Time for a Big Shift

We work and save for decades. And then what? A behavioral finance expert writes about aging, providing for future generations, and the tough transition that many face.

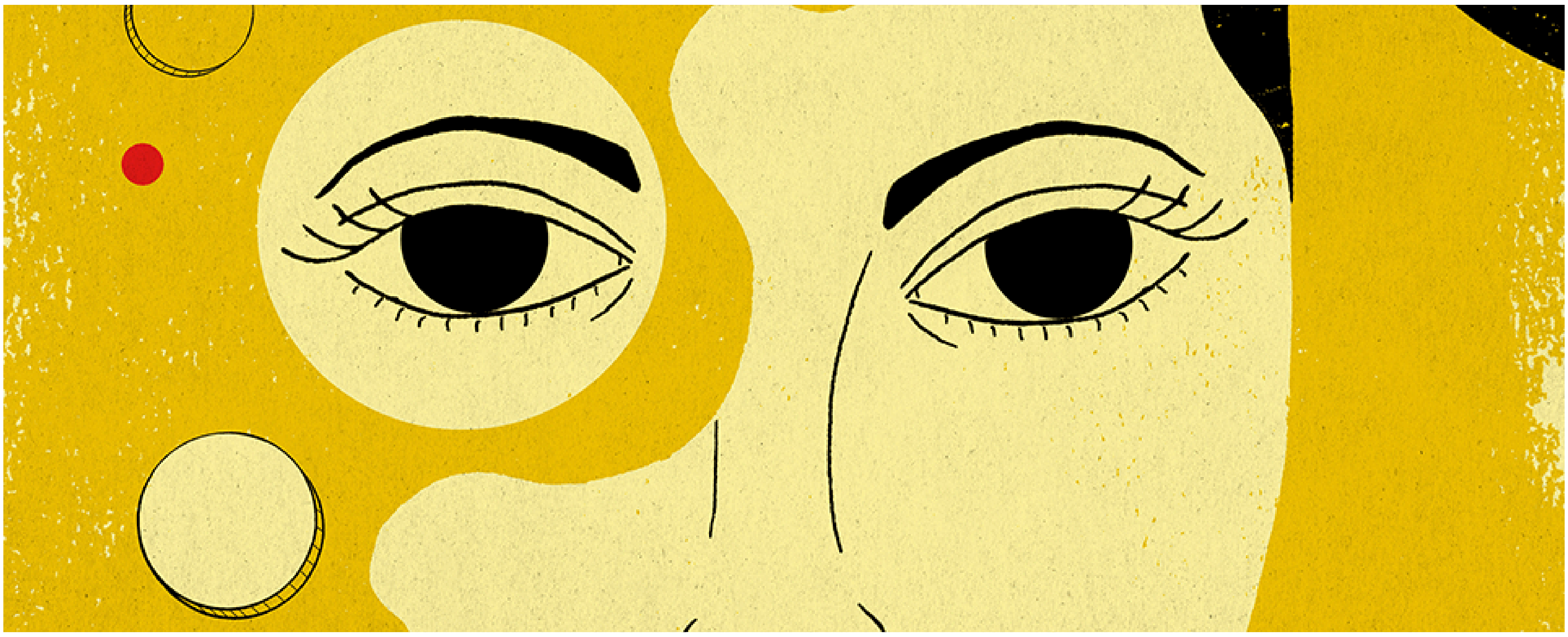

Illustration by Hanna Barczyk

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An elderly couple moving to an assisted living apartment call their son in another state for help in moving their belongings. A widow in her 90s finds it difficult to clean her home, yet refuses to hire help. These people are not wealthy, but neither are they poor. Each has more than enough to pay a moving company or cleaning crew, without risk of running out of money before running out of life. Yet they resist, insisting that they cannot afford these services. Why do people behave this way?

I was intrigued by that question, especially given that at the Leavey School of Business I research and teach behavioral finance—a field that combines finance and human behavior. I wanted to know what we could learn about how people change—or fail to change—attitudes about saving and spending as they go from work to retirement. So I set out to answer them in my latest book, *Finance for Normal People*, and in recent presentations to financial advisors and in an article for the *Wall Street Journal*. Responses have been fascinating. "I've been a dedicated saver and investor for 40 years, always practicing self-denial to the point that it's extremely difficult to spend money," wrote one reader. "I get uptight about small purchases that are insignificant. The difficulty is changing a mindset that has gripped my thinking for four decades."

To bring readers of this magazine into the conversation, here are some basic points I put forward in the book to answer that first question: *Why do people behave this way?* And here are stories from people who agree—or push back.

HARD TO GRASP

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

Pensions promote financial well-being. Those lucky to have them typically do not need to save much for retirement and do not fear running out of money. But fewer have pensions these days, and more have retirement savings in IRA and 401(k) accounts. We bear the task of saving enough during our working years—and spending the right amount in retirement. These tasks are difficult because spending needs and temptations abound during working years, and fear of running out of money haunts us in retirement.

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

OUR MENTAL TOOLBOX

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

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

SELF-CONTROL HELPS

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

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

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

EXCESSIVE SELF-CONTROL

Self-control can be *excessive*. Indeed, excessive self-control is as prevalent as *insufficient* self-control. Excessive self-control is evident in the tendency to spend less today than is ideal, driving tightwads to extremes beyond frugality. The prospect of spending money inflicts emotional pain on tightwads even when it might be in their interest to spend. The interplay between emotion and cognition is evident in functional magnetic resonance imaging of people who see a product followed by its price and then are asked to decide whether to buy it or not. Seeing the price caused greater activation in the brain's insula among people who decided not to buy the product than among people who decided to buy. (The insula is the region associated with painful sensations such as social exclusion and disgusting odors.)

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

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

DYING SOONER THAN WE HOPE

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

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

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

SPEND HERE NOW

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

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

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

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

BETTER WARM THAN COLD

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

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

One last story and lesson: “My husband was reared by extremely thrifty parents who survived the Great Depression and WWII, and through hard work and frugality bordering on stinginess (all Christmas gifts came from the Salvation Army) they accumulated a very comfortable nest egg. They passed on to him their fiscal philosophies and my husband absorbed them like a sponge. My husband handled our finances. Once he died and I took over the finances, I was amazed at how much money we had. I shall have to work very hard to spend all of it, but I plan to give it my best effort. In the two and a half years since my husband died, I have been to Africa and made three trips to Europe. I have already booked trips to see lowland gorillas in Rwanda and Uganda, snow monkeys in Japan, penguins in Antarctica, and ride a horse across the Mongolian steppes. These trips were booked after my doctor told me that based on her patients, 80 is the age at which people lose their energy and enthusiasm for traveling. I am attempting to get in as many trips as I can before hitting that mile marker. I have also made many donations to local charities and plan to set up a trust fund for a friend’s grandchild who has Down syndrome and would otherwise become a ward of the state when his hand-to-mouth existence parents die. My husband never reaped any benefits from his saving habits and only received three months of Social Security before dying. May others escape his fate.”

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