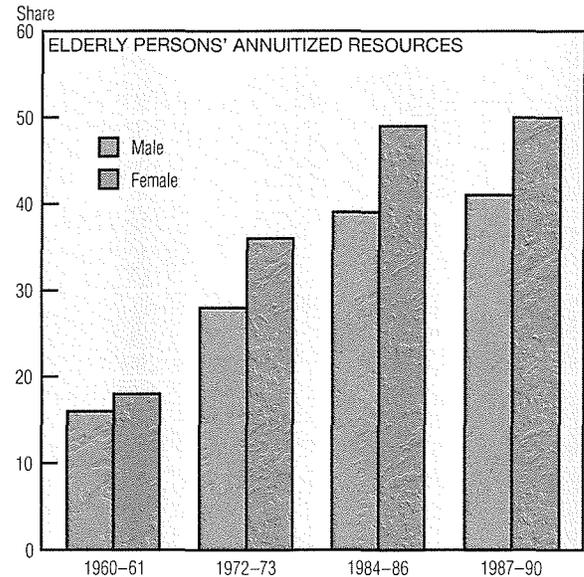
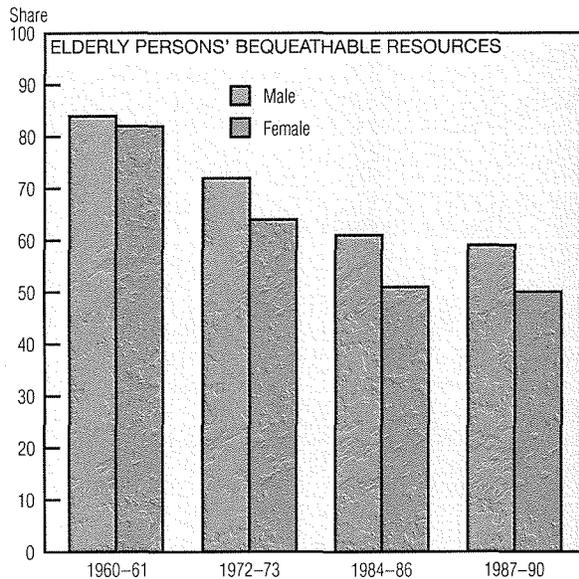
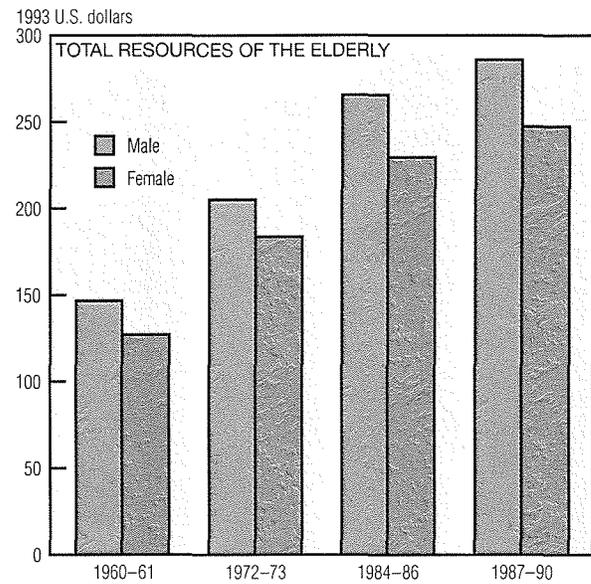
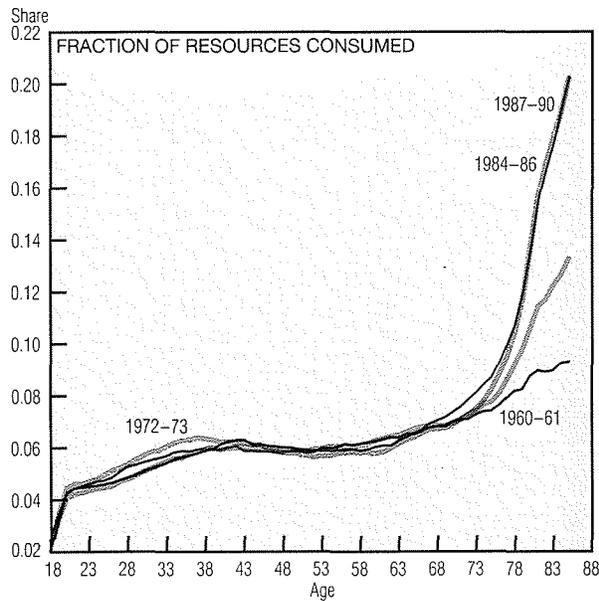


Resource Annuitization and Consumption



NOTE: Resources are defined as net worth plus the present value of labor earnings, pension benefits, and transfer receipts, minus the present value of taxes.
SOURCE: Jagadeesh Gokhale, Laurence J. Kotlikoff, and John Sabelhaus, "Understanding the Postwar Decline in U.S. Saving: A Cohort Analysis," *Brookings Papers on Economic Activity*, no.1 (1996), pp. 315-407.

From the early 1960s to the late 1980s, the fraction of resources consumed annually has remained more or less steady for all U.S. age groups except retirees, for whom this fraction increased dramatically. What might be the underlying reason for such impressive growth in older generations' "propensity to consume"?

By the late 1980s, the resources of the elderly (those aged 65-89) were almost double what they had been in the early 1960s. Moreover, the composition of these resources had changed significantly. At the beginning of this period, almost

four-fifths of older Americans' resources were made up of bequeathable assets—bank deposits, CDs, stocks, bonds, and so forth; by its end, this share had fallen to just over half. The declining share of bequeathable resources was mirrored by a rising share of resources in annuitized form—monthly benefit payments from Social Security, private pensions, and (for those in poor health) regular benefits from Medicare and Medicaid.

Two aspects of this change in resource composition may explain the higher consumption propensities of

the elderly during the late 1980s. First, Medicare and Medicaid benefits are paid in kind and therefore must be consumed. Second, annuitized benefits provide insurance against uncertainty about one's longevity. Resources in bequeathable form encourage caution in the speed of consumption because people fear running out of money in old age. On the other hand, the annuitization of resources guarantees economic security no matter how long one lives, thereby providing an incentive to consume at a faster rate.