ADJUSTING SOCIAL SECURITY FOR INCREASING LIFE EXPECTANCY: EFFECTS ON PROGRESSIVITY

BY COURTNEY MONK, JOHN A. TURNER, AND NATALIA A. ZHIVAN

Restoring long-term solvency to Social Security is an important aspect in retirement benefit reform. Although several factors are at play, Social Security's actuarial deficit arises in part because life expectancy continues to increase.

One solution is to change the Full Retirement Age (FRA), which is set in law to increase from age 66 to 67. A possible way to offset the benefit cuts caused by this change is to raise the Early Entitlement Age (EEA), which has been 62 for more than 40 years. However, an EEA increase has a larger adverse effect on people who have a lower life expectancy. In addition, raising the EEA hurts people who have poor job prospects, due to poor health or low skills, and who have to rely on Social Security benefits as the only source of income.

Low-income, high-mortality households

This paper attempts to develop a policy option that could protect replacement rates for people in households that have both low income and high mortality. While people who have low lifetime incomes clearly are a policy concern for Social Security, low family income tends to be correlated with low life expectancy, so that those people are doubly disadvantaged. Considerations of equity may include concern over both low annual Social Security benefits and low lifetime benefits, due in part to low life expectancy.

It first examines how the effects of some Social Security reform options differ depending on differences in life expectancy across demographic groups. Using data from the *Health and Retirement Study*, it explores the correlation between Average Indexed Monthly Earnings (AIME) and life expectancy.

While the correlations between life expectancy and education, current income, and financial wealth have been explored in other studies, we are unaware of previous studies examining the correlation with the AIME. AIME is information that the Social Security Administration could use to construct policies that differentiate between people who have different lifetime income and life expectancy. The paper also explores the correlation between AIME and disability.

The paper offers a robustness check for the AIME model by comparing it to one with demographic characteristics as explanatory variables. We present a proposal for a flexible FRA based on differences in AIME. If AIME is correlated with life expectancy, a flexible FRA with a constant EEA could mitigate the dual problems of low replacement rates at the EEA and disparate effects of policy changes on people who have both low lifetime income and low life expectancy.

The max AIME and other measures

We found that AIME is not correlated with life expectancy when pooling men and women, but that a new, household measure of AIME, the max AIME, is correlated. Max AIME is the AIME for single, never-married persons and the maximum of the husband's and wife's AIME for married persons and formerly married persons who were married sufficiently long (ten years) so that one spouse could receive benefits based on the other spouse's earnings record. Max AIME is a household measure because it takes into account the earnings of the other spouse.

The paper discusses implications of a flexible FRA based on a max AIME. Individuals in households with a low max AIME would have a lower FRA than other individuals. Some people may consider it unfair for lower-income persons to have a lower retirement age than higher income persons, but this objection would be based on a misunderstanding. Despite its name, the FRA has nothing to do with the age at which a person is eligible to retire, which is age 62. All workers working past the FRA, up to age 70, see further increases in their benefits because actuarial adjustments for postponed retirement are made up to age 70.

Other household measures related to the AIME could also possibly be used for constructing a flexible FRA. For example, one could construct a family AIME, which would be based on the combination of the husband's and wife's AIME, divided by a scaling factor. We save the exploration of those alternatives for future work.

Negatives and positives

The political economy of Social Security reform may make it desirable that a reform containing negatives – benefit cuts and tax increases – also contain positives. A flexible FRA would be a positive for low-income workers, but would make larger benefit cuts than otherwise for high-income workers. It would increase the progressivity of Social Security, which studies have found is at most mildly progressive.

Conclusion

We have investigated the policy option of a flexible FRA as a way of dealing with inequities in Social Security policies arising from the large differences in life expectancy across groups. With a flexible FRA, future increases in the FRA to restore solvency to Social Security would be linked to a household measure of the AIME, with lower increases for people with lower AIME.

Specifically, this paper investigates the possibility of using the max AIME, which is the AIME for a single person and the maximum of the AIME for a husband or wife. We have shown that while AIME is not well-targeted by life expectancy, the max AIME could be used to construct a policy that would be targeted by life expectancy, as well as by low lifetime income.

CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE

Hovey House, 140 Commonwealth Avenue, Chestnut Hill, MA 02467-3808

phone 617.552.1762   fax 617.552.0191   crr@bc.edu   www.bc.edu/crr