



The role of information for retirement behavior: Evidence based on the stepwise introduction of the Social Security Statement[☆]

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ABSTRACT

In 1995, the Social Security Administration started sending out the annual Social Security Statement. It contains information about the worker's estimated benefits at the ages 62, 65, and 70. I use this unique natural experiment to analyze the retirement and claiming decision making. First, I find that, despite the previous availability of information, the Statement has a significant impact on workers' knowledge about their benefits. These findings are consistent with a model where workers need to gather costly information in order to improve their retirement decision. Second, I use this exogenous variation in knowledge to analyze the optimality of workers' decisions. Several findings suggest that workers do not change their retirement behavior: i) Workers do not change their expected age of retirement after receiving the Statement; ii) monthly claiming patterns do not show any change after the introduction of the Social Security Statement; iii) workers do not become more sensitive to Social Security incentives after receiving the Statement. More research is needed to establish whether workers are already behaving optimally, but the information contained in the Statement is not sufficient to improve their retirement behavior.

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1. Introduction

Many older workers know little about their retirement benefits.¹ To help workers make provisions for their retirement, the Social Security Administration (SSA) introduced the Social Security Statement in 1995. The Statement is a concise record of past earnings and a summary of estimated benefits as a function of different claiming ages. It is mailed to all workers paying payroll taxes, typically three months before their birthday. In 2008 the cost of sending an individual Statement was only about 36 cents, but given the large number of Statements sent each year, the total cost is 53 million

dollars (SSAB, 2009). This paper evaluates whether sending the Statement increased workers' knowledge and influenced retirement behavior. The more general question is how workers make decisions, and to what extent these decisions change when workers are provided with additional information.

In 1995 the SSA was required to mail the annual Statement—then named the Personal Earnings and Benefit Estimate Statement—to all workers age 60 and older and in later years it has been sent out in phases. The stepwise introduction allows me to identify the effect of the Statement controlling for age and time. Using The Health and Retirement Survey (HRS) data, I find that workers aged 55 to 64 who received the Statement and had not previously contacted SSA regarding their benefits are 20 percentage points (50%) more likely to be able to provide an estimate of their future benefits than workers that did not receive the Statement.

While these are very large effects, if workers were behaving optimally this additional information would not substantially change workers' retirement or saving behavior. In contrast, some workers might just be procrastinating: the cost of becoming informed and learning the optimal retirement age and savings are borne upfront, while the corresponding utility gains are received only sometime later. Workers with high discount rates should, therefore, seek information later. For these workers, the Social Security Statement might actually induce changes in behavior. I use three different ways to measure changes in behavior. First, I look at whether workers are

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¹ See among others, Bernheim and Levin (1989), Gustman and Steinmeier (2001), Chan and Stevens (2008), Lusardi and Mitchell (2006), Lusardi and Mitchell (2007).

more likely to update their retirement plans upon receiving a Statement. Then, I check whether workers change their actual claiming behavior. Finally, I see whether workers are more likely to respond to the retirement incentives provided by the Social Security benefit formula after receiving a Statement.²

I find no evidence that receiving the first Statement induces workers to update their expectations. Social Security claiming patterns also show no change upon the introduction of the Statement. Retirement decisions do not become more sensitive to Social Security incentives. Overall, the results suggest that either workers were already behaving optimally or that the additional information provided by the Statement isn't sufficient to improve uninformed workers' retirement choices.

2. Literature review

2.1. Retirement behavior

Standard economic theory assumes that all agents base their retirement decisions on forward-looking variables. Krueger and Meyer (2002) provide a comprehensive survey of studies that modeled retirement behavior. These studies typically assume implicitly that workers know their future benefits as a function of their retirement age and are able to compare future streams of benefits. Empirical evidence, however, suggests that these are strong assumptions. When asked, only around 50% provide an estimate of their expected Social Security benefits.³ Gustman and Steinmeier (2001) show that fewer than 30% of respondents are able to estimate their future benefits to within about \$1500 per year. Moreover, Lusardi and Mitchell (2006) show that financial illiteracy is widespread among older Americans. Only half of the age 50+ respondents can correctly answer two simple questions regarding interest compounding and inflation. Is it then reasonable to assume those same respondents are able to compute their retirement incentives, which typically involve relatively complex calculations?

Despite the apparently little knowledge about retirement incentives, the fact that people seem to respond to incentives when making their retirement decisions has been called by Chan and Stevens (2008) an "important empirical puzzle in the retirement literature". Gustman and Steinmeier (2001) try to test the robustness of the retirement models when a measure of knowledge about benefits is added to the retirement regression. They find that explicitly controlling for knowledge does not affect workers' responsiveness to changes in the present value of the stream of Social Security benefits from postponing retirement, which are also called accruals. Chan and Stevens (2008) go one step further and analyze how the interaction of knowledge and accruals affects workers' decisions. The authors find that responsiveness to pension incentives is entirely driven by the 20% of workers who perceive them correctly.⁴ The validity of using measures of knowledge in the regressions, however, is questionable as knowledge is endogenous: workers gather information when they approach their expected retirement age. Most workers contact the SSA in order to learn about their future Social Security benefits. Once they do so, the data show that they become more likely to provide a benefit estimate, and their estimate becomes more precise.⁵ This is not surprising. The SSA's benefit

formula is complicated, and workers would have a hard time trying to calculate their expected benefits without the SSA's help. But this additional information is only valuable if individual workers can use it and are unconstrained with respect to their retirement choice, i.e. workers who face health problems or have liquidity constraints tend to retire as soon as possible. Consistent with this, I find that wealthier and healthier workers are significantly more likely to get informed.

2.2. The Social Security Statement

Economists have not studied the introduction of Statements, apart from the Government Accountability Office's (GAO) evaluation of their understandability.⁶ Therefore, Jackson (2005) concluded that: "Given the importance of Social Security benefits to so many Americans, it is surprising how little academic attention has been given to the content and implications of Social Security benefits" and "what is clear is that the Social Security Statement is one of the most important communication that the federal government sends out to the general public each year, and as such the document deserves much more attention from public official and academic writers than it has received to date. According to the GAO reports the overall public reaction to receiving an unsolicited Statement has been favorable. The reports cite a nationally representative survey in which, as predicted by Bernheim (1987), "the majority of the respondents indicated they were glad to receive their Statements and 95% of them said the information provided was helpful to their families." The April 2005 report finds that 66% of workers remember receiving a Statement (unfortunately they do not provide this number by age groups), and that 90% of those who remember receiving a Statement say that they remember the amount of estimated Social Security benefits. The results of a Gallup survey revealed that individuals who had received a Statement had a significantly increased basic understanding of Social Security, and understanding of some important basic features of Social Security: the amount of Social Security benefits depends on how much people earned; Social Security pays benefits to workers who become disabled; Social Security provides benefits to dependents of workers who die (see <http://www.ssa.gov/>.) According to the 2004 Retirement Confidence Survey, 80% of workers use retirement benefit Statements (not necessarily only Social Security Statements) and 20% find them the most helpful tool in retirement and claiming decision making (Helman and Paladino, 2004). Jackson analyzes the content of the Social Security Statement, and reports how because of various cognitive biases workers may misinterpret the value of their benefits. He then suggests that including the present discounted value of Social Security benefits may facilitate the comparison with other sources of income and minimize labor market distortions.

3. Exogenous variation in knowledge

3.1. The phasing in schedule of the Statement

The administration started sending the Statements in 1995. The main purpose is to inform the public about benefits under SSA programs, to aid in financial planning, and to ensure that the worker's earnings records are complete and accurate. The Statement contains expected Social Security benefits at the early (62), the normal (usually 65, though increasing since 2003), and the late (70) retirement ages as well as the worker's entire earnings history. The Statement also informs workers about spouse's benefits, survivors' benefits, and disability benefits. The Statement does not report the present discounted value of these benefits, also called the Social Security Wealth (SSW).

² The administrative records are used to compute retirement incentives (see, for example, Coile and Gruber, 2007; Panis et al., 2002; Liebman et al., 2009).

³ See Bernheim and Levin (1989), Gustman and Steinmeier (2001). In my sample that focuses on workers aged 55 and above, two-thirds of workers are able to provide an estimate.

⁴ They do not find any link between knowledge and Social Security accruals, which they consider a result of data limitations. A limitation of their test, and as a matter of fact, of mine as well, is that they can measure if workers correctly perceive their Social Security benefits, but not if they correctly compute their forward-looking Social Security incentives, like the present-discounted stream of benefits.

⁵ Gustman and Steinmeier (2001) show that having contacted the SSA is the strongest predictor for being knowledgeable about Social Security benefits.

⁶ See GAO/T-HEHS-96-210, GAO/HEHS-97-19, GAO/HEHS-98-228, GAO/T-HEHS-00-101, GAO-05-192 on <http://www.gao.gov>.

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