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HOW MUCH DO MEANS-TESTED BENEFITS REDUCE THE DEMAND FOR ANNUITIES?

ABSTRACT

Means-tested retirement benefits create incentives to cash out pension wealth. Individuals trade off the advantages from annuitization, receiving longevity risk insurance, to the disadvantages, giving up 'free' wealth in the form of means-tested supplemental income. We quantify the impact of means-tested benefits with a calibrated life-cycle model, demonstrating that they substantially reduce the desire to annuitize especially for low and intermediate levels of pension wealth. Using an administrative dataset on pension choices, we show that the model's predicted fraction of retirees choosing the annuity is able to match the annuitization pattern of occupational pension wealth observed in Switzerland. On the base of our model, we also assess alternative policies such as mandatory annutization and tougher asset tests.