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TESTIMONY

RESTORING AND MODERNIZING SOCIAL SECURITY THROUGH SUSTAINABLE REFORM

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House Committee on the Budget
Hearing: Restoring the Trust for Americans at or Near Retirement

July 13, 2016

Good morning, Chairman Price, Ranking Member Van Hollen, and members of the committee. Thank you for inviting me to testify today.

My name is Jason Fichtner, and I'm a senior research fellow at the Mercatus Center at George Mason University, where I research fiscal and economic issues, including Social Security. I am also an affiliated professor at Johns Hopkins University, Georgetown University, and Virginia Tech, where I teach courses in economics and public policy. Previously I served in several positions at the Social Security Administration (SSA), including deputy commissioner of Social Security (acting) and chief economist. All opinions I express today are my own and do not necessarily reflect the views of my employers.

I'd like to begin by thanking Chairman Price and Ranking Member Van Hollen for holding this hearing and creating an intellectual space that allows for reasoned discourse and ensures that important public policy issues involving Social Security and retirement security get the attention and debate they deserve. It is truly a privilege for me to testify before you today.

My testimony focuses on three key issues: first, the extent of the Social Security financial shortfall; second, whether we're actually facing a so-called "retirement crisis;" and third, how the current structure of the nation's largest retirement program, Social Security, provides *dis*incentives to work and save[1] and is in need of modernization if the program is to fit the needs of the twenty-first century and achieve fiscal sustainability.

1. For further discussion and analysis of disincentives to work and save created by the existing structure of Social Security, see Jason J. Fichtner, "Reforming Social Security to Better Promote Retirement Security" (Testimony before the House Committee on Ways and Means, Mercatus Center at George Mason University, Arlington, VA, May 23, 2013) (attachment).

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From this discussion, I hope to leave you with the following takeaways:

1. The Social Security crisis is not only real; it is already upon us.[2]
2. Painting all Americans with the broad brush of facing a “retirement crisis” creates an incomplete picture of the true financial landscape faced by America’s future retirees.
3. The narrative of the “retirement crisis” tempts us to look toward greater dependence on, and the expansion of, government programs—such as Social Security—which are already facing severe financial problems.
4. Social Security is in need of modernization. Reforms should not exacerbate existing problems; instead they should encourage savings and labor force participation.

SOCIAL SECURITY IS IN FINANCIAL CRISIS

The Social Security Board of Trustees now estimates that the combined trust funds will be depleted in 2034. It’s important to understand that there are actually two separate trust funds: one for the retirement program (Old-Age and Survivors Insurance or “OASI”), and one for the disability program (Disability Insurance or “DI”). For the retirement program, the trustees estimate that the trust fund can continue to pay full benefits until 2035, at which point the program will only be able to pay about three-fourths of scheduled benefits. For the disability program, the trustees estimate the program will hit insolvency in 2023—less than a decade from now.

To further put this in perspective, the 75-year financial shortfall for the combined trust funds is $11.4 trillion in present-value terms. If we indefinitely extend past the 75-year period, the so-called infinite horizon, the shortfall is a whopping $32.1 trillion. For comparison, our nation’s gross domestic product is slightly over $18 trillion[3]—and our gross national debt (not including unfunded liabilities) at the end of June is $19.3 trillion.[4]

The original intent of Social Security when it was signed into law in 1935 was to provide income insurance against poverty in old age and to provide benefits to survivors of deceased workers. The key word is “insurance.” Insurance is designed to provide coverage against a high-cost but low-probability event. When Social Security was enacted, a small percentage of the population lived many years past age 65. But times have changed. People born today are living longer than those born when the program was created. Living longer is a good thing. But longer lives create a financial strain on Social Security because the retirement age is not indexed for increases in longevity.

For example, using cohort life expectancy data, males born in 1940 were expected to live, on average, about 70.5 years and females 76.7 years. And males who reached age 65 in 1940 could expect to live, on average, another 12.7 years and females another 14.7 years. In 2015, the life expectancy for men was 83.1 years and 85.3 for women. But for those who turned 65 in 2015, a male can expect to live another 19.1 years and a female 21.5 years. Jump forward to 2035, a year after the combined trust funds are estimated to be depleted, and males turning 65 in that year can expect to live another 20.4 years and females another 22.7 years.[5] Also, it is important to note that about 54 percent of men and 61 percent of women survived to age 65 in 1940. In 1990, the percentage surviving to 65 was 72.3 percent for men and 83.6 percent for women.[6]

2. SSA, *The 2016 OASDI Trustees Report*, 2016, tables VI.F1 and VI.F2.
3. “United States GDP Annual Growth Rate: Forecast 2016–2020,” *Trading Economics*, accessed July 7, 2016.
4. Department of the Treasury, “The Debt to the Penny and Who Holds It,” TreasuryDirect.gov, accessed July 6, 2016.
5. SSA, *The 2016 OASDI Trustees Report*, table V.A5.
6. SSA, “Life Expectancy for Social Security,” accessed July 7, 2016.

These numbers mean that the Social Security Old-Age and Survivors Insurance program now has to finance more people[7] over a longer period of time. Instead of an *insurance* program, Social Security is now a de facto national retirement program—that is an important distinction because those are quite different policy purposes. With insurance, the intent is to tap resources contributed by a larger group to protect a subgroup from an unanticipated income shock. By contrast, retirement programs are intended to benefit all participants. Increasing the challenge in the case of Social Security, the program now has to fund individuals for over 20 years of retirement based off the same number of years of worker contributions as when the program was originally created.

Changing fertility rates also create a financial strain on Social Security's finances. In a largely pay-as-you-go financing structure such as Social Security, the fertility rate has an impact on the number of workers providing payroll taxes to cover retiree benefits. In 1940, the fertility rate was 2.23, meaning a woman born in 1940 could be expected to have at least 2 children in her lifetime. The fertility rate jumped up to over 3 beginning around 1950 and peaked in 1960 at 3.61. Today, however, the fertility rate has dropped to an estimated 1.87.[8] To put this in context, in 1945 there were almost 42 covered workers paying into the program for every OASDI beneficiary receiving benefits. As the program matured, around 1965 when Medicare was signed into law, there were 4 workers for every beneficiary. The ratio has been declining ever since. It now stands at 2.8 workers per beneficiary and is estimated to drop to 2.2 by 2035, the year after the combined OASDI trust funds are estimated to be depleted. To turn these numbers around, in 1965 there were 25 OASDI beneficiaries per 100 workers. In 2015, there were 35 beneficiaries per 100 workers. And in 2035 there will be 46 beneficiaries per 100 workers. Jumping out to 2090, the furthest out the trustees estimate, the ratio will be 50 beneficiaries for every 100 workers.[9]

PERCEPTION OF A RETIREMENT CRISIS

The national newspapers are full of stories claiming that Americans are woefully unprepared for retirement. A top story on the *Wall Street Journal*–affiliated *MarketWatch* was titled "Our Next Big Crisis Will Be a Retirement Crisis."[10] An often-cited index of retirement preparedness compiled by the Center for Retirement Research at Boston College claims that "53 percent of households are 'at risk' of not having enough to maintain their living standards in retirement."[11] Referencing a similar study by Putman Investments, financial reporter Robert Powell writes, "Americans are on track to replace just 61% of their current income once they reach retirement."[12] Powell further notes that the picture looks even gloomier for those without an employer-sponsored retirement plan, who are "projected to be able to replace just 42% of their working income once they retire, even with Social Security factored in."[13]

The economic meltdown that began in 2008 and resulted in a great and unanticipated loss of wealth for millions of Americans fueled the perception that we are facing a "retirement crisis." The uneven pace of the economic recovery and lingering effects of the financial crisis have further underscored this perception. The US stock market, as measured by the broad S&P 500 Index, fell nearly 57 percent from a peak on October 10, 2007, to a bottom on March 9, 2009.[14] Housing prices plummeted and unemployment rose quickly to double digits. Survey research suggests financial wealth for the median household declined by 15 percent as a result of the 2008 financial crisis.[15]

7. Ibid.
8. SSA, *The 2016 OASDI Trustees Report*, table V.A1.
9. SSA, *The 2016 OASDI Trustees Report*, table IV.B3.
10. Brett Arends, "Our Next Big Crisis Will Be a Retirement Crisis," *MarketWatch*, March 3, 2014.
11. Center for Retirement Research at Boston College, "National Retirement Risk Index," accessed May 12, 2014.
12. Robert Powell, "Americans Fall Short on Retirement Income," *MarketWatch*, May 2, 2014.
13. Ibid.
14. The data are available from Yahoo Finance. S&P 500 Index value at market close on October 10, 2007, was 1562.47. Index value at close on March 9, 2009, was 676.53. The National Bureau of Economic Research, the arbiter of the start and end dates of a recession, determined that the recession that began in December 2007 ended in June 2009, roughly coinciding with the peak and trough dates of the S&P 500 Index.
15. Michael D. Hurd and Susann Rohwedder, "The Effects of the Economic Crisis on the Older Population" (Working Paper 2010-231, University of Michigan Retirement Research Center, Ann Arbor, MI, 2010).

But do these statistics truly equate to a looming "retirement crisis"? Economists Syl Schieber and Andrew Biggs wrote that "the story about the declining income prospects of retirees is not true."[16] Schieber and Biggs base their argument on the fact that the data most often cited to show there is a crisis is compiled by the Social Security Administration based on the Current Population Survey (CPS) from the US Census Bureau. The CPS data do not accurately reflect the total amount of income in retirement derived by individual retirement accounts. When Schieber and Biggs instead looked at tax return data from the Internal Revenue Service, the reported income was much higher: "The CPS suggests that in 2008 households receiving Social Security benefits collected $222 billion in pensions or annuity income. But federal tax filings for 2008 show that these same households received $457 billion of pension or annuity income."[17]

Additionally, in order to have a financially secure retirement, many financial planners suggest a total "replacement rate"—or the percentage of preretirement income a person will need in retirement—of 70 percent.[18] Social Security was designed to replace about 40 percent of a person's preretirement income, with higher replacement rates for lower-income workers,[19] and the remaining amount to be covered by an employer pension or personal retirement savings. For example, a person who earns $50,000 in each of the final five years leading up to retirement should plan to have enough retirement savings to generate $35,000 a year in income ($50,000 × 0.70). The 70 percent figure includes income received from Social Security. This is just a general rule of thumb, and everybody's retirement needs are different. For example, some find they need less in retirement as their consumption tends to decline and their house may be paid off. It is worth noting that, for many groups, Social Security replacement rates are higher than most people understand, due to the way the Social Security Administration historically presented replacement rates. In many cases total retirement income, including Social Security benefits, far exceeds a 70 percent replacement rate.[20] It is further worth noting that the proper way to measure replacement rates is currently debated by scholars[21]—whether they should be based on average lifetime earnings, wage-adjusted earnings, earnings in the final year before retirement, or a combination of these and other factors.[22]

16. Sylvester J. Schieber and Andrew G. Biggs, "Retirees Aren't Headed for the Poor House," *Wall Street Journal*, January 23, 2014.
17. Ibid.
18. Michelle Singletary, "The Color of Money: Calculating the 'Replacement Rate,'" *Washington Post*, December 31, 2013.
19. Depending on the measure of replacement rate used, Social Security benefits may provide a higher replacement rate than 40 percent. As noted by Biggs and Springstead, "Measuring replacement rates is far from straightforward, and different replacement rate measures can result in widely different indicators of retirement income adequacy." Further, "Social Security pays higher average replacement rates to those with lower lifetime earnings, although there is significant dispersion of replacement rates within groups with similar lifetime earnings." Andrew G. Biggs and Glenn Springstead, "Alternative Measures of Replacement Rates for Social Security Benefits and Retirement Income," *Social Security Bulletin* 68, no. 2 (2008).
20. Charles Blahous, "Understanding Social Security Benefit Adequacy: Myths and Realities of Social Security Replacement Rates" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, November 2012).
21. See, for example, Biggs and Springstead, "Alternative Measures of Replacement Rates"; Blahous, "Understanding Social Security Benefit Adequacy"; and Stephen Goss et al., "Replacement Rates for Retirees: What Makes Sense for Planning and Evaluation?" (Actuarial Note no. 155, Social Security Administration, Baltimore, MD, July 2014).
22. "Financial advisors commonly use earnings replacement rates to assist workers in their retirement planning. Policymakers and analysts use them to gauge the adequacy of Social Security benefits and other retirement income in allowing retirees to maintain preretirement living standards. In recent years, the Social Security trustees regularly published replacement rates that have been widely interpreted as the extent to which Social Security benefits replace earnings of workers at various points in the lifetime earnings distribution. However, the trustees' replacement rates are calculated differently than those generally used for retirement planning purposes possibly leading to confusion among policymakers and others regarding how much of workers' earnings are replaced by Social Security and how much those workers need to save on their own for retirement. Financial planners calculate replacement rates by comparing an individual's retirement income to that same individual's pre-retirement earnings, generally earnings in the years immediately preceding retirement. The Social Security Administration, by contrast, effectively calculates replacement rates by comparing retiree incomes to the incomes of contemporaneous workers. This latter measure is often used in other countries, but differs both qualitatively and quantitatively from the more common replacement rate calculations used for financial planning purposes. We find that replacement rates calculated on a financial planning basis are generally higher than those published by the Social Security trustees and that Social Security benefits generally replace somewhat more of individual workers' earnings than the trustees' rates suggest." Andrew G. Biggs, Gaobo Pang, and Sylvester J. Schieber, "Measuring and Communicating Social Security Replacement Rates" (AEI Economic Policy Studies Working Paper 2015-01, American Enterprise Institute, Washington, DC, January 8, 2015).

To be clear, I'm not arguing that everyone has adequately saved for retirement. Nor am I arguing that policymakers shouldn't focus their efforts on public policy options that will help Americans save for their retirement. But I do want to stress that painting all Americans with the broad brush of a "retirement crisis" creates an incomplete picture of the true financial landscape faced by America's future retirees. Further, I'm concerned that the narrative being told of a "retirement crisis" is leading us to look toward greater dependence on—and even the expansion of—existing government programs, many of which, Social Security included, are already facing severe financial problems. *This is not a reasonable plan*. *It's certainly not a sustainable plan*. We must turn instead toward policy options that will encourage individuals to work, save, and invest so that they can build their own financially secure retirement.

REFORMS FOR A FINANCIALLY SECURE RETIREMENT

It is important that Social Security reforms improve work incentives and promote individual saving while also addressing the program's financial solvency problems.

As I have discussed in a previous congressional testimony (see attachment),[23] possible reforms include:

- basing future cost-of-living adjustment (COLA) increases on the chained CPI,
- gradually raising the early and full retirement ages,
- increasing the delayed retirement credit,
- adjusting the benefit formula,
- constraining nonworking spousal benefits for high earners,
- providing payroll tax relief to seniors,
- increasing access to personal retirement accounts, and
- increasing financial literacy.

Within the past several months, nonpartisan research organizations have released reports with their recommendations for reforming Social Security. The Committee for a Responsible Federal Budget released a book on ways to reform the disability insurance program that brought together experts from across the political aisle and included both academics and practitioners.[24] A more expansive project sponsored by the Bipartisan Policy Center suggested policy reforms to improve retirement security and personal savings. The BPC report includes reforms to Social Security that would put the program back on a secure financial footing, while also reducing senior poverty and improving work incentives, by making changes to both benefits and taxes.[25]

CONCLUSION

Social Security faces real and increasingly urgent financial challenges. Reform is not only the wise thing to do, it is critical to ensure that Social Security remains solvent and fiscally sustainable and can continue to provide retirement security for generations to come.

23. Fichtner, "Reforming Social Security to Better Promote Retirement Security."
24. The McCrery-Pomeroy SSDI Solutions Initiative, *SSDI Solutions: Ideas to Strengthen the Social Security Disability Insurance Program* (Washington, DC: The Committee for a Responsible Federal Budget, 2015).
25. *Securing Our Financial Future: Report of the Commission on Retirement Security and Personal Savings* (Washington, DC: Bipartisan Policy Center, June 2016).

Social Security reform must not only address the program's fiscal solvency issues but also remove the disincentives to working later in life. This means reforms must focus on reining in the growth of program costs, encouraging personal saving and investment, and rewarding those in middle and early retirement age who make the decision to extend their working careers.

Finally, Social Security reform must begin immediately. We can reform this critical program, and we can do it in a way that will improve the financial security of all future Americans in retirement. But we must act now. The Social Security trust fund for the retirement portion of the program is projected to become insolvent in 2035, while the disability trust fund is projected to become insolvent in 2023, less than a decade away. To close the current financial shortfall of the combined trust funds would require an *immediate* 21 percent increase in the OASDI payroll tax rate (from 12.4 percent to 14.98 percent) or an *immediate* 16 percent cut in benefit payments (19.6 percent if applied only to new beneficiaries after 2016).[26] The magnitude of the changes necessary will only increase with time.

Thank you again for your time and this opportunity to testify today. I look forward to your questions.

ATTACHMENT

Jason J. Fichtner, "Reforming Social Security to Better Promote Retirement Security" (Testimony before the House Committee on Ways and Means, Mercatus Center at George Mason University, Arlington, VA, May 23, 2013).

26. SSA, *The 2016 OASDI Trustees Report*.

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TESTIMONY

REFORMING SOCIAL SECURITY TO BETTER PROMOTE RETIREMENT SECURITY

JASON J. FICHTNER, PHD

United States House of Representatives
Committee on Ways and Means
Subcommittee on Social Security

Hearing on "The President's and Other Bipartisan Entitlement Reform Proposals"

May 23, 2013

Good morning, Chairman Johnson, Ranking Member Becerra, and Members of the Committee. Thank you for inviting me to testify today.

My name is Jason Fichtner, and I'm a senior research fellow at the Mercatus Center at George Mason University where I research fiscal and budgetary issues, including Social Security. I am also an adjunct professor at Georgetown University, Johns Hopkins University, and Virginia Tech, where I teach courses in economics and public policy. All opinions I express today are my own and do not necessarily reflect the views of my employers.

I'd like to begin by thanking Chairman Johnson and Congressman Becerra for the leadership you provide this committee in ensuring that important public policy issues involving Social Security and retirement security get the attention and debate they deserve, and also for ensuring that ideas and viewpoints from all sides are aired in a collegial and respectful manner. It is truly a privilege for me to be here testifying before you today.

My testimony focuses on the Social Security program's incentives—specifically, how the current structure provides disincentives to work and save. I will also discuss how Social Security reform, if done correctly, can increase US savings, labor force participation, economic growth, and federal revenues.

THE ECONOMY'S EFFECTS ON WHEN PEOPLE CLAIM SOCIAL SECURITY BENEFITS

The financial crisis that began in 2008 resulted in a great and unanticipated loss of wealth for millions of Americans. The US stock market, as measured by the broad S&P 500 index, fell nearly 57 percent from a peak on October 10, 2007, to a bottom on March 9, 2009.[1] Housing prices plummeted and unemployment rose quickly to double digits. Survey research suggests financial wealth declined by 15 percent for the median household as a result of the 2008 financial crisis.[2] General confidence in the financial system was greatly weakened.

The widespread economic crisis affected a range of ages and income levels. According to data from the Health and Retirement Study (HRS),[3] about 28 percent of surveyed households reported that they had been affected "a

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lot" by the financial crisis, 46 percent responded they had been affected "a little," and only 26 percent reported not having been affected.[4]

Though the broad stock market has recovered much of its losses and reached new highs, and housing prices have started to recover, unemployment is still too high. Unemployment rates for workers ages 55–64 averaged 7 percent for the years 2009–10 compared to 3 percent for the period 2005–8.[5] As of April 2013, the unemployment rate for workers ages 55–64 was 5.1 percent—still far above the 3 percent average between 2005 and 2008.[6]

A sudden and unplanned drop in wealth and income can have significant effects on retirement behavior. Research I've done with coauthors John Phillips and Barbara Smith finds that more people will elect to begin taking Social Security retirement benefits as soon as eligible, due to financial shocks, increases in unemployment because of the global financial crisis,[7] and an arrested economic recovery.[8]

A study by Michael Hurd and Susann Rohwedder after the 2008 crisis finds that 3.5 percent more individuals expected to work past the age of 62 than previously, while an additional 4.3 percent planned to work past the age of 65.[9] A financial shock, such as steep drops in the value of stock prices, investment portfolios, and housing assets might cause a delay in people's retirement plans,[10] with workers remaining in the workforce longer than originally planned to rebuild retirement savings.[11] Those near or post-retirement are more limited in their ability to attain or maintain a secure retirement. For current retirees, sudden declines in wealth from housing assets and financial portfolios might force immediate changes in consumption.

The loss of a job has particularly pronounced effects on workers above the age of 55 and on the decision to retire. According to a special study in 2010 from the US Bureau of Labor Statistics,[12] older workers who lose their jobs are likely to have longer durations of unemployment than younger workers. A Congressional Research Service study finds that older workers who are unemployed have a higher incidence of withdrawing from the labor market than younger workers.[13] When they do retire, they replace earnings with available sources of income, such as pensions and Social Security benefits. Workers who retire early may experience lower lifetime benefits from Social Security, and their removal from the workforce slows economic growth.

Though the decision to start receiving Social Security benefits can be concurrent with retirement, electing to receive benefits is not necessarily a predictor of leaving the workforce.[14] In fact, the decision whether to stop working can be completely independent from the decision whether to begin collecting Social Security benefits. For example, a worker might choose to stop working but delay receipt of Social Security benefits to take advantage of higher monthly benefit amounts that accrue the later one waits to claim (up to age 70). Or a worker might decide to elect retirement benefits as early as age 62, receiving a permanently reduced monthly benefit,[15] yet continue to work full- or part-time for continued income support.[16] In some cases, a worker might opt to select Social Security benefits and then return to work.[17]

Researchers have long recognized the role Social Security benefits play in a secure retirement.[18] Social Security retirement benefits provide income security for millions of Americans, with 65 percent of all aged recipients[19] relying on Social Security for 50 percent or more of their income, and 36 percent relying on Social Security for 90 percent or more of their income.[20] Because low-income households use Social Security benefits for a larger portion of annual income, the financial crisis has affected these retirees less.[21] As a result, the structure of Social Security has its most significant economic and behavioral effects on the middle class.

NEGATIVE EFFECTS ON LABOR FORCE PARTICIPATION

Most analyses of Social Security have concluded that its current design offers substantially negative incentives for work, especially for younger seniors and for secondary household earners. Research by Gayle Reznik, David Weaver, and Andrew Biggs has found that Social Security's return on payroll tax contributions by those aged 62–65 is −49.5 percent,[22] meaning that the program literally pays back just pennies in additional benefits for each additional dollar contributed. Barbara Butrica and her coauthors have found that the broader array of federal laws strongly inhibits continued work by seniors, with disincentives growing stronger as they age: "The implicit tax rate on work increases rapidly with age, rising for our representative worker from 14 percent at age 55 to 50 percent at age 70."[23]

Notably, labor force participation did not immediately decline for those younger than 65 (and thus originally ineligible for Social Security benefits) until Social Security's early eligibility age (EEA) of 62 was established.[24] After the creation of the EEA, labor-force participation by males aged 55–64 also began to trend downward, from 87.3 percent in 1960 to 67.7 percent by 1990. As the Bureau of Labor Statistics notes, "Labor force participation decreases started in the 1960s for those 55 to 64. Since this time, some of the 20-percentage points decrease for men in this age group has to be attributed to the availability of Social Security benefits to men 62 years of age."[25] The Bureau of Labor Statistics report also notes the new availability of Social Security's disability benefits and suggests that they further dampened middle-aged labor-force participation.

How Does Social Security Penalize Work?

The basic Social Security benefit formula is itself designed to impose net incremental income losses on those who extend their working careers.[26] Previous studies by Charles Blahous;[27] Gopi Shah Goda, John B. Shoven, and Sita Nataraj Slavov;[28] and others have explained how returns on contributions generally diminish the longer one works and why they become even more sharply negative once a worker has contributed for 35 years.

The primary reasons for the work disincentives are the facts that the Social Security benefit formula is progressive, while also based on a worker's top 35 years of earnings on average. Thus, the longer one works, the more "zero earnings years" in one's wage history are replaced with positive earnings years and the more one's "average earnings" rise (so that one is gradually considered a relatively higher-wage earner), and thus the worse one's returns under the program's progressive benefit formula.[29]

This worsening becomes particularly pronounced after 35 years of earnings,[30] when the best a worker can hope for is to replace a previous year in the highest 35 years of one's wage history with a higher earnings year. That is to say, after 35 years of work, one's benefit can only rise in proportion to the differential between two previous earnings years, despite paying a full additional year of payroll taxes. Indeed, someone who takes a part-time "transition job" on the way to full retirement may well pay a full year's worth of additional taxes while receiving no additional benefit credits whatsoever. This embodies a substantial work disincentive at precisely the time when a worker is likely to make a retirement decision.

Penalties against Seniors and 55–65-Year-Olds

Though this sustained trend toward early retirement has bottomed out and begun to reverse somewhat in recent years, Social Security on balance clearly remains a substantial barrier to labor participation by Americans in their late middle age. For example, seniors who continue to work after claiming Social Security benefits at 62 (but before normal retirement age [NRA] of 66) are subject to an earnings limitation under which they are required to temporarily give up as much as $1 in benefits for every $2 earned above a $15,120 threshold.[31] This rule is but one of the program's facets that nudge individuals into early retirement.

Social Security's EEA of 62 is, in fact, the most common age of benefit-claiming.[32] Over 70 percent of beneficiaries take advantage of the opportunity to claim Social Security retirement benefits before NRA, despite receiving lower monthly benefits by doing so.[33] Not long ago, Social Security Administration (SSA) field offices often encouraged early retirement under the mistaken belief that it leaves beneficiaries better off. Early retirement is only certain to make beneficiaries better off in the short run, however. The reduction in monthly benefits that accompanies early claims also results in net lifetime benefit reductions for those who live to especially advanced ages—often a time in life when beneficiaries are most likely to rely on Social Security benefits to pay their expenses. Fortunately, the SSA has more recently adopted policies recognizing that individual circumstances must be carefully considered when determining one's optimal age for claiming benefits.[34]

Penalties for Two-Earner Couples

Social Security specifically provides a disincentive to taxpaying work by more than one earner per household. Incremental returns on taxes paid by women have been estimated at −32.0 percent relative to what they would receive by staying out of the paid workforce altogether and instead often collecting the nonworking spouse benefit.[35] As a general rule, Social Security aggressively redistributes income from two-earner married couples to one-earner married couples, thus penalizing a household decision to have both spouses work and contribute payroll taxes. For example, a medium-wage two-earner couple, both born in 1955, can expect to receive back only 80 cents from Social Security on each dollar contributed (in present value), whereas a one-earner couple can expect to receive $1.39.[36] Today 61 percent of married women participate in the labor force, compared to only 32 percent in 1960—and there are more women than men in the modern-day workplace.[37] Much of the original welfare system was designed to support single-earner families.[38] As a result of changing demography, Social Security needs to reflect the evolving workplace and not penalize two-earner couples.

One reason for this income redistribution and these negative labor participation incentives is the structure of Social Security's nonworking spouse benefit. Individuals without any history of paid employment can be entitled to receive a benefit equal to 50 percent of their spouse's earned benefit. Consequently, an individual who is married to a high-wage earner may receive a benefit well exceeding what another individual might earn based on an entire working career of payroll tax contributions.

Despite the complexities involved in determining one's net effective tax rate on Social Security–covered work, there is evidence that individuals and two-earner couples do respond rationally to these disincentives. As Jeffrey B. Liebman, Erzo F. P. Luttner, and David G. Seif point out in a 2008 study, "Our estimates conclusively reject the notion that labor supply is completely unresponsive to the incentives generated by the Social Security benefit rules. We find reasonably robust and statistically significant evidence that individuals are more likely to retire when the effective marginal Social Security tax is high."[39] For most seniors, these effective marginal tax rates are indeed enormously high.

These various features of Social Security—from the technical details of its benefit formula, to the earnings limitation, to the benefit eligibility at age 62, to the nonworking spouse benefit, to others—all act as a drag on labor-force participation and thus interfere with the goal of maximizing future economic growth.

THE FISCAL IMPORTANCE OF LABOR-FORCE PARTICIPATION

The financial unsustainability of current federal entitlement programs is substantially attributable to insufficient projected growth in the US labor force. This conclusion can be substantiated by some simple math. Social Security's initial benefit formula, for example, increases along with growth in the national Average Wage Index.[40] Because program payroll tax revenues also automatically grow with national wages, this benefit formula would be financially sustainable within a stable tax rate if the worker-to-beneficiary ratio never declined—or in other words, if gains in longevity and health were always matched by proportional increases in the duration of workers' taxpaying careers.[41] This proportionality, however, is not being maintained. Worker–beneficiary ratios are projected to become much more unfavorable going forward.

Though press attention rightly focuses on how the Baby Boomers' Social Security and Medicare benefit claims will increase federal spending, the other side of the coin is the corresponding reduction in labor force growth rates as the Boomers cease working. Whereas from 1963 through 1990 inclusive annual labor-force growth rates never once dropped below 1.2 percent despite periodic recessions, from 2019 onward labor force growth rates are projected never to exceed even half that rate (0.6 percent).[42] Thus, to the extent that Baby Boomers and subsequent generations perceive greater rewards for extending their working lives, the picture of our national economic future will brighten enormously.

It bears emphasis that workforce participation trends among those in their 60s are not driven primarily by issues of physical incapacity. Labor-force participation among males over 65 was much higher in the mid-20th century than it is now despite substantial gains in national health and longevity since then. Incentives have played a much greater role. Beyond the fact that it is generally more attractive to enjoy additional years of leisure rather than to continue work, our federal entitlement policies have made the decision to retire virtually irresistible financially as well. Given these incentives, it is unsurprising that our future economic growth outlook is depressed by current projections for labor-force participation, relative to what would be the case if more of our national gains in longevity and health were converted into longer periods of taxpaying work.

The economic benefits of longer working careers well exceed, however, what is shown in federal scorekeepers' analyses of program finances. Repeal of the Social Security earnings limitation, for example, is scored under current SSA methodology as actuarially neutral, although it would almost certainly incentivize longer working careers, both generating additional government tax revenue and benefiting the economy as a whole. Similarly, proposals to raise Social Security's EEA of 62 are not scored by the Social Security actuaries as producing direct financial gains for the program, though the change would better incentivize taxpaying work by those in their early 60s.

A recent Congressional Budget Office (CBO) analysis of raising the EEA acknowledges this effect conceptually but does not attempt to quantify it: "This option also would probably lead workers to remain employed longer, which would increase the size of the workforce and boost federal revenues from income and payroll taxes. Moreover, the additional work would result in higher future Social Security benefits, although the increase in benefits would be smaller than the increase in revenues." But "the 10-year estimates for this option do not include those two effects."[43] Other CBO analyses, including those of the Diamond-Orszag and the Bush Commission's proposals, quantify some potential advantages of reforming Social Security benefits for promoting economic growth. CBO found that the Bush Commission plan to constrain the growth of benefits beyond price inflation would increase national GNP relative to the budget baseline, whereas the Diamond-Orszag proposal to raise Social Security taxes would reduce it. These findings in turn reflected analyses that the Bush Commission proposal "could cause some people to work longer or harder,"[44] whereas under the Diamond-Orszag proposal, "households would choose more leisure."[45]

Extended workforce participation would pay dividends for individual seniors as well as for the economy as a whole. As Butrica and her coauthors noted in 2004, "Working longer increases the net output and productivity of the economy, generates additional payroll and income tax revenue, and reduces the number of years that individuals receive retirement benefits. . . . [P]eople could increase their annual consumption at older ages by more than 25 percent simply by retiring at age 67 instead of age 62. The increased tax revenues generated by this work could be used to support a wide range of government services, including public support for the aged."[46]

For these and many other reasons, Social Security reform as well as broader entitlement reform should be undertaken with an eye toward rewarding those in late middle age who decide to extend their working careers.

SOCIAL SECURITY REFORMS TO IMPROVE WORK INCENTIVES

Bowles-Simpson and the Bipartisan Policy Center Plans

The impact of Bowles-Simpson and the Social Security reforms of the Bipartisan Policy Center (BPC) on work incentives vary depending on the specific provision examined. While some reforms encourage greater participation in economic activity, others limit the desirability of work and could incentivize even earlier retirement. Some proposals would encourage significant behavioral shifts while others would encourage only marginal changes.

Both plans include the following policy recommendations that would encourage greater labor force participation: adjusting the cost-of-living adjustment (COLA) to be indexed according to a Chained-CPI-U, to account for substitution effects as consumers change what goods they purchase in response to changes in prices; reducing the growth of benefits for the highest-earning beneficiaries; and indexing the benefit formula for longevity. Of these three reforms, indexing the COLA to Chained-CPI-U would most increase the desirability of individual saving. President Obama has also proposed indexing the COLA to the Chained-CPI-U in his FY 2014 budget.

The proposed CPI-U price index accounts for living expenses for around 87 percent of the US population. It is a measure of inflation facing all urban consumers. The current CPI-W index, however, measures the higher rate of inflation experienced by all urban workers, roughly 32 percent of the population.[47] Because the W index represents a subset of the U population, many Social Security recipients experience inflation-adjusted wages that exceed their actual cost-of-living increases. Adjusted wages in excess of inflation incentivizes less individual saving and lower labor-force participation in exchange for greater reliance on Social Security.

The two other benefit reductions considered by the Bowles-Simpson and BPC plans are designed to make the benefit structure more progressive and to slow the growth of benefits for higher-income workers. The first would marginally reduce the growth of benefits for approximately the top 25 percent of beneficiaries. The proposal by BPC would slowly reduce the top bend point in the primary insurance amount (PIA) formula applied to a person's average indexed monthly earnings from 15 percent to 10 percent over a 30-year period.[48] For someone eligible for benefits in 2013, this percentage would apply to additional monthly covered earnings in excess of $4,768. The Bowles-Simpson plan would also adopt a more progressive benefit formula that slows the growth of benefits for higher-income earners by expanding the amount of earnings at the bottom end that are covered by the 90 percent replacement rate and would subject higher-income earners to a new and lower top-end replacement rate of 5 percent. While this reform should encourage the top 25 percent of beneficiaries to work longer and save more, a more progressive benefit formula that gives a higher benefit amount to lower-income workers could have the opposite effect and would not encourage additional saving or longer labor-force participation.

The second benefit change considered by both Bowles-Simpson and BPC is to adjust benefits for expected increases in longevity. As Americans live longer, the financial commitment of Social Security increases as well. Lifetime benefits for Social Security recipients are greater than ever and will continue to increase. BPC would reduce benefits beginning in 2023 (after the full retirement age increases to 67 under current law) by 0.3 percent each year in order to offset part of the additional costs of estimated longevity increases. Bowles-Simpson would gradually increase both the early eligibility age and normal retirement age to account for increases in longevity. Adjusting Social Security to reflect increases in longevity would encourage greater labor-force participation and saving.

The following policy recommendations would penalize the decision to work and encourage earlier retirement: raising the amount of income subject to payroll taxes and increasing the special minimum benefit. Raising the amount of income subject to payroll taxes could have negative implications for investment and saving levels. I won't elaborate in detail in my testimony on the negative economic effects of raising payroll taxes, as previous witnesses have testified before this committee extensively on the topic.[49] But, in brief, raising Social Security payroll taxes would generally mean that people would work less, because the financial return from work has been decreased; save less, because they now have less after-tax income with which to save; and retire early, because the replacement rate of Social Security benefits will rise.[50]

The final policy recommendation from the BPC and Bowles-Simpson is to increase the special minimum benefit and to provide a "bump up" in benefits for beneficiaries in their 80s. The special minimum benefit was enacted in 1972 to provide minimum financial protection for low-income workers.[51] However, the current minimum benefit is adjusted for changes in prices, not wages. As wages have grown faster than prices, the PIA for most low-wage workers is higher than the special minimum PIA. The BPC plan would propose a special minimum benefit set at 133 percent of the poverty level for retirees with at least 30 years of covered work. The Bowles-Simpson plan would set the special minimum benefit at no less than 125 percent of the poverty level in 2017 and index it to wage growth thereafter. The proposed "bump up" is a small boost in income that retirees would receive between the ages of 81 and 85 (BPC plan), and for those on benefits 20 years after the earliest eligibility age (Bowles-Simpson), as saving levels tend to be significantly reduced once beneficiaries reach this age range.

The goal of the special minimum benefit and "bump up" for those in their 80s should be to reach beneficiaries who would otherwise be unable to provide for themselves rather than to provide a general welfare expansion for all retirees. Social Security's benefit structure already discourages labor-force participation. So, while we should definitely ensure that our society's most vulnerable members are protected against poverty, an expansion of the special minimum benefit should reach only those most in need in order to avoid having further negative impacts on the labor-force participation rate.

Raising the Early Eligibility Age

With age 62 now the most popular age to claim benefits, raising the EEA would necessarily delay many claims and would likely correlate with continued employment.[52] Research has estimated that raising the EEA to 65 would increase long-run GDP by 3–4 percent.[53]

Several key points should be kept in mind with regard to raising the earliest eligibility age. First, an EEA increase of three years, for example, would merely bring the age of earliest eligibility to what it was at the program's inception; it would not begin to adjust for the substantial health and longevity gains since. Period life expectancy at birth has grown by more than 14 years since 1940, while life expectancy at 65 has grown by more than six years.[54]

Second, raising the EEA to bring it closer to the NRA would likely reduce poverty among seniors, as they would be subject to a smaller early retirement penalty. As previously noted, annual benefits under Social Security law are adjusted downward from full benefit levels in proportion to how early one claims before reaching the NRA. This keeps expected lifetime benefits constant, regardless of the age of claim; some of the risk of old-age poverty resides with seniors who retire early, have "too low" an annual benefit, and then outlive their other savings.

Increase the Delayed Retirement Credit

Another positive work incentive could be created by increasing the program's actuarial penalty for early retirement as well as its delayed retirement credit (DRC). The current actuarial penalty for early retirement is a 25 percent reduction in annual benefits for those who retire at 62, four years before the current NRA of 66, or about a 6 percent reduction for each year.

On the other hand, the delayed retirement credit is an 8 percent increase in annual benefits for each year (up to age 70) claims are delayed beyond the NRA. For someone delaying claiming benefits until age 70, this credit amounts to a 32 percent increase in the monthly benefit.[55] These current-law adjustments hold expected lifetime benefits constant for a typical retiree, and thus do not account for the value of additional payroll taxes likely contributed if an individual delays claiming benefits and continues working. Increasing these adjustments may better reflect the value of additional payroll taxes contributed by working seniors.

Offering the DRC as a lump-sum option could potentially provide an additional incentive to continue working, without adding a financial cost to the system. The current DRC offers an increase in one's monthly Social Security benefit proportional to the time over which the benefit claim is delayed. However, only a minority (between 5 and 6 percent in 2011) take advantage of this option.[56] It is also worth noting that more than 70 percent of those claiming retirement benefits in 2011 did so before their normal retirement age, thus receiving reduced monthly benefits.[57] An option potentially more attractive to workers would be to allow an individual to receive the entire DRC as a lump sum when claimed, while also receiving the basic monthly benefit as it would have been calculated at NRA. This option could potentially allow claimants to receive a lump sum of tens of thousands dollars on the date of their delayed claim. Recent research by Jingjing Chai and his coauthors confirmed that offering a lump-sum option could boost the average retirement age by 1.5–2 years.[58]

The precise amount of a lump-sum DRC could be calculated to be the actuarial equivalent of the standard monthly DRC, thus creating no additional system costs but potentially spurring longer taxpaying work. But even if the lump sum were designed to be slightly smaller in present value than the DRC would have provided as a monthly benefit stream—thus producing a net improvement in system finances—many individuals might still find the lump-sum option more attractive because they would have immediate access to and control over the funds.

The various reforms mentioned above would likely be useful if enacted separately, but would work best in tandem. Steepening the actuarial penalty for early benefit claims could, despite its other policy benefits, potentially worsen some early claimants' subsequent risk of poverty if enacted as a standalone measure, but would not do so if accompanied by an increase in the EEA. If the NRA is increased while the EEA is held at the current age of 62, a higher minimum benefit could be offered to those in physically challenging jobs unable to work past age 62. However, it is worth noting that SSA only has wage data available and determining which individuals would be allowed a higher minimum benefit at EEA, instead of a regular actuarial reduction, would be administratively challenging and burdensome to say the least, and may be impossible to administer.

As mentioned earlier in my testimony, both the Bowles-Simpson and BPC plans would offer an increased minimum benefit to protect low-wage workers, as well as a bump-up in the benefit amount for those in their 80s and the long-term disabled. While the Bowles-Simpson plan recommends increasing the early eligibility and normal retirement ages, the plan also recommends that the Social Security Administration be tasked with designing a policy that would allow a hardship exemption for those that cannot physically work past age 62.

Adjust the Benefit Formula

Another potentially important work incentive reform would be to redesign the basic benefit formula so that it operates on each separate year of work rather than on one's career average earnings. As discussed previously, the current formula causes one's returns from Social Security to drop with extended work, as one's career average earnings rise and the system's progressive benefit formula thus delivers lower returns.

An alternative suggested by Charles Blahous, a public trustee for Social Security, would be to calculate benefits by considering every year of one's earnings, rather than only the highest average 35 years of earnings.[59] In addition to greatly improving work incentives for seniors, this reform would have other advantages. For example, the current formula often mistakes intermittent high-wage earners for low-wage earners because their career "average earnings" look the same. This confusion causes problems in the treatment of those who move in and out of Social Security coverage—for example, higher-wage state and local employees and immigrants, whom the formula mistakes for needy low-wage workers—necessitating complex fixes such as the Windfall Elimination Provision (WEP) and the Government Pension Offset (GPO). Such controversial complexities would become unnecessary if Social Security simply accrued proportional benefits with each additional year of tax-paying work, since all intermittent workers would be treated the same, more in the fashion of a traditional private-sector pension.

Constrain Nonworking Spouse Benefits for High Earners

Another work-incentive reform would be to gradually restrain the growth of nonworking spouse benefits associated with higher earners. The nonworking spouse benefit does play a useful role within Social Security by recognizing the value of stay-at-home work and of raising the next generation of wage earners. It is, however, inefficiently designed in that it is both regressive and a significant disincentive to paid employment. A two-earner couple both with low wages, for example, receives lower returns from Social Security than a high-wage one-earner couple,[60] despite the intended progressivity of the basic benefit formula.[61] Additionally, someone married to a high-earning spouse might well receive a higher nonworking spouse benefit than another individual might earn based on a full career of paying payroll taxes on modest annual earnings.

It is not necessary to eliminate the nonworking spouse benefit to address the inequities described above. One option is simply to constrain its growth so that no future nonworking spouse can receive a benefit exceeding the inflation-adjusted value of the benefits that today's low-wage workers receive based on a full career of payroll tax contributions.

Payroll Tax Relief

Others have suggested that payroll tax relief be offered to seniors who extend their working lives.[62] There are policy downsides to this approach. For example, it would reduce much-needed Social Security tax revenues, though it would increase regular income tax revenues. Also, if enacted in the wrong way, eliminating or reducing the payroll tax contributions for seniors could embody age discrimination. That said, the positive effects such a policy could have on labor participation by seniors should not be dismissed. Versions that avoid the age-discrimination pitfall have been put forward by Mark Warshawsky and John Shoven.[63] The basic idea would be to establish a status of being "paid up" under Social Security after a given number of years of contributions (45 in the Warshawsky formulation), after which no further payroll taxes would be collected. Notably, this change would offer a work incentive to individuals on the way to paid-up status, and not only upon reaching a given age.

One policy challenge associated with improving Social Security's work incentives is that doing so will likely shift the distribution of Social Security income somewhat from women (who are more likely to have work interruptions to bear and raise children) to men (who are more likely to have longer working careers). This income shift is indeed a likely effect of enacting work-incentive repairs in isolation, and it is a concern if one wishes to preserve the full amount of income redistribution from men to women that occurs under current-law Social Security. The concern can be addressed, however, by making the basic benefit formula incrementally more progressive at the same time that work incentive improvements are enacted.[64]

There is no way to know for certain how much Americans in late middle age would respond to reforms to render Social Security friendlier to those who extend their working careers. Evidence from Liebman, Luttner, and Seif suggests that there would be a positive labor supply effect and thus a positive effect on federal revenues, retirement income security, and broader economic growth.[65] At a time when America desperately needs the labor productivity of our skilled, healthiest younger seniors to foster economic growth, we would do well to advance a Social Security system that sides with those who provide us with the benefits of their continued work.

Financial Literacy

The Social Security Administration plays a unique role in the financial security of millions of Americans, and in helping people better prepare for retirement. Therefore, both the Bowles-Simpson and BPC plans encourage the SSA to increase financial literacy efforts to inform people about their retirement choices and to increase savings. Specifically, the BPC plan

> directs SSA to revise aggressively its communications and messaging around the retirement choice. The material provided to workers during their careers about the retirement decision must more clearly show the implications of collecting benefits at different ages. It must highlight the permanent financial consequences of this choice, not only for workers, but for spouses and survivors as well. In particular, SSA should remind workers of uncertainties in retirement, such as potential health-care costs and the possibility that they may live for many years after retiring.

Although people are living longer, a significant fraction of workers continues to start receiving Social Security benefits early, though this permanently reduces monthly benefits. Research links financial literacy and saving behavior, indicating that the less financially literate are also less likely to plan for retirement.[66] Better informing people about the full costs of claiming benefits early may lead to more people choosing to delay claiming until the full retirement age, or longer, thus improving labor-force participation among seniors. For example, an innovative study by Jeff Brown, Arie Kapteyn, and Olivia Mitchell uses the American Life Panel to experiment with different ways of framing monthly benefit information. The authors hold constant the factual information presented but vary how the information is presented to highlight the financial gains of delaying or claiming. That study finds that framing information strongly shaped respondents' expected claiming ages.[67]

Promoting financial literacy should be done regardless of any Social Security reform plan, in part because research finds differences between how much people expect to receive in Social Security benefits when they retire and what they actually receive. For example, only 19 percent of workers can correctly identify the age at which they will be eligible for full benefits from Social Security.[68] Further, the 2011 Retirement Confidence Survey (RCS) found that current workers are half as likely to expect Social Security to provide a major share of their income in retirement (33 percent) as current retirees are to say Social Security makes up a major share of their income (68 percent).[69] However, research conducted by the Employee Benefit Research Institute (EBRI) found that 60 percent of those aged 65 or older received at least three-quarters of their income from Social Security in 2009.[70] Additionally, although people are living longer, a significant fraction of workers continues to take Social Security benefits at age 62 even though this permanently reduces monthly benefits for the rest of their lives. Research also links financial literacy and saving behavior, indicating that the less financially literate are also less likely to plan for retirement.[71]

A number of Social Security reforms could be implemented that provide incentives to healthy seniors to continue working. Some of these changes would produce net direct savings for the program, whereas others would benefit individual participants at some expense to program finances. The following often-discussed proposals to raise Social Security eligibility ages would likely have a positive effect on worker output and economic growth.

CONCLUSION

Social Security faces real financial challenges. Dismissing the real and current fiscal challenges facing the Social Security system and kicking the "reform can" further down the road will only increase the severity of the burden associated with reforms when they inevitably must take place.

In order to ensure that Social Security remains solvent and continues to provide retirement security for generations to come, while minimizing the burden on current and future generations, reforms must happen sooner rather than later. The Social Security Trustees

> recommend that lawmakers address the projected trust fund shortfalls in a timely way in order to phase in necessary changes and give workers and beneficiaries time to adjust to them. Implementing changes soon would allow more generations to share in the needed revenue increases or reductions in scheduled benefits. Social Security will play a critical role the lives of 56 million beneficiaries and 159 million covered workers and their families in 2012. With informed discussion, creative thinking, and timely legislative action, Social Security can continue to protect future generations.[72]

These reforms should not only address the program's fiscal solvency issues, but also remove the disincentives to working later in life.

Thank you again for your time and this opportunity to testify today. I look forward to your questions.

ENDNOTES

1. The data are available from Yahoo Finance's Historical Prices calculator, http://finance.yahoo.com/q/hp?s=%5eGSPC+Historical+Prices. S&P 500 index value at market close on October 10, 2007, was 1562.47. Index value at close on March 9, 2009, was 676.53. The National Bureau of Economic Research, the arbiter of the start and end dates of a recession, determined that the recession that began in December 2007 ended in June 2009, roughly coinciding with the peak and trough dates of the S&P 500 index.
2. Michael D. Hurd and Susann Rohwedder, "The Effects of the Economic Crisis on the Older Population" (MRRC Working Paper No. 2010-231, Michigan Retirement Research Center, Ann Arbor, MI, 2010).
3. The Health and Retirement Study is a longitudinal survey of health, retirement, and aging that has been conducted every two years since 1992 and interviews more than 22,000 Americans over the age of 50. For more information on the study, see http://hrsonline.isr.umich.edu.
4. Hurd and Rohwedder, "Effects of the Economic Crisis."
5. US Bureau of Labor Statistics, Labor Force Statistics from the Current Population Survey, accessed May 15, 2012, www.bls.gov/data/#unemployment.
6. US Bureau of Labor Statistics, "Employment Status of the Civilian Noninstitutional Population by Age, Sex, and Race," Labor Force Statistics from the Current Population Survey, accessed May 15, 2012, http://www.bls.gov/web/empsit/cpseea13.htm.
7. Jason Fichtner, John Phillips, and Barbara Smith, "Retirement Behavior and the Global Financial Crisis" (Working Paper 2011-10, Pension Research Council, Philadelphia, PA, November 2012), http://www.pensionresearchcouncil.org/publications/document.php?file=980 or http://www.pensionresearchcouncil.org/publications/0-19-966069-7.php (sign-in only).
8. Congressional Budget Office, "Estimates of Potential GDP and the Related Unemployment Rate," February 5, 2013, http://www.cbo.gov/publication/43903. The spreadsheets span January 1991 to February 2013.
9. What is described here are the expectations of working past either age 62 or age 65. Michael Hurd, Monika Reti, and Susann Rhowedder have found that these retirement expectations are predictive of actual retirement. Hurd, Reti, and Rohwedder, "The Effect of Large Capital

Gains or Losses on Retirement," in *Developments in the Economics of Aging*, ed. David A. Wise (Chicago: University of Chicago Press, 2005).

10. In this context, "retirement plans" refers to peoples' goals, strategies, and behaviors, not to defined-contribution or defined-benefit retirement plans.

11. Gary Bosworth and Gary Burtless, "Recessions, Wealth Destruction, and the Timing of Retirement" (CRR Working Paper No. 2010-22, Center for Retirement Research at Boston College, Chestnut Hill, MA, 2010). The timing of retirement can be affected by more than age, including accumulated savings, the availability of an employer-provided pension, the willingness or ability to continue working part-time in retirement, personal health, access to health coverage, and general economic conditions.

12. Emy Sok, "Record Unemployment among Older Workers Does Not Keep Them Out of the Job Market," US Bureau of Labor Statistics, Issues in Labor Statistics, Summary 10-04, March 2010, www.bls.gov/opub/ils//summary_10_04/older_workers.htm.

13. Julie M. Whittaker, "Unemployment and Older Workers" (CRS Report for Congress, Congressional Research Service, August 29, 2007), http://www.aging.senate.gov/crs/pension27.pdf.

14. Bosworth and Burtless, "Recessions, Wealth Destruction, and the Timing of Retirement."

15. Social Security benefits taken between ages 62 and the full retirement age (FRA), currently 65 or 66 depending on birth year, are actuarially reduced so that the expected value of total lifetime benefits received is approximately the same regardless of when benefits are claimed.

16. Income earned by individuals who claim benefits prior to attaining the full retirement age (FRA) is subject to the retirement earnings test. There are two different exempt amounts depending on when the individuals attain FRA. For individuals claiming benefits and working in 2012 but attaining FRA in 2013 or later, the annual exempt amount in 2013 is $15,120. For those individuals attaining FRA in 2013, the exempt amount is $40,080 and applies only to income earned in the months prior to attaining FRA. After attaining FRA, individuals are no longer subject to the earnings test. SSA withholds $1 in benefits for every $2 in earnings in excess of the lower exempt amount and $1 in benefits for every $3 of earnings in excess of the higher exempt amount. US Social Security Administration, "Exempt Amounts under the Earnings Test," http://www.ssa.gov/oact/cola/rtea.html.

17. US Social Security Administration, "Retirement Planner: Getting Benefits While Working," http://www.ssa.gov/retire2/whileworking.htm.

18. For a summary of research work on this area, see Richard Burkhauser, Alan Gustman, John Laitner, Olivia S. Mitchell, and Amanda Sonnega, "Social Security Research at the Michigan Retirement Research Center," *Social Security Bulletin* 69, no. 4 (2009).

19. An aged beneficiary or "unit" is either a married couple living together or a nonmarried person, which also includes persons who are separated or married but not living together. A married couple's age is defined as the age of the husband—unless he is under age 55 and the wife is 55 or older, in which case it is the age of the wife. The example in the paper refers to aged units that are 65 years of age or older. In this case, the age of the married couple is the age of the husband if he is 65 or older; if the husband is younger than 55 and the wife is aged 65 or older, the age of the married couple is the age of the wife. See: http://www.socialsecurity.gov/policy/docs/chartbooks/fast_facts/.

20. United States Social Security Administration, "Relative Importance of Social Security, 2008," *Fast Facts & Figures*, August 2010, http://www.ssa.gov/policy/docs/chartbooks/fast_facts/2010/fast_facts10.html#agedpop.

21. Michael D. Hurd and Susann Rohwedder, "The Effects of the Economic Crisis on the Older Population" (MRRC Working Paper No. 2010-231, Michigan Retirement Research Center, Ann Arbor, MI, 2010).

22. Gayle Reznik, David Weaver, and Andrew Biggs, "Social Security and Marginal Returns to Work near Retirement" (SSA, April 2009), http://www.ssa.gov/policy/docs/issuepapers/ip2009-02.html.

23. Barbara A. Butrica, Richard W. Johnson, Karen E. Smith, and Eugene Steuerle, *Does Work Pay at Older Ages?* (Washington, DC: Urban Institute, December 2004), http://www.urban.org/uploadedpdf/411121_DoesWorkPay.pdf.

24. Geoffrey Kollmann, "Social Security: Summary of Major Changes in the Cash Benefits Program," May 18, 2000, http://www.ssa.gov/history/reports/crsleghist2.html. The option was created for women in the 1956 amendments and for men in the 1961 amendments.

25. Fullerton, "Labor Force Participation."

26. SSA, "When to Start Receiving Retirement Benefits," August 2012, http://www.socialsecurity.gov/pubs/10147.pdf.

27. Charles Blahous, "Social Security and Work," *National Affairs* 2 (Winter 2010).

28. Gopi Shah Goda, John B. Shoven, and Sita Nataraj Slavov, "Removing the Disincentives in Social Security for Long Careers," NBER, December 15, 2006, http://www.nber.org/programs/ag/rrc/NB06-06%20Goda,%20Shoven,%20Slavov%20FINAL.pdf.

29. See Testimony of Charles Blahous before the Subcommittee on Social Security of the U.S. House of Representatives Committee on Ways and Means, July 8, 2011, http://waysandmeans.house.gov/uploadedfiles/blahoustestimony78.pdf.

30. Goda, Shoven, and Slavov, "Removing the Disincentives."

31. SSA, *How Work Affects Your Benefits*, 2013, www.ssa.gov/pubs/EN-05-10069.pdf.
32. SSA, "Annual Statistical Supplement, 2012," http://www.ssa.gov/policy/docs/statcomps/supplement/2012/6b.html#table6.b5.
33. Ibid.
34. SSA, "When to Start Receiving Retirement Benefits," August 2012, http://www.socialsecurity.gov/pubs/10147.pdf.
35. April 2007 memorandum from SSA to Charles Blahous.
36. Social Security Online, "Moneys Worth Ratios Under the OASDI Program for Hypothetical Workers," Actuarial Publications, http://www.ssa.gov/OACT/NOTES/ran7/index.html.
37. US Census Bureau, "Table 597. Labor Force Participation Rate by Marital Status, Sex, and Age: 1960 to 2010," http://www.census.gov/hhes/www/income/data/historical/people/2011/P05AR_2011.xls; US Census Bureau, table P-5, "Regions-People by Median Income and Sex," http://www.census.gov/compendia/statab/2012/tables/12s0597.xls.
38. *The Economist*, "We Did It!," December 30, 2009, http://www.economist.com/node/15174489.
39. See Jeffrey B. Liebman, Erzo F. P. Luttner, and David G. Seif, "Labor Supply Responses to Marginal Social Security Benefits: Evidence from Discontinuities," May 8, 2009, http://www.nber.org/~luttmer/ssbenefitlink.pdf.
40. The Average Wage Index is a measure of average wages in the economy as a whole. It is explained in greater detail in a number of Social Security Administration Office of the Actuary publications, including "Average Wages for Indexing Under the Social Security Act," Actuarial Note 103, May 1981, http://www.ssa.gov/oact/NOTES/note1980s/note103/introduction.html.
41. This scenario is complicated somewhat by the fact that benefits after initial claim are adjusted for growth in the Consumer Price Index, but it is nevertheless true as a zeroth-order approximation.
42. Social Security Trustees Report.
43. *Reducing the Deficit: Spending and Revenue Options* (Washington, DC: CBO, March 2011), http://www.cbo.gov/ftpdocs/120xx/doc12085/03-10-ReducingTheDeficit.pdf, page 63.
44. Holtz-Eakin to Craig, "Long-Term Analysis of Plan 2."
45. Holtz-Eakin to Craig, "Diamond-Orszag Social Security Plan."
46. Butrica et al., "Does Work Pay at Older Ages?"
47. US Bureau of Labor Statistics, "Chapter 17. The Consumer Price Index," updated 06/2007, http://www.bls.gov/opub/hom/pdf/homch17.pdf
48. For an explanation for the Primary Insurance Amount (PIA) and the Average Indexed Monthly Earnings (AIME), see: http://www.ssa.gov/oact/cola/piaformula.html
49. See, for example, http://waysandmeans.house.gov/calendar/eventsingle.aspx?EventID=247231.
50. See, for example, Andrew Biggs, Statement before the United States House of Representatives, Committee on Ways and Means, Social Security Subcommittee. June 23, 2011. http://waysandmeans.house.gov/UploadedFiles/Biggs.pdf.
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