Individual Heterogeneity in Loss Aversion and Its Impact on Social Security Claiming Decisions

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Key Findings and Policy Implications

This paper examines how loss aversion affects people’s financial decision-making, including when to claim Social Security benefits. Loss aversion is the idea that “losses loom larger than gains,” and it varies widely across individuals. The data for the analysis come from six different online studies conducted by the authors from 2012 through 2015, and with a cumulative sample of more than 7000 respondent of pre-retirement age. Among the findings:

- The new choice-based measure of loss aversion developed in the study has a similar distributional pattern as more complicated measures used in other studies. The new measure is also correlated with other characteristics of individuals; for example, women tend to have higher loss aversion than men.
- Loss aversion is highly predictive of a range of expressed preferences for financial decisions. For example, we consistently find that higher levels of loss aversion predict individuals’ preference for claiming Social Security benefits early. We also find that loss aversion is predictive of decisions about retirement savings, life annuities, and investment preferences, such choices between bond and stock funds.
- As illustration of the magnitude of impact, an individual with a low loss aversion score of 3 would be expected to claim Social Security about 6 months later than an individual with a high loss aversion score of 9 (age 66.8 versus age 66.3).
- Loss aversion has a predictive value over and above traditional measures of risk aversion, suggesting that loss aversion captures aspects of risk-taking preference that go beyond people’s subjective beliefs about the level of risk in a financial gamble.

Many policymakers and financial services firms currently employ generic risk perception questions when working with new clients; the new loss aversion measure developed in this study offers them the ability to gather individual information that is more predictive of actual financial choices, including Social Security claiming decisions. In may also be useful in framing the Social Security claiming options in ways that acknowledge the behavioral influence of loss aversion.

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