In Debt and Approaching Retirement: Tap into Your Social Security or Work Longer?

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Abstract

According to data tracked by the Federal Reserve System's Board of Governors, Americans' indebtedness increased dramatically from the late 1980s until just before the Great Recession (Federal Reserve Board 2010). Although household debt declined slightly following the most recent recession, in 2013 American households had considerably more debt than their counterparts in 1989. Older families, in particular, experienced the largest increases in debt over the period. Between 1989 and 2013, the median value of their debt increased between 4 and 5 times. In contrast, the median value of debt among younger families only doubled (Bricker et al. 2014).

Indebtedness could affect older adults in two ways. On one hand, debt might compel older individuals to keep working and thus delay retirement into their mid-sixties and beyond, so they can pay off their financial obligations. On the other hand, indebted adults who are cash-strapped and unable to service their debt might be tempted to tap into their Social Security benefits early to cover their required cash payments. Determining which of these two opposing effects dominates and how debt influences labor supply and claiming decisions is an empirical question, which previous literature has not addressed, but whose answer has important implications for individuals' economic well-being in retirement, and for government programs such as Social Security. Because taking up benefits early reduces monthly benefits for life, early

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claiming could significantly impair recipients' retirement income security. Although early Social Security claiming has declined over the last decade, it remains commonplace today as more than half of all Social Security beneficiaries claim their benefits before reaching full retirement age (Manchester and Song 2011, Purcell 2016).

This paper uses data from the Health and Retirement Study to fill this gap in the literature. With a simple conceptual framework, we show that early Social Security claiming provides older adults who are liquidity constrained with an additional income source for achieving better consumption smoothing. A testable implication of our simple model is that both increased labor supply and early benefit claiming, individually or in combination, are potential responses to the existence of borrowing constrains, with the magnitude of the response being a function of how binding the constraint is, among other factors.

In the empirical specification we model the probability of work and benefit receipt, as well as the duration till initial claiming and till full retirement as a function of indebtedness, using a variety of measures, and capturing different types of debt. Our robustness checks test for endogeneity and the presence of individual effects. Results show that the incidence as well as the absolute and relative value of debt among older households has been increasing. Further our empirical findings suggest that even when controlling for other factors, having debt is associated with higher propensity to work and lower likelihood of receiving Social Security benefits. Older individuals with outstanding mortgages, as well as other debt are more likely to postpone the initial claim of their benefits and delay fully retiring from the labor force.

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