



AMERICAN ACADEMY *of* ACTUARIES

Statement of
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To the
Committee on Ways and Means
Subcommittee on Social Security
U.S. House of Representatives

Hearing on
Proposed adjustments to Social Security benefits, as included in the
President's Fiscal Year 2014 Budget, the report by the National
Commission on Fiscal Responsibility and Reform, and the report of the
Bipartisan Policy Center's Debt Reduction Task Force.

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The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Chairman Johnson, Ranking Member Becerra – and distinguished members of the subcommittee. Thank you for the opportunity to appear before you today to assist in your examination of bipartisan proposals to adjust Social Security benefits and their impacts on the program’s finances, beneficiaries, workers, and the economy.

I appear before you today on behalf of the American Academy of Actuaries, where I am the Senior Pension Fellow. The Academy is the nonpartisan professional association representing all actuaries in the United States. Our mission is to serve the public and the actuarial profession by providing independent and objective actuarial information, analysis, and education to help in the formation of sound public policy.

Background

Americans are living longer today than they did in the past, thanks in part to improvements in public-health systems, the quality and quantity of our water and food supply, healthcare, and medical technology. These improvements have led to substantial increases in life expectancy, and in particular, the life expectancy of the elderly. A longer life creates some obvious and numerous benefits for individuals, but brings with it not only personal challenges, but a societal challenge in how to prepare for and manage financial security in retirement.

Social Security is a major component of financial security for the elderly. However, the financial sustainability of the program is itself facing challenges. As the Social Security actuaries remind us each year, the program is not in actuarial balance. At some point in the near future —2033 according to the 2012 Trustees Report—absent corrective measures, the program will no longer generate enough revenue to pay full benefits in a timely fashion. Addressing the program’s solvency now would allow Congress to have a fuller range of options to consider, many of which could be more modest in their adjustments, such as slow phase-ins over many years. Deferring efforts to address the solvency of the program to the next decade or beyond will more profoundly affect beneficiaries and the taxpaying public.

Social Security’s Old-Age and Survivors Insurance (OASI) challenges stem from our population demographics: Partly from lower birth rates and immigration levels, and in part from Americans living longer. Simply put, the longer someone lives, the more benefits Social Security must pay. In 1940, when the new Social Security Administration began paying monthly retired-worker benefits, the “full retirement age” was 65. At that time, workers who survived to age 65 had a remaining life expectancy of 12.7 years for males and 14.7 years for females. In 2011, life expectancy at age 65 was 18.7 years for males and 20.7 years¹ for females, an increase of six full years for males and females.²

Actuaries expect the trend to continue into the foreseeable future. Under the Social Security actuaries’ intermediate projection, future life expectancy is projected to increase about one year

¹ 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, Table V.A4.—Cohort Life Expectancy.

² For more information, please view the table located in the appendix.

per decade. In 20 years, life expectancy at age 65 for males is expected to be more than 20 years and more than 22 years for females.

The Social Security Amendments of 1983³

The 1983 Social Security Amendments made increases in the full retirement age partially reflect the improvements in life expectancy since 1940. These scheduled increases were part of a package of changes adopted to fend off near-term program insolvency. Under the 1983 adjustments, the full retirement age has gradually increased to age 66 for workers born in 1943 (who reached age 66 in 2009). Still to come as a result of the 1983 amendments, the full retirement age gradually increases to age 67 for workers born in or after 1960. These increases are summarized in the table below.

Year of Birth	Current Law Social Security Full Retirement Age
1943—1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 & older	67

From today’s perspective, however, the 1983 schedule of increases in the full retirement age account for only two of the additional six years of life expectancy that we’re experiencing today. Congress should enact additional raises to the retirement age to keep healthy older Americans productively working and to keep Social Security affordable.

The 1983 amendments solved what was then an immediate crisis—full benefits could not have been paid later that same year without action. But valuations done at the time of the 1983 amendments projected solvency for 75 years, and did not project sustainable solvency beyond that time frame. Today, the Social Security actuaries’ projections anticipate the crisis arriving sooner than projected in 1983. Congress should act now to provide sustainable solvency for future generations. An important component of a change that will promote sustainable solvency should be raising the full retirement age with a provision for additional raises if life expectancy after full retirement age continues to increase.

³ Public Law 98-21.

Raising the Full Retirement Age

Social Security defines the full retirement age as the earliest age an individual can receive unreduced old-age benefits. For 60 years, starting in 1940, the full retirement age was 65.

Actuaries and demographers project increases in life expectancy to continue, although the rate of increase is the subject of ongoing debate. Regardless, any increase in longevity among the elderly population without a corresponding change in the full retirement age actually constitutes an increase in the amount of benefits paid, and this has a profound effect on the system. First, although the monthly amount a retiree receives remains unchanged under current law formulas, the number of payments a retiree will receive obviously increases with longer life spans. These additional payments lead to a higher value of benefits, increasing the cost of the system. Second, as life expectancy increases, one's lifetime proportion spent in retirement increases, while the proportion spent working decreases. That means that individuals receive benefits for a greater portion of their lives and pay Social Security taxes for less, even if the number of years they pay into the system remains the same.

To address the effect of longevity increases on Social Security, increases in the retirement age could be structured at least three ways: 1) a modest increase to merely restrain the growth in the value of future benefits, 2) an increase designed to keep benefits approximately the same in value, or 3) more significant increases that would reduce overall benefits. It should be noted that the third method goes beyond addressing longevity increases and would actually reduce the lifetime value of benefits.

Based on the assumptions in the trustees report, the full retirement age would need to increase by about one month every two years in order to offset the effects of increasing life spans on the system.

The Actuarial and Public Policy Case for Raising the Full Retirement Age

The shifting balance between working years and retirement years has contributed to the system's long-term actuarial imbalance. As actuaries, we see this as a demographic problem that demands a demographic solution.

That said, the Academy does recognize that an increase in the retirement age is not a solution to address the entire imbalance in the system. It is but one component, though a necessary one, of restoring Social Security's long-term financial health. In particular, raising the full retirement age will:

- *Compensate for Increases in Longevity* – Raising the full retirement age connects Social Security directly to covered workers living longer. Even large proposed increases in the full retirement age would still provide for a lengthier retirement on average than workers enjoyed during most of the time their full retirement age was 65. Current retirement surveys consistently show that, in order to maintain one's current standard of living, most workers expect they will need to or want to work longer to accumulate the needed retirement savings in employer-sponsored plans and personal savings accounts.

- *Preserve the current benefit formula.* The current benefit formula has existed for more than 30 years and provides a certain balance to the circumstances of the many demographic groups among Social Security’s covered population. Raising the retirement age addresses the financial challenges associated with longevity without having to modify the current formula.
- *Increase labor force participation.* Raising the full retirement age can induce workers to remain in the labor force longer. Part of this effect is behavioral: to the extent Americans consider a higher full retirement age the “normal” retirement age, workers will view delaying retirement as the “new normal.” More significantly, workers could continue full-time employment in order to retire later with an adequate Social Security benefit or switch to part-time employment to supplement a lower benefit. Making greater use of older workers increases total economic output and raises the living standard for both active and retired workers.
- *Preserve disability benefits.* Raising the full retirement age will not reduce disabled-workers’ benefits, while a direct reduction in Social Security’s benefit formula would reduce these benefits.

Considerations When Raising the Retirement Age

Possible negative consequences of raising the full retirement age include:

- *Disproportionate effect on low-wage workers.* Not all demographic groups will experience the same increases in longevity. Lower-wage workers and those with lower levels of education generally have experienced smaller increases in longevity compared to more highly compensated and more educated workers. Also, lower-wage workers often may not be able to work to a higher full retirement age because they tend to work in more physically demanding jobs. An increase in the full retirement age can adversely affect these workers who may have a need for claiming benefits early. Notably, lower-wage workers also rely most heavily on Social Security for income, sometimes as their only income source.

Policy options that might address these problems include liberalizing the current “vocational factors” that are used to define disability for workers at age 40 or older, or revising the early retirement factors to provide a lesser reduction on benefits below the first bend point.⁴

- *Jobs may not be available.* Barriers exist to keeping elderly workers in the labor force, especially if younger workers are readily available. If the economy cannot provide jobs for older workers, raising the retirement age will constitute a financial hardship for many

⁴ Social Security’s bend points, where the factors in the formula change, are dollar amounts indexed over time by increases in average wages. The 2013 bend points, for example, are \$791 and \$4,768.

who may have to retire with reduced benefits. The seriousness of this concern depends on how the labor market responds over the coming decades to the gradual aging of the population.

Options for Increasing the Full Retirement Age

While the American Academy of Actuaries advocates for inclusion of an increase in full retirement age in efforts to restore Social Security's long-term actuarial balance, it has not endorsed any one proposal as there are several approaches that can make this adjustment. Increasing the retirement age can contribute significantly to stemming the impact of the program's inadequate financing as a result of the demographic trend of increased longevity and help put the program back on track toward actuarial balance.

Some approaches for increasing the Social Security full retirement age include the following:

- *Fixed-schedule increases to full retirement age.* Various methods exist to increase the retirement age. The Social Security Administration's Chief Actuary Steve Goss and his staff have developed eight examples, including the most accelerated – beginning the increase in the full retirement age from age 66 to age 67 immediately, followed by increases by one month (in retirement age) every two years (in birth-date years) until the full retirement age reaches age 70. This would reduce the long-range actuarial deficit by about one-third. Further reductions of the long-range deficit would require a rate of increase more rapid than one month every two years.
- *Index based on years in retirement.* This method would index the full retirement age in a manner that keeps life expectancy at the full retirement age constant over time. For example, life expectancy at age 65 (weighted between males and females and rounded to the nearest whole year) is now nearly 20 years. To keep a 20-year life expectancy at full retirement age, the full retirement age would have to increase about one month every year or two for life based on the expected increases in longevity from the trustees report. This method would decrease system costs over time because the payout period for benefits would remain the same, while the period over which payroll taxes increases, although the savings from this change alone would not restore actuarial balance. Another, perhaps more accurate, method would index retirement age based on demographic trends as they develop, given that experts disagree on the long-term rate of mortality improvement.
- *Index based on ratio of retirement to working years.* This indexing would change the period from workforce entry age to the full retirement age to increase at the same rate as life expectancy at the full retirement age. This method, which was recommended in 1983 by a majority of the members of the National Commission on Social Security Reform, would increase the full retirement age a little more slowly than maintaining a constant life expectancy at full retirement age and, therefore, would reduce program costs to a lesser degree. But by using this method, policymakers may intend that some portion of the increase in life expectancy at full retirement age may reflect years of unhealthy life during which workers could not continue working and that extra years of life expectancy

should be split in some manner between work and retirement.

- *Index to maintain actuarial balance.* If actuarial balance of the OASI Trust Fund occurred through reforms, Congress could put in place a mechanism that would automatically adjust the full retirement age as necessary to restore actuarial balance going forward. An adjustment of this nature also could be combined with automatic adjustments to the payroll-tax rate or benefit amounts to maintain actuarial balance. The Academy's issue brief, *Automatic Adjustments to Maintain Social Security's Long-Range Actuarial Balance*⁵, discusses this topic in great detail.

Similar Modifications

The National Commission on Fiscal Responsibility and Reform (Bowles-Simpson/Simpson-Bowles) report includes a proposal to index both the full retirement age and the early retirement age to increases in longevity after 2027, the first year workers receive unreduced benefits at age 67 under current law. The proposal also contains a directive to the Social Security Administration to create a "hardship exemption" for workers who cannot continue working past age 62 but who do not qualify for disability benefits. It is estimated the proposal would reduce the long-range actuarial deficit by 18 percent.

The proposal would not fully reflect the improvement in longevity since 1940. This could be accomplished by ad hoc increases to the full retirement age instead of or in addition to indexed increases. However, this could be done by increasing in accelerated fashion the full retirement age enough to eliminate Social Security's long-range actuarial deficit entirely. This still would not take into account the full extent of improvements in longevity, but few major proposals eliminate more than approximately one-third of the deficit through adjustment to the full retirement age. This is due in large measure to concern for workers in strenuous jobs, who might not be able to continue working beyond the current full retirement age.

The Bipartisan Policy Center Debt Reduction Task Force (Domenici-Rivlin) proposed a way to adjust benefits for longevity by decreasing the 90 percent, 32 percent and 15 percent factors used in calculating the Primary Insurance Amount as people live longer. The factors would be multiplied by the ratio of life expectancy of someone reaching age 67 in 2018 to the life expectancy of someone reaching age 67 in the fourth year before benefit eligibility. The Task Force proposal also would apply to disabled workers at the time of conversion to disabled worker status, with the ratio only applying to the proportion of the benefit earned while not disabled.

The Task Force's method could be designed to produce essentially the same effect as any particular change to the full retirement age and thus may have a similar financial benefit. However, it does not provide similar signaling to American workers as an increased retirement age. An increased retirement age signals American workers that they can and should continue to

⁵ http://www.actuary.org/files/publications/IB_Auto_Adjustments_FINAL.pdf

participate in the workforce, thereby having greater opportunity to save more for retirement and earn a greater Social Security benefit.

Mitigating the Effect of a Higher Retirement Age

There are ways to lessen the impact on working Americans and certain segments of the workforce who could be particularly affected by any increase in the Social Security retirement age:

- Gradually phase in any change over an extended period of years, even decades, to allow for more time for society to adapt to the new work-life reality.
- Modify the progressivity of the benefit formula in conjunction with retirement age changes or introduce progressivity into the early retirement reduction factors. This may address the disparate distribution of longevity gains across the population—with wealthier socioeconomic groups recently showing more longevity improvements than poorer socioeconomic groups.
- Additional occupational bridge pensions, perhaps combined with revisions to existing disability programs, could address people having difficulty in continuing to work in occupations that involve physical labor.
- Measures that facilitate employment at older ages (such as reductions to the payroll tax at older ages) to address the greater difficulties that older workers sometimes face in finding jobs.

Early Eligibility Age

The Early Eligibility Age for Social Security has been age 62 since 1956 for women and 1961 for men. The 1983 amendments that raised the full retirement age did not change the early eligibility age, but the amount of benefit at the early eligibility age was further reduced for those workers with a full retirement age above 65. Early benefits are reduced 30 percent at age 62; that is 6.7 percent per year for the first three years and 5 percent for the remaining years to full retirement age (for persons born in 1960 or later). Some proposals to change the full retirement age also suggest changing the early eligibility age, for example to keep the earliest eligibility age five years before the full retirement age.

From a financial as well as societal perspective, raising the early eligibility age has the beneficial result of encouraging most individuals to work longer. Individuals who remain in the labor force are a productive part of our economy and are able to save more for their deferred retirement.

Raising the early eligibility age also helps prevent payment of benefits that may prove inadequate. The 1983 amendments increased the maximum number of years one can retire early and draw early benefits from three to five years prior to full retirement age, and increased the reduction in the benefit from 20 percent at three years to 30 percent at five years. Increasing the

full retirement age beyond age 67 without also raising the early eligibility age would mean that benefits at the early eligibility age would be reduced more than the current 30 percent. This reduction applies to the benefits over the full lifetime of the individual and may as a result prove to be inadequate, potentially causing pressure for benefit increases. Raising the early eligibility age in concert with the full retirement age would maintain the maximum reduction at 30 percent.

Raising the early eligibility age does not significantly change Social Security's financial position because early retirement benefits are already reduced to the approximate actuarial equivalent payments.

Partial Claiming of Benefits at Age 62

Another proposal that mitigates the effect of higher early eligibility age is to allow individuals to claim a portion of their benefit, say up to 50 percent, at age 62 or later, even if before early eligibility age. This portion of the Primary Insurance Amount would be reduced for early commencement accordingly. This proposal would provide partial income to individuals who have difficulty working but do not qualify for disability benefits. Again, because early retirement benefits are approximate actuarial reductions, there would be relatively small effects on the financial status of Social Security.

Currently, the age 62 early retirement age is the single most popular age for electing receipt of benefits. Despite the larger benefits that are available at later ages, many people continue to elect to receive benefits at their first opportunity. Retaining age 62 as the early retirement age or allowing partial benefits at age 62 is likely to result in many people selecting commencement at this early age with a smaller lifetime benefit. This may result in lifetime benefits that prove to be inadequate.

Studies indicate the proportion of jobs that are physically demanding has shrunk to less than 8%, and less than 20 percent of workers who retire early do so for health reasons⁶. Perhaps programs other than Social Security's OASI could be designed to provide adequate lifetime retirement income for the percentage of workers needing such assistance.

Summary

In closing, I again thank the subcommittee for the opportunity to present some ideas on behalf of the American Academy of Actuaries on these important issues facing Social Security. The increased longevity of Americans is a benefit to us in many ways, but it also increases the cost of financing a secure retirement. Delaying action to fix Social Security can only reduce the options available to us. By dealing with this issue sooner rather than later, we can ensure that the system that has benefited several past generations will continue to provide retirement security for generations to come. Thank you. I would be happy to answer any questions you might have at the appropriate time.

⁶ Munnell and Sass, "Working Longer," and Lakdawalla, Bhattacharya and Goldman, "Are The Young Becoming More Disabled."

Appendix

Life Expectancy at Age 65

Year (age 65)	Male	Female
1940	12.7	14.7
1950	13.1	16.2
1960	13.2	17.4
1970	13.8	18.5
1980	14.7	18.8
1990	16.0	19.3
2000	17.5	20.0
2010	18.6	20.7
2011	18.7	20.7
2035	20.3	22.3
2060	21.7	23.4
2085	22.9	24.6

Source: 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds

<http://www.ssa.gov/oact/tr/2012/tr2012.pdf>