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The impact of retirement on household consumption in Japan

Melvin Stephens Jr. ^a, Takashi Unayama ^{b,*}

^a Department of Economics, University of Michigan, 611 Tappan St., 341 Lorch Hall, Ann Arbor, MI 48109-1220, United States

^b Graduate School of Economics, Kobe University, Nada-ku Rokko-dai 2-1, Kobe, Japan

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ABSTRACT

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Using monthly data from the Japanese Family Income and Expenditure Survey, we examine the impact of retirement on household consumption. We find little evidence of an immediate change in consumption at retirement, on average, in Japan. However, we find a decrease in consumption at retirement for low income households that is concentrated in food and work-related consumption. The availability of substantial retirement bonuses to a large share of Japanese retirees may help smooth consumption at retirement. We find that those households that are more likely to receive such bonuses experience a short-run consumption *increase* at retirement. However, among households that are less likely to receive a retirement bonus, we find that consumption decreases at retirement. *J. Japanese Int. Economies* **26** (1) (2012) 62–83. Department of Economics, University of Michigan, 611 Tappan St., 341 Lorch Hall, Ann Arbor, MI 48109-1220, United States; Graduate School of Economics, Kobe University, Nada-ku Rokko-dai 2-1, Kobe, Japan.

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1. Introduction

Driven in part by the aging of populations across the globe, there is widespread concern regarding the ability of households to adequately plan and save for retirement. A lack of planning for retirement as well as a lack of knowledge regarding one's private pension benefits has been found in studies of households in the US (Gustman and Steinmeier, 1999; Lusardi, 2003; Chan and Stevens, 2008). The

* Corresponding author.

E-mail addresses: mstep@cmu.edu (M. Stephens Jr.), unayama@person.kobe-u.ac.jp (T. Unayama).

empirical evidence as to whether households are adequately saving for retirement yields conflicting findings. Studies that use simulation methods to compare optimal savings levels to those found in the actual US population indicate that savings are indeed adequate (Engen et al., 1999; Scholz et al., 2006). Studies that examine consumption changes at retirement find evidence that consumption systematically falls at retirement which, based on the Life-Cycle/Permanent Income Hypothesis (LCPIH), may indicate that households do not adequately save in advance of an expected reduction in income at retirement. This result has been found in the UK (Banks et al., 1998; Smith, 2006), the US (Bernheim et al., 2001; Fisher et al., 2008; Haider and Stephens, 2007), Italy (Miniaci et al., 2003; Battistin et al., 2009), and Germany (Schwerdt, 2005).

More recently, however, there is evidence of heterogeneity in the consumption response at retirement. For example, Smith (2006) only finds a response for those individuals who involuntarily retired while Battistin et al. (2009) find no effect once they control for changes in household composition at retirement. In addition, Aguiar and Hurst (2005), Hurd and Rohwedder (2003) and Hurd and Rohwedder (2008) provide evidence which suggests modifying the LCPIH to incorporate household production may help explain the drop in consumption at retirement. In a thorough review of this literature, Hurst (2008) notes that there is substantial heterogeneity in spending changes at retirement across consumption categories and across households. In this sense, more evidence is needed.

In this paper we investigate whether consumption falls at retirement in Japan. Specific features of the Japanese retirement system provide an interesting setting for examining retirement consumption changes. Many private employers in Japan institute a feature known as “Teinen” retirement, now typically at age 60, when employees must either leave their firm or are transferred to significantly lower paying jobs elsewhere within the company. However, many workers receive rather sizable bonuses upon reaching their Teinen retirement age which, depending upon the worker’s sector of employment, can average more than four times their annual income. In addition, retiring private sector workers were eligible to receive unemployment benefits, in addition to their public pension benefits, for up to one year following retirement prior to 1998. These additional sources of income can help households offset the large drop in monthly income at retirement and may lead to dramatically different retirement consumption changes in Japan relative to other developed countries.

We use data from the Japanese Family Income and Expenditure Survey (JFIES), which is a large monthly household panel survey that collects information on consumption and income for six consecutive months and thereby enables us to analyze within-household consumption changes at the exact month of retirement. As Blau (2008) and Hurd and Rohwedder (2008) emphasize, using a true panel dataset is much more advantageous when identifying the impact of retirement on consumption, whereas prior studies typically use synthetic cohorts or cross-sectional surveys (e.g. Banks et al., 1998; Hurd and Rohwedder, 2003; Fisher et al., 2008; Wakabayashi, 2008).

We find little evidence that consumption immediately decreases at retirement, on average, in Japan although monthly income decreases sharply when households exit the labor force. We also find that consumption falls when workers exit the labor force due to unemployment which suggests that data quality issues do not preclude us from finding a response at retirement. Our finding that consumption does not fall at retirement in Japan is consistent with the results of Wakabayashi (2008) who finds, using data from a cross-sectional survey, that *expected* consumption changes at retirement can be explained by life-cycle factors including expected changes in household composition at retirement. Since Japan has a relatively high personal savings rate, we address the possibility that these results are driven primarily by asset accumulation by separately estimating the model for above and below median income households. We find that consumption decreases at retirement for the below median income households although this reduction is limited to food and work-related consumption. This finding is consistent with results in the prior literature surveyed in Hurst (2008).

An important institutional difference between Japan and most other countries is the generous bonuses distributed by firms at Teinen retirement. Battistin et al. (2009) note that Italian households also receive large retirement bonuses and, similar to our full sample results for Japan, find that the consumption of these households does not fall at retirement (after controlling for contemporaneous family size changes). We present evidence that the receipt and magnitude of bonuses in Japan depends upon one’s sector of employment. Public sector and large private firm employees are more likely to receive these bonuses and, conditional upon receipt, collect larger bonuses. We find that workers in

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