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The Potential Effect of Offering Lump Sums in the Social Security Program

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The Potential Effect of Offering Lump Sums in the Social Security Program

Summary
New research reframes the debate about Social Security solvency and moves away from questions of who should bear the greater burden of fixing the system by offering a lump sum payment model as a way to encourage people to delay claiming their Social Security benefits. Under one of the lump sum alternatives presented in this brief, survey participants indicated a willingness to delay claiming Social Security by up to eight months, on average, compared to the status quo, and to continue working for four of them. Delayed claiming would mean additional months or years of Social Security payroll tax contributions, which could modestly improve the program’s solvency.

Keywords
social security, budget, payroll, tax

Disciplines
Public Policy | Social Welfare | Taxation

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Headlines about H.R. 1314, the 2015 “Bipartisan Budget Act,” focused mainly on the deal’s success in avoiding another collision with the debt ceiling, along with the fact that the compromise included federal spending increases for the first time in several years.

Another key component, however, was a change to the Old Age, Survivors and Disability Insurance program (OASDI)—the official name for Social Security in the United States—and this merits a closer look.

When Social Security revenue is collected through payroll taxes, the vast majority of these taxes flow to either the Old Age and Survivors Insurance (OASI) Trust Fund or the Federal Disability Insurance (SSDI) Trust Fund. Collectively, these Trust Funds have enough reserves to remain solvent until 2034. But as noted recently in Penn Wharton Public Policy Initiative’s September 2015 Issue Brief, “Social Security's Trustees have indicated that [the SSDI Trust Fund] will be fully depleted by late 2016 unless the U.S. Congress enacts changes before then.”

While no change in H.R. 1314 alters the combined OASI-SSDI reserve projection of 2034, the Act does delay SSDI Trust Fund reserve depletion until 2022. This is to be accomplished via the reallocation of payroll taxes in calendar years 2016 through 2018, when a greater portion of the OASDI payroll tax, financed equally by employees and employers, will be directed to the SSDI Trust Fund.

The postponement of SSDI reserve depletion means that cuts in monthly benefits to disabled workers and

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**SUMMARY**

- Political debate has focused on the question of whether Social Security 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.

- But new research reframes this debate, offering a budget-neutral, actuarially fair lump sum payment, instead of the current delayed retirement credit, as a way to encourage people to delay claiming their Social Security benefits and work longer.

- Under one of the lump sum alternatives presented here, survey participants indicated a willingness to delay claiming Social Security by up to eight months, on average, compared to the status quo, and to continue working for four of them.

- Delayed claiming would mean additional months or years of Social Security payroll tax contributions, which could modestly improve the program’s solvency. Other benefits are possible as well: improved physical and mental health among the elderly from extended labor force participation, which could reduce the strain on health care programs like Medicare and Medicaid and help offset the macroeconomic costs of an aging population.
their families will not materialize in the weeks leading up to the 2016 Presidential election. Given that, it seems unlikely that Congress will do much more in the short run to resolve longer-term Social Security solvency. Nevertheless, a few Presidential candidates, specifically Senator Bernie Sanders (I-VT) and New Jersey Governor Chris Christie, have made Social Security solvency concerns a central part of their respective platforms and could influence future legislation to address future Trust Fund shortfalls. To date, however, it appears that their proposed solutions may improve solvency only very slightly, if at all.

Recent analysis from the Urban Institute looked at several reform options in terms of their impact on Social Security solvency. For example, it showed that raising the OASI full retirement age (FRA), 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 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. Yet new research by Olivia S. Mitchell of the University of Pennsylvania, her colleagues Raimond Maurer and Tatjana Schimetschek of Goethe University Frankfurt, and Ralph Rogalla of St. John's University (the research team hereafter referred to as MMRS), reframes the Social Security debate in a different light. As this Issue Brief describes, they offer a budget-neutral, actuarially fair lump sum payment—instead of the current delayed retirement credit—as a way to encourage people to delay claiming their OASI benefits and work longer.

As life expectancies continue to rise and OASI Trust Funds hurtle toward insolvency, attempts to prolong working years and incentivize delayed benefits claiming become very important in sustaining Social Security. Accordingly, the results of this alternative approach 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 FRA, that first-time benefits claimants would receive monthly benefits equal to 100 percent of their primary insurance amounts, or PIAs. 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 FRA (from age 62 to 67). Despite these substantial monthly increases, a large share of U.S. workers claims benefits and ceases working

NOTES

1 This research draws on the authors’ research. See 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 This exhaustion date is taken from the 2015 Annual Report of the Board of Trustees of the OASI and DI Trust Funds, July 22, 2015. We note that Trust Funds assets consist mainly of IOU’s owed by the US Treasury to Social Security; see John Cogan and Olivia S. Mitchell, “Perspectives from the President’s Commission on Social Security Reform,” Journal of Economic Literature 17(2): 149-172.
4 Letter from the Social Security Administration to Speaker John Boehner, October 27, 2015. Note: these estimates are preliminary and subject to change.
5 Of the 12.40% OASDI payroll tax, the SSDI Trust Fund will receive 2.37% from 2016-2018, up from 1.80%.
7 See MMRS, cited above.
8 The SSA determines workers’ PIAs based on their personal earnings histories; for the agency’s benefit calculators see http://1.usa.gov/1RyfynL.
9 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
as young as possible. According to the SSA, Social Security accounts for the lion’s share of aggregate income, roughly 84%, for Americans older than age 65 in the lowest income quintile. 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.

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. For this reason, the MMRS team 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), they 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. They 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, the researchers offered two alternative scenarios to their 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 FRA to claim Social Security, she would receive her higher monthly payment (just as under the status quo), but if she delayed claiming even longer, she would receive her higher FRA 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

<table>
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<tr>
<th>Claiming Age</th>
<th>Monthly Benefit: (% of PIA)</th>
<th>Boost with 1 year delay (%)</th>
<th>Cumulative boost compared to age 62 (%)</th>
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<tr>
<td>70</td>
<td>124</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


NOTES


11 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.


set as actuarially neutral.

The order in which respondents saw each of the two scenarios was randomized, so that researchers could compare how claiming ages would change vis-à-vis the status quo, and to control for framing effects across survey participants. Finally, the researchers 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

The researchers 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. 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 (i.e., 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 FRA. 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 respondents would engage in an additional 38.7 months of full-time work after age 62 on average, more than double the 12 months the status quo would have entailed.

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
that these respondents would spend 38.7 percent of their time in additional full-time work post-age 62, or 4 months more than under the *status quo*.

The researchers 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 the 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 were 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.\(^\text{11}\)

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.\(^\text{12}\) 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.\(^\text{13}\)

Lastly, though the survey designed by the researchers in this instance was created 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.

**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 the U.S. needs new thinking based on solid evidence.
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