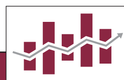

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WORKING THE GRAVEYARD SHIFT

Why raising the Social Security retirement age is not the answer

BY MONIQUE MORRISSEY AND EMILY GARR

The life expectancy of older Americans has increased by three and a half years over the past half century. In 2005, Americans who survived to age 65 could expect to live another 18.6 years, up from 15.1 years in 1955 (Bell, Bye, and Winters 2008).[1]

By 2050, the Social Security Administration estimates that the average 65-year-old will live 21 years in retirement (see **Figure A**). As our golden years grow longer, we will need to work longer, work harder, or increase the share of earnings devoted to funding retirement in order to ensure a comfortable old age. The choice depends on whether we prefer to enjoy the fruits of economic growth in the form of increased leisure or increased consumption.

Recently, much of the focus has been on working longer and retiring later. This is already a reality for many older Americans, whose labor force participation has been climbing over the past decade. But there are a number of Americans who still claim Social Security at or near the earliest eligibility age of 62, which concerns some experts and policy makers.[2] In their view, workers who retire at 62 may be retiring too soon for their own good, since taking early retirement reduces Social Security benefits while also requiring retirees to stretch their savings to last over more years.[3] A scheduled increase in the normal retirement age will reduce benefits further. Meanwhile, health care costs are mounting while other factors, such as a shift from traditional pensions to 401(k) plans, are compounding retirement insecurity.

Raising the earliest eligibility age may *seem* to be a solution to the problem of inadequate retirement incomes. Delaying retirement would increase early retirees' monthly benefits while keeping lifetime benefits the same. However, raising the early retirement age would disproportionately hurt lower-income workers and minorities, many of whom have little choice but to stop working in their early 60s due to poor health and job prospects. These workers have not seen significant gains in life expectancy and typically spend fewer years in retirement. Furthermore, raising the early retirement age

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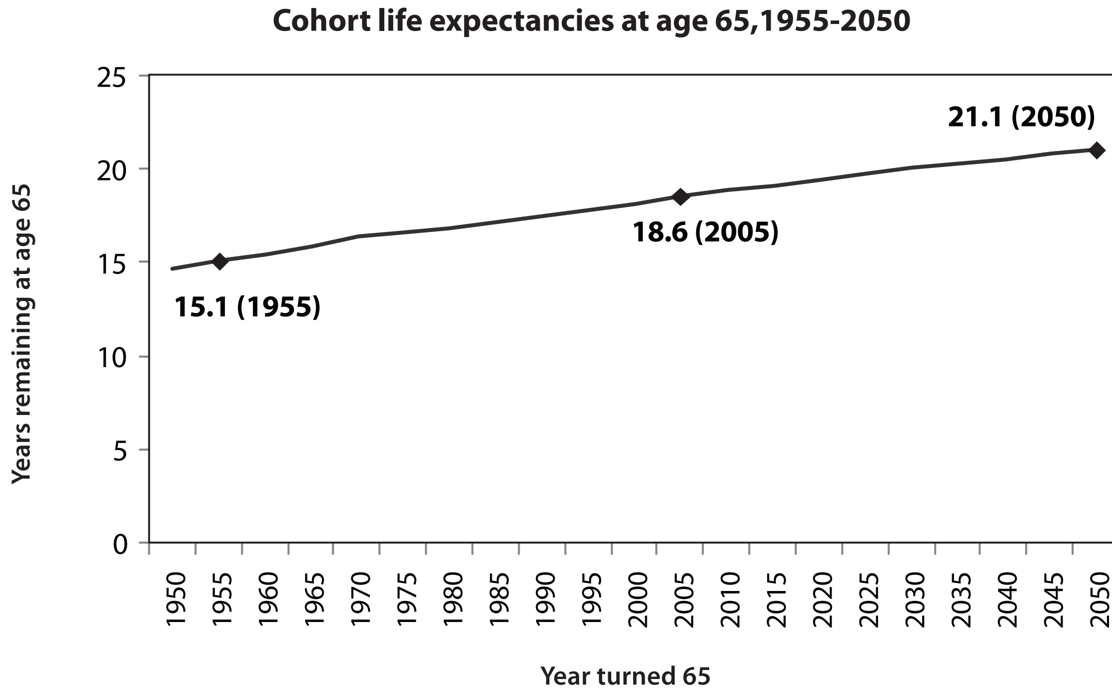
FIGURE A



SOURCE: Social Security Administration.

would do nothing to improve the system's finances because it does not change retirees' lifetime benefits.

Another option is increasing Social Security's normal retirement age, which is already in the process of moving up from 65 to 67.[4] Because this is equivalent to an across-the-board benefit cut, this would help Social Security's finances but would also reduce benefits at a time when Americans are increasingly ill-prepared for retirement.

Is another increase in the normal retirement age a painful but necessary choice, given that Social Security is facing a shortfall? Not necessarily, since Americans are also working harder and longer, and younger workers affected by the increase in the normal retirement age will likely spend a greater proportion of their lives in paid work relative to covered retirement than their parents did.

In fact, the projected Social Security shortfall that has emerged since 1983 has less to do with the increase in life expectancy, and more to do with a weak labor market and increasing income inequality. While the earnings of most workers have stagnated and earnings of those at the top have skyrocketed, the system's revenues have suffered because earnings above the taxable earnings cap are not subject to the Social Security payroll tax. The most direct and fairest solution to this problem would be to raise the cap on taxable earnings, not to raise the normal retirement age.

This Briefing Paper addresses the following points:

- **Raise taxes or cut benefits?** With Americans living longer and Social Security facing a projected long-term deficit of around 0.6% of gross domestic product do some are calling for another increase in Social Security's normal retirement age. But is such a benefit cut necessary, or should we raise revenues to deal with this modest shortfall?
- **Retirement security is declining.** The value of 401(k) assets has fallen by nearly a third since 2007, exacerbating a longer-term decline in retirement security as fewer Americans are covered by traditional pensions. Meanwhile, older Americans face rising out-of-pocket health costs.
- **Life expectancy should not be viewed in isolation.** Other long-term trends, such as an increase in women's

labor force participation and a tendency toward later retirement, have helped Social Security's bottom line. Over the program's history, Social Security contributions have grown much faster than life expectancy at retirement.

- **Today's workers pay more into the system.** Today's workers will live longer than their parents, but they will also pay more into the system, working more hours per year and retiring later.

- **Younger workers will see reduced benefits.** While paying more into the system, younger workers will forgo two years of covered benefits as the normal retirement age increases from 65 to 67. Unlike earlier generations, today's workers will also owe taxes on Social Security benefits.

- **Working women have helped Social Security's finances.** Americans work the equivalent of six days more a year on average than they did half a century ago, due to an increase in women's labor force participation. This increase in women's employment has helped Social Security's finances because the system subsidizes spouses who do not work and those who earn much less than their partners.

- **Raising the earliest eligibility age does not help the system's finances.** Some experts are concerned about the number of workers who retire when they first become eligible for reduced benefits at 62. Whether or not these workers are retiring too early for their own good, raising the earliest eligibility age would not help Social Security's finances because those who retire early receive reduced benefits.

- **Forcing people to work longer may hurt those it is meant to help.** Retiring at 62 makes sense for workers with shorter life expectancies and those who started working at a young age. Raising the earliest eligibility age would also hurt those who have little choice but to retire early due to poor health and job prospects.

- **Raising the Social Security retirement age would hurt low-income and minority workers.** Most of the increase in life expectancy in recent decades has been among higher-income workers, yet an increase in the retirement age would adversely affect low-income and minority workers who rely on Social Security the most.

- **The shortfall has more to do with widening income inequality and other labor market factors.** The earnings of most workers have stagnated while those at the top have skyrocketed. Meanwhile, rising health care costs are creating a growing wedge between compensation and wages. Both these trends have affected the system's finances because earnings above the taxable earnings cap and fringe benefits are not subject to the Social Security payroll tax. Meanwhile, rising Social Security disability rates may also be a function of a weak labor market and declining health coverage.

- **Reform efforts should directly address these challenges.** Serious efforts to close the Social Security shortfall and long-term fiscal imbalances should start by raising the cap on taxable earnings and tackling comprehensive health care reform. Other changes, including a modest increase in the payroll tax, may eventually prove necessary, but it makes no sense to cut benefits at a time when retirement insecurity is rising.

Is it necessary to raise the retirement age?

Proposals to raise Social Security's retirement age surface periodically. In August 2008, the idea received the prominent support of the American Academy of Actuaries, which called on policy makers to "immediately address Social Security's long-term financial issues by increasing the retirement age to reflect increased longevity" (American Academy of Actuaries 2008).

An earlier Academy of Actuaries Issue Brief summed up the profession's view of the demographic pressures facing Social Security and pension plans:

> In 1940, when Social Security first paid monthly retirement benefits and the number of private pension plans was just beginning to grow, individuals reaching age 65 lived, on average, for another 13 years. Furthermore, many workers entered the

> labor force at age 18, immediately after graduating from high school. These individuals could expect to work for 47 years before attaining "normal" retirement age…
>
> Fast forward to 2006: the demographics of pension planning have changed significantly. Approximately two-thirds of eligible non-disabled workers claim Social Security retirement benefits at age 62 rather than 65, and they enter the labor force at a later age, often at age 21 or even older, rather than age 18. This leaves about 40 years of work before an expected retirement at age 62, at which point remaining life expectancy is approximately 20 years. (American Academy of Actuaries 2006)

The Issue Brief went on to say that the increase in the ratio of years spent in retirement to the years spent in the labor force would require a 79% increase in contribution rates to finance the same level of benefits in 2006 as in 1940, an increase the authors said was not affordable.

This sounds convincing, but does it hold up under close scrutiny? Who are these hypothetical workers—presumably men—who began work before the turn of the last century and worked steadily for 47 years before retiring in 1940? Do we really know how much time they spent at work and in retirement? What about their wives?

This paper will challenge such actuarial determinism by focusing on more relevant time periods, and by examining the time different generations spent in paid employment and covered retirement. Many of today's workers, far from straining the system due to their tendency to live longer, will spend more time working and less time in covered retirement than their parents did, forgoing two years of benefits due to a scheduled increase in the normal retirement age.

It is also necessary to consider Social Security contributions, which have grown much faster than life expectancy in retirement. For example, workers who retired in 1940—the generation hailed for its industriousness by the Academy of Actuaries—contributed just 2% of earnings[5] to Social Security, compared to 12.4% for today's workers (both these figures include employer contributions).

In short, longevity trends should not be considered in isolation, but should be viewed alongside the many demographic and economic factors that affect Social Security and household finances. These include productivity gains, the increase in women's workforce participation, and changes to contribution rates and benefits.

Productivity gains

Can we afford longer retirements? The simple answer is yes—easily. Because of productivity growth, per capita income is rising even with an aging population and longer life expectancy. This means our economy is growing fast enough to support an increasing number of retirees at current, or even slowly rising, living standards. The more interesting question is how much of this increased productivity we want to channel into baking a bigger pie, and how much we want to channel into time off from pie-baking—enjoying longer retirements, taking longer vacations, pursuing interests outside of work, and taking time off to raise children. The answer reflects both individual preferences and public policy, with Europeans generally opting for longer retirements and increased leisure and caretaking, and Americans opting for increased consumption.

But the fact that as a society we can afford longer retirements at current or slowly rising benefit levels does not necessarily mean we are actually saving enough to avoid a drop in living standards at retirement. In other words, while productivity growth will easily enable us to support future retirees at current standards of living, in order to support future retirees at *future* standards of living we will need to work longer, work harder, or save more to compensate for longer lifespans. That said, it is important to remember that working longer is only one option.

Is Social Security in crisis?

Critics of Social Security often focus on the dependency ratio—the ratio of active workers to retirees at a given point in time. Because the large Baby Boom generation is entering retirement age and Americans are living longer, the dependency ratio will increase dramatically in coming years, making it appear as though the system is in crisis, even though it is not.

In fact, the projected Social Security shortfall is quite manageable. The Congressional Budget Office (CBO) estimates that a 1 percentage point increase in Social Security taxes would be sufficient to bring the program into balance for the next 75 years, and even the more pessimistic Social Security Trustees' Reports put the long-term gap at 1.7% of taxable payroll or 0.6% of GDP (U.S. Congressional Budget Office 2008; U.S. Social Security Administration 2008).

Even if nothing is done to close this shortfall, productivity growth will ensure that future retirees will receive higher benefits than current retirees. However, they will receive less than what they were promised and will experience a significant drop in income at retirement, since wages will have increased faster than retirement benefits (CBO 2008).

The focus on the dependency ratio is also a holdover from the days when retiree benefits were funded mostly from current taxes—what is known as a pay-as-you-go system. Such a system works well as long as the ratio of workers to retirees is stable. However, in 1983, the looming retirement of the baby boom generation led to an increase in payroll taxes and other changes that resulted in an accumulation of money in a trust fund for future retirees. In such an advance-funded system, it is less the dependency ratio that matters, but rather the ratio of time people spend in paid employment to time they spend in covered retirement over the course of their lifetimes.

In the absence of a payroll tax increase, work hours and retirement hours need to increase at the same pace to keep the system in balance and to prevent a drop in living standards at retirement. However, it is important to remember that an increase in work hours can occur during prime work years, not just by working longer into our 60s and 70s.

Even if the goal is to delay the *average* age of retirement, it does not follow that the way to do this is to raise the earliest eligibility age. Such a policy would penalize those who begin work at a younger age and who have shorter life expectancies—typically workers with less education and lower incomes. There are less punitive ways to increase the average age of retirement, such as educating workers and their spouses on the financial implications of early retirement.[6]

Other policies that use a "carrot" rather than "stick" approach include extending Medicare coverage to workers age 65 and older in order to encourage employers to hire and retain older workers, and permitting workers to opt out of additional Social Security contributions when they reach the normal retirement age (Goda, Shoven, and Slavov 2007; Burtless and Quinn 2002). However, such policies can be expensive and would tend to benefit wealthier, healthier workers.

Macroeconomic policies matter a lot, as tight labor markets boost the employment of both younger and older workers. Another priority, which will be discussed later in this paper, is to reform the employer-based retirement system so that it provides adequate retirement income to supplement Social Security, while encouraging workers to keep working if they are able and willing.

How Social Security benefits are calculated

It is useful to review how Social Security benefits are calculated to help us understand how raising the early or normal retirement age affects workers' monthly and lifetime benefits and the system's finances. Social Security retirement benefits are based on a formula that takes into account the following: workers' career earnings and their earnings relative to the general wage level; the number of years they worked; their age at retirement; and spousal earnings.

We can use prototypical workers to illustrate the progressive structure of retirement benefits. These are workers with career-average earnings equal to 45%, 100%, and 160% of Social Security's average wage index ("low," "medium," and "high earners," respectively):

- After 35 years, a low earner making around $18,400 who retired at the normal retirement age would receive benefits worth around $10,250 per year, or 55.7% of his or her pre-retirement earnings.
- A medium earner making around $40,900 would get benefits worth around $16,900 per year, or 41.3% of pre-retirement earnings.
- A high earner making around $65,300 would get benefits worth around $22,400, or 34.3% of pre-retirement earnings.[7]

Since payroll taxes are a fixed percentage of earnings up to the Social Security earnings cap, low-wage workers get smaller benefit checks to reflect their smaller contributions into the system. At the same time, Social Security's progressive benefit structure gives these workers higher benefits as a share of pre-retirement earnings—that is, they have what is known as a higher replacement rate. This helps ensure that these workers have enough to live on, while also compensating them for their shorter life expectancy—on average, low-wage workers will collect retirement benefits over fewer years.[8] This is a key point in the retirement age debate.

Currently, earnings above $102,000 are not taxed and are not factored into benefit calculations. In 2008, a worker who had earned the maximum taxable earnings throughout his or her career would receive benefits of around $26,450, or 28.4% of career-average earnings. The earnings cap is indexed to the average wage, but as income inequality has risen, an increasing share of earnings is not subject to Social Security tax. Raising the earnings cap would increase both contributions into the system and benefits paid out, but the net impact on the system's finances would be positive because of the progressive benefit structure.

Spouses are also eligible for retirement benefits. Spousal benefits are equal to 50% of the eligible worker's benefit. When both spouses work, the lower-earning spouse, often the wife, will receive the higher amount of either his or her own retiree benefits or the spousal benefit.

Benefits are also adjusted for retirement age, so that lifetime benefits are roughly the same for someone who retires at 62 as someone who retires at 70—they are simply spread out over more years. Likewise, benefits are adjusted for the number of years worked up to 35 years.

The fact that benefits are adjusted for age and years worked means that encouraging people to work longer has little impact on the program's finances. It is also neither a better nor worse deal for the average worker. However, postponing retirement does increase the size of a retiree's monthly check and can thus prevent a significant drop in income at retirement. But for workers in poor health or with poor job prospects, this may not be a good reason to postpone retirement.

There are some exceptions to the general rule that postponing retirement does not change lifetime benefits nor affect the system's finances. For example, since benefits are based on the highest 35 years of earnings, raising the early retirement age would increase the number of workers who stop accruing significant new benefits after 35 years yet are still paying into the system. However, this would also increase the number of workers who apply for disability benefits (disabled workers who would have taken early retirement at 62). Therefore, experts believe the net impact on Social Security would likely be negative (Munnell et al. 2004).

The Greenspan Commission

In the late 1970s, stagflation—high inflation and stagnant wages—coupled with an ill-conceived benefit expansion, led to a short-term funding crisis. Social Security historians consider this a watershed in the program's history, as four decades of expansion gave way to concerns about the program's finances (Martin and Weaver 2005).

In 1977, amendments to the Social Security Act corrected the flawed benefit formula and made other changes to shore up the program, but Social Security again faced a shortfall less than six years later. A presidential panel that became known as the Greenspan Commission recommended a number of changes that Congress and President Reagan implemented in 1983, which included accelerating a scheduled increase in the payroll tax rate, delaying cost-of-living adjustments, and partially taxing Social Security benefits and dedicating the revenues to the Social Security trust fund.

These cutbacks closed the short-term shortfall, but were not sufficient to deal with the looming retirement of the Baby Boom generation. The Commission was divided on whether to address this longer-term fiscal problem by increasing payroll taxes or pushing back the retirement age. In the end, Congress decided to gradually increase the normal retirement age from 65 to 67 over 22 years beginning in 2000, the first increase in the retirement age since the program was founded.

As a result of these changes, today's workers will pay higher payroll taxes and receive lower benefits than previous generations. When fully implemented, the increase in the normal retirement age will amount to a roughly 13%

cut in retirement benefits for most workers.[9] Meanwhile, future retirees will also pay taxes on Social Security benefits and face higher Medicare premiums.

For workers retiring before and after the scheduled increase in the retirement age, these cutbacks will more than outweigh the expected increase in life expectancy. The Social Security Administration estimates that a 65-year-old in 2025 will live 1.6 years longer than a 65-year-old in 2000 who was eligible for full retirement benefits, yet will have to work two more years before reaching the normal retirement age.

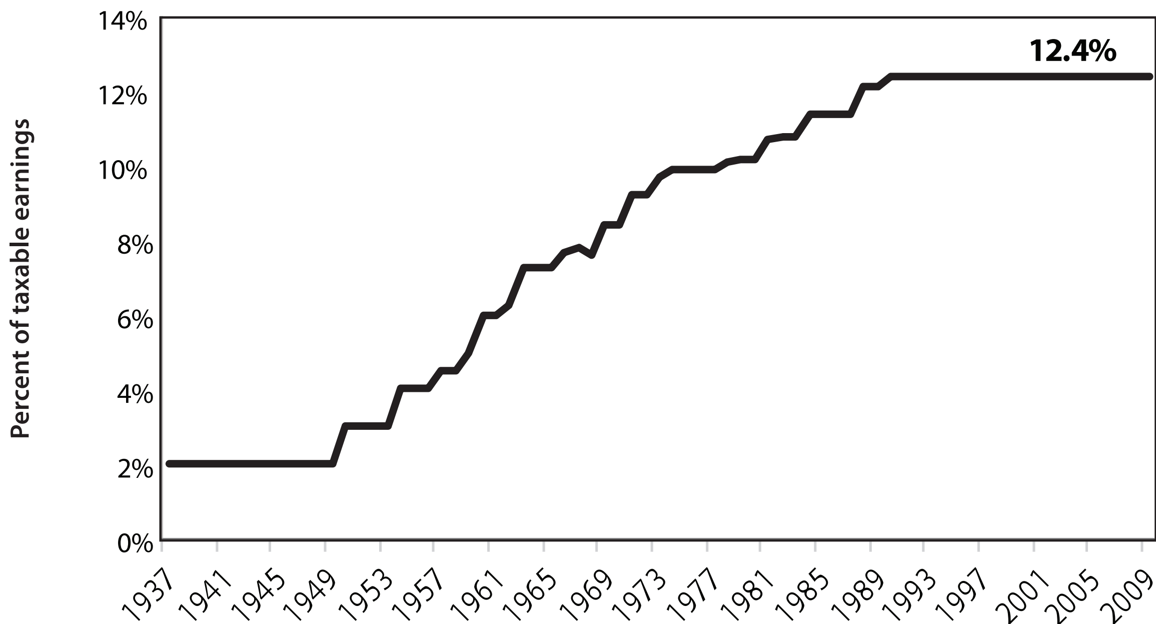
Of course, one could argue that the increase in the normal retirement age was overdue, since life expectancy at 65 has risen by about five years since the program's inception. But Social Security taxes have increased more than life expectancy—from 2.0% of covered earnings in 1937 to 12.4% in 1990 (**Figure B**)—allowing the program to expand benefits and increase coverage while accommodating longer lifespans.[10]

Americans are working longer

A higher normal retirement age is simply a benefit cut; it may or may not affect when people actually retire. Nevertheless, the past two decades have seen a reversal of the long-term trend toward earlier retirement. In 2007, more than half (53%) of Americans in their early 60s were in the labor force, up from 43% two decades earlier (see **Figure C**). Similarly, the share of Americans 65 and older who were still in the labor force rose from 11% to 16% in that period.

The timing suggests that this phenomenon had little to do with the gradual increase in the retirement age beginning in 2000 and more to do with the shift from traditional pensions to 401(k) plans. Whereas traditional pensions often encourage and enable workers to retire at or before the normal retirement age for Social Security, 401(k) plans make no distinction between workers retiring between age 59-and-a-half (the earliest that participants can tap into these accounts without paying a penalty)

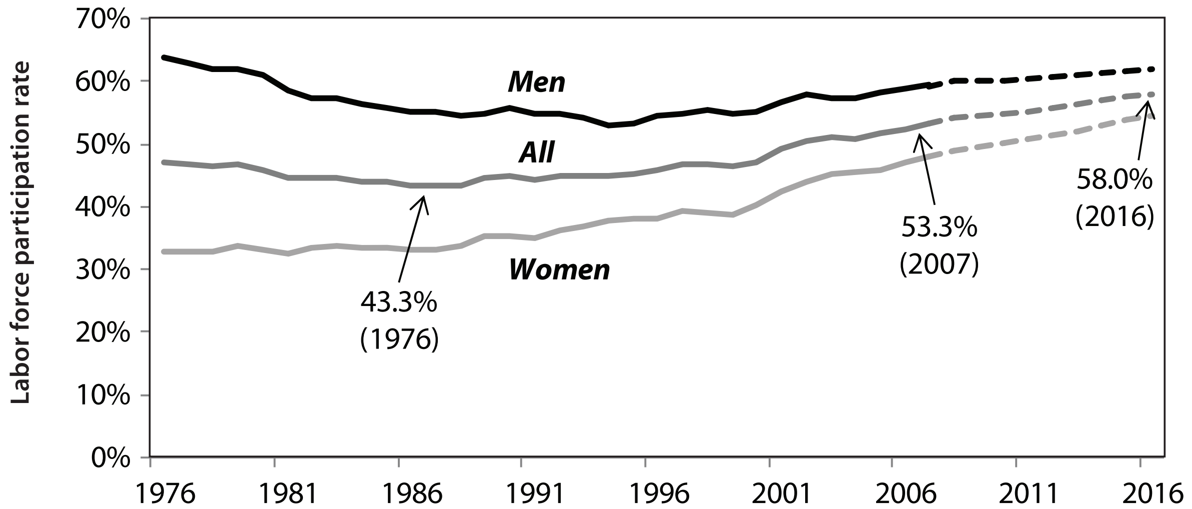
FIGURE B



* Total contribution from both employees and employers.

SOURCE: Social Security Administration.

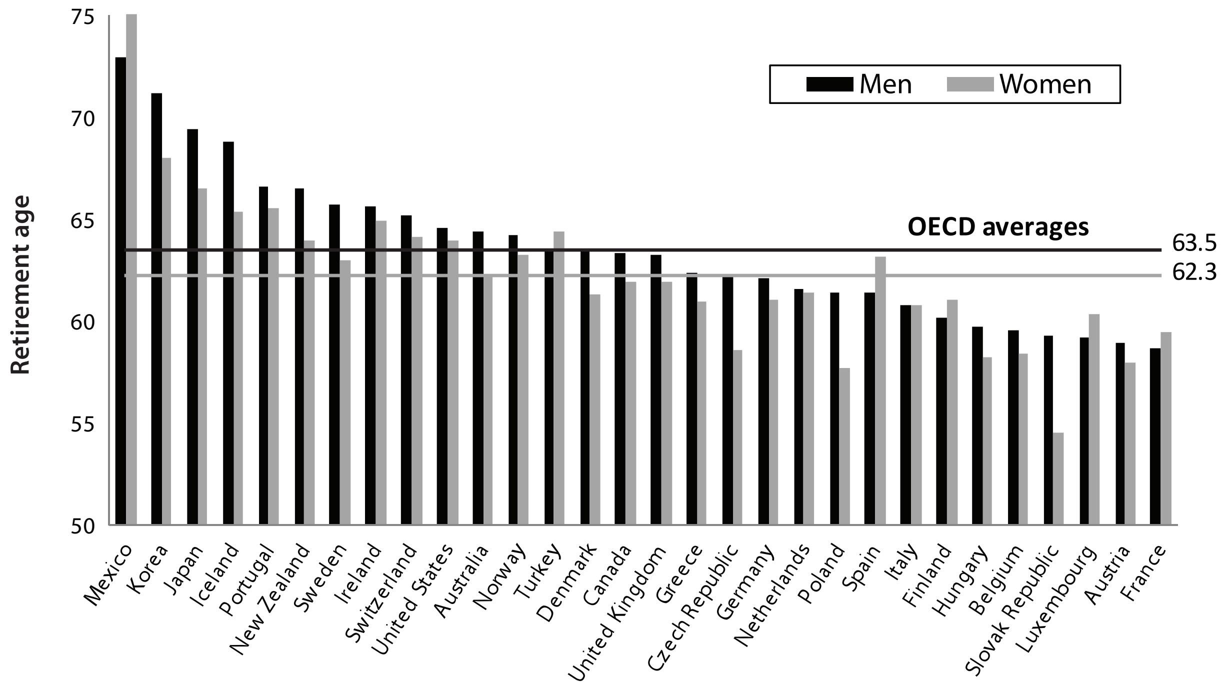
FIGURE C



*2008-2016 are BLS projections.

SOURCE: Bureau of Labor Statistics.

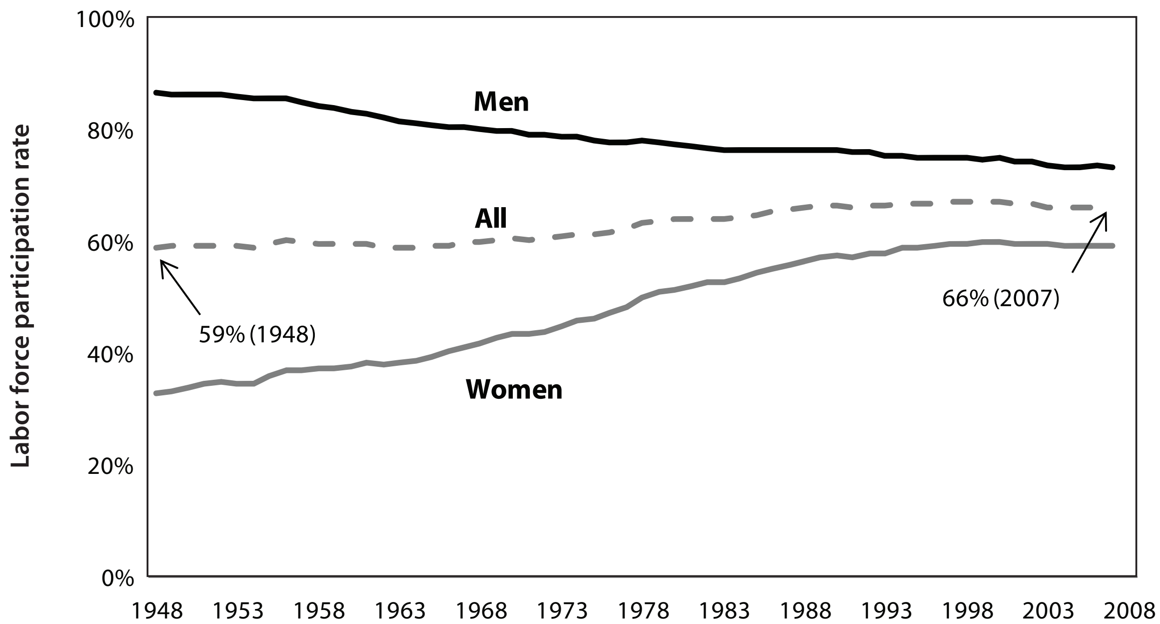
FIGURE D



SOURCE: OECD, using average effective age of retirement from European and national Labor Force Surveys.

FIGURE E

Labor force participation rates of people 16 and over, 1948-2007



SOURCE: Bureau of Labor Statistics.

and 70-and-a-half (when retirees must begin taking money out).

While retirement age *per se* matters less to 401(k) participants, they may be forced to keep working simply because they have inadequate funds in their accounts. The 2001 recession was unusual in that the labor force participation of 60- to 64-year-olds rose rather than fell—as used to be the pattern during recessions—possibly because some workers delayed retirement in response to the collapse of the stock market bubble (Morrissey 2008). This pattern appears to be repeating itself in the current recession, as the labor force participation rate of 60- to 64-year-olds rose from 53.2% in December 2007 to 55.2% in December 2007 (U.S. Bureau of Labor Statistics).

Regardless of the reason, it is important to recognize that Americans are retiring later than they did 20 years ago, and later than their counterparts in most other industrialized countries, particularly in Western Europe. The average effective age of retirement[11] in the United States is 64.6 years for men and 63.9 years for women, compared to 63.5 and 62.3 years for men and women respectively in the Organization for Economic Cooperation and Development (OECD) countries as a group (**Figure D**).

The Bureau of Labor Statistics projects that older workers' labor participation will only continue to increase, with the participation rate for 60- to 64-year-olds rising from 54% to 58% between 2008 and 2016. The rate for those 65 and over is projected to rise from 17% to 22% in the same period.

Americans are working harder

Not only are more Americans extending their working lives, but their work hours have trended upward in the postwar period by about an hour per year. The increase coincided with an influx of women into the labor force, which more than offset a smaller decline in men's labor force participation (see **Figure E**).[12]

The increase in women's labor force participation and earnings has had a dual impact on our retirement system, boosting many households' Social Security benefits while also helping the system's finances. This is because the

program subsidizes spouses who do not work, or who earn substantially less than their partners.

As women have earned more and contributed more to Social Security, households' retirement benefits have also risen, though not as fast. The Center for Retirement Research has estimated that the average married couple's benefits, as a share of pre-retirement earnings, declined from around 50% in 1961 to around 45% in 2005.[13] Since contributions rose faster than benefits, this provided a boost to the system's finances, a trend that is likely to continue as women narrow the earnings gap with men.

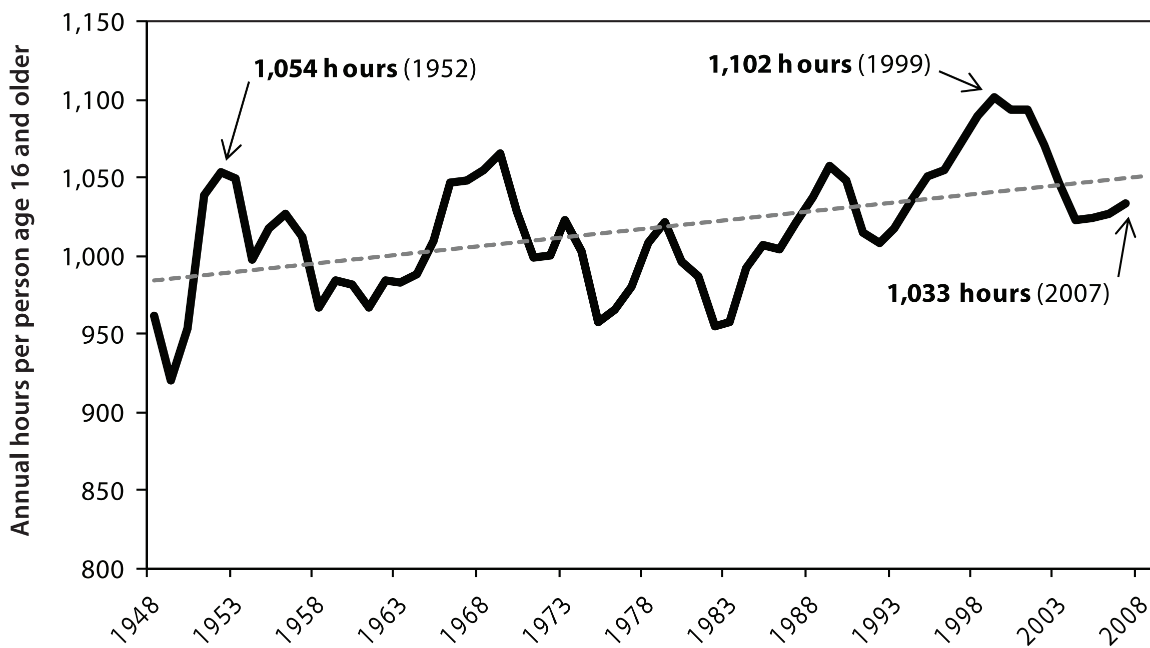
As a result of the increase in women's labor force participation, the average person aged 16 and over worked 48 more hours in 1999—the equivalent of six extra days—compared to the average person in 1952, at comparable high points in the business cycle. This increase occurred despite an aging population (**Figure F**).

An estimate of lifetime work hours per capita can be calculated by summing over 50-year periods corresponding to ages 16-65 for each generation, and dividing this total by 2,000 hours per year. This converts lifetime work hours to full-time equivalent (FTE) years worked per person, capturing the growth in hours by prime-age workers, but understating the effect of people retiring later.[14]

If work hours resume their 1999 peak levels (they have since dropped off due to a weak economy), this will translate into the equivalent of 1.7 years of additional full-time work over the lifetime of someone born in 1975 compared to one born in 1935 (**Table 1**). This is less than the increase in life expectancy at retirement (2.4 years), but more than the increase in *covered* retirement (0.4 years), taking into account the scheduled increase in the retirement age. However, if per capita work hours do not recover—if they remain at the current low level—then the increase in life expectancy may need to be addressed within these younger workers' lifetimes.

Is it realistic to assume that per capita work hours will regain or surpass 1999 levels? Perhaps. The Social Security Administration projects that labor force participation and average hours per worker will be relatively flat going forward (U.S. Social Security Administration 2008), and some experts, such as Bureau of Labor

FIGURE F



SOURCE: Author's analysis of U.S. Department of Commerce, BEA data.

TABLE 1

Estimated years of work and covered retirement for successive generations

Birth year	1935	1945	1955	1965	1975
Years of work (FTE), if future hours same as 1999*	25.4	25.7	26.1	26.6	27.1
Years of work (FTE), if future hours same as 2007	25.4	25.5	25.5	25.5	25.5
Normal retirement age (NRA)	65	66	66 & 2 mos.	67	67
Life expectancy at 65	18.2	18.9	19.5	20.1	20.6
Covered retirement (65+ life expectancy – NRA)	18.2	17.9	18.3	18.1	18.6

* Full-time equivalent.

SOURCE: Author's analysis of U.S. Department of Commerce (BEA) and Social Security Administration data.

Statistics economist Mitra Toossi, even project declines (Toossi 2006).

However, such estimates tend to be heavily influenced by recent trends and often downplay or ignore macroeconomic factors.[15] Projecting forward from current levels and adjusting only for compositional changes in the labor force could lead to pessimistic forecasts, since the labor market has been very slack during what has been dubbed the "jobless recovery" in the years following the 2001 recession.[16] In this period, the decline in labor force participation was concentrated among teens and young adults, groups typically sensitive to economic slowdowns (Mosisa and Hipple 2006).

Over the past two decades, per capita work hours have also been depressed by the high share of people on Social Security Disability Insurance (SSDI). This itself is partly a function of a weak labor market that reduces job opportunities for people with work limitations while also making disability benefits more attractive relative to wages. Thus, disability incidence rates rose in the early 1990s, leveled off in the second half of the decade when the job market tightened, and then began climbing again in 2001 (SSAB Technical Panel 2008). Disability take-up is also influenced by declining health care coverage because SSDI recipients are eligible for Medicare after two years.

Work hours and participation could easily recover with a stronger economy, which would have numerous other beneficial effects, including reducing the number of older workers who lose their jobs and are left with few options besides early retirement or going on disability. Comprehensive health care reform could also help Social Security's finances, both because universal coverage could reduce the number of workers on SSDI, and because the skyrocketing cost of health insurance is creating a growing wedge between compensation and taxable earnings.

Whether or not work hours rebound also depends on whether the long-term trend of higher participation and hours by women has peaked. While much has been made about the decline in women's labor force participation over the recent decade (Cohany and Sok 2007), this itself appears largely a function of weak labor demand (Boushey 2005).

Even if the trend toward increasing participation and hours has leveled off, and young women entering the workforce are no more inclined to work than their immediate predecessors, work hours will still get a boost as long as these young women are more job-oriented than the generation entering retirement.

Is it fair?

Any increase in the normal retirement age is equivalent to an across-the-board benefit cut, so it should have the same impact on all workers—at least in theory. In practice, low-income workers can less easily absorb these cuts since they rely much more on Social Security to fund their retirement and to keep them out of poverty in old age.

Similarly, an increase in the earliest eligibility age disproportionately affects workers with lower socioeconomic status, since these workers have shorter retirements. The

evidence also suggests that these workers are more likely to retire at or near age 62.[17] Research published by the Boston College Center for Retirement Research found that 66% of early claimants had a high school diploma or less, versus 50% of those who claimed at age 63 or later. Not surprisingly, early retirement also tends to be correlated with poor health. Early claimants are much more likely than later claimants to describe themselves as in fair or poor health and to express doubt that they will live to 75 (Zhivan et al. 2008).

There is a strong and well-established link between socioeconomic status and life expectancy. Thus, whether or not low-income workers and other disadvantaged groups tend to retire at a younger age, their shorter life expectancy translates into shorter retirements on average. This is especially true for African American males, more than a quarter of whom will die before reaching Social Security's early retirement age, a mortality rate more than twice as high as that of the general population.[18] Black men who do live to age 62 can expect to live an additional 16.9 years, compared to 19.3 years for white men and 20.9 years for the general population (Arias 2007). Thus, any increase in the earliest eligibility age would disproportionately affect these workers.

Conversely, most of the *increase* in life expectancy in recent decades has been among higher-income workers. According to a study by Hilary Waldron of the Social Security Administration, a man in the top half of the earnings distribution who turned 65 in 1977 could expect to live 0.7 years longer than one in the bottom half. By 2006, the gap had widened to 5.4 years (**Figure G**) (Waldron 2007).

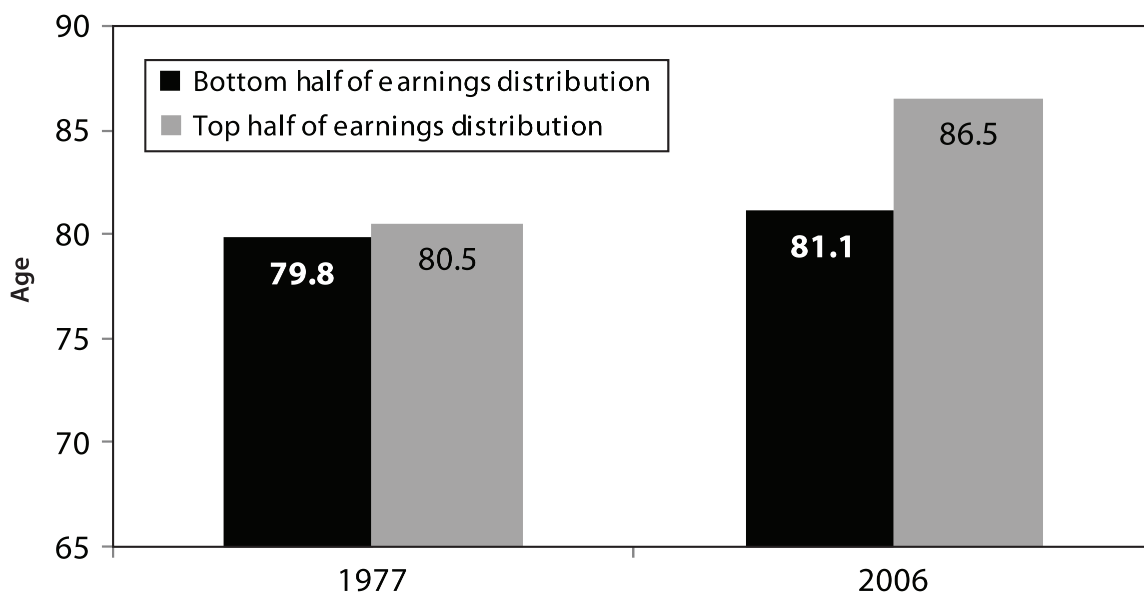
Other research confirms that socioeconomic disparities in life expectancy are large and growing. A study published in 2006 in the *International Journal of Epidemiology* ranked U.S. counties according to an index of socioeconomic status.[19] It found that life expectancy at birth was 2.8 years longer for the least-deprived group than for the most-deprived group in 1980-82, a gap that had widened to 4.5 years by 1998-2000 (Singh and Siahpush 2006).

Is working longer a realistic option for everyone?

Many workers are forced to retire earlier than anticipated because of health reasons or job loss. Thus, working

FIGURE G

Expected longevity for males at age 65



SOURCE: Author's calculations based on Waldron (2007).

longer—at least in a job with comparable pay and benefits—is often not an option for those who develop health problems or are laid off late in their careers. A 2006 McKinsey survey found that about 40% of workers are forced to retire earlier than they planned, with health—or health of a family member—the reason cited for over half of these early retirements (Rotenberg 2006).

Even for older workers for whom health is not a factor, the labor market presents daunting challenges. Older workers are now more likely to be displaced from their job than younger workers, either because a plant or company closed, their position was eliminated, or other shifts in labor demand.

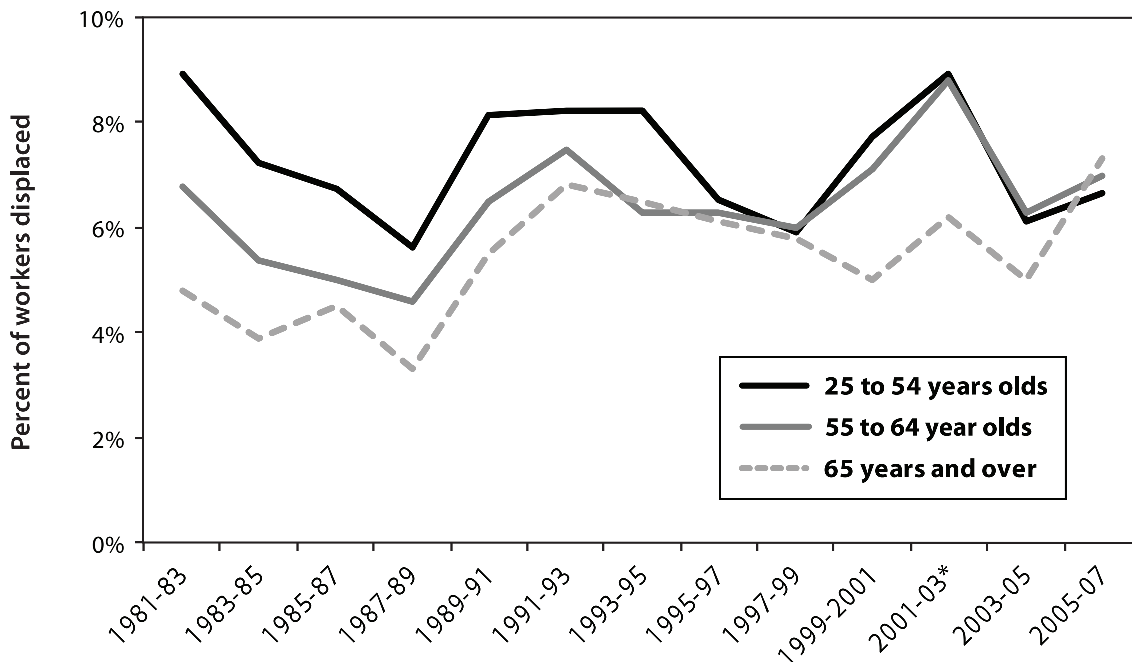
Historically, older workers had lower displacement rates than younger ones. This is in part because employers, especially unionized ones, often laid off workers in reverse order of seniority. But as lifetime employment has become the exception rather than the norm, there has been a decline in job tenure and an increase in the displacement of older workers. In 2003, the displacement rate of 55 to 64-year-old workers surpassed that of workers 25 to 54 (**Figure H**). In the most recent survey covering 2005-07, the same occurred for workers 65 and over.

This is bad news for older workers, who have more difficulty finding new jobs than younger ones. Only 61% of workers age 55-64 who lost their jobs in 2005-07 had been reemployed as of January 2008, compared to 75% of those age 25 to 54.[20] For older workers who do find jobs, displacement also has a disproportionately negative effect on their earnings compared to younger workers (O'Leary and Eberts 2008). An Urban Institute study found that 43% of older workers who were laid off from long-term jobs saw their wages decline by a quarter or more, and 22% saw their wages decline by half or more (Johnson and Kawachi 2007).

This suggests that early retirement may be a rational economic decision—and perhaps the only real option—for many older workers, especially lower-income workers whose Social Security benefits may replace upwards of 45% of earnings even with early retirement.

FIGURE H

Displacement rates by age group, 1981-2007



* Revised employment using Census 2000-based population controls.

SOURCE: Displaced worker supplement of the CPS, Bureau of Labor Statistics.

Addressing the real challenges

The other legs of the retirement stool

Despite recent cutbacks, Social Security remains the cornerstone of our retirement system, providing nearly three-fourths of the typical retiree's income.[21] The importance of Social Security is due to the fact that only half of all workers participate in a retirement plan at work, a share that has remained roughly unchanged since the early 1990s (Copeland 2008; Sanzenbacher 2006).

In recent years, the two weaker legs of what is often referred to as the "three-legged stool" of retirement income—employer-based plans and personal savings—have become even wobblier. In particular, the shift from traditional defined-benefit pensions to 401(k)s and similar defined-contribution plans (**Figure I**) has placed much of the cost and the risk of retirement on workers. The failure of the current system was laid bare by the recent market downturn, in which the typical participant saw the value of their 401(k) assets plunge by nearly a third since the end of 2007.[22]

The shift from traditional pensions to 401(k)s has led to inadequate savings and leakages from the retirement system in the form of high fees, loans, and early withdrawals. Those who do manage to contribute steadily to their 401(k)s are exposed to the risk of market downturns and of outliving their savings. Meanwhile, government subsidies go to those who need the least help saving for retirement, as an estimated 70% of tax breaks for 401(k) plans and IRAs go to the top 20% of households ranked by income (Burman et al. 2004).

Thus, while much attention has focused on the relatively manageable Social Security shortfall, the employer-based retirement system, which has never done a good job providing benefits for low-income workers, is now failing even the middle class. The focus of reform should be on ensuring steady contributions, preserving savings for retirement, shielding participants from financial and longevity risk, and helping everyone, not just the wealthy, save for retirement. These are the goals of the Guaranteed Retirement Plan (GRA) developed by Professor Teresa Ghilarducci as part of the Economic Policy Institute's Agenda for Shared Prosperity (Ghilarducci 2007). Ideally, the employer-based retirement system should also encourage—but not force—workers to postpone retirement. The GRA plan would allow workers to steadily accumulate retirement benefits for every hour worked, regardless of when they decide to retire.

Another concern is that the role of housing as a conduit to steady savings eroded with the spread of sub-prime mortgages and home equity withdrawals, and the housing crisis is now in the process of wiping out the remaining "brick and mortar" savings of many Americans.

The real challenges facing Social Security

In 1983, following the reforms associated with the Greenspan Commission, Social Security was projected to be in balance over the 75-year planning horizon. A quarter century later, the 2008 Social Security Trustees Report projected a long-term deficit equal to 1.70% of taxable payroll, or 0.61% of GDP. The Congressional Budget Office, which has generally been less pessimistic about the system's finances, projects a 75-year deficit equal to 1.06% of taxable payroll, or 0.38% of GDP (U.S. CBO 2008).

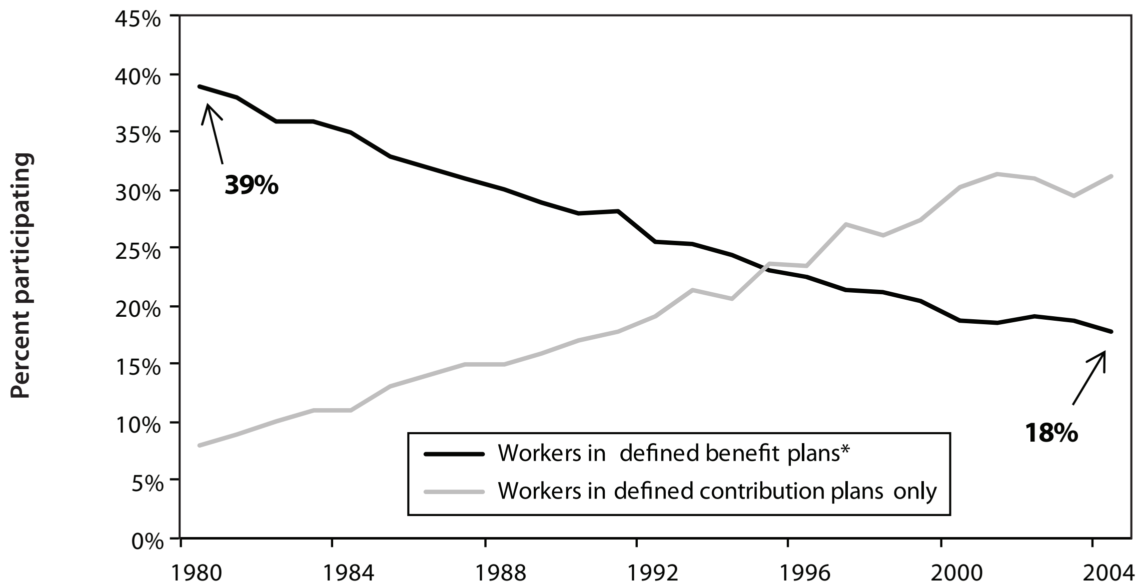
What happened after 1983 to put Social Security in the red? According to an analysis of Social Security projections by EPI economist Josh Bivens, more than half of the projected shortfall that emerged between 1983 and 2005 was due to higher disability costs and economic factors, like sluggish wage growth. Demographic factors, including longer life expectancies, were much less important.[24]

The Trustees' Reports do not explicitly account for the effect of rising inequality, though this had a significant impact on the system's finances. Because the earnings of most workers have stagnated while those at the top have skyrocketed, the share of earnings below the taxable earnings cap (currently set at $102,000) has shrunk from 90% in 1983 to around 83% today. Restoring the taxable earnings cap to levels capturing 90% of earnings would eliminate approximately 40% of the projected shortfall, and getting rid of the cap altogether would put the program back in balance over the 75-year horizon (Mulvey and Whitman 2008).

Another factor has been rising health care costs, because untaxed fringe benefits are not included in taxable earnings. The 2008 Social Security Trustees' Report projects that fringe benefits will continue to erode taxable earnings, lowering real wage growth from 1.3% to 1.1%

FIGURE I

Share of workers in defined-contribution and defined-benefit plans, 1980-2004

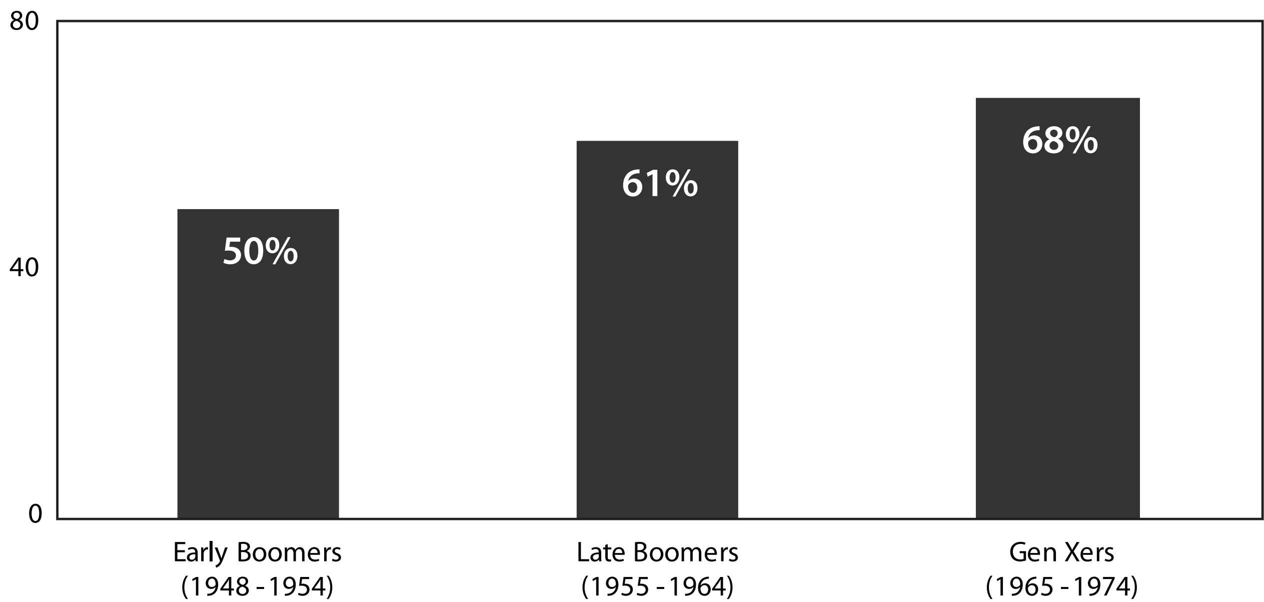


* Includes those who have supplementary defined contribution plans as well.

SOURCE: Center for Retirement Research (2006).

FIGURE J

Share at risk of not being able to maintain their standard of living in retirement*



* Based on National Retirement Risk Index (NRRI), with health care expenses included.

SOURCE: Boston College Center for Retirement Research (2008).

and increasing the 75-year deficit by about 0.23% of taxable payroll (around 14% of the projected shortfall).[25]

Are there fairer solutions?

Over the postwar period, Americans have increased their Social Security contributions and their hours worked as more of them have survived into old age. This enabled an increasing number of workers to enjoy retirement, a privilege previously reserved for a wealthy and healthy few. Meanwhile, the poverty rate for seniors has fallen dramatically and is now less than a third what it was in 1960 (NBER 2004).

Yet many experts predicted that the later Baby Boomers would be the first generation in modern U.S. history with less retirement security than their parents (**Figure J**), even before the drop-off in 401(k) values.[26] As discussed in this paper, the problem is not a growing imbalance between work and leisure, but the unraveling of the postwar social compact that provided broadly shared prosperity, including pension and health benefits for many workers. Former EPI economist Jared Bernstein has characterized recent policies, which have led to increased inequality, underemployment, and the shifting of health and financial risks to the individual as "you're on your own," or yo-yo economics (Bernstein 2006).

The first priority is directly addressing one of the main causes of the Social Security deficit by raising or eliminating the cap on covered earnings. Other reforms, including a modest increase in the payroll tax, may eventually prove necessary. However, it makes no sense to cut benefits at a time when retirement insecurity is increasing.

Americans of all ages understand this. A recent AARP poll found that workers ranked increasing the taxable earnings cap *first*, and increasing the payroll tax second, as the best ways to ensure that Social Security can meet its long-term financial obligations. Whereas 71% of respondents favored raising the cap to $150,000, only 33% supported gradually increasing the retirement age to 70 (AARP 2007). The fact that even younger workers were leery of raising the retirement age is striking, since people tend to overestimate their ability to continue working into their 60s or 70s (Helman, Copeland, and VanDerhei 2006).

If anything, our discussions should revolve around restoring Social Security benefits trimmed in the wake of the Greenspan Commission. These benefits were hardly generous to begin with. Americans receive smaller government-provided pensions than workers in other countries. Social Security replaces 43.6% of pre-retirement earnings for the average U.S. worker (see **Figure K**), compared to 60.8% for the OECD countries as a group.

Ultimately, a comprehensive solution will need to do more than close the relatively manageable Social Security shortfall. We need to fix our national health care system. The United States spends roughly twice as much as other developed countries on health care, with no significant difference in outcomes or longevity. We also need to fix our employer-based retirement system by increasing contributions into the system and plugging leakages out of it, rather than mandating later retirement. Last but not least, we need an economy that works for working Americans, with a tight labor market that reduces inequality and increases hours worked.

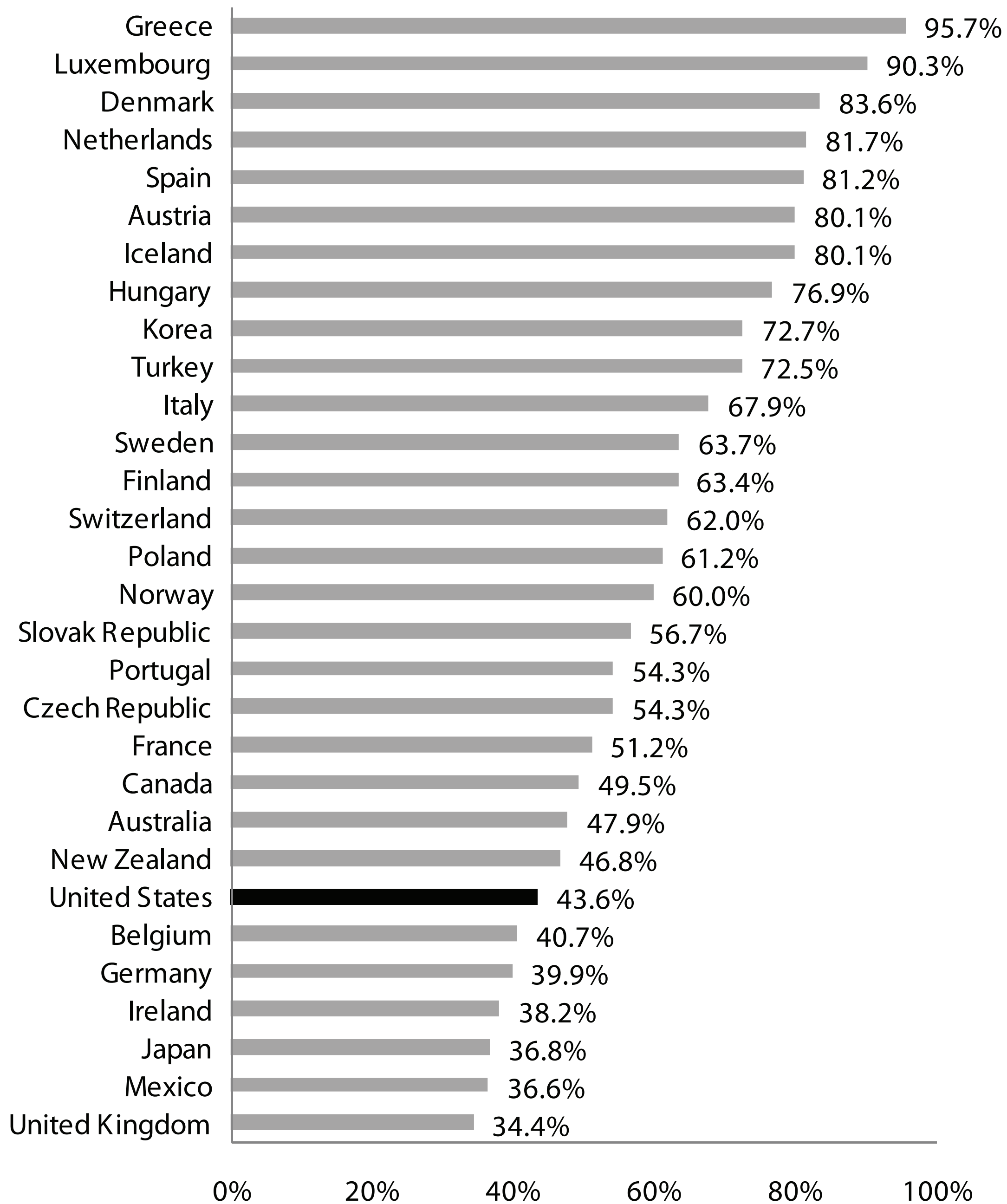
Conclusion

The assumption of many retirement experts is that people do not know what they are doing when they claim Social Security benefits at age 62. This concern is understandable, given the voluminous evidence of Americans' short-sightedness when it comes to planning for retirement. Left to their own devices, people tend to put short-term needs before long-term goals, have trouble converting lump sums to income streams, and underestimate their life expectancy at retirement. The result is that people tend to underestimate how much they need in order to retire comfortably.

However, the fact that people fail to adequately prepare for their retirement does not necessarily mean that people make the wrong decision when faced with the two options they have left: continuing to work—or to look for work—into their 60s or 70s, or accepting a reduced income in retirement. Until retirement experts can demonstrate that many people come to regret their decision to retire early, the assumption should be that they are doing what is best for them.

Many experts acknowledge that they may be biased by their own experiences. As educated workers with interesting and secure jobs, the idea of postponing retire-

FIGURE K



SOURCE: OECD (2007), Pensions at a Glance.

ment may not seem as onerous as it would be for someone working in a meat-packing plant or even a sales job.

Some experts, such as Alicia Munnell and other researchers associated with the Center for Retirement Research, have suggested that we may be able to push back the early retirement age while protecting vulnerable people—exempting low-income workers, for example (Miller 2008; Zhivan et al 2008). But the danger is that

the protections will be lost in the political process, yet the idea will be planted that an increase in the early retirement age is necessary.

Two centuries ago political economist Thomas Malthus focused on what he viewed as the mathematical certainty that child-bearing by the poor would cause the planet to be overrun, ignoring the promise of productivity growth and downplaying distributional issues. Similarly, the current debate about retirement often focuses narrowly on increases in life expectancy to paint an image of a looming demographic catastrophe.

The fact that more of us are living long enough to retire in good health should be celebrated, not deplored. Retirement should not be viewed as a luxury reserved for the few or a necessity reserved for the sick, but rather the broadly shared goal of any civilized, prosperous nation.

Endnotes

1. Note that life expectancy at birth has increased faster than life expectancy at retirement (Weller 2000).
2. See, for example, Munnell et al. (2004).
3. In 2000, the benefit check of a worker who claimed Social Security benefits at 62 was 20% smaller than that of a worker who retired at 65. The scheduled increase in the normal retirement age will reduce benefits still further—to 30% below the normal amount.
4. This will take place over a 22-year period that began in 2000, part of a package of Social Security reforms instituted in 1983 to improve the system's finances.
5. This generation contributed for only three years before retiring. The legacy costs of these early retirees were paid by subsequent generations.
6. See, for example, Munnell (2008).
7. Authors' calculations, based on the 2008 Social Security Trustees Report. All dollar figures are adjusted for inflation.
8. The issue of whether the ratio of *lifetime* retirement benefits relative to contributions is higher or lower for low-income workers is a much-debated topic. However, experts generally agree that the Social Security program as a whole—including disability and survivor benefits—is progressive, that is, favors low-income workers.
9. Authors' calculations based on Social Security Administration, "Effect of Early or Delayed Retirement on Retirement Benefits," available online at http://www.ssa.gov/OACT/ProgData/ar_drc.html. The reduction is less for those who retire at age 66 or above.
10. In addition, the 1983 reforms instituted the partial taxation of Social Security benefits.
11. This is the average age of all persons 40 and over who withdrew from the labor force in 2002-07, whether by choice or due to death or disability.
12. The increase in women's labor force participation more than offset the decline in men's participation as well as a decline in hours per worker, so that hours *per capita* increased in the postwar period. See, for example, SSAB Technical Panel (2008).
13. Before rounding, this amounted to a roughly 4 percentage-point decline (Munnell, Sanzenbacher, and Soto 2007).
14. Hours worked by those over 65 are included in total hours and therefore in the average hours worked per person 16 and over. This methodology implicitly attributes these workers' hours to workers age 16-65, a simplifying assumption that is nevertheless more realistic (for the purpose of highlighting intergenerational differences) than assuming that people 66 and older work the same number of hours as workers age 16-65. By normalizing retirement at 66, the tendency toward later retirement is not captured by this methodology except insofar as the previous generation's work at older ages is included in the current generation's total hours. This methodology thus understates lifetime hours for all generations, but particularly underestimates the hours of later generations who retire later and whose work years coincide with an aging population.
15. Toossi, for example, highlighted the fact that women's labor force participation appeared to have "peaked" at 60% in 1999, declining to 59.3% by 2005.
16. According to EPI economists Josh Bivens and John Irons, the recent expansion ranked last in average growth of GDP, employment, and employee compensation among the 10 postwar expansions (Bivens and Irons 2008).
17. It may indirectly help all older job seekers because employers are less likely to view them as short-timers.
18. Author's calculations, based on Arias (2007).
19. The index included measures of education, occupation, wealth, income distribution, unemployment, poverty, and housing quality.
20. See U.S. Bureau of Labor Statistics (2008). Reemployment pertains to workers who had been at their previous jobs for over three years, were displaced, and had actively been seeking work. See also Heidkamp and Van Horn (2008).
21. In contrast, employer-based retirement plans provide only 17% of retirement income, and savings and other sources account for the remaining 10% (Munnell and Sundén 2006).
22. As of January 22, 2009, the adjusted value of the S&P500 was down 46% from its October 9, 2007 peak. With over two-thirds of 401(k) assets invested in stocks (Orszag 2008), this translates into a decline of 31% or more in asset values, not taking into account contributions or withdrawals. Taking into account contributions and withdrawals, Fidelity Investment reports that account balances in Fidelity workplace savings plans fell 27 percent between 2007 and 2008, based on annual averages (Fidelity 2009).
23. The personal saving rate in the National Income and Product Accounts—the mostly commonly cited measure—counts spending on owner-occupied housing as savings. Other personal savings measures treat home equity and mortgage payments differently (Verma and Lichtenstein 2000).
24. Together, demographic factors, including longer life expectancy and larger than anticipated immigration flows, made a net *positive* contribution to the program's finances over the original 75-year period. However, the changing valuation period worsened the shortfall, and some of this is due to expected longevity improvements. Combined, the change in the valuation period and demographic factors were responsible for about 31% of the projected shortfall that emerged between 1983 and 2005 (Bivens 2005).
25. The sensitivity analysis in the 2008 Trustees Report estimates that each 0.5 percentage-point increase in the assumed real-wage differential increases the long-range actuarial balance by about 0.58% of taxable payroll.
26. See, for example, Weller and Wolff (2005); Gale and Pence (2006); Munnell et al. (2008).

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