

INDIVIDUALS' RESPONSES TO SOCIAL SECURITY REFORM

ADELINE DELAVANDE AND SUSANN ROHWEDDER*

September 2008

The Social Security trust fund is predicted to be depleted by 2041. While there are several viable reform proposals to restore long-term solvency of the Social Security system, one important element that is critical to the success of any reform remains unknown: how will individuals respond, for example, to a cut of their Social Security benefits? Will they work longer or save more or both, and to what extent will their response make up for the cut in benefits? How would the adjustment be split across spending less and working longer?

It is important to understand how workers might respond to a benefit cut for at least two reasons. First, to evaluate its impact on the well-being of individuals, i.e., whether responses in behavior will be adequate to buffer the shortfalls in benefits and whether this would be the case across all groups of workers. Second, the response in individuals' behavior determines the size of benefit cuts required to restore the long-term solvency of Social Security. If all workers decided to work longer to make up for the shortfall, then Social Security revenues would increase more than if workers decided to make up for the shortfalls by reducing spending, but otherwise sticking with their retirement (and Social Security claiming) plans in the absence of reform. For some workers additional Social Security contributions would only result in a minor increase of their annual Social Security benefits whereas for others the increase in benefits would be larger, depending on the worker's earnings history.

WORK LONGER OR REDUCE SPENDING?

Using stated preferences data we analyze what individuals in their 50s and 60s say they would do if everyone's Social Security benefits were cut by 30 percent. In particular, we investigate whether individuals would work longer or reduce spending or both. The stated preferences were elicited from a sub-sample of respondents to the Health and Retirement Study (HRS) who were interviewed over the Internet in the summer of 2007.

We find that more than 75 percent of the respondents report that they would definitely adjust their behavior in case of a 30 percent cut of Social Security benefits. About a third report that they would only reduce spending, while another third report that they would both work longer and reduce spending. About 9 percent would only consider working longer as a response to the cut in benefits.

There is substantial heterogeneity in the response by sex, marital status, education and wealth. Being male, living in a couple or being younger than 54 are associated with a significantly lower willingness to commit (i.e. say definitely yes) to reducing spending, while having an education at high school level or less and being in the lowest wealth tertile are associated with a higher willingness to commit to reducing spending. Being in the lowest Social Security Wealth tertile and the lowest tertile for other wealth and being single are associated with a significantly higher willingness to commit to working longer.

*Adeline Delavande is Associate Economist at RAND and Assistant Professor of Economics at Universidade Nova de Lisbon. Susann Rohwedder is Economist at RAND. This Research Brief is based on MRRC Working Paper WP 2008-182.

DELAY CLAIMING OF SOCIAL SECURITY BENEFITS

We also investigate in greater detail respondents' answers regarding delaying their claiming of Social Security benefits in case of a 30 percent cut of their benefits. On average Social Security claiming would be postponed by 1.13 years. If this time was spent working by everyone, then the annual Social Security benefit would be adjusted upward due to additional earnings and due to less of an early claiming penalty or a higher delayed claiming credit. Rather than experiencing a 30 percent drop in the annual benefit, respondents would experience a 20 percent drop on average when taking into account their adjustments to claiming later and working longer. However, this average masks substantial heterogeneity in the population ranging from a drop of 30 percent among those who said they would definitely not claim later to a drop of minus 9 percent at the 90th percentile of the distribution of changes.

CONCLUSION

The results of this study provide unique information on respondents' answers to a Social Security reform that would implement a cut of 30 percent of benefits. Note, however, that we observe variation in the strength of individuals' responses as a function of their subjective probability of the chances that their own Social Security benefits would be cut some time over the next ten years. Respondents who give a high subjective probability for this event are more likely to commit to working longer and reducing spending. It is possible that respondents with lower subjective probabilities for the event of Social Security reform cutting their own benefits would respond more strongly should this event occur in real life than indicated by their responses in our survey in the context of a hypothetical situation. Should this be the case then our results would underestimate the full response in the population.

UNIVERSITY OF MICHIGAN RETIREMENT RESEARCH CENTER

INSTITUTE FOR SOCIAL RESEARCH 426 THOMPSON STREET ROOM 3026 ANN ARBOR, MI 48104-2321
PHONE: (734) 615-0422 FAX: (734) 615-2180 MRRC@ISR.UMICH.EDU WWW.MRRC.ISR.UMICH.EDU

The research reported herein was performed pursuant to a grant from the U.S. Social Security administration (SSA) through the Michigan Retirement Research Center (MRRC). The findings and conclusions expressed are solely those of the author(s) and do not represent the views of SSA, any agency of the federal government, or the MRRC.

Regents of the University of Michigan

Julia Darrow, Laurence B. Deitch, Olivia P. Maynard, Rebecca McGowan, Andrea Fischer Newman, Andrew C. Richner, S. Martin Taylor, Katherine E. White, and Mary Sue Coleman, ex officio