INCREASING THE ELIGIBILITY AGE FOR SOCIAL SECURITY PENSIONS

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Summary

Social Security faces a long-term financing problem. Many young workers believe the problem is so severe they may never receive a Social Security check. The most logical solution to Social Security's financing problem is to trim promised benefits and increase payroll taxes moderately. A sensible way to reduce future benefits is to increase the early eligibility age and normal retirement age for retirement pensions. This reform is justified by the substantial increase in life spans that has occurred since Social Security was established in the 1930s. An increase in life spans, when the normal retirement age remains unchanged, is equivalent to a sizable increase in lifetime Social Security benefits.

Increasing the retirement age is unpopular with voters. Unfortunately, so are all other reforms that would restore Social Security to solvency, including tax hikes and cuts in the formula for calculating full pensions.

Many policymakers worry that even though Americans' life spans have increased, their capacity to work past age 60 has not improved and may actually have declined. While this may be true for a minority of workers, the best evidence suggests it is untrue for most of the population between 60 and 70 years old. On average, the health status and work capacity of Americans in their 60s have improved in line with improvements in their longevity. The decline in employment rates among Americans between 60 and 70 has not been caused by diminished work capacity but by growing Social Security and private pensions, increasing wealth, wider availability of disability income, and the changing taste for retirement living. Nonetheless, any increase in the early eligibility age or deep reduction in benefits available to 62-year-old workers should make special provision for workers with impaired health. Disability Insurance benefits might be made available under liberalized eligibility rules for workers with steady careers in physically demanding occupations.

If the normal retirement age were increased, we would probably see a reversal of the long-term trend toward earlier retirement. a trend that has slowed dramatically since the late 1980s. However, most recent research suggests the effect of increasing the normal retirement age on labor force participation will probably be small. The increase in labor force participation rates of older workers would almost certainly be larger if the increase in the normal retirement age were combined with an increase in the early eligibility age for pensions (currently age 62). In the long run, U.S. employers will not have serious difficulty accommodating the wishes of older Americans to remain in jobs longer. Since labor force growth will slow sharply in the next century, employers may in fact face pressure to make employment more attractive to older workers.

Congress will have to increase contributions or cut benefits to keep Social Security solvent. Increasing the normal and early retirement ages is an essential element of any plan that is fair and that addresses the long-term financing problem.

Background

The solvency of every pension program depends on four crucial elements: (1) The contribution rate imposed on workers and their employers; (2) The pension fund's rate of return on its investments; (3)

The age of eligibility for pensions; and (4) The average monthly pension paid to retirees. The first two elements determine the annual amount of funds flowing into the system; the last two determine the annual amount flowing *out* of the system. Each of the four elements must be carefully calibrated to ensure that benefit promises are matched by expected future revenues. If a pension program is exactly solvent and one of the four elements changes, some adjustment in the other three elements may be necessary to restore the solvency of the program. For example, if the rate of return on pension fund investments falls, it will be necessary to increase the contribution rate, delay the age of eligibility for pensions, or lower monthly pensions in order to restore the pension program to solvency.

Improvements in the life expectancy increase the funding requirements of a pension plan. If contributors live one additional year in retirement, the plan must find extra resources to pay for extra benefit payments. To keep the pension system solvent, this requires higher contributions to the program, a higher rate of return on investments, a delay in the retirement age, or a reduction in monthly benefits. It is worth emphasizing that this is true for every type of pension plan *whether public* or *private*. If Social Security had never been established, increases in American life spans over the past half century would have required *private* pension plans to increase their contribution rates, find investments that yield higher rates of return, delay the age of eligibility for pensions, or reduce monthly pension payments.

The current debate over reforming Social Security often ignores this simple reality. A large part of Social Security's long-term funding problem arises because of good news about longevity. Americana now live longer than their parents and grandparents did. Their children and grandchildren can be expected to live longer than we do. The improvements in longevity mean that living Americans will survive much longer past age 65 than was true when Social Security was established in the Great Depression. The longevity increases provide the equivalent of a benefit increase to Social Security recipients. The benefit increase must be paid for if the system is to remain solvent.

Table 1 below shows the Social Security Actuary's estimates of average life expectancy at age 65, 70, and 75 for selected years between 1940 and 2070. These estimates reflect the average mortality experience of both men and women. The estimates for years through 1990 are based on observed mortality rates in past years. The estimates for 2000 and later years are based on the Actuary's projections in the 1995 *OASDI Trustees Report.* The estimates in Table 1 show that average life expectancy at age 65 has risen about 5 years, or roughly 40%, since the Social Security system was created. Under the Trustees' intermediate assumptions, it is expected to rise another 3 years by 2070.

The dramatic improvement in life spans past age 65 means that retired workers can expect to collect far more monthly pensions than was the case in the past. Monthly pension payments have not been reduced to accommodate this increase (monthly benefits have actually increased). Social Security's solvency has been maintained by boosting the contribution rate imposed on workers and their employers.

Table 1. Unisex Life Expectancy at Selected Ages, 1940-2070

	Life expectancy in years		
	Age		
Year	65	70	75
1940	12.71	9.92	7.56
1960	14.52	11.53	8.88

1980	16.33	13.19	10.38
1990	17.09	13.85	10.90
2000	17.49	14.15	11.11
2010	17.83	14.43	11.34
2020	18.25	14.82	11.69
2030	18.68	15.21	12.04
2040	19.10	15.59	12.38
2050	19.51	15.97	12.72
2060	19.90	16.33	13.05
2070	20.29	16.69	13.38

Source: Office of the Actuary, Social Security Administration (1997)

Congress took no steps to increase the eligibility age for Social Security pensions until 1983, when it raised the normal retirement age from 65 (for persons born in 1937 and earlier years) to 67 (for persons born in 1960 and later years). The normal retirement age (NRA) is the earliest age that a worker can obtain a full Social Security pension. Workers can claim reduced pensions before the NRA. The early eligibility age (EEA) is the youngest age that a worker can obtain a Social Security old-age pension. (An early pension is permanently reduced by about a half percentage point for each month before the NRA that the worker claims the pension.) When it raised the NRA in 1983, Congress did not change the EEA, which was left at 62. Of course, workers who claim an early pension in the next century will pay a larger penalty than workers do today. Instead of receiving 80% of a full pension at age 62, workers born in 1960 and later years will only receive 70% of a full pension.

A major financing gap in Social Security has opened up since Congress last overhauled the program in 1983. Productivity and wage growth have remained slow, and the expected future ratio of beneficiaries to contributors continues to rise. In order to restore the long-term solvency of Social Security the nation must boost contributions to the program, reduce future benefits, or find some other source of financing. The combination of increased contributions, reduced benefits, or outside financing must total about 2.2% of predicted taxable earnings over the next 75 years.

A straightforward way to close the long-term financing gap is to raise payroll taxes and reduce promised benefits. Reform should occur before 2010, when the baby boom generation begins to retire. It is desirable to make decisions about future taxes and benefits as soon as possible. The OASDI Trustees' intermediate assumptions imply that the Trust Funds will be depleted shortly after 2030. The youngest baby boom workers will be in their middle 60s when that year arrives. If workers are to plan sensibly for their retirement, it is desirable to inform them what combination of higher taxes or reduced benefits they will face over their careers.

Increasing the Retirement Age

Since the eligibility age for pensions is one of the main features of a pension plan that affects its solvency, Congress should consider adjustments in the eligibility age to help restore Social Security's solvency.

Normal retirement age. One possibility is to accelerate the increase in the NRA already scheduled under present law. Instead of phasing in the increase over 23 years, for workers reaching age 62 between 2000 and 2022, Congress could phase in the NRA change over just 12 years. This would mean that the higher NRA will be fully implemented for workers reaching age 62 in 2011.

A second possibility is to increase the NRA automatically in line with increases in life expectancy after 65. A majority of members of the 1994-96 Social Security Advisory Council proposed increasing the NRA as necessary after 2011 to maintain a constant ratio of retirement years to potential years of work. "Retirement years" is defined as life expectancy at the NRA, and "potential years of work" as the number of years from age 20 to the NRA. Under the Social Security Trustees' intermediate assumptions, this proposal would push up the NRA to age 70 by about 2080. The Social Security Actuary estimates that the combination of accelerating the NRA increase and then increasing the NRA in line with longevity improvements eliminates nearly one-quarter of Social Security's long-term funding gap.

Lifting the NRA while leaving the EEA unchanged produces almost exactly the same effect on retired workers' Social Security benefits as a proportional reduction in the full pension (usually referred to as the "primary insurance amount" or PIA). Even though most people describe an increase in the normal retirement age as a "delay" in the retirement age, it is in fact closer to a reduction in monthly pensions. Workers can still obtain pensions at the same age as before, but their monthly pensions are smaller.

There are some important *noneconomic* differences between raising the NRA and cutting the full Social Security pension, however. First, increasing the NRA signals to workers that the same monthly benefit can be obtained by postponing retirement, which may encourage some workers to delay retirement rather than accept a lower pension. Sponsors of employer pension plans might also be induced to modify their plans to encourage delayed pension acceptance if the Social Security NRA were increased. Second, in light of the well-known improvements in life expectancy, American workers might find increases in the retirement age to be more understandable and fairer than equivalent reductions in full pensions. By increasing the retirement age rather than reducing full pensions, Congress conveys the message that the benefit level is appropriate, but workers ought to postpone their retirements.

Early eligibility age. Nothing prevents Congress from increasing the early eligibility age at the same time and at the same pace as it increases the NRA. An increase in the EEA is fundamentally different from an increase in the NRA, however. If the EEA is increased above age 62, 62-year-old workers will be prevented from obtaining old-age pensions. Under current law they can collect reduced old-age pensions or they can try to obtain Disability Insurance (DI) pensions. When the possibility of obtaining old-age pensions is eliminated, some 62-year-olds who otherwise would have received old-age pensions will apply for benefits under the DI program. This will increase Social Security administrative costs, because eligibility is much more expensive to determine in DI. It may also impose serious hardship on workers whose DI applications are denied.

These consequences of increasing the early eligibility age have made Congress reluctant to tamper with it. Many policymakers are more uneasy about a reform that denies benefits completely to an identifiable class of people than they are about one that reduces benefits modestly to a much wider population.

It is important to recognize why Social Security has an early eligibility age, however. If workers could apply for benefits as soon as they accumulated enough earnings credits, some low-income workers would be tempted to apply for benefits in their late 50s or even their late 40s. But their monthly benefits would be very low, because early pensions are reduced below the full pension in proportion to the number of months between the age a worker claims benefits and the NRA. The low level of the monthly pension might not represent a problem for a worker who is 50 or 60 years old and can supplement monthly pensions with modest wages. But it could cause serious hardship when a worker reaches age 68 or 70 and finds he or she is no longer able to work. The EEA prevents short-sighted workers from applying for pensions that will be too small to support them throughout a lengthy retirement.

When the NRA reaches 67, workers claiming early pensions at age 62 will receive 70% of a full pension. If the NRA were eventually increased to 70 and the early eligibility age remained unchanged, workers claiming pensions at age 62 might receive monthly benefits as low as 52% of a full pension - probably too little to live on for a worker with few other sources of income. If the NRA is increased above 67, it seems sensible to increase the early eligibility age. I do not think it reasonable to allow workers to claim benefits so early that their monthly benefit falls below 70% of a full pension. This implies that the early eligibility age must eventually be raised above 62. In order to implement this reform in a humane way, Congress should liberalize eligibility requirements for Disability Insurance benefits starting at age 62. People who have worked in physically demanding occupations and are in impaired health should be given access to benefits that permit them to retire with a decent standard of living.

Health Status and the Eligibility Age

Critics of increasing the retirement age sometimes argue that, while life expectancy has increased, the health condition of many older workers -- and their ability to continue working -- has not improved. Is this true? Or has the increase in life spans been matched by an improvement in the health status of older Americans? The key question is whether increases in life expectancy have resulted in longer productive lives or merely longer periods of failing health.

While nearly all studies of work in later life find that health plays an important role in the timing of retirement, I see no persuasive evidence that the average health of Americans in their 60s has declined. Falling mortality rates as well as recent evidence about the trend in physical disabilities suggest instead that health is *improving,* at least in early old age. Moreover, analyses of the growth of different kinds of occupations and in their physical requirements imply that the physical demands of work are now easier to meet than they were in the past. A much smaller proportion of jobs requires strenuous physical effort; a larger percentage requires only moderate or light physical exertion.

In the 1970s and early 1980s, some observers thought the health of older Americans was declining. Rising life expectancy in the 1970s was accompanied by increased prevalence of self-reported health problems among the aged and near aged. Researchers were divided on the meaning of this trend. Some concluded that the improvements in life expectancy were caused by falling death rates from chronic disease, producing an aged population with a higher percentage of people with chronic health problems. Other researchers believed that while the initial effect of falling mortality from chronic disease was to increase the prevalence of health problems, these levels would be reduced as medical science turned its attention to increasing the age of onset of chronic disease.

More recently, researchers have found evidence that the trend toward deteriorating self-reported health among the middle-aged and older population was reversed in the 1980s. A number of researchers now find evidence of a fall in prevalence of chronic health problems among the elderly. Economists suggest that the increase in self-reported health problems in earlier periods was probably the result of a combination of social forces affecting the way individuals perceive their health and describe it to interviewers. More generous disability benefits and easier access to such benefits increased the percentage of Americans who apply for and receive disability benefits. The fraction of people describing themselves as impaired has consequently increased. Medical progress in disease prevention and early diagnosis also increased dramatically after 1970, leading to wider awareness of health problems among the elderly. Increased awareness and earlier diagnosis of health problems rather than an absolute increase in the incidence of such problems probably accounts for part of the 1970s rise in self-reported health limitations. Self-reported health problems among people in their 60s and 70s have declined since the early 1980s.

Improvements in longevity and health status among people in their 60s are not universal, of course. Some researchers find a growing gap between the death rates of Americans with low and high levels of education. People with advanced education or high lifetime incomes may have enjoyed a disproportionate share of the overall improvement in longevity and health conditions, while those with lower education and less income, even if they saw small absolute gains, fell further behind.' If this pattern continues, increasing the age of eligibility for Social Security benefits will impose special hardship on Americans with lower education and income, a population which has not shared fully in the general improvement in longevity and health. As noted earlier, I think we should make humane provision for workers in physically demanding jobs who have impaired health if we increase the early eligibility age above 62.

On balance, the best available evidence suggests that the health of the middle-aged and elderly populations has improved during the 1980s and 1990s, though the improvement has probably been greater among people with higher income and education. The health gains seem likely to continue. This will tend to reduce the portion of time we spend in dependence and ill-health, at least when we are in our 60s. Continuing increases in educational attainment should reinforce the trend toward better health in view of the observed relationship between good health and education.

Effects on Trends in Employment

Before assessing the impact of a higher retirement age on workers and employers, it is worth considering the long-term trend in work at older ages.

Historical trends. At the turn of the century, retirement was relatively rare but not unknown. Two out of three men past age 65 were employed, but one-third were not. By mid-century retirement was far more common. Fewer than half of men 65 and older held a job in 1950. In 1990 the proportion at work had fallen still further. Just 16 percent of men over 65 were employed or actively seeking a job. Eighty-four percent were outside the active labor force. The proportion of women past 65 who were employed also fell during the century, but the reduction was far smaller than among men because the percentage of older women in paid work has always been quite low.

The pattern of declining work among older men is clearly evident in Chart 1. Each line in the figure traces the labor force participation rate of older American men, by age, during a different year of the past century. The top line shows age-specific participation rates of older men in 1910. Labor force participation falls with advancing age. Even at age 74, however, the male participation rate in 1910 was only slightly below 50 percent. Participation rates in 1940, 1970, and 1995-96 are displayed in the lower three lines. Each of these lines shows a characteristic pattern of labor market withdrawal as men grow older. The crucial difference between the pattern in 1995-96 and earlier years is that the fall-off in labor force participation begins at an earlier age and proceeds at a faster pace. It is worth emphasizing that the fall in employment rates and labor force participation rates among older men slowed sharply in the second half of the 1980s. Employment and participation rates of older men have stabilized, and employment and participation rates of women between 55 and 65 have begun to rise.

By far the biggest declines in participation occurred among men past the age of 65. In 1996, for example, the participation rate among 74-year-olds was nearly 80 percent below the equivalent rate in 1910. The fall-off in participation has been smaller at younger ages. In general, large declines in participation occurred early in the century for the oldest age groups; large declines have occurred more recently among in younger age groups, notably, among men under 65. The biggest declines among men under 65 did not occur until after 1960. This pattern of labor market withdrawal is consistent with the view that the introduction and liberalization of Social Security played an important role in pushing down participation rates. Nonetheless, evidence in Chart I suggests that the trend toward earlier retirement was already underway during the first decades of the century, long before Social Security could have affected labor force behavior.

Chart 2 shows the trend in the "average" retirement age if we define that age as the youngest age when fewer than half the men in the age group remain in the labor force. Under this definition, the average male retirement age fell from 74 to 62 between 1910 and 1960, a drop of about 1.4 years per decade.

The decline in the average retirement age occurred in an environment of rising life expectancy among older Americans, especially in the period since 1940 (see Table 1). Falling mortality rates among the elderly added more than 3 years to the expected life span of a 65-year-old man (and 51/2 years to the life expectancy of a 65-year-old woman) after 1940. Since expected male life spans increased about 0.6 years per decade during a period in which the retirement age dropped 1.4 years per decade, the amount of the average male life span devoted to retirement has climbed about 2 years per decade. Retirement now represents a substantial fraction of a typical worker's life. For many workers, retirement may now last longer than the number of years from birth until full-time entry into the job market.

Effects of increasing the early eligibility and normal retirement ages. It is natural to ask whether increasing the early and normal retirement ages would have much effect on when workers actually retire. Almost all researchers who have examined this question agree that such reforms would tend to increase the average age at retirement, though the effect may not be large. This conclusion was reached in a great majority of economists' studies conducted in the 1980s and early 1990s. Most studies found that even big changes in Social Security would cause only small changes in the average retirement age. In research with Robert Moffitt, for example, I estimate that increasing the normal retirement age in Social Security from 65 to 68 would add only a little more than 4 months to the full-time working careers of men who have no disabilities.

One way to assess the impact of Social Security reforms is to examine differences in retirement patterns among people who face different incentives because the program has been *changed in* an unanticipated way. In 1969 and again in 1972 Social Security benefits were increased much faster relative to wages than at any time in the recent past. By 1973 benefits were 20 percent higher than would have been the case if pensions had grown with wages as they did during the 1950s and 1960s. In 1977 Congress passed amendments to the Social Security Act sharply reducing benefits to workers born in 1917 and later years (the "notch" generation) in comparison with benefits available to workers born before 1917. 1 examined the first episode, and Alan Krueger and J.S. Pishke examined the second.

Both studies reached an identical conclusion: Major changes in Social Security generosity produced small effects on the retirement behavior and labor force participation of older men. I found, for example, that the 20-percent benefit hike between 1969 and 1973 caused only a 2-month reduction in average retirement age of men who were fully covered by the more generous formula. This is equivalent to a reduction in the labor force participation rates of 62-year-old and 65-year-old men of less than 2 percentage points. The effects of the 1977 amendments found by Krueger and Pischke were even smaller.

These findings suggest that an increase in the *normal retirement age* will probably have only a small effect on the age that male workers withdraw from the work force. It is harder to predict the effects of an increase in the *early retirement age* because we do not have good enough historical evidence to evaluate the impact of this kind of change. It is conceivable that elimination of early retirement pensions would make early retirement impossible for low wage workers who have no other sources of retirement income except Social Security. In that case, increasing the early eligibility age might cause labor force participation and employment rates at age 62 to rise by 5 percentage points or more.

Employer responses. Many people wonder how employers would respond to changes in the early and normal retirement ages in Social Security. If workers wanted to delay their retirements to become eligible for more generous Social Security pensions, would employers create enough extra jobs to employ them? Or would employers discriminate against older job seekers, making it hard for them to find and keep jobs?

Historical evidence about the job creating capacity of the U.S. market is reassuring on this point. Over the long run, the U.S. labor market seems capable of absorbing large numbers of extra workers without a significant rise in joblessness. From 1964 through 1989, when the baby boom generation reached adulthood and entered the job market, the labor force grew by 50.4 million persons, or slightly more than 2 million a year. Most of this surge was driven by the jump in U.S. fertility between 1946 and 1964, but part was also due to a growing demand for employment by women, who entered the workforce in record numbers. From 1964 to 1989 the number of Americans holding jobs climbed by 47.7 million, or slightly more than 1.9 million workers a year. In other words, about 95 percent of new job seekers in this period were able to find jobs, though the number of people available for work swelled by two-thirds. The unemployment rate rose only slightly, increasing from 5.0 percent to 5.2 percent.

Many people find it surprising that so many extra job seekers can be absorbed by the labor market. They overlook a basic reality of flexible labor markets: In the long run employers are free to change their product lines and production methods to exploit the availability of a newly abundant type of labor. Moreover, they ignore the possibility that wages can rise or fall in response to the entry and exit of large numbers of potential workers.

In the 1970s, for example, the wages received by younger workers fell in comparison with those earned by older workers, in large measure because younger workers became much more abundant. Faced with a huge increase in the availability of workers who had limited job experience, employers adopted production methods that took advantage of less experienced workers. Restaurant meals were prepared and served by eleventh grade students and high school dropouts rather than by experienced cooks or waiters. Gardening and domestic cleaning were performed by unskilled and semi-skilled employees rather than by homeowners themselves. In the end, 95 percent of new job seekers were successful in finding jobs. Of course, many of the new jobs were not particularly well paid. The huge increase in the abundance of less experienced workers is one reason that pay in many jobs fell.

If older workers were forced to wait for two or three extra years for full Social Security retirement benefits to begin, many would choose to remain in their career jobs for a few months or years longer than workers presently do. Older workers who lose their jobs would try harder and more persistently to find new jobs. The jobs that many find would pay lower wages than the jobs they previously held. In fact, the availability of increased numbers of older workers would almost certainly depress the relative wages of aged job seekers. But low U.S. fertility means the future labor force will grow slowly, placing some pressure on employers to retain older workers and make jobs attractive to older job seekers.

Although some observers are pessimistic about the willingness of employers to accommodate the special needs of an aged workforce, I am not. Employers have created millions of part-time jobs to accommodate the needs of students and mothers who are only available to work short weekly hours. People who work on part-time schedules pay a price for short hours in terms of low weekly earnings and lost fringe benefits, but the great majority accepts this price willingly. My guess is that a comparable accommodation will be made for the special needs of older workers. Most older workers who want jobs to tide them over between the time their career jobs end and eligibility for full Social Security pensions will be able to find suitable jobs.