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Would Raising the Social Security Retirement Age Harm Low-Income Groups?

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Social Security's projected financial shortfall has spurred discussions about increasing the age at which workers can first receive retirement benefits.[1] A major reason for the shortfall is one of the most positive developments of the last century: people are now living longer. Since Social Security's inception, life expectancy at age 65 has increased by almost 4.5 years for men and over 5.5 years for women (Board of Trustees 2006). A higher Social Security retirement age would bolster the system by reducing benefits and encouraging people to work longer. In addition to helping Social Security, working longer would also improve individuals' own retirement finances, by generating more retirement wealth and reducing the number of years their wealth needs to fund.

But would raising the retirement age disproportionately hurt vulnerable populations? Since lower-income groups have shorter life expectancies than higher-income groups, raising the retirement age may reduce their retirement years by a greater percentage. Also, lower-income groups depend more on Social Security than higher-income groups, so any reduction in benefits may have a greater impact on their retirement resources.

This brief uses the Urban Institute's Dynamic Simulation of Income Model (DYNASIM3)[2] to examine the future distributional impacts of raising the retirement age by about three years. We find that increasing the retirement age **reduces** lifetime benefits for all groups, but reduces benefits **less** for those with lower lifetime earnings and less education. The policy change does not disproportionately reduce lifetime benefits for lower-income groups because the Social Security disability program provides some protection. Disability beneficiaries are unaffected by the retirement age change and tend to be lower income. Also, much of the life-expectancy differences across groups occurs before retirement age is reached.

Still, we find a higher retirement age increases the number of older Americans living in poverty, as would many policy changes designed to improve the system's solvency. One way to maintain progressivity would be to combine the change with an enhanced minimum benefit for lower earners. We find combining the retirement age change with an enhanced minimum benefit increases lifetime benefits for the lowest earners and substantially cuts the Social Security deficit without significantly increasing poverty rates.

Pros and Cons of Raising the Retirement Age

The advantage of raising the retirement age, compared to other options for balancing Social Security, is that it would encourage people to work longer. By delaying retirement, workers avoid early retirement reductions to Social Security and defined pension benefits, accumulate more Social Security and pension credits and other savings, and reduce the number of retirement years that they must fund. By working until age 67 instead of retiring at age 62, for example, a typical worker could gain about $10,000 in annual income at age 75, significantly reducing the likelihood of falling into poverty at older ages (Butrica et al. 2005). Further, working longer would increase the total production of goods and services in the economy, enhancing living standards and raising government revenues that fund services including Social Security. If raising the retirement age led all workers to delay retirement by even one year, the additional payroll and income tax revenue generated could be as much as 28 percent of the annual Social Security deficit in 2045 (Butrica et al. 2006).

An important concern with increasing the retirement age is whether it would place special burdens on low-income retirees who generally do not live as long as other retirees and typically depend more on Social Security. For example, life expectancy at age 30 for today's young workers is 4.7 years shorter for those without high school degrees than for college graduates (table 1). Social Security is projected to provide over 50 percent of aggregate retirement income for workers in the bottom fifth of earners as compared with 24 percent for those in the top fifth, and 44 percent for African Americans as compared with 32 percent for non-Hispanic whites.[3] Almost any across-the-board reduction in benefits, including raising the retirement age, could disproportionately affect the retirement incomes of groups that are more reliant on Social Security.

Background

The Social Security retirement age consists of both the normal retirement age (NRA) and the early eligibility age (EEA). The NRA, currently 66 and scheduled to increase to 67 for workers who reach age 62 by 2022, is the age at which workers can receive full benefits. The EEA, currently 62, is the age at which workers can first claim retirement benefits. Workers retiring before the NRA and after the EEA receive reduced annual benefits; those who retire after the NRA receive enhanced annual benefits.[4] Increasing the NRA is equivalent to reducing benefits across the board for most retirees and has no more impact on work incentives at older ages than a general benefit cut.[5] Unlike increasing the NRA, increasing the EEA has a direct impact on work at older ages, as it would force workers currently taking benefits early to delay retirement.

In addition to paying benefits at retirement, Social Security also provides benefits at earlier ages for workers who become disabled. To qualify for disability benefits, individuals must have a sufficient work history and be found incapable of "substantial gainful activity." Disability benefits are unaffected by the age at which workers apply for benefits and do not change when beneficiaries reach the EEA or NRA.[6] Consequently, raising the retirement age has no impact on benefits for disabled workers.

TABLE 1. Life Expectancy for Individuals Surviving to Ages 30 and 62, for Individuals Born between 1976 and 1980

	Surviving to Age 30	Surviving to Age 62
All	81.8	84.8
Education		
< HS	79.4	83.4
HS Grad	80.8	84.2
College Grad	84.1	86.3
Race / Ethnicity		
White, Non-Hisp	81.5	84.3
Black, Non-Hisp	78.1	83.0
Hispanic[a]	82.8	85.4
Lifetime Earnings Quintile		
Bottom	79.8	84.0
Middle	81.4	84.5
Top	84.3	86.1

Source: Urban Institute tabulations from DYNASIM3 (run id440v2).

Notes: Lifetime earnings are the average of wage-indexed earnings from age 22 to 61. Earnings include an individual's entire value in years he or she is single and half of the couple's value in years he or she is married.

a. Hispanics have lower mortality rates than non-Hispanic whites in official mortality statistics based on death certificates and in longitudinal surveys. However, some researchers question whether this is really the case. See discussion in Rosenberg et al. (1999) and Palloni and Arias (2004).

Methodology

We use DYNASIM3 to simulate two policy alternatives—raising the retirement age by about three years and combining a slightly larger retirement age increase with an enhanced minimum Social Security benefit. To capture the long-term effects of these changes, we examine lifetime benefits for individuals born between 1976 and 1980 and annual total retirement income for all beneficiaries in 2050.

First we simulate raising the NRA to 69 and 8 months and the EEA to 65, enough to cut the Social Security deficit in half by 2050. The change phases in gradually between 2006 and 2029. We assume that nondisabled workers retiring before age 65 under current rules continue working until the new EEA under the policy change, but that other workers do not delay retirement. Then we simulate combining a new minimum benefit with the retirement age change, paying for the minimum by further increasing the NRA an additional 6 months. The minimum benefit provides a floor below which benefits cannot fall, guaranteeing workers with at least 40 years in the labor force a benefit equal to at least 120 percent of a wage-adjusted poverty level.[7]

Raising the Retirement Age Hits Lower-Income Workers Less Hard Than Other Groups

Boosting the retirement age would reduce lifetime benefits for all workers, but the impact would be less for workers without high school degrees and for low-income workers. Overall, increasing the NRA to 69 and 8 months and the EEA to 65 reduces lifetime benefits for today's young workers to 90 percent of the levels scheduled under current benefit rules (table 2).[8] Raising the retirement age reduces lifetime benefits by 8 percent for high school dropouts as compared to 11 percent for college graduates. Workers in the bottom fifth of earners see a 6 percent drop in benefits as compared to 13 percent for those in the top fifth. The policy change reduces lifetime benefits by about 10 percent for all racial groups.

We do not observe a disproportionate impact on vulnerable groups primarily because low-income workers are more likely to be disabled; the disabled are protected from the retirement age change. Raising the retirement age does not affect when disabled workers can apply for benefits or the amounts they can receive. High school dropouts, African Americans, and workers in the lowest fifth of earners are more likely to be disability beneficiaries than are college graduates, whites, and workers in the top fifth (table 3). For example, 25 percent of individuals without high school degrees take up Social Security through disability and therefore are unaffected by the retirement age change. In contrast, only 13 percent of college graduates ever receive disability. Additionally, mortality differences narrow by age 62 (table 1). For example, the difference in life expectancy between non-Hispanic whites and African Americans narrows from 3.4 years at age 30 to 1.3 years at age 62.

A Minimum Benefit Softens Poverty Blow

While raising the retirement age does not hit lower-income groups harder than others, it **does**

TABLE 2. Lifetime Benefits by Demographic Group, for All Individuals Born between 1976 and 1980 Surviving until at Least Age 30

	Scheduled Benefits[a]	Raise NRA to 69 and 8 Months and EEA to 65	Raise NRA to 70 and 2 Months and EEA to 65 with Minimum Benefit
	2006 Dollars	Percent of Scheduled Benefits	
All	309,100	90	90
Education			
< HS	195,300	92	97
HS Grad	287,300	91	91
College Grad	386,000	89	87
Race / Ethnicity			
White, Non-Hisp	328,900	90	89
Black, Non-Hisp	255,300	91	92
Hispanic	282,800	91	91
Lifetime Earnings Quintile			
Bottom	158,000	94	106
Middle	311,100	91	90
Top	446,200	87	85

Source: Urban Institute tabulations from DYNASIM3 (run id440v2).

Notes: Lifetime benefits and earnings are based on shared annual amounts. Shared annual benefits and earnings include an individual's entire value in years he or she is single and half of the couple's value in years he or she is married. Lifetime benefits are the present value of annual shared benefits at age 65 using a 2 percent real discount rate. Single individuals are credited with all benefits they receive, including spouse and survivor benefits. For classifying into earnings quintiles, lifetime earnings are the average of wage-indexed earnings from age 22 to 61.

a. Current tax rates cannot support scheduled benefits, as the trust funds are expected to reach exhaustion in 2040. Lifetime benefits under a payable benefits scenario, which equates outlays and revenue in years after trust fund exhaustion, are 78 percent of lifetime scheduled benefits for individuals born between 1976 and 1980.

EEA = early eligibility age.

NRA = normal retirement age.

TABLE 3. Percentage Taking Up Disability Benefits, for All Individuals Born between 1976 and 1980 Surviving until at Least Age 30

	Percentage
All	17.8
Education	
< HS	24.8
HS Grad	19.3
College Grad	12.8
Race / Ethnicity	
White, Non-Hisp	17.0
Black, Non-Hisp	22.0
Hispanic	18.3
Lifetime Earnings Quintile	
Bottom	22.5
Middle	19.4
Top	9.4

Source: Urban Institute tabulations from DYNASIM3 (run id440v2).

Notes: The incidence of disability over a lifetime, as shown in the table, will generally exceed the prevalence of disability at a point in time. For instance, DYNASIM3 projects that only 13.8 percent of individuals born between 1976 and 1980 will be disabled in 2042 when the individuals are ages 62 to 66.

push more retirees below the poverty level. As compared to currently scheduled benefits, raising the retirement age would increase the share of retirees with incomes below the wage-indexed poverty level in 2050 from 14.4 percent to 16.2 percent, an increase of 1.5 million people (figure 1).

But change is inevitable. As is, Social Security cannot support scheduled benefits in the long run. Other reform proposals such as across-the-board benefit reductions, or even some tax increases given the regressive nature of the payroll tax, would also increase poverty rates among retirees or workers when considered in isolation. Most proposals considered in isolation have drawbacks.

Adding a minimum benefit to Social Security could mitigate the impact of raising the retirement age on vulnerable groups. A higher retirement age in conjunction with a minimum benefit only slightly increases the wage-indexed poverty rate as compared to scheduled benefits, and raises lifetime benefits for workers in the bottom fifth of earners by 6 percent (figure 1 and table 2). An even more generous minimum, or other progressive changes, could reduce the poverty rate compared to scheduled benefits. The modest cost of the minimum examined here could be paid by a six-month increase in the NRA.

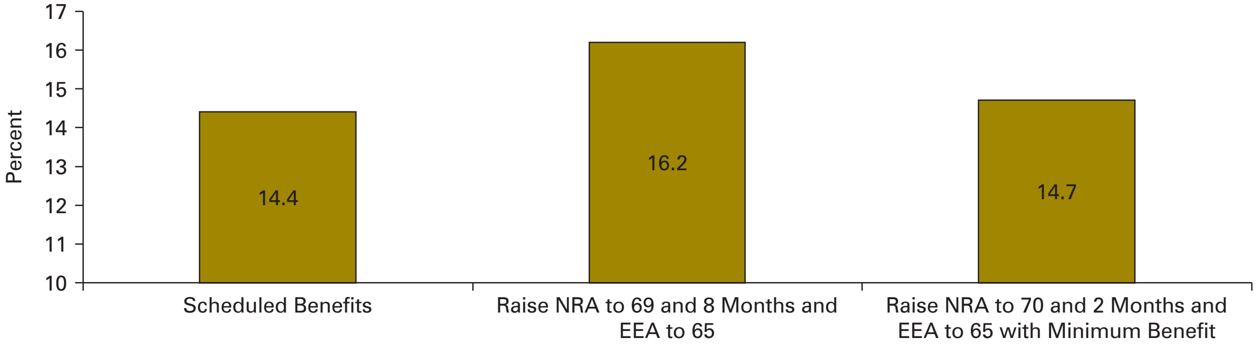
Conclusion

This brief demonstrates the importance of evaluating policies as part of larger packages rather than in isolation. A policy that achieves certain desirable goals but harms low-income groups can be combined with other mitigating policies. Raising the Social Security retirement age is superior to other benefit reductions because it makes individuals more likely to work longer. The additional revenue from working longer and the reduction in the number of retirement years that need to be funded allow the system to provide higher lifetime and annual benefits for a given tax rate. While raising the retirement age alone increases poverty rates, combining the change with a minimum benefit could mitigate the impact on vulnerable groups.

This analysis also demonstrates the importance of the disability program. A change in retirement age reduces lifetime benefits less for lower-income groups, primarily because they are more likely to be protected by disability benefits. While our analysis assumes that early retirees can continue working when the early eligibility age is raised, in fact, health problems would potentially prevent some retirees from working longer. The disability program would likely fill the gap for some in this group. If policymakers wish to further protect those in poor health or in strenuous occupations while raising the retirement age, disability eligibility could be made more lenient at older ages. Unlike raising the retirement age, most other benefit changes do affect disability benefits. When considering other benefit changes, policymakers concerned with progressivity should pay careful attention to the potential impact on the disability program.

Finally, this brief suggests that mortality differences may be less of an issue for raising the retirement age then some have feared. Much of the mortality differences across education, race, and income groups occurs before age 62, the current Social Security early eligibility age. The retirement age is less relevant for struggling workers who have the misfortune of not surviving to their early 60s. Far more important for these workers are disability benefits, government health benefits, tax rates, and work supports like job training and the earned income tax credit.

FIGURE 1. Percent of Individuals with Family Income Less than Wage-Adjusted Poverty Level in 2050, for Beneficiaries Age 62 and Older



Source: Urban Institute tabulations from DYNASIM3 (run id440v2).

Notes: The wage-adjusted poverty level is what the poverty level would be if it grew over time by wages instead of prices. Tabulations include early retirees forced to work longer by the retirement age change. Family income includes Social Security, pensions, earnings, Supplemental Security Income, and asset income.

EEA = early eligibility age.

NRA = normal retirement age.

Notes

1. See the Hagel and Liebman, MacGuineas, and Samwick plans, described in Social Security Administration (2005a, b). The Social Security actuaries project that system outlays will exceed revenues in 2017 and the Social Security trust funds will be depleted by 2040 (Board of Trustees 2006).
2. See Favreault and Smith (2004) for model details.
3. Authors' calculation based on DYNASIM3.
4. The intent of these actuarial adjustments is to provide the same lifetime benefits regardless of when benefit receipt begins.
5. Reducing benefits may result in more work at older ages as retirement becomes less affordable. Despite its equivalence with an across-the-board benefit reduction, if workers view the NRA as an indicator of the appropriate retirement age, raising it might have a larger effect on work.
6. Technically, disability beneficiaries convert into retired worker beneficiaries at the NRA. They receive the same inflation-adjusted benefits after conversion.
7. The wage-adjusted poverty level is what the poverty level would be if it grew over time by wages instead of prices. The official poverty level, which grows by prices, becomes less relevant in the future because increasing real wages pushes it farther behind average living standards. The minimum would provide a benefit equal to 80 percent of the wage-indexed poverty level for individuals with 10 years of work, increasing to 100 percent for those with 20 years of work, and 120 percent for those with 40 years of work.
8. Current tax rates cannot support scheduled benefits, as the trust funds are expected to be depleted in 2040. Lifetime benefits under a scenario that equates outlays and revenue in years after trust fund exhaustion would equal 78 percent of currently scheduled lifetime benefits for individuals born between 1976 and 1980.

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THE RETIREMENT PROJECT

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THE RETIREMENT PROJECT

The Retirement Project is a research effort that addresses how current and proposed retirement policies, demographic trends, and private-sector practices affect the well-being of older individuals, the economy, and government budgets.