

Does the Social Security Statement Improve Americans' Knowledge of Their Retirement Benefits?

The Social Security statement is sent annually to each working American age 25 and over. The statement includes information regarding the Social Security program, a record of the individual's covered earnings and contributions to the program, and, most important, an estimate of the individual's future retirement benefits. More than 149 million people were mailed a statement in 2008.

Given the complexity of the Social Security benefit formula, the statement represents the best—and perhaps only—estimate of the benefits that an American will receive. But how well do people understand it? Although the information is critical in calculating the total income one will have in retirement, little research has been conducted on how effectively the statement has improved Americans' knowledge of their benefits. The study summarized in this brief tackles that question. Using data from the Health and Retirement Study (HRS), a federally funded survey of older Americans, it assesses how well people who are one or two years from claiming benefits are able to predict what they will

receive from Social Security. The analysis relies on the fact that HRS respondents are interviewed in biennial waves from 1994 to 2008—that is, the survey contains data for many individuals on both their expected benefits and the actual benefits they received. Because the Social Security Administration began mailing the statements to near-retirees in 1995, investigators were able to compare errors in predicting benefits for individuals before and after universal distribution of the statement.

The study finds that the accuracy with which near-retirees predict future benefits did not improve following the distribution of statements in 1995.

Importance of the Social Security Statement

The Social Security statement provides estimates of retirement benefits payable at full retirement age (currently age 66), the earliest eligibility age of 62, and at age 70, after which delayed retirement benefits are no longer payable. In addition, the statement estimates the disability benefit that would be payable immediately

upon qualification for disability insurance, and survivors' insurance benefits payable to children or a spouse, up to a family maximum.

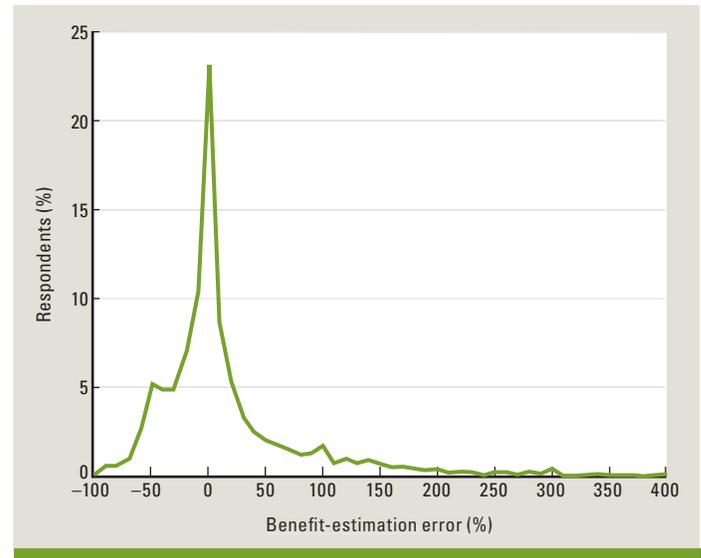
The statement is particularly important because the formula used to calculate benefits is too complex for people to use in calculating their own benefits. While a typical defined-benefit pension equals a percentage of final salary multiplied by the number of years of employment, Social Security's benefit calculation is significantly more involved. The formula first indexes a worker's past earnings (up to age 60) to the growth of average national wages. It then averages the highest 35 years of indexed earnings and divides by 12 to produce the average indexed monthly earnings (AIME), which are run through a progressive benefit formula to produce the primary insurance amount (PIA) payable at the full retirement age, currently 66. The benefits are then reduced or increased based on whether they are claimed before or after the full retirement age, which is itself increasing for those born between 1954 and 1959. Benefits might also be reduced for early claimants who continue working. Few Americans would be capable of making these calculations even if they had a computer spreadsheet program. Thus, individualized estimates of future retirement benefits are crucial if working Americans are to adequately plan their retirement saving.

Findings

Many People Cannot Estimate Their Social Security Benefits Accurately

The study found that the ability of individuals on the cusp of retirement to estimate their Social Security benefits is not strong. Figure 1 shows the combined results for all HRS waves from 1994 to 2008. Many responses—nearly 25 percent—are centered close to the true value of realized benefits (the peak in the figure). Many others, however, miss the mark by large margins. One-quarter of respondents underestimated their benefits by more than 22 percent, and one-tenth underestimated them by more than 50 percent. Likewise, one-quarter of respondents overestimated their benefits by more than 21 percent, and one-tenth overestimate their benefits by more than 100 percent.

Figure 1. Benefit-Estimation Errors, 1994–2008



The study also finds that women are more likely to incorrectly estimate their benefits than men and that individuals with relatively little education make greater errors than individuals with relatively high levels of education. The authors point out that it is common for a woman in their sample to earn benefits based on her husband's earning history even though the statement she receives from SSA describes benefits based on the woman's own earning history.

Slightly more people overestimated than underestimated their benefits. Over the period studied, the *median* individual overestimated benefits by 4 percent; due to the long right tail, the *average* error during that period was an overestimate of 14 percent.

The fact that expectations of retirement benefit levels are reasonably accurate at the median and the mean suggests that no one single factor, such as an inability to account for inflation, is causing prediction errors. Rather, it appears more likely that difficulty in predicting Social Security benefits arises simply because of the complexity of the benefit formula. Without outside assistance, Social Security benefits are difficult for most people to predict.

Americans' Knowledge of Benefits Has Not Improved with Access to the Statement

This study hypothesizes that people's ability to predict their benefits should have increased markedly when state-

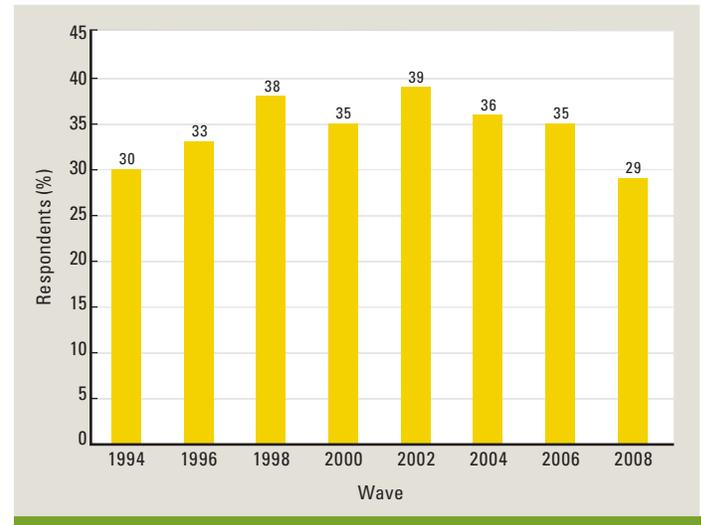
ments were first mailed to all near-retirees, followed by a more-gradual improvement as later retirees had repeated access to annual statements. Study results, however, did not support this hypothesis. People close to retirement have not become more accurate in predicting their benefits. In 2006–2008, the median difference between estimated and actual benefit levels was nearly 13 percent. This difference is slightly higher than in 1994, before the statement began universal distribution to near-retirees. In the intervening years, benefit-estimation errors have often been significantly larger.

More specifically, in 1994, 20 percent of respondents could estimate their retirement benefit within ± 5 percent; 46 percent could estimate their benefit within ± 10 percent; 56 percent could estimate within ± 15 percent; and 61 percent could estimate their true benefit within ± 20 percent. Following the introduction of automatic mailings of the statement, these percentages fell fairly steeply, recovering by 2008 to approximately 1994 levels.

To determine whether changes in population characteristics, such as gender, education, and race or ethnicity, might help account for changes in knowledge of retirement benefit levels, regression analysis was conducted to control for those factors. The results showed no statistically significant change overall in mean prediction errors before and after statements were first mailed in 1995. This finding of no effect also holds for particular subgroups of the population, such as women, African Americans, Hispanics, and individuals with a high school degree or less.

Another measure of how well Americans understand their Social Security statement is their ability to make *any* estimate at all—that is, to make a guess rather than responding that they “don’t know.” If fewer people claimed they “don’t know” after the Social Security statement was introduced, that would suggest rising confidence in their own knowledge. Study findings, however, do not reveal such a rise in confidence. Figure 2, which plots the percentage of “don’t knows” by HRS wave, shows they actually rose from 1994 (30 percent) through 1998 (38 percent). After peaking at 39 percent in 2002, the percentage declined to 29 percent for people claiming in the 2008 wave. Overall, there is no statistically significant change between 1994 and 2008 in the percentage of

Figure 2. Percentage of Respondents Who Do Not Provide Any Estimate of Benefits



respondents who claim they do not know how to estimate their benefits.

Conclusions

To conclude, the study does not find evidence that Americans have become more accurate in estimating their Social Security benefits since the Social Security statement has been universally distributed. Such a finding is difficult to explain. How could the universal distribution of the Social Security statement *not* improve understanding of expected benefits, especially for people just a year or two from retirement? As noted earlier, it is difficult for individuals to estimate benefits on their own. And until recently, online benefit estimators were not widespread. Given this, it is surprising that sending the statement to all near-retirees has not improved understanding of expected Social Security benefits. One possible explanation is that people simply have difficulty recalling numbers. If so, providing a dollar benefit estimate, however accurate, might not improve knowledge of benefit levels unless some further context were provided, such as the replacement rate paid to the individual by Social Security.

Another possible explanation is that many Americans are interpreting Social Security benefits as accruing to households rather than to individuals. Several of the his-

tograms generated by this analysis show spikes in benefit-estimation errors at negative 50 percent and positive 100 percent. In other words, many people are estimating their benefits at either half or double their actual value. Men tend to cluster at errors of -50 percent and women at errors of 100 percent of their realized benefits. It is not clear why this might occur, but it is worth further investigation. One possibility is that men disproportionately tend to view the benefit estimate in the statement as a household benefit, which they mentally divide in two to estimate their personal benefit. Likewise, women might

disproportionately attempt to estimate a household benefit, which they calculate by multiplying the statement's estimate by two.

Although this study focused on near-retirees, further research is needed to examine the statement's effect on young workers. It might be that the statement provides its greatest benefits to younger adults: They probably have little idea of what they will be entitled to receive, and they could make changes in their saving rates or portfolio allocations if they knew their likely future benefits from Social Security. ●