker.

"I have also made many donations to local charities and plan to set up a trust fund for a friend's grandchild who has Down syndrome and would otherwise become a ward of the state when his hand-to-mouth-existence parents die.

"My husband never reaped any benefits from his saving habits and only received three months of Social Security before dying. May others escape his fate." ➤

Meir Statman is a Glenn Klimek professor of finance at Santa Clara University, Santa Clara, California. His latest book is "Finance for Normal People: How Investors and Markets Behave" (Oxford University Press, 2017). Find out more about Statman at www.aaii.com/authors/meir-statman.