CENTER for RETIREMENT RESEARCH at BOSTON COLLEGE

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# SOCIAL SECURITY'S *REAL* RETIREMENT AGE IS 70

By Alicia H. Munnell*

## Introduction

Social Security was designed to replace income once people could no longer work. In the 1930s, the retirement age was set at 65, which coincided with the age used by many private and public pension plans. In the late 1950s and early 1960s, Congress changed the law to enable workers to claim benefits as early as 62. But benefits claimed before 65 were actuarially reduced, so that those who claimed at 62 and those who claimed at 65 could expect to receive about the same total amount in benefits over their lifetimes.

In the early 1970s, Congress introduced the Delayed Retirement Credit, which increased monthly benefits for those who claimed after the so-called Full Retirement Age of 65. That credit, which was modest at first, now fully compensates for delayed claiming. As a result, lifetime benefits are roughly equal for any claiming age between 62 and 70, and the highest monthly benefits are available at 70. In that regard, 70 has become the new 65. Moreover, the level of monthly benefits at 70 appears appropriate given the increased deductions for Medicare premiums, the greater taxation of benefits, the declining importance of the spouses' benefit, and the diminished sources of other retirement income. This *brief* aims to clarify Social Security's current benefit structure.

The discussion proceeds as follows. The first section describes how 70 became Social Security's new retirement age. The second section explores whether 70 is the "right" age by looking at "equivalency" to 65, the increasing dispersion in life expectancy by socioeconomic status, and actual retirement patterns. The third section looks at the Social Security replacement rates that workers will face at different retirement ages. The fourth section clarifies that with the maturation of the Delayed Retirement Credit, the "Full Retirement Age" no longer describes the benefit structure; further increases in this benchmark simply reduce replacement rates for everyone. The final section presents a threefold conclusion. First, the shift to age 70 may be appropriate given the increase in life expectancy, health, and education for the majority of workers, but will lead to low replacement rates for the many workers who retire early. Second, further cuts in benefits by extending the Full Retirement Age will lead to very low benefits for early retirees. Third, policymakers need to inform those who can work that 70 is the new retirement age and devise ways to protect those who cannot work.

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# How 70 Became Social Security's Retirement Age

When Social Security benefits were first paid in 1940, the retirement age was 65. The notion was that 65 was the age at which people could no longer work and needed benefits to support themselves. No benefits were paid before that age, and no increments were added for claiming later.

In 1956, Congress gave women the option to retire as early as age 62 on a reduced monthly benefit. The reason for the change was to allow married women, who were typically the younger member of the couple, to retire and claim benefits at the same time as their husbands. Congress made the option available to all women, so as not to discriminate against unmarried women. Congress extended this option to men in 1961, a recession year that made early retirement an attractive policy option. The reduction in monthly benefits was designed so that, for a person with average life expectancy, the cost of lifetime benefits would be much the same whether benefits were claimed at 62 or 65.[1] That is how things remained for about a decade: actuarially reduced benefits were available at 62 and the maximum benefit at 65.

In 1972, Congress introduced a Delayed Retirement Credit, which increased benefits by 1 percent of the "Full Retirement Age" benefit for each year of delay up to age 72. The result was that those who retired later got a little bonus for delaying. But a 1-percent credit did not come close to compensating for the fact that late claimers had to wait and would get benefits over fewer years. In 1983, the age was lowered to 70 and the adjustment was raised to 3 percent and scheduled to increase gradually to 8 percent for those turning 65 in 2008. At this point, the adjustment provided by the Delayed Retirement Credit is actuarially fair – that is, for a person with average life expectancy, it keeps lifetime benefits constant for those who claim between the Full Retirement Age and 70.

The question is whether 70 is the right age for retirement and whether the benefit provided at that age is appropriate.

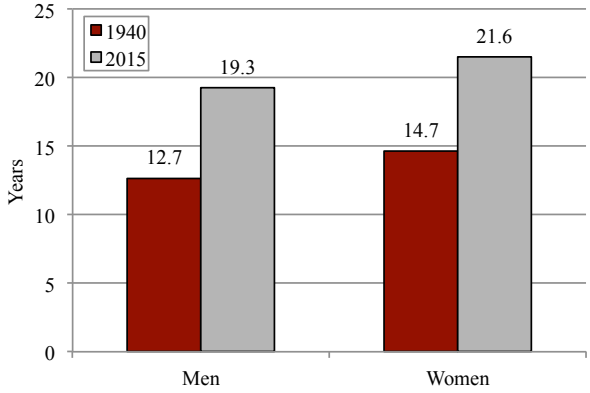
# Is 70 the "Right" Age?

"Right" can mean a number of things. Here we consider three possible metrics: 1) How does 70 in 2013 compare with 65 in 1940 in view of the increase in life expectancy?; 2) How does the increase in life expectancy vary by socio-economic status?; and 3) How does 70 compare with actual retirement patterns?

## *How Does 70 in 2013 Compare with 65 in 1940?*

People are living longer in 2013 than they did in 1940; the increase has been about seven years for both men and women (see Figure 1). This increase in life expectancy suggests that people may have outgrown the physical need for retirement at 65 that may have existed in earlier years.

Figure 1. Life Expectancy at 65 by Gender, 1940 and 2015




*Source:* U.S. Social Security Administration (2013).

The question is how these additional years of life expectancy should be spent. The following reports on two measures. The first is the age at which the expected number of years in retirement remains unchanged, using 1940 as the base year. This should be viewed as the limiting case because it assumes that all of the adult years added by improved mortality should be spent in the labor force. The other measure identifies the retirement age at which the ratio of the expected number of years spent in retirement to the expected number of years working – assuming a starting age of 20 – remains constant. This seems like a better measure because it distributes gains in life expectancy into both working years and retirement years. Table 1 on the next page shows that the limiting case suggests a retirement age of 72 in 2020, while the one that distributes gains between work and leisure suggests age 70.

Table 1. Retirement Age Equivalent to Age-65 Retirement in 1940, Based on Rising Life Expectancy (In Years: Months)

| Year | Age at which: | |
|---|---|---|
| | Expected retirement years remain constant | Ratio of expected retirement to working years remains constant |
| 1940 | 65:00 | 65:00 |
| 1950 | 66:04 | 65:11 |
| 1960 | 67:05 | 66:08 |
| 1970 | 68:08 | 67:06 |
| 1980 | 69:05 | 68:00 |
| 1990 | 70:01 | 68:06 |
| 2000 | 70:10 | 69:00 |
| 2010 | 71:07 | 69:07 |
| 2020 | 72:04 | 70:02 |
| 2030 | 73:01 | 70:08 |

Note: For the ratio of expected retirement to working years, people are assumed to start work at 20.
*Source*: U.S. Social Security Administration (2004).

## *How Does Life Expectancy Vary by Socioeconomic Status?*

The previous exercise is based on the assumption that all groups of workers face average mortality risk. To the extent that such an assumption does not hold, an increase in the retirement age to 70 could involve a significant additional burden for many. An enormous amount of evidence, both for the United States and other developed countries, shows that richer, better-educated people live longer than poorer, less-educated people. According to calculations from the *National Longitudinal Mortality Survey*, which tracks the mortality of people originally interviewed in government surveys, men whose 1980 family income fell in the top 5 percent had a life expectancy at all ages that was about 25 percent longer than those in the bottom 5 percent.[2]

Moreover, the discrepancy in life expectancy between those with high and low socioeconomic status is getting larger with each cohort.[3] This trend is evident in mortality differentials for a sample of male workers age 60 and over, covered by Social Security. Table 2 shows the first age at which less than half the sample was still alive for those in the top half of the earnings distribution and for those in the bottom half. (Earnings were measured at peak earnings years (45-55) and therefore serve as a proxy for socioeconomic status.) For male workers who were born in 1912 and lived to age 60, the difference between the benchmark age for high and low earners was only two years. For those born in 1941, the difference between the ages for low and high earners had increased to six years.

This strong and increasing relationship between earnings and life expectancy makes it difficult to design any equitable retirement benefit structure.

Table 2. Age at Which Less than Half the Sample was Still Alive, by Birth Year and Earnings Group

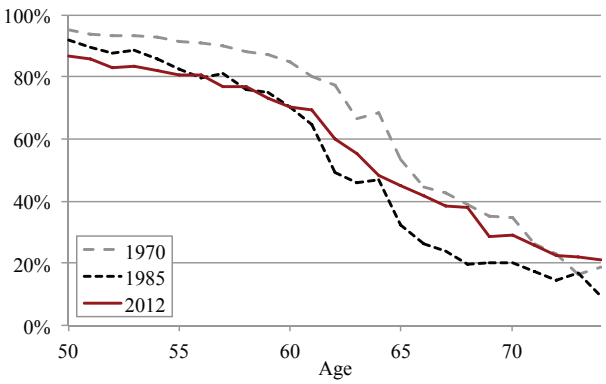
| Earnings group | Year of birth | | | |
|---|---|---|---|---|
| | 1912 | 1922 | 1932 | 1941 |
| Bottom half | 77 | 78 | 79 | 80 |
| Top half | 79 | 81 | 84 | 86 |

*Source*: Waldron (2007).

## *How Does 70 Compare with Actual Retirement Patterns?*

In considering whether 70 is the correct age, it is also useful to look at current work patterns to see the extent to which people are in the labor force around that age. Figure 2 presents labor force participation for men by age for 2012 (the most recent year for which data are available), and for two earlier years, 1970 and

Figure 2. Labor Force Participation Rates of Men Age 50-74, 1970, 1985, and 2012




*Source:* U.S. Census Bureau, *Current Population Survey* (CPS) (1970, 1985, 2012).

1985. The figure shows that only about 30 percent of men are currently employed at age 70. This percentage has risen substantially since 1985 due to a host of factors, which could continue to push participation higher.[4] The fact that the age-70 labor force participation rate in 2012 is below the 1970 rate also suggests that labor force activity at older ages could increase further. (Remember that both Social Security and defined benefit plans created strong incentives not to work beyond 65 in the 1970s and 1980s.) The question is what fraction of the population could work to 70, and what fraction would justify characterizing 70 as the "correct" age.

Again, as in the case of life expectancy, it is useful to look at *who* is working at older ages. Table 3 pools data over a 13-year period to examine the relationship between narrowly defined age and educational groups. The data show a strong positive relationship between educational attainment and labor force activity. Clearly, working longer is more attractive to those with more education and more interesting jobs. But, within each group, a greater proportion might work until 70 if they understood the economic security offered by higher monthly Social Security benefits.

# How Do Replacement Rates Vary by Age?

To get a sense of the stick as well as the carrot requires some knowledge about how much people will receive from Social Security at different claiming ages. Most people do not understand the relationship between claiming age and monthly benefits. As Table 4 shows, claiming at 62 instead of 70 cuts the monthly benefit almost in half, from an illustrative $1,000 to $568. Given that Social Security is a particularly valuable type of income – inflation adjusted and lasts for a lifetime – it generally makes sense for workers to postpone claiming as long as possible to get the highest monthly amount, assuming they are in good health for their age.

Table 3. Labor Force Participation by Age Group and Education Level, 1999-2012

| Age | Educational attainment | | | |
|---|---|---|---|---|
| | High school | Some college | College | Advanced |
| 50-58 | 69% | 75% | 79% | 85% |
| 59-61 | 57 | 62 | 68 | 72 |
| 62-64 | 42 | 50 | 55 | 62 |
| 65-67 | 29 | 35 | 39 | 47 |
| 68-70 | 22 | 25 | 28 | 34 |
| 71-73 | 15 | 18 | 21 | 30 |
| 74-76 | 10 | 13 | 16 | 20 |
| 77-79 | 7 | 10 | 12 | 16 |
| 80-83 | 5 | 6 | 8 | 11 |

*Sources*: Updated data from Haider and Loughran (2001); and 1999-2012 CPS.

Table 4. Illustrative Monthly Social Security Benefits by Claiming Age

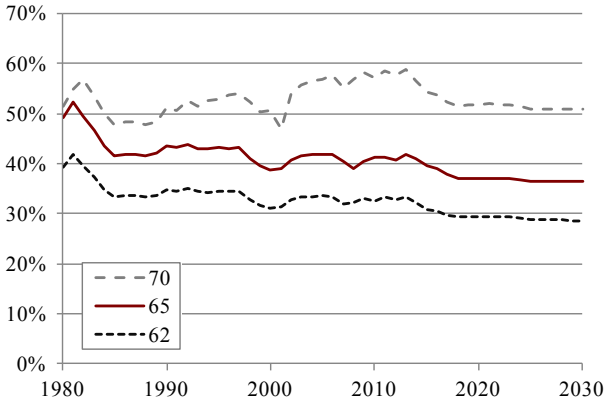
| Claiming age | Monthly benefit |
|---|---|
| 70 | $1,000 |
| 67 | 818 |
| 65 | 707 |
| 62 | 568 |

*Source*: Authors' calculations from U.S. Social Security Administration (2013).

To determine the extent to which people can maintain their standard of living in retirement, it is more useful to focus on replacement rates – benefits as a percent of pre-retirement earnings – rather than dollar amounts. Figure 3 on the next page shows replacement rates for the medium earner, as reported by the Social Security Administration, at ages 70, 65, and 62 over the period 1980-2030. Replacement rates for all three ages incorporate the effect of the increase in the Full Retirement Age from 65 to 66 and the scheduled increase to 67. The age-70 replacement rates reflect the increase in the Delayed Retirement Credit from 3 percent to 8 percent over the period 1983-2008.

Social Security replacement rates for those with medium earnings who claim at age 70 will stabilize around 50 percent. But the reported replacement rates overstate the amounts that retirees will actually get in retirement. First, premiums for Medicare Parts B and D are automatically deducted from Social Security benefits, and these premiums are scheduled to rise substantially over time.[5] Second, Social Security benefits are taxed under the personal income tax. Individuals with more than $25,000 and married couples with more than $32,000 of "combined income" have to pay taxes on up to 85 percent of their Social Security benefits.[6] Since the thresholds are not indexed for growth in average wages or even for infla-

Figure 3. Social Security Replacement Rates for Medium Earner at 70, 65, and 62, by Year Retiree Reaches 65




*Source:* Social Security Administration (2013); and Myers (1993).

tion, the percentage of recipients whose benefits are subject to tax increases over time. (Note that the full Social Security benefit is considered for tax purposes, even though the Medicare Part B premium is deducted before payment.)

Table 5 shows estimates of the "net" Social Security replacement rates, which take into account Medicare and taxes, over time. The ultimate net replacement rate at age 70 will equal 43 percent, once the Full Retirement Age has moved to 67. This replacement rate will provide a solid base on which to add 401(k) savings and home equity for a secure retirement. Those who retire at 62, however, will see replacement rates of 24 percent. Retiring at 62 will not be a reasonable option for those who have any ability to stay in the labor force. Those who retire at 65 will receive a benefit equal to 31 percent of pre-retirement earnings, a very modest base particularly given the extremely low balances in 401(k) plans.

## What Does it Mean to Change the "Full Retirement Age"?

If 70 is the age at which Social Security expects most people to retire and at which it pays a benefit that serves as the base for a secure retirement, what does the "Full Retirement Age" mean? What does it mean that it has moved from 65 to 66 and is scheduled to move to 67 for workers born in 1960 or later? And what does it mean to increase the Full Retirement Age beyond the age-67 threshold already scheduled under current law?

The Delayed Retirement Credit has rendered the Full Retirement Age a largely meaningless concept. It does not describe the age when benefits are first available. That is age 62. It does not describe the age when monthly benefits are adequate. That is age 70. Yet workers appear to respond to changes in announced retirement ages. Figure 4 on the next page shows that participants in the *Health and Retirement Study* subject to a Full Retirement Age of 66 retire later than those with a Full Retirement Age of 65.

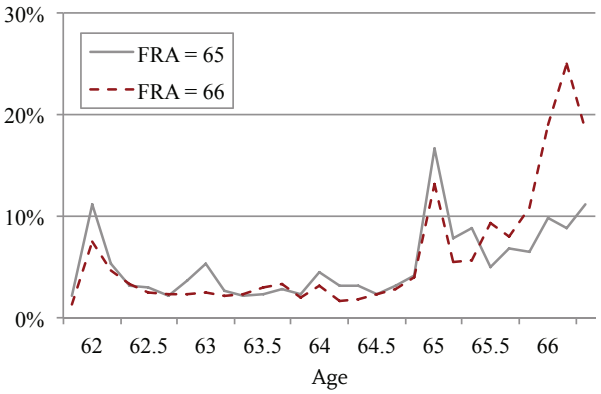
And policymakers couch across-the-board benefit cuts in terms of the Full Retirement Age. When the Full Retirement Age moves from 66 to 67 as scheduled under current law, benefits for those claiming at

Table 5. "Net" Replacement Rate for Medium Worker by Retirement Age, 1980-2030

| Claiming age | 1980 | 1990 | 2000 | 2010 | 2020 | 2030 |
|---|---|---|---|---|---|---|
| 70 | 51% | 49% | 49% | 53% | 48% | 43% |
| 65 | 48 | 42 | 37 | 38 | 34 | 31 |
| 62 | 38 | 33 | 29 | 28 | 26 | 24 |

Note: Year is the date a retiree reaches age 65. Replacement rate is net of Part B and D premiums, as well as taxation of benefits. Part B SMI deduction for 2030 assumes SMI continues to cover 26 percent of plan costs and uses Medicare Trustees' Report enrollment and cost growth assumptions. The assumptions are that the beneficiary has enough other income to have benefits taxed (about $10,000 in 2030) and that the tax rate is 12.5 percent.
*Sources*: Authors' calculations based on Centers for Medicare and Medicaid Services (2013); and U.S. Social Security Administration (2013).

Figure 4. Retirement Rate, by Social Security Full Retirement Age




*Source:* Coe, Khan, and Rutledge (2013).

each age will be about 7 percent lower, for life. Benefits at 62 will continue to be 57 percent of benefits at 70, but they will be 7 percent lower for claims at each age.

Increasing the Full Retirement Age to, say, 70 (after it reaches 67) would be equivalent to about a 20-percent reduction in benefits. The stated benefit for those claiming at 70 would decline to a 41-percent replacement rate (see Table 6), and the "net" benefit would be in the 30-percent range. Those levels would no longer be adequate for those working to 70 and would be grossly inadequate for anyone claiming earlier. Some could offset the cut in monthly benefits by working longer, but many would not be able to do so.[7]

# Conclusion

The maturation of the Delayed Retirement Credit has created a new Social Security benefit structure. Working until 70 is the way for people to have an adequate benefit on which they can build for a secure retirement. The shift to age 70 may be appropriate given the increase in life expectancy, health, and education for the majority of workers, but it will lead to low replacement rates for the many workers who retire early. Further cuts in benefits by extending the "Full Retirement Age" will lead to very low benefits for early retirees.

This discussion is not to argue that Social Security benefits can never be cut. People are healthier, better educated, have less physically demanding jobs, and can work longer. They are also living much longer. So keeping monthly benefit levels unchanged results in ever increasing costs. But constantly reducing benefit levels by increasing the Full Retirement Age is very hard on those who cannot change their retirement date. If we want to cut benefits, it makes much more sense to directly change the benefit formula. Such an approach allows for larger cuts for the higher-paid than for those at the bottom of the earnings distribution.

Eliminating the Full Retirement Age would dramatically clarify Social's Security benefit structure.[8] It would clearly signal that claiming at age 70 provides the appropriate benefit and would encourage people to work longer. Eliminating the concept would also force policymakers to call a cut a cut, and perhaps target reductions where they would cause less pain.

Table 6. Social Security Replacement Rates for Medium Earner by Full Retirement Age

| Claiming age | Full Retirement Age | | | | |
|---|---|---|---|---|---|
| | Current policy | | Hypothetical | | |
| | 66 | 67 | 68 | 69 | 70 |
| 70 | 54% | 51% | 48% | 46% | 41% |
| 65 | 38 | 36 | 33 | 30 | 27 |
| 62 | 31 | 29 | 26 | 24 | 22 |

Note: This table assumes that Social Security targets a 41.1 percent replacement rate at the Full Retirement Age.
*Source*: Author's calculations and U.S. Social Security Administration (2013).

# Endnotes

1 The intuition for the size of the reduction can be seen from the fact that the average life expectancy at age 65 in 1960 was about 15 years. A worker who claimed at 62 collected benefits for three additional years or about 20 percent longer (3 years/15 years). If an individual were to receive benefits for 20 percent longer, the only way to keep the cost to the system constant would be to pay 20 percent less each year.

2 Deaton (2002). See also Waldron (2013).

3 Waldron (2007).

4 In addition to the factors cited above – the increase in Social Security's Delayed Retirement Credit and longer life expectancy – other potential influences on rising labor force participation include the shift in employer pensions to defined contribution plans, workers' rising educational levels, improved health, the trend toward less physically demanding jobs, a preference among men to retire at the same time as their working spouses (who tend to be younger), the decline of retiree health insurance, and non-pecuniary factors such as a desire to stay actively engaged in the workforce.

5 Centers for Medicare and Medicaid Services (2013); U.S. Social Security Administration (2013).

6 Combined income is adjusted gross income as reported on tax forms plus nontaxable interest income plus one half of Social Security benefits.

7 Interestingly, those who retire at age 70 cannot replicate their previous monthly benefit by working longer, because the Delayed Retirement Credit is not applicable after 70. No matter what they do, they will see a reduction in their monthly as well as lifetime benefits. Right now, this is not a significant problem. The age-70 retirees today are largely lawyers, doctors, and Ph.Ds., as discussed above. Moreover, if age 70 is considered the "correct" age, it is not necessary to incent people to work longer. But if retirement patterns change and the correct age is deemed to be more than 70, then policymakers will need to consider extending the Delayed Retirement Credit beyond age 70.

8 A number of specific provisions are linked to the Full Retirement Age. An earnings test applies before age 66 (the Full Retirement Age) but not thereafter. Widow and spousal benefits are reduced if claimed before the Full Retirement Age and not thereafter. Workers can claim spousal benefits at the Full Retirement Age and then subsequently claim their own benefits.

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