American Academy *of* Actuaries
ISSUE BRIEF
OCTOBER 2010

Key Points

- When Social Security began paying monthly benefits in 1940, workers could receive unreduced retired-worker benefits beginning at age 65. This age is known as the Normal Retirement Age (NRA).
- To address an impending solvency crisis, changes legislated in 1983 included gradually increasing the NRA (from age 65 to 67) beginning in 2000, recognizing that longevity had increased greatly since the system began.
- Social Security now faces another solvency challenge, with long-term income projected to be insufficient to pay promised benefits.
- Raising the NRA further would improve Social Security's financial status. Depending on the timing and magnitude, raising the NRA could make a significant contribution toward restoring the Social Security program to long-range actuarial balance and sustainability.
- The American Academy of Actuaries issued a public statement in 2008 advocating that raising the retirement age be part of any package of reforms designed to restore the system's long-term financial health.
- Contrary arguments to raising the retirement age have been made.

Raising the Retirement Age for Social Security

This issue brief examines in some detail the potential impact of raising the retirement age. It is important to note that the Social Insurance Committee of the American Academy of Actuaries has extensively reviewed different reform options for Social Security. For example, a recent issue brief on Social Security Reform focuses on possible changes in the benefit formula or in the federal income tax treatment of Social Security benefits. The Academy believes that raising the retirement age is one component, though a necessary one, of restoring Social Security's financial health.

Background

Social Security's Board of Trustees projects that, under their best-estimate assumptions, income to the system will be insufficient to finance its benefits in the long run, absent corrective legislation. These financial problems stem partly from the impact of individuals' living longer and receiving Social Security benefits for a longer period of time, and this trend is expected to continue indefinitely into the future. One way to reduce expenditures—and thereby improve Social Security's financial status—is to increase the normal retirement age (NRA), that is, the age at which retired workers can begin to receive unreduced Social Security benefits.

For over 60 years, starting in 1940, the NRA was set at 65. In 1983, Congress enacted increases in the NRA, partially recognizing that life expectancy had increased substantially since 1940. These scheduled increases were part of a package of changes adopted to fend off im-

American Academy *of* Actuaries
1850 M Street NW, Suite 300, Washington, DC 20036
Tel 202 223 8196, Fax 202 872 1948
www.actuary.org

pending program insolvency. The NRA has gradually increased to age 66 for workers born in 1943 (who will reach age 66 in 2009). The NRA then remains at age 66 for 12 years, before gradually increasing to age 67 for workers born in or after 1960 (who will reach age 67 in 2027 and later). These increases are summarized in the table below.

Year of Birth	Normal Retirement Age
1937 and earlier	65
1938	65 2/12
1939	65 4/12
1940	65 6/12
1941	65 8/12
1942	65 10/12
1943 through 1954	66
1955	66 2/12
1956	66 4/12
1957	66 6/12
1958	66 8/12
1959	66 10/12
1960 and later	67

Since 1961 (1956 for women), non-disabled workers could begin receiving benefits as early as age 62. The monthly benefits payable to non-disabled workers who elect to receive benefits before the NRA are reduced to compensate for the resulting longer payout period. As long as this reduction comes close to reflecting the actual cost to the system of retiring early, raising the earliest retirement age has a modest impact on Social Security's finances. Under the 1983 legislation, the earliest retirement age remains age 62.

Social Security is not in immediate financial crisis as in 1983, but it does face a financial challenge because projected income over the next 75 years is insufficient to pay promised benefits. Increasing Social Security's NRA beyond the current schedule of increases is one way to make up part of this shortfall.

Demographic, Health, and Economic Considerations

In 1940, when Social Security began paying monthly retired-worker benefits, workers who survived to age 65 had a remaining life expectancy of 12.7 years for men and 14.7 years for women. In 2010, life expectancy at age 65 was 18.1 years for men and 20.4 years for women. In other words, since Social Security began paying monthly benefits, life expectancy at age 65 has increased between five and six years for both men and women. Moreover, Social Security's Board of Trustees anticipates further significant increases in life expectancy over the 75-year projection period. If the projections are borne out by actual experience, life expectancy at age 65 will have increased by nearly 10 years from 1940 to 2085. The following table summarizes past increases and expected future increases in life expectancy at age 65:

Year (age 65)	Male	Female
1940	12.7	14.7
1950	13.1	16.2
1960	13.2	17.4
1970	13.8	18.5
1980	14.7	18.8
1990	15.9	19.2
2000	17.2	19.8
2010	18.1	20.4
2035	19.8	22.0
2060	21.2	23.5
2085	22.5	24.7

Source: 2010 Social Security Trustees Report, Intermediate Assumptions

Under current law, once the NRA reaches age 67 in 2027, increases in longevity will translate into higher lifetime Social Security benefits because workers will, on average, receive benefits for a longer time. Raising the NRA further would constitute a benefit decrease relative to current law for anyone whose payments start after this change becomes effective because

Members of the Academy's Social Insurance Committee who participated in drafting this issue brief include: Janet Barr, EA, ASA, MAAA, chairperson; Michael Callahan, EA, FSPA, MAAA; Eric Klieber, EA, FSA, MAAA; Eric Lofgren, FCA, FSA, MAAA; Michael Peskin, AIA, ASA, CERA, FCA, MAAA; Bruce Schobel, FSA, FCA, MAAA; Mark Shemtob, EA, ASA, MAAA, MSPA; Richard Schreitmueller, FSA, MAAA; P.J. Eric Stallard, ASA, FCA, MAAA; and Louis Weisz, FSA, MAAA.

monthly benefits at any given retirement age would be lower. On the other hand, because each future generation is expected to live longer and receive benefits to a later age than the previous one, a gradual rise in the NRA would, in the larger context of work and retirement, merely slow the rate of increase in the value of lifetime benefits from one generation to the next.

However, research shows that the improvement in longevity cited above is not uniform across the income spectrum but represents an average of greater improvement among high-wage workers and slower improvement among low-wage workers. Further, the slower improvement among low-wage workers is not concentrated in a small group of economically disadvantaged workers at the lowest end of the income scale but includes the entire bottom half of the population. Unless this longevity gap begins to close, raising the NRA will impact low-wage workers more than high-wage workers.

To further complicate this situation, studies have shown that the average age of retirement in the United States decreased until the mid-1980s. It is unlikely this trend toward earlier retirement could have been a result of poorer health among persons approaching NRA. Studies have also shown that, while past increases in life expectancy include additional years of healthy and unhealthy life, years of healthy life predominate. Earlier retirement has combined with increased years of healthy life to create an even healthier retiree population today than would have resulted from either change alone. The result is that, at least until recently, older Americans have been enjoying longer and healthier periods of retirement.

Even before the economic downturn beginning in late 2007, many economists questioned whether this early retirement trend could continue. Employers have been freezing or terminating defined benefit pension plans and turning to defined contribution plans, such as 401(k) plans, as the centerpiece of their employee retirement programs. As a result, saving for retirement increasingly involves building up assets in individual accounts, whether in employer-sponsored plans, individual retirement accounts (IRAs), or personal savings. As life expectancy increases, workers must either save more or retire later in order for the assets accumulated in their accounts to provide adequate income during retirement. Periods of low or negative returns on these retirement accounts could exacerbate the difficulty in retiring early.

Work and the Elderly

Social Security is primarily a pay-as-you-go system; that is, benefit payments to each generation of retirees are funded by contributions from contemporaneous workers. Although the system has built up a trust fund that seems large in absolute dollars, the trust fund comes nowhere near large enough to prefund the benefits of the current generation of workers. The current accumulation of the trust fund should be viewed as a byproduct of the agreement in the 1983 amendments to fund rising benefit payments by a constant tax rate rather than as a departure from pay-as-you-go financing. Indeed, the trust fund is expected to be exhausted and the system to be returned to pure pay-as-you-go financing in about three decades.

Within the public policy debate over Social Security, its financial problems are often explained with reference to the declining ratio (known as the dependency ratio) of workers contributing to the system compared to retirees receiving benefits. This ratio has been declining slowly for decades, but the upcoming retirement of the baby boom generation is expected to accelerate the trend. In a pay-as-you-go system a declining number of workers per retiree makes the system more difficult to finance. The finances can be improved if workers work longer without receiving higher benefits, since this would both increase the number of workers making contributions and reduce the number of retirees receiving benefits.

Social Security's financial challenges are only a symptom of broader economic consequences of the declining dependency ratio. If the retirement pattern of the baby boomers matches that of prior generations, workers may not be able to produce enough to maintain the past rate of improvement in living standards for both themselves and retirees, absent unprecedented increases in worker productivity. Therefore, many economists believe workers should be encouraged to retire later for reasons that go beyond improving Social Security's finances. These reasons include increasing national income and savings, giving workers more time to save for retirement, and tapping the experience of older workers for the benefit of employers and the economy at large.

However, there are barriers to increasing labor force participation among the elderly. Many employers perceive elderly workers as inflexible and unable to adapt to rapidly changing technologies. Elderly workers may demand higher salaries and increase an employer's health benefit costs. Workers who have spent their careers in physically demanding occupations may be unable to continue in those occupations and be unable to train for alternative employment. Most important, past experience of workers retiring earlier, even though healthy enough to continue working, indicates most workers prefer to retire as soon as financially able to do so. Although there is anecdotal evidence that people are beginning to work longer, this may be only a short-term response to financial losses due to the recent economic downturn rather than the beginning of a long-term trend toward delayed retirement. Conflicting incentives regarding when to retire make predicting future labor force participation among the elderly a hazardous enterprise.

Approaches to Raising the NRA

Proposals for raising the Social Security NRA include the following:

- **INCREASES TO THE NRA**—The web site of the Social Security Chief Actuary shows the effect on Social Security's long-range financial condition of eight different schedules and combinations of increases to the NRA. The most rapid increase illustrated—beginning the increase in the NRA from age 66 to age 67 immediately, followed by a continued increase by one month every two years until the NRA reaches age 70—reduces the long-range actuarial deficit by about a third. A rate of increase more rapid than one month every two years would be required to further reduce the long-range deficit.

- **PAY BENEFITS FOR THE SAME NUMBER OF YEARS**—The NRA could be indexed so that life expectancy at the NRA remains constant over time. For example, life expectancy at age 65 (weighted between men and women and rounded to the nearest whole year) is now 19 years. Based on expected increases in longevity from the Trustees Report, the NRA would have to increase by about one month every year or two for life expectancy at NRA to remain 19 years. This method would decrease system costs over time, because the payout period for benefits would remain the same while the period over which payroll taxes would be paid would increase. However, the savings from this change alone would not be sufficient to restore actuarial balance. Indexing the NRA by one month every two years in combination with other changes to the system, could restore actuarial balance. Another method of indexing which is based on demographic trends as they develop might make more sense than using a formula (i.e. one month every two years) since there is disagreement among the experts on the long-term rate of mortality improvement.

- **KEEP THE RATIO OF RETIREMENT YEARS TO WORKING YEARS THE SAME**—The NRA could also be indexed so that the life expectancy at NRA increases by the same percentage as the period from age 22 to NRA. This method, which was recommended in 1983 by a majority of the members of the National Commission on Social Security Reform, would increase the NRA a little more slowly than maintaining a constant life expectancy at NRA and, therefore, would reduce program costs to a lesser degree. By using this method policymakers may intend that some portion of the increase in life expectancy at NRA may reflect years of unhealthy life during which workers could not continue working and that extra years of life expectancy should be split in some manner between work and retirement.

- **ADJUST THE NRA TO MAINTAIN ACTUARIAL BALANCE**—If Social Security were restored to actuarial balance by an ad hoc increase to the NRA or by some other change or combination of changes, actuarial balance could be maintained by automatically adjusting the NRA as necessary to achieve this goal. An adjustment of this nature could also be combined with automatic adjustments to the payroll-tax rate or benefit amounts to maintain actuarial balance. Automatic adjustments of this nature have been adopted by other developed countries for their national retirement systems. These issues are discussed in greater depth in our issue brief Automatic Adjustments to Maintain Social Security's Long-Range Actuarial Balance.

The Case for Raising the NRA

Proponents of raising the NRA contend that their proposals address Social Security's long-range financial problems while responding to changing demographic factors. They generally make the following arguments, that their plans:

- **COMPENSATE FOR INCREASED LONGEVITY**—Raising the NRA is a natural response to increasing longevity among covered workers. Since most workers will need to work longer to accumulate adequate retirement savings in employer-sponsored plans and personal accounts, it seems reasonable they should also work longer to receive their full Social Security benefits. Further, improvements in health among the elderly enable most workers to work longer. Even the largest proposed increases in the NRA still provide a longer period of retirement on average than workers enjoyed during most of the time the NRA was 65.
- **PRESERVE THE CURRENT BENEFIT FORMULA**—Proponents of raising the NRA generally start with the presumption that reducing benefits of workers across the income spectrum must be part of any package of changes to fix Social Security's long-term financial problems. They argue that the current benefit formula, which has now been in place for over 30 years, successfully balances the competing interests of the many demographic groups among Social Security's covered population. Raising the retirement age preserves the current benefit formula. While equivalent benefit reductions can be achieved by simply changing the formula, this could arouse intense political battles that might delay needed legislation or result in an ultimate reform package that satisfies nobody, jeopardizing long-term popular support for the system.
- **INCREASE LABOR FORCE PARTICIPATION AMONG THE ELDERLY**—Raising the NRA would induce workers to remain longer in the labor force. Part of this effect is psychological: to the extent a higher NRA comes to be considered the "normal" retirement age, some workers will view delaying retirement as conforming to social norms. More important are the financial incentives. Workers might continue full-time employment in order to retire later with an adequate Social Security benefit or switch to part-time employment to supplement a lower benefit. Making greater use of older workers increases economic output and raises the living standard for both active and retired workers. This is a particularly important consideration as members of the baby boom generation approach retirement.
- **PRESERVE DISABILITY BENEFITS AND BENEFITS OF CURRENT BENEFICIARIES**—One interesting advantage of increasing the NRA is that it does not reduce disabled-worker benefits, whereas direct reductions in Social Security's benefit formula would reduce these benefits. Raising the NRA would most likely be phased in slowly, so that it would not affect current retirees, beneficiaries and even some near retirees (e.g., workers over age 55).

The fact that increased longevity is among the causes of Social Security's financial problems suggests that raising the retirement age be among the solutions to these problems. Nevertheless, increased longevity, in and of itself, is not necessarily a compelling argument for raising the retirement age. In the end, proposals for solving Social Security's financial problems must be judged by how well they use the available revenues to fulfill the system's purpose—to provide a basic level of retirement income for all American workers.

The Case Against Raising the NRA

Opponents of raising the NRA often argue:

- **WORKERS DON'T WANT TO WORK LONGER**—The trend toward earlier retirement noted above indicates workers prefer to retire as soon as financially practicable. Opponents of raising the retirement age argue that Social Security, as the principal governmentrun retirement program, should accommodate this preference for early retirement rather than fight against it. Put another way, workers should be allowed to choose longer retirement over higher living standards. Further, they believe efforts to increase employment should be directed at people at the traditional working ages experiencing high levels of unemployment and underemployment, such as minority youth in the inner cities. They claim increasing the labor force participation among these groups will fund a portion of Social Security's financial deficit through higher payroll tax receipts while providing numerous other social benefits. The remaining deficit could be addressed through increasing the wage base and other changes designed to increase revenue rather than cut benefits. Benefit cuts, if necessary, would be limited to high-wage workers. The danger in shoring up Social Security's finances by revenue increases and benefit cuts that fall primarily on high-wage workers is that this politically powerful constituency may cease supporting the system. This could make Social Security vulnerable at a later time to benefit cuts of the magnitude that befell various welfare programs over the past several decades.

- **JOBS MAY NOT BE AVAILABLE**—Until recently, it was common for employers to provide incentives for older workers to retire from their jobs. As noted above, there are still barriers to elderly workers remaining in the labor force, especially if younger workers are readily available. If jobs are not available for older workers, raising the retirement age will constitute a financial hardship for many who may have to retire with reduced benefits or endure a period when they are neither working nor eligible for Social Security benefits. The seriousness of this concern depends on how the labor market responds over the coming decades to the gradual aging of the population. If there are not enough new workers to replace those who reach traditional retirement ages, employers may overcome their reluctance to hire or retain older workers.
- **DISPROPORTIONATE EFFECT ON LOW-WAGE WORKERS**—As noted above, longevity for low-wage workers has not increased as much as for high-wage workers. Therefore, the argument that raising the NRA compensates for increased longevity does not apply as strongly to them. Also, many low-wage workers will not be able to work to a higher NRA because they tend to be in poorer health, have fewer skills, and work in more physically demanding jobs. An increase in the NRA would disproportionately affect these workers to the extent they claim early-retirement benefits with reductions greater than under current law. Moreover, low-wage workers rely most heavily on income from Social Security to provide their retirement income. Proposals that might alleviate these problems include liberalizing the current "vocational factors" that are used to define disability for workers at ages 40 or older and/or providing an alternative definition of disability for workers unable to perform their customary jobs once they reach some specified age. For example, this alternative definition of disability might apply beginning at age 62 and provide an unreduced benefit beginning at age 65. This would ensure that a worker who qualifies under only the alternative definition of disability would be no worse off than a non-disabled worker prior the 1983 amendments.

Other Effects of Raising the NRA

Any legislation increasing the NRA should also address the following issues:

- **EFFECT ON OTHER GOVERNMENTAL PROGRAMS**—Increasing the NRA would raise the Social Security disability program's costs, because the change would encourage impaired workers younger than NRA to file for disability benefits in order to avoid increased actuarial reductions associated with claiming early-retirement benefits. (A much larger impact on disability program costs would result from paying disabled-worker benefits longer—i.e., until the new, higher NRA—but that cost is exactly offset by lower costs to the retirement program.) Raising the NRA might raise the Supplemental Security Income (SSI) program's costs, because SSI benefits are reduced by Social Security benefits received. A higher

NRA could increase costs for workers' compensation and unemployment insurance if significant numbers of older people choose to continue working and ultimately become eligible to receive those benefits.

- **EFFECT ON EMPLOYEE BENEFITS**—As noted above, a higher NRA could increase the costs of employer-sponsored health benefit plans. A higher NRA also could increase the costs of certain employer-sponsored pension plans (e.g., Social Security offset plans and plans with supplemental benefits). However, when members of the baby-boom generation begin to retire in large numbers, employers may want to implement retirement strategies to encourage older employees to work longer. Ways for employers to accomplish this include raising the retirement age required for full pension benefits and reducing early-retirement subsidies in pension plans. Such changes would reduce employer pension costs.

Raising the Early Eligibility Age

Under present law, workers must wait until the early eligibility age (EEA), currently 62, to be eligible to receive retired-worker benefits. At present, most non-disabled workers start to draw their Social Security retirement benefits at age 62 or shortly thereafter. Retired-worker benefits beginning at exact age 62 are 70 to 80 percent of the full retirement benefit, depending on the worker's NRA, to compensate for the resulting longer payout period. If the NRA were raised to age 70, then the benefit commencing at age 62 would be only about 57 percent of the full retirement benefit (depending on the early-retirement reduction factors used), which could be inadequate for some retired workers.

In response, some proposals would raise the EEA in addition to raising the NRA. This would result in many workers receiving larger monthly benefits, thus alleviating problems with benefit inadequacy, particularly at very old ages when workers may be less able to supplement their benefits with earnings from work. However, raising the EEA could adversely affect individuals with low incomes, who, as noted above, tend to have poorer health and rely most heavily on income from Social Security.

Raising the EEA would make a small contribution toward improving Social Security's financial condition. At present, the reduction in benefits for early retirement compensates only for the fact that the recipient gets benefits for more years. The reduction does not compensate for the reduced tax revenue based on the worker's shorter period of covered employment. Raising the EEA would reduce this negative impact on the system's finances.

Conclusion

The American Academy of Actuaries issued a public policy statement in 2008 advocating that raising the NRA be part of any package of reforms designed to restore the system's long-term financial health. Nevertheless, the Academy recognizes that there are arguments against this proposal and that the issues raised in these arguments, as well as other issues, need to be addressed before any legislation to raise the retirement age is enacted.

REFERENCES

American Academy of Actuaries. 2008. *Actuaries Advocate Raising Social Security's Retirement Age.* Policy Statement. Washington, DC: American Academy of Actuaries.

Board of Trustees of the Social Security Trust Funds. 2010. *2010 OASDI Trustees Report.* Baltimore, MD: Social Security Administration.

Chen, Yung-Ping and John Turner. 2007. "Raising the Retirement Age in OECD Countries," In *Work Options for Older Americans,* Teresa Ghilarducci and John Turner, eds. Notre Dame, IN: University of Notre Dame Press.

Duggan, James E., Robert Gillingham and John S. Greenlees. 2007. *Mortality and Lifetime Income: Evidence from U.S. Social Security Records.* IMF Working Paper. Washington, DC: International Monetary Fund.

Duggan, Mark, Perry Singleton and Jae Song. 2005. "Aching to Retire? The Rise in the Full Retirement Age and Its Impact on the Disability Rolls." NBER working paper no. 11811. Cambridge, MA: National Bureau of Economic Research.

National Center for Health Statistic 2002. *Health, United States, 2002.* http://www.cdc.gov/products/pubs/pubd/hus/tables/2002/02hus028.pdf

Klieber, Eric. 2009. "Strengthening Social Security for Workers in Physically Demanding Occupations." In *Strengthening Social Security for Vulnerable Groups*. Washington , DC: National Academy of Social Insurance.

Long, Valarie. 2005. *Testimony before the Subcommittee on Social Security of the House Committee on Ways and Means, June 14, 2005.* Washington, DC: U.S. House of Representatives.

Morrissey, Monique and Emily Garr. 2009. *Working the Graveyard Shift: Why Raising the Social Security Retirement Age Is Not the Answer.* Briefing Paper. Washington, DC: Economic Policy Institute.

Munnell, Alicia. 2007. "Working Longer: A Potential Win-Win Proposition," In *Work Options for Older Americans,* Teresa Ghilarducci and John Turner, eds. Notre Dame, IN: University of Notre Dame Press.

Social Security Administration. 1986. "Increasing the Social Security Retirement Age: Older Workers in Physically Demanding Occupations or Ill Health", from *Social Security Bulletin,* vol. 49, no. 10.

Social Security Administration. 2008. *Long Range Solvency Provisions.* **http://www.ssa.gov/OACT/solvency/provisions.**

Social Security Advisory Board. 2008. *Working for Retirement Security,* Washington, DC: Social Security Advisory Board.

Steuerle, C. Eugene. 2005. *Testimony before the Subcommittee on Social Security of the House Committee on Ways and Means, June 14, 2005.* Washington, DC: U.S. House of Representatives.

Technical Panel on Methods and Assumptions 2007. *Report to the Social Security Advisory Board,* Washington, DC: Social Security Advisory Board.

Turner, John A. 2007. *Autopilot: Self-Adjusting Mechanisms for Sustainable Retirement Systems,* Schaumburg, IL: Society of Actuaries.

Uccello, Cori E. 1998. *Factors Influencing Retirement: Their Implications for Raising Retirement Age,* Washington, DC: American Association of Retired Persons.

Waldron, Hilary. 2007. *Trends in Mortality Differentials and Life Expectancy for Male Social Security-Covered Workers, by Average Relative Earnings* ORES Working Paper No. 108. Washington, DC: Social Security Administration, Office of Policy, Office of Research, Evaluation and Statistics.

Weller, Christian E. 2000. *Raising the Retirement Age: The Wrong Direction for Social Security.* Issue Briefing. Washington, DC: Economic Policy Institute

American Academy *of* Actuaries

1850 M Street NW
Suite 300
Washington, DC 20036
Tel 202 223 8196
Fax 202 872 1948
www.actuary.org