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Mr. Chairman and Members of the Committee:

Thank you for the opportunity to speak about raising the retirement age for Social Security benefits. Many of the proposals before the Congress to mitigate Social Security's long-term financial shortfall of nearly \$3 trillion dollars contain a provision to raise either the normal retirement age (NRA), currently 65, the early retirement age (ERA), currently 62, or both. Increasing retirement ages is envisioned to help alleviate the financing problem by increasing the amount individuals pay into the Social Security trust fund and reducing the amount of benefits they draw out.

Today, I would like to discuss (1) how raising the retirement ages could affect Social Security's long-term solvency and the U.S. economy, (2) how the labor market for older workers might respond to these changes, and (3) the possible impacts from raising the retirement ages on the Disability Insurance (DI) and Supplemental Security Income (SSI) programs. My testimony is based on our ongoing work for your Committee in which we are analyzing data from the Social Security Administration (SSA), two nationally representative surveys, and the literature on Social Security.

In summary, raising the retirement ages does appear to improve the Social Security program's long-term solvency and could increase the nation's economic output. Raising the ages at which individuals can draw benefits creates incentives for workers to remain in the labor force, thereby increasing revenues to the trust fund and decreasing the amount of benefits paid. The majority of older workers, aged 62 to 67, do not appear to have health limitations that would prevent them from extending their careers, and thus their labor force participation should increase as the retirement ages are raised. This greater labor force participation should raise the level of economic output as more people work longer. However, the extent to which labor force participation increases depends on whether sufficient jobs are available for older workers. Employees may be willing and able to extend their careers, but it is unclear whether employers will be willing to retain or hire them because of negative perceptions about costs and productivity. Blue-collar workers may be disproportionately affected by these labor demand and supply factors because they are at greater risk for incurring certain health problems that could limit their ability to remain in the labor force. For example, workers in poor health who otherwise might have kept working until they qualified for Social Security retirement benefits may opt to apply for DI, which could increase costs to this program. In addition, SSI could also experience increased participation and higher costs because some individuals will be dually eligible for DI and SSI.

BACKGROUND

The Social Security Act was enacted in 1935 during the Great Depression as a social insurance program to provide an income foundation upon which individuals could build for their retirement years. In 1956, the DI program was added to Social Security to provide income to disabled workers. Over the years, the three main components of retirement income-Social Security, pensions, and savings-have dramatically improved the income of the elderly, thereby substantially reducing their poverty rates. According to SSA data, Social Security benefits constitute approximately 80 percent of total income for elderly households (households in which the head of household is aged 65 or older) in the lowest two-fifths of

the income distribution, compared with only 21 percent of total income for households in the highest fifth.

The Social Security Act established 65 as the minimum age at which retirement benefits can be obtained. Sixty-five was selected as a compromise between age 60, which appeared too low from a cost standpoint, and age 70, which appeared too high given that life expectancy at the time was 59 years for men and 63 years for women. Since 1956, women have had the option to take reduced benefits at age 62, and since 1961, this option has also been available to men. As a result, 62 has been defined as the ERA and 65 is considered the NRA.

The long-term financing problem that Social Security faces is largely a result of lower birth rates and increasing longevity. One way to at least partially compensate for these changes is to raise the retirement ages. The Congress has already approved one change in the retirement age, in 1983, when it enacted legislation that phased in an increase in the NRA to 67 over a 22-year period beginning in the year 2000. Currently, there are proposals before the Congress to raise the retirement ages further by increasing the ERA from 62 to 65, along with several proposals to further increase the NRA from 67 to 70. Longer life expectancy and the improved health of the nation's elderly are the primary justifications for these recommended increases.

RAISING THE RETIREMENT AGES IMPROVES SOCIAL SECURITY SOLVENCY AND COULD INCREASE ECONOMIC OUTPUT

Raising the retirement ages effectively reduces benefits and thereby would improve Social Security's solvency. The extent of the improvement depends on how much and how soon the retirement ages are raised. Because individuals retiring before the NRA receive lower benefits and those retiring after the NRA receive a premium, raising the NRA reduces the initial benefits for all retirees. For example, if the NRA was increased to 70, people who retire between ages 65 and 69 would have their benefits reduced for early retirement. And those who retire at age 70 would then receive the basic benefit amount now received at 65 instead of receiving the premium for delayed retirement.

SSA's actuaries estimate that increasing the NRA from 65 to 69 over the years 2000 through 2015, and raising the ERA at the same rate, would close over one-half of the long-term trust fund shortfall and thereby extend the period of projected solvency by 13 years. If the NRA and ERA were further increased at the rate of 1 month every 2 years starting in 2016, then depletion of the fund would not occur for an additional 5 years (because 19 percent more of the shortfall would be made up). The combined effect of these retirement age increases would eliminate 72 percent of the difference between the Social Security trust fund's revenues and outlays over the next 75 years.

Raising the retirement ages also could lead to an increase in economic activity if people worked longer. By remaining in the work force, older workers would be increasing the number of their productive years. In effect, there would be an increase in the economy's resource base—in this case, society's stock of human resources—and these increased resources would allow the economy to produce more goods and services. However, the increase in economic activity assumes that, by remaining in the labor force for more years, older workers would not be displacing younger workers.

RAISING RETIREMENT AGES PROVIDES INCENTIVES FOR WORKERS TO EXTEND THEIR CAREERS, BUT THEIR PARTICIPATION AND THE DEMAND FOR THEIR LABOR ARE UNCERTAIN

Raising the Social Security retirement ages would provide many individuals an incentive to work longer,

but whether they do depends on how the labor market responds. Having people work longer would help solve the problem of the declining ratio of workers to retirees. Working longer could also give workers more time to save and to accrue pension benefits. Still, it is unclear whether workers will want to work longer and whether employers will want to retain or hire them. For many years, Americans have been choosing to receive Social Security benefits earlier, although the decline in the average age at which people elect to receive benefits has leveled off since the 1980s. In 1940, the average age for drawing Social Security benefits was 68.8, but by 1985 it had fallen to 63.7, where it remains today. Less than one-sixth of men aged 65 and over are in the labor force today, compared with nearly half in 1950. In addition, life expectancies have increased by nearly 12 years for men and 14 years for women since 1940. The combination of decreasing retirement ages and increasing life expectancies means that people are spending an increasing proportion of their lives in retirement.

Data from the Survey of Income and Program Participation (SIPP) shows that approximately 22 to 31 percent of men aged 62 to 67 report that they have a disability that limits their ability to work. These data suggest that although a substantial portion of the population may have difficulty continuing to work to later ages, the majority of people have the capability to work beyond the current ERA and NRA.

Social Security policy is a factor that affects individuals' choice of when to retire. Social Security currently gives incentives for individuals to reduce their working hours once they reach ages 62 or 65. Individuals make their decisions to work based primarily on the trade-off of earnings versus leisure time. The availability of Social Security benefits allows workers to substitute their earnings with nonlabor income and to take more leisure time. The majority of workers (53 percent) take Social Security benefits at age 62, the first year they are eligible. Also, individuals tend to retire more often at ages 62 and 65 than at any other ages, suggesting that the ERA and NRA influence the decision on when to retire.

Social Security, however, is only one of the factors influencing the retirement decision. Other factors are employer-provided benefits, household wealth, and the employee's health status. Research suggests that the decision to retire is based primarily on financial considerations. One recent study, by Burkhauser and others, examined the effects of raising the ERA and concluded that such an increase would have only a limited impact on individuals in poor health because the majority of people who retire at the ERA do so because they are financially able to do it. This study suggests that raising the ERA would, on average, deny Social Security benefits to people who could work longer and not take benefits away from unhealthy individuals who retire early because they can no longer work.

This research concludes that raising the ERA and the NRA should lead to individuals working longer, but those who cannot work longer may see their household income decline. In households with two or more income earners, the healthy member(s) of the household may be able to work longer to offset some or all of the lost Social Security benefits. However, households without this option could experience large declines in their income if the retirement ages are raised. For some households, this decline in income could be sufficient to push the household below the poverty level.

Labor force participation is not solely the workers' decision—there must also be an effective demand for their labor. Employers' perceptions may form potential barriers to older workers' retaining their current jobs, finding new jobs if they are laid off, or whether they need to reenter the work force after retiring because their retirement income is inadequate. While older workers have positive attributes such as experience and good judgment, there are a number of reasons that employers might not want to employ them. For example, employers incur higher benefit, recruitment, and training costs for older workers. Recent evidence indicates a negative relationship between the employer provision of health care benefits and the hiring of older workers. The researchers who found this negative correlation speculated that it is the result of the Age Discrimination in Employment Act (ADEA), which mandates that firms must offer workers with similar experience the same level of benefits. Since younger employees are less costly to

insure, firms will prefer them.

The potential tenure with an employer is another obstacle to hiring older workers because of recruitment and training costs. Recruitment involves job advertising costs and interview time. Newly hired employees may also require significant training to perform their new job. If these costs are substantial, they can serve as barriers to hiring older workers. Firms would be more likely to invest in younger workers because they have the potential to remain with the firm for a longer period, which reduces the average costs of recruitment and training.

A final obstacle that older workers face is a negative perception among employers about their productivity. Surveys find that most managers believe the negative aspects of older workers outweigh the positive aspects. The productivity traits of older workers that managers tend to find favorable are experience, judgment, commitment to quality, low turnover, and good attendance and punctuality. The negative perceptions that managers have about older workers' productivity are a tendency toward inflexibility, an inability to effectively use new technology, difficulty in learning new skills, and concerns about physical ability.

The effect of the factors highlighted above-(1) health care costs, (2) recruitment and training costs, and (3) perceptions about productivity-is that older workers may have fewer job opportunities compared with younger workers. If unemployment rates rose, older workers could be disproportionately affected. An older worker who is displaced from a job will have greater difficulty finding another one compared with a younger worker because of these obstacles. This situation, rather than a desire to retire, could discourage an older worker from remaining in the labor force.

Blue Collar Workers May Be More Adversely Affected by an Increase in the Retirement

Blue-collar workers will likely experience more difficulties in extending their careers than will white-collar workers. Because of the nature of their jobs, many older blue-collar workers-who compose 40 percent of the labor force between the ages of 53 and 63-experience health problems that may inhibit their ability to work and reduce the demand for their labor. We analyzed the Health and Retirement Study (HRS), a nationally representative sample composed of individuals born between 1931 and 1941, to compare the health status of blue- and white-collars workers.

Our analysis found that older blue-collar workers are at greater risk for having several health problems compared with older white-collar workers. We assessed the effects of occupation on specific health problems, controlling for employment status, age, race, sex, alcohol consumption, and smoking. Blue-collar workers are more likely to have musculoskeletal problems, respiratory diseases, diabetes, and emotional disorders than are white-collar workers. For example, blue-collar workers are 58 percent more likely to have arthritis, 42 percent more likely to have chronic lung disease, and 25 percent more likely to have emotional disorders. White-collar workers were not at greater risk for having any of the health problems we examined. White-collar workers did have higher rates of cancer; however, the difference was not statistically significant.

When all blue-collar occupations are grouped together, blue-collar workers are 80 percent more likely than white-collar workers to experience pain that affects their ability to perform their jobs. The blue-collar occupations with risk factors for pain affecting performance are personal services; farming, fishing, and forestry; mechanics and repair; construction; mining; precision production; machine operator; transportation operator; and material handler. These occupations comprise one-third of workers aged 53 to 63.

Older blue-collar workers with health problems have lower earnings and are in less demand for their labor. Blue-collar work is often physically demanding, and current or potential employers may foresee a risk of a worker's compensation claim or increased health care costs from older employees. This reduced labor demand means these workers may accumulate less wealth, which makes it difficult for them to afford to retire even if they are not physically capable of working more years. For example, 18 percent of blue collar workers with two or more health problems are retired, while only 14 percent of those with no problems are retired.

Table 3 shows that older blue-collar workers with health problems had higher unemployment rates than healthy blue-collar workers. Our analysis also showed that blue-collar workers had higher unemployment rates than white-collar workers with similar health status. Corresponding to these higher unemployment rates, the blue-collar workers with health problems had lower earnings. The older blue-collar workers who had arthritis, a foot or leg problem, chronic lung disease, asthma, diabetes, or an emotional problem -- all conditions that blue-collar workers are at greater risk for having compared with white-collar workers -- have 38 percent, 33 percent, 27 percent, 36 percent, 25 percent and 78 percent lower median earnings, respectively, than blue-collar workers without these conditions. AS noted earlier, these reduced earnings make it difficult for unhealthy, older blue-collar workers to afford to retire.

THE EFFECT OF RAISING RETIREMENT AGES ON OTHER GOVERNMENT PROGRAMS

Given the health problems we have identified among older workers, an increase in retirement ages and the corresponding reduction in benefits may prompt more people to seek disability benefits. Raising the ERA and NRA, without a corresponding change in DI benefits, could encourage individuals in poor health to apply for disability benefits, because the gap between retired worker benefits and disability benefits would be increased. For example, under current law, retired worker benefits taken at age 62 after the NRA has increased to age 67, will be 30 percent lower than the full benefits available at age 67. However, unless disability benefits are adjusted after the NRA increase, workers who receive DI benefits at 62 will not have their benefits reduced. This means that DI benefits awarded at age 62 will be 43 percent higher than retired worker benefits awarded at that age. Some of the individuals with low income and assets who are awarded DI may also qualify for SSI disability benefits.

Another incentive for individuals to apply to the DI program is that participants are eligible for medical coverage under Medicare 2 years after DI benefits begin. Thus, individuals awarded DI benefits before age 63 get extra Medicare coverage that they would otherwise not be eligible for until age 65. Therefore, if Medicare eligibility was raised along with the ERA and NRA, individuals would have an incentive to try to attain DI benefits. An additional medical coverage issue is that individuals who are dually eligible for DI and SSI benefits are also generally eligible to receive Medicaid, which will increase costs to this program.

Raising retirement ages would change some of the disincentives that currently keep people from applying for DI benefits at age 62. Data from SSA show that the current structure of Social Security reduces claims for new DI participants aged 62 to 64. Figure 15 shows a steady increase in the rate of new disability awards from ages 53 to 61. The rate of new awards then drops substantially at age 62 and falls further through age 64. DI participation is discouraged at ages 62 to 64 because of the application process and restrictions on earnings. There is a 5-month waiting period after the onset of the disability until someone can apply for benefits, and the application process is lengthy and complex. In comparison, the application process for Social Security retirement benefits is more straightforward, given that the applicant meets the coverage and age requirements. In addition, DI benefits are generally subject to greater reduction than Social Security retirement benefits if beneficiaries have any earnings. As, DI benefits are offset by worker's compensation benefits, while Social Security retirement benefits

are not.

If the ERA was raised to 65 and the NRA to 70, then the incentives that apply to Social Security retirement benefits would be applicable at age 65 rather than age 62. Under this scenario, individuals aged 62 to 64 would have a greater incentive to apply for disability benefits, and they would be expected to do so at rates comparable to individuals at younger ages (55 to 61) under the present system. Figure 1 contains a trend line to indicate the expected rate of change if the increase in new DI participation continues beyond age 62. The trend in new DI participation among individuals aged 55 to 61 under the present system suggests that DI participation among individuals aged 62 to 64 would increase approximately 2.5 percent if the ERA was raised to age 65. As noted earlier, some of these new DI participants would be dually eligible for SSI and Medicaid benefits, which would impose additional costs.

CONCLUDING OBSERVATIONS

Addressing Social Security's solvency problem is one of the most important issues currently facing the administration and the Congress. Numerous proposals are before the Congress to restore the balance between promised benefits and available funds. Increases in the ERA and NRA could make up a substantial amount of Social Security's long-term financing shortfall, depending on the size of the increases. Increases in retirement ages may also have positive economic effects by inducing individuals to extend their careers, which could increase economic output. Since life expectancies and the health of the elderly are improving, many people have the capability to work longer, and increasing retirement ages would encourage this.

While raising the retirement ages will extend the life of the Social Security trust fund and could lead to higher levels of economic output, the potential negative consequences should be recognized. For example, older workers who are laid off or need to reenter the workforce after retiring may have difficulty finding a job. Blue-collar workers may experience these problems to a greater degree, because the nature of their work leads to several health problems that inhibit their ability to continue working to later ages, compared with those in white-collar jobs. These health problems reduce their employability and hence their ability to accumulate enough wealth to afford to retire if they are not physically capable of working longer. Finally, in considering retirement age increases, the effect of this action on other government programs needs to be understood. Participation in disability insurance programs will likely increase, primarily by blue-collar workers, if retirement ages are raised. The magnitude of the increase depends on the extent to which individuals react to the newly created incentives to apply to these programs.

Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions you or Members of the Committee may have.