

Understanding retirement journeys: Expectations vs reality

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Executive Summary

What does this report seek to address?

This report outlines the findings of detailed research into what retirement is really like. The recent “pension freedoms” have stimulated much debate about the appropriateness of retirement income products for those on the verge of retirement. But there has been little research into people’s actual spending patterns in retirement and how these relate to everyday activities. We seek to fill this gap through detailed analyses of two large datasets: 1) the Living Costs and Food Survey, which enables us to gain insights into income and expenditure patterns of the older population, and 2) the English Longitudinal Study of Ageing, which allows us to explore what people are actually doing in their daily lives and whether they are content with this. In this way, we are able to better understand the types of retirement journeys currently experienced by the older population. This has important implications for public policy and financial products and services.

Retirement expectations

- The nature of retirement has changed from a few years at the end of life, often in poverty, to a period of twenty plus years, which for many (though not all) is increasingly characterised by relative financial security. Older consumers are now a large and growing part of our economy.
- With the nature of retirement changing, expectations of a leisure-filled retirement have become broadly entrenched, though many remain concerned about whether they will be able to afford the costs of retirement while often preferring not to think about future health and care needs that might arise.
- The recent “pension freedoms” - which provide individuals with greater flexibility in using defined contribution (DC) pension pots - support the notion that pensioners should be able to do what they want in retirement.
- But until we better understand real life retirement journeys, including the extent to which retirement realities match up to expectations, it is difficult to help individuals take advantage of the new flexibilities in ways that meet their long term income needs.
- The stakes are high. Auto-enrolment is raising the number of people saving into a DC pot. Exploring what sorts of financial products and services this group will need in retirement will be key to the overall success of the initiative.

In reality, consumption falls and savings rise during retirement

- As people get older, they spend progressively less on consumption, regardless of their income. A household headed by someone aged 80 and over spends, on average, 43% less than a household headed by a 50 year old.
- Many older households continue saving throughout retirement. Indeed, we calculate that individuals aged 80 and over are saving, on average, around £5,870 per year.
- Lower earning households start saving in later life as consumption falls but incomes remain flat.
- While a low earning household consumes, on average, about 113.7% of their income at age 50 and about 75.7% at age 80, higher earning households consume only 67.7% of their income at age 50 and about 62.6% at age 80.

Reduced spending on non-essential items drives savings in later life

- Much of the decline in consumption is explained by falls in spending on “non-essential items” such as recreation, eating out and holidays.
- Spending on essential items remains relatively flat during retirement, which means essential items account for an increasing proportion of the overall household budget. Indeed, by age 80+, over 50% of expenditure is on essential goods and services.
- There does not appear to be a post-retirement spending boom on leisure and holidays. In fact from

age 50 onwards, spending on most non-essential items begins a slow decline.

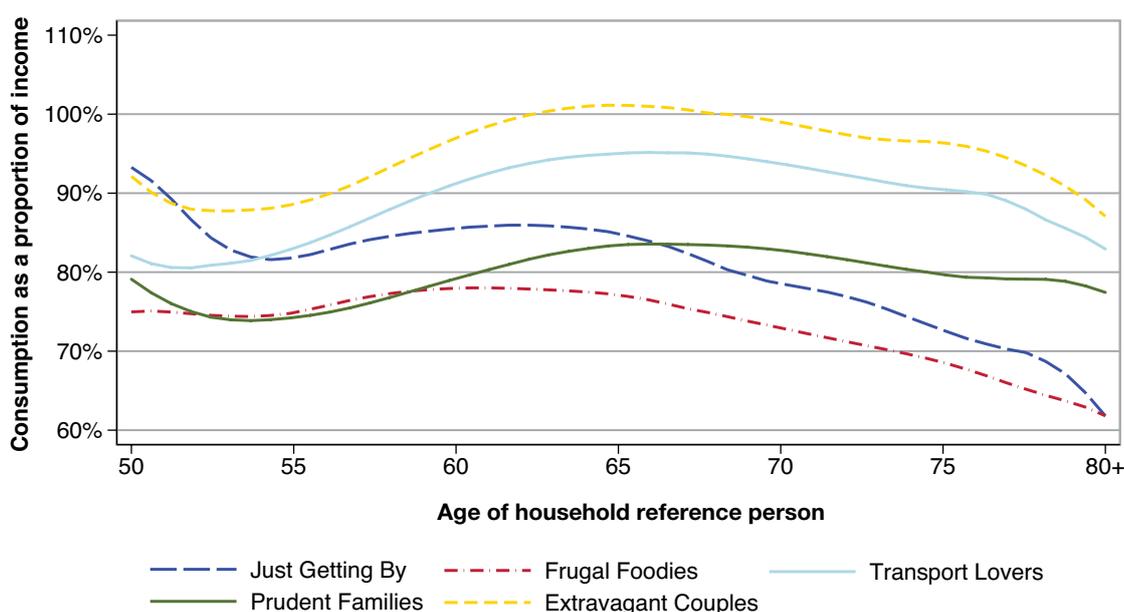
Retirement does not lead to more holidays, while those at older ages spend more time alone

- Time at home alone increases by age, while time spent with family and friends falls. By age 90+, watching television and spending time at home alone are the most common daily activities.
- The age group 70-74 appears to be a tipping point. From this age, the average amount of time spent at home alone increases markedly, while the time spent with family and/or friends falls.
- With the exception of early retirement, retirement does not lead to more holidays or other leisure activities. Nor does retirement lead to a sudden splurge in eating out.

While there is no such thing as “the” older consumer, all consumer groups identified for this report make significant savings in later life

- We outline consumption patterns for five different consumer groups based on their spending preferences, and explore potential risks facing them. The groups include:
 - “Just Getting By” who spend over 45% of their total expenditure on housing and bills;
 - “Frugal Foodies” who spend 27.5% of their budget on food and drinks and over 13% on furnishing, housing equipment etc.;
 - “Prudent Families” who spread their expenditure evenly on many items and save consistently as they age;
 - “Extravagant Couples” who spend nearly 40% of their total expenditure on recreational goods and services;
 - “Transport Lovers” who spend more than a third of their total expenditure (36.8%) on transport (both public and private).
- All of the groups save in later life. From age 75 onwards, even the “Just Getting By” group, which is the lowest income group, starts to save. The savings are the consequence of falling consumption towards the end of life on non-essential items.
- The “Extravagant Couples” spend more than their income in the first decade or so of retirement, as do those who are “Just Getting By”, while the “Prudent Families” and “Frugal Foodies” consistently spend below their income over the duration of retirement (see chart).

Figure 1: Consumption by consumer segment



Source: author's calculations from Living Costs and Food Survey/Expenditure and Food Survey (years 2003 to 2013). Data are weighted using annual weights.

Consumption falls are likely to be driven by poor health, a desire to provide bequests and changing personal preferences for goods and services in old age

- Having a limiting long-standing illness helps to explain some of the rising incidence of time spent alone in retirement. Indeed, health appears to restrict an increasing proportion of older people from doing the things they want to do in retirement.
- However, the vast majority of retirees say that they are able to do the things they want. Even by age 90+, 65% of the population say they can do the things they want “often” or “sometimes”.
- As people get older they are less likely to report being constrained by a lack of money.
- On average, retirees think they have a 70% chance of leaving an inheritance of £50,000 or more.

Excess savings in retirement could have adverse macroeconomic implications

- One of Japan’s economic problems since the 1990s has been excess savings relative to investment which has acted as a drag on economic growth.
- If older people are saving, we need to find effective ways of putting those savings to good use to help drive economic growth.
- We calculate total per annum savings made by those in retirement in the UK today of around £48.7bn. This equates to 2.8% of GDP.
- The majority of savings made by older people are sitting in low interest current accounts.

Conclusions and policy recommendations

- This report finds evidence of something akin to a default consumption path in retirement, with consumption falling during retirement leading to savings in later life.
- While today’s retirees will be different to tomorrow’s, the consumption patterns identified in this report are robust over time and common to high and low income groups. This suggests they may persist even as retirement expectations evolve and patterns of asset accumulation change.

...the need for initial flexibility but with security of income in later life

- The “pension freedoms” introduced in April 2015 have already stimulated much debate about what sorts of financial products are needed in order to deliver an income in retirement.
- Given the reality of retirement journeys, it may make sense for financial products and services to facilitate relatively high initial income before guaranteeing a base level of income in later life as people reduce expenditure on non-essential items but maintain spending on essential every-day items.
- For those with a high concentration of wealth in defined contribution pensions, such an approach to funding retirement would likely involve some flexibility of income in the initial years followed by investing in an annuity later on.
- The above approach would have two benefits: 1) it would enable greater spending in the initial retirement period and 2) annuitising later in life is likely to deliver greater annual income over the remaining years.

...rules of thumb should be built into the financial guidance process

- For the moment at least, the average amount of wealth held in DC pots for those on the verge of retirement is relatively small (circa. £30,000) which may necessitate somewhat different decumulation strategies:
 - o For those with small DC pots and little else, they might best use their DC savings to give them some flexibility early on in retirement and rely on pensioner benefits to meet essential spending needs later on.
 - o Others, who have sizeable final salary pensions and small DC pensions may also think it best to exhaust their DC savings relatively early on before relying on their final salary pension plus the State Pension to meet their spending needs in later life.

- It should be possible to develop rules of thumb for different consumer segments that are built into the financial guidance process.

...and be supplemented by a mid-retirement financial health check and financial advice

- A retirement strategy which combines flexibility at the beginning but with the emphasis on security towards the end may require a significant degree of financial engagement as well as capability throughout retirement.
- We recommend that people are actively reengaged in the retirement planning process in their early 70s when they are typically on the verge of reducing their consumption. At this age, a full financial health check with information about what to do next run by Pension Wise, the Money Advice Service or another independent body would be a good start.
- But a one-off financial health check will not be sufficient. Bringing financial advice to the mass market - whether face to face, over the phone or on the internet - is long overdue and we call on the Financial Advice Market Review to facilitate real change in this area.

...Auto-enrolment will raise the stakes

- With the death of final salary pension schemes and the advent of Auto-enrolment, tomorrow's pensioners may need to use their DC savings for flexibility and security of income.
- But there is a risk that in failing to annuitise at the point of retirement, individuals consume even less of their income than they do today because they have no certainty of income in later life. As a result, rather than raising people's quality of life, flexibility could actually erode it.
- In this regard, striking the right balance between flexibility and security in any decumulation strategy will be of critical importance so that people are confident they won't run out of money. But this relies on people not simply pulling all their money out of their pension pots and putting it in a low interest savings account.

...what should we do about those excess savings?

- With the majority of savings made by older people sitting in low interest current accounts, the financial services industry should seek to understand how it can tap into this market to improve the returns that consumers are making on these savings.
- The potential macroeconomic challenges posed by excess savings necessitate a long-term strategy about how the UK economy can harness these savings to deliver increased investment and drive forward economic output within the context of an ageing society.

Introduction

Older consumers are an increasingly important part of the UK economy. There are approximately 12.4 million people over State Pension age in the UK today and this is set to rise to nearly 14 million by 2030.¹ How we harness the spending power of older consumers could significantly shape the future direction of our economy.

Expectations for a fulfilling, consumption driven retirement have perhaps never been greater, reinforced by stereotypical images in the media of older people on cruises and playing golf. The very real decline in pensioner poverty witnessed over the last decade and growing corporate interest in marketing to older consumers strengthens a story of a prosperous cohort. Yet too few make adequate plans for their retirement ahead of leaving the workforce despite the increasing onus on individuals to make decisions about how they are going to meet the costs of a potentially long and uncertain road ahead.

The recent pension reforms giving people flexibility in terms of how they use their defined contribution pension pots means that many will have to think about what shape of income they will need in retirement to meet their changing consumption needs. In this regard, many have argued that products that deliver a U shaped income - high initial income for leisure and holidays on entering retirement, low in the middle of retirement as preferences change and then high again at the end of life to fund long term care costs - might be most appropriate. However, hard empirical analyses about what consumption during retirement actually looks like, how this relates to people's daily activities, and whether people are happy with this are few and far between.

To fill the evidence gap, this report provides detailed analysis of two large representative data sets – the Living Costs and Food Survey and the English Longitudinal Study of Ageing which allows us to explore both consumption and income data, as well as information on what people are actually doing in retirement.

Based on this analysis, we find five big trends:

1. Consumption (measured in terms of expenditure) declines with age much faster than income which results in big savings in later life. Even low income groups are saving significant amounts in later life.
2. The vast majority of the decline in consumption is driven by falls in spending on non-essential items, with essential spending remaining relatively constant.
3. The decline in consumption is not always the result of people leaving the workforce and therefore happily cutting back on non-essential expenditures. While a significant proportion of retirees appear content with their lot, others would like to do more, with evidence that poor health is getting in the way particularly at older ages.
4. The average older person has a high expectation of leaving a bequest worth £50,000 or more to loved ones.
5. The age group 70-74 appears to be a tipping point. It is at this age, on average, regardless of other factors, that consumption starts to decline and savings rise. It is also at this point that time spent at home alone starts to rapidly rise.

The UK is not alone in terms of its older population reducing consumption as they age and continuing to save. Japan is a notable case where excessive saving amongst older people has acted as a drag on economic growth.

We estimate that aggregate annual savings made by those aged over 65 and retired in the UK equates to around £48.7bn – approximately 2.8% of GDP. So it appears, on the face of it at least, that there is a significant disconnect between retirement stereotypes, which emphasise leisure and freedom during retirement, and the reality, whereby retired people appear to find it increasingly hard to use all of their income as they age and so save whatever is left. But where do all these savings go? High-level analysis of the Wealth and Assets Survey data suggests the vast majority ends up in low interest earning current accounts.

¹ ONS (2015).

Our findings have significant implications for retirement planning as well as for public policy. With this in mind, the following report is structured in eight chapters:

Chapter 1 outlines individuals' expectations about what they will face in retirement and some of the drivers for these.

Chapter 2 explores the realities of income and consumption during retirement, identifying how these differ for low and high income groups.

Chapter 3 looks at what types of consumption people engage in and how this changes over the course of retirement.

Chapter 4 examines the kinds of activities that older people undertake – both in terms of occasional leisure and holidays as well as daily activities – and how these change over the course of retirement.

Chapter 5 delves deeper into consumption in retirement by segmenting the older population into five distinct groups based on their consumption patterns.

Chapter 6 delves deeper into the possible reasons for consumption falls at older ages and whether this is an active choice or forced upon individuals due to health, financial security or other reasons.

Chapter 7 looks at the potential economic cost of excess savings in retirement with reference to Japan.

Chapter 8 concludes the report and outlines recommendations for public policy.

Background: Changing expectations of retirement

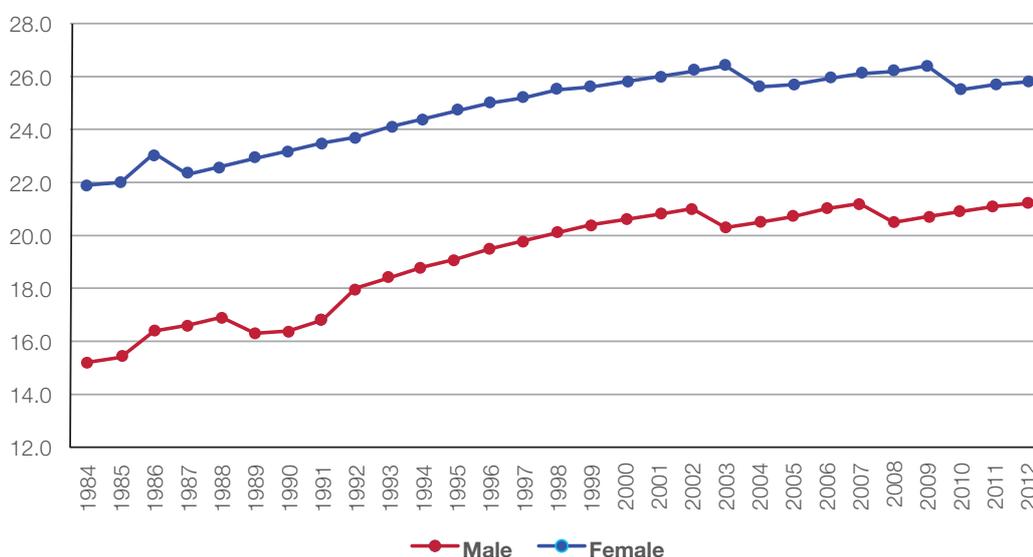
Key points

- The nature of retirement has changed from a few years at the end of life, often in poverty, to a period of twenty plus years, which for many (though not all) is increasingly characterised by relative financial security. Older consumers are now a large and growing part of our economy.
- With the nature of retirement changing, expectations of a leisure-filled retirement have become broadly entrenched, though many remain concerned about whether they will be able to afford the costs of retirement while often preferring not to think about future health and care needs that might arise.
- The recent “pension freedoms” - which provide individuals with greater flexibility in using defined contribution (DC) pension pots - support the notion that pensioners should be able to do what they want in retirement.
- But until we better understand real life retirement journeys, including the extent to which retirement realities match up with expectations, it is difficult to help individuals take advantage of the new flexibilities in ways that meet their long term income needs.

The changing nature of retirement

Over the course of the last 50 years or so, the reality of retirement has markedly changed. Growing prosperity after the end of World War II, combined with increased social security and rising membership of occupational pension schemes has enabled increasingly longer periods of retirement. It is only since the middle of the 1990s that the average age of leaving the labour market has started to rise after consistently falling for many decades. But because life expectancy has risen faster than the age of exit, the average number of years spent in retirement has continued to rise.

Figure 2: Estimated average number of years spent in retirement



Source: DWP (2014), ONS and author's calculations²

This shift to longer retirements has led to a perception that retirement can be a time of enjoyment and not simply a short period of time in relative deprivation before the end of someone's life. Indeed, since the year 2000 perhaps one of the great public policy successes has been the fall in poverty rates at older ages: in 2002/3 over 1 in 4 people over the age of 75 was in poverty (higher than any other age group). However, three things have happened since then. First housing costs and low wages have driven up working age poverty. Second, so called pensioner benefits have continued rising, even during the recession, helping to

² Average number of years spent in retirement for each gender is calculated as average remaining cohort life expectancy at the average age of leaving the labour market for each given year.

reduce poverty in later life. Third, those now in their 70s and older are significantly better off than the cohort that preceded them due to wage rises and increased occupational pension scheme membership. As a result today, less than 1 in 6 over 75s are in poverty, by comparison to more than 1 in 4 in their early 40s.³

The recent so called “pension freedoms” have capitalised on the changing nature of retirement. In April 2015, the tax penalties for individuals with defined contribution (DC) pensions pots taking all their money out in cash were reduced.⁴ Until the recent reforms, individuals in the UK with DC pots were effectively incentivised to purchase an annuity or income drawdown plan that capped the amount of withdrawals that could be taken from the pension fund. Approximately 75% of individuals with DC pensions annuitised prior to the introduction of the reforms.⁵ But as of April 2015, individuals have much greater freedom with regards to how they choose to use their private pension wealth.

Sold to the public on the basis of enabling people to do what they want in retirement, the pension freedoms have arguably supported the notion that retirees can take control and live out retirement as they would wish. But with ever longer retirements allied to an increasing onus on the individual to make active choices about how to use their pension wealth, planning for retirement has become ever more important but also complicated. In this context, today’s retirement expectations appear a confused, and at times, contradictory mix, with evidence of many expecting to live a fulfilling and leisure-filled retirement while also fearing they may not be able to afford it.

Retirement expectations today

Leisure and Travel

“I expect to have a Leisurely retirement.”

Although ill health and the need for care in later life may limit the kinds of activities in which people engage later in life, the notion of leisure remains a prominent theme in people’s retirement expectations.

Undertaking leisure activities including hobbies in retirement is the most prominently aspired to retirement activity.⁶ And there is evidence to suggest that people increasingly value leisure as they approach retirement, with survey research showing more frequent mentions of leisure as important to quality of life for those aged over 65 (23.8%) than for those aged 15-25 (14.6%).⁷

Expectations of an enjoyable and leisure filled retirement might be on the rise. One study has found that 51% of 46-65 year olds planned to travel more in their ‘long term future’, compared to just 23% of their parents’ generation at the same age.⁸

Finances

“My savings will be inadequate to fund retirement.”

Despite desiring a leisure filled retirement, many on the verge of retirement are concerned about not having enough money in old age. The Pensions Regulator found that only 24% of defined contribution pension owners were confident or extremely confident that state and personal/company pensions would “provide an adequate retirement income”.⁹ Recent comparative international research has shown that future retirees (those aged 30-45) are more than twice as likely to report being worried about their finances in retirement compared to older generations (those aged 60-75).¹⁰

In addition, survey evidence has suggested that people on average have less saved in advance of retirement than they believe they will need. ILC-UK research found that would-be pensioners expected to need on average £20,000 a year to pay their regular bills in retirement, but their total private pension income was expected to be worth £15,800 a year, a £4,200 per year shortfall.¹¹

3 Joseph Rowntree Foundation Analysis of Households Below Average Income data: <http://www.jrf.org.uk/data/adult-poverty-rate-age>

4 Some with defined benefit pensions are also able to take advantage of the freedoms.

5 Pensions Policy Institute (2014).

6 Humphrey et al. (2011).

7 Plagnol and Scott (2011).

8 Standard Life (2009) 51% of a representative sample of 46-65 year olds planned to travel more in their long term future, compared to 23% of their parent’s generation.

9 The Pensions Regulator (2012).

10 Allianz (2014).

11 Franklin and Creighton (2015).

“I just don’t expect to live that long.”

Some people’s expectations for retirement are shaped by a perception that this period of their life will be relatively short, at least compared to their working lives. However, people consistently underestimate their own life expectancy. For example, previous ILC-UK research has shown that on average men approaching retirement expect to live between 4.2 and 5.5 fewer years than their life expectancy would suggest, while women expect between 5.6 and 6.3 fewer years.¹² DWP and industry research echo these findings.¹³

The reasons why people underestimate their life expectancy are difficult to determine, but recent research suggests that the expectation of ill health (63%) and concerns about lifestyle choices (23%) are particularly strong determinants. “Family does not live long” (28%) is also a prominent response.¹⁴ Therefore a mixture of pessimism regarding individuals’ own prospective health, worries about lifestyle choices that they have made, and using parents’ life expectancies as a marker for their own all help to lower expectations.

Health and Care Needs

“I don’t want to think about health and long-term care.”

Expectations related to health and long-term care funding needs are deeply linked with individuals’ expectations of how long they will live, their financial preparedness for retirement, and the extent to which they understand what long-term care costs they might be liable for – none of which are trivial.

In the wake of all this complexity, research has found that people are reluctant to think about or discuss the issue of declining health and its financial implications.¹⁵ The reluctance to plan is reinforced by a prominent misconception that social care services will be delivered for free like NHS services; 54% of the public wrongly think care services are free at the point of use.¹⁶ Our analysis of ELSA data shows that on average, people expect a less than 50% chance of ever having to pay for long-term care (47.0% of those aged 50+, 48.4% for those 65+).

Planning

“I have not given much thought to my needs in retirement”

Evidence consistently shows a lack of retirement planning across all age groups. Among people aged 55-70 but yet to retire, 3 in 5 are yet to make a plan and even for those less than a year away from retirement, around 2 in 5 are yet to make a plan.¹⁷ A lack of planning may help to explain why nearly half (46% of 60-64 year olds) have either “not thought about [their hopes and ambitions] that much” or “not thought about [them] at all”.¹⁸

Recap and discussion: the need to understand what retirement is really like

People’s expectations of a leisurely retirement are broadly entrenched and do not significantly change according to varying financial circumstances.¹⁹ In other words, people expect certain things from retirement whether or not they can afford them. This contributes to the substantial difficulty that many people have in building realistic expectations and thus adequately planning for retirement.

Retirement planning is indeed complicated, with individuals having to think about their consumption needs over their remaining healthy and unhealthy years – both of which are uncertain. In this context, it is important that research sheds light on what retirement is really like, in order to help individuals on the verge of retirement manage their expectations and set realistic plans for the future. And in the context of

12 Franklin and Creighton (2015).

13 See Aviva (2015) and (Humphrey et al. 2011) For those aged 50-64, both studies found men and women underestimated their life expectancy at 65 by approximately two to three years. The figure for Humphrey et al. is averaged across two age cohorts.

14 Aviva (2015) Although lifestyle choices such as drinking and exercise garnered the same percentage as ‘family does not live long’ as a reason given for estimates below average life expectancy, smoking as a condition was polled separately and given by 20% of respondents as an answer. If smoking was incorporated into lifestyle choices, lifestyle choices would likely garner a higher percentage of mentions than ‘family does not live long’. These responses are consistent across genders.

15 Kotecha et al. (2011).

16 Department of Health/Ipsos MORI (2010), as cited in CII (2011).

17 Franklin and Creighton (2015)

18 Humphrey et al. (2011) Only 44% of those aged 65-69 and 30% of those aged 75+ said they had hopes or ambitions for retirement; the remaining respondents had either ‘not thought about it that much’ or ‘not thought about it at all’.

19 Goodwin and O’Connor (2014) Most of the respondents’ notions of retirement were consistent with a life of leisure and consumption that, given their financial situations, were likely to be unachievable.

the “pension freedoms”, such research can help support the creation of products and services that better meet the changing income needs of retirees with defined contribution pension pots over the long-run.

The stakes are high. The advent of Auto-enrolment is raising the number of people saving into a DC pot and, over the long term, will increase the proportion of people who have their wealth concentrated in this form of saving. Exploring what sorts of financial products and services this group will need in retirement will be key to the overall success of the initiative. Therefore with the onus increasingly on the individual to prepare for and fund later life, the need to develop a better understanding of “real life” retirement journeys is arguably more important than ever.

Retirement Realities: Consumption and expenditure in old age

Key findings

- As people get older, they spend progressively less, regardless of their income.
 - A household headed by someone aged 80 and over spends, on average, 43% less than a household headed by a 50 year old.
- Many older households continue saving throughout retirement. Indeed, we calculate that individuals aged 80 and over are saving on average around £5,870 per year.
- Lower earning households show much flatter spending trajectories over the lifetime. While our analysis suggests low earners spend beyond their means before retirement, they actually start saving in later life as consumption falls but incomes remain flat.
- On the other hand, higher earning households save consistently across all ages.
- While low earning households consume about 113.7% of their income at age 50 and about 75.7% at age 80, high earning households consume only 67.7% of their income at age 50 and about 62.6% at age 80.

Approach and data

In order to study the relationship between age and consumption, we carried out a series of empirical analyses drawing on 10 years' worth of data from the Living Costs and Food Survey (LCFS, 2003/2013). Previously named the Expenditure and Food Survey (EFS), the LCFS is a repeated cross-sectional survey containing the highest quality measurements of household consumption and its components. All analyses are conducted at the household level, so when we refer to age, gender and ethnicity, we mean age, gender or ethnicity of the household reference person (the primary respondent to the survey), while income and consumption refer to the entire household. Clearly, different household sizes will show different consumption levels, so we account for this by adjusting total income and consumption using the OECD equivalence scale.²⁰

What aspects of consumption do we include and what do we exclude?

Our study focuses mainly on expenditure on non-durable consumption (i.e. items that have a relatively short life-span), even though we include expenditure on certain types of durable items. For instance, the “transport” category includes expenditure on cars, motorcycles, caravans, bikes and other vehicles, as well as expenditure on the maintenance of such vehicles. The category “recreation” includes expenditure on some types of durables, such as musical instruments, computer games, television sets etc. Other items that may be considered durables, such as jewellery, clocks or watches, are included in the “miscellaneous” category.

What we do not include is the amount of money spent to buy property, such as residential housing and second homes. We do not include expenditure on housing for a series of reasons: first of all, it is for the sake of comparability, since most of the literature on consumption over the life cycle focuses on non-durable consumption. Secondly, because housing has a dual nature of being both a consumption and investment good, it is more difficult to conceptualise. Indeed, because we have a repeated cross section, i.e. we only see our consumers at one point in time rather than following them over time, we cannot account for the investment features of durable goods.

Economic theory and consumption in retirement

The consumption of goods and services is a basic determinant of human well-being. Studying how consumers spend their money across the life course is “not only necessary for explaining and forecasting

²⁰ Income corresponds to wages, benefits, and investment income when people are working and private/public pension plus investment income when they are not. The (modified) OECD equivalence scale assigns a value of 1 to the head of household, 0.5 to each additional adult member, and 0.3 to each child.

actual consumption patterns, but also crucial in evaluating how policy reforms affect the welfare of different groups”.²¹

The standard economic framework to study consumption and saving choices by households is Modigliani and Brumberg’s Life-Cycle Hypothesis (LCH).²² The model’s key prediction can be described as follows: **consumers form long-term plans to avoid excessive variability in their standard of living over their lifetime** (known as consumption smoothing). In other words, people spend and save at different rates across their lives in order to avoid major changes to their standard of living.

According to the simplest version of the LCH, how much people consume at a given point in time is determined by the total amount they can expect to earn during their entire lifetime (i.e. their “permanent income”) rather than their income at that specific time. In order to achieve a stable level of consumption throughout their lifetime they will:

- Borrow when younger, i.e. when their current income is below their permanent income;
- Save when middle aged, since they earn more than at other points during their lifetime; and
- Run down their assets when they are older and on lower income.²³

The underlying idea is that, by saving and running down assets, people have some kind of control over their standard of living, rather than letting fluctuations in income dictate how much they can consume. The major purpose of saving is to provide a cushion against the variations in income that typically occur during the life cycle. Of course, keeping consumption smooth does not mean keeping consumption or expenditures constant. Rather, smoothing means that people try to do the best they can, given their expected lifetime budget and needs, which may involve quite different levels of expenditure at different times.

Entering retirement generally means a large drop in income, but because the drop in income is expected, it should not automatically translate into a drop in consumption. In other words, because people are aware that once retired they will be earning much less than when they are in work, they will try to compensate for this reduction by saving well in advance of leaving the workforce.

Why the reality may be different

A substantial amount of research has been devoted to understanding whether people (unwillingly) consume less upon entering retirement and how this may change over time. In particular, the economic literature has focused on two stylised facts:

- Older people keep accumulating assets in retirement, and the amount of money they save increases with age. This appears to be true in several developed countries including the US, the UK, and Italy and has been labelled “**the savings puzzle**”.²⁴
- There is a one-off drop in consumption at the time of retirement that cannot be fully explained in terms of the life-cycle theory, which is documented for both the UK and the US and is known as the “**retirement consumption puzzle**”.²⁵

In this section, we will provide evidence to understand the extent to which consumption changes across the life course so as to assess the extent of the savings puzzle in the UK, before seeking to unpick some of the determining factors.

Income and consumption across the life course in the UK

Figure 3 shows that as people get older they spend progressively less during retirement. A household headed by someone aged 80 and over spends, on average, 43% (or £131) less than a household headed by a 50 year old. If we include the amount of money people pay for their mortgage as household expenditure, then the decline becomes even steeper with households headed by someone aged 80+

²¹ The Royal Swedish Academy of Sciences (2015).

²² Modigliani and Brumberg (1954).

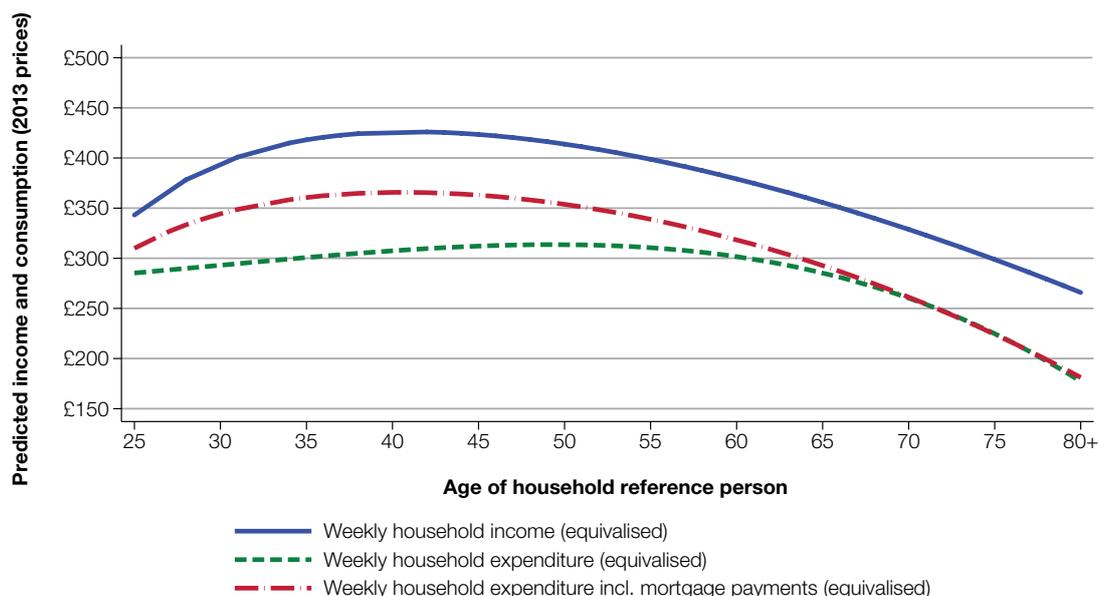
²³ In the purest form of the model, without a public pension system, income in retirement would be zero.

²⁴ For a comprehensive overview see Börsch-Supan and Brügiavini (2001).

²⁵ For the UK, see Banks et al. (1998); for the US, see Bernheim et al. (2001).

spending 56.4% less (or £173) than households headed by a 50 year old. Indeed, we calculate that by age 80+, individuals are saving, on average, around £5,870 per year.²⁶

Figure 3: Income and consumption expenditure at different ages

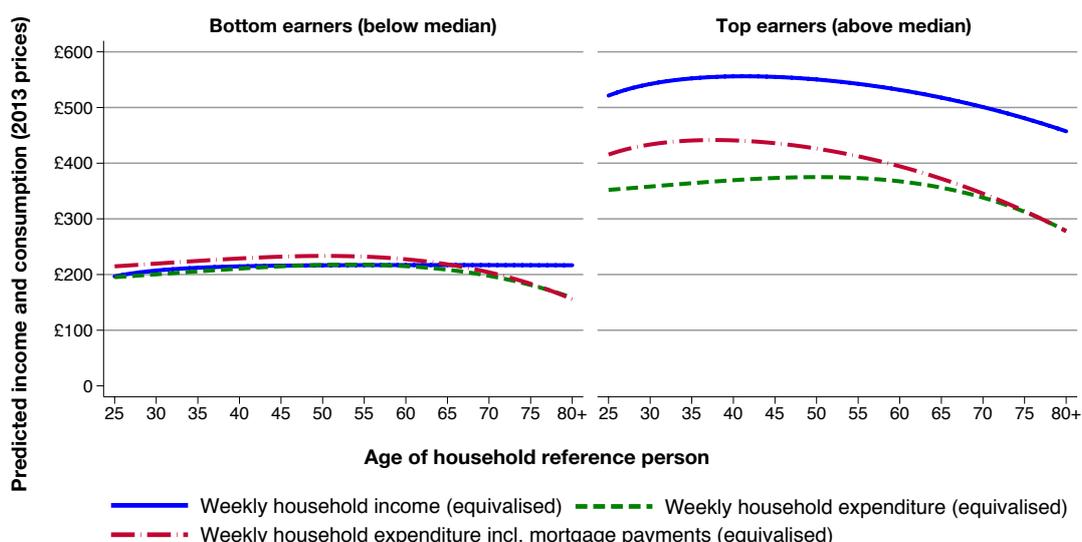


Source: author's calculations from Living Costs and Food Survey / Expenditure and Food Survey (years 2003 to 2013)
 Consumption expenditure and household income deflated by RPI index at 2013 prices; OECD equivalence scale used to account for household composition; top and bottom 1% of the distribution of consumption expenditure and household income have been trimmed to exclude outliers; data are weighted using annual weights.

The difference between high and low earners

The above figure illustrates the average trend across the life-course, but people with different levels of income over the lifetime will have markedly different patterns of consumption. By splitting the population aged 50+ between top and bottom earners (i.e. people whose income is either above or below the median), we unsurprisingly find that households who earn more also spend more at every age. However, high earners experience a much faster and steeper decline in spending after age 60 than bottom earners. Indeed, bottom earners have more stable spending patterns throughout their lifetime, and their total expenditure starts to decline only after age 70 (see Figure 4).

Figure 4: Income and consumption expenditure at different ages – top and bottom earners



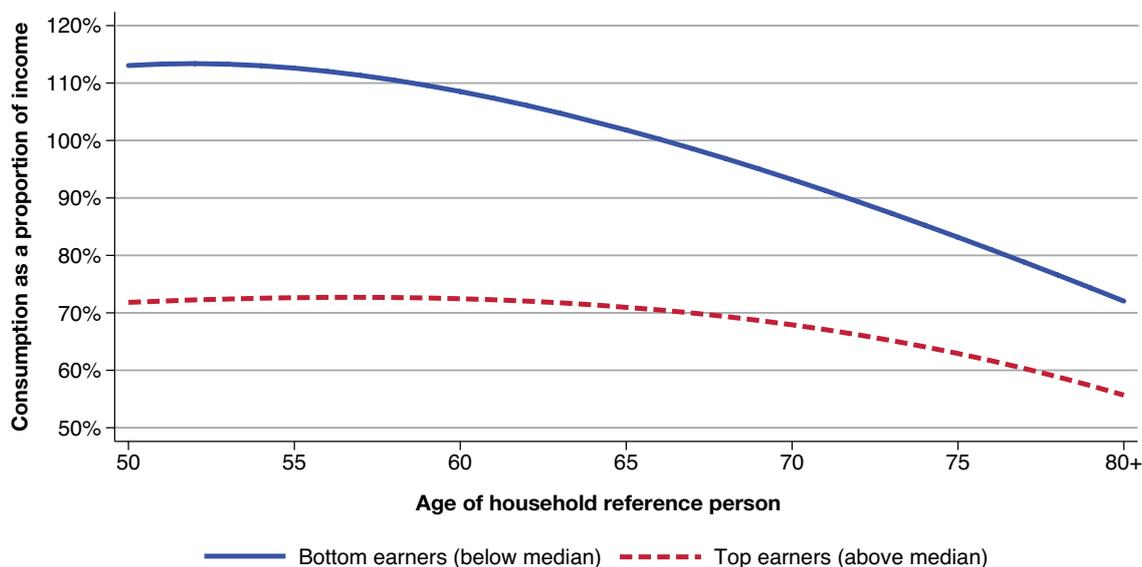
Source: author's calculations from Living Costs and Food Survey / Expenditure and Food Survey (years 2003 to 2013)
 Consumption expenditure and household income deflated by RPI index at 2013 prices; OECD equivalence scale used to account for household composition; top and bottom 1% of the distribution of consumption expenditure and household income have been trimmed to exclude outliers; data are weighted using annual weights.

²⁶ Calculated in terms of income – consumption on an individual rather than household level. This simple calculation of savings by subtracting spending from income does not capture savings arising from unrealised capital gains (or losses) and cannot distinguish between saving in different types of assets.

Both high and low income groups save in later life

Another noticeable difference between people of different income groups relates to their level of consumption as a proportion of income. Lower earning households seem to spend more than they earn during their younger years and only start saving after age 65. On the other hand, high earners save consistently across all ages. More specifically, while bottom earning households consume about 113.7% of their income at age 50 and about 75.7% at age 80, top earning households consume only 67.7% of their income at age 50 and about 62.6% at age 80 (Figure 5). Therefore, it would appear that both high and low income groups save in later life.

Figure 5: Consumption expenditure as a proportion of income at different ages



Source: author's calculations from Living Costs and Food Survey / Expenditure and Food Survey (years 2003 to 2013) Consumption expenditure and household income deflated by RPI index at 2013 prices; OECD equivalence scale used to account for household composition; top and bottom 1% of the distribution of consumption expenditure and household income have been trimmed to exclude outliers; data are weighted using annual weights.

Is the decline in consumption a robust and persistent trend?

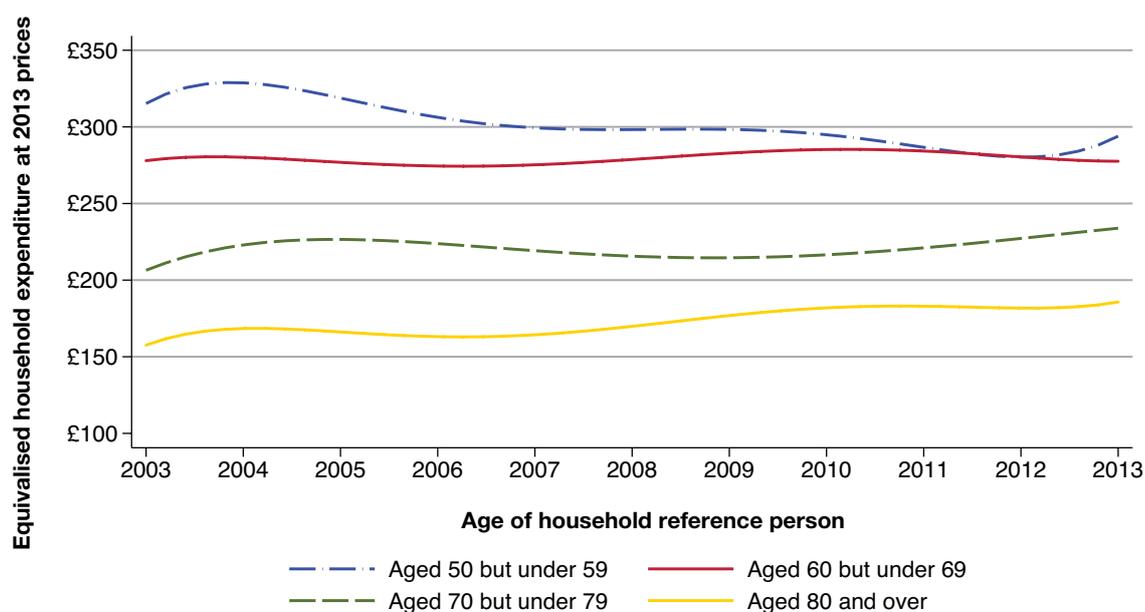
The above analyses illustrate how older people spend consistently less than their younger counterparts regardless of their income. However, it is unclear whether this is a persistent trend or whether it reflects particular social and/or economic conditions common to a specific period of time or in a given year (also known as period effects).

We can help answer this question by looking at the relationship between ageing and spending over ten years, between 2003 and 2013.²⁷ The results plotted in Figure 6 suggest:

1. The trend is persistent, in that between 2003 and 2013 households headed by a younger person (aged 50-59) consistently consumed more than households headed by an older one.
2. Very little has changed for the middle group, i.e. households headed by someone aged 60 to 79, while the trends are reversing both for the youngest and for the oldest households. Indeed, younger households (50-59) have seen their consumption somewhat decrease over time, especially between 2010 and 2012, a few years after the 2008 recession.
3. Conversely, the oldest households have been spending progressively more, so that their total consumption in 2013 rose by nearly 25% compared to 2003. It is worth pointing out that while this group spent significantly more in 2013 than in 2003, it is still spending significantly less than other age groups.

²⁷ We account for inflation using the RPI index with baseline year of 2013.

Figure 6: Weekly consumption expenditure in different age groups (2003–2013)



Source: author's calculations from Living Costs and Food Survey / Expenditure and Food Survey (years 2003 to 2013)
 Top and bottom 1% of the distribution have been trimmed; data are weighted using annual weights.

Focus: Other drivers of consumption in retirement

While our analysis helps to support the notion that consumption declines as people move through different stages of retirement, age is not the only factor determining how much households spend during this period. For instance, many people entering mid to later life will be more likely to have paid off their mortgage and become outright homeowners, and this can provide them with higher disposable income to spend on other goods. Yet some older people with children may decide to use part of their disposable income and wealth to help their children pay for university fees and avoid debt, while others may use a substantial part of their accumulated wealth to help their children onto the housing ladder.

Other transitions in later life, such as divorce or widowhood, the onset of mobility issues, and the transition into retirement itself can also have substantial (and in some cases potentially devastating) impacts on people's consumption and quality of life. This last set of factors are often described as "shocks" within the economics literature – unplanned events which cause sudden and unexpected changes in the circumstances of individuals.

We performed a regression analysis to identify the independent explanatory power of different factors and found that:

- Households headed by a woman spend on average 2% more than households headed by a man.
- Households headed by someone belonging to an ethnic minority group spend 14.2% less than a household headed by a white person.
- Larger households spend less (in relative terms), while, unsurprisingly, households headed by a single, widow(er) or a divorcé(e) spend significantly less than married/cohabiting households (-20% if single, -23.4% if widowed and -16.7% if divorced/separated).²⁸
- Higher income households spend more but not as much as one might expect, since a 1% increase in income only translates into a 0.4% increase in equivalised household consumption.
- Homeowners who still have to pay off their mortgage spend on average just 6.2% less than outright owners.
- When controlling for all of the above factors, as the head of a household gets one year older, equivalised household consumption decreases by 1.4%.²⁹

²⁸ Note that we are still talking about equivalised consumption, therefore the difference is not due to the sheer number of people in the household.

²⁹ This is an average decrease for any one year increase in age. Actual change from one specific age to another will vary depending on the age (i.e. the specific decline is greater at older ages than younger ages and consumption at some points will rise with age rather than fall).

Our results suggest that a number of factors help to determine changing consumption patterns in retirement, but that even after controlling for many of the most relevant factors, age is still a statistically significant determinant of falling consumption in later life.

Not all older people are savers

Research from the Consumer Financial Education Body has shown that people tend to define themselves as either “savers” or “spenders” and a saving attitude is associated with higher financial capability.³⁰

While the median retiree saves approximately £74 per week the differences are huge - nearly 1 in 4 individuals aged 60+ spend more than what they earn, with an average debt of £100 per week; the remaining 3 in 4 save approximately £145 per week. Even past age 80, 1 in 7 retirees spends £87 in excess of what they earn on a weekly basis.

Table 1: Proportion of households saving/not saving

	% Not Saving	Median Weekly Debt	% Saving	Median Weekly Savings
Aged 60 but under 65	38.9%	-£112.7	61.1%	£141.8
Aged 65 but under 70	30.1%	-£113.0	69.9%	£138.4
Aged 70 but under 75	24.5%	-£96.7	75.5%	£140.6
Aged 75 but under 80	20.2%	-£92.3	79.8%	£143.6
Aged 80 and over	14.6%	-£85.7	85.4%	£153.9
Total	22.9%	-£100.2	77.1%	£145.1

Source: author's calculations from Living Costs and Food Survey (2003-2013). Data are weighted using annual weights. Note that for these estimates the sample has been restricted to retired heads of household.

Recap and discussion

Consumption in retirement starts relatively high and ends low. This pattern is common to both high and low income groups, is robust to the inclusion of factors other than age and is not simply the result of the time period in which the data was collected. Subsequently, households make substantial savings in later life. Now of course, not all older people are savers, a significant proportion do not save and hold debt, but the vast majority of older households (77.1%) put something away at the end of the week.

...the absence of U shaped consumption

Our findings suggest that typical consumption in retirement does not follow a U shaped path - consumption does not dramatically rise at the start of retirement or pick up towards the end of life to meet long-term care related expenditures. At this point it should be noted that our data is restricted to households only and therefore excludes those actively living in care homes who may be paying for it from their remaining assets. Yet we can explore the extent to which care expenditures eat into household budgets across different ages. Analysis of the data suggests that even for the 80+ age group, only a minority (6.4% of households) are putting money towards meeting long-term care needs. This doesn't mean that U shaped consumption in retirement is a misnomer, but perhaps implies that it is atypical.

30 Elliot et al. (2010).

Table 2. Proportion of households spending on long-term care

	Proportion spending on care	Average care spending (for those who spend)
50 but under 55	0.1%	£19.9
55 but under 60	0.5%	£59.1
60 but under 65	0.4%	£27.2
65 but under 70	0.6%	£32.8
70 but under 75	0.9%	£44.3
75 but under 80	2.3%	£51.3
80 and over	6.4%	£45.5

Source: author's calculations from Living Costs and Food Survey (2003-2013). Data are weighted using annual weights. Note that care expenditures relate to residential care or home helps.

Retirement Realities: How consumers allocate their spending

Key points

- Much of the decline in consumption is explained by falls in spending on “non-essential items” such as recreation, eating out and holidays.
- Spending on “essential items” remains relatively flat during retirement which means essential items account for an increasing proportion of the overall household budget. Indeed, by age 80+, over 50% of expenditure is on essential goods and services.
- There does not appear to be a post-retirement spending boom on leisure and holidays. In fact from age 50 onwards, spending on most non-essential items begins to fall.

Approach

The evidence presented so far has demonstrated that consumption does indeed fall as people age and this is true even after accounting for other factors and time periods. But what type of consumption do older people forego and how does this change during retirement?

The Living Costs and Food Survey collects detailed information on the amount of money households spend across twelve different groups of goods and services. Consistent with previous research we split this group of goods into two broad categories of essential and non-essential items.³¹

In the **essentials** category, we include expenditure on:

- Food and Non-alcoholic Drinks;
- Clothing and Footwear;
- Housing, Water, and Electricity;
- Health Expenditure;
- Transport.

In the **non-essentials** category, we include expenditure on:

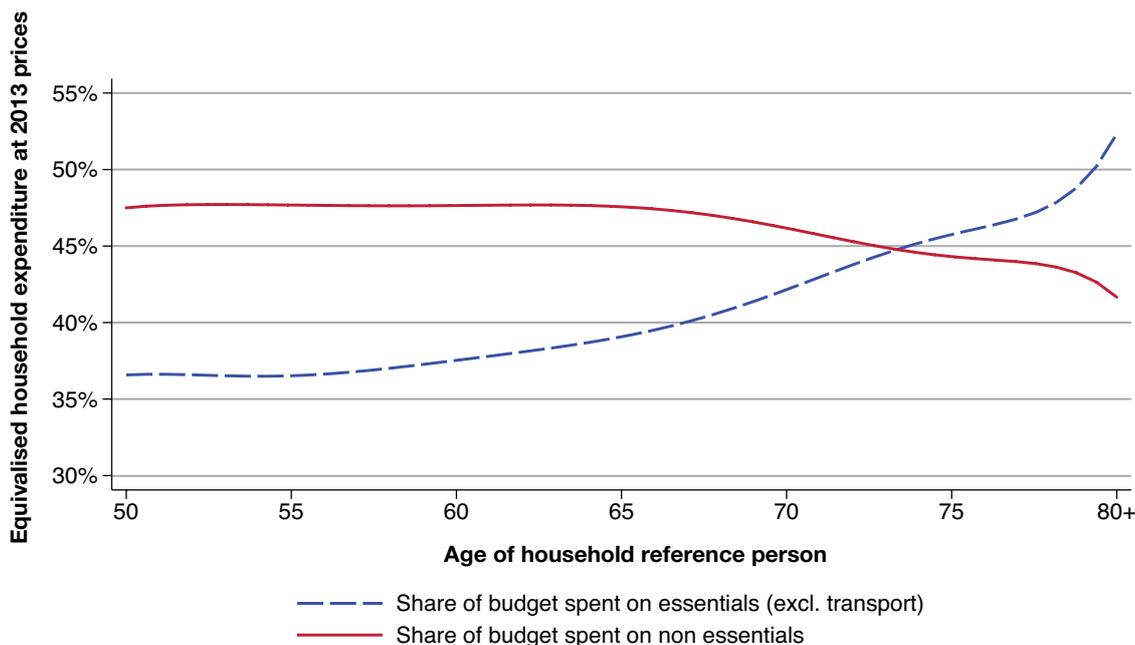
- Alcohol and Tobacco;
- Recreation and Culture;
- Restaurants and Hotels;
- Communication;
- Education;
- Household Goods and Services;
- Miscellaneous Goods and Services.

Expenditure on essential and non-essential items during retirement

By adopting this more nuanced perspective, we see that the composition of the household “shopping basket” substantially changes with age. As people get older, they spend an increasingly larger share of their total expenditure on essential goods and services, with a parallel reduction in the share of non-essentials (see Figure 7).

³¹ See for instance, Hayes, D., Finney, A. (2014).

Figure 7: Proportion of expenditure on essential and non-essential goods at different ages



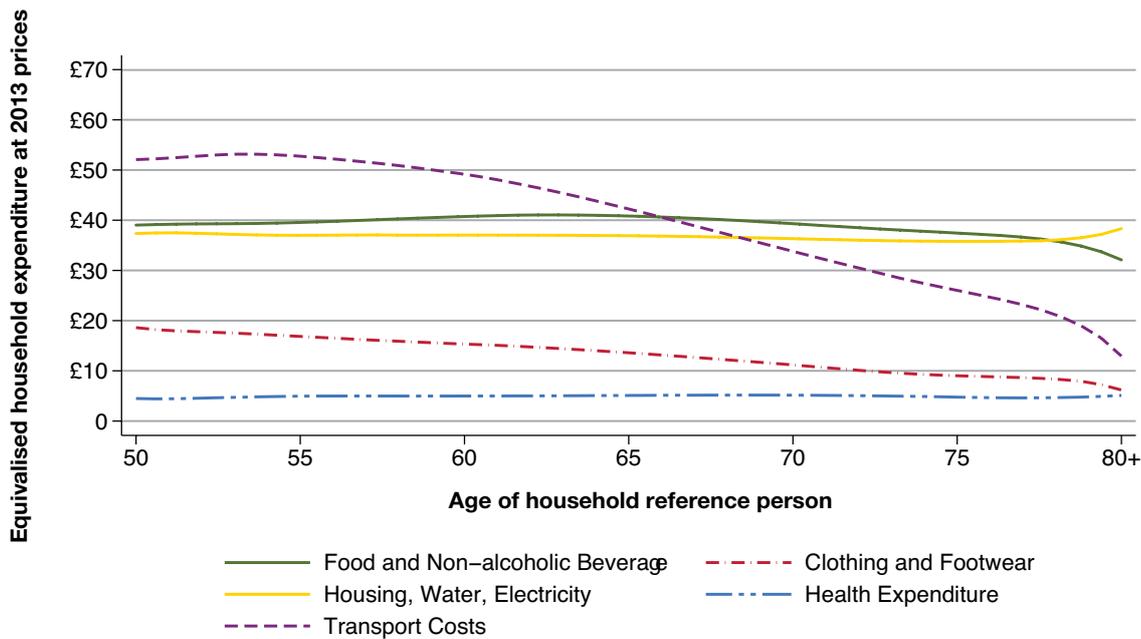
Source: author's calculations from Living Costs and Food Survey / Expenditure and Food Survey (years 2003 to 2013)
 Shares do not add up to 100% because expenditure on transport is missing; data are weighted using annual weights.

The increasing proportion of overall spending allocated to essential items in later life is largely explained by declining spending on non-essentials rather than rising spending on essential items. In other words, as people age they spend less on non-essential goods but maintain their level of spending on essential goods. Indeed, we find that expenditure on food and non-alcoholic drinks, housing and utilities, and health³² remains remarkably stable throughout life. We should stress that this is an average, which, by definition, will mean that some individuals will not experience stable patterns of expenditure on essential items.

By contrast, spending on transport falls from £56 a week at the age of 50 to about £17 by the age of 80+ (-69%). While transport is technically an essential item, the drop in spending does not necessarily imply a decline in living standards, since it will be driven, at least in part, by people leaving the workforce. At the same time, many people in their 60s are entitled to a free bus pass, and this will account for some of the drop in transport costs. Expenditure on clothing and footwear also declines, from approximately £20 a week at age 50 to less than £7 by age 80+.

³² Health expenditure: This group covers medicines, prostheses, medical appliances and equipment, and other health-related products purchased by individuals or households, either with or without a prescription, usually from dispensing chemists, pharmacists or medical equipment suppliers. They are intended for consumption or use outside a health facility or institution. Such products supplied directly to outpatients by medical, dental and paramedical practitioners or to in-patients by hospitals and the like are included in outpatient services or hospital services.

Figure 8: Expenditure on categories of essential goods and services at different ages



Source: author's calculations from Living Costs and Food Survey / Expenditure and Food Survey (years 2003 to 2013)
 Equivalised household consumption expenditure deflated by RPI index at 2013 prices; data are weighted using annual weights.

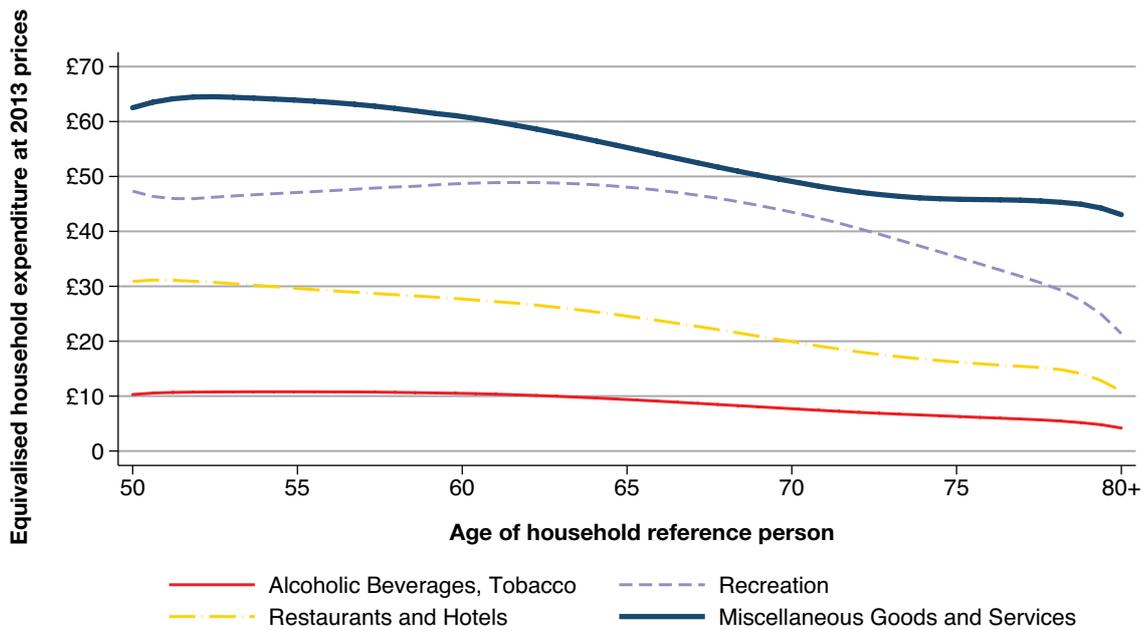
The absence of a post-retirement spending boom

The amount of money spent on non-essentials – primarily for the pursuit of pleasurable activities, such as recreation or going to restaurants and hotels – declines steadily with age (see Figure 9). A closer look at the different categories of non-essential spending, reveals that people spend a relatively similar amount of money on recreational goods and services between the age of 50 and 65, and only then do they start spending progressively less. This seems to contradict the stereotypical image of retirees splurging in the immediate post-retirement phase of life, going on cruises and spending all their hard-earned cash on fun activities.

With respect to expenditure related to going out to restaurants and staying in hotels, the decline that occurs after the age of 65 is much steeper than that which occurs between 50 and 65. Again, it would appear that the post-retirement stereotype of extravagant dinners and nights away in hotels or on cruises (i.e. on holiday) is not reflected in the evidence based on average expenditure.

We group the categories of communication, education, household goods and services, and miscellaneous goods and services into one category of “Miscellaneous Goods and Services”, since, individually, they only represent a negligible quantity.

Figure 9: Expenditure on categories of non-essential goods and services at different ages



Source: author's calculations from Living Costs and Food Survey / Expenditure and Food Survey (years 2003 to 2013)
 Equivalised household consumption expenditure deflated by RPI index at 2013 prices; data are weighted using annual weights.

A quick recap

The decline in consumption during retirement is mainly explained by reduced spending on non-essential items while expenditure on essential items remains relatively flat. There are both potential positive implications and potential negative ones stemming from this. On a positive note, at least essential spending does not fall by much, the majority are still able to purchase the same quantity of essential goods and services that they were able to before. However, falling expenditure on non-essential items might be unwanted – retired people might want to continue going to restaurants or undertaking recreational activities once they reach their late 70s. In the next chapter we explore what activities older people are actually doing and how this changes with age.

Retirement Realities: What are people actually doing in later life?

- Time at home alone increases by age, while time spent with family and friends declines. By age 90+, watching television and spending time at home alone are the most common daily activities.
- The age group 70-74 appears to be a tipping point. From this age, the average amount of time spent at home alone increases markedly, while the time spent with family and/or friends continues on a slight downward trend.
- With the exception of early retirement, retirement does not lead to more holidays or other leisure activities. Nor does retirement lead to a sudden splurge in eating out.

Approach

While our exploration of consumption in retirement reveals crucial information on older people's wellbeing, we must be careful not to extrapolate too much from expenditure figures alone. Expenditure does not capture the complete picture related to people's activities in later life. For example, people in retirement may use their extra time to cook, so their spending on going out to eat may decline.³³ This would not reflect a negative decline in quality of life or living standards, while lower spending on eating out because of ill health or insufficient savings would.

To offer insights into how activities in later life might change, and the extent to which these activities can tell us more about people's consumption patterns, we look at some of the evidence available from the English Longitudinal Study of Ageing (ELSA) dataset. In particular, there are questions related to how often people engage in particular cultural activities and if they desire to do more. In addition, the most recent survey collected information on how much time people spend in a given day on different activities. These all help clarify what people are doing during retirement.

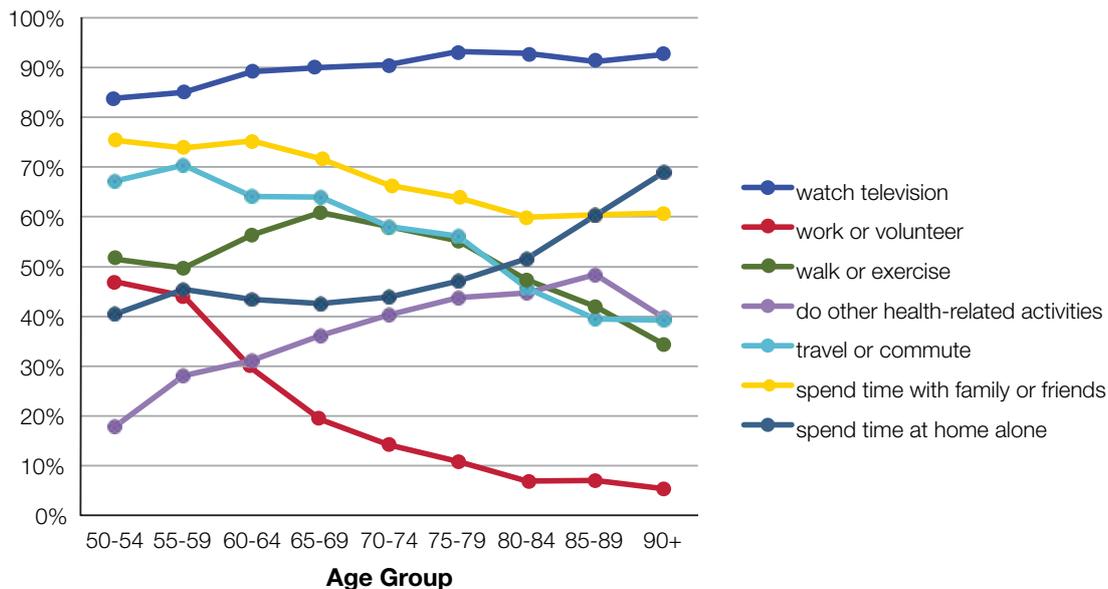
What are older people doing in their daily lives?

In terms of what people actually do with their time in later life, the ELSA survey asked a subsample of respondents if they had done seven types of activities the day before the interview and to report the amount of time they spent on them.

A number of activities show predictable trends: In particular, we see that for those in groups aged 80+, the primary activities are watching television, spending time at home alone, and socialising (spending time with family or friends). The amount of time spent at home alone shows the starkest change between the ages of 70-74, when 43.8% of people spent time alone, to 90+ when 69% of people spent time alone. The proportions of people working or volunteering declines with age.

³³ The conceptualization of "home production" goes as far back as Gary Becker's "Theory of the Allocation of Time" (1965).

Figure 10: Proportion of people in different age groups who did activities the previous day



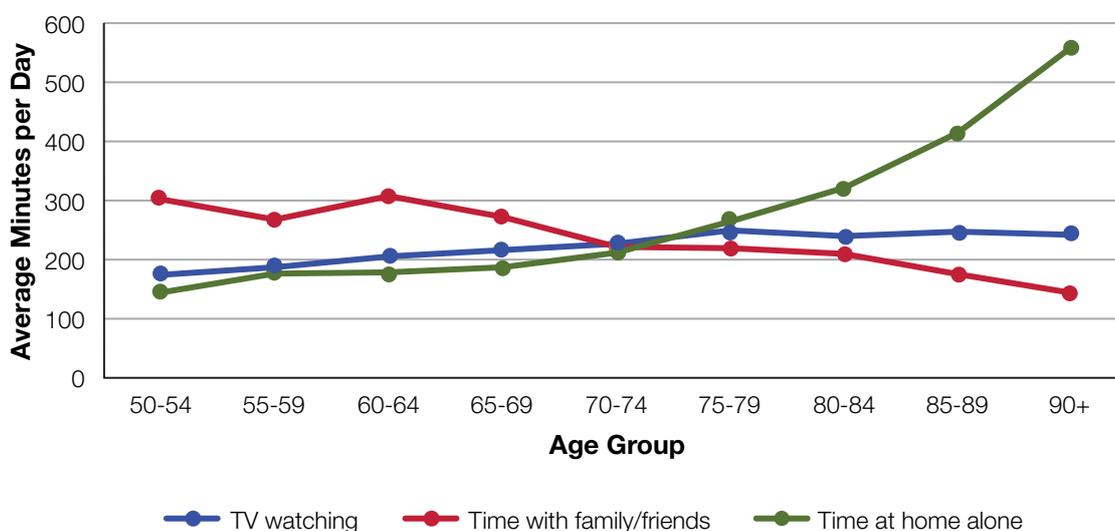
Source: ELSA Wave 6 (2012/13)

Whether or not people engage in these activities provides only part of the story; the amount of time they spend – and whether or not this changes over time – may also provide useful insights. Based on the average number of minutes spent on the different activities, we can classify them into frequent and infrequent activities. Frequent activities include watching television, spending time with friends and/or family, and spending time at home alone. Infrequent activities are working/volunteering, walking/exercising, other health-related activities, and travelling/commuting.

The 70-74 age group is a tipping point

In terms of frequent activities, we see that there is something of an inflection point at the age group 70-74. From this age upward, the average amount of time spent at home alone increases markedly, while the time spent with family and/or friends continues on a slight downward trend. Indeed, time at home alone rises from 3.5 hours a day for those aged 70-74 to more than 9 hours a day by age 90+. The average amount of time spent watching television remains relatively steady from this age group up.

Figure 11: Average time spent on frequent activities by age group



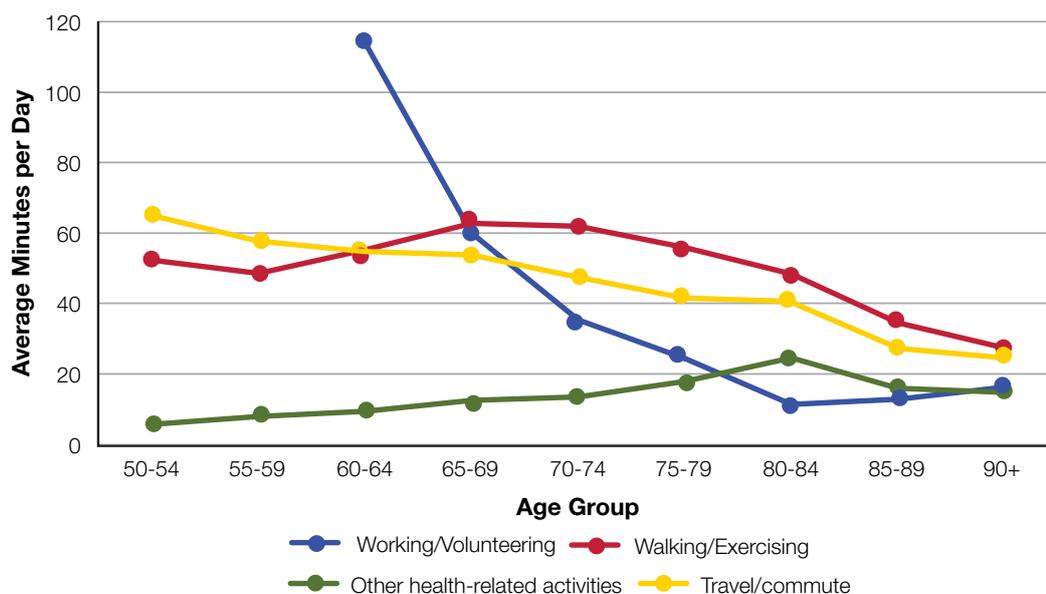
Source: ELSA Wave 6 (2012/13)

With respect to the infrequent activities, we see that walking and exercising begin a noticeable decline from the age group 70-74. At the same point, there is an increasing trend in other health-related activities, with a

peak for those aged 80-84. This is most likely explained by the consequences of ill health; it is unclear what respondents may have considered other-health related activities to be, but – since it excludes exercise – it likely relates to doctor/medical visits and activities related to care. The decline after this age group may simply relate to longevity factors, i.e. healthier people or those with fewer health issues are the ones who survive to this age.

The trends in working/volunteering and travelling/commuting are also worth noting. It could be argued that the downward trend in travelling/commuting relates to people leaving work, but the decrease in working/volunteering is much steeper than the corresponding decline in travelling/commuting which suggests that, although people are travelling/commuting less in later life, they continue to travel for other reasons. Indeed, people aged 90+ are still travelling, on average, for almost 25 minutes a day.

Figure 12: Average time spent on infrequent activities by age group



Source: ELSA Wave 6 (2012/13). Note: Time spent working/volunteering is high for those in their 50s (i.e. before retirement), so we have omitted those values from this chart to better display the variation and trends for older age groups.

Leisure activities

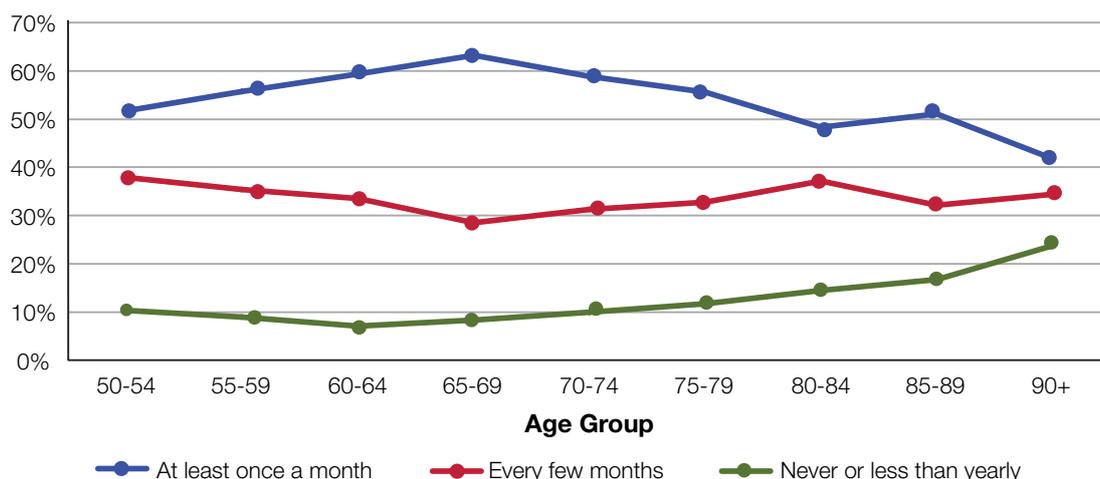
The ELSA data allow us to explore the frequency with which people in different age groups engage in different leisure activities:

1. Going to the cinema.
2. Eating out of the house.
3. Visiting an art gallery or museum.
4. Attending the theatre, a concert, or the opera.

A majority of people aged 50+ never or rarely (less than once a year) say they engage in these leisure activities except for eating out of the house, which a majority of people of this age group say they do. But the frequency of eating out does appear to change over the course of old age.

More specifically, there is an increase in the proportion who “never” eat out or who eat out “less than once a year” rising from 7% of the 60-64 age group up to 23.8% of the 90+ age group. In addition, the proportion of people who eat out at least once a month falls from 63.2% of those aged 65-69 to 41.8% for those aged 90+ (see Figure 13). The proportion eating out every few months remains relatively constant.

Figure 13: Proportion of age group eating out of the house by frequency



Source: ELSA Wave 6 (2012/13)

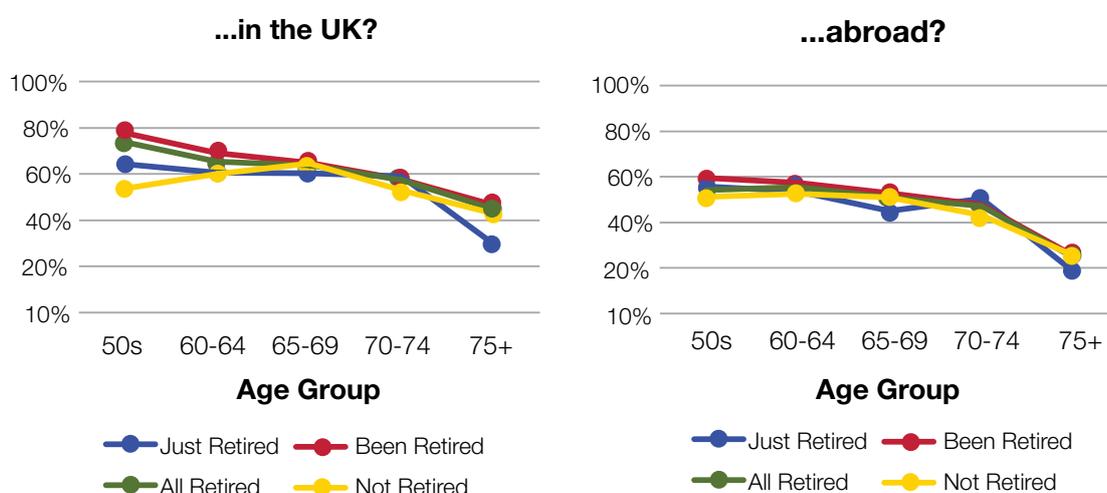
Retirement does not result in a sudden eating out spending splurge

The age group eating out the most frequently is the 65-69 age group, perhaps indicating some post-retirement increase in dining. However, when we examine the same information but compare those who are retired with those who are not, we find that the increase in frequent dining up to the age group 65-69 is primarily due to those who are not retired. For those who are retired, frequent dining shows a steady decline from 73.8% of people aged 50-54 down to 39.4% for those aged 90+, while infrequent and rare dining increases. Overall then, it would appear retirement does not result in a sudden increase in eating out.

Does retirement lead to increased holidays?

Given stereotypical expectations of holidays in retirement depicted in advertisements, we again turn to the ELSA data to explore information on whether people in England had taken a holiday. In addition, because of the idea that holidays and leisure may be more concentrated in the first few years of retirement, we compare the results of people who had become recently retired with those who had been retired for more than two years.³⁴ We also examined all people who were retired and those who were not retired.

Figure 14: In the past 12 months, have you taken a holiday... (Proportions Reporting Yes)



Source: ELSA Waves 5 & 6 (2010/11 & 2012/13)

³⁴ Specifically, we used self-reported retirement status from Waves 5 & 6; the recently retired were retired at Wave 6 (2012/13) but not retired at Wave 5 (2010/11), while those already retired were retired at both waves.

Retirement does not result in more holidays with the exception of early retirement

Despite the conventional notion that people in retirement would be more likely to travel and take holidays, the findings illustrated in Figure 14 show that this is in fact not the case. There are no significant differences between those who are more recently retired and those who had been retired for more than two years in any age group. This suggests that there is no immediate surge of holiday-making for people shortly after they enter retirement.

There is, however, one exception; a larger proportion of retired people in their 50s took a holiday in the UK compared to those not retired. More specifically, 73.8% of retired people in their 50s had a UK holiday versus only 53.6% of those not retired.³⁵ Retired people in their 50s may not be well enough or physically able to continue working in their previous job but healthy enough to travel and go on holiday. Early exit can also be driven by redundancies and financial incentives from employers to encourage workers to retire early; this may positively position some people to take a holiday.

A quick recap

In contrast to the expectations of a leisure filled retirement, with a boom in holidays and cruises, the reality appears to be quite different. Retirement does not appear to result in more holidays, while time spent on leisure activities falls with age. And perhaps the most startling trend is time spent at home alone. Between the ages of 70-90 time spent alone rises from an average of 3.5 hours to 9 hours. Now clearly not all retirees will experience retirement in the same way, and looking at the average can mask big differences between different groups of people. For this reason, in the next chapter we delve deeper by segmenting the older population into five distinct groups based on their consumption patterns in retirement.

³⁵ Significant differences were determined by looking at non-overlapping 95% Confidence Intervals; for retired people in their 50s, this ranged from 65.8%-81.8% compared to 50.3%-56.8% for those not retired. Looking at 95CIs also shows that, despite an apparent decline across the age groups, only the 75+ group is significantly lower than the others (except for those not retired taking holiday in the UK).

Delving Deeper: There is no such thing as the older consumer

Key findings

- In this chapter we outline consumption patterns for **five different consumer groups** based on their spending preferences, and explore potential issues facing them. The groups include:
 - “Just Getting By” who spend over 45% of their total expenditure on housing and bills;
 - “Frugal Foodies” who spend 27.5% of their budget on food and drinks and over 13% on furnishing, housing equipment etc.;
 - “Prudent Families” who spread their expenditure evenly on many items and save consistently as they age;
 - “Extravagant Couples” who spend nearly 40% of their total expenditure on recreational goods and services;
 - “Transport Lovers” who spend more than a third of their total expenditure (36.8%) on transport (both public and private).
- A key finding in this chapter is that all of our groups save in later life. From age 75 onwards, even the “Just Getting By” group, which is the lowest income group, starts to save. The savings are the consequence of falling consumption towards the end of life on non-essential items.
- While all groups experience falls in consumption, patterns of consumption over the course of retirement are different for the different groups. The “Extravagant Couples” spend more than their income in the first decade or so of retirement, as do those who are “Just Getting By” while the “Prudent Families” and “Frugal Foodies” consistently spend below their income over the duration. Below we tease out some of the most pertinent trends and issues facing each group.

Approach

There is no such thing as **“the”** older consumer. Looking at the average retirement journey without considering the significant diversity of outcomes experienced in retirement can lead to one-sized-fits-all public policy, and retirement products that are inappropriate for specific groups and individuals. In this context, this chapter seeks to understand how consumption in retirement differs for different groups.

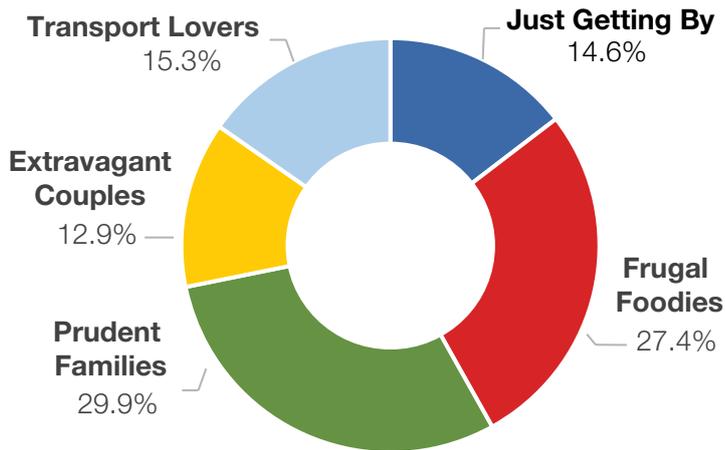
Because we are particularly interested in understanding whether different groups of consumers spend differently, we segment our data using a technique called “cluster analysis”. Cluster analysis is a statistical technique used to classify observations into a finite and, ideally, small number of groups based upon two or more variables, which in our case are different types of spending. In this regard, we identify five categories of consumers based on how much they spend on each item as a proportion of total expenditure. We then highlight the demographic characteristics of each of the consumer groups resulting from a series of regression analyses.³⁶ Finally, based on the characteristics of the groups and their spending patterns we draw some high level conclusions about the types of issues and risks facing them in retirement.

It is worth mentioning that in this study we found fewer groups than Hayes and Finney (2014) which provided the empirical analysis for our 2014 report³⁷ because we are using a much larger sample, including many years of observations, and because we are looking at shares not levels of itemised spending.

³⁶ We undertook a series of logistic regression analyses, details of which we would be happy to provide on request.

³⁷ ILC-UK (2014).

Figure 15: The consumer groups as % of total population



Source: author's calculations from Living Costs and Food Survey / Expenditure and Food Survey (years 2003 to 2013). Data are weighted using annual weights

Introducing the Consumer Groups

Group 1: Just Getting By

Consumers in this group spend more than **45%** of their total expenditure on **housing and bills**.

Socio-demographic characteristics:

- Median age 70;
- More likely to be headed by a non-white, single, widowed or divorced person;
- More likely to be a renter, either private or social, than an outright homeowner;
- More likely to be on low income and not receiving income from investments;
- Furthermore, consumers in this group are disproportionately more likely to live in London or the North.

Issues/risks:

Older consumers belonging to this group are less likely to have a family safety net, are more likely to be renters and tend to be concentrated in London. As a result, as the group name suggests, individuals may struggle to afford day to day essential spending and cannot afford non-essential spending on recreation and holidays. Some individuals in this group are at particular risk in the event of rising rental costs or energy prices.



JGB's

Spend more than **45%** of their total expenditure on housing and bills.

Group 2: Frugal Foodies

Consumers in this group spend more than **27.5%** of their total expenditure on **food and non-alcoholic drinks**, and over **13%** on **furnishings and other household equipment** (nearly twice the average).

Socio-demographic characteristics:

- Median age 70;
- More likely to be a woman;
- More likely to be on low income, and not have private pensions or income from investments.

Issues/risks:

This group under-consume throughout their lifetime relative to all the other groups identified. Despite having a relatively low equivalised household income (£308.6 per week), they consume a lower proportion of their income than any other group. For this group, longevity insurance may be a solution, but perhaps those in this group are less aware of the options out there and end up under-consuming as a result.



FF's

Spend more than **27.5%** of their total expenditure on food and non-alcoholic drinks

Group 3: Prudent Families

Consumers in this group are consistent savers; they spread their expenditure quite evenly on all items, except for restaurants and hotels, which they seem to enjoy more than other groups.

Socio-demographic characteristics:

- Median age 61;
- More likely to be a woman, part of a couple and living in a larger household;
- Have relatively high household income, likely to have private pensions and income from investments.

Issues/risks:

“Prudent Families” are doing well. The only issue they might be facing is under-consuming, in that they could attain a higher standard of living given their means. However, consumers in this group also spend a lot more money on health than other groups do, and therefore some may be saving because they pre-empt declining health conditions. Having a larger than average family size, “Prudent Families” may also be saving in order to leave a bequest.



PF's

Are consistent savers; they spread their expenditure quite evenly on all items

Group 4: Extravagant Couples

The “Extravagant Couples” like to enjoy their life and spend nearly **40%** of their total expenditure on recreational goods and services.

Socio-demographic characteristics:

- Median age 65;
- More likely to be part of a couple, but living in a smaller household;
- High household income, having income from investments;
- More likely to own their home outright;
- More likely to live in the North of England than other groups.

Issues/risks:

“Extravagant Couples” are not savers until very late in life so, despite having relatively high income for most of their lives, there is a potential risk that they could run out of money in later years. For this group, financial advice is likely to be particularly beneficial to ensure that they have the means of meeting their rather more extravagant retirement needs.



EC's

Like to enjoy their life and spend nearly **40%** of their total expenditure on recreation.

Group 5: Transport Lovers

“Transport Lovers” spend a very large proportion, up to **36%** of their total expenditure, on transport – including the use of and other costs associated with their own vehicles.

Socio-demographic characteristics:

- Median age of 61;
- More likely to be male, part of a couple and living in an average sized household;
- High household income.
- More likely to be buying their home with the help of a mortgage than other groups.
- More likely to live in the East Midlands than other groups.

Issues/risks:

Given the amount spent on transport right across the life-course, consumers in this group are likely to be spending money on their own cars, rather than public transport which older people may get concessions on. A potential risk for them is that health problems and disability in older age might prevent them from travelling as much as they might like to the detriment of their quality of life. Despite having high income, they do not spend as much of their income as the “Extravagant Couples”, and indeed consistently save during retirement.



TL's

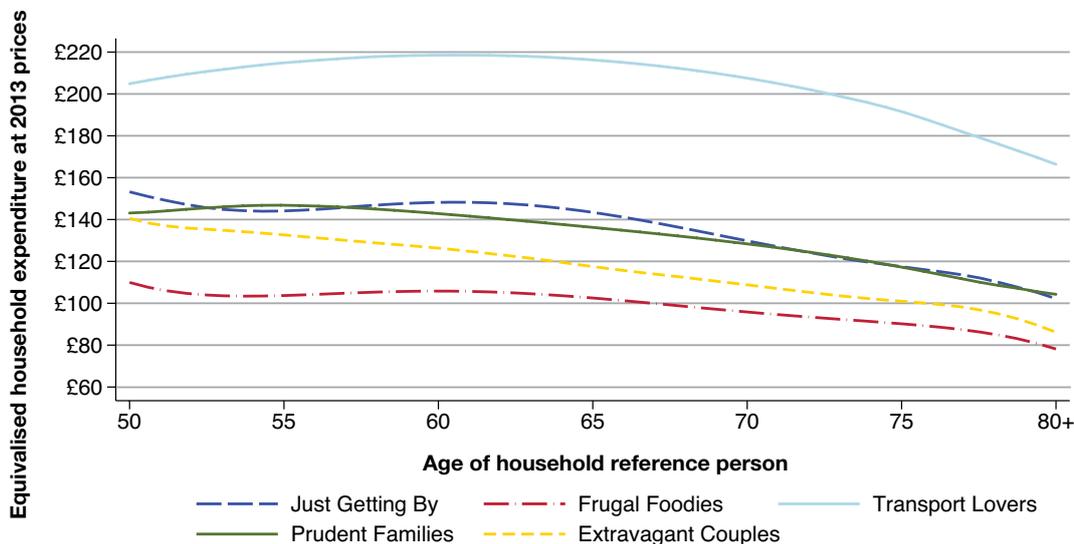
Spend a very large proportion, up to **36%** of their total expenditure, on transport

How does expenditure vary for the different consumer groups in retirement?

Expenditure on essential goods and services

The patterns are quite similar for all groups – expenditure on essential items falls during retirement though this is almost entirely explained by falling expenditure on transport. The “Frugal Foodies” spend less than everyone else throughout retirement, but show a slower decline in total expenditure on essential items than other groups, while the “Just Getting By” and “Extravagant Couples” experience the sharpest overall drops (see Figure 16).

Figure 16: Expenditure on essential goods and services by consumer group

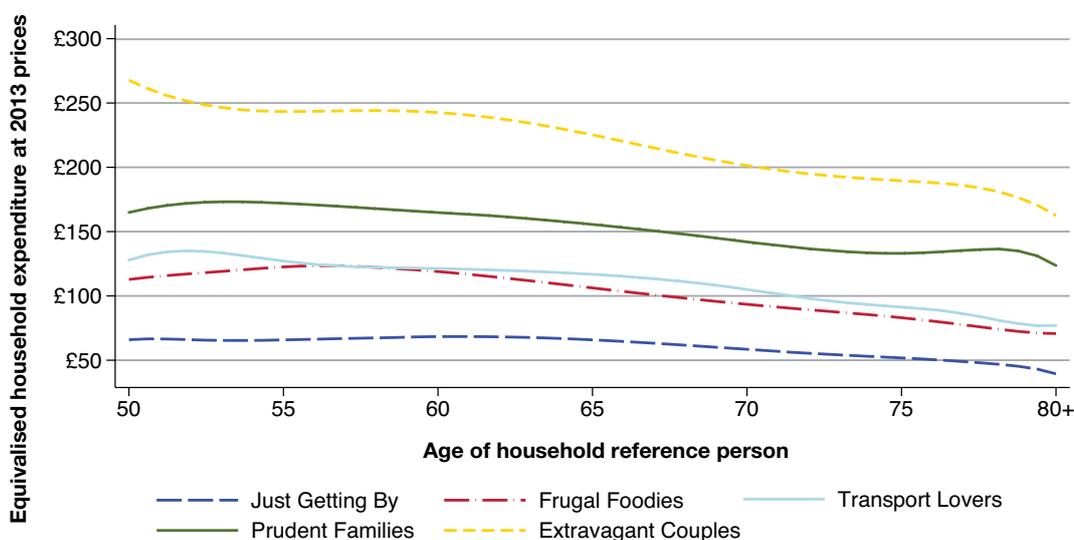


Source: author’s calculations from Living Costs and Food Survey / Expenditure and Food Survey (years 2003 to 2013). Data are weighted using annual weights.

Expenditure on non-essential goods and services

When it comes to non-essential goods and services, unsurprisingly, the “Extravagant Couples” are the highest spenders, though they also experience the sharpest decline in expenditure on non-essentials during retirement. Consumption trajectories for all other groups are much flatter. The “Frugal Foodies” appear to spend a bit more on non-essentials during their late fifties, but progressively less thereafter (see Figure 17).

Figure 17: Expenditure on non-essential goods and services by consumer group

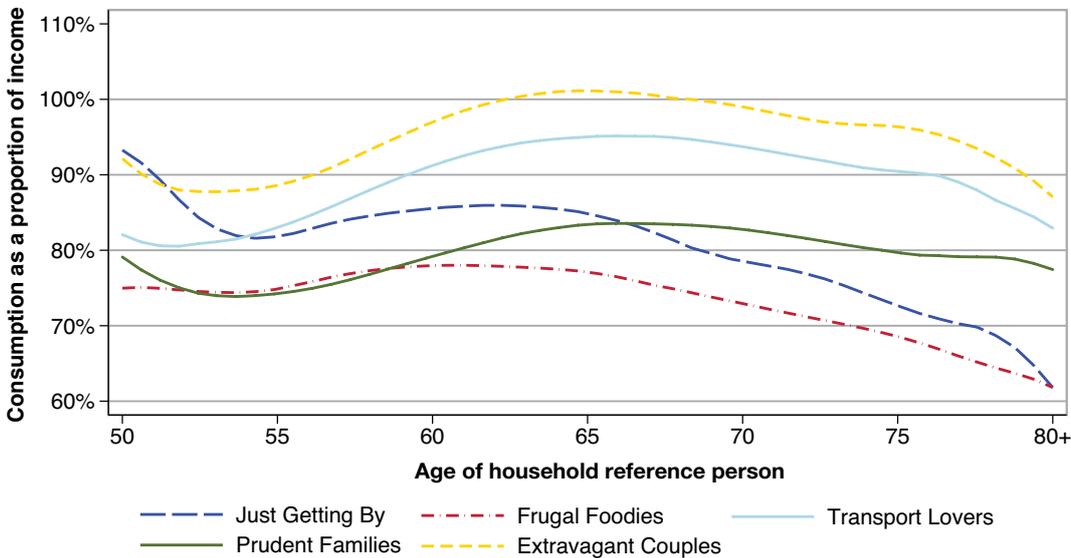


Source: author’s calculations from Living Costs and Food Survey / Expenditure and Food Survey (years 2003 to 2013). Data are weighted using annual weights.

To what extent do the different groups save during retirement?

All groups other than the “Extravagant Couples” appear to be saving throughout retirement and increasingly so as they age; in fact, even the “Extravagant Couples” start saving from their mid-70s onwards. However, there are significant differences in the level of saving – “Frugal Foodies” and the “Just Getting By” groups initially save around 20% of their income in retirement, rising to around 40% by their 80s. By contrast, “Transport Lovers” save around 10% of their income throughout retirement. “Prudent Families” maintain their consumption and saving at a relatively flat level for the duration of retirement.

Figure 18: Expenditure as a proportion of income by consumer group



Source: author’s calculations from Living Costs and Food Survey/Expenditure and Food Survey (years 2003 to 2013). Data are weighted using annual weights.

Of course even within our groups there are differences in terms of savings and debt. **Table 2** illustrates the proportion of people who are savers in the different groups and the median amount of debt that the consumers in the groups are carrying. In all groups, significantly more than 50% of retirees are saving – rising to 85% of consumers in the “Frugal Foodies” group. There are fewer “Extravagant Couples” who are savers (61.6%) than any other group with higher median weekly debt.

Table 2: Proportion of retirees who spend more than their income

	% Not Saving	Median Weekly Debt	% Saving	Median Weekly Savings
Just Getting By	17.2%	-£72.7	82.8%	£136.4
Frugal Foodies	14.7%	-£81.8	85.3%	£141.0
Prudent Families	25.9%	-£99.1	74.1%	£158.4
Extravagant Couples	38.4%	-£124.5	61.6%	£141.1
Transport Lovers	35.8%	-£120.1	64.2%	£154.4
Total	22.9%	-£100.2	77.1%	£145.1

Source: author’s calculations from Living Costs and Food Survey (2003-2013). Data are weighted using annual weights. Note that for these estimates the sample has been restricted to retired heads of household.

Cumulative savings by groups

In Table 2, we report estimated average savings by consumer group during retirement. Despite having lower wages - on average £285 a week – consumers within the “Just Getting By” group end up accumulating savings during retirement that are as large as the “Prudent Families” who have much higher incomes – approximately £428 per week. Conversely, the relatively well-off “Extravagant Couples” and

“Transport Lovers” – earning more than £400 per week – save less than all other groups – though this may be because they have accumulated greater savings and assets before retirement.

Table 3: How much income is not consumed during retirement?

	Just Getting By	Frugal Foodies	Prudent Families	Extravagant Couples	Transport Lovers
Age 65	£3,394.5	£3,995.5	£5,151.3	-£818.0	-£734.6
66	£3,408.9	£4,604.9	£3,293.4	£930.7	£3,553.0
67	£2,075.0	£4,663.7	£3,517.9	£1,318.4	£39.7
68	£2,013.0	£4,869.4	£4,042.9	£3,460.0	£3,316.1
69	£4,503.2	£4,258.5	£4,286.7	£1,486.9	£2,971.4
70	£4,098.6	£5,325.8	£4,667.3	£1,229.2	£4,079.7
71	£4,706.0	£5,159.1	£5,159.0	£1,888.2	£2,371.5
72	£4,257.3	£5,333.5	£4,078.0	£2,335.1	£4,417.2
73	£5,123.1	£5,146.2	£4,689.9	£1,146.1	£2,723.5
74	£3,872.6	£5,296.1	£5,885.9	£1,647.1	£2,624.5
75	£4,827.0	£5,821.9	£5,472.1	£1,973.3	£3,258.9
76	£5,024.5	£5,322.9	£3,852.4	£2,358.7	£2,641.1
77	£6,272.1	£6,626.5	£5,643.3	£3,076.8	£3,829.6
78	£3,797.4	£5,779.1	£5,688.4	£3,898.3	£4,726.8
79	£5,338.1	£4,946.6	£6,725.3	£3,862.8	£2,452.3
80 and over	£6,598.4	£6,785.8	£5,845.1	£3,423.7	£4,578.1
Annual Average	£4,075.2	£4,427.4	£3,642.6	£1,825.8	£2,207.2

Source: author's calculations from Living Costs and Food Survey (2003-2013). Data are weighted using annual weights. Note that for these estimates the sample has been restricted to retired heads of household.*

Discussion and Recap

The first two consumer groups, “Just Getting By” and “Frugal Foodies” share similar risks, in that they have lower incomes and increase their savings as they get older, despite the low levels of overall spending. Both groups spend very little on non-essential goods and services, even though some could afford to spend more and attain a higher standard of living. It is possible that they keep on saving as a precaution, because of the uncertainty surrounding their future health and care related needs. To reduce this uncertainty, the “Just Getting By” group may benefit from state-backed insurance against future long-term care costs. They might also have, retrospectively, benefitted from arrangements that would have allowed them to borrow against their future State Pension, so that they would have been able to spend more on “non-essentials” at younger ages, and therefore attained a higher overall standard of living over their lifetime.

“Prudent Families”, which comprise nearly 1 in 3 retired British households, are relatively well off by comparison to other groups. They do, however, continue saving substantial amounts during retirement while spending more money on health related items than other groups. “Prudent Families” may therefore be under-consuming partly as a consequence of anticipating care costs in later life, or potentially because they wish to give some inheritance to their children (amongst other reasons). But overall, because consumers amongst this group exhibit relatively constant income and spending patterns during retirement, they are perhaps less of a worry than some of the other consumer groups identified in this chapter.

The group “Extravagant Couples” is our smallest group, but still represents more than one in ten retired households. Consumers in this group spend more than their income until their later years and are therefore

most at risk of not having sufficient assets to fund the remainder of retirement. Consisting of a high proportion of homeowners, people in this group may therefore benefit from equity release products that seek to unlock capital tied up in property. This group would also benefit from financial advice before they decide on their decumulation strategy to prevent them from spending beyond their means and facing shortfalls in later life.

The “Transport Lovers” are the only ones who keep a high and steady level of expenditure on transport well into their seventies, but they spend very little on everything else. This group might benefit from better access to public transport, allowing them to reduce transport costs and spend more on other goods and services if that is their preference.

Delving Deeper: What explains falling consumption across retirement?

Key points

- Having a limiting long-standing illness helps to explain some of the rising incidence of time spent alone in retirement. Indeed, health appears to restrict an increasing proportion of older people from doing the things they want to do in retirement.
- However, the vast majority of retirees say that they are able to do the things they want. Even by age 90+, 65% of the population say they can do the things they want “often” or “sometimes”.
- As people get older they are less likely to report being constrained by a lack of money.
- On average, retirees think they have a 70% chance of leaving an inheritance of £50,000 or more.

Approach

While economic theory predicts at least some level of asset decumulation as people get older, the evidence gathered for this report suggests that people keep saving in later life. The evidence that older people save in retirement is not limited to the UK, but is common to many developed countries, giving rise to what economists call “the retirement savings puzzle”. In this chapter, we discuss our findings within the context of the broader economic literature to better understand the extent to which the fall in consumption is due to an active choice, i.e. people rationally deciding to consume less, or whether it is forced upon them, i.e. people have to consume less because of financial constraints or health problems.

What trends have other researchers identified?

Studies undertaken in other countries have also found that consumption declines with age and this results in savings in later life. Whether or not the decline in consumption is consistent with economic theory has been hotly debated for over 50 years, but the recent consensus is that once we account for low financial literacy,³⁸ habits,³⁹ uncertainty over future health expenditure and the desire to leave a bequest,⁴⁰ the theory has a high predictive power. Furthermore, when disaggregating consumption into its components - the approach we adopted in this report - studies have found that the decline in total consumption is largely explained by a drop in work related expenses.⁴¹

At the same time, consumption may decline because of external shocks, such as the death of a spouse or sudden ill health resulting in a disability, which may reduce the ability of individuals to undertake activities they might otherwise enjoy. The anticipation of ill health and disability may also increase the desire to save in order to help meet potential health and long-term care costs in later life. In this context, insufficient saving for retirement and future uncertainty about life expectancy and health can also result in under-consumption and saving in retirement.⁴²

Clearly unexpected and unwanted declines in consumption are cause for concern, so in this chapter we seek to understand the extent to which people are unhappy doing less in retirement and the potential drivers for reduced activity in later life.

Limiting long standing illness helps explain time spent at home alone

Poorer health could explain the increase in time spent at home alone for older age groups, and the decrease in time spent out of the house – e.g. for social activities – may translate into the lower expenditure levels observed in non-essential categories like recreation and culture or restaurants and hotels. When we analyse the amount of time spent at home alone using regression analysis to control for a range of different factors, we find that having a limiting, long-standing illness is strongly associated with a greater amount of time spent at home alone, suggesting that this sort of isolation is driven by particular conditions that impact

38 Lusardi and Mitchell (2006).

39 Guariglia and Rossi (2002).

40 For examples see Attanasio and Weber (2010); Browning and Crossley (2001).

41 Aguiar and Hurst (2013).

42 The authors undertook a review of relevant international literature in order to develop this summary. We are happy to provide more details on relevant literature for readers of the report.

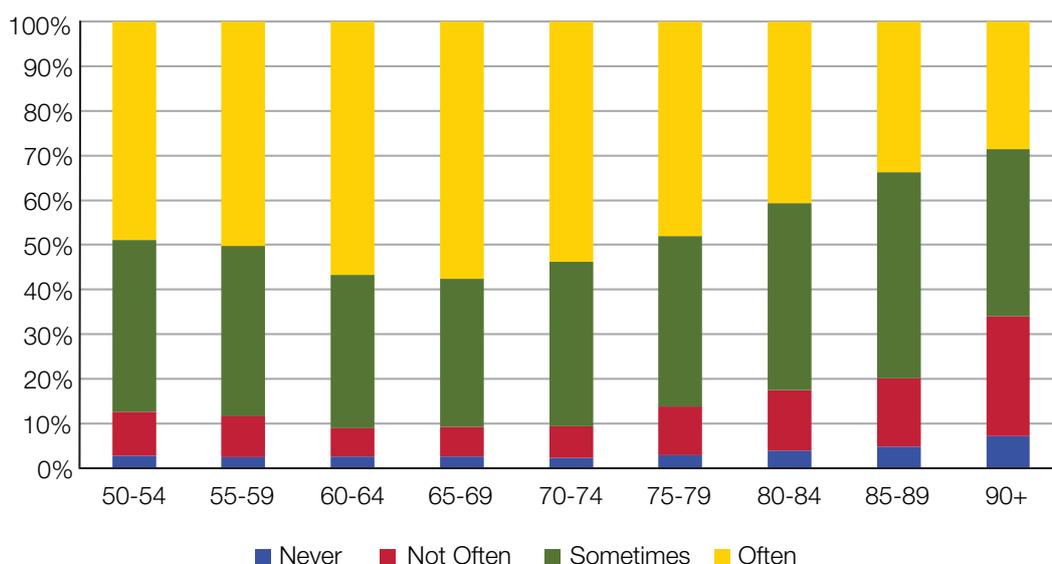
people’s ability to do things. However, self-reported health, i.e. the subjective measure of health based on people’s own views about their health does not have a significant impact on time spent alone. Other significant factors associated with less time home alone are being female, partnered, in a larger household, and a carer for someone. Age itself is only weakly associated with time at home alone after controlling for these other factors.

Health restricts a significant proportion of the oldest old from doing the things they would like

It may be the case that people are content to do less as they age, even if this is driven by some kind of health condition. Two other items in the ELSA dataset allow us to explore this assertion. Respondents were asked how often they would agree with two different statements: “I can do the things that I want to do” and “My health stops me from doing things I want to do”.⁴³

Figure 19 suggests that those in their 60s are doing what they want more than any other age group over 50. But then after this point, the proportion of people who are never able, or not often able, to do the things they want increases over time. Indeed, by age 90+ more than 3 in 10 are never or not often able to do the things they want. But this still leaves around two-thirds of 90 somethings who often or sometimes feel they can do the things they want; for those aged 80-84 and 85-89, the proportions are 82.5% and 79.9% respectively. So while there is certainly scope to improve how well people in older age groups feel enabled to do what they want, the findings suggest that many older people do feel a positive degree of self-determination, though this falls with age.

Figure 19: How often would you agree: “I can do the things that I want to do”?

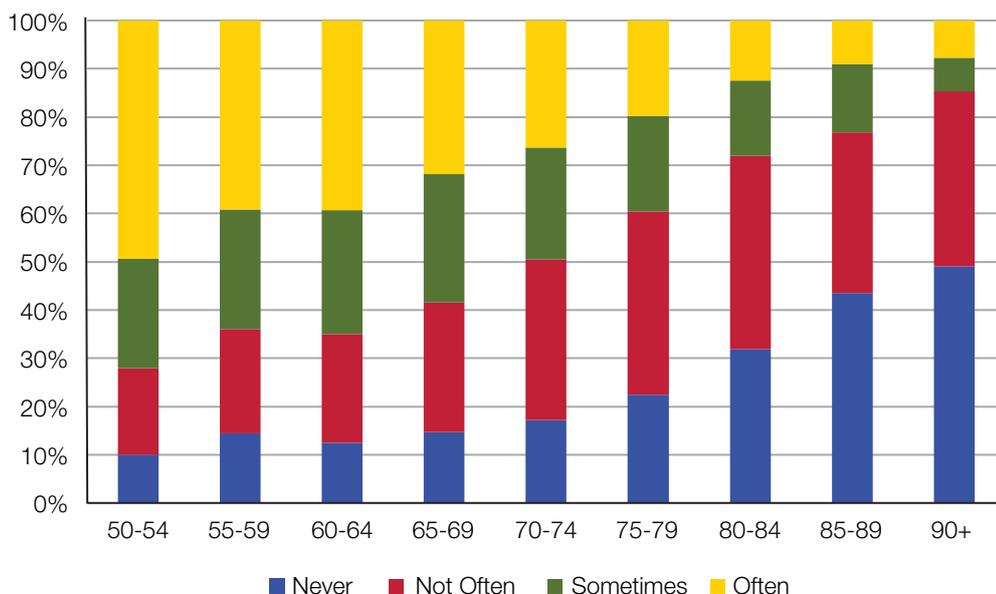


Source: ELSA Wave 6 (2012/13)

But health more specifically does appear to restrict people from meeting their retirement aspirations. As Figure 19 shows, many people in later life do consider health to interfere with what they would like to do. Just over half (50.5%) of those aged 70-74 often or sometimes agree that their health stops them doing things they want to, and this proportion steadily increases with each age group to reach 84.5% of those 90+.

⁴³ These two items are actually part of a 19-item battery of questions called CASP-19, which is a widely recognised measure of quality of life for older people (see Hyde et al. (2003) for more on its development).

Figure 20: How often would you agree: “My health stops me from doing things I want to do”?



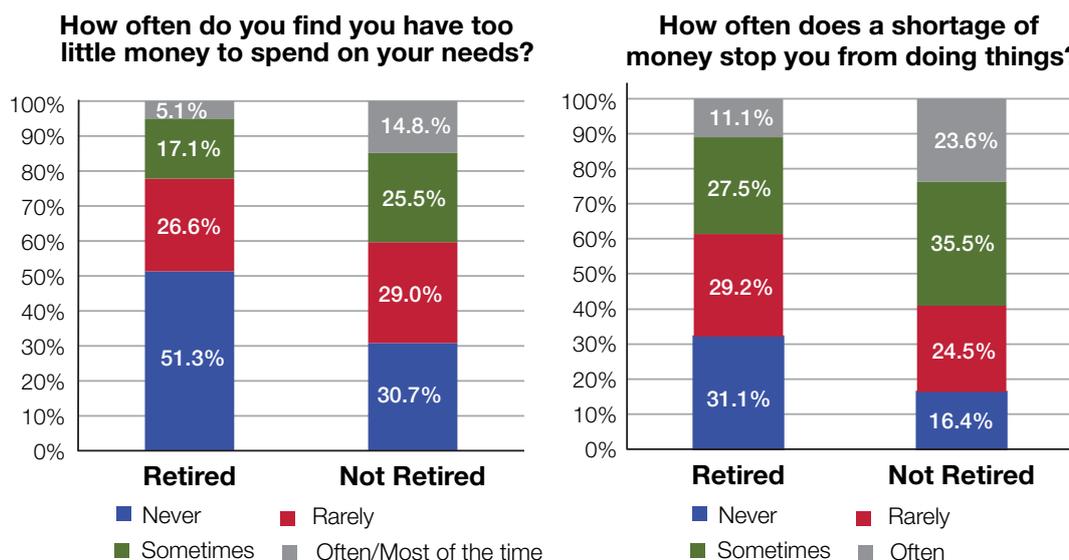
Source: ELSA Wave 6 (2012/13)

While the above evidence offers a somewhat incomplete picture of whether people’s retirement aspirations are being fulfilled, it does suggest that poorer health has an important influence in limiting people’s activities in later life. Given that we know people are reluctant to discuss declining health and care needs before they arise, this suggests that the health issues and subsequent declines in activity may be largely unplanned for.

Are older people constrained by a lack of money?

Our analysis suggests retired people are less constrained by money shortages than those who are not retired. For example, 77.9% of retired people said that they never or rarely had too little money for their needs, compared to only 59.7% of those not retired. Similarly, over 3 out of 5 retired people (61.4%) said that a shortage of money never or not often stopped them from doing things; this was true for only 2 out of 5 people not retired (40.9%).

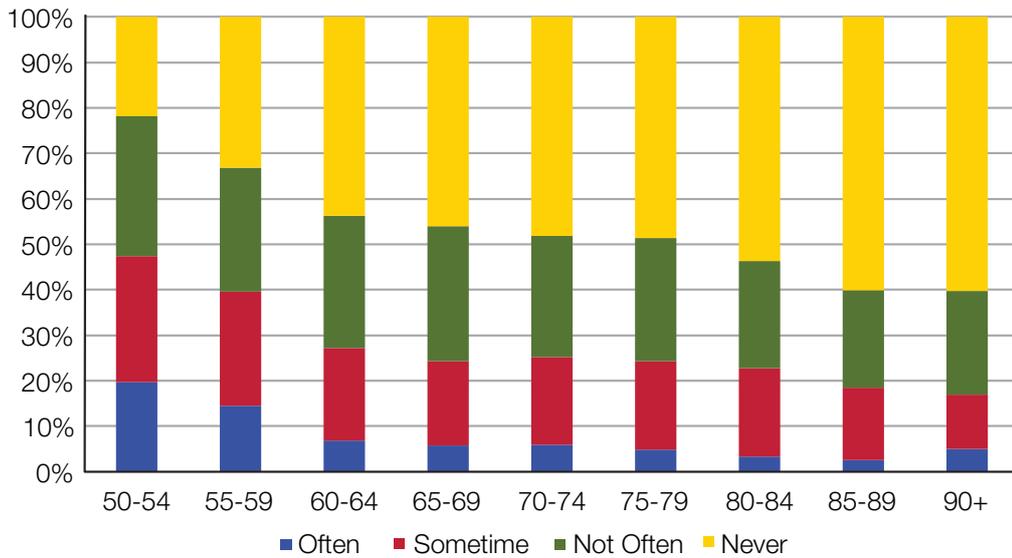
Figure 21: Reported financial difficulties for retired and not retired people (Aged 50+)



Source: ELSA Wave 6 (2012/13)

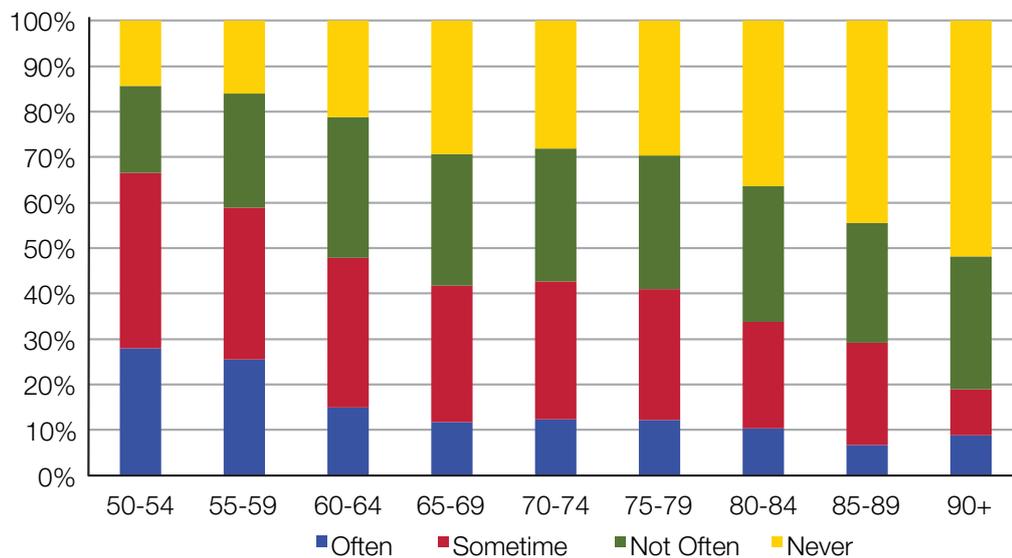
Looking at the same two questions across all of the age bands appears to suggest that as people get older they are less likely to report being constrained by a lack of money. So while some older people have identifiable concerns related to their financial wellbeing in retirement, it appears that people in retirement may actually benefit from a higher degree of financial security than those still in the workforce, and this rises with age.

Figure 22: How often do you find you have too little money to spend on your needs?



Source: ELSA Wave 6 (2012/13)

Figure 23: How often does a shortage of money stop you from doing things?



Source: ELSA Wave 6 (2012/13)

Precautionary savings due to uncertainty

If people knew exactly how long they were going to live, whether they will need long-term care, and the future price of goods and services, they would be able to devise more accurate savings plans allowing them to optimise consumption over their lifetime. However, many aspects of the future are uncertain; people may live longer than they expect, investments may generate exceptionally low (or high) returns, and prices on certain goods and services may unexpectedly rise. For this reason, prudent individuals may set aside a certain amount of wealth to avoid running out of cash in case of unexpected expenditures.⁴⁴

This type of saving is called precautionary and it is the additional saving resulting from the knowledge that the future is uncertain. Precautionary savings are a kind of “self-insurance” and therefore are likely to be reduced if the state provides higher insurance against income loss or income fluctuations.

But can precautionary motives really explain the level of savings we are seeing in the data? One potential significant cost that may lead to high levels of precautionary savings is long-term care, with the average care home without nursing costing £28,500 per annum rising to an average of £37,500 for a care home with nursing.⁴⁵

⁴⁴ See Carroll (1997); Banks et al. (2001).

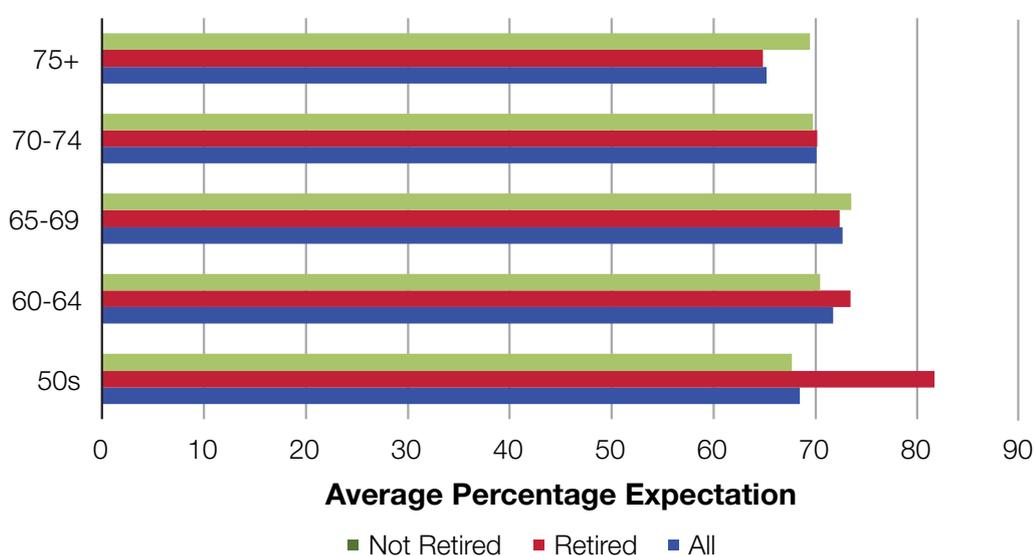
⁴⁵ For more details including regional breakdown see: <http://www.payingforcare.org/care-home-fees>.

If older households are saving upwards of £4,000 per year this could potentially go towards funding a care home, though even sustained over a prolonged period, say 10 years, this would only fund 1 person for around 1 year in an average care home with nursing. Indeed, as has been noted by others, to date both the private sector and government have achieved very little in terms of incentivising people to save for care or by providing affordable financial solutions to help fund it.⁴⁶ It seems unlikely then that the level of savings in retirement identified in this report is largely due to anticipated care costs though it cannot be entirely ruled out.

Bequest motives

Some older people may under-consume simply because they wish to leave a bequest to their children. From the ELSA data, we see that people, regardless of age group or retirement status, have a similar expectation that they will leave a bequest worth £50,000 or more. On average, people think they have a 70% chance of leaving such a bequest, which does suggest that people may limit their spending or decumulation in later life for this specific reason. Alternatively, it could suggest they recognise that their consumption habits will not exhaust their wealth, so reasonably expect to pass on their remaining assets as an inheritance.

Figure 24: Average expectation of leaving an inheritance of £50,000 or more



Source: ELSA Wave 6 (2012/13)

Recap and discussion

Our analysis of ELSA data suggests that health is getting in the way of some people doing the things they want later in retirement, though the majority still appear to be content with their lot. Meanwhile, money constraints do not appear to be a significant driver of reduced activities amongst older people - though clearly it will remain a determining factor for some. This chapter has also highlighted that bequest motives may play a part in driving reduced activity in old age and increased savings. However, it is unclear whether people are actively saving in order to provide a bequest or “accidentally” saving because they cannot consume all their wealth due to other factors. In short then, this chapter implies that some of the consumption falls highlighted earlier in this report might be due to unwanted health problems preventing people from undertaking different tasks, while for others it may be the result of changing preferences as people age, including the desire to provide a bequest for loved ones. In the next chapter, we attempt to quantify the size of all the savings made by the older population and briefly discuss their macroeconomic implications.

46 Mayhew et al. (2015).

The Macroeconomic Implications of Saving in Retirement

- One of Japan's economic problems since the 1990s has been excess savings relative to investment which has acted as a drag on economic growth.
- If older people are saving, we need to find effective ways of putting those savings to good use to help drive forward economic growth.
- We calculate total per annum savings made by those in retirement in the UK today of around £48.7bn. This equates to 2.8% of GDP.

Approach

Excess savings in retirement are not just relevant from a financial planning perspective, but will also have implications for overall output in an economy. In this section, we focus on the “decumulation phase” of people's lives and calculate aggregate savings for people who entered retirement as a proportion of GDP.

Because we do not have self-reported measures of savings, we calculate them as the difference between inflation adjusted net income and consumption. We also subtract mortgage payments though since approximately 9 in 10 retired homeowners own their home outright we expect mortgage payments to make a relatively small difference to the overall result.

Why might saving in retirement be bad for the economy?

If older people do not consume, this can ultimately help exacerbate the economic problems caused by population ageing. According to the consumption smoothing hypothesis, people who are middle aged are the big savers readying themselves for leaving work, while those of older age consume their accumulated wealth. However, we know that older people do not always consume as might be expected and this can limit economic output. Excess savings are not always a problem, assuming there are sufficient investment opportunities to put those savings to good use, but if there aren't sufficient opportunities this can spell economic trouble.

In his analysis of what went wrong in Japan, economist Paul Krugman argued that individual savings were too high relative to the economy's investment opportunities. More specifically he wrote:

“Japan, like the United States only much more so, is an aging society. Thanks to a declining birth rate and negligible immigration, it faces a steady decline in its working-age population for at least the next several decades while retirees increase. Given this prospect, the country should save heavily to make provision for the future [...] and it does. But investment opportunities in Japan are limited, so that businesses will not invest all those savings even at a zero interest rate. And as anyone who has read John Maynard Keynes can tell you, when desired savings consistently exceed willing investment, the result is a permanent recession.”⁴⁷

While the specific reasons for high savings rates in Japan have been long debated, bequest motives amongst older people are often cited. The populations of many advanced (and developing) countries are growing older while many of their older people are continuing to save in later life. Unless we a) understand how to convert these savings into investment opportunities or b) stimulate greater consumption amongst older people, it could be argued that the UK and others might experience similar economic stagnation – albeit the UK is not ageing as fast as Japan.

What is the aggregate UK level of saving for those in retirement?

To calculate total annual savings in retirement for all retirees we start with the simplifying assumption that weekly savings remain the same throughout the year, and thus annual savings will correspond to personal income minus personal consumption and mortgage repayments multiplied by 52.⁴⁸ We then create an

⁴⁷ Krugman (1998).

⁴⁸ For this calculation savings are calculated at the individual and not household level.

aggregate figure for retirees in the UK as a whole by multiplying average savings in each age group by the population within that age group.⁴⁹

Note that, in order to match savings with the ONS population estimates, we recalculate savings at the individual level.

Table 4: Savings in retirement

	Personal Weekly Savings	Annual Savings	Number of Retirees (in Thousands)	Median Savings (in Billion)
Aged 65 but under 70	£79.7	£4,142.0	2,685.9	£11.1
Aged 70 but under 75	£88.1	£4,582.1	2,250.7	£10.3
Aged 75 but under 80	£100.9	£5,247.4	1,953.0	£10.2
Aged 80 and over	£112.9	£5,872.5	2,890.4	£17.0
Total	£74.1	£3,855.7	9,780.0	£48.7

Source: author's calculations from Living Costs and Food Survey (2003-2013). Data are weighted using annual weights. Note that for these estimates the sample has been restricted to retired heads of household.

The results reported in Table 3 are remarkable since, with an estimated number of retirees equal to 9.8 million people, cumulative savings approximate to £48.7 billion on a per annum basis. Assuming other things were to remain equal, an increase in consumption raises GDP by the same amount. So if half of these savings, i.e. £24.3 billion, were spent on consumption, UK GDP would be 1.4% larger.

Recap and discussion

In Krugman's analysis, conducted in the late 1990s, he argued that Japan must undertake measures to stoke up inflation in order to reduce the incentives to save and increase overall spending and borrowing. Of course, over the last few decades, Japan has been unable – barring a few exceptional moments in time – to generate inflation and has experienced at least one “lost decade”. Now some think that other advanced economies face a similar threat. Central banks have set interest rates to near zero in the UK, the Eurozone and the United States since the financial crisis and yet inflation continues to remain below target. Officials may need to consider unconventional policy measures if we are to avoid the fate of Japan and ensure savings across the life-course are put to good productive use.

49 ONS population estimates for the UK in 2012.

Conclusions and Recommendations

“[The] elderly, particularly the oldest old, may find themselves physically constrained in their consumption possibilities. At very old ages, they may even consume less than their annuity income and end up with forced savings which they had otherwise consumed if they were not constrained in their consumption possibilities”.

Axel Borsch-Supan - (The German Case, 1992)⁵⁰

This report finds strong evidence that people substantially reduce their consumption in later years and this results in significant savings in retirement even for low income groups. Indeed, the pattern appears to be so strong that it might be termed the “default consumption path”. While for some, the declines in consumption may be a conscious choice as the value they put on certain leisure and other activities falls with age, our analysis has shown that for others, this path is forced upon them predominantly as a result of health issues and, to a lesser extent, financial constraints and bequest motives. By age 90+, the most common daily activities are watching television and spending time at home alone. For many, this means continuing to accumulate savings over time.

What does all this mean in the context of freedom and choice?

The “pension freedoms” introduced in April 2015 have already stimulated much debate about what sorts of financial products are needed in order to deliver an income in retirement. On the one hand, some argue that the reforms spell disaster because people will blow their pension savings too early and run out of money in later life, while others argue that the new flexibilities will better allow people to match incomes in retirement to their changing spending needs. But as yet, there has been little empirical evidence conducted on what these changing spending needs might look like.

Many have speculated that in the new world, financial products that provide a U shaped income in retirement are likely to be most appropriate – first to provide a high level of income to enable retirees to undertake leisure activities, then a low level of income during the middle part of retirement, before finally a high level of income as care needs arise in later life. But this report leads to a somewhat different conclusion.

...the need for initial flexibility but with security of income in later life

The reality, on the basis of evidence collected for this report, is that for many, retiring does not lead to a sudden spending splurge and that, from around the age of 75, there is a continuous decline in consumption. Given evidence of continued savings in later life, this suggests that individuals could actually have spent greater amounts earlier on in their retirement, and therefore benefitted from improved quality of life without running out of money to pay for essential items later on. If this is the case, then financial products that provide high income initially but guarantee a base level of income in later life, when consumption on non-essential items falls, might be most suitable. Income would therefore follow the typical retirement consumption pattern identified in this report, allowing for greater spending in initial years but ensuring people can still afford regular bills in later life.

Now such an approach is likely to be controversial, making the assumption that people in the future will be happy to lead a somewhat limited and inactive later life when this may not be the case. Indeed, our research has shown that a significant proportion of older people would like to do more if they could but health gets in the way. Unfortunately however, unless we make substantial gains in supporting active ageing as well as create the products and services that meet the unmet demands of older people with health conditions, the default retirement consumption path highlighted in this report is likely to continue. It may therefore make sense for individuals to invest in financial products that at least maximise their happiness in the initial phases of retirement while ensuring they don't run out of money before the end.

...how to combine flexibility with security

While it may make sense for individuals to drawdown their private pension wealth in the initial phase of retirement, secure guaranteed income should still play an important role in meeting essential consumption

50 Borsch-Supan (1992).

needs in later life. In this regard, a recent paper demonstrated how some degree of variable drawdown can help meet the greater consumption needs early in retirement while annuities become better value the longer individuals wait before purchasing them.⁵¹ One potential strategy for those with defined contribution pensions, may therefore be to drawdown on the pension early in retirement before buying an annuity later on when consumption needs change and the annuity becomes better value for money.

In NEST's recent publication outlining a retirement income blueprint for its members, it explores the possibility of its members being able to make small payments from a default drawdown fund to gradually "buy" later life protected income. The payments would remain refundable up to a certain age, at which point the money would be locked in to ensure a secure income is available for the remainder of the member's life. This way, NEST's default decumulation approach would combine initial flexibility with protected income in later life.

While NEST rightly believes that protecting members' incomes from long term erosion by inflation "should be a critical aspiration", in some cases – particularly over shorter horizons, it notes "a higher starting income that declines in real terms at a later stage may be better for members than an income that starts lower and remains flat in real terms". This is because "consumption generally declines as people enter very old age, and the basket of goods that represents personal consumption evolves as consumer discretionary spending is gradually replaced by things like healthcare".⁵²

NEST's publication sets out a convincing approach for how it could combine initial flexibility of income in retirement with security in later life for its members, as well as the possibility of a nuanced approach to delivering secure income that meets people's changing consumption needs at very old ages. Its emerging approach to decumulation is therefore broadly consistent with the findings of this report regarding typical consumption patterns in retirement. However, for those who are retiring too soon to be defaulted into such an arrangement, or who are unable to find an alternative private sector equivalent, some form of income drawdown plan followed by purchasing an annuity in later life may make sense in the context of this report's findings. However, as we stress below, individually tailored solutions, informed by financial guidance and advice, will lead to the best outcomes.

...rules of thumb should be built into the financial guidance process

Those on the verge of retirement are a diverse bunch. There are currently some 850,000 individuals who are on the verge of retirement and who have a high proportion of their wealth tied up in defined contribution pots. For these individuals, using their DC pots for a combination of flexibility and security will be essential.⁵³ However, many of those retiring today only have moderate levels of DC wealth. For these individuals a tailored approach to using their DC pots might reasonably emphasise flexibility over security, especially if they have other assets to fall back on such as a final salary pension. And even those with very small pots and no other savings might reasonably decide to use up all their DC wealth in the initial stages of retirement when their consumption needs are greater, before falling back on Pensioner Benefits to fund essential every day expenditure in later life. In this context, financial guidance should provide simple rules of thumb to help different consumer segments make the most of their pension savings.⁵⁴

...rules of thumb should be supplemented by a mid-retirement financial health check and advice

A retirement strategy that emphasises higher income at the beginning of retirement but with security towards the end may require a significant degree of financial capability amongst the older population to optimise and tweak the strategy over the course of retirement. But we know that financial capability is low amongst the general population.

Individuals therefore need significant support with financial planning not just at the point of retirement, but throughout. Indeed, we would argue there is a very strong case for ensuring that people are actively reengaged in the retirement planning process in their early 70s when they are typically on the verge of reducing their consumption. It is perhaps at this point that security rather than flexibility becomes of increasingly important.

51 Mayhew et al. (2015).

52 NEST (2015).

53 Brancati and Franklin (2015).

54 See Mayhew et al (2015) for initial views on what these rules of thumb might look like.

The government has already overseen the creation of financial guidance through Pension Wise, and this should be expanded upon to help facilitate reengagement in financial planning mid-way through retirement. A full financial health check for those in their early to mid-70s run by Pension Wise, the Money Advice Service or another independent body would be a good start.

But a one-off financial health check will not be sufficient. Bringing financial advice to the mass market - whether face to face, over the phone or on the internet - is long overdue. In this regard, the Financial Advice Market Review must act to facilitate real change in this area to ensure financial advice becomes the preserve of the many rather than the few.

Note of caution...the potential for increased underconsumption in retirement

In the future it looks highly likely that defined contribution pensions will have an increasingly important role to play in funding retirement. Tomorrow's pensioners will not be able to supplement their retirement incomes with final salary pensions and they are less likely to be homeowners. For this reason, making appropriate choices regarding the DC pension pot – either through active choice or by default – will become increasingly important.

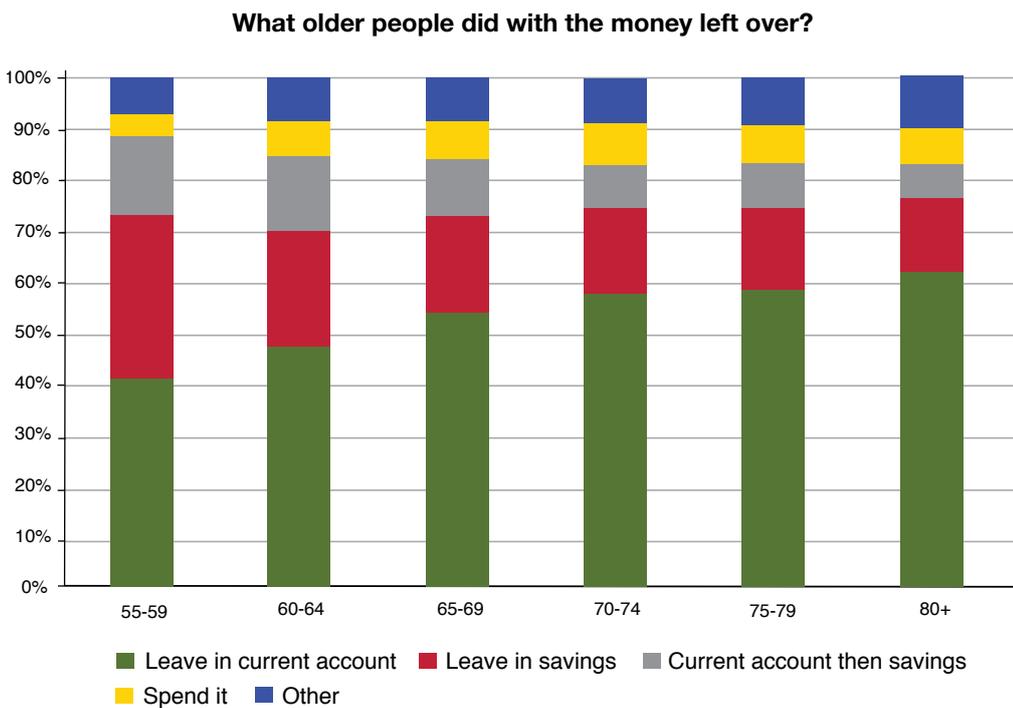
While the data in this report imply that drawdown in the initial period of retirement might make sense, there are clear risks attached to this strategy. In failing to annuitise at the point of retirement, individuals might end up consuming even less of their income than they do today because they have no certainty of income in later life. As a result, rather than raising people's quality of life, increased flexibility could actually erode it. Evidence from Australia – where similar pension freedoms are in place – indicates that few individuals take out longevity insurance (i.e. an annuity) and this partly explains why some people are overly cautious in their retirement spending habits and underconsume.⁵⁵ In this regard, striking the right balance between flexibility and security in any decumulation strategy will be of critical importance so that people are confident they will not run out of money before the end of their lives. But, crucially, such a strategy relies on people not simply pulling all their money out from their pension pot and putting it in a low interest earning savings account at the earliest opportunity.

What's happening to all those savings made in retirement?

A key finding in this report is that older people save considerable amounts of money in old age. But what happens to all that money? Based on analysis of the Wealth and Assets Survey, it turns out that the majority of money left over for people aged over 65 is simply left in their current accounts (see Figure 25). Indeed, over 60% of people aged 80+ left their remaining money in their current account. This implies that there could be a significant number of older people who save in later life but earn very little interest as their money is just left in a low interest current account. The financial services industry should consider ways to support these individuals to earn greater returns on the savings they make during retirement.

55 Keohane et al. (2015).

Figure 25: Use of money in later life



Source: ONS Wealth and Assets Survey (2012) and author's calculations, data weighted using cross-sectional weights. Note: Other includes: purse for the next week, cash at home, give it to someone else, give it away, something else and depends on the amount

The long run: harnessing the economic potential of savings

This report has discussed the potential economic challenges posed by excess savings in old age. In the case of Japan, those savings were not adequately harnessed for investment purposes, helping to contribute to more than a lost decade of stagnant economic growth. The UK is highly dependent on consumption driven growth – as are all developed economies – but, since the financial crisis, consumption has been the only game in town, with business investment continuing to disappoint. As the UK's population continues to age, consumption driven growth is likely to fall as savings rise. Those in their 40s and 50s will be saving, while, if trends continue, older people are also likely to save particularly in later life. We must find ways as an economy to put these savings to good use, investing them in services and industries that will help counteract falling consumption growth. The example from Japan is clear that actions taken by the central bank alone will not be enough to deliver sufficient investment opportunities and we must get ahead of the game in order to prevent long-run economic decline. The UK is not ageing as fast as Japan or some other developed countries, but the demographic winds of change are in motion and long term planning is needed to turn a potential economic threat into an opportunity.

Final word

In awarding the Nobel Prize for Economics to Angus Deaton for his analysis of consumption, poverty, and welfare,⁵⁶ the Nobel committee said that “to design economic policy that promotes welfare and reduces poverty, we must first understand individual consumption choices”. In this context, this report is merely the tip of a very big iceberg. We must undertake increasingly detailed and specific analysis of the retirement consumption puzzle to truly understand it, and from there to develop tailored public policy solutions.

56 The Royal Swedish Academy of Sciences (2015).

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Data Acknowledgements

Living Costs and Food Survey

The empirical analyses on household consumption are carried out using the Living Costs and Food Survey (LCF), previously Expenditure and Food Survey (EFS).

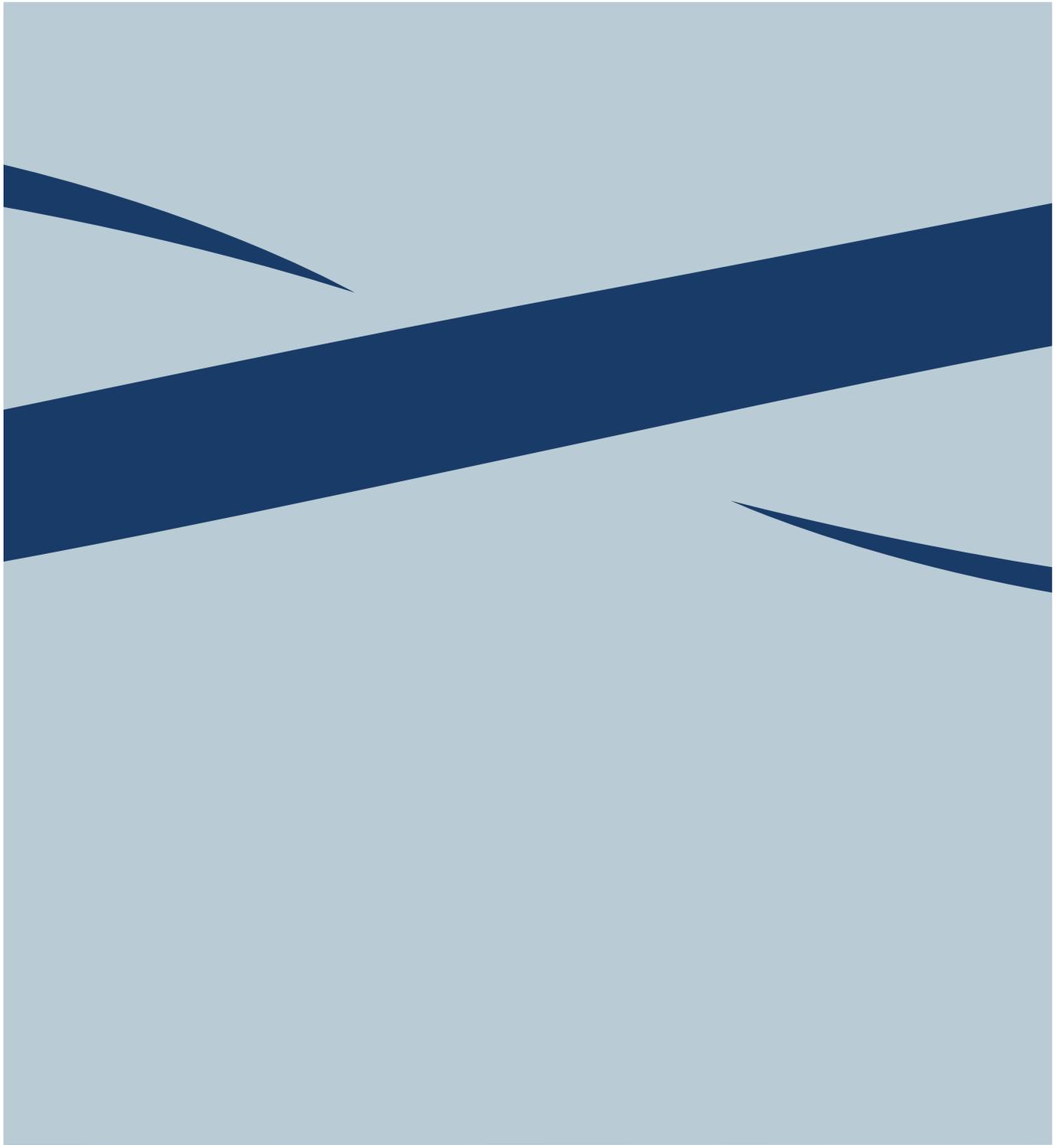
The LCF is a repeated cross-sectional survey containing the highest quality measurement of household consumption and its components. The LCF is managed by the Office for National Statistics (ONS) that also has financial responsibility, while the Department for Environment Food and Rural Affairs (DEFRA) sponsors the food data. The LCF uses the expenditure classification system COICOP (Classification of Individual Consumption by Purpose), published by the United Nations Statistics Division.

One of the survey's primary functions is to determine the 'basket of goods' that make up the Consumer Price Index. It is undertaken continuously throughout the year to account for seasonal effects and the data are collected via a detailed face-to-face household interview for regular expenditure and larger, infrequent items of expenditure, and a diary of daily expenditure that each household member is asked to complete for 2 weeks. The data were made available through the UK Data Archive (UKDA)

The English Longitudinal Study of Ageing

This report uses data from Waves 5 and 6 of the English Longitudinal Study of Ageing (ELSA). ELSA was developed by a team of researchers based at the NatCen Social Research, University College London and the Institute for Fiscal Studies. The data were collected by NatCen Social Research. Funding is provided by the National Institute of Aging in the United States, and a consortium of UK government departments co-ordinated by the Office for National Statistics.

The LCFS and ELSA data were made available through the UK Data Archive (UKDA). The developers and funders of ELSA and the LCFS as well as the Archive do not bear any responsibility for the analyses or interpretations presented here.



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