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Raimond Maurer, Olivia S. Mitchell, Ralph Rogalla
and Tatjana Schimetschek

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A cooperation of the Center for Financial Studies and Goethe University Frankfurt

House of Finance | Goethe University
Theodor-W.-Adorno-Platz 3 | 60323 Frankfurt

Tel. +49 69 798 33684 | Fax +49 69 798 33910
policy_center@safe.uni-frankfurt.de | www.safe-frankfurt.de

The Potential Effect of Offering Lump Sums as Retirement Payments[1]

Raimond Maurer, Olivia S. Mitchell, Ralph Rogalla and Tatjana Schimetschek[2]

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As life expectancies continue to rise, the Trust Fund connected to the Old Age, Survivors and Disability Insurance Program (OASDI) – the official name for Social Security in the United States – is hurtling toward insolvency. Correspondingly, the Social Security Trustees' Reports have strongly emphasized the need for reforms to help enhance the solvency of the United States' old age income system. The supposedly reasonable solution of requiring workers to delay retirement by raising the retirement age is unpopular, as demonstrated by protests around the world.

A recent analysis from the Urban Institute looks at traditional reform options to improve the solvency of the Social Security system.[3] The analysis shows, for example, that raising the full retirement age, currently age 67, would extend Trust Fund reserves by only one year. Similarly, a modest increase in the early retirement age, currently age 62, would have virtually no impact on solvency. Boosting the payroll tax rate could help, but this is politically unappealing to many. And finally, eliminating the current wage cap of $118,500 (as suggested by Sanders) would require the roughly 7% of earners who earn more than the cap to send 12.4% more of their pay into OASDI each year. Nevertheless, even this action only adds 21 additional years of solvency to the Trust Fund. In other words, even the last, fairly costly, proposal is not an enduring solution. Almost inevitably, then, political debate has

[1] This text draws from the Issue Brief: Volume 3, No.9 of the Public Policy Initiative at Penn Wharton. The research it draws on appears in: Raimond Maurer, Olivia S. Mitchell, Ralph Rogalla, and Tatjana Schimetschek, "Will They Take the Money and Work? An Empirical Analysis of People's Willingness to Delay Claiming Social Security Benefits for a Lump Sum." NBER Working Paper 20614, 2014. Below we refer to this study as MMRS.

[2] Raimond Maurer, Professor of Finance at Goethe University; Olivia S. Mitchell, Professor of Insurance/Risk Management and Business Economics/Public Policy at the Wharton School, University of Pennsylvania; Ralph Rogalla, Assistant Professor in the School of Risk Management, Insurance and Actuarial Science at St. John's University; Tatjana Schimetschek, Research Assistant in Finance at Goethe University.

[3] Karen E. Smith, "Can Social Security Be Solvent?" Urban Institute, October 2015.

turned to a discussion over whether solvency should be achieved by larger benefit cuts or higher taxes, which in effect asks which people – current or future generations – should bear the greater burden of fixing the system.

To this discussion we add an additional reform proposal for enhancing Social Security solvency[4] which reframes the debate in a different light. In our research, we focus on incentives to prolong working years and to delay benefits claiming as a way of sustaining Social Security. Specifically, we analyze how the offer of a budget-neutral, actuarially fair lump sum payment -- instead of the current delayed retirement credit – would encourage people to delay claiming their OASI benefits and work longer. The results of our research will be useful for policymakers, namely in (1) measuring who would delay claiming benefits if offered a lump sum instead of higher annuity payments, (2) examining how long they would wait, and (3) how much longer, if at all, they would continue working in the interim.

The Most Important Financial Decision Many Households Will Ever Make

Currently, the U.S. Social Security *status quo* rules allow eligible workers to claim retirement benefits as early as age 62 and as late as age 70. It is not until age 67, the aforementioned full retirement age, that first-time benefit claimants would receive monthly benefits equal to 100 percent of their primary insurance amounts.[5] Table 1 shows the boost in monthly benefits for each year of benefit deferral, such as the 43 percent increase in benefits to workers who delay claiming OASI until their full retirement age (from age 62 to 67). Despite these substantial monthly increases, a large share of U.S. workers claims benefits and ceases working as young as possible. According to the Social Security Administration, Social Security accounts make up the lion's share of aggregate income, roughly 84%, for Americans older than age 65 in the lowest income quintile.[6] Therefore, given the sheer dependence that many U.S. households have on Social Security, the choice of when to elect benefits is likely the most important financial decision they will ever make over their lifetimes.

[4] See MMRS, cited above.

[5] The SSA determines workers' PIAs based on their personal earnings histories; for the agency's benefit calculators see http://1.usa.gov/1RyfynL.

[6] Meanwhile, OASI payments make up only about 17% of aggregate income for Americans age 65+ in the highest income quintile, as funds from pensions, personal financial assets, and other earnings streams act to diversify retirement income sources. Source: Social Security Administration, *Income of the Aged Chartbook, 2012*. US SSA: April 2014.

Table 1: Delayed Claiming Boosts Monthly Social Security Benefits: Status Quo

Claiming Age	Monthly Benefit: (% of PIA)	Boost with 1 year delay (%)	Cumulative boost compared to age 62 (%)
62	70		
63	75	7.14	7.14
64	80	6.67	14.29
65	86.67	8.34	23.81
66	93.33	7.70	33.33
67	100	7.15	42.86
68	108	8	54.29
69	116	7.41	65.71
70	124	6.90	77.14

Notes: Full Retirement Age (FRA): 67; PIA = Primary Insurance Amount. Source: www.ssa.gov.

In related work, Mitchell has also shown that many Americans lack a good command of even basic aspects of financial literacy, much less annuitized payments like Social Security or how to value them.[7]

For this reason, we designed a test to determine the perceived value of an actuarially fair lump sum option for delaying Social Security benefit claiming, and whether offering people this could induce them to delay claiming and work longer. Developing a survey of U.S. residents within the framework of the RAND American Life Panel (ALP), we assessed people's responsiveness to the idea of suddenly having access to the present value of benefit increases earned by working longer in the form of a lump sum. We first calculated and presented to each respondent their unique monthly OASI benefit from age 62 through age 70 under the *status quo* system rules, based on answers from questions about their own work histories. Then, after asking respondents their planned claiming ages, we offered two alternative scenarios to the 2,451 survey participants.

In the first experimental scenario (i.e., Lump Sum, or LS), a worker was offered her age 62 monthly benefit plus a lump sum that would grow the longer she waited to claim Social Security. This lump sum was actuarially fair, meaning that it was equal to the present value of all future benefit increases under the *status quo*, payable on the date of her claiming. In the second experimental scenario (i.e., Delayed Lump Sum, or DLS), if a worker waited until her full retirement age to claim Social Security, she would receive her higher monthly

[7] See Annamaria Lusardi and Olivia S. Mitchell. "Financial Literacy and Economic Outcomes: Evidence and Policy Implications. *Journal of Retirement Economics*. 2015. 3(1): 107-114; and Jeffrey R. Brown, Arie Kapteyn, and Olivia S. Mitchell. "Framing and Claiming: How Information Framing Affects Expected Social Security Claiming Behavior." *Journal of Risk and Insurance*. 2013.

payment (just as under the *status quo)*, but if she delayed claiming even longer, she would receive her higher full retirement age benefit (as of age 67) plus a lump sum, similar to the LS scenario. These scenarios accordingly cost taxpayers no more or less money than the current system, since the lump sums and benefits were set to actuarially neutral.

The order in which respondents saw each of the two scenarios was randomized, so that we could compare how claiming ages would change vis-à-vis the *status quo*, and control for framing effects across survey participants. Finally, we asked respondents to state how much additional work each would engage in, depending on the scenario, in order to determine whether any delayed claiming would be associated with an increase in work, along with the longer wait to claim benefits.

Survey Findings

We find that a large group of respondents would prefer to work longer and delay claiming Social Security if they can receive an actuarially fair lump sum instead of higher annuity payments. Compared to the *status quo*, people would delay claiming under the LS scenario by an additional five months on average, and of those five months, they would continue working for two of them. Under the DLS scenario, people would delay claiming by about eight months more on average, and of those eight months they would continue working for four of them.

As noted above, the presentation of each scenario was randomized, and the authors found that framing did play a significant role in shaping respondents' claiming patterns. For those who first saw the LS scenario which offered a substantial lump sum relatively early (e.g., on average $73,000 for claiming at age 66), respondents delayed their claiming by very little. For those shown the DLS scenario first, survey participants anchored on a higher claiming age and lower lump sum, since the lump sum would be payable only after reaching full retirement age. Accordingly, those who saw the LS scenario second delayed their claiming by more, although not as long as in the DLS scenario.

Figure 1 depicts the results of the delayed claiming decision due to the lump sum incentives, while Figure 2 shows how much additional labor force participation would result. In both cases, the box plots denote the 25th and 75th percentiles, while the line inside each box reflects the median survey response (the dot represents the mean response). All numbers are in months post age 62. For example, under the DLS scenario, Figure 1 shows that respondents would claim at 53.3 months after age 62 on average, or about eight months later than their stated claiming ages under the *status quo* (45 months, on average). Additionally, Figure 2 shows that these respondents would spend 38.7 percent of their time in additional fulltime work post-age 62, or 4 months more than under the *status quo*.

Figure 1: Distribution of Claiming Ages: Status Quo vs. Two Lump Sum Alternatives

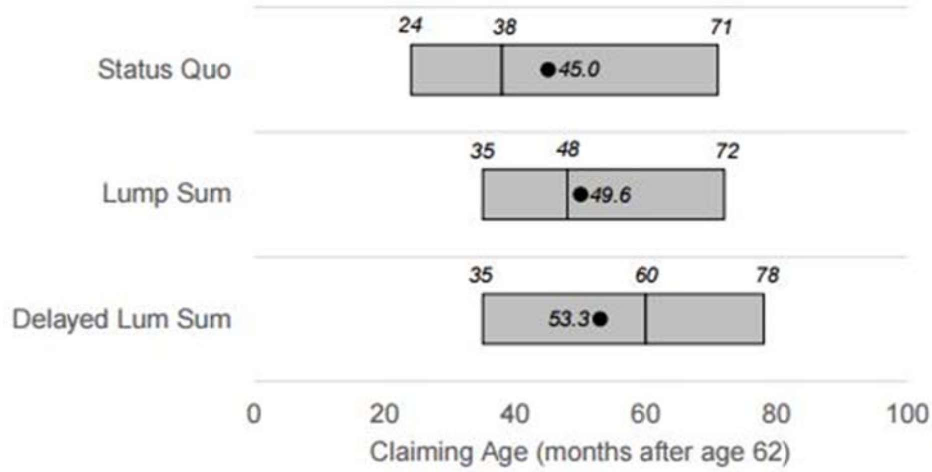
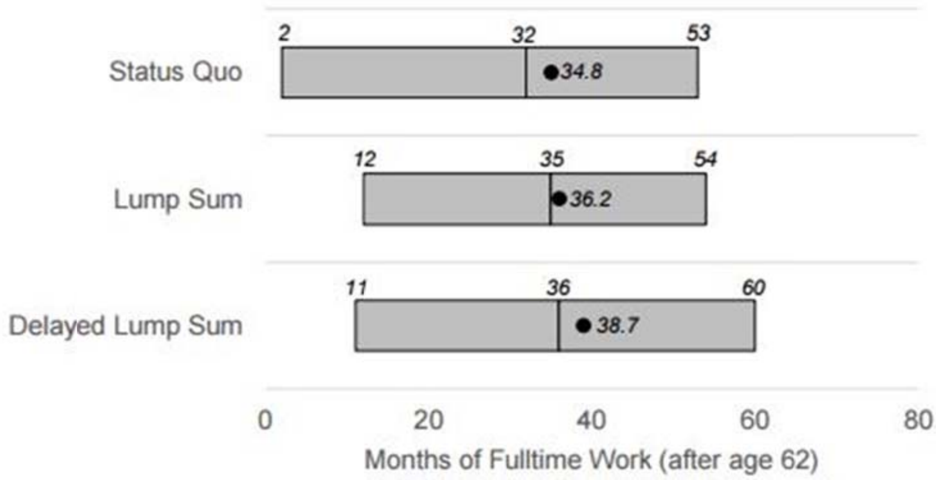


Figure 2: Distribution of Total Work Effort: Status Quo vs. Two Lump Sum Alternatives



We then conducted multivariate regression analysis to evaluate how people with specific characteristics (e.g., sex, age, marital status, education level, economic status, and other preferences) might change their behavior under the two alternative scenarios, holding other factors constant. Ultimately, only a few variables significantly differentiated those who were responsive to a lump sum offer, from those who were not. In addition to the order in which respondents saw the scenarios, other significant factors included financial literacy, political trust in the OASDI program, and a high level of indebtedness, all associated with a larger claiming delay (presumably in order to obtain a larger lump sum). But perhaps the most interesting result of all is that the respondents who were most responsive to the lump sum alternatives were those who would have claimed earliest under the *status quo.* In other words, these were the same people who stand to benefit the most from higher monthly payments under the current regime.

Lessons for Policymakers

Policymakers seeking to bolster the solvency of Social Security without raising taxes or cutting retirement benefits may find new reform ideas in these findings, as well as the fact that people's delayed claiming patterns do not differ by wealth levels, the presence of other annuities, OASI benefit amounts, planning horizons, or expected investment.[8]

The benefits of delayed claiming include the obvious result of additional months or years of individual contributions to Social Security through payroll taxes, which could modestly improve the program's solvency. Continued labor force participation could also result in improved physical and mental health among the elderly.[9] In turn, this latter benefit may enhance the financial status of healthcare systems such as Medicare and Medicaid. It could also help offset the macroeconomic costs of an aging population, if quality of life for individual workers does in fact improve on account of longer working lives.[10] Lastly, though the survey was designed, in this instance, to be budget-neutral to avoid any wealth transfers between generations, it remains to be seen whether people might also be willing to delay claiming and work longer for lump sums that are less than actuarially fair, which would enhance the Social Security program's sustainability.

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[8] Wealth also plays a role in the labor force participation decision: those with the most wealth are the least likely to extend their working lives, since they can choose to self-finance their retirements before collecting their lump sums.

[9] Susann Rohwedder and Robert J. Willis, 2010, "Mental Retirement," *Journal of Economic Perspectives*, 24(1), 119-38.

[10] Gabriel Sahlgren. "Work Longer, Live Healthier – The Relationship between Economic Activity, Health, and Government Policy," IEA Discussion Paper No. 46, 2013.

Conclusion

Policymakers who are serious about reforming Social Security to improve solvency would do well to explore lump sums as an alternative to the *status quo* of higher annuity payments as a reward for delayed claiming. The usual reform options which fuel current debates about winners and losers in the realm of Social Security have not advanced the dialogue, much less action, regarding how to make the system solvent for current and future generations. The clock ticks, and new thinking based on solid evidence is needed.