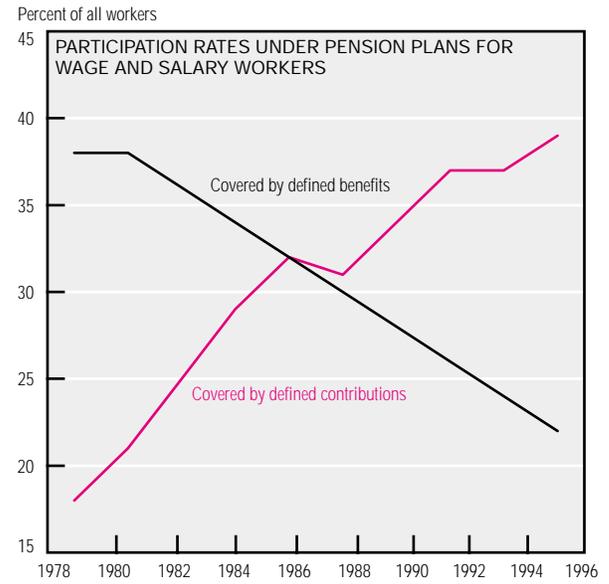
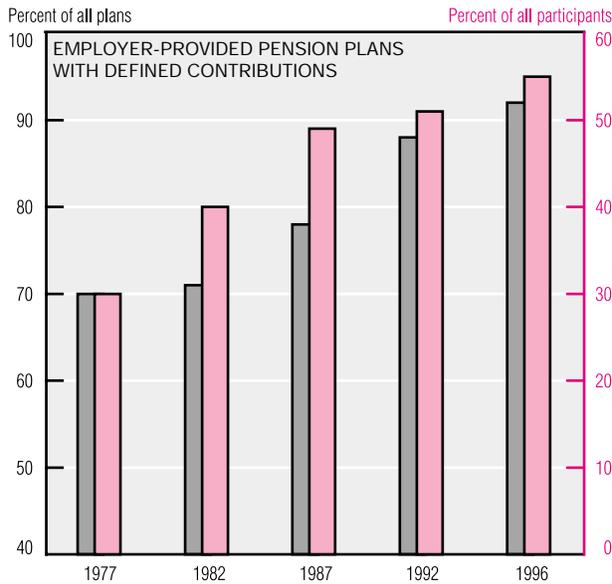
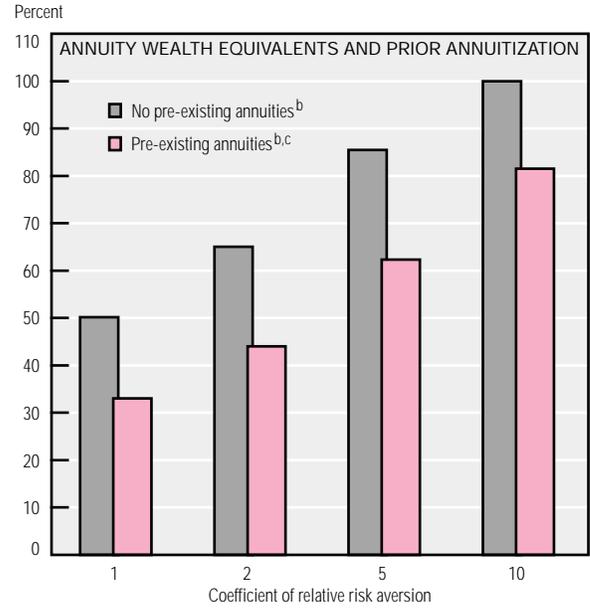
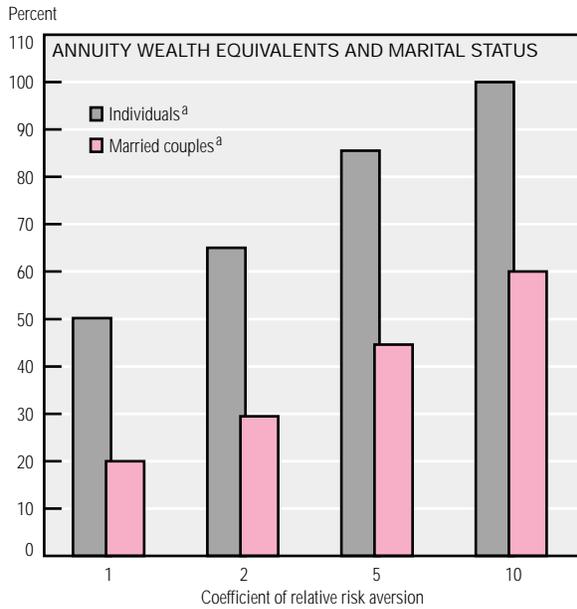


Annuities



- a. No pre-existing annuities.
- b. Case of single individuals.
- c. Social Security wealth equals 50% of total wealth.

SOURCES: Jeffrey Brown, Olivia Mitchell, and James Poterba, "The Role of Real Annuities and Indexed Bonds in an Individual Accounts Retirement Program," National Bureau of Economic Research, Working Paper no. 7005 (1999); and Jeffrey Brown and James Poterba, "Joint Annuities and Annuity Demand by Married Couples," *Journal of Risk and Insurance* (2000, forthcoming).

Retirees who use their savings to self-insure their consumption after retirement face two major risks: If they consume at too rapid a rate, they may spend their last years in extreme poverty. If they consume too slowly, they may leave sizeable assets behind when they die. But if annuities are available, retirees can avoid both risks completely. At the same time, they can maximize their annual consumption because annuity returns exceed returns on safe assets by a mortality premium, which is always positive.

One measure of the value of access to actuarially fair annuity markets is the *annuity wealth equivalent*.

It calculates the percentage increase in wealth at retirement that a household without access to annuities would need to make it just as well off as one with the same initial wealth level but with access to annuity markets. How greatly annuities can improve retirees' welfare (relative to self-insuring) is positively related to how intensely retirees dislike the risks of spending too fast or too slowly. Calculations for moderate levels of risk aversion show that welfare gains could be substantial—more than 80% for singles and nearly 45% for married couples. Most retirees would not run out of resources completely before death

because Social Security already annuitizes a sizeable fraction of their wealth. Hence, percentage gains in welfare would be lower from annuitizing all non-Social Security wealth.

Despite potential benefits, individuals may choose not to annuitize their wealth because of high loads on individually purchased annuities or personal preferences, such as a wish to bequeath. Also, the trend toward defined-contribution retirement plans rather than defined-benefit plans may have reduced retirees' annuitization rates because most defined-contribution plans do not offer options to buy annuities at retirement.