A NEW APPROACH TO RAISING SOCIAL SECURITY'S EARLIEST ELIGIBILITY AGE

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Social Security's Normal Retirement Age (NRA) is currently rising from age 65 to age 67. An individual must wait until the NRA to claim full benefits; benefits claimed at an earlier age are actuarially reduced. Despite the rise in the NRA, the Earliest Eligibility Age (EEA) — the earliest age individuals can claim reduced benefits — remains at 62. A question facing policymakers is whether the EEA should be increased to 64 to match the increase in the NRA. A rise in the EEA would protect workers from facing an increased risk of inadequate benefits if they or their spouse live beyond average life expectancy. However, raising the EEA involves making a tradeoff between ensuring retirement income adequacy and insuring workers against the prospect that they will find it difficult to work or find jobs as they age.

To avoid hurting those unable to work, some have proposed tying the EEA to the length of a worker's labor force participation. The idea of differentiation based on labor force participation rates has an intuitive appeal and is easy to implement. Those who went to college and thus delayed entry into the workforce usually have a safer working environment, higher incomes, better health, and longer life expectancies, and thus can remain in the labor force more easily. While health status, ability to work, or even level of education are not directly observed by the Social Security Administration, information on earnings and number of quarters of covered earnings are routinely used to determine eligibility and the level of monthly benefits.

Our analysis demonstrates that policy rules that tie labor force participation to eligibility for unreduced benefits at age 62 fail to help those who are in poor health. We find a positive correlation between being unhealthy and claiming benefits at the EEA. However, we find a negative correlation between number of covered quarters in the labor force and health and between number of covered quarters in the labor force and education. Unhealthy workers are simply unable to obtain 35 years of labor force participation, while workers in good health satisfy the proposed test for eligibility. Healthy workers, however, tend to postpone claiming and retirement until a later age regardless of the EEA. Thus, tying the EEA to the length of a worker's labor force participation would not help many individuals who are unable to work due to poor health or an inability to find jobs in their 60s.

While the number of covered quarters is a poor measure of health status, earnings are a good predictor of health, wealth, and job prospects later in life. Our analysis shows that tying the EEA to the Average Indexed Monthly Earnings (AIME) may have some potential. Using the ratio of AIME to the average wage, we divide workers into three categories: those with a ratio below 0.5 (low AIME), those with a ratio between 0.5 and 1 (middle AIME), and those with a ratio of at least one (high AIME). Com-

pared to the high AIME group, a much higher proportion of men in the low AIME group report poor or fair health, a work-limiting health condition, or a spouse with a work-limiting health condition. Additionally, a higher proportion of men in the low AIME group lack a high school diploma, which indicates a higher risk of having good job prospects. Finally, the self-perceived life expectancy of individuals in the low-AIME group is significantly less than those in the high-AIME group. All these factors point to using AIME to determine which workers need to be protected from an increase in the EEA.

Under our alternative policy, a worker's EEA would depend on his AIME at age 55. For the low-AME group, the EEA would remain at 62. For the middle-AIME group, the EEA would rise by approximately one-half month (4 percent of a year) for every one percentage point increase in AIME as a share of average monthly earnings above 50 percent. For example, an individual with an AIME equal to 75 percent of average earnings would have an EEA of 63 years (25 percentage points x 4 percent of a year = 1 year). Finally, for the high-AIME group, the EEA would be 64. The objective is to increase the EEA for most workers, while leaving it unchanged for those with the highest risk of suffering hardship due to a delay in benefit eligibility.

By providing for a gradual increase in the EEA from 62 to 64 as AIME increases, the proposed policy avoids the "cliff effect" problem found in many social programs, where eligibility changes abruptly with income or other endogenous characteristics. This feature would help to attenuate the incentive for individuals to reduce earnings in order to qualify for earlier benefits.

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