"Age of Decision: Pension Savings Withdrawal and Consumption and Debt Response"

Prof. Sumit Agarwal
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National University of Singapore

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Abstract

This paper uses a unique panel of consumer financial transactions to examine how aging consumers respond to the option to cash out retirement savings. To obtain causal identification, we exploit an administrative regulation in Singapore that allows individuals to cash out a fraction of their pension savings at age 55. We find a large and highly significant increase in bank account balances when an individual turns 55, suggesting that the average consumer in our sample withdraws a large portion of their eligible retirement savings. In line with the predictions from the life-cycle/permanent-income hypothesis, we find modest increases (about 9% of the increase in account balance) in cumulative total spending twelve months later. This increase is driven largely by an increase in debit card spending and is concentrated among low-liquidity consumers. Consumers also use the increase in disposable income to pay down their credit card debt. We do not find any evidence that the average consumer responds by excessively increasing present consumption at the expense of future financial security. Nevertheless, consumers leave a sizeable portion of their withdrawn savings in low-interest accruing bank accounts for at least a year after withdrawal. We provide some suggestive evidence that consumer demographics, especially those related to financial literacy and sophistication appear to matter for consumers’ withdrawal decisions.