Social Security Advisory Board

September 2008

Working for Retirement Security

Social Security Advisory Board

An independent, bipartisan Board created by the Congress and appointed by the President and the Congress to advise the President, the Congress, and the Commissioner of Social Security on matters related to the Social Security and Supplemental Security Income programs.

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Message From The Board

The Social Security Advisory Board was created by Congress through the *Social Security Independence and Program Improvements Act of 1994*. In that Act, Congress gave several directives to the Board including the task of analyzing the nation's retirement and disability systems and making recommendations with respect to how the Old-age, Survivors, and Disability Insurance program and Supplemental Security Income program, supported by other public and private systems, can most effectively assure economic security.

In this report we focus on the need to assure adequate income in retirement by addressing when to withdraw from the workforce and when to begin to receive Social Security retirement benefits. It has been nearly 75 years since President Franklin Roosevelt signed *The Social Security Act of 1935* and the United States has undergone significant changes. Decades of economic growth and prosperity coupled with improved health status has meant that Americans are living longer and spending a greater portion of their lives in retirement. Because of longer life spans, low savings rates, and the growth of health care costs, retirement is becoming increasingly expensive for individuals and families. Moreover, as the nation's population ages, and each worker must support a larger number of retirees, the cost of Social Security will increase. We believe that encouraging workers to extend their working lives can address both of these issues.

We are very aware that the decision to retire or withdraw from the workforce is not always voluntary. Nothing in this report should be seen to contradict our strong belief that our nation's system of providing economic security to those who cannot work should be maintained and even strengthened. Nonetheless, we believe that there are substantial benefits to individuals and to the nation of extending the working lives of most Americans.

Throughout the development of this report the Board elicited ideas and perspectives from a wide range of experts so that we may better understand the influences that shape personal decisions as well as national policy.

Sylvester J. Schieber, Chairman

Dorcas R. Hardy
Dana K. Bilyeu
Jeffrey R. Brown
Marsha Rose Katz
Mark J. Warshawsky

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Executive Summary

Longer life spans and other demographic changes are making it increasingly expensive to finance an adequate retirement income. One way to reduce this burden is for older workers to participate longer in the workforce. Policy makers should consider ways to remove barriers to continued work at older ages with the objective of improving the economic security of American workers in their retirement years.

Over the past 50 years, Americans have enjoyed steadily increasing life spans, and they have also been retiring earlier. The combined effect of these two trends is that the average American worker today can now be expected to spend 50 percent more time in retirement than a similar worker 50 years ago. Experts project life spans will continue to increase.

As a result, the amount of income that must be put aside to fund workers' retirement must grow. Funding retirement is becoming more expensive for individual workers and for our public retirement systems, and the expense is growing to the point where it is putting strains on the ability of workers and society to bear it. Under our retirement systems that depend on workers and/or firms putting aside earnings during the working years to fund retirement income, the period of accumulation is getting shorter while the payout period is getting longer. Under our Social Security system, which uses the contributions of today's workers to pay today's retirees, the declining number of workers relative to retirees raises costs directly.

Although the need to set aside income has grown, many workers have not been accumulating enough savings in their personal or retirement accounts. Rapidly rising health care costs also consume a growing share of earnings and retirement incomes. Experts project these costs will continue to rise faster than national income. Social Security benefits, the major source of income in retirement for most workers, are on track to replace a smaller share of pre-retirement income (about 4 percent less) as the normal retirement age rises to 67, owing to reforms enacted in 1983. Most individuals choose to receive the earliest yet smallest Social Security benefit available to them. The long-term financing imbalances in Social Security remain an unresolved issue.

For some share of our population, economic security in retirement is at risk. The problem is greater for widows and single women, who on average live longer than men, and tend to accumulate fewer savings and earn lower Social Security benefits.

In the past, this Advisory Board has recommended that policy makers address the long-term financial health of our Social Security system, and we have drawn attention to the predictable but growing threats to retirement security. In this report, the Board adds its voice to a growing consensus that one effective way to shore up retirement security in the future is to find ways to extend individual working careers when possible.

Continuing to work and/or postponing retirement benefits can significantly increase the resources available to individuals in retirement. Every additional year spent working provides income, reduces the need to draw down one's assets, provides an additional opportunity to save, and allows already accumulated savings to grow. This can be especially important for those approaching retirement with inadequate savings and for those who will experience longer than average lifetimes.

More Americans choose to begin receiving Social Security benefits at the earliest age of eligibility than at any other age. But for each year they delay taking benefits, they can significantly increase their monthly benefit for the rest of their lives. This choice can be critical for economic security at older ages.

At the same time, delaying retirement also has the potential to enhance economic security for those covered by employer-sponsored retirement plans. In most traditional defined benefit plans and in cash balance plans today, benefit accruals continue for many workers at advanced ages. In defined contribution plans, extending work has two beneficial effects: (1) it extends the period over which contributions are made; and (2) it shortens the period where accumulated savings are relied on for retirement income.

Having a greater share of older Americans continuing to work will also provide additional tax revenue to improve the financial condition of the Social Security system as well as state and federal government budgets. Extending individual working lives should ameliorate the projected decline in national labor force growth and add to national income.

We recommend that older workers should be given information about the personal advantages of remaining employed for a longer period of their lifetimes to the extent they are able. We also recommend that individuals be encouraged strongly to consider under what circumstances it would be advantageous for them to delay the age they choose to begin receiving Social Security benefits.

We recommend that the Social Security Administration continue to provide the most accurate and objective information possible to help the public make appropriate choices about when to claim benefits. The agency should review all communication with the public to ensure it is not inadvertently encouraging people to claim at the earliest date possible.

There are already signs that older workers are beginning to reverse a decades-long trend toward earlier retirement, perhaps responding to the pressures described above. In addition, fewer people are applying for Social Security benefits at the earliest possible age. Some recent survey data suggest that those nearing the usual retirement ages desire and intend to work to older ages.

A substantial share of older Americans, however, will not be able to work longer because of ill health, disability, or a lack of employment opportunities. And even for those who wish to work longer, important barriers to remaining employed still exist. Our current patchwork of laws and regulations should be changed to do a better job of helping those who can work a few years longer and secure a better standard of living in retirement.

We believe there are opportunities to reform policies and regulations that affect Social Security, public and private pensions, health care, and tax and labor laws that can assist workers to stay in the workforce longer and reward their efforts adequately.

We recommend that public policy should be geared toward removing barriers and improving incentives to continued employment at older age. A set of coordinated and coherent policies should encourage and support those who want to extend their working lives, while providing adequate support for those who are unable to do so.

We reiterate that our nation's systems of providing economic security to those who cannot work should be maintained and improved. Nothing in this report should be seen to contradict this strong belief.

Raising awareness of the benefits of longer working lives and supporting the choices of those who desire to do so will require more than just a more coherent set of policies:

We encourage employers to evaluate how older workers can continue to contribute in the workplace and, to the extent it is economically feasible, to adopt policies and practices that can accommodate a greater share of those who desire to extend their working lives. Older workers and their advocates, for their part, should consider the requirements they will have to meet so that continued employment benefits employer and employees alike.

In addition, individuals, institutions and public policies should recognize the importance of making lifelong investments that enhance a worker's ability to remain productive at older ages and adapt to the changing needs of the economy. Adequate preparation for retirement is a life-long endeavor.

Introduction

The Social Security Advisory Board's primary statutory responsibility is to analyze how the Social Security system, supported by other public and private systems, can most effectively assure economic security for those in retirement or who are disabled.

In our 2005 report, *Retirement Security: The Unfolding of a Predictable Surprise*, we described the major economic and demographic forces that will present the greatest challenges to economic security in retirement in the 21st century:

- longer life spans
- a declining ratio of workers to retirees
- a somewhat less generous Social Security system
- a private pension system that depends increasingly on employees to make active decisions about how much to contribute to retirement savings and how to invest
- health care costs that are growing faster than incomes and the economy as a whole
- globalization and economic changes that are shifting ways of doing business and changing employer-employee relationships.

We emphasized the need to meet those challenges through public policies to achieve sustainable Social Security and employer pension systems and to constrain health care costs. We also encouraged individuals to make responsible and informed choices about adequate saving, maintaining healthy lifestyles and considering how and when to retire.

In this report, we continue to focus on the need to assure adequate income in retirement by addressing two critical decision points: (1) when to withdraw from the workforce and (2) when to begin receiving Social Security benefits. Because of longer life spans, retirement is becoming increasingly expensive for individuals and families to fund. As our nation ages, and each worker must support a larger number of retirees, the cost of Social Security will increase. Working longer can help address both of these issues.

The Board is keenly aware that the decision to retire or withdraw from the workforce is not always voluntary, and that encouraging longer careers will not be practical for some portion of the population. Many older Americans are unable to work by virtue of their own health, or because of the need to take care of members of their family, or because of the unavailability of adequate economic opportunities. In addition, the willingness of older Americans to continue working depends heavily on the demand for their services and the state of the national economy.

Nothing in this report, therefore, should be seen to contradict our strong belief that our nation's systems of providing economic security to those who cannot work should be maintained and improved. Nonetheless, we believe there are substantial benefits to individuals and to the nation of extending the working lives of most Americans. The benefits may well be most important for those who have had a lifetime of low earnings, who may not have ever participated in a private pension plan, or who for whatever reason are most in need of the "floor of protection" that Social Security was designed to provide.

This report is organized as follows:

Section I describes our concerns about the current workforce and retirement conditions: retirement is becoming more expensive as we live longer, and low savings, escalating health care costs, the rising Social Security retirement age and early claiming all make it harder to achieve economic security in retirement.

Section II describes the advantages to both individuals and the nation of having a larger share of older workers remaining in the workforce.

Section III explains that while older workers are already beginning to delay retirement, there remain policies and practices that make working longer more difficult.

Section IV discusses a series of principles to guide policy makers in devising ways to improve the ability of those who are able to extend their working lives to do so.

I. Rising cost of retirement

Retirement in the United States is becoming more expensive. Our Social Security system costs will rise as the proportion of the population in retirement rises. As life expectancies continue to increase, individuals will need to accumulate more resources during their working years to fund a longer-than-expected retirement. Low savings rates, insufficient pension balances, rapidly escalating health care costs, and the increase in the Social Security full retirement age to 67 will present challenges for workers and families who wish to maintain a decent standard of living as they withdraw from the workforce.

Our Social Security system is becoming more expensive

The long-term financial shortfalls in the Social Security system are well known. This Board has written several reports detailing the causes of the impending and inevitable rise in the cost of benefits relative to payroll tax revenue. We have urged policy makers to address these long-term health of Social Security sooner rather than later.

The cause of the rising cost of Social Security is straightforward: our population is steadily growing older. Birth rates fell in the 1960s and have since remained at about those levels. Americans are, on average, living longer lives than at any time in our history. In 1960, only 9 percent of the population was age 65 or over. By 2000, that had risen to 12 percent. By 2030, 19 percent of the population will be age 65 or over. As the very large baby boom generation enters its retirement years, the share of the population that is no longer in the workforce rises dramatically.

Because the contributions of today's workers are used to pay the Social Security benefits of today's retirees, as the proportion of the population receiving benefits increases, the cost of the system increases.[1] **Figure 1** illustrates that over the next 25 years our society will shift from having about one retiree for every three workers to having about one retiree for every two workers. As a result, the cost of our Social Security system will increase by 25 percent.

Most discussions of how we choose to face these rising costs of Social Security lead to the inevitable conclusion that additional revenues will have to be raised, and/or benefits will have to be reduced. The additional costs will be borne by workers or retirees. In this context, the importance of encouraging a larger fraction of the population to stay in the workforce at older ages is clear. Increasing the share of the population that is working and reducing the share that is drawing benefits will reduce the burden of rising costs.

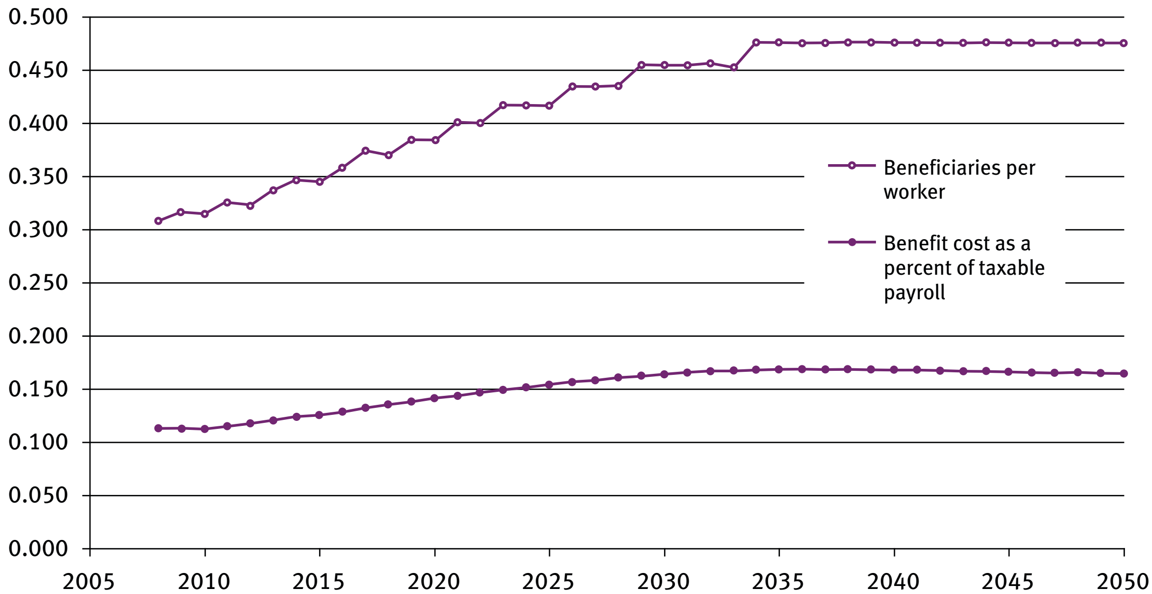
Preparing for retirement is becoming more expensive for individuals

The forces that are making the nation's Social Security system more expensive are also making it more expensive for families and individuals to accumulate adequate resources to fund their own retirements.

First, individual life spans are getting longer. According to the Social Security Administration, a 65-year-old man was expected to live to age 78 in 1960, age 82 in 2000 and is projected to live to 85 in 2040. A 65-year-old woman was expected to live

[1] The cost of a pay as you go pension system can be expressed as [number of beneficiaries/ numbers of workers] x [average benefits/ average covered wages]. Under the U.S. Social Security system benefit formula, benefits increase with increases in the average wage, so the second term is rather stable. The major source of increased cost, therefore, is the significant increase in the ratio of retired beneficiaries to workers.

Figure 1: Projected ratio of Social Security beneficiaries to workers: 2008-2050



Source: The 2008 Annual Report of the Board of Trustees of the Federal Old-age and Survivors Insurance and Federal Disability Insurance Trust Funds.

even longer: to 82 in 1960, 85 in 2000 and is projected to live to 87 by the year 2040. There will also be a substantial increase in those reaching very advanced ages. About one in four of today's 65 year olds can be expected to live to age 90, and one in ten will live to age 95. While there is some disagreement among demographic experts, many believe the extension of life spans will occur even faster.[2]

Second, even as Americans have been living longer, they have been retiring earlier. The median age of withdrawing from the workforce has fallen about five years for men and seven years for women over the past 50 years. While recent evidence suggests a slowing of that decline and notable increases in employment rates among older cohorts, those who do retire at age 62 will, on average, spend approximately one-third of their adult lifetime in retirement.

The combined effect of these two trends – living longer and retiring earlier – is that the average American worker today can expect to spend 50 percent more time in retirement than a similar worker did just 50 years ago. **Table 1** illustrates these trends. In 1955 a typical working man would leave the workforce at 67 and expect to live in retirement about 12 more years until age 79.[3] Today, a typical working man retires at age 62 and lives about 19 more years in retirement, to age 81.

Clearly, to maintain a similar standard of living, saving for a longer and longer period of retirement requires setting aside a greater share of income during one's working life. Solely as a function of living longer, attaining retirement security becomes more expensive.[4] The costs are increasing no matter what the format of retirement savings or retirement plan. This is true for workers who fund retirement

[2] Social Security Administration projections of life expectancy in 2040 assume reductions in the mortality rate of about 0.6 percent per year, yielding improvements in life expectancy of about 0.6 years per decade. The 2007 Technical Panel Report on Assumptions and Methods examined the range of expert projections and suggested improvements on the order of one year per decade are more reasonable. For evidence that eradication of smoking could dramatically improve life expectancy see Haidong Wang and Samuel Preston, *Forecasting U.S. Mortality Using Cohort Smoking Histories*. For a more pessimistic view of future improvements in life spans see Bruce Carnes and Jay Olshansky, "A Realist View of Aging, Mortality and Future Longevity," *Population and Development Review*, 33(2), 2007. David M. Cutler, Edward L. Glaeser, Allison B. Rosen "Is the U.S. Population Behaving Healthier?" NBER Working Paper, March 2007, suggests rising levels of obesity could contribute to mortality enough to offset gains from declining smoking rates.

[3] In this discussion we refer to the "typical worker" as someone at the *median* age of retirement. Half of workers can expect to spend more time in retirement and half less.

[4] We assume for the sake of simplicity that the returns on savings and investments will remain similar to the long run historical averages.

Table 1: Median age at withdrawal from the workforce and expected years of life remaining in retirement by gender for selected periods

	Median age at Retirement		Remaining life expectancy as of the median age of retirement	
Period	**Men**	**Women**	**Men**	**Women**
1950-1955	66.9	67.6	12.0	13.6
1965-1970	64.2	64.2	13.5	16.7
1980-1985	62.8	62.7	16.0	20.5
1985-1990	62.6	62.8	16.3	20.3
1990-1995	62.4	62.3	17.2	21.3
1995-2000	62.0	61.4	18.0	22.0
2000-2005	61.6	60.5	19.0	23.1

Source: Murray Gendell, "Older Workers: Increasing Their Labor Force Participation and Hours of Work," *Monthly Labor Review*, January 2008.

out of private savings, a 401(k) or an Individual Retirement Account (IRA). The costs are also borne by employers who make contributions to their workers' 401(k) account or fund defined benefit pension plans.

Below is a simplified example of how longer life spans and earlier retirements lead to pension costs that are about 50 to 100 percent more than 50 years ago.

Illustrating the higher cost of longer retirement:

This numerical exercise demonstrates that the cost of saving for retirement increases as the lifetime devoted to working gets shorter and the time spent in retirement, in part due to a longer life span, gets longer.

Consider two workers, Jacob and Emily whose only source of income in retirement is their own savings. Jacob exhibits patterns of work and retirement that would have been common in the early 1960s. He starts work at age 21 and retires on his 65th birthday. He will spend the remaining 13 years of his life (through age 77) in retirement. Emily exhibits patterns of work that are common in the first decade of the 21st century. She also starts work at age 21 but retires on her 62nd birthday, and then spends the remaining 21 years of her life (through age 82) in retirement.

We assume both start work earning $30,000 a year and get 4 percent annual pay raises. They earn a 6.5 percent annual return on their savings throughout their lifetime and their goal is to save enough so that they could withdraw in each year of retirement an amount that would replace 40 percent of their final year's salary.[5]

Jacob would have to set aside 4.78 percent of annual pay throughout his career to meet his retirement income goal. Emily, who has a shorter working life and longer retirement, needs to set aside 7.01 percent of annual pay throughout her career to meet her retirement income goal. Emily must save 47 percent more than Jacob, as a percentage of her pay, to meet the same retirement income goal.

For comparison consider a third worker, Hannah, who is similar to Emily in regard to her retirement income goals, retirement age and life expectancy, but because she spent more time in school, only begins working at age 25. All assumptions for the purposes of the calculation are the same as described above except her starting salary is higher, $35,000, in recognition of her higher education level. Hannah, who has an even shorter working life than Emily but just as long a period of retirement, must set aside 8.23 percent of her annual pay to meet her retirement income goal. That amounts to 72 percent more than Jacob needs to save, and 17 percent more than Emily, as a percentage of annual pay.

It should be noted that this example is for illustrative purposes only and it not meant to be prescriptive. In the real world, the future is subject to considerable uncertainty in the expected ability to work a full lifetime without interruption, in the ability to achieve a desired rate of return on investments, and in the ability to estimate one's own longevity. A real world worker, who was concerned about outliving his or her assets, might consider saving an even higher percentage of annual pay, or he or she may be able to purchase at retirement an insurance product with a guaranteed stream of income, known as an annuity. Social Security benefits are such a valuable part of retirement security because it provides insurance against the inability to work, against outliving one's assets in retirement, and also against the increased cost of living through inflation.

[5] For simplicity, we assume savings are deposited at the end of the year and are compounded annually.

Additional factors make accumulating adequate retirement savings more challenging

Even as the need to set aside income rises, there are other forces that will, for some, put economic security in retirement at risk. Many workers have not been accumulating enough savings in their personal or retirement accounts. Rapidly rising health care costs will consume a growing share of earnings and retirement incomes. Experts project these costs will continue to rise faster than national income. Social Security benefits, the major source of income in retirement for most workers, is on track to replace a smaller share of pre-retirement income as the retirement age rises to 67. Many individuals choose to receive the earliest yet smallest Social Security benefit available to them. Below we examine each one of these forces separately.

Savings

As **Figure 2** illustrates, the household savings rate in the U.S. has fallen dramatically from a peak in the early 1980s to record lows today.[6] Along with declines in the financial savings rate, households have accumulated more debt, leading to an even greater decline in the total net savings rate. Although the household wealth of the baby boom is greater than previous generations, at least until the recent massive declines in the values of homes and the stock market, it is unclear whether those levels of wealth will be sufficient to support the retirement income expectations of future retirees. Recent survey data from the Employee Benefit Research Institute indicate that only about 70 percent of Americans report having saved money for retirement and a slightly smaller share are currently saving money.[7]

Retirement plan balances

About half of all full time workers participate in a retirement plan, and over the past 25 years there has been a dramatic shift from defined benefit (DB) plans to defined contribution (DC) plans. In 1980, 62 percent of those with any retirement plan had only a defined benefit pension, while 16 percent had only a defined contribution plans, and 22 percent had both. By 2005, that share had largely reversed – 63 percent are enrolled only in a DC plan and 10 percent only have a traditional defined benefit plan, while 27 percent have both.[8]

For many households, in addition to their home, the dominant form of saving for retirement is their 401(k) plan. While these tax deferred plans can be a very effective vehicle to accumulate adequate assets for retirement, current workers do not universally participate, and many contribute a lower percentage of their pre-tax earnings than they are allowed. In fact, some do not even contribute up to the amount that is matched by their employer.[9] As recent events in the financial markets have shown, the value of assets in retirement plans can decline quite dramatically, which can affect the timing of and adequacy of income in retirement.[10] Average balances in 401(k)s in 2006 were $121,000, but the median balance was just slightly more than half that at $66,650. As would be expected, average accumulated 401(k) assets increase with age, salary and job tenure with the same employer.[11]

Although average or median accumulations are important in explaining how private retirement savings plans are being used by workers, they mask the extent to which some people are using these vehicles effectively and others are not. Earlier we noted that a worker needed to save 8.2 percent of pay starting at age 25 if he or she wanted to retire by age 62 with accumulated savings that would replace 40 percent of pre-retirement salary during the retirement period. Under the assumptions we used there, such a worker would accumulate about three times pay in his or her retirement savings account by age 50 and about five times pay by age 62.

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[6] For a discussion of how different data sources affect measurement of the private savings rate, see: Rudolph Penner, "Measuring Personal Saving: A Tale of American Profligacy," Urban Institute Brief Series, May 1, 2008.

[7] Ruth Helman, Jack VanDerhei, and Craig Copeland, "The 2008 Retirement Confidence Survey: Americans Much More Worried about Retirement, Health Costs a Big Concern," Employee Benefit Research Institute Issue Brief, April 2008.

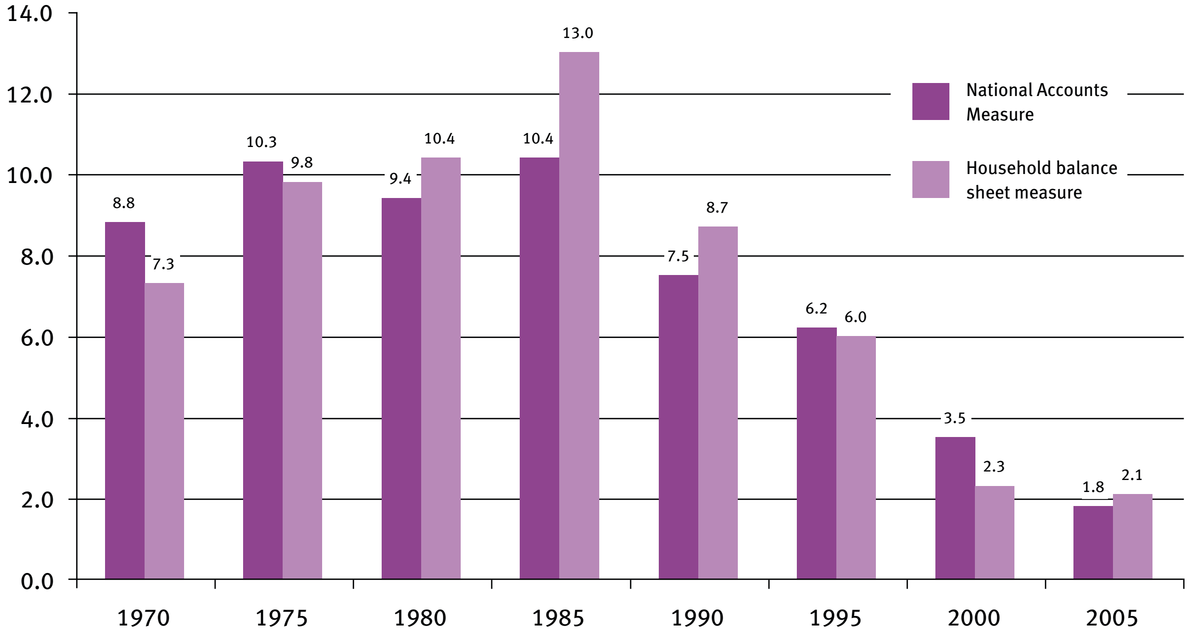
[8] Employee Benefit Research Institute, based on U.S. Department of Labor, Form 5500 Summary Report. See http://www.ebri.org/publications/benfaq/index.cfm?fa=retfaqt14a

[9] James Choi, John Beshears, David Laibson, and Brigitte C. Madrian, "The Importance of Default Options for Retirement Savings Outcomes: Evidence from the United States." In Stephen J. Kay and Tapen Sinha, eds., *Lessons from Pension Reform in the Americas*, pp. 59-87. Oxford: Oxford University Press, 2008.

[10] We note that this is also true for balances in employer sponsored defined benefit plans. In the case of the private DB plans, the financial risk is borne by the employer, because by law they must meet their benefit payment obligations. In the DC plan, as in private savings, the financial risks are borne by individuals who are responsible for their level of contribution and choice of investment portfolio.

[11] Employee Benefit Research Institute Issue Brief: "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006," August 2007.

Figure 2: Household savings rate 1970-2005 (percent of disposable income; 5-year trailing moving average)



Source: McKinsey Global Institute, *Talkin' 'bout My Generation: The Economic Impact of Aging U.S. Baby Boomers*, June 2008.

A recent study of actual savings behavior in a sample of private 401(k) plans found that few workers were saving at rates sufficient to reach these goals. The analysis in this study focused on workers between the ages of 50 and 64 who had been with their current employer for at least 20 years and were covered by a 401(k) plan. Among plan participants in the plans studied, 8.8 percent had no funds at all and 26.2 percent, including those with zero balances, had less than one-half their current annual pay. A total of 39.6 percent of participants had accumulated less than their annual pay. Only 36.5 percent had more than two times pay in their 401(k) accounts and only 9 percent had accumulated four times current pay.[12]

Health care costs

The cost of health care is rising rapidly for workers and retirees, even more rapidly than pension costs, and constitutes a major challenge to economic security in retirement. Estimates of the annual growth of health care spending over the next ten years is about 7 percent, considerably faster than the currently projected growth of national income (including inflation), of about 5 percent, according to the *2008 Annual Report of the Board of Trustees of the Federal Old-age and Survivors Insurance and Federal Disability Insurance Trust Funds*.

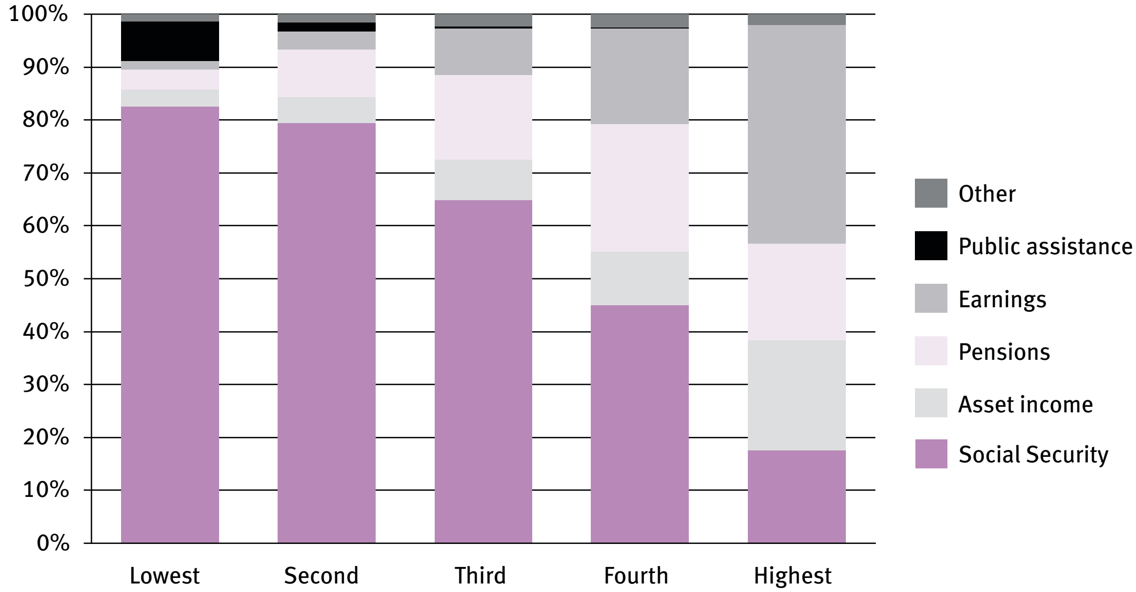
For workers who are already not setting aside more of their income to fund their retirement, rapidly rising out-of-pocket health care costs and/or insurance premiums will put even more of a strain on their budgets. Some will undoubtedly save less to be able to afford the current cost of their health care. For those with employer sponsored health insurance, the average employee contribution to premiums for family coverage has increased from $1,542 in 1999 to $3,354 in 2008, an increase of 117 percent.[13] Those who are self-insured or without coverage at all face a similar cost increase from a higher base.

For retirees, health care expenditures are also expected to consume an ever increasing share of their incomes. In 2007, the average annual Medicare out-of-pocket expense for an individual amounted to $3,800 ($316 a month) with expected growth of 5-6 percent per year. Spending can vary significantly

[12] Sylvester J. Schieber, *Pension Aspirations and Realizations: A Perspective on Yesterday, Today and Tomorrow* (Washington, D.C.: Watson Wyatt Worldwide, 2007).

[13] Kaiser Family Foundation and Health Research and Education Trust, "Employer Health Benefits," *2008 Annual Survey*.

Figure 3: Sources of income for people age 65 and over, by income quintile, 2006



Source: U.S. Census Bureau, "Current Population Survey," Annual Social and Economic Supplement, 2007.

around this average, for example, based on a person's health habits or chronic illnesses. A recent study estimates that a couple retiring in 2010 would need to have an account worth about $206,000 to provide a stream of income over their lifetime that would cover their out-of-pocket health care costs.[14] Another way to appreciate the impact of rising health care cost in retirement is to compare the growth of the average Social Security benefit and average out-of-pocket costs for Medicare Parts B & D. In 2010, total out-of-pocket costs will comprise about one-quarter of the average Social Security benefit. By 2080 that will rise to about two-thirds.[15]

The costs are rising at the same time that fewer private employers are offering retiree health benefits, and even when these benefits are still offered, retirees face rising premiums, higher out-of-pocket expenses and more stringent eligibility requirements. Among employers with over 500 employees, the share offering health insurance to early retirees has fallen from 46 percent to 29 percent from 1993 to 2006, while the share offering them to Medicare-eligible retirees has fallen from 40 percent to 19 percent over that same period. Most active workers will never be eligible for employer-provided health insurance in retirement. [16]

An unanticipated episode of serious illness can create significant financial liabilities. And even the need to prepare for anticipated costs, for example for long-term care at advanced ages, tend to be underestimated. As Americans live to advanced ages, the need to plan for long-term care will grow as well.

Social Security

Social Security covers over 90 percent of all paid employment, and it has become the single most important source of income for most retirees. **Figure 3** illustrates that payments from Social Security, consistent with the program's progressive design, are most important for those with the lowest incomes. Social Security benefits are also more important for those at advanced ages as the share of income from other sources declines. Currently, benefits provide

[14] Another way to put this is a couple would have to buy an annuity worth $206,000 today to fund the average out-of-pocket costs over the rest of their lives. See Alicia H. Munnell, Mauricio Soto, Anthony Webb, Francesca Golub-Sass, and Dan Muldoon, "Health Care Costs Drive Up the National Retirement Index," Center for Retirement Research at Boston College Issue in Brief, February 2008.

[15] *2008 Annual Report of The Boards Of Trustees of The Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, 2008.

[16] Provision of retiree health care benefits is declining for private employers, but remaining stable under public retirement systems such as for state and federal workers. See also Paul Fronstin and Stephen Blakely, "Is The Tipping Point in Health Benefits Near?" *Wall Street Journal*; and Paul Fronstin, "The Future of Employment-Based Health Benefits: Have Employers Reached a Tipping Point?" Employee Benefit Research Institute Issue Brief, December 2007.

about 50 percent of income for the average beneficiary ages 62-64, about 62 percent for those ages 70-74, and 74 percent for those over age 80. More than four in ten beneficiaries over age 80 rely on Social Security for 90 percent of their total income, and just over one in four rely on it for 100 percent of their income.[17]

The amount of pre-retirement income Social Security benefits replace is falling. Under changes already enacted into law in 1983, the full retirement age gradually rose from 65 to 66, and starting in 2017 will incrementally rise to age 67 by 2022. Under the Social Security system, the raising of the full retirement age results in a relatively smaller benefit at any given age. A decade ago a person could retire at 62 and receive 80 percent of the benefit they would have been eligible for at full retirement age. In another decade, a person retiring at 62 will receive 70 percent of the benefit they would have been eligible for at full retirement age.

Workers covered by Social Security are eligible to receive benefits as early as age 62. Social Security reduces monthly benefits for those who claim earlier than the full retirement age and raises them for those who delay claiming after the full retirement age up until age 70. From the perspective of the Social Security program's finances, paying lower benefits for a longer period of time or higher benefits for a shorter period of time results in the same program costs. For any individual, the choice has a direct effect on the level of their inflation-protected Social Security benefits for the rest of their lives, and potentially the lifetimes of their spouses or survivors.

As **Figure 4** illustrates, more people take their benefits at the earliest age they are eligible, 62, than at any other age. By choosing the smallest monthly benefit available to them for the rest of their lives, they are effectively reducing the value of the insurance Social Security provides against inadequate income later in life. To choose to begin receiving benefits at an age where one is still capable of working is to choose to receive less income protection at ages when other sources of income may not be available.

Are Americans adequately prepared for retirement?

Various researchers using various methods have tried to address the question of whether the future generations will have adequate income in retirement. There is a wide range of conclusions, but most acknowledge that some share of the population – from as little as one out of six to as many as two out of three – is unlikely to have sufficient financial assets or streams of pension income sufficient to achieve a standard of living comparable to when they were working.[18] Because of recent large and widespread declines in the value of financial assets, the percentage of those nearing retirement that fall into this category today has likely increased.

The risk of inadequate retirement income appears to be greater for those with lower lifetime earnings, for younger cohorts and single persons.[19] Because of their different patterns of employment and earnings, women tend to accumulate fewer assets for retirement than men. They also live, on average, several years longer. Single women are far more at risk than married women because married women, in addition to their own accumulated assets, can inherit their spouse's wealth.

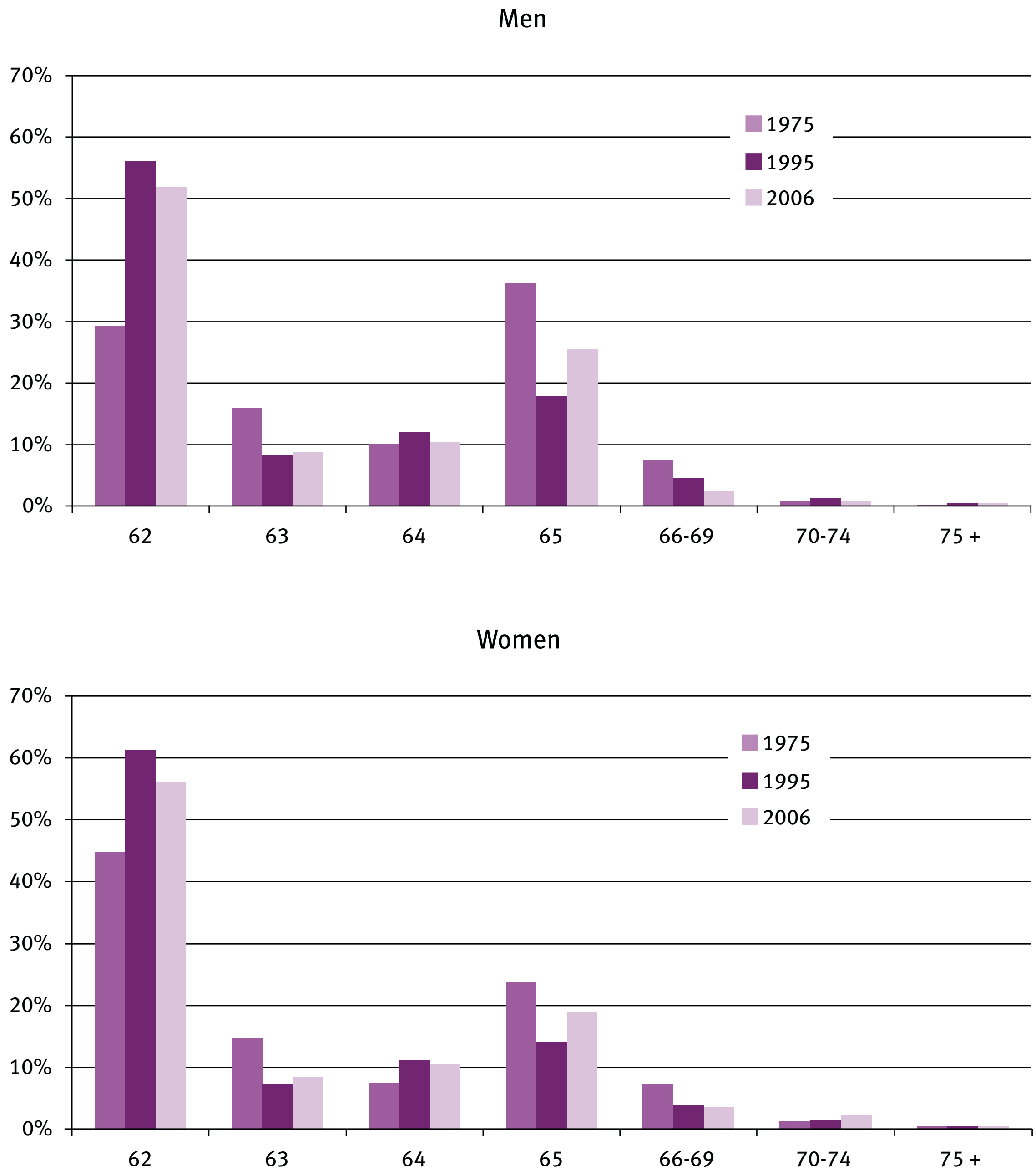
We do not attempt to resolve in this report which of these studies is most accurate in this report, but instead emphasize that the range of estimates is cause for concern and justifies considering ways to help individuals extend their working lives. As the next section will show, working longer can still improve retirement security whether individuals have made sufficient preparations or not.

[17] Social Security Administration, *Income of the Population 55 or Older*, 2004, released July 2008.

[18] At low end of estimates, less than 20 percent of near retirees had less wealth than their "optimal targets." See: John Karl Scholz, Ananth Seshadri and Surachai Khitatrakun, "Are Americans Saving "Optimally" for Retirement?" *Journal of Political Economy*, 2006. A McKinsey Global Institute report in 2008, reported that two-thirds of baby boomers will not be able to replace 80 percent of their pre-retirement earnings. Estimates by scholars from Boston College in the New National Retirement Risk Index are somewhere in the middle at about 40 percent.

[19] Center for Retirement Research at Boston College, "Retirements at Risk: A New National Retirement Risk Index," June 2006; and Alicia H. Munnell, Anthony Webb, and Francesca Golub-Sass, "Is There Really A Retirement Savings Crisis? An NRRI Analysis," Center for Retirement Research at Boston College, August 2007.

Figure 4: Age distribution of those claiming retirement benefits in 1975, 1995, 2006



Source: Social Security Administration, *Annual Statistical Supplement to the Social Security Bulletin*, 2007.

II. Managing the cost of retirement

As funding retirement becomes more costly there are many responses we can take as a nation and as individuals. Finding ways to boost saving, improve retirement plan participation and coverage, reduce health care costs, and put Social Security on a sustainable footing would all be positive developments.

We believe that one effective strategy workers can use to manage the cost of retirement is to remain in the workforce longer. By working longer, one extends the period their retirement savings can accumulate and reduces the period of payout. We also believe many individuals and couples can better insure themselves against lower standards of living at older ages by delaying when they choose to take Social Security benefits. Waiting to take Social Security benefits can produce a higher stream of income for the rest of one's life.

There are also wider benefits to society. If a higher share of the population is working relative to those who are retired, the cost of our Social Security system will be lower, government budgets should improve and labor force growth will improve. We discuss each of these advantages below.

Impact on individual well-being

Put simply, working longer and claiming retirement benefits later accomplishes three things: (1) it increases lifetime resources, (2) it shortens the period that must be financed from savings, and (3) it provides more guaranteed lifetime income.

Working longer

Continuing to work provides a household with more lifetime earnings than if they stop working. In addition to wages, those workers who have health or disability insurance through their employer, or who receive employer contributions to their retirement plan, will continue to benefit from these forms of compensation, or could receive larger pension benefits.

Continuing to work lengthens the time to accumulate retirement income as additional contributions to savings can be made out of current earnings. Any accumulated balances will have additional time to grow.[20] Even those who have sufficient savings to continue at their current standard of living can benefit from accumulating larger savings balances as protection against unforeseen or emergency expenses. If health care costs continue to rise unabated, it may take more income to afford non-health care consumption.

Continuing to work shortens the draw down period from one's accumulated assets.[21] As was discussed in the previous section, funding a shorter retirement is less costly.

Delaying Social Security benefits

Independent of the decision to stop working, individuals can improve their economic security in retirement by waiting longer to claim their Social Security benefits.

Delaying claiming of Social Security will increase a person's monthly benefit amount for life. For example, as **Figure 5** illustrates, a person who is eligible today to receive a monthly benefit of $1,000 at age 66, would receive only $750 per month (or 25 percent less) if benefits are claimed at the earliest possible age of 62. Waiting until age 70 would increase monthly benefits by 32 percent to $1,320.[22]

[20] On average over time the expectation is that investment returns will continue to grow the longer they remain invested. Saving should be a part of preparation for economic security as early in life as possible.

[21] Individuals who convert their savings, or pension balances into annuities, can insure themselves, for a price, against outliving their assets.

[22] These reduced or increased benefits apply for the rest of the

Figure 5: Monthly benefits increase with starting age

assuming eligibility for a benefit of $1,000 at the current full retirement age of 66

Source: Social Security Administration, 2008.

Claiming Social Security benefits at either the full retirement age or later is valuable because the monthly sum provides a stream of inflation-protected income over the rest of one's lifetime. Thus delaying claiming provides a higher level of insurance against insufficient income at advanced ages. Although no one has perfect foresight about how long they or their spouse may live, many people underestimate the amount of time they spend in retirement and overestimate how long their assets will last. A 62-year-old man in the year 2008 is expected to live another 19 years, while a 62-year-old woman can be expected to live for 22 years. It should be noted that half of the people will live longer than their "expected" life span.

While strategies for maximizing Social Security income over one's lifetime can be complicated and depend on many circumstances, new research suggests that it can be advantageous for most individuals and couples to delay claiming Social Security benefits.[23] Couples, in particular should consider how much the future benefits of the longer living spouse can be increased if the higher earning spouse delays the age at which they begin to receive their benefits.[24]

Estimates of the financial impact of working longer

Those who continue to work and who claim benefits later can reduce the cost of saving for retirement, or can enjoy a higher standard of living when they stop working. Simulations conducted by researchers at the Urban Institute calculate that working an additional year and delaying Social Security by one year increases retirement income in each year of retirement by almost 10 percent. Working an additional five years can boost annual retirement income by more than 50 percent. The effect is greatest for those with lower lifetime income. Those in the bottom 20 percent of lifetime income could increase their annual retirement income by almost

claimant's life, although benefits are increased each year to keep up with inflation. If additional earnings are high enough to replace earlier earnings in the benefit calculation, additional work will increase benefits even further.

[23] James I. Mahaney and Peter C. Carlson, "Rethinking Social Security Claiming in a 401(k) World" in John Ameriks and Olivia S. Mitchell, Eds., *Recalibrating Retirement Spending and Saving*, September 2008. Alicia H. Munnell and Mauricio Soto, "Why Do Women Claim Social Security Benefits So Early?" Issue Brief, Center for Retirement Research at Boston College, October 2005. Steven A. Sass, Wei Sun, and Anthony Webb, "When Should Married Men Claim Social Security Benefits?" Issue Brief, Center for Retirement Research at Boston College, March 2008.

[24] The odds of one or both members of a 65-year-old married couple living past age 90 are close to 60 percent.

16 percent after one year, and almost 100 percent if they were able to work five more years.[25]

Estimates by the Congressional Budget Office (CBO) arrive at a similar conclusion. They calculated what a typical married couple with the median household income would need to accumulate in savings to produce a stream of income that would replace 80 percent of their pre-retirement after-tax income.[26] If they both retire at 62 they would need to accumulate about $510,000 in assets in addition to Social Security. If they retire at age 66, they would need only $298,000 in accumulated assets and receive almost 40 percent more in annual Social Security payments. The CBO calculations show similar gains across all income groups and for single persons as well as couples.

Individual circumstances may be different, but across a wide range of scenarios, working longer and delaying the start of Social Security benefits can increase the stream of income available in retirement, and reduce the amount of assets that need to be accumulated by a given age. Those who accumulate more assets through pensions, personal saving or 401(k)s will be better off in retirement than those who accumulate less. But these results also suggest that working longer can help those who failed to save adequately for retirement.

There may well be additional non-financial benefits for individuals who continue to work at older ages. According to some researchers, work promotes social integration and social support, contributes significantly to a sense of personal identity, and may in fact promote physical health.[27]

Impact on Social Security finances

Increasing labor force participation by older workers has a modest but positive affect on the long-term finances of Social Security.

We begin by noting that there is no effect on Social Security finances if everyone claims their Social Security benefits one year later, but does not also work an additional year. The increase in monthly benefits from delaying an extra year is roughly offset by the shorter payout period.

By contrast, if everyone delays benefits and works an additional year, according to simulations done by the Urban Institute, Social Security's long term financial deficit in 2045 would be 2 percent smaller. If everyone worked five more years, the deficit in 2045 would be reduced by about 30 percent.[28] In general, having more people working increases the total payroll tax receipts but does little to increase benefit costs. The net effect depends in part on who works longer and at what wages, but under most scenarios overall financial impact would be positive.

Impact on federal budget/general revenues

In a similar fashion increasing the employment rates of older Americans would increase federal and state income tax revenue in addition to payroll taxes.

According to the Urban Institute projections, if everyone worked an additional year, by 2045, federal and state taxes (including income and payroll taxes) would be higher by an amount that is equivalent to 28 percent of the projected Social Security Trust Fund deficit. If everyone worked five additional years, the additional total tax revenues in 2045 would be 59 percent larger than the projected Social Security deficit in that year.[29]

As the U.S. population ages the cost of public programs for retirees will claim a significantly larger share of federal budget resources. The growth in those programs, particularly Medicare and Medicaid, could make other government programs more difficult to fund. The greater the contributions to general revenues from additional labor force participation by older workers, however, the less necessary it will be to increase taxes, cut programs or increase borrowing to deal with the demands on the budget.

Impact on labor force growth and GDP

Because of demographic trends discussed earlier, the working age population in the U.S. is expected to grow more slowly than in the past. According to the Social Security Trustees annual labor force growth is declining from about 2.5 percent during the late

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[25] Barbara Butrica, Karen E. Smith, C. Eugene Steuerle, "Working for a Good Retirement," Urban Institute Retirement Project Discussion Paper, May 23, 2006.

[26] Congressional Budget Office Economic and Budget Issue Brief, "Retirement and the Need for Saving," May 12, 2004.

[27] See Richard Johnson, Urban Institute.

[28] Barbara Butrica, Karen E. Smith, C. Eugene Steuerle, "Working for a Good Retirement," Urban Institute Retirement Project Discussion Paper, May 23, 2006.

[29] We mention the increase in total taxes to measure the scale of revenue increase. Only payroll taxes are used to pay Social Security benefits.

1960s and 1970s, to just over 1 percent during the current decade, to less than 0.5 percent by 2020.

Slower growth in the labor force unless accompanied by faster growth in labor productivity will lead to slower economic growth. The Social Security Trustees project that annual real economic growth between 2020 and 2080 will average only 2.1 percent a year, compared to 3.1 percent growth average over the past 40 years.

The major factors influencing future labor force growth are demographic and behavioral. Positive workforce growth depends on larger numbers of workers entering the workforce in any given period than the number withdrawing for retirement or other purposes. The pool of new workers entering the workforce is largely determined by a combination of young people reaching working age and new potential workers coming to the country from elsewhere around the world.

The size of future cohorts of workers will depend both on birth rates and the net rate of immigration. If birth rates were to rise, it would still take about two decades to affect the size of the workforce because added newborns today would not be entering the workforce until they reached their late teens or early twenties. Increased immigration of working age adults has a more immediate impact on labor force growth. While more immigration would help to ameliorate some of the issues being raised here, the current political environment does not suggest that this a solution that policymakers will likely pursue as they consider the policy options open to them.

Another way to stimulate workforce growth rates is to change behavior patterns among the population groups able to work. Over much of the last half of the 20th century, for example, the labor force in the United States grew considerably because an increasing percentage of women of working age chose to work outside the home. At the same time, the growth in the U.S. labor force was dampened because many workers chose to retire at earlier ages than prior generations. Labor force participation rates of women are such today that there is little potential to increase aggregate labor force levels by encouraging more prime-age women into the labor market. But there are many able-bodied people in their 50s and 60s, who have been retiring but could instead choose to extend their working lives and have a significant effect on the size of the labor force going forward.

III: Influences on a changing retirement landscape

The concept of leaving the labor force simply because one reaches an arbitrary age is a fairly recent phenomenon. Historically, it was quite common for people to remain in the labor force as long as they were physically able to do so because they simply did not have enough income to retire. Even as recently as the late 1940s nearly half of the men aged 65 and over were still in the labor force compared to only about one in five today. For most of the 20th century, economic and policy developments that have improved retirement income security have allowed workers to devote a larger portion of their lives to an increasingly attractive period of retirement. The steady growth of household income during one's working years allowed for the accumulation of personal savings, while public and private pensions systems arose to provide secure streams of income during retirement.[30]

The expectation that workers could retire with economic security sometime in their early 60s has become an important accomplishment of national policy as well as a measure of national prosperity. But economic and demographic forces continue to evolve with important implications for how and when workers can and should expect to retire. This section describes how today's workers are adapting to this changing landscape: how some workers are already making the decision to continue working longer and how policies and practices affect the ability of workers to improve their economic security in retirement.

Changing patterns in labor force participation

For most of the 20th century, men have retired at earlier and earlier ages as they have become increasingly able to afford leaving the workforce. However, over the past 15 years this trend seems to have leveled off and even reversed for men over age 60 (see **Figure 6**). In the 30 years from 1955 to 1985 the labor force participation rates of men aged 60-64 fell 33 percent before leveling off. Since 1994 the rate has increased about 12 percent. Those most likely to work at older ages are more educated, in better health, and have higher incomes.

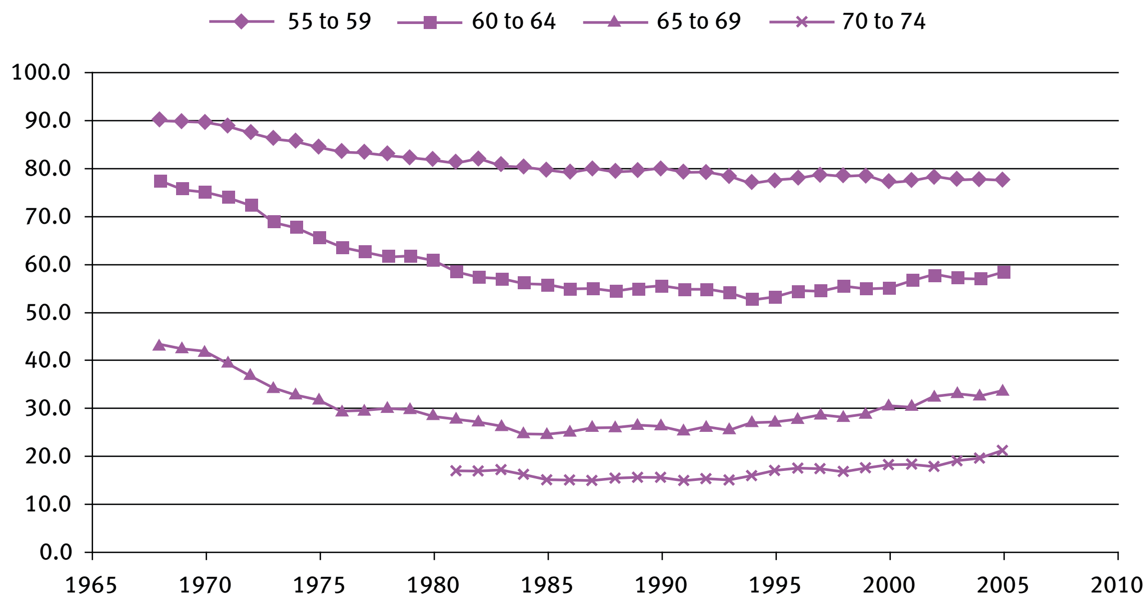
The working lives of women have followed a different pattern than the working lives of men, as **Figure 7** illustrates. Over the past 40 years, more and more women at all ages have entered the labor force and for the most part are staying to older ages. The labor force participation of women aged 60 to 64 increased 15 percent from 1955 to 1985; between 1985 and 1993 the rate continued to rise but a slower rate of about 10 percent. The rate began to accelerate in 1994, rising to over 25 percent. Women are more likely to stay attached to work for longer periods than in previous generations where women tended not to work outside of the household or moved in and out of work. In addition, women over age 55 are currently much more likely than men of a similar age to work part-time.

It seems quite likely that this trend toward working longer may continue. In a recent survey by the McKinsey Global Institute about 40 percent of baby boomers said they expected to work longer during what they might have previously thought of as their retirement years. Of those about one-third said they would do so to stay engaged in the world of work, because they enjoyed the job, the interactions with others, or the chance to make positive change. About two-thirds expected to work longer for financial reasons, to maintain benefits, maintain their lifestyle, or to meet expenses.[31] The desire

[30] See Dora Costa, *The Evolution of Retirement: An American Economic History 1880-1990*, University of Chicago Press, 1998.

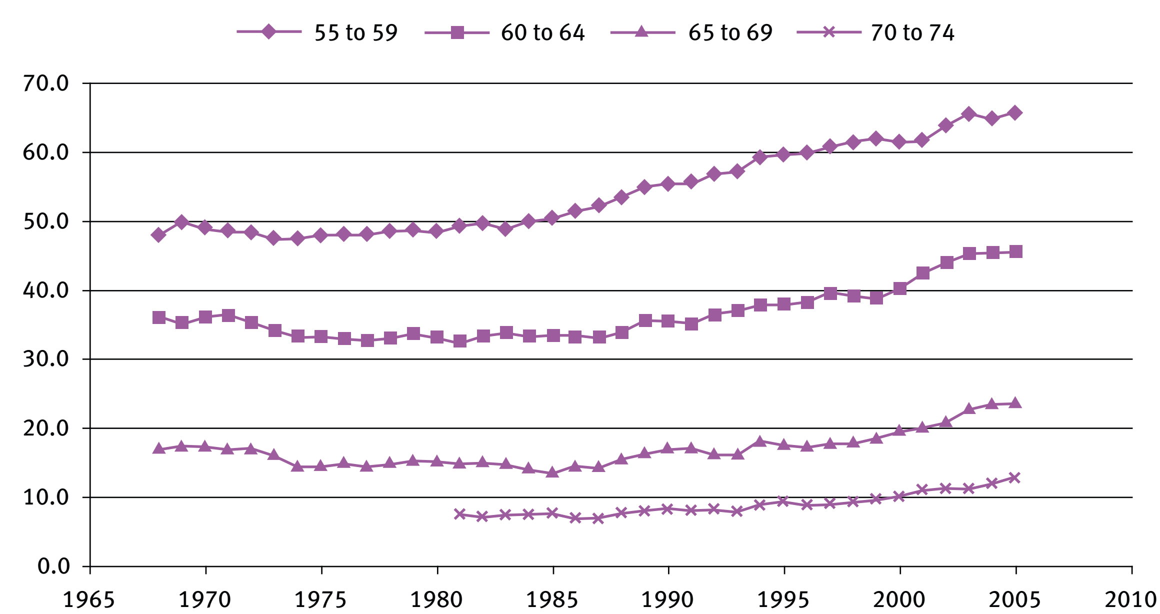
[31] McKinsey Global Institute, *Talkin' 'Bout My Generation: The Economic Impact of Aging U.S. Baby Boomers*, June, 2008.

Figure 6: Labor force participation rates of men by age group: 1968-2005



Source: Bureau of Labor Statistics.

Figure 7: Labor force participation rates of women by age group: 1968-2005



Source: Bureau of Labor Statistics.

to maintain employer-based benefits, in particular health insurance, is a major decision factor for some workers when they are weighing their retirement options.[32]

Possible reasons for the increase in labor force participation

The reasons for the more recent patterns of increased labor force participation by older workers are varied. For some, this is a response to the rising cost of retirement and changing structure of incentives in public and private retirement plans. Social Security rule changes have raised the full retirement age and increased the rewards that come with working and claiming benefits after reaching the full retirement age. Private employer-sponsored retirement plans have undergone a dramatic shift away from defined benefit plans and toward defined contribution plans that are generally portable, accrue gradually and do not have a target retirement age. And for some workers, the need to maintain health insurance coverage that is tied to employment has led to decisions to delay retirement.[33]

Recent trends in claiming Social Security benefits

As workers delay their withdrawal from the workforce, they are also choosing to delay slightly the age at which they take their Social Security benefits.[34] In 1995, over 45 percent of men aged 62 to 64 were receiving Social Security retirement benefits. By 2006 only about 38 percent of men aged 62 to 64 were receiving retirement benefits.[35] The age at which both men and women have been claiming retirement benefits has been rising for many of the same reasons that may explain why they are remaining in the workforce longer. Recent changes in Social Security rules, namely the increase in the full retirement age[36] and the elimination of the retirement earnings test after the full retirement age,[37] have had some effect on benefit claiming. The tendency to elect benefits at the earliest age is diminishing. [38] The incremental addition to benefits for delaying claiming benefits beyond the full retirement age until age 70, known as "delayed retirement credits" has grown more generous providing an additional incentive to postpone taking benefits.

Wide-range of "retirement" ages may be sending mixed signals

For each individual the decision about how and when to retire is a very complex issue that requires an assessment of available retirement income and assets, personal and family health status, as well as such factors as job satisfaction, and availability of desirable work opportunities. There are many areas of federal law and regulations that affect mature workers, and navigating the myriad retirement options and rules can be quite challenging for many potential retirees. The nation's well-intentioned patchwork of laws and regulations designed to meet the needs of workers in a wide range of circumstances sends a variety of often confusing signals about when is the "right" time to retire. Depending on which type of program or plan is involved, the "retirement age" can range from as early as age 55 to as late as age 70.

Workers with sufficient covered employment are first eligible for reduced Social Security benefits at age 62. The "full" retirement age for Social Security has traditionally been 65, but has increased from

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32 Gaobo Pang, Mark Warshawsky, and Ben Weitzer, *The Retirement Decision: Current Influences on the Timing of Retirement among Older Workers*, Watson Wyatt, February 2008.

33 Friedberg, Leora, "The Recent Trend Towards Later Retirement," Center for Retirement Research at Boston College Issue Brief, March 2007; and Gaobo Pang, Mark Warshawsky, and Ben Weitzer, *The Retirement Decision: Current Influences on the Timing of Retirement among Older Workers*, Watson Wyatt, February 2008.

34 Jae Song and Joyce Manchester, "Have People Delayed Claiming Retirement Benefits? Responses to Changes in Social Security Rules," *Social Security Bulletin*, Vol. 67, No. 2, 2007; also Muldoon and Kopcke, "Are People Claiming Social Security Benefits Later?" Center for Retirement Research at Boston College Issue Brief, June 2008.

35 Congressional Research Service Report for Congress, *Older Workers: Employment and Retirement Trends*, September 15, 2008.

36 The 1983 Amendments to the Social Security Act implemented a schedule of gradual increases in the full retirement age. For individuals born in 1937 or earlier, the full retirement age – or the age at which full retirement benefits are payable, remains at age 65. But for people born in 1938 and later, the full retirement age increases by 2-month intervals until it reaches age 67 for those born in 1960 or later. The amendments did not change the age for claiming reduced benefits at the earliest age of 62.

37 The *Senior Citizen's Freedom to Work Act of 2000* eliminated the earnings test for individuals aged 65-69 who had elected to receive retirement benefits. Prior to this change, beneficiaries who had reached full retirement age and worked and earned above a certain threshold had their monthly benefits either reduced or withheld in its entirety.

38 Jae Song and Joyce Manchester, "Have People Delayed Claiming Retirement Benefits? Responses to Changes in Social Security Rules," *Social Security Bulletin*, Vol. 67, No. 2, 2007.

age 65 to 66 at the beginning of this decade, and in the next decade will gradually increase to age 67 for workers born in 1960 and later. The maximum benefit is available to those who claim at age 70.[39] Medicare eligibility begins at age 65, and it has not changed since its inception, despite increases in longevity and increases to Social Security's full retirement age.

Tax and pension regulations define a wide range of retirement ages. IRS rules require that the "normal retirement age" in a defined benefit tax-qualified pension plan not exceed age 65.[40] Normal retirement ages vary across firms but participants in defined benefit pension plans may be eligible for benefits at earlier ages provided they leave employment of the plan sponsor.[41] State and local retirement plans frequently base eligibility on years of service rather than on age and, as a result, it is not unusual for employees to qualify for an unreduced benefit before age 60. Tax rules permit withdrawals without penalty from both defined benefit and defined contribution plans as well as IRAs as early as age 59 ½. If distributions are provided as an annuity, there is no tax penalty even at earlier ages. IRS rules also require minimum payouts by age 70 ½.

What effect this range of retirement eligibility ages has on the decisions of workers to retire is unclear. But some researchers believe that the age at which public and private rules define the earliest eligibility for retirement does play an important role in setting social expectations about what is normal or acceptable.[42]

[39] Incremental benefit increases, known as delayed retirement credits, were first made available in 1971 to those working until 1970, briefly raised to age 72 then returned to 70 in 1983.

[40] Or the 5th anniversary of plan entry if a participant enters within five years of the normal retirement age. GAO, *Retirement Decisions: Federal Policies Offer Mixed Signals About When to Retire*, July 2007.

[41] In about two-thirds of private employer plans the normal retirement age is set at 65; in about one-sixth of them, the age is 62, and in most of the remainder, age is set at 60 or 55. Bureau of Labor Statistics (BLS) National Compensation Survey: Employee Benefits in Private Industry in the United States, 2002–2003. Washington, DC: U.S. Department of Labor, 2005.

[42] See Eugene Steuerle presentation to Social Security Advisory Board Forum ,"Policies to Help Extend the Working Life of Older Americans," in Appendix I of this report. The volume *Social Security Programs and Retirement Around the World*, Volume I, Univers ity of Chicago Press, 1999 edited by Jonathan Gruber and David Wise shows that across countries, the age workers withdraw from the workforce responds to the official retirement age in national pension systems.

Understanding the messages about claiming retirement benefits

When to claim Social Security retirement benefits is a very important decision in the lives of most workers and should be made within the context of an individual's unique circumstances. The Social Security Administration has developed a variety of public information tools designed to present the salient issues relevant to that decision. Many of these communication vehicles, however, unintentionally send unclear messages about the relationship between the claiming of benefits and withdrawing from the workforce – between taking "retirement benefits" and actually "retiring" from work. The agency inadvertently frames the benefit election choice in a manner that treats these very different and separate decisions as if they were inextricably linked, and as a result may send mixed signals to potential retirees about how continuing to work affects their benefits. The Advisory Board recognizes and is encouraged by recent efforts of the Social Security Administration to review its public information vehicles and clarify its procedures and communication strategies.

Pension plans and the effect on retirement decisions

Pension plans, whether public or private, form the foundation for retirement security in the United States for many workers. Their relative generosity has been instrumental in assuring retirement security for several generations. However, we have entered an era where the expected income from pensions is, for many private sector workers, shrinking or disappearing and this realization may result in changing expectations relative to the length of time they spend in active employment. Moreover, the features of these plans can influence an employee's decision to stop working, as well as the employer's decision to encourage older workers to stay at work.

Recent changes in federal law have created a more favorable employment environment that could aid in the retention of older workers. While workers still need to understand their particular pension plan rules and how those rules may affect their retirement timing, the option of working longer and continuing to contribute to a pension plan deserves consideration. As we have discussed earlier, working and contributing for a longer period can have a positive financial impact on an individual's overall income stream in retirement.

Defined benefit plans

Traditional defined benefit (DB) pension plans provide retirement benefits based on a specific period of participation and contribution. While the age of eligibility may vary, each plan carries a definition of normal retirement age; and the benefits typically accrue based on salary and/or years of service. For each year spent working after reaching the plan's retirement age, in some plans, the employee often foregoes a year of pension benefits without adding appreciably to the amount of the pension.

Social Security provides an extremely valuable income stream that protects retirees against outliving their assets and the increasing cost-of-living. For most retirees it is the single largest source of income throughout retirement. Somewhat different than traditional defined benefit plans, Social Security benefits accrue rapidly with years of work up to some point, and then the rate of accrual diminishes up to 35 years of coverage. After that, it drops to almost nothing for many workers.

Specifically, Social Security benefits are calculated based on the average of a worker's highest 35 years of earnings.[43] To qualify for benefits, workers must have at least ten years of covered earnings in order to qualify for benefits. For a worker with only ten years of covered earnings at retirement, the earnings are still averaged over a 35-year period. The redistributive feature of Social Security means a typical worker earns about half of his or her lifetime benefits in the first ten years of covered employment. Beyond that, each year of earnings for an individual with fewer than 35 years of earnings increases lifetime average earnings but at a declining rate, since it replaces a zero in the 35-year average. As average lifetime earnings increase, the Social Security benefit continues to grow. But an individual who has already worked 35 years will not increase their average lifetime earnings or benefit much, if at all, with a 36th year of covered earnings but will continue to pay the payroll tax.[44] There is little additional financial payoff from Social Security in continuing to work after 35 years.

Defined contribution plans

In contrast to defined benefit plans, benefits in a defined contribution (DC) plan, such as a 401(k), continue to increase with age because the pension balance can increase as long employees continue to make contributions and assets are allowed to earn interest or grow. Employer contributions are typically based on a percentage of salary matched to the employee's contribution up to some limit. Defined contribution plans require participants to assume the risks associated with the value of their investments, and must develop a strategy to avoid outliving their accumulated assets on retirement. Research shows that in part due to the absence of age-related incentives, workers in defined benefit plans retire as much as two years earlier, on average, than those in defined contribution plans.[45] In addition, research suggests that those who experience significant income loss in their DC plans, such as during the major downturn in the stock market after 2000, are less likely to retire.[46]

Cash balance plans

Cash balance plans are defined benefit plans that promise a benefit based on an account balance that grows annually, typically by a stated percentage of the employee's compensation and a rate of interest accumulation. Balances continue to accumulate with the number of years in the plan, like a defined contribution plan, thereby providing an incentive to work longer. Unlike a DC plan, the investment

[43] The benefit calculation starts with the full record of a worker's lifetime annual earnings. Past earnings up to age 60 are indexed by the "Average Wage Index" to reflect increases in the standard of living over time. Earning after age 60 are inflated by growth in the Consumer Price Index. The top 35 years of indexed earnings, including if necessary years with 0 earnings, are chosen divided by 420 (12x35) to get the worker's Average Indexed Monthly Earnings (AIME). A progressive formula is applied to the AIME to yield the Primary Insurance Amount which is then decreased or increased based on the age of the claimant relative to their full retirement age. A person who continues to work while receiving benefits will have their benefits recalculated annually if additional earnings are large enough to replace one of the 35 highest.

[44] It is possible that the 36th year of working will replace an earlier, lower amount of earnings in the average, but earnings after age 60 are not indexed and are likely to make only a small difference.

[45] Leora Friedberg and Anthony Webb, "Retirement and the Evolution of Pension Structure," *Journal of Human Resources*, XL(2):281-308, 2005.

[46] Pang, Warshawsky and Weitzer, *The Retirement Decision: Current Influences on the Timing of Retirement among Older Workers*, Watson Wyatt, February 2008.

risk is borne solely by the employer, and the employer is required to offer the benefits in the form of a life annuity.

Recent changes in pension and tax law

Recent changes in pension and tax law have improved the ability of employers to provide incentives to employees to extend their working lives. Pension statutes and regulations traditionally have prohibited individuals from working for the same employer while receiving retirement benefits, unless they have reached the plan's normal retirement age.[47] *The Pension Protection Act of 2006*, however, now permits employers to pay in-service benefits to employees age 62 and over. In addition, this law provides for the automatic enrollment of employees in a firm's 401(k) plan. This shift in emphasis from optional enrollment to an automatic one will likely result in significantly higher plan participation rates. As workers become more involved in their retirement plans and begin to appreciate the ease of this savings method, they are more likely to strive to maximize their balances, which for some will mean working longer.[48]

Policies may adversely affect options

Medicare

Health care, as an employment and a retirement security issue, is one of the most pressing concerns for all Americans. For mature workers under age 65 who are covered under an employer-based health care, the decision to stay at work is often motivated by this access to health insurance. However, the link to the work place may become less important for some once they reach 65, the age at which Medicare coverage begins.

Nearly all retirees have Medicare as their primary source of health insurance.[49] Medicare pays for acute care and requires that beneficiaries pay part of the cost of their health care. This leaves about half of the expenses to be covered by other sources. As a result, most Medicare enrollees have some type of supplemental insurance, either through an employer's retiree health plan or private insurance that covers the gap in coverage; in the case of low-income workers, Medicaid may cover the additional expenses. In any case, Medicare is the primary payer and the supplemental insurance covers the shortfall.

However, for individuals aged 65 and over who are working and are covered by an employer–sponsored health insurance plan, Medicare becomes a "secondary payer." Thus, any health insurance claims that arise must be paid first by the employer's plan; then any remaining uncovered services may be paid for by Medicare, provided the services are covered under Medicare.[50] The purpose of the policy is to allow Medicare to target its limited resources at those who do not have another source of coverage.

Some researchers are concerned that the policy may have the unintended effect of making it harder to keep older workers in the workforce.[51] There are two alternative ways of looking at the issue. From an employer's perspective, older employees appear to be relatively more expensive because costs which might have been borne primarily by Medicare are now the employer's responsibility.[52] From an employee's perspective, potential take-home pay is less because they must take a significant share of their compensation in the form of health benefits, even though they are entitled to primary coverage through Medicare. Whether understood as an increased cost to employers or a decrease in an employee's take-home pay, the secondary payer policy may lessen employer demand for older workers, or employees may become less inclined to continue working much past 65.

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[47] Federal law allows workers to access defined contribution benefits at age 59½ regardless of employment status. Employers may only allow plan participants who have left the firm to withdraw benefits. (Johnson, Mermin, Steuerle, 2006, p.28.)

[48] It is also possible that employees who participate in their 401(k) plan from an early age, who contribute sufficiently and who earn returns on par with historical averages, may find they have accumulated enough savings to retire at earlier ages without needing to work longer.

[49] At age 65, enrollment in premium-free Medicare Part A (hospital insurance) and Part B (physician and medical services), which has a premium, is automatic; however, there is an "opt-out" provision for Part B. Under certain conditions, postponing enrollment in Part B can increase the monthly premium by 10 percent.

[50] By law employers must provide the same coverage to their older and younger employees and they cannot require older workers to contribute more to their own health plans than younger workers. They cannot provide only Medigap coverage, and they cannot provide cash in lieu of health insurance benefits to those over 65.

[51] Gopi Shah Goda, John B. Shoven, Sita Nataraj Slavov, "A Tax on Work for the Elderly: Medicare as a Secondary Payer," NBER Working Paper No. 13383, September 2007 estimates the implicit tax rate faced by workers age 65 and over who are eligible for Medicare and who have employer sponsored health insurance.

[52] Employers are prohibited from requiring older employees to contribute more to their own health plan than younger workers. In addition, age-discrimination rules limit the ability of employers to reduce salaries based solely on age. See Richard W. Johnson, Gordon Mermin, C. Eugene Steuerle, "Work Impediments at Older Ages," Urban Institute Retirement Project Discussion Paper, May 2006.

Retirement: does it have to be "all-or-nothing"?

As workers begin to approach their later years and think about retirement, many choose to stop working entirely. But for others, a transition phase from full time work into something less, but still short of complete withdrawal from the labor force, has tremendous appeal. Phased retirement, often defined as continuing to work for the same employer while gradually reducing the hours of work, presents a unique opportunity for employees and employers. As the nation faces the retirement wave of the baby boomers it is critical for employers to manage this exodus of knowledge and expertise; facilitating an employee's ability to retire in a more staged fashion is one option.

A variety of approaches to phased retirement such as job sharing, reduced work schedules, and rehiring retired employees on a part-time basis, can be used under the current pension laws. However, the extent to which current laws and policies discourage phased retirement arrangements, or render them not financially feasible, may encourage some to retire earlier than they would prefer. The structure of some traditional defined benefit plans could make phased retirement financially untenable if working at reduced hours affects an employee's benefit calculation. If, for example, pension benefits are based on a worker's final salary, moving to part-time status at the end of a career could result in significantly lower benefits. Furthermore, current tax rules and the *Employee Retirement Income Security Act* (ERISA) requirements that make it difficult for employers to establish equitable phased retirement plans present a potential barrier to change.[53]

Health and opportunity shape older workers' decisions

The long trend during the past century toward earlier retirement has been, in many respects, the very positive result of higher incomes during the working phase of life and the increasing attractiveness of leisure opportunities.[54] Some older individuals are financially prepared for retirement and will be able to sustain their lifestyle through the many years ahead. For some mature workers the decision to work longer is not merely a financial decision; working beyond the earliest point of retirement eligibility may have no appeal, even if it means improving their standard of living in retirement. The more powerful influence on the decision to withdraw from work may be one's own health status or that of family members, or it may be their assessment of the availability or attractiveness of alternative employment.

Health

Americans are living longer and are healthier than ever before. For most, these two factors can have a positive influence on whether they choose to work longer. Yet, there are individuals who may wish to continue working but are unable to for health reasons. For those in poor health, applying for Social Security disability benefits or electing early retirement benefits may be the appropriate or only choice.

About one in four workers age 51 to 55 develops serious health problems by age 62 that limit their ability to work.[55] Although the incidence of Social Security disability is projected to remain stable or fall slightly in the population as a whole,[56] the incidence of disability rises rapidly after age 50. In 2006, for example, the incidence of Social Security disability awards for men aged 50-54 was .89 percent, and for men aged 60-64 the rate was just over 1.7 percent. Current estimates are that 15-20 percent of those in their early 60s will not physically be able to work longer, at least not in jobs they are qualified for and that are available to them.[57] The population of those too unhealthy or disabled to work is concentrated among those who have held physically demanding jobs and those whose health has interfered with their work careers throughout their lives. These latter groups, including those who receive Social Security disability benefits, are also less likely to have been able to save adequately for their retirement.

53 Richard W. Johnson, Gordon Mermin, C. Eugene Steuerle, "Work Impediments at Older Ages," Urban Institute Retirement Project Discussion Paper, May 2006.

54 Dora Costa, *The Evolution of Retirement: An American Economic History 1880-1990*, University of Chicago Press, 1998.

55 Richard W. Johnson, Gordon Mermin, Dan Murphy, "The Impact of Late-Career Health and Employment Shocks on Social Security and Other Wealth," Urban Institute Discussion Paper Series, December 2007.

56 *2008 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, 2008.

57 See for example, John A. Turner, "Promoting Work: Implications of Raising Social Security's Early Retirement Age," Center for Retirement Research at Boston College, Issue in Brief, August 2007.

Job opportunities

The desire and the ability to work at older ages are often muted by the lack of available opportunities. One in five workers age 51 to 55 is laid off from their job by age 62.[58] Although older workers are no more likely to be laid off than their younger counterparts, they may have significantly more difficulty finding new jobs if necessary. The ability of older workers to remain employed or to find a job may also be more dependent on local labor market conditions than for younger, more mobile workers.[59] Older workers may also be less willing to re-locate to find work. In the nation's rural, frontier and tribal communities, there may be few jobs available for anyone.

Some older workers may find that their skills have become obsolete or do not match those needed by employers. Older workers may not be willing or able to make additional investments in their own education or training since the return on that investment may be uncertain or last only briefly. It is not clear that there are adequate or effective training opportunities available for older workers.

The decision to look for a job or invest in acquiring new skills might also be affected by pessimistic perceptions about the willingness of employers to hire older workers. Awareness of laws forbidding age discrimination in hiring may mitigate that perception. Older workers may also be more sensitive to the conditions of work and the willingness of employers to accommodate flexible work arrangements. They may be unwilling to work if they cannot work part-time, or if their pay is significantly less, or if a job is too physically demanding.

Employer's demand for older workers

If continuing to work is to be an effective antidote to less secure retirements for older Americans, then employers will have to be willing to employ older workers. The attitudes of employers toward their current employees who wish to extend their careers, and toward older job applicants looking for a new job or coming back to work after a period of retirement can be a significant boon or a significant barrier to older workers. From an objective standpoint one would expect firms to hire workers regardless of age if it makes economic sense.

Older workers are often more expensive. Those with longer job tenure or seniority or with greater experience tend to have higher wages or salaries. Fringe benefits for older employees also tend to be more costly.[60] Because health insurance claim costs are higher for older workers on average, employers with a greater share of older workers may face higher premiums.[61] The cost of hiring older workers under traditional defined benefits plans can be higher than for younger new employees.[62] The net costs of training tend to be higher for older workers relative to younger workers, because there is less time for the employer to recover the costs of the investment.

The important questions are: do older workers have characteristics that make them valuable to employers despite their higher costs, and do employers accurately perceive their value. Older workers may, in fact, be more productive than their younger counterparts; many employers report that this is in fact their belief.[63] Older workers may have firm–specific knowledge or experience that is hard to replace. Survey data suggests that older workers are perceived as being more loyal, more reliable, more experienced and as having a stronger work ethic than younger workers.[64]

Age discrimination

The Age Discrimination in Employment Act (ADEA) prohibits age based discrimination in hiring, firing, layoffs, compensation and working conditions for workers age 40 and over in firms with over 20 em-

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[58] Richard W. Johnson, Gordon B.T. Mermin, and Dan Murphy, "The Impact of Late-Career Health and Employment Shocks on Social Security and Other Wealth," Urban Institute Discussion Paper Series, December 2007.

[59] Leora Friedberg, Michael Owyang, and Anthony Webb, "Identifying Local Differences in Retirement Patterns," Center for Retirement Research at Boston College Working Paper, December 2008.

[60] Richard W. Johnson, Gordon Mermin, C. Eugene Steuerle, "Work Impediments at Older Ages," Urban Institute Retirement Project Discussion Paper, May 2006.

[61] Under law, employers cannot require older employees to contribute more to their own health plan than younger workers do. As health care cost continue to escalate faster than growth of the economy or inflation these costs may become more and more salient to employers.

[62] In a typical traditional DB plan new employees near the plan's retirement age will qualify for pension benefits that represent a significantly higher share of their wages than a much younger new employee. Federal law prohibits employers from requiring more than seven years of service to qualify for full benefits and more than 80 percent of DB plans require 5 years. We note, however, that increased vesting periods in DB plans may promote longevity in the workplace in ways DC plans do not.

[63] Munnell, Sass, and Soto, *Employer Attitudes Toward Older Workers: Survey Results*, 2006.

[64] *Ibid*.

ployees. Similarly, age discrimination laws are vigorously enforced in the states, and legal action to address discrimination typically is brought first at the state level.

By some accounts, age discrimination is less prevalent today than in the past, although some studies report complaints that some employers treat older workers less fairly than younger workers, and that they are more likely to be laid off.[65] In fiscal year 2006, 14,000 claims were filed with the Equal Employment Opportunity Commission under ADEA. Research on the effects of the ADEA suggests the law has prevented companies from unfairly dismissing older workers. There is some concern, however, that companies may have been inhibited from hiring older workers in the first place for fear of making themselves more vulnerable to future suits. In fact, proving discrimination in hiring may be more difficult than doing so in the case of termination.

[65] Scott Reynolds, Neil Ridley and Carl Van Horn, "A Work-filled Retirement: Workers' Changing Views on Employment and Leisure," *Worktrends* 8.1, 2005. http://www.heldrich.rutgers.edu/uploadedFiles/Publications/WT16.pdf

IV. Guiding principles for future policy considerations

The decision to retire, clearly a life changing event, can be a difficult one to make no matter how well prepared an individual may be. Ideally, older Americans should be able to enjoy a level of retirement income that allows them to maintain an appropriate standard of living, and retire with "dignity after years of contribution to the economy."[66] Clearly, individual savings and investment strategies play a major role, as do employer pensions and Social Security retirement benefits. No one can predict the future; workers who intend to extend their working lives may find those plans interrupted by disability, deterioration of their own health or by that of a spouse or close family member or by the development of unexpected changes in the labor market. The challenge is assuring that the nation's laws and policies facilitate adequate retirement income, while not harming the income security of those who cannot work in their later years.

Adequate preparation for a secure retirement should begin early in life, thus the policies and practices that affect that preparation should be available throughout a worker's lifetime not just as they approach retirement age. Investments in financial as well as human capital – education, training, health maintenance – should allow workers to attain the flexibility when making choices about work and retirement.

The issues raised in this report require serious consideration by policy makers. To that end, the Board echoes the call in recent reports of the Government Accountability Office and of the Organization for Economic Cooperation and Development (OECD) for a comprehensive government-wide strategy for dealing with the implications of an aging population and an aging workforce and would urge policy makers to study the approaches that other countries are using to encourage longer working lives (see Appendix II).

As a Board we recommend that policy makers should address the issue of enabling longer working lives. Rather than prescribe specific policies, however, we suggest several principles that should guide consideration of any future reforms.

- A primary objective of encouraging workers to remain in the labor force longer is to help people secure an adequate income in retirement at a time when that goal is becoming more and more challenging. The nation's retirement security policies should support and reward additional years of work. Policy makers should look closely at removing barriers that stand in the way of a worker's choice to stay in the workforce longer, or an employer's desire to accommodate older workers.
- Policy approaches should be consistent and coordinated in order to minimize unintended consequences. Too often we have seen cases where a well-intentioned policy change has resulted in negative outcomes for some parts of the population. Specifically, policies to encourage later retirement need to be coordinated with policies that address workers with the most difficulty remaining at work whether because of a lack of opportunities, insufficient skills, or medical condition. In late 2006, the Board issued a major report, *A Disability System for the 21st Century*, that addresses the need to strengthen our system of providing economic security to those who cannot or can no longer work because of disability. We encourage policy makers to consider the ideas in that report as they address the continuum of circumstances over the life course affecting the ability of Americans to work.

[66] P.L., 89-73 *Older Americans Act of 1965*.

- Proposed policies should be designed using the sophisticated, rigorous and comprehensive modeling tools now available. Such tools should be used to simulate the likely effects of several policies at once and estimate their costs, including not just narrow programmatic measures, but broader budgetary and economic measures.
- Policies should be coordinated across a broad range of policy domains and contexts. At present there is no single federal agency responsible for coordinating such efforts. Moreover, legislative jurisdiction is spread across numerous Congressional committees, making it difficult to develop formal national policy goals for the desired level of labor force participation of older workers. The Federal Taskforce on the Aging of the American Workforce, coordinated by the Department of Labor's Employment and Training Administration was convened in 2006 to address this lack of coordination. Their policy recommendations, however, did not touch on major areas of policy including Social Security rules.
- Policies that change expectations about how long working careers should be or that change the balance of incentives between work and retirement should be fair. They should give workers sufficiently advanced notice that changing behavior is warranted, but also provide enough impetus for the kind of changes in behavior that will increase the economic security of workers and retirees alike. Any reform proposals must be transparent to the public and the implications of those proposals clearly understood. For example, mechanisms that adjust retirement ages or link pension returns to longevity provide policy makers with flexibility, but such changes may not be well understood by the public.
- Not all policies need to be targeted specifically at older workers. Older workers' needs are diverse and often coincide with the needs of younger workers, as well as people with disabilities. Policies that affect all workers such as universal design for more accessible work sites, more flexible work schedules, telecommuting, etc., can also have important benefits for older workers.

The nation's first major effort to deal with economic security in retirement, the Social Security Act of 1935, arose during a time of great economic hardship and uncertainty. Over time, as the nation's wealth grew, the system of social insurance that supports retirement security including Disability Insurance, Medicare, Medicaid, and SSI, as well as the employment-based private programs, and private savings have greatly improved the standards of living of those in retirement as well as provided an important level of security.

Almost 75 years after the founding of Social Security, our nation faces a different kind of challenge: longer life spans and relatively low birth rates mean our population will undergo an unprecedented degree of aging. This fundamental demographic shift in our population will challenge many of our assumptions about how we allocate income between workers and retirees, between the periods in our own lives when we are working and when we are retired. Devoting some additional share of our longer lifetimes to working is one way to meet this challenge. Employers and workers will have to adjust their expectations and make appropriate adjustments to the new realities of our evolving workforce. Policy makers can and should find ways to support that transition.

This Advisory Board has in the recent past addressed the need to look comprehensively at retirement security, to address the long-term financing shortfalls in Social Security, and to design a disability system for a new century. Even as policy makers turn their attention to these issues, we know that challenges to retirement security will continue. None is more pressing today than the rapidly rising cost of health care. Therefore, a crucial part of this process must be to educate and raise awareness about what is necessary to achieve economic security in retirement, not only among policy makers, professionals and researchers, but also among the general public.

Appendix 1

Summary of a Public Forum on Policies to Help Extend the Working Life of Older Americans Held Friday, January 18, 2008

In January of 2008, the Social Security Advisory Board and the University of Illinois Center for Business and Public Policy sponsored a public forum to facilitate discussion of public policies and workplace practices to help older workers extend their working lives. Nine experts from academia, think tanks, federal, state and international governmental organizations, and representatives of private employers and organized labor were invited as speakers to share their ideas and perspectives. Over 100 guests representing policy makers, federal government agencies, advocacy groups, and independent research organizations were in attendance and participated in the discussion.

This appendix summarizes the main points of each of the presenters, highlighting the nature of the issues involved and proposed policy options to address them. The ideas of the speakers do not reflect any endorsement by the Advisory Board. All the papers and presentation materials from that public forum are available to the public on the Advisory Board's website.

http://www.ssab.gov/WorkforceForumMaterials.htm

Forum Presenters:

Alicia Munnell, Drucker Professor of Management Sciences and Director of the Center for Retirement Research, Boston College

Professor Munnell observed that the retirement system is contracting and that a substantial portion of the population will not have as much income in retirement as they would want to maintain their standard of living. She suggested that "most people should work longer and claim their Social Security benefits later." She made three policy recommendations. First, the Social Security Administration should develop educational materials including an informational guide to help older workers and their families decide when to claim retirement benefits. Second, some administrative hurdles should be placed in front of those who are prone to apply for benefits at the earliest age, for example, by requiring spousal approval. Third, raise the earliest eligibility age for Social Security retirement benefits, currently age 62, in a way that would protect the most vulnerable.

Presentation slides: http://www.ssab.gov/documents/Slides-1MunnellPDF.pdf
Paper: http://www.ssab.gov/documents/Paper-1MunnellSSABForum1-18-08.pdf

John Shoven, Schwab Professor of Economics, Stanford University and Director of the Stanford Institute for Economic Policy Research

Professor Shoven explained that because Americans are living longer but still retiring relatively early, they must prepare for considerably longer retirements than in the past. He said that a 65-year-old man in the year 2000, a 70-year-old woman in the year 2000 and a 59-year-old man in 1970 all had about the same mortality risks. He noted that several aspects of current retirement policy impose relatively high implicit taxes on older workers and recommended several policy reforms to remove barriers for longer careers. First, increase to 40 from 35, the number of years of earnings used to calculate a workers retirement benefits. Second, calculate lifetime monthly earnings in the Social Security benefit using only the months a person actually works and then prorating the benefit amount. Third, eliminate payroll taxes for those who already have 40 years worth of earnings. He stated that these changes could be done in a way that keeps the average benefit constant. A final policy option he recommended would be to change Medicare from being the secondary payer to the primary payer for those workers eligible for Medicare, and also enrolled in an employer sponsored health plan.

Presentation slides: http://www.ssab.gov/documents/Slides-2ShovenPDF.pdf
Paper: http://www.ssab.gov/documents/Paper-2ShovenSSABForum1-18-08.pdf

Eugene Steuerle, Senior Fellow, Urban Institute (currently Vice-President Peter G. Peterson Foundation)

Dr. Steuerle made the observation that working more at older ages has broader implications than the impact on Social Security since it would increase national income, personal income, government tax revenues and as a result would reduces pressure on other workers to support all other government programs. He suggested several ways to encourage more work at older ages. First, change the "announcement effect" of Social Security that tells people they are "old" at age 62. Second, improve the transparency of Social Security benefits, by changing the confusing presentation of "actuarial adjustments," removing the "earnings test," and changing the presentation of replacement rates to adequately reflect relative income at older ages. Third, reducing implicit taxes on work at older ages due to the Social Security benefit formula, for example by eliminating payroll taxes after the retirement age, and removing the Medicare as secondary payer rule. Fourth, he described ways to "backload" benefits, by changing the lifetime benefit package so you receive more benefits at older ages and less at younger ages.

Presentation slides: http://www.ssab.gov/documents/Slides-3SteuerlePDF.pdf

John Martin, Director, Employment, Labor and Social Affairs, Organization for Economic Cooperation and Development

Mr. Martin made two recommendations. The first was to link pension benefits to life expectancy. He noted that 13 of the 16 OECD countries, as part of their pension reform packages, had introduced measures that would automatically link future pensions to changes in life expectancy. His second recommendation was to increase incentives for older unemployed workers to find jobs. He suggested that one way to do this was through introducing some form of wage insurance. For a displaced worker who accepts a job at a lower wage, as is often the case with re-employed older workers, wage insurance would provide an earnings supplement to make up part of the gap in earnings in the new job, compared to the previous job.

Paper: http://www.ssab.gov/documents/Paper-6MartinSSABForum1-18-08.pdf

Keith Brainard, Research Director, National Association of State Retirement Administrators

Mr. Brainard noted that more than 16 million workers—about 12 percent of the nation's workforce—are employed by state or local governments. Ninety-eight percent of those employees have access to an employer-sponsored retirement plan, and 90 percent of them have some form of traditional pension or defined benefit plan as their primary retirement benefit. He described several approaches that state legislatures have approved to allow retiring participants to return to work after they have met normal retirement eligibility, but without forfeiting their pension benefit. He noted, however, that some such programs do not clearly mesh with federal tax laws or age discrimination and employment act laws.

Paper: http://www.ssab.gov/documents/Paper-4BrainardSSABForum1-18-08.pdf

Thomas Dowd, Administrator, Office of Policy Development and Research, Employment and Training Administration, U.S. Department of Labor

Mr. Dowd described the work of a federal government interagency task force that the Department of Labor convened in 2006 to focus on the aging of the American workforce and the impacts of this demographic change on American society. The task force identified the following strategies: inventory the legal and regulatory barriers and disincentives to employment of older workers; coordinate research and demonstration agendas across federal agencies; develop a blueprint for awareness and outreach activities for older workers; facilitate self-employment for older workers; promote flexible work arrangements; make available to states tools and technical assistance to support the employment of older workers; and make available to older workers education resources on retirement and financial literacy.

Report of the Taskforce on the Aging of the American Workforce, February 2008:

http://www.doleta.gov/reports/FINAL_Taskforce_Report_2_27_08.pdf

Cynthia Donohoe, Vice President, Benefits, BAE Systems, Inc.

Ms. Donohoe discussed her company's initiatives to retain experienced workers through a phased retirement program. After describing the flexible work schedules and options that her company provides, she discussed some practices that can encourage employees to take advantage of those options. One was to provide information to employees to show both the financial gains and the health advantages associated with longer employment. Another was to help employees find the options to extend their careers that best fit their situations. She also mentioned the need to educate managers to make them aware of alternatives for their employees. Finally, she noted that employee engagement is important. Employees have to feel that what they are doing is important and valued.

Presentation slides: http://www.ssab.gov/documents/Slides-7DonohoePDF.pdf

Kevin Mahoney, Associate Director, Human Capital Leadership and Merit System Accountability Division, U.S. Office of Personnel Management

Mr. Mahoney described U.S. Office of Personnel Management's (OPM) efforts to deal with the coming retirement wave in the federal workforce. Strategies include advertising to help attract potential employees and restructuring of the hiring process to make it faster and more user-friendly. OPM has also suggested legislation, which has sponsors in both the House and the Senate, that would allow retirees to return to work on a part-time basis without adversely affecting their pension annuity.

Presentation slides: http://www.ssab.gov/documents/Slides-8MahoneyslidesPDF.pdf

Gerald Shea, Assistant to the President for Governmental Affairs, AFL-CIO

Mr. Shea stated that in order to keep people at work, they need good jobs, including decent wages, health care coverage, and some way to provide savings for retirement. He said that we cannot change the terms of the global economy, but we can help our country adjust to it through both private initiatives and public policy. One route that the AFL-CIO has taken toward developing good jobs is by creating, with employers and on its own, career-advancement programs. Such programs encourage workers to transition to a different skill set through higher education. He said that the educational system has not provided people with the reading and math skills they need for apprenticeship programs. As a result, there is a need to create a skill-building system that allows people to get into productive career paths toward good jobs.

Presentation slides: http://www.ssab.gov/documents/Slides-9SheaPDF.pdf

Appendix II:

What Some Other Countries are Doing

Many other advanced industrial countries in Europe and Asia are faced with the same economic challenges of rapidly aging populations and long trends toward earlier retirement. Compared to the United States, Japan and most countries in Europe are experiencing significantly more rapid population aging as their life expectancies' improve faster and birth rates have fallen further. While about one in five Americans are projected to be over 65 by 2050, about one in three will be over 65 in countries such as Japan, Korea, Italy and Spain. Labor force growth in many of the 30 developed countries that are part of the Organization for Economic Co-operation and Development (OECD) is expected to halt or even fall.[67] In most of these countries, the public pension programs are also more generous and incentives for early retirement are greater than in the United States. Effective retirement rates in about two-thirds of OECD countries, however, are lower than in the United States.

But just as the challenge of their aging workforces appear more severe than in the U.S., their efforts to reform public retirement systems and encourage workers to delay retirement and remain employed longer have been more aggressive.

Recent reforms of public pension systems in OECD countries have reduced incentives for early retirement:[68]

- Twelve counties have reduced pension generosity for workers retiring at a given age with a given contribution history.
- Six have enacted other measures that reduce overall replacement rates.
- Eleven have increased the rewards and penalties involved with timing of retirement. Seven countries are increasing pension eligibility ages for both men and women, and five others are increasing ages for women.

Thirteen OECD countries now automatically link future retirement benefits to changes in life expectancy.[69] Two-thirds of the major retirement-income reforms in OECD countries since 1990 have linked benefits and life expectancy in a variety of ways. In the late 1990s, five countries began to use defined contribution plans as a substitute for some or all of their public pensions; two others mandated contributions to private pensions in addition to their public plans. Three countries replaced their defined-benefit public plans with notional accounts. These notional accounts are financed on a pay-as-you-go basis, but they imitate defined-contribution plans by calculating benefits in a way similar to annuities, using life expectancy as a factor. Three countries have linked their defined-benefit public plans to life expectancy by introducing automatic reductions of benefit levels as life expectancy increases. And two countries have linked to either the pension eligibility age or the number of years of contributions needed to qualify for a full pension.[70]

OECD countries have also been reviewing other programs that may be alternative routes to leaving the workforce prematurely, such as long-term sickness and disability benefits and unemployment benefits, although changes in these programs have been more limited than those in pension programs. Canada and the Netherlands, for example, have re-

[67] The 30 OECD countries include 23 European countries, the United States, Canada and Mexico, Australia, New Zealand, Japan, South Korea.

[68] Organisation for Economic Co-Operation and Development, *Live Longer, Work Longer*, 2006, pp. 88-9; John Martin, "Some Suggestions for Reforms Based on OECD Countries' Experiences," p. 3.

[69] John Martin, *ibid*.

[70] *Ibid*., pp. 5-6.

duced the number of new disability beneficiaries between 50 and 64 years of age. And Australia and the Netherlands have increased job-search requirements for unemployed older workers.[71]

OECD countries have also recognized the need to change employer attitudes and practices. Most OECD countries have enacted age-discrimination legislation and some have also undertaken public information campaigns to improve employer attitudes toward older workers. The United Kingdom, for example, began its Age Positive information campaign in 1999 to promote the benefits of age diversity in the workplace. The Netherlands has employed a cooperative effort of government, employers, and labor unions to improve attitudes toward older workers.[72]

The expense of older workers' wages relative to their productivity may discourage employers from hiring or retaining them. OECD countries have taken a variety of approaches to this problem. Korea has encouraged the use of a "peak wage" system that would give greater employment security to older workers in exchange for downward flexibility in wages. Policies in some other countries have had a less direct effect. Moving from a system that sets wages based on seniority to one that uses individual performance, as has been done in Sweden's public sector, has the effect of increasing wage flexibility.[73] Several other countries have taken a more direct approach, offering wage subsidies or exemption from social insurance taxes for employers if they hire unemployed older workers.[74]

Some OECD countries have also taken measures to improve the employability of older workers by promoting training, providing employment assistance, and improving working conditions. In the late 1990s, Norway introduced a Competence Reform to meet growing demands for workplace skills. One of the target groups was older workers who did not have access to education when they were young. The effectiveness of training in returning unemployed workers to employment is difficult to evaluate, and there has been a range of outcomes of programs in various countries.[75]

Several OECD countries have been trying employment assistance programs targeted at older workers. The New Deal 50 Plus program in the United Kingdom, for example, provides participants with their own personal advisor at a job center to help with the job search and arrange for training to improve employability. In the Netherlands, specialized companies have been hired to provide workforce re-integration services to jobseekers over 50. Korea and Japan have established special offices to support older jobseekers. Canada, Australia, and the Czech Republic have also been experimenting with new approaches to provide employment services to older workers.[76]

Some countries are also undertaking programs to encourage longer working lives through meeting older workers' needs through rehabilitation, training, and improvements in health and safety. Germany, for example, initiated a campaign called "30, 40, 50 plus – Working healthily as you get older." Finland has a program to help employees better manage health conditions in order to maintain employability. In Denmark, a worker whose work capacity has become limited can hold a "flexjob," receiving full-time pay while working only part-time or at a reduced pace, and the employer receives a subsidy for the reduced production. A number of efforts have also been undertaken to ease the transition from full-time to part-time work. In 2004, the United Kingdom changed its regulations on occupational pensions to allow workers to access pension benefits while continuing to work for the same employer on a part-time basis.[77]

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71 OECD, pp. 96-7.
72 OECD, pp. 104-07.
73 In the United States, this policy would not likely pass muster of age discrimination laws as currently interpreted.
74 *Ibid*., pp. 111-12.
75 *Ibid*., 118-22.
76 *Ibid*., 123-30.
77 *Ibid*., 131-34.

Establishment of the Board

In 1994, when Congress passed Public Law 103-296 establishing the Social Security Administration as an independent agency, it also created an independent, bipartisan Advisory Board to advise the President, the Congress, and the Commissioner of Social Security on matters related to the Social Security and Supplemental Security Income programs. Under this legislation, appointments to the Board are made by the President, the Speaker of the House of Representatives, and the President pro tempore of the Senate.

Advisory Board members are appointed to staggered six year terms, made up as follows: three appointed by the President (no more than two from the same political party); and two each (no more than one from the same political party) by the Speaker of the House (in consultation with the Chairman and the Ranking Minority Member of the Committee on Ways and Means) and by the President pro tempore of the Senate (in consultation with the Chairman and Ranking Minority Member of the Committee on Finance). Presidential appointments are subject to Senate confirmation. The President designates one member of the Board to serve as Chairman for a four year term, coincident with the term of the President, or until the designation of a successor.

Sylvester J. Schieber, Chairman

Sylvester J. Schieber is a private consultant on retirement and health issues based in New Market, Maryland. He retired from Watson Wyatt Worldwide in September 2006 where he had served as Vice President/U.S. Director of Benefit Consulting and Director of Research and Information. From 1981 - 83, Dr. Schieber was the Director of Research at the Employee Benefit Research Institute. Earlier, he worked for the Social Security Administration as an economic analyst and as Deputy Director at the Office of Policy Analysis. Dr. Schieber is the author of numerous journal articles, policy analysis papers, and several books including: Retirement Income Opportunities in An Aging America: Coverage and Benefit Entitlement; Social Security: Perspectives on Preserving the System; and The Real Deal: The History and Future of Social Security. He served on the 1994 - 1996 Advisory Council on Social Security. He received his Ph.D. from the University of Notre Dame. First term of office: January 1998 to September 2003. Current term of office: October 2003 to September 2009. Appointed by the President in September 2006 to serve as Chairman of the Advisory Board from October 2006 to January 2009.

Dana K. Bilyeu

Dana K. Bilyeu is the Executive Officer of the Public Employees' Retirement System of Nevada. As the Executive Officer of the $21 billion pension trust she is responsible for all aspects of fund management including analysis of plan funding, investment oversight, operational and strategic planning, and fiduciary and governance issues. Mrs. Bilyeu is principally responsible for the relationship with the System's independent actuary and oversees the data reconciliation process for actuarial valuations of the System. In her capacity as the Executive Officer, Mrs. Bilyeu provides information and analysis to the Nevada Legislature in consideration of pension policy issues affecting state and local government. Prior to her appointment as the Executive Officer, Mrs. Bilyeu served for eight years as the System's Operations Officer, overseeing all aspects of benefit administration, including survivor, disability, and retirement benefit programs. Mrs. Bilyeu also was responsible for cost effectiveness measurement for all activities of the System. She was accountable for technology oversight as well as policy issues related to the public safety sector of public employment. Prior to her employment at the System, Mrs. Bilyeu was the System's legal counsel, representing the System in a variety of aspects from benefits litigation, contracts analysis, to Board governance. Mrs. Bilyeu is a member of the National Association of State Retirement Administrators, the National Council on Teacher Retirement, the National Conference of Public Employee Retirement Systems, and the National Association of Public Pension Attorneys. She also serves on the Public Employee Advisory Board for the International Foundation of Employee Benefit Plans. She received her Juris Doctor from California Western School of Law and her B.A. from the University of Arizona. Term of office: December 2006 to September 2010.

Jeffrey R. Brown

Jeffrey R. Brown is a professor in the Department of Finance at the University of Illinois at Urbana-Champaign. Prior to joining the Illinois faculty, Dr. Brown was an assistant professor of public policy at Harvard University's John F. Kennedy School of Government. During 2001-2002, he served as Senior Economist at the White House Council of Economic Advisers, where he focused primarily on Social Security, pension reform, and terrorism risk insurance. During 2001 he also served on the staff of the President's Commission to Strengthen Social Security. In January 2005, President Bush nominated Dr. Brown to become a member of the Social Security Advisory Board for a term ending September 2008. Professor Brown holds a Ph.D. in economics from the Massachusetts Institute of Technology, a Masters of Public Policy from Harvard University, and a B.A. from Miami University. He is a Research Associate of the National Bureau of Economic Research, a Research Fellow with the Employee Benefits Research Institute, and a Senior Fellow of the China Center for Insurance and Social Security Research. Professor Brown is a member of the American Economic Association, the American Risk and Insurance Association, the National Academy of Social Insurance, and the Risk Theory Society. Professor Brown has published extensively on public and private insurance markets, including publications in *The American Economic Review*, *The Journal of Political Economy*, *The Journal of Public Economics*, *The Journal of Monetary Economics*, *The Journal of Risk and Insurance*, *The National Tax Journal*, and numerous books. He is the recipient of the Lumina Award for Outstanding Research in Insurance and E-Commerce. Professor Brown is co-author of the book, *The Role of Annuities in Financing Retirement* (MIT Press), and is co-founder and co-editor of *The Journal of Pension Economics and Finance*, published by Cambridge University Press. He has served as a consultant / expert panel member for the Executive Office of the President of the U.S., the General Accounting Office, the U.S. Treasury, the World Bank, and several private firms. Prior to graduate school, he was a Brand Manager at the Procter & Gamble Company. Term of office: October 2006 to September 2008.

Dorcas R. Hardy

Dorcas R. Hardy is President of DRHardy & Associates, a government relations and public policy firm serving a diverse portfolio of clients. After her appointment by President Ronald Reagan as Assistant Secretary of Human Development Services, Ms. Hardy was appointed Commissioner of Social Security (1986 to 1989) and was appointed by President George W. Bush to chair the Policy Committee for the 2005 White House Conference on Aging. Ms. Hardy has launched and hosted her own primetime, weekly television program, "Financing Your Future," on Financial News Network and UPI Broadcasting, and "The Senior American," an NET political program for older Americans. She speaks and writes widely about domestic and international retirement financing issues and entitlement program reforms and is the co-author of *Social Insecurity: The Crisis in America's Social Security System and How to Plan Now for Your Own Financial Survival*, Random House, 1992. A former CEO of a rehabilitation technology firm, Ms. Hardy promotes redesign and modernization of the Social Security, Medicare, and disability insurance systems. Additionally, she has chaired a Task Force to rebuild vocational rehabilitation services for disabled veterans for the Department of Veterans Affairs. She received her B.A. from Connecticut College, her M.B.A. from Pepperdine University, and completed the Executive Program in Health Policy and Financial Management at Harvard University. Ms. Hardy is a Certified Senior Advisor and serves on the Board of Directors of Wright Investors Service Managed Funds, and First Coast Service Options of Florida. First term of office: April 2002 to September 2004. Current term of office: October 2004 to September 2010.

Marsha Rose Katz

Marsha Rose Katz is a Project Director at the University of Montana Rural Institute in Missoula, where her work has concentrated on assisting persons with disabilities to utilize Social Security work incentives to start their own businesses or engage in wage employment. Since coming to the Rural Institute in 1999, Ms. Katz has focused on providing training and technical assistance on both employment and SSI/SSDI to rural, frontier and tribal communities across the country. Previously, she worked for nearly 20 years in a disability rights community based organization, the Association for Community Advocacy (ACA), a local Arc in Ann Arbor, Michigan. She served as both Vice President of ACA, and Director of its Family Resource Center. It was at ACA that Ms. Katz began her nearly 30 years of individual and systems advocacy regarding programs administered by SSA, especially the SSI and SSDI programs. Ms. Katz has written numerous articles and created many widely distributed user-friendly general handouts on SSI and SSDI, the majority of which focus on the impact of work on benefits, and utilizing work incentives. She is the author of *Don't Look for Logic: An Advocate's Manual for Negotiating the SSI and SSDI Programs*, published by the Rural Institute. Her Bachelor's and Master's Degrees are from the University of Michigan. Ms. Katz's many years of experience as a trainer, technical advisor, and advocate have been guided and informed by her partnership with people with disabilities, from her husband, Bob Liston, to the people she assisted in her work with ACA and the Arc Michigan, her current work at the Rural Institute, and her longstanding participation in ADAPT, the nation's largest cross-disability, grassroots disability rights organization. Term of office: November 2006 to September 2012.

Barbara B. Kennelly

Barbara B. Kennelly became President and Chief Executive Officer of the National Committee to Preserve Social Security and Medicare in April 2002 after a distinguished 23-year career in elected public office. Mrs. Kennelly served 17 years in the United States House of Representatives representing the First District of Connecticut. During her congressional career, Mrs. Kennelly was the first woman elected to serve as the Vice Chair of the House Democratic Caucus. Mrs. Kennelly was also the first woman to serve on the House Committee on Intelligence and to chair one of its subcommittees. She was the first woman to serve as Chief Majority Whip, and the third woman in history to serve on the 200-year-old Ways and Means Committee. During the 105th Congress, she was the ranking member of the Subcommittee on Social Security. Prior to her election to Congress, Mrs. Kennelly was Secretary of State of Connecticut. After serving in Congress, Mrs. Kennelly was appointed to the position of Counselor to the Commissioner at the Social Security Administration. As Counselor, Mrs. Kennelly worked closely with the Commissioner of Social Security Kenneth S. Apfel, and members of Congress to inform and educate the American people on the choices they face to ensure the future solvency of Social Security. Mrs. Kennelly served on the Policy Committee for the 2005 White House Conference on Aging. Mrs. Kennelly received a B.A. in Economics from Trinity College, Washington, D.C. She earned a certificate from the Harvard Business School on completion of the Harvard-Radcliffe Program in Business Administration and a Master's Degree in Government from Trinity College, Hartford. Term of office: January 2006 to September 2011.

Mark J. Warshawsky

Mark J. Warshawsky is Director of Retirement Research at Watson Wyatt Worldwide, a global human capital consulting firm. He conducts and oversees research on employer-sponsored retirement programs and policies.

A frequent speaker to business and professional groups, Dr. Warshawsky is a recognized thought leader on pensions, social security, insurance and health care financing. He has written numerous articles published in leading professional journals, books and working papers, and has testified before Congress on pensions, annuities and other economic issues. In addition to being a member of the Social Security Advisory Board , he is also on the Advisory Board of the Pension Research Council of the Wharton School.

From 2004 to 2006, Dr. Warshawsky served as assistant secretary for economic policy at the U.S. Treasury Department. During his tenure, he played a key role in the development of the Administration's pension reform proposals, particularly pertaining to single-employer defined benefit plans, which were ultimately included in the Pension Protection Act (PPA) of 2006. He was also involved extensively in the formulation of Social Security reform proposals, and oversaw the Department's comprehensive 2005 study of the terror risk insurance program. In addition, Dr. Warshawsky led the efforts to update and enhance substantially the measures and disclosures in the Social Security and Medicare Trustees' Reports, as well as the setting of the macroeconomic forecasts which underlie the administration's budget submissions to Congress.

Dr. Warshawsky's research has been influential in the 2001-2 regulatory reform of minimum distribution requirements for qualified retirement plans, the increasing realization of the importance of financial protection against outliving one's financial resources in retirement, and a product innovation to integrate the immediate life annuity and long-term care insurance. For the latter research, he won a prize from the British Institute of Actuaries in 2001 for a professional article he co-authored. Favorable tax treatment for this integrated product was also included in PPA due to Dr. Warshawsky's advocacy.

Dr. Warshawsky has also held senior-level economic research positions at the Internal Revenue Service, the Federal Reserve Board in Washington, D.C. and TIAA-CREF, where he established the Paul A. Samuelson Prize and organized several research conferences. A native of Chicago, he received a Ph.D. in Economics from Harvard University and a B.A. with Highest Distinction from Northwestern University. Term of office: December 2006 to September 2012.

Members of the Staff

Katherine Thornton, Staff Director
Deborah Sullivan, Deputy Staff Director
Joel Feinleib
Beverly Rollins
George Schuette
Jean Von Ancken
David Warner