Raimond Maurer, Goethe University & SAFE
Olivia S. Mitchell, University of Pennsylvania & SAFE

Incentivizing Older People to Delay Social Security Claiming

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Olivia S. Mitchell, University of Pennsylvania & SAFE

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Given rising life expectations around the world, it seems that old-age pension benefits will need to be cut and pension contributions boosted in many nations.
Yet our research on old-age system reforms does not require raising mandatory retirement ages or contributions.
Instead, we offer ways to enhance incentives for people to work longer and delay retirement.

There are good reasons to incentivize older people to work longer and delay retirement. These include rising longevity, the shrinking workforce, and emerging evidence indicating that working longer can be associated with better mental and physical health for many people. Nevertheless, old age Social Security systems in many nations find that people tend to claim benefits early, usually leading to reduced benefits.

In the United States, for instance, a majority of Americans claim their Social Security benefits at the earlier feasible age, namely 62, even though their monthly benefits would be 75% higher if they waited until age 70. To test whether this is the result of people underweighting the economic value of higher lifetime benefit streams, we examine whether people would claim later and work longer if they were rewarded with a lump sum instead of a higher lifetime benefit stream for deferring.

Two arguments have been offered to explain early claiming. One is that workers claim early to avoid potentially "forfeiting" their deferred benefits should they die too soon (Brown et al., 2016). A second explanation is that many people underweight the economic value of lifetime benefit streams (Brown et al., 2017). This latter rationale motivates the present study.

Experimental Module in the Health and Retirement Study

We developed and fielded an experimental module in the 2014 U.S. Health and Retirement Study (HRS) to measure older persons' willingness to voluntarily defer claiming of Social Security benefits, and potentially to work longer, as a function of incentives to delay claiming their benefits. We conducted the survey on a nationally representative sample of people age 50 to 70 for whom claiming decisions are of the utmost financial importance, and we investigated whether and which individuals might be willing to delay claiming benefits in exchange for different compensation options.

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* SAFE policy papers represent the authors'personal opinions and do not necessarily reflect the views of the Research Center SAFE or its staff.

[1] This research brief reports on our study "Older People's Willingness to Delay Claiming Social Security" by Raimond Maurer and Olivia S. Mitchell, SAFE Working Paper No. 170, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2945967.

The module included two sets of questions. In both settings, HRS respondents were asked whether they would be willing to defer claiming their Social Security retirement benefits beyond the age of 62 to age 66, in exchange for *either* a higher annuity benefit stream (status quo scenario), *or* for the same (not-increased) monthly payment plus a lump sum equivalent to the benefit increment due to delayed claiming.

In the first setting, respondents could choose between these two options without having to work longer, and assuming that they had enough private savings to live on without working from age 62 to 66. We first showed each respondent a scenario as to whether he or she would prefer to claim USD 1,000 in monthly benefits from age 62, or wait until age 66 to claim USD 1,330 in monthly payments for life. Next, we asked the same respondent to indicate whether he or she would be willing to delay claiming for a monthly benefit of USD 1,330 or a monthly benefit of USD 1,000 plus a lump sum of USD 60,000, which is the actuarially fair equivalent to the monthly benefit in the first scenario. Respondents who chose the second option were routed to a subsequent question that asked them to specify the smallest lump sum they would take additionally to the monthly paid USD 1,000. Respondents who selected the first option were asked what how much they would need as a larger lump sum to select option 2.

In the second setting, we explored leisure preferences by asking whether respondents would still delay claiming if they had to work at least half time in each of the intervening years. Accordingly, the goals of the experiment were to measure respondent willingness to trade a decrease in his or her annuity benefit stream for a delayed lump sum (i) if no extra work were required in the interim, or (ii) if at least half-time work were required.

Many Favored the Lump Sum Alternative Over the Status Quo

About half of the survey respondents indicated that they would defer claiming under the U.S. status quo benefit rules, and only slightly fewer, 46%, if partial work were required. By contrast, if they could access a lump sum worth USD 60,000 at the delayed claiming date, 20%more respondents said they would delay claiming (in the no-work condition, 10%more in the part-time work setting). The average amount needed to induce delayed claiming when no work was required was about USD 60,400, while it was USD 66,700 when part-time work was required. This implies that the utility value of the leisure foregone from part-time work until the delayed claiming age of 66 in the second condition is only about USD 6,300 on average, a relatively low amount compared to the average household income of USD 67,000.

When the lump sum was available in the no-work condition, the percentage of men willing to delay claiming rose by far more (49%) than the percentage of women (36%), resulting in more or less equal fractions (69.0% vs. 71.3%) willing to delay claiming. Comparing people by educational status, we found that less-educated people were more willing to delay claiming for a lump sum (50.3%) than was the case for the better educated (34.2%), without the work requirement. If additional work was required, the less-educated group did not respond much, while 22% more of the better-educated group said they would delay claiming for the lump sum compared to the status quo. Perhaps unsurprisingly, those self-reporting themselves to be in “excellent,” “very good,” or “good” health were far more likely (by 41%) to defer claiming for the lump sum in the no-work condition (and 20% more given the work requirement). The additional work requirement was particularly disliked by those in poor health. We also found that those younger than age 60 were slightly more responsive to the lump sum than people age 60+. (See Table 1).

	No work				With work			
	Status quo	Lump sum	LS-SQ difference	% change	Status quo	Lump sum	LS-SQ difference	% change
Total	49.9	70.3	20.4	40.9	45.6	55.5	9.9	21.7
Men	46.3	69	22.7	49.0	46	55.9	9.9	21.5
Women	52.5	71.3	18.8	35.8	45.3	55.2	9.9	21.9
Age 50-59	51.5	73	21.5	41.7	46.2	59.1	12.9	27.9
Age 60-70	48.6	67.6	19	39.1	44.5	51.9	7.4	16.6
High school or less	44.5	66.9	22.4	50.3	45	44.1	-0.9	-2.0
Some college education or more	54.6	73.3	18.7	34.2	46	56	10	21.7
In excellent, very good or good health	51.6	72.8	21.2	41.1	47.1	56.5	9.4	20.0
In fair or poor health	45.5	63.9	18.4	40.4	41.8	32.6	-9.2	-22.0

Table 1: Incentive effects of offering a lump sum*. This table reports relative frequencies of respondents (in percent of the overall sample) who indicated that they would delay benefit claiming under the status quo and when offered a lump sum. The no work condition appears in the left Panel, and the part-time work condition is in the right Panel.*

Motivation

Two key explanations for the responses we observe may be identified. First, people who defer claiming under the U.S. Social Security rules earn an eight percent increase in annual benefits per year of delay. This is likely to be far more than most people can earn on their own investments (Coile et al., 2002). Moreover, people with above-average health and the very risk-averse find delayed claiming even more attractive than average due to the higher lifelong benefits they will receive. Second, providing a lump sum instead of an increased annuity benefit for deferred Social Security benefits allows retirees to shift consumption to the earlier phase of retirement when mortality risk is low (Chai et al., 2013).

Policy Significance

Our research shows that many people would be willing to defer claiming their Social Security old-ageold age benefits if they could receive a (reduced) lifelong benefit plus an actuarially fair lump sum payment when they eventually access their benefits. In other words, a large fraction of people prefer lump sums and would claim later (and some would work more) compared to the current system. This would have a positive effect on their wellbeing, as they prefer the lower income stream and higher lump sum to the status quo.

In additional analysis, we have also shown that some people would be willing to delay claiming for much less than an actuarially fair value, indicating that they would be better off than under the current rules (Maurer, Mitchell, Rogalla, and Schimetschek, 2017). This is important because it suggests that the national retirement system could save money by providing smaller lump sums; at the same time, people would be better off since they have access to the lump sum plus the base annuity. Moreover, from a macroeconomic perspective, longer work lives also offer additional economic resources to help cover the costs of population aging. Accordingly, giving people incentives to voluntarily delay claiming

Social Security benefits in exchange for lump sums – and possibly work longer – could benefit both society and the older individuals as well.

While these estimates draw on our experiment with U.S. data, the research may also be relevant policy for the current discussion on the German retirement system. As in the US, early retirees in Germany also experience reductions in monthly payments of 3.6% per year, up to a maximum of 14% if claimed at the earliest possible age of 63. Moreover, the German retirement system offers higher monthly payments to those who voluntarily delay claiming, of 6% per year of delay.

It stands to reason that offering a lump sum payment in lieu of an increased monthly benefit for delayed claiming could be highly relevant in the German pension debate.

References

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