EVALUATING LUMP SUM INCENTIVES FOR DELAYED SOCIAL SECURITY CLAIMING

Executive Summary

Olivia S. Mitchell, The Wharton School of the University of Pennsylvania
Raimond Maurer, Goethe University of Frankfurt
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Using behavioral parameters suggested by our research and simulated by the Dynamic Simulation of Income Model (DYNASIM) team at the Urban Institute, we evaluate the potential impact of a lump sum reform for delayed Social Security claiming. First, we demonstrate that the lump sum delayed benefit plan does not dramatically change solvency outcomes for either the payable or the scheduled benchmarks. Thus, the proposed reform does not rectify the solvency problem facing Social Security nor does it worsen it materially. Second, we find that the differences in projected poverty fractions are remarkably small and may even be overestimated. Third, we present other distributional analyses that show income increases, but the changes are small relative to both scheduled and payable benchmarks. Fourth, we give asset projections that show that the lowest- and middle-income groups accumulate higher nest eggs under the lump sum delayed benefit plan. This is a positive result inasmuch as lower-paid individuals are more likely to value the additional assets in retirement. Accordingly, the lump sum reform we have outlined here has positive distributional consequences overall without costing the system more money.

CURRENT SOCIAL SECURITY POLICY AND THE LUMP SUM POLICY ALTERNATIVE

Under the current Social Security rules, an eligible individual can claim retirement benefits as early as age 62 or defer them as late as age 70. The monthly benefit paid for life depends on his or her earnings history and claiming age, with a reduction if the individual claims before the full retirement age (FRA), and an additional increment for deferring claiming after the FRA. (An individual’s FRA depends on his or her year of birth and currently ranges from 66 to 67.) For someone born in 1960 or later, for example, deferring the benefit from age 62 to the FRA of 67 would entitle him or her to an increase in monthly benefits of around 43 percent. In particular, delaying claiming to age 70 implies a 77 percent increase in lifetime monthly benefits.
The lump sum policy we explored involves a policy innovation for Social Security that induces later claiming among a large fraction of the population. Rather than cutting benefits, however, our reform offers people an incentive to delay claiming their Social Security benefits. Specifically, someone willing to defer claiming beyond the early retirement age would receive—at his or her eventual claiming age—a monthly benefit as of age 62 for the remainder of his or her life plus a lump sum reflective of the additional benefit otherwise gained by delaying claiming. In other words, retirees would still receive their age 62 (reduced) benefits at the delayed claiming age but in addition would get from Social Security a substantial immediate payout at that age, which will encourage them to claim later. Moreover, at least some older individuals would work longer, which would delay the date when they start withdrawing money from their savings, thus preserving more for later in retirement.

The particular alternative considered in the simulation analysis allowed people to claim their early Social Security benefits at age 62 with the early retirement reduction factor applied as under current rules, or else to delay claiming by a year or more all the way up to age 70. At each later claiming age, the retiree would be entitled to his or her age 62 benefit from the later age onward, plus a lump sum. In the Urban Institute simulations, the entire lump sum amounts were assumed to be deposited into nontaxable Roth accounts which, after retirement, were invested in 10-year US Treasury bonds earning a 3 percent real return. After retirement, households were assumed to spend down their retirement assets (including the Roth accounts) using the DYNASIM approach to spend-downs. The Roth investment earnings and withdrawals were excluded from taxable income but were assessed for Supplemental Security Income (SSI) eligibility. Any remaining lump sums at the first retiree’s death would be made available to the surviving spouse, if any. The lump sum delayed benefit plan was simulated incorporating the delayed claiming patterns derived from the survey evidence we cite. Inasmuch as we found that similar changes in work and claiming patterns obtained when lump sum payments were reduced by 13 percent, the actual simulations implemented that reform.

RESULTS

The DYNASIM simulations of the lump sum reform for delayed Social Security claiming suggest several key conclusions. First, the similarities between the projections confirm that the lump sum delayed benefit reform does not dramatically change system solvency outcomes versus the payable or scheduled benchmarks. In other words, while the reform does not by any means rectify the Social Security system’s solvency problem, it does not make solvency materially worse. Second, the differences in projected poverty
fractions are remarkably small and may even be overestimated, since the Roth account payout rates assumed by the DYNASIM model are not conventional annuity payout rates. Third, other distributional analyses show that incomes increase, but the changes are relatively small relative to the payable benchmark. Changes are even smaller for the scheduled benchmark. Fourth, the asset projections show that the lowest- and middle-income groups accumulate higher nest eggs under the lump sum delayed benefit reform. This is a positive result inasmuch as lower-paid individuals are more likely to value the additional assets in retirement. Accordingly, the lump sum plan we have outlined here has positive distributional consequences overall without costing the system substantially more money.