BEYOND 'NORMAL'
Raising the Retirement Age Is the Wrong Approach for Social Security

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Social Security currently runs a healthy surplus, but a number of factors lead the program's trustees to anticipate a modest shortfall over the next 75 years. The conventional wisdom is that the projected gap is driven largely by rising life expectancy, and that the key to restoring solvency is raising the normal retirement age, the age when participants are eligible for full retirement benefits.[1] After all, if life has given us a bounty of extra years, shouldn't our work ethic incline us to devote a little time to working longer?

However, gains in life expectancy represent only a small part of the fiscal challenge facing Social Security. The increase in the normal retirement age from 65 to 67, currently underway, already offsets gains in life expectancy for workers born before 1960, and longevity gains for younger generations account for *only a fifth* of the projected Social Security shortfall.

The bigger problems are weak wage growth and rising earnings inequality, which account for more than half the projected shortfall that has emerged since the system was last restored to long-term balance in 1983. Earnings inequality has eroded Social Security's taxable earnings because earnings above a cap are exempt from Social Security taxes. Likewise, slower wage growth increases the costs as a share of taxable earnings. Rising health care costs, which create a growing wedge between compensation and taxable wages, a falling birth rate, and higher disability take-up are also contributing to the projected shortfall.

Rising life expectancy *before* retirement, increased work effort by women and older workers, and immigration have helped counter these trends. Such offsetting factors explain why the ratio of beneficiaries to workers has been stable for decades despite rising life expectancy.

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Social Security's costs, unlike health care costs, are not spiraling upward. Instead, there will be a one-time cost shift from 4.8% to 6.0% of GDP, or 1.2 percentage points, driven primarily by a decline in the birth rate in the generations that follow the baby boomers. The 75-year shortfall is smaller than this 1.2% of GDP because Social Security is currently running a surplus and building up a $4.2 trillion trust fund to pay for the baby boomers' retirement.

For most of Social Security's history, gains in life expectancy were more than offset by higher contribution rates, which also served to expand benefits. These tax increases were easily accommodated by rising wages, which for the medium earner almost doubled over this period in inflation-adjusted terms. The contribution rate has not risen since 1990. Instead, reforms implemented by Congress in 1983, including a gradual increase in the normal retirement age, reduced benefits relative to pre-retirement earnings.

Raising the normal retirement age is the same as an across-the-board benefit cut. Though some workers may be able to offset such a cut by working longer, most will experience it as a reduction in retirement income. There is little reason to assume that most workers will be able to work to 67, let alone 68, 69 or even 70, as some propose. Instead, further increases in the normal retirement age would exacerbate the problem of growing retirement insecurity. This is especially true of low-income workers who have seen only modest gains in life expectancy yet are the hardest hit by Social Security cuts.

Despite a successful effort by conservative think tanks to convince younger generations that Social Security will not be available to them when they retire, the program is actually in sound financial shape. As a result of policies enacted in 1983, Social Security is currently running a surplus and building up a trust fund that is projected to peak at $4.2 trillion in 2024 and to last through the peak baby boom retirement years. The projected 75-year shortfall is 1.92% of taxable payroll or 0.60% of GDP, roughly the cost of extending the Bush-era tax cuts for people making over $250,000 (CBPP 2010).

Since high-income workers have seen the lion's share of gains in both earnings and life expectancy, raising or eliminating the taxable earnings cap, currently set at $106,800, would be the logical first step toward restoring the system to long-term solvency. This and other minor adjustments on the revenue side would be sufficient to close the projected shortfall without exacerbating retirement insecurity.

This report seeks to put gains in life expectancy in proper context by looking at a number of trends that have affected Social Security's finances. The focus is on demographic and labor market trends since 1983, when the system was last restored to balance. Except where otherwise noted, statistics are from the latest report and related tables produced by the program's trustees (Social Security Trustees 2010), and projections are intermediate projections from the report.

Deficit commission made the wrong call

In a 2008 newspaper op-ed entitled "Tackle Social Security First," former Federal Reserve vice chair and Congressional Budget Office director Alice Rivlin suggested "gradual increases in the retirement age" as a way to address a looming demographic challenge:

> With the large baby boom generation retiring and Americans living longer, the ratio of workers to Social Security beneficiaries is falling fast. Quite soon the payroll taxes coming into the Social Security system will be inadequate to pay all the benefits promised to retirees. (Rivlin and Kingdon 2008)

As a member of President Obama's National Commission on Fiscal Responsibility and Reform, Rivlin's theme was taken up by Commission co-chairs Alan Simpson and Erskine Bowles (Berry 2010). Their report, which failed to get the required 14 votes for adoption, blamed demographic changes for a Social Security funding crisis:

> In 1950, there were 16 workers per beneficiary; in 1960, there were 5 workers per beneficiary. Today, the ratio is 3:1 – and by 2025, there will be just 2.3 workers "paying in" per beneficiary. Unless we act, these immense demographic

changes will bring the Social Security program to its *knees*. Without action, the benefits currently pledged under Social Security are a promise we cannot keep.

Although Social Security's demographic challenges are real, the concern over the retirement of the baby boomers and rising longevity is exagerrated. As Social Security Chief Actuary Stephen Goss points out, the biggest challenge is not the baby boom but a baby bust—a decline in birth rates from three surviving children per woman to two. "Because the large shift in the cost of [Social Security] over the next 20 years is not due to increasing life expectancy," Goss says, "it is not clear that increasing the NRA should be the principal approach for restoring long-term solvency" (Goss 2010).[2]
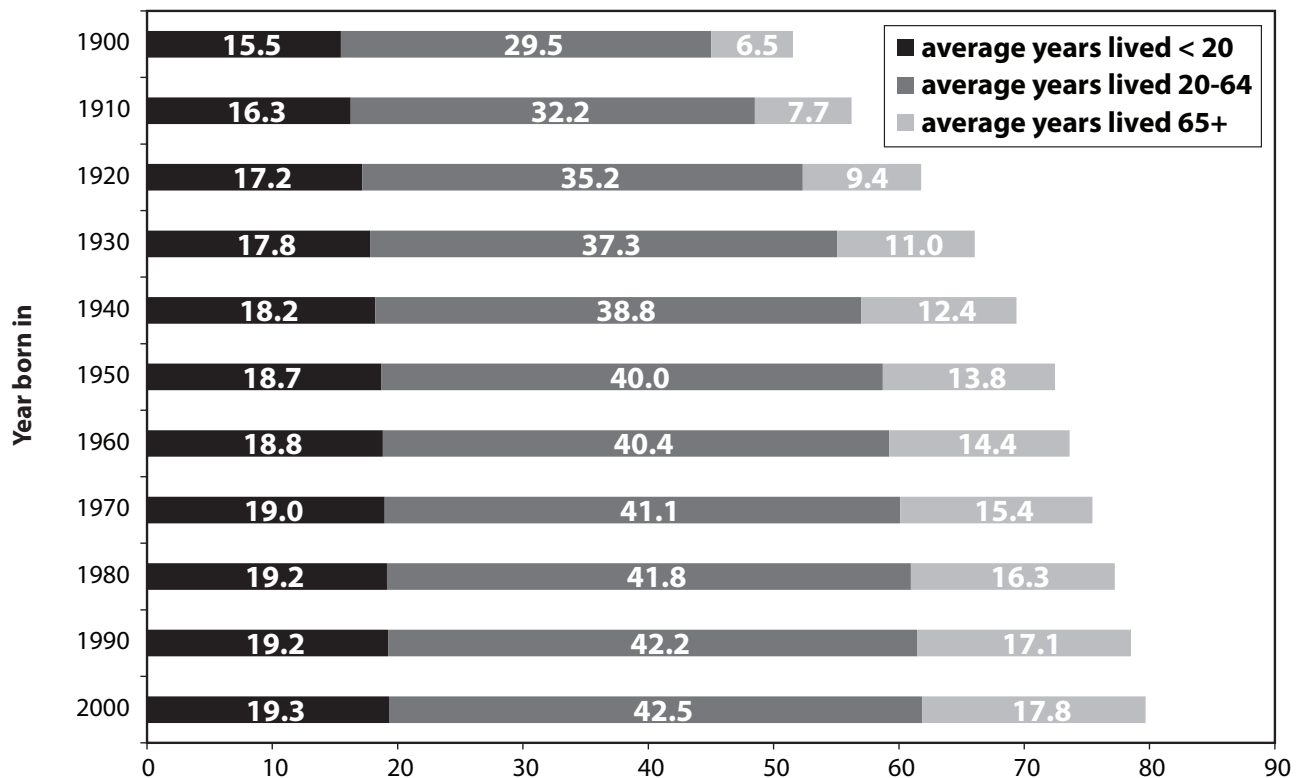
Factors that impact program outlays

Life expectancy. Since the first Social Security retirement claim was filed in 1939, the number of additional years one can expect to live at age 65 has risen by about five-and-a-half, from 12.7 to 18.1 years for men and from 14.7 to 20.4 years for women. The number is projected to keep increasing, and this is the main reason cited by the American Academy of Actuaries (2010) for raising the retirement age.

The narrow focus on life expectancy at 65 is misleading, however, because Social Security is also affected by improvements in life expectancy during prime working years. Improvements in life expectancy from ages 20 to 64 generally help the system's finances because they increase the number of workers paying into the system.

FIGURE A

Life expectancy of male birth cohorts, 1900-2000, by number of years in childhood, prime working years, and retirement

- ■ average years lived < 20
- ■ average years lived 20-64
- ■ average years lived 65+

Year born in	average years lived < 20	average years lived 20-64	average years lived 65+
1900	15.5	29.5	6.5
1910	16.3	32.2	7.7
1920	17.2	35.2	9.4
1930	17.8	37.3	11.0
1940	18.2	38.8	12.4
1950	18.7	40.0	13.8
1960	18.8	40.4	14.4
1970	19.0	41.1	15.4
1980	19.2	41.8	16.3
1990	19.2	42.2	17.1
2000	19.3	42.5	17.8

SOURCE: EPI, based on Bell and Miller (2005).

On the other hand, they also increase the number who survive to retirement as well as the number receiving disability and dependent benefits.
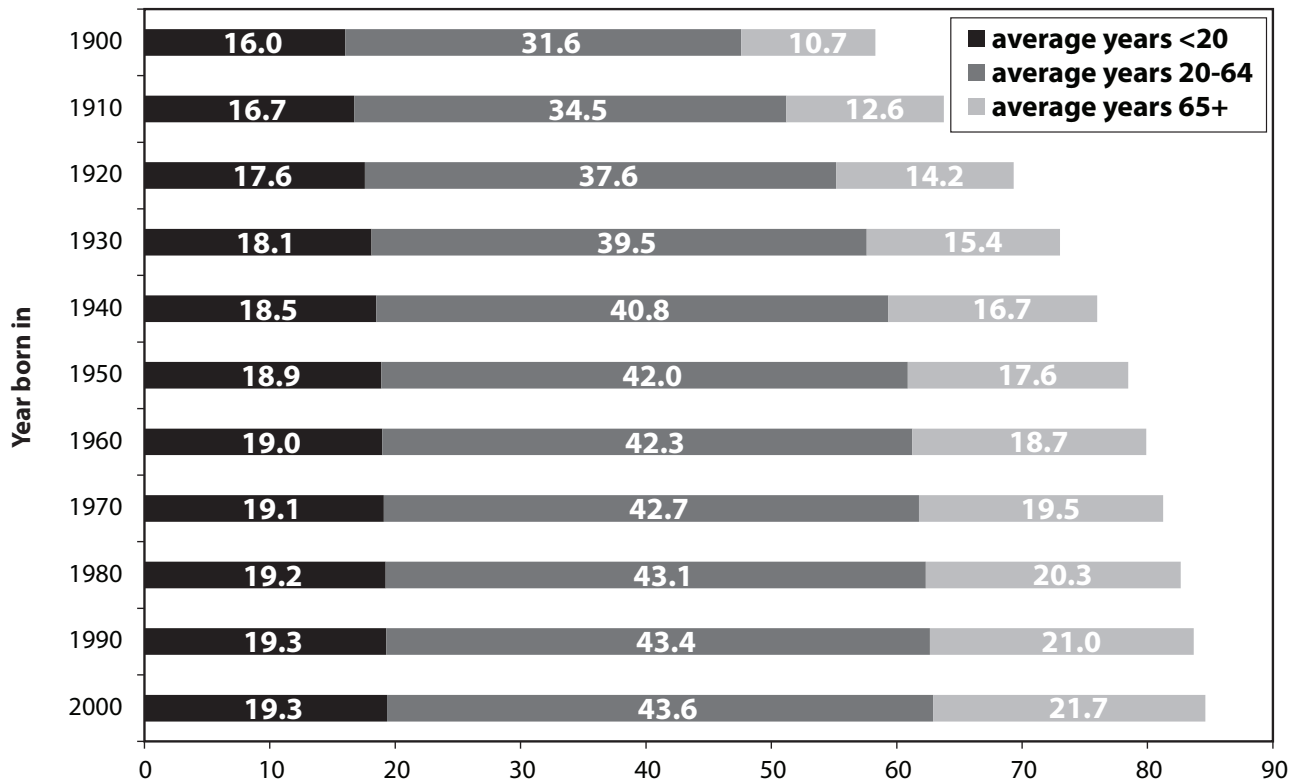
A more complete picture is provided by analyzing trends in life expectancy at birth broken down into the average time spent in youth (ages 0-19), prime working years (20-64), and what used to be the "normal" retirement years (65+).[3] Americans born around 1950—members of the baby boom generation entering retirement today—will live nearly 21 more years on average than Americans born around 1900 who retired in the 1960s (see **Figures A** and **B**). However, more than half these gains occurred during prime working-age years. Whereas men and women born in 1950 will live on average around seven more years after turning 65 than those born in 1900, they will live around 10 more years on average during prime working years.

Baby boomers will still spend a greater proportion of their adult lives in what used to be normal retirement, but the effect is not nearly as pronounced as it would be if all of the gains had occurred after age 65. Specifically, the over-65 years will account for 25.6% of adulthood for baby boomer men, compared with 18.1% for males born a half century earlier. Likewise, these years will account for 29.5% of adulthood for baby boomer women, compared with 25.3% for the earlier cohort (author's analysis of Bell and Miller 2005). These calculations do not factor in the increase in the NRA from 65 to 67. As will be discussed later in this paper, the ratio of *covered* retirement years to working years actually declined slightly for workers born between 1930 and 1960 due to the increase in the NRA.

The NRA is gradually rising from 65 to 67 for Americans born between 1938 and 1960. The Social Security actuaries estimate that raising it by one month

FIGURE B

Life expectancy of female birth cohorts, 1900-2000, by number of years in childhood, prime working years, and retirement

Year born in	average years <20	average years 20-64	average years 65+
1900	16.0	31.6	10.7
1910	16.7	34.5	12.6
1920	17.6	37.6	14.2
1930	18.1	39.5	15.4
1940	18.5	40.8	16.7
1950	18.9	42.0	17.6
1960	19.0	42.3	18.7
1970	19.1	42.7	19.5
1980	19.2	43.1	20.3
1990	19.3	43.4	21.0
2000	19.3	43.6	21.7

SOURCE: EPI, based on Bell and Miller (2005).

every two years for generations born after 1960 would off-set future gains in life expectancy and reduce the long-run deficit by about a fifth (Reno and Lavery 2009b; Senate Aging Committee 2010).[4]

These projected longevity gains, if they materialize, could also be offset by a 0.01 percentage-point increase in the payroll tax per year from 2025 to 2084 (from 6.2% to 6.8% overall).[5] Over this 60-year period, average wages are projected to nearly double in inflation-adjusted terms.

Population growth. Faster population growth tends to reduce the aged dependency ratio—the ratio of those 65 and older to those 20-64—while slower population growth tends to increase it. The dependency ratio is projected to rise with the baby boomer retirement and then level off at a higher level due to a permanent decline in the fertility rate from around three surviving children per woman to two.[6] As the program's chief actuary has noted, this drop in birth rates is the dominant factor behind the projected increase in Social Security costs over the next 75 years (Goss 2010).

Immigration increased significantly over the past three decades, and by contributing to growth in the workforce it provided a boost to Social Security's finances. Though immigration has dropped off in the economic downturn, the Social Security actuaries estimate that a return to the pre-recession peak level would reduce the 75-year shortfall by 10%, even if one assumes flat rather than rising immigration.

Labor force participation and benefit take-up. The beneficiary-to-worker ratio is the most straightforward way to compare the number of people paying into the system and the number receiving benefits. Unlike the aged dependency ratio, the beneficiary-to-worker ratio takes into account changes in labor force participation and assumption of benefits (referred to as benefit take-up).

The beneficiary-to-worker ratio rose rapidly in Social Security's early decades and then stabilized at around 30 beneficiaries per 100 workers in the 1970s (see **Figure C**). The ratio began climbing again in 2008 with the economic downturn and the start of the baby boomer retirement, and it is projected to level off at around 50 after the peak

boomer retirement years. If life expectancy were the prime driver of increases in the dependency ratio, then this figure would show a steady, uninterrupted rise; instead, the figure illustrates that the baby boom retirement and subsequent baby bust will drive the increase in the coming decades, and that other factors—such as increased labor force participation—can offset increases in life expectancy.

In recent decades, the influx of women into the workforce and a trend toward later retirement have caused employment to grow faster than population growth and helped offset increases in life expectancy. Though labor force participation by prime-age men has declined (a symptom of shrinking job opportunities for less-educated workers), this decline was less pronounced than the increase in women's participation, and so work effort has increased overall.

Higher employment rates help Social Security's finances because they reduce the beneficiary-to-worker ratio and because Social Security retirement benefits are based only on participants' highest-paid 35 years (additional years of work and contributions count towards additional benefits only to the extent that they are associated with a later retirement age or higher wages). There is no obvious advantage to encouraging later retirement as opposed to more employment during prime working ages, since Social Security benefits are reduced for early retirement in order to equalize lifetime benefits.[7]
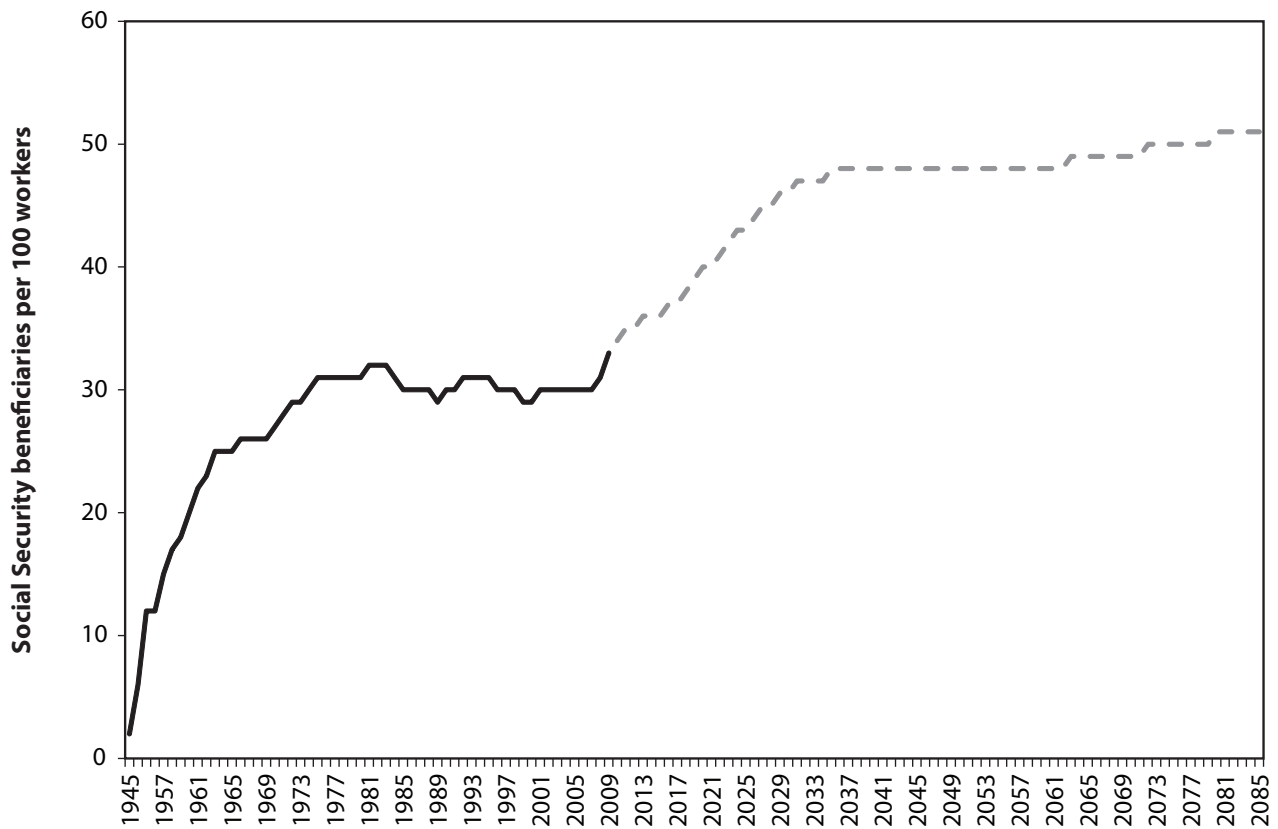
The beneficiary-to-worker ratio is also affected by trends in benefit take-up. The influx of women into the workforce and the rise of two-earner couples have reduced the share of beneficiaries receiving dependent benefits. At the same time, however, higher disability take-up, reflecting in part worsening job prospects for workers in poor health, has drawn down Social Security's capacity.

Factors that affect Social Security revenues

Wages and inequality. The Social Security shortfall is due not just to rising costs but also to declining revenues as a share of GDP. A rising profit share, slow wage growth, earnings inequality, and rising health care costs have contributed to an erosion in taxable earnings from 42% of GDP in 1983 to 37% today.

FIGURE C

Beneficiary-to-worker ratio, 1945-2085

SOURCE: Social Security Administration.

Just as faster growth in the covered workforce helps offset gains in life expectancy to stabilize the beneficiary-to-worker ratio, faster wage growth helps stabilize costs as a share of taxable earnings or GDP. Though higher wages eventually lead to higher benefits, faster wage growth reduces the cost of current benefits relative to current wages, in part because cost-of-living adjustments after retirement are tied to consumer prices rather than wages.

Unfortunately, most workers' wages have grown very slowly in recent decades and have lagged productivity growth, except for a period in the late 1990s. If real wage growth had kept up with productivity from 1983 to 2007, the trust fund would now be larger by roughly $450 billion, equal to 8% of the $5.4 trillion shortfall.[8] Going forward, the Social Security actuaries project relatively slow

wage growth of 1.2% above inflation, but wage growth of 1.8% above inflation (the average productivity growth rate over the past quarter century) would eliminate 43% of the projected shortfall, according to the trustees' 2010 report. All together, then, slow wage growth accounts for roughly half (51%) of the projected shortfall that has emerged since the system was last restored to balance.

As the earnings of most workers have risen very slowly while earnings of those at the top have skyrocketed, the system's revenues have also suffered because the share of earnings above the taxable earnings cap, currently $106,800, has expanded. Though the cap is indexed to average wages, these have not grown as fast as earnings at the top, leading to an erosion of Social Security's tax base. As a result, the share of untaxed earnings grew from 10%

in 1983 to 16% in 2008 (Social Security Administration 2010). Restoring the taxable earnings cap to cover 90% of earnings would close 31% of the projected shortfall.[9] Add in forgone revenues and interest from 1983 to 2008, and the trust fund would now be larger by over $850 billion, equal to 16% of the $5.4 trillion shortfall. All told, growing inequality accounts for roughly half (47%) of the projected shortfall that has emerged since the system was last restored to balance.

It is difficult to gauge the combined impact of slow wage growth and rising inequality since the two are related—the taxable earnings cap is indexed to average wages. It is safe to say, however, that the two trends together account for the bulk of the projected shortfall.

**Health care.** The erosion of taxable earnings has been exacerbated by health care cost inflation, which increases the share of compensation going to untaxed fringe benefits. The Social Security actuaries estimate that the recent health care overhaul[10] will slow the erosion of earnings as a share of compensation by roughly half, from 0.2% per year to 0.1% per year,[11] thereby reducing the projected shortfall by roughly 7%. It is fair to assume that totally eliminating excess health care cost inflation (slowing the erosion of earnings from 0.2% to zero) would reduce the projected shortfall by an additional 7%.

Current benefits are affordable

Social Security alarmists often focus narrowly on the aged dependency ratio, which will nearly double over the course of the 75-year projection period (see **Figure D**). There are, however, better ways to assess the system's long-term health. Over the same period, the beneficiary-to-worker ratio will increase by 50%, and costs as a share of GDP will increase

FIGURE D

Four ways to look at sustainability of Social Security, 2010-85

Legend:
— Aged dependency ratio
- - Costs as a % of taxable payroll
— Beneficiary-to-worker ratio
···· Costs as a % of GDP

Y-axis: 2010=100
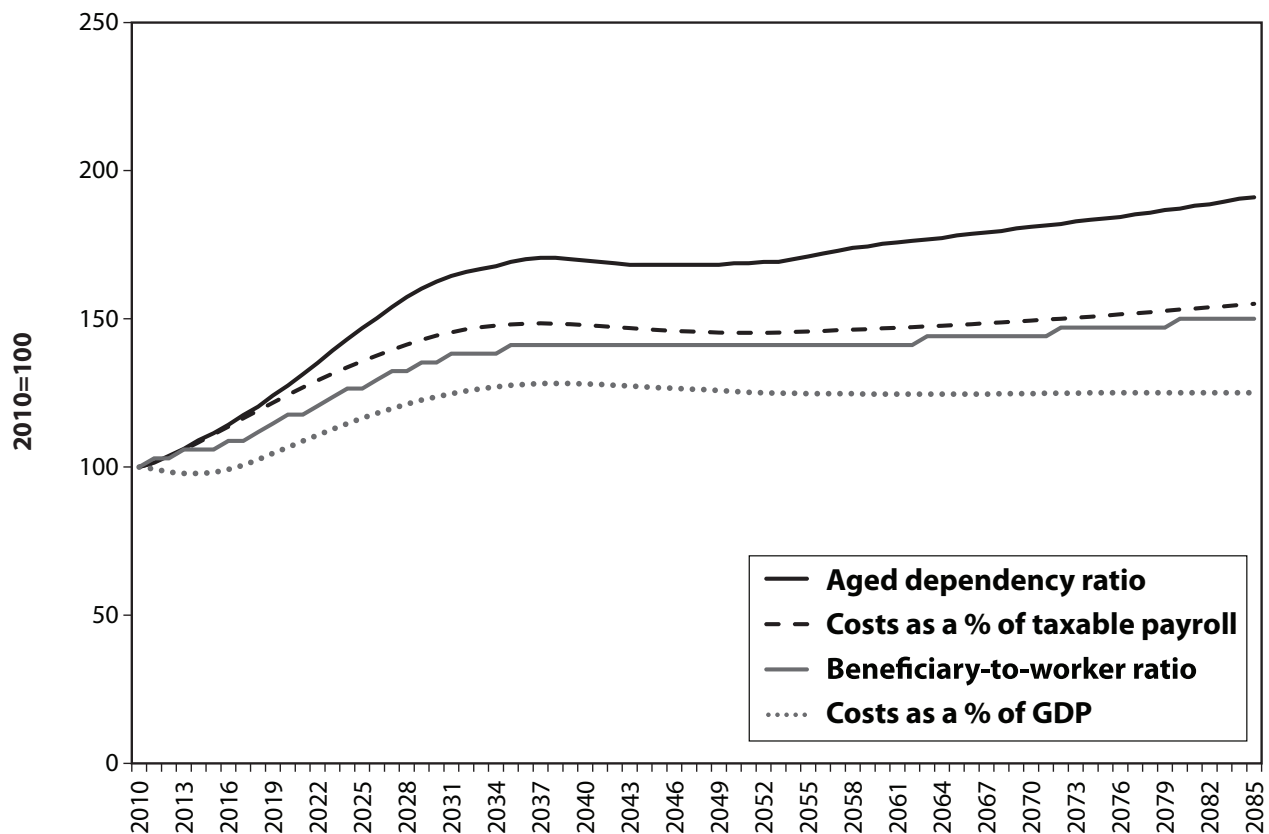
SOURCE: Social Security Administration.

by only 25%. Even this last measure overstates the scale of the problem because it ignores the fact that Social Security has been running a surplus and building up a large trust fund for a quarter century. All told, an increase in the payroll tax rate from 6.2% to 7.2%, equivalent to a 16% increase in tax revenues, would be sufficient to close the 75-year shortfall.

Over the same period, real wages for the medium earner are projected to more than double, so only a small fraction of the wage increase would go to higher taxes. This is not to suggest that all or even most of the projected shortfall *should* be closed by raising payroll taxes on all participants, but it is nevertheless likely that a tax increase would be more than offset by rising living standards.

Reforms to Social Security, past and proposed

For most of Social Security's history, gains in life expectancy were more than offset by higher contribution rates, and these adjustments were made routinely and not presented as evidence of a system in crisis. The contribution rate increased 19 times in Social Security's history, from 1% in 1937-1949 to 6.2% in 1990. These tax increases were easily accommodated by rising wages, which for the medium earner nearly doubled over this period in inflation-adjusted terms.

Higher contribution rates also served to expand benefits, which, along with expanding coverage, dramatically reduced poverty rates among the elderly. Nevertheless, most older Americans live modestly—many just above the federal poverty line—and have much lower median incomes than working-age households.

The period since 1990 is the longest without an adjustment in the contribution rate, and during this time average real wages have increased by more than a quarter.

Reforms implemented by Congress in 1983 reduced benefits relative to pre-retirement earnings, primarily by implementing a gradual increase in the normal retirement age. An increase in the NRA is simply an across-the-board cut in monthly benefits, though workers can theoretically offset this cut by working longer. For example, since the NRA increased from 65 to 66, workers who retire now at 65 will receive benefits that are roughly 93% of what they would have received when the NRA was 65 (see **Table 1**). Or they can work an extra year to make up the difference, though they would receive less at 66 than they would have

| | | TABLE 1 | | | | | | |

Social Security retirement benefit levels as normal retirement age (NRA) rises

Year of birth	NRA	Benefit, as a percentage of full benefit, beginning at age--						
		62	63	64	65	66	67	70
1937	65	80	86 2/3	93 1/3	100	106 1/2	113	132 1/2
1938	65, 2 mo.	79 1/6	85 5/9	92 2/9	98 8/9	105 5/12	111 11/12	131 5/12
1939	65, 4 mo.	78 1/3	84 4/9	91 1/9	97 7/9	104 2/3	111 2/3	132 2/3
1940	65, 6 mo.	77 1/2	83 1/3	90	96 2/3	103 1/2	110 1/2	131 1/2
1941	65, 8 mo.	76 2/3	82 2/9	88 8/9	95 5/9	102 1/2	110	132 1/2
1942	65, 10 mo.	75 5/6	81 1/9	87 7/9	94 4/9	101 1/4	108 3/4	131 1/4
1943-54	66	75	80	86 2/3	93 1/3	100	108	132
1955	66, 2 mo.	74 1/6	79 1/6	85 5/9	92 2/9	98 8/9	106 2/3	130 2/3
1956	66, 4 mo.	73 1/3	78 1/3	84 4/9	91 1/9	97 7/9	105 1/3	129 1/3
1957	66, 6 mo.	72 1/2	77 1/2	83 1/3	90	96 2/3	104	128
1958	66, 8 mo.	71 2/3	76 2/3	82 2/9	88 8/9	95 5/9	102 2/3	126 2/3
1959	66, 10 mo.	70 5/6	75 5/6	81 1/9	87 7/9	94 4/9	101 1/3	125 1/3
1960 and later	67	70	75	80	86 2/3	93 1/3	100	124

SOURCE: Social Security Administration.

Social Security net income-replacement rates for the average earner retiring at age 65 in 2002 and 2030
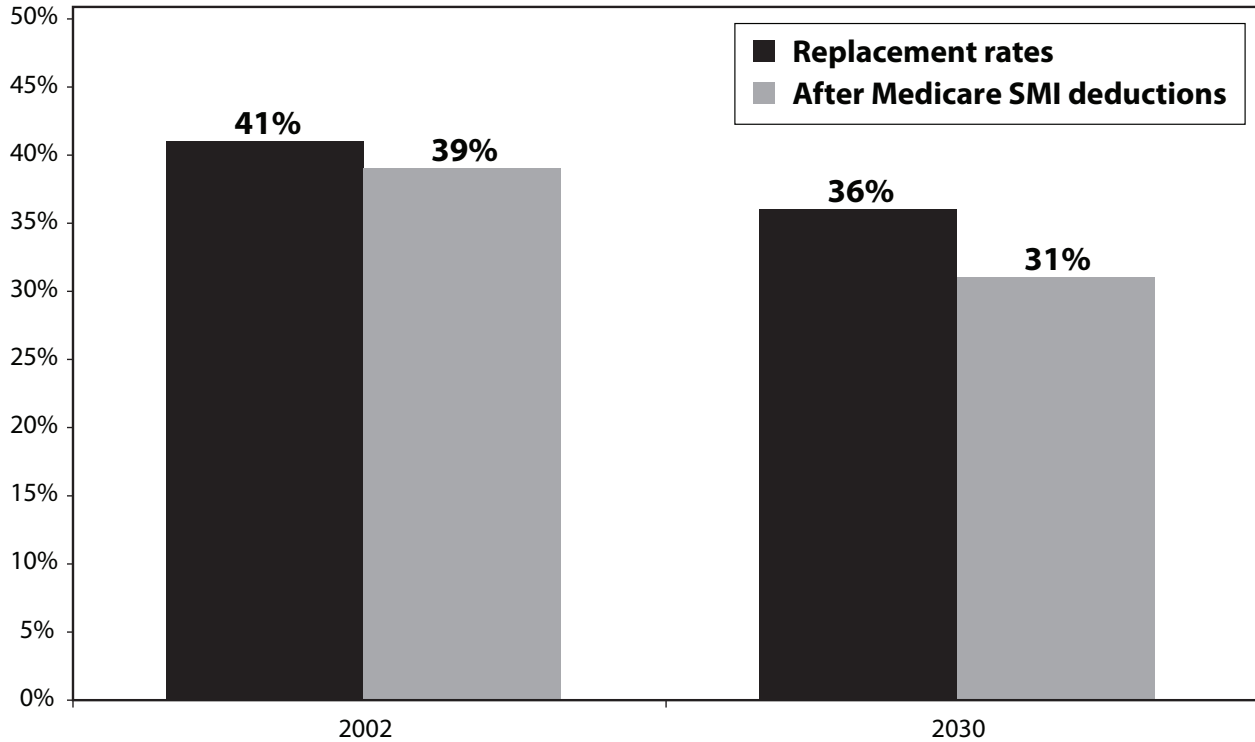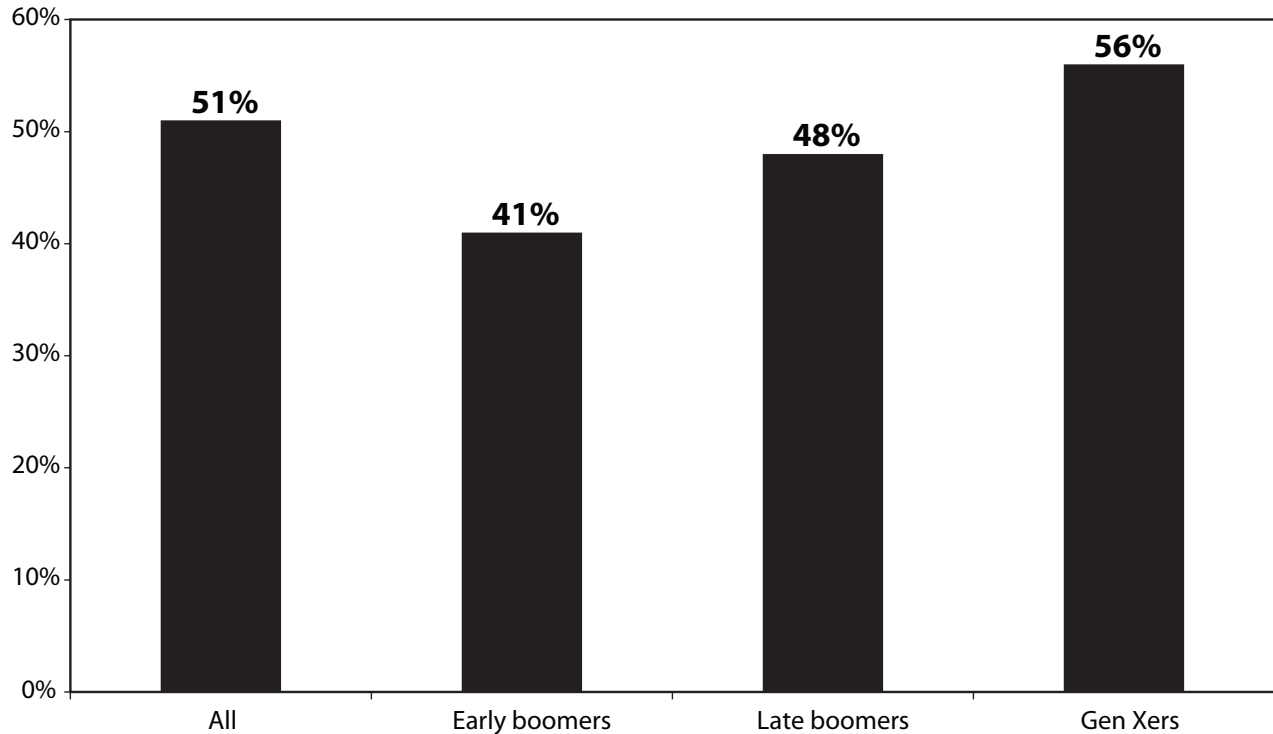

SOURCE: Munnell, Webb, and Golub Sass (2009).

before the increase in the NRA. When it has fully taken effect, raising the NRA from 65 to 67 will be equivalent to a 12-14% benefit cut for workers who retire before age 70.

For generations born between 1938 and 1960, gains in life expectancy will be offset not by higher payroll tax rates but by the increase in the NRA. Specifically, referring back to Figures A and B, males born in 1960 will spend on average 26.3% of their adulthood (ages 20 and older) in what used to be "normal" retirement (ages 65 and older), compared with 22.8% for males born in 1930. For women, the proportion spent in what used to be normal retirement rose from 28.1% to 30.6%. However, factoring in the increase in the NRA, the proportion spent in normal retirement falls slightly over this period (to 22.6% for men and 27.3% for women). In other words, the increase

in the NRA has more than offset the increase in life expectancy over this period (author's calculations, based on Bell and Miller 2005).

Despite an increase in work effort at older ages, for most people the increase in the NRA will be experienced primarily as a reduction in monthly benefits, not as delayed retirement, since retirement timing is not very responsive to changes in Social Security benefits (Burtless and Moffitt 1985). In addition to receiving reduced benefits, future retirees will pay higher Medicare premiums and some will pay income tax on some Social Security benefits. As a result of these changes, net benefits after Medicare deductions will replace only 31% of pre-retirement earnings for average earners who retire at 65 in 2030, compared to 39% for their counterparts who retired in 2002 (see **Figure E**).

Share at risk of being unable to maintain living standards in retirement

All	51%
Early boomers	41%
Late boomers	48%
Gen Xers	56%

SOURCE: Munnell, Webb, and Golub Sass (2009).

Growing retirement insecurity beyond Social Security

Cuts to Social Security have not been offset by improvements in employer-based pensions or personal savings. To the contrary, the other two legs of the proverbial three-legged retirement stool are shakier than ever, with secure defined-benefit pensions being replaced by risky and inadequate 401(k) plans and with retirement nest eggs, whether in the form of 401(k) balances or homeowners' equity, shrinking. Overall, household net worth has declined by more than one-fourth relative to disposable personal income since 2006 (Federal Reserve 2010), even though savings should have grown to make up for declines in defined-benefit pension coverage and reduced Social Security benefits (Delorme et al. 2006).

As a result, younger workers today are more likely to face a drop in living standards at retirement than did earlier generations, the first such reversal in modern U.S. history. The Center for Retirement Research estimates that more than half of households are now at risk of seeing a significant drop in living standards at retirement, with younger generations at greatest risk (see **Figure F**).

The Center for Retirement Research has also estimated that households age 32-64 now have a "retirement income deficit" of $6.6 trillion (Retirement USA 2010). This measure, an average of $90,000 per household, is the gap between the pensions and retirement savings that these households have accrued and what they should already have accrued to maintain their standard of living over their lifetimes. It takes into account all major sources of retirement income and assets and assumes people will continue to work, save, and accumulate additional pension and Social Security benefits until they retire at age 65. It also conservatively assumes that retirees will spend down

all their wealth in retirement, including home equity. A further increase in the NRA would cause the retirement income deficit to grow.

Can Americans work longer?

At 66, the normal retirement age is unrealistically high. It is already higher than in most industrialized countries and is still rising. Though the work effort of older Americans has increased significantly over the past two decades, relatively few workers keep working until the normal retirement age.

Working longer is not a viable choice for many Americans. Many retire sooner than planned due to job loss, illness, or the need to care for a sick spouse. A 2006 McKinsey survey found that 40% of workers were forced to stop working earlier than planned, with slightly more than half citing health reasons or the need to care for a spouse or other family member; the rest cited job loss (Rotenberg 2006).

The increase in the labor force participation of older workers over the past quarter century seems driven more by need than opportunity, though the evidence is mixed. There appears to be a growing divide between older workers with secure jobs and those at increased risk of losing their jobs who also face poor reemployment prospects. Over the past decade, the pay of full-time workers age 55 and older has risen relative to the pay of full-time workers age 25 to 54. On the other hand, the labor force participation of middle-age men has been depressed for years, and the unemployment rate of older workers has been catching up to that of prime-age workers. As noted earlier, elevated disability rates reflect at least in part poor job prospects for older workers in poor health.

Though the unemployment rate for older workers remains below that for workers under 55, this is partly because some older workers who lose their jobs simply retire or become "discouraged" and are not counted among the unemployed. Another reason is that older workers tend to have been with their employer longer. Holding tenure constant, older workers are as likely as younger workers to lose their jobs—more likely, in the case of older men (Johnson and Mommaerts 2010). Thus, the trend toward declining job tenure does not bode well for the employ-

ment prospects of older workers, at least for men working in the private sector (Farber 2008).

When older workers lose their jobs, their employment prospects are bleak. They are more likely to be unemployed for long periods than are their younger counterparts (Ilg 2010) and to experience larger pay cuts if they manage to find a job (Johnson and Mommaerts 2010; Munnell et al. 2009). Among displaced workers age 55-64 who lost their jobs in 2007-09, only 39% were reemployed when surveyed in January 2010, compared with 53% for workers age 25-54. For those age 65 years and over, the reemployment rate was 23% (Bureau of Labor Statistics 2010).

Another indicator that the trend toward delayed retirement is driven more by growing retirement insecurity rather than expanding job prospects is the fact that the labor force participation of older workers kept climbing as the economy entered into the last two recessions, both of which were triggered by declines in asset values. In the past, older workers were more likely to retire early during economic downturns, and they injected funds into the economy by tapping Social Security and pension benefits. Now it appears that 401(k)-style savings plans are causing many older workers to delay retirement even as jobs are becoming scarcer.

Age discrimination remains common. Economist Joanna Lahey (2008) found that younger job seekers were 40% more likely to be offered an interview than older job seekers with similar résumés. Some have suggested that employers will become more open to hiring and retaining older workers as the population ages. Whether or not this transpires—a lot depends on how much slack there is in the economy—it will be difficult to accommodate the expected increase in older workers and job seekers, even without another increase in the NRA.

Proponents of raising the retirement age point to a decline in the share of jobs that are physically strenuous. But the fact that fewer Americans work in steel mills or on farms does not mean it will be easy for many workers to keep working well into their 60s or 70s—whether they are standing at cash registers or working in daycare centers. Research by Hye Jin Rho (2010) of the Center for Economic and Policy Research found that 45% of older workers were employed in physically demanding jobs or

Male life expectancy at 65
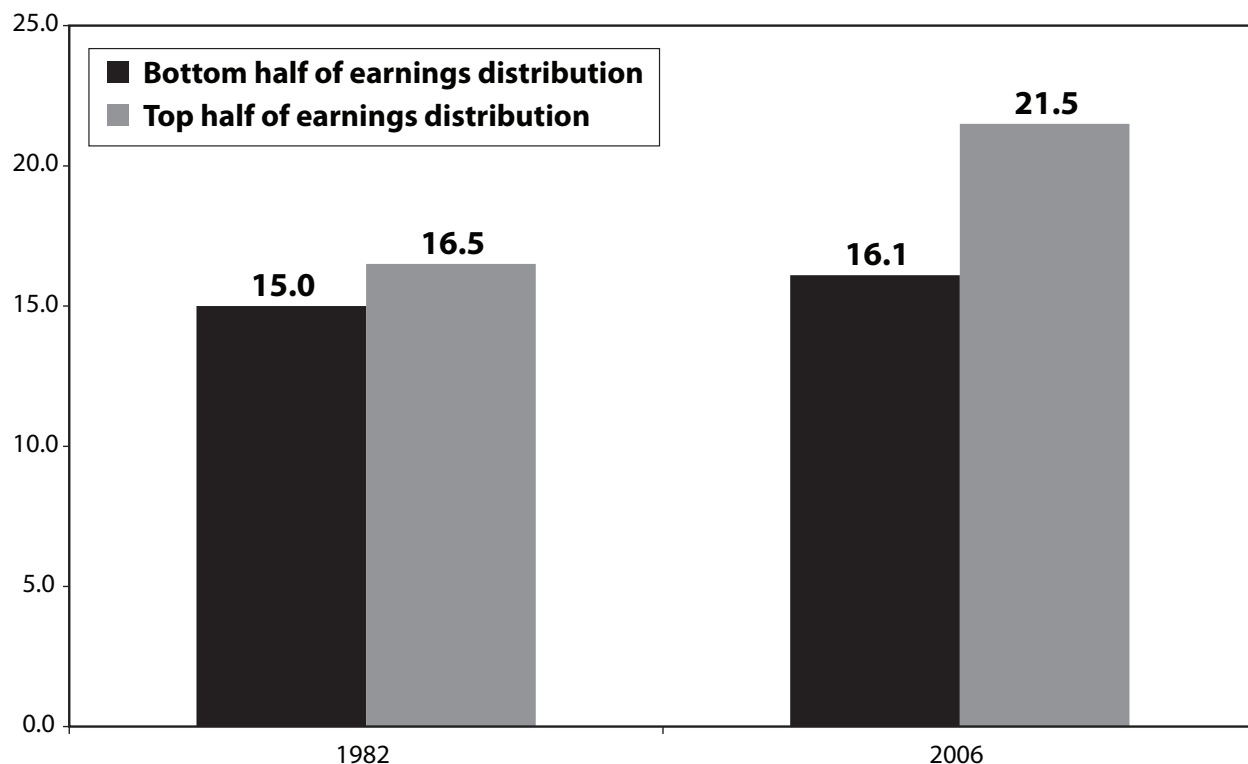
SOURCE: Waldron (2007).

jobs with difficult working conditions. These are jobs most likely to be held by less-educated workers who are also more likely to find themselves out of work late in life.

Low-income groups are hardest hit

Perversely, an increase in the normal retirement age would have the biggest impact on low-income workers who have seen little or no improvement in life expectancy. A number of studies have documented that in recent decades gains in life expectancy have been concentrated among those with higher incomes and more education, especially men (CBO 2008; Cristia 2009; Cutler et al. 2010; Singh and Siahpush 2006; Waldron 2007). Over a quarter century, life expectancy at age 65 increased by one year for lower-income men compared to five years for upper-income men (see **Figure G**). In 2006, men in the lower half of the earnings distribution had not even caught up to where upper-income men were in 1982 (Waldron 2007). In the

case of women, life expectancy has grown more slowly overall, with lower-income women age 35-76 actually seeing declines and upper-income women seeing only modest improvements (Cristia 2009).

These lower-income workers depend on Social Security the most and therefore are hardest hit by increases in the normal retirement age. For those retiring at 65, the 13% cut in benefits resulting from the increase in the NRA from 65 to 67 translates to an 11% reduction in overall income among seniors in the bottom fourth of the income distribution; for seniors in the top fourth the reduction in overall income is less than 3% (author's analysis of Purcell 2009).

Closing the long-term shortfall

Americans across the political spectrum strongly prefer increasing revenues to strengthen Social Security rather than raising the retirement age or otherwise cutting benefits (Reno and Lavery 2009; Wright and Davies 2007). This is

not surprising when you consider that the average Social Security retirement benefit is around $14,000—less than the income of a full-time minimum-wage earner—yet is the main source of income for most seniors.

Since earnings inequality accounts for half of the projected shortfall, a logical place to begin closing the gap is by raising or eliminating the cap on taxable earnings, especially since high earners have also seen the lion's share of gains in life expectancy. Unlike raising the retirement age for people born after 1960, raising or eliminating the cap would have an immediate impact on Social Security's finances and would forestall the exhaustion of the Social Security trust fund.

Indexing the taxable earnings cap to cover 90% of earnings would eliminate roughly a third of Social Security's projected shortfall. Better yet, gradually raising the cap to cover 90% on the employee side and eliminating it altogether on the employer side would close nearly three-fourths of the projected shortfall while maintaining the historic link between employee contributions and benefits. As mentioned earlier, longevity increases could be fully offset by a very gradual increase in the payroll tax of 0.01 percentage points per year beginning in 2025; these adjustments would close a fifth of the gap. These changes along with other minor adjustments, such as making salary reduction plans subject to payroll taxes, would close the entire projected shortfall.

Other policies outside Social Security could also help. While much has been made of the need to encourage later retirement, it makes sense to focus on policies that boost employment of all workers. In particular, monetary and fiscal policies promoting full employment and labor law reform facilitating unionization would lead to faster wage growth and a substantial positive impact on the system's finances. Similarly, efforts to restrain health cost inflation or encourage immigration would also improve Social Security's outlook.

Unlike raising the NRA, these policies would help restore long-term solvency without hurting vulnerable groups. Most of these measures would also avoid causing increases in other federal spending such as an increase in disability benefits or additional tax subsidies for retirement savings.

Conclusion

Like the Reverend Thomas Malthus, who at the turn of the 19th century believed relief efforts for the poor spurred ruinous population growth, Social Security alarmists warn of the dire effects of a growing dependent population, in this case the elderly. These neo-Malthusians ignore the fact that younger generations are paying for their own longer retirements through higher contributions and longer working lives, and, like Malthus, fail to take into account that productivity growth can support growing populations with rising living standards.

Encouraging additional years of work can help, but there is no obvious reason to focus on work at older ages as opposed to work during prime working-age years. Though the labor force participation rate of prime-age workers cannot rise indefinitely, the same is likely true of life expectancy. There is, however, no limit to productivity growth, which has risen much faster than life expectancy in retirement.

Economists sometimes frame the issue as a choice between enjoying the fruits of a growing economy in the form of leisure or consumption. However, this assumes people can choose when to work and to retire. It is more realistic to view it as a tradeoff between higher or lower taxes during working years and a smaller or greater drop in living standards at retirement.

An increase in the normal retirement age is a way to maintain the same ratio between the average time spent in the covered workforce and the average time spent in covered retirement. But it ignores the fact that different people start working at different ages and have different life expectancies. In particular, raising the normal retirement age would impose the greatest hardship on low earners who have seen little or no gains in life expectancy.

A gradual increase in the normal retirement age sufficient to offset future gains in life expectancy would close only a fifth of the projected shortfall while exacerbating retirement insecurity. A faster increase in the NRA would simply be an effort to cut benefits while attempting to avoid—as suggested by the Academy of Actuaries (2010)—the "intense political battles" that might arise if these cuts were made transparently through a change in the benefit formula.

Endnotes

1. The *normal retirement age* is the term used by the Social Security Administration to denote the age at which retirees can receive full benefits (the "primary insurance amount"). Those who retire before or after the NRA receive lower or higher monthly benefits, respectively, to make up for their longer or shorter expected retirements. The term is misleading because most people retire before the "normal" age and because the maximum benefit is received at age 70, not at the NRA (which is currently 66).

2. Goss referred specifically to the costs of the Old-Age, Survivors, and Disability Insurance (OASDI) program, the official name for Social Security.

3. Life expectancy at birth is often interpreted as the life span of the average person born in a given year. But this statistic can also be viewed as the average number of years lived by a group of people, which can be broken down into time spent at various ages. Thus, while it might sound odd to say that the average male born in 1950 lived 18.7 years before turning 20, it tells us that among this group of men some died during childhood and young adulthood. Note that the conventional measure of life expectancy at 65 is different from the measure used here of the average number of years lived at various ages (including ages 65 and older) because the former only includes those who survive to age 65, whereas the latter includes everyone in the birth cohort. Using the conventional measure, there is no way to know whether the ratio of retirement years to working years is actually rising, since life expectancy at 65 can rise without an increase in the aged dependency ratio due to offsetting gains at younger ages.

4. The Congressional Budget Office estimates that tying benefits to life expectancy would reduce the shortfall by one third (CBO 2010). The CBO method reduces benefits proportionally to increases in life expectancy at 62; it thus freezes lifetime benefits rather than maintaining the same ratio of working years to retirement years. The cuts would take effect five years sooner than the method analyzed by the Social Security actuaries and would have an impact on workers currently in their mid-50s, not just workers born after 1960.

5. This assumes that changes in the taxable earnings cap or other reforms would close the part of the projected shortfall not attributable to longevity gains.

6. The term "dependency ratio" can also refer to the ratio of the combined younger and older populations (0-19 and 65+) to the prime working-age population (20-64). This total dependency measure peaked when the baby boomers were young.

7. The exception is workers who retire after age 70, who do not receive higher benefits to make up for shorter expected retirements.

8. Author's estimate, based on the assumption that the 1983-2007 balance would have been 2.03% rather than 1.69% of payroll if the average real wage differential had been 1.8% rather than 1.3% (extrapolated from Table B2 in the 1983 trustees report).

9. This assumes that the share of earnings above the cap remains at the 2008 level (15.9%) and that 18.5% of forgone revenues would go toward higher benefits. The latter estimate is extrapolated from the Social Security actuaries' estimates of potential revenues from eliminating the taxable earnings cap with and without counting the revenues toward higher earnings (Senate Aging Committee 2010).

10. The overhaul refers to the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010.

11. The actuaries assume that the annual percentage change in earnings as a share of compensation will go from -0.2% per year to -0.1% per year between 2020 and 2083. The actuaries assume that health care reform will have no effect on costs in the first five years of the projection period. Over the next five years, they assume the legislation will put a temporary halt to excess cost inflation (0.0% per year instead of 0.2%).

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