Key Findings and Policy Implications

Nobody knows how long they will live. Even the probability of surviving to one age or another may be uncertain. This paper analyzes the welfare cost of survival ambiguity (without private annuity markets), but also the potential value of survival ambiguity in improving the function of private annuity markets. The paper finds that:

- If there were no private annuity markets, then the welfare cost of survival ambiguity is large and regressive. On average, individuals would pay as much as 1% of total lifetime consumption to know their survival probabilities. The welfare cost for the bottom income quintile is about 4 times higher than for the top income quintile.

- With the availability of competitive annuity contracts, survival ambiguity may be welfare improving, because it allows insurance companies to pool risk across the population more broadly. Ambiguity is good, in this case, because it is harder to differentiate between low- and high-risk applicants, thereby reducing selection and market segmentation, and allowing annuity markets to function more effectively.

For some households, private annuities can be a valuable supplement to Social Security benefits in providing for financial support in retirement. Both provide an annuitized source of income that continues throughout later life, no matter how long a person lives. While Social Security is universal and mandatory, however, the availability of private annuity products depends on a well-functioning private marketplace. The contribution of this study is in better understanding the functioning and potential value of private annuity markets, and how they may benefit from survival ambiguity.

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