The Impact on Inequality of Raising the Social Security Retirement Age

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Executive Summary

There have been a number of proposals in policy circles that involve raising the Social Security retirement age. This is viewed as both a way to reduce or eliminate the projected shortfall in the program and also a response to projected increases in longevity.

This paper examines the impact of an increase in the retirement age on various demographic groups. Treating future Social Security benefits as a form of wealth, it projects the impact of a gradual increase in the normal retirement age from 67 to 70 (2 months a year for 18 years) on each quintile of the wealth distribution using data from the Federal Reserve Board's 2007 Survey of Consumer Finances.

It constructs separate projections for homeowners and non-homeowners, single individuals and couples in the age cohorts 35-44, 45-54, and 55-64. The projections show that Social Security wealth is a far larger share of the wealth of the bottom four quintiles in each of these categories, therefore a reduction in Social Security benefits will have the effect of increasing inequality.

For example, for the lowest wealth quintile of non-homeowner couples in the 35-44 cohort in 2012, this increase in the retirement age would imply an 18 percent decline in wealth. By contrast, the top quintile of this cohort would see a decline of just 8 percent.

For single individuals in this cohort, the cut would imply a reduction in wealth of 18 percent for the bottom quintile of homeowners, compared to 5 percent for the top quintile.

For the 45-54 cohort, the increase in retirement age implies a reduction in wealth of 6 percent for the bottom quintile of couples who are homeowners. It implies a reduction of less than 1 percent for the top quintile.

For the bottom quintile of single homeowners, this increase in the retirement age implies a 5 percent reduction in wealth, whereas the fall in wealth is less than 1 percent for the top quintile.

For the bottom quintile of homeowners in the 55-64 cohort, the increase in the retirement age implies a cut in wealth of more than 2 percent. The reduction in wealth for those in the top quintile is less than 1 percent.

Since Social Security is hugely important to moderate- and middle-income families and relatively unimportant to the wealthy, an increase in the retirement age, like any other cut in benefits, will have the effect of increasing inequality. This should be an important factor in considering such measures.

Introduction

The full retirement age for Social Security benefits – originally 65 – is currently 66 years, and is scheduled to increase over the next 15 years to age 67 for workers born in 1960 and later. Every year of increase in this "normal" retirement age (NRA) is equivalent to a cut in benefits of 6-7 percent.[1] Despite this increase, there has been discussion of raising the retirement age even further – to 69, 70, or even higher.

The primary justification for such an increase is that the Social Security Trust Fund faces a looming shortfall. Yet the Congressional Budget Office projects that Social Security will be able to pay all promised benefits through 2038.[2] Thereafter, even with no changes whatsoever, Social Security will be able to pay more than 80 percent of benefits until 2070. Under current law, a young worker planning to retire at age 70 will receive a monthly benefit 24 percent larger than if the same worker retired at age 67. However, those credits for delayed retirement would be eliminated if the retirement age were increased to 70, resulting in a 19 percent cut in benefits. In addition, workers who start collecting benefits at an earlier age would see a reduction in benefits of roughly 18 percent compared to current law.

Another justification for an increase in the retirement age is that life expectancy is increasing, and the retirement age has not kept up. But this makes little sense when discussing workers in physically demanding jobs who are often unable to continue working into their late 60s.[3] Additionally, as we reported in earlier work, there has been considerable widening of the gap in life expectancy between high- and low-income workers. As a result, the already-scheduled increase in the retirement age has effectively wiped out the gains in expected years of retirement (if workers retire at NRA) for males in the bottom half of the income distribution.[4]

In this paper, we investigate the impact of advancing the scheduled increase in the retirement age and extending those increases until the retirement age reaches 70 for those born in 1975. Specifically, we project the impact on the distribution of wealth of the loss of future Social Security benefits due to an increase in the NRA.

1 2011 Social Security Trustees Report, Table V.C3. http://www.socialsecurity.gov/OACT/TR/2011/V_C_prog.html#180548

2 CBO. 2011. "CBO's 2011 Long-Term Projections for Social Security: Additional Information." Washington, DC: CBO. http://www.cbo.gov/publication/41644

3 See Rho, Hye Jin. 2010. "Hard Work? Patterns in Physically Demanding Labor Among Older Workers." Washington, DC: Center for Economic and Policy Research. http://www.cepr.net/index.php/publications/reports/patterns-in-physically-demanding-labor-among-older-workers

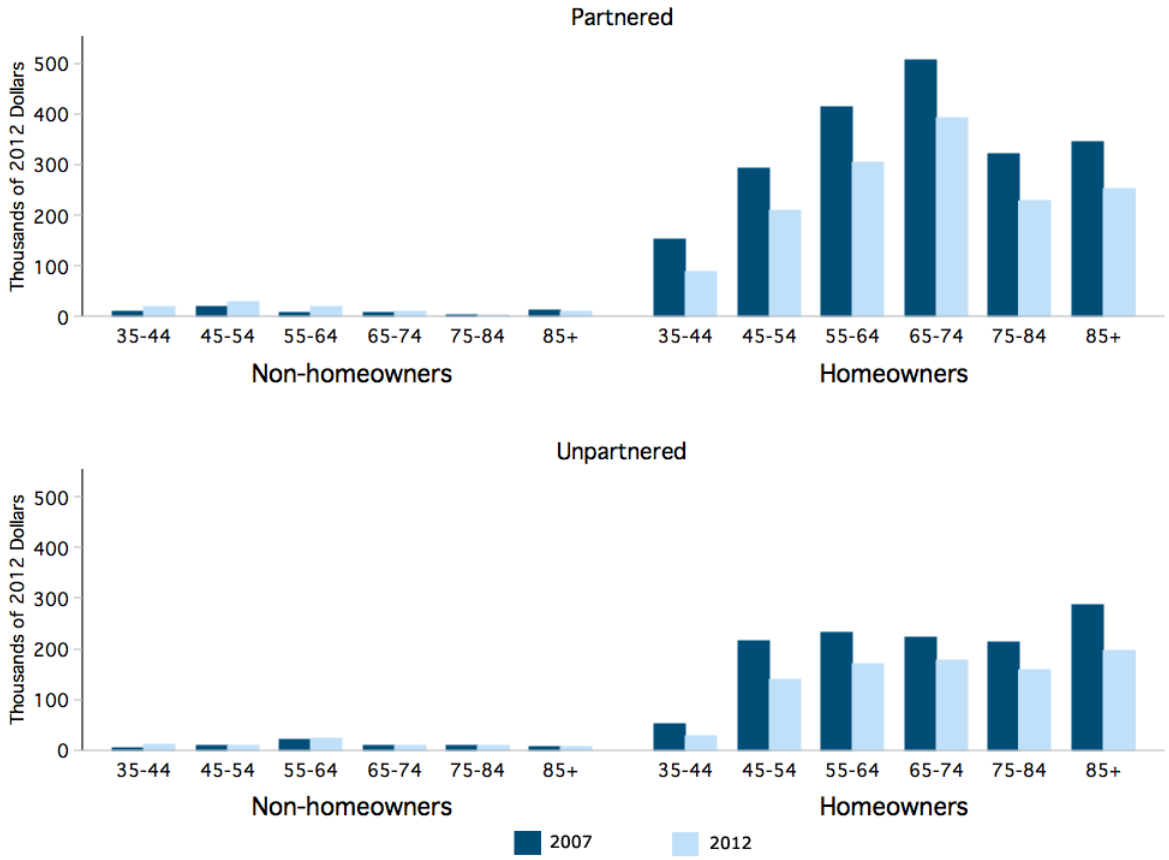
4 Baker, Dean and David Rosnick. 2010. "The Impact of Income Distribution on the Length of Retirement." Washington, DC: Center for Economic and Policy Research. http://www.cepr.net/index.php/publications/reports/impact-of-income-distribution-on-retirement-length

The Distribution of Wealth by Household Types

Net worth varies greatly by age and partnership status. Among all respondents to the 2007 Survey of Consumer Finances,[5] there were some 16 times as many un-partnered household heads aged 30-39 in the bottom fifth of national net worth as were in the top fifth. By contrast, there were nearly five partnered household heads aged 60-69 in the top fifth of overall net worth for every one in the bottom fifth.

From the time of the survey to December 2011, stock prices fell 15 percent and home prices fell 30 percent. For homeowners, who in general are much more wealthy than non-homeowners, this represented a significant fall in net worth. Non-homeowners, having relatively little wealth, are much more dependent on Social Security to support their retirements. **Figure 1** shows real median net worth in 2007 and at the start of 2012 by age, partnership status, and homeownership. (See the Appendix for the data shown in all figures.)

FIGURE 1
Median Household Net Worth by Age, Partnership Status, and Homeownership, 2007 and 2012



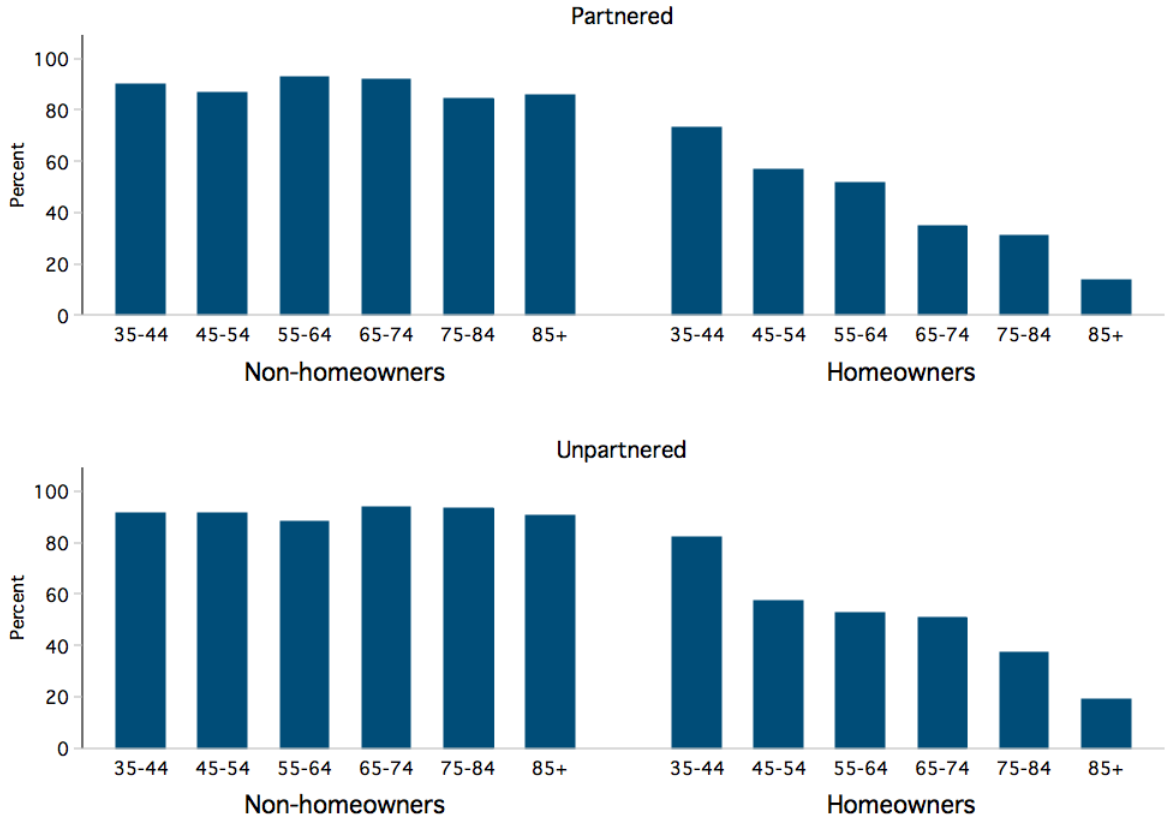
Source: Authors' analysis of 2007 Survey of Consumer Finances

5 The most recent year for which the full Survey of Consumer Finances is available is 2007.

Figure 1 shows a distressing story. Excluding defined-benefit pensions, we estimate the median net worth of partnered homeowners aged 65-74 in 2012 to be $391,600 – enough to produce an annuity of approximately $15,000 per year. For partnered renters aged 45-54 the median reached only as high as $29,000. These low-wealth households will be, in effect, entirely dependent on Social Security.

We therefore create an expanded measure of net worth by adding the current value of promised Social Security benefits into net worth. This allows us to observe just how dependent households are on Social Security.[6] **Figure 2** shows that for half of renting households, Social Security accounts for 85-95 percent of their expanded net worth. Even for homeowners, future Social Security benefits represent a large portion of their wealth.

FIGURE 2
Projected Median Social Security Share of Expanded Net Worth, by Age, Partnership Status, and Homeownership, 2012



Source: Authors' analysis of 2007 Survey of Consumer Finances

Even so, there is great variation in net worth within each group. **Figures 3A** though **3C** show mean net worth by percentile defined within each partnership/homeownership group. Figure 3A covers household heads aged 55-64 in 2012, while Figures 3B and 3C cover ages 45-54 and 35-44,

6 See Appendix for details.

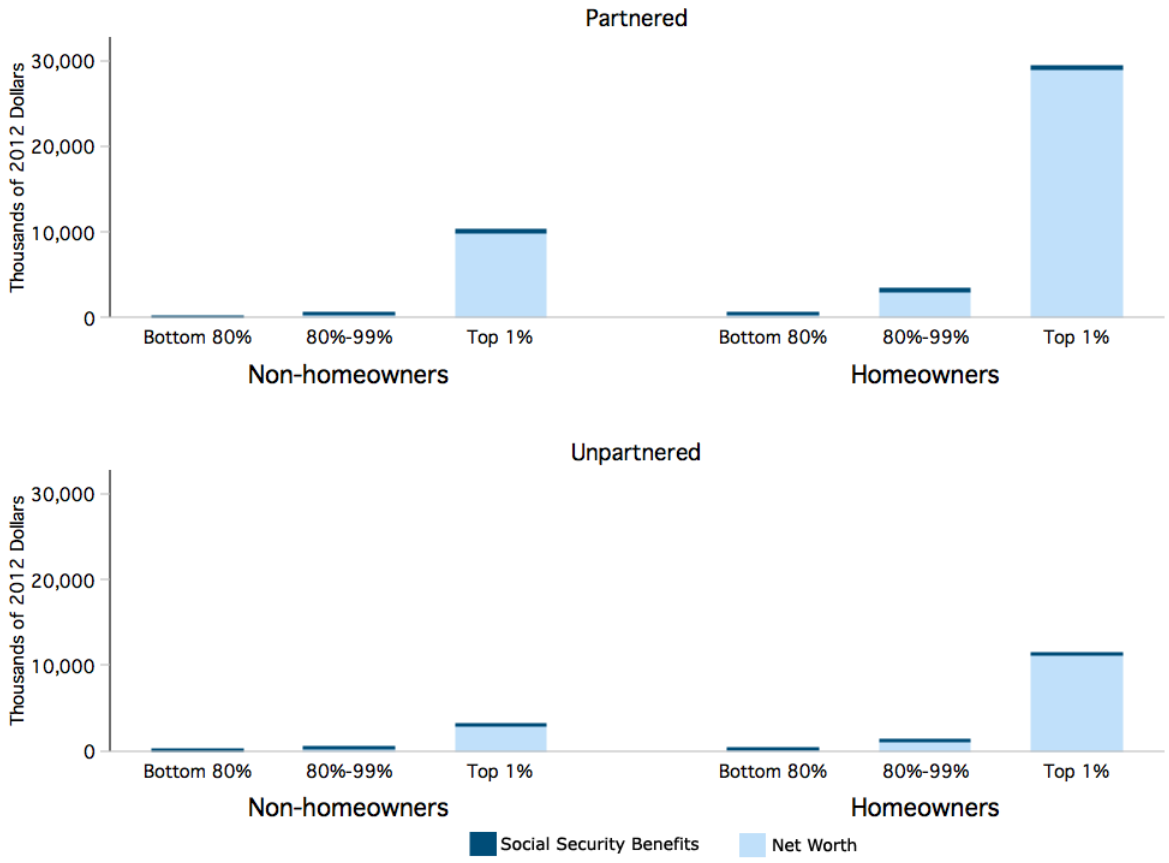
respectively. In addition to net worth, each graph shows the impact of including future Social Security benefits to the total.

As may be seen in Figure 3A, and the accompanying table, the distribution of Social Security benefits is far more even than the distribution of other wealth. Thus, the bottom 80 percent of non-homeowning partnered households aged 55-64 are extremely dependent on Social Security. These benefits account for 93 percent of the group's expanded net worth. By contrast, within the top 1 percent of such households, Social Security accounts for only 5 percent of net worth. Any cut to benefits would impact these wealthier households far less than the vast majority.

The bottom 80 percent of partnered homeowners, holding as a group 19 times as much wealth than their renting counterparts, are correspondingly less dependent on Social Security. Yet Social Security still accounts for more than half of their expanded net worth. To the top 1 percent, who average nearly $30 million per household in net worth, Social Security is nearly meaningless.

We see a similar story in Figures 3B and 3C, below. The younger cohorts have less wealth than their older counterparts, and are therefore relatively more dependent on Social Security.

FIGURE 3A
Mean Net Worth by Group Percentile, Householders Aged 55-64 in 2012

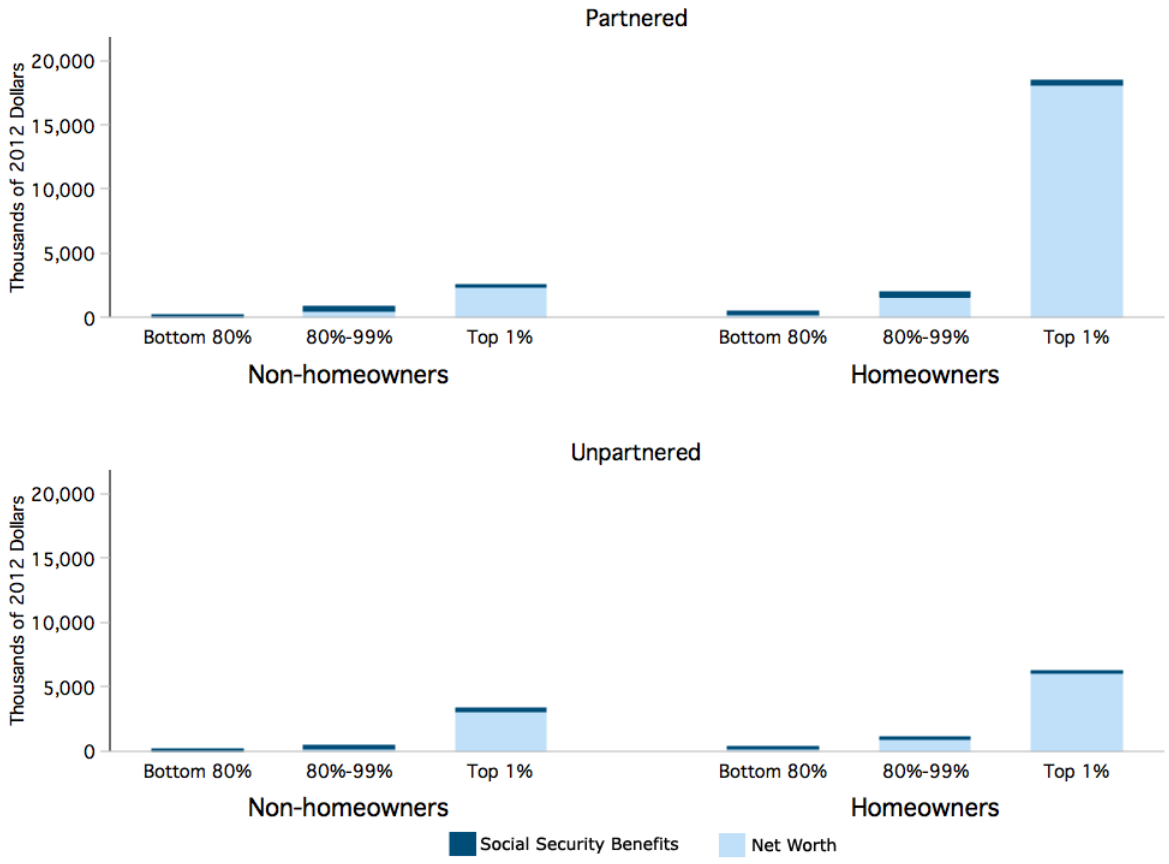


Source: Authors' analysis of 2007 Survey of Consumer Finances

DATA TABLE FOR FIGURE 3A

Group		Percentiles within Group	Net Worth (2012 dollars)	Social Security (2012 dollars)	SS Share (percent)
Partnered	Non-homeowners	Bottom 80%	15,100	213,500	93
		80%-99%	312,900	342,900	52
		Top 1%	9,871,000	490,200	5
	Homeowners	Bottom 80%	290,800	334,400	53
		80%-99%	2,980,200	393,100	12
		Top 1%	28,948,800	427,700	1
Unpartnered	Non-homeowners	Bottom 80%	23,800	180,400	88
		80%-99%	250,600	209,400	46
		Top 1%	2,935,000	286,900	9
	Homeowners	Bottom 80%	143,900	189,100	57
		80%-99%	1,114,300	248,100	18
		Top 1%	11,146,600	279,800	2

FIGURE 3B
Mean Net Worth by Group Quintile, Householders Aged 45-54 in 2012

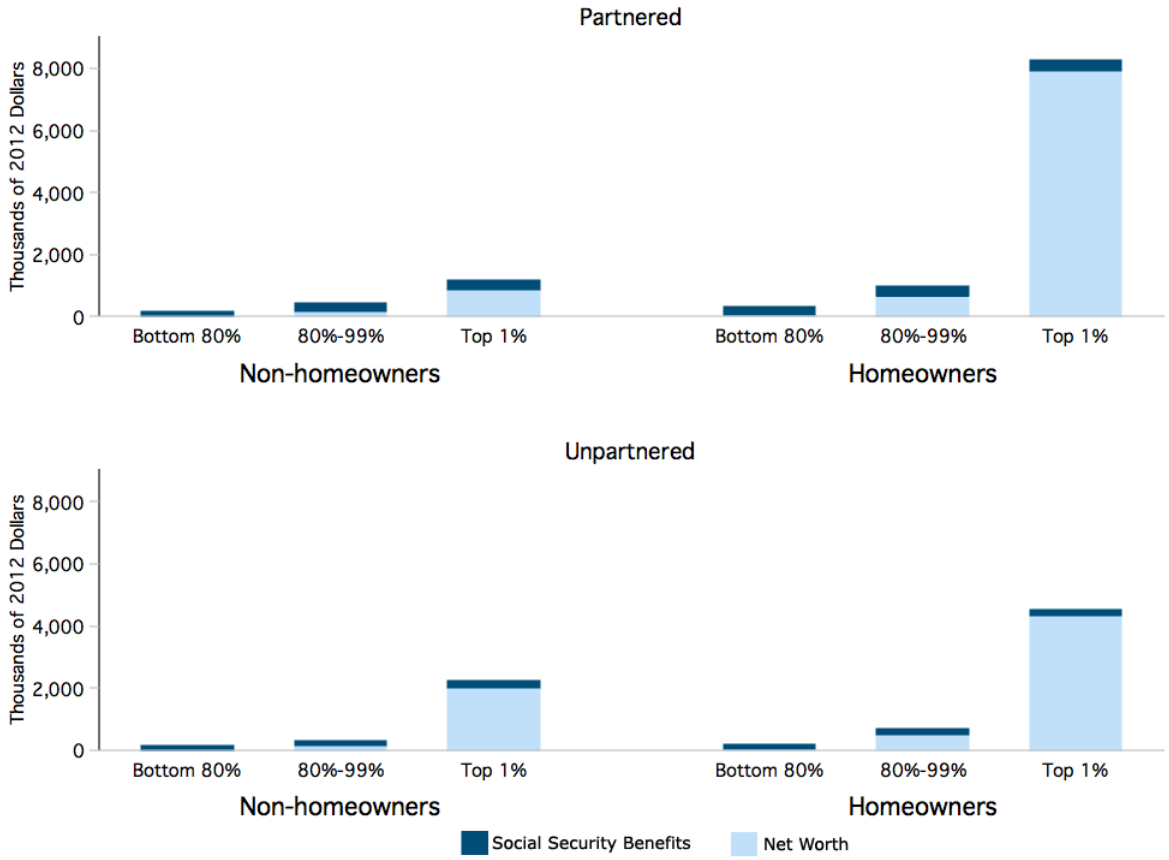


Source: Authors' analysis of 2007 Survey of Consumer Finances

DATA TABLE FOR FIGURE 3B

Group		Percentiles within Group	Net Worth (2012 dollars)	Social Security (2012 dollars)	SS Share (percent)
Partnered	Non-homeowners	Bottom 80%	30,700	204,400	87%
		80%-99%	504,200	326,800	39
		Top 1%	2,368,600	215,000	8
	Homeowners	Bottom 80%	173,600	278,400	62
		80%-99%	1,599,800	363,800	19
		Top 1%	18,073,700	400,700	2
Unpartnered	Non-homeowners	Bottom 80%	11,800	129,600	92
		80%-99%	210,100	200,600	49
		Top 1%	3,084,800	254,900	8
	Homeowners	Bottom 80%	118,700	185,000	61
		80%-99%	868,100	229,800	21
		Top 1%	6,044,900	247,400	4

FIGURE 3C
Mean Net Worth by Group Quintile, Householders Aged 35-44 in 2012



Source: Authors' analysis of 2007 Survey of Consumer Finances

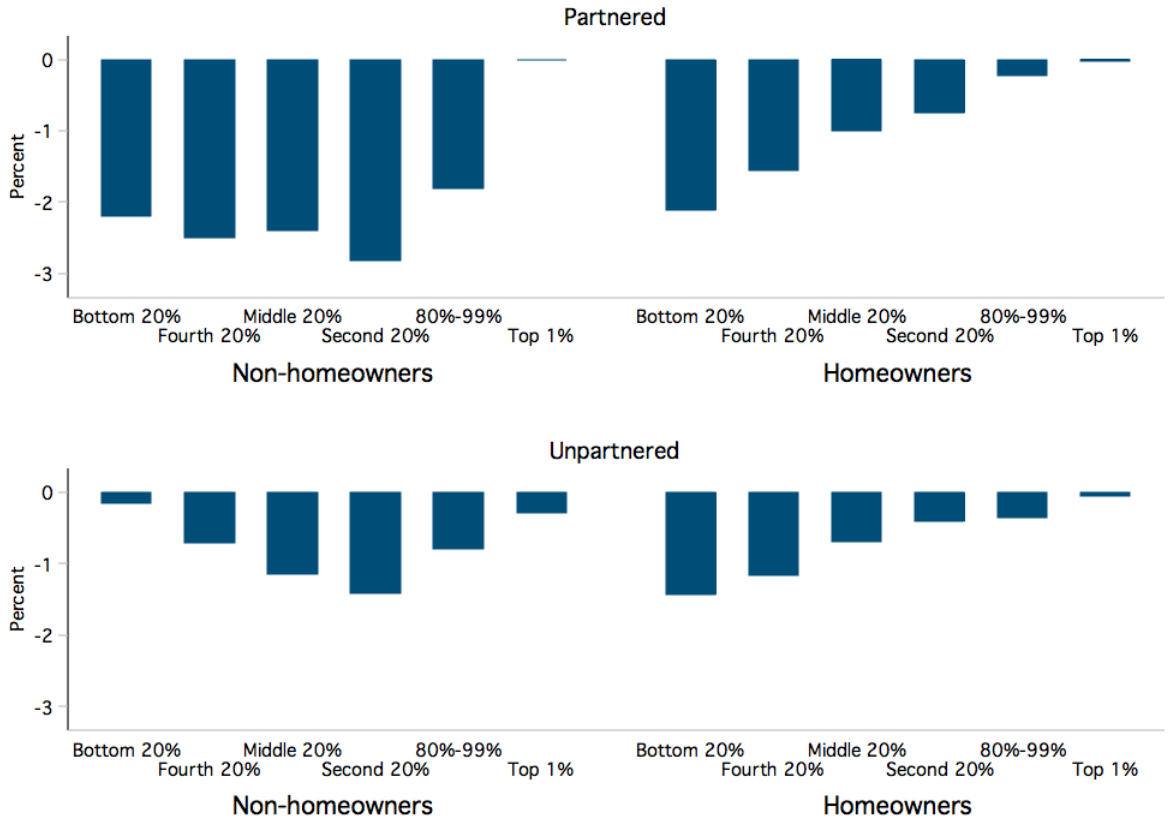
DATA TABLE FOR FIGURE 3C

Group		Percentiles within Group	Net Worth (2012 dollars)	Social Security (2012 dollars)	SS Share (percent)
Partnered	Non-homeowners	Bottom 80%	10,500	168,100	94
		80%-99%	175,000	271,300	61
		Top 1%	877,000	317,500	27
	Homeowners	Bottom 80%	70,800	246,000	78
		80%-99%	663,400	302,600	31
		Top 1%	7,930,900	354,800	4
Unpartnered	Non-homeowners	Bottom 80%	5,000	124,400	96
		80%-99%	143,400	157,500	52
		Top 1%	1,991,900	232,200	10
	Homeowners	Bottom 80%	25,200	148,800	86
		80%-99%	481,600	191,700	28
		Top 1%	4,315,300	210,100	5

Given the large share of Social Security in the expanded wealth of most households, it is natural to ask what effect an increase the retirement age would have on net worth. **Figures 4A** through **4C** shows the mean change in expanded net worth if such a change were included. Retirees and near-retirees would be hardly affected. However, for the youngest households – who would be most affected by such a change – an increase in the retirement age to 70 can be quite significant.

As expected, a hike in the retirement age does not have a large impact on the 55-64 age cohort as the previously scheduled increase to 67 is moved up three years. The increase generally takes a bigger bite out of the less wealthy – especially renters – but we see an interesting pattern among un-partnered renters. In the first four quintiles the effect of the retirement age actually has a larger impact on wealthier households. This is explained by the fact that an unusually large percentage of these less-wealthy households were already receiving Social Security benefits – as with the 82 percent of the bottom quintile receiving benefits in 2007. They are therefore not penalized by any future increase in the retirement age.

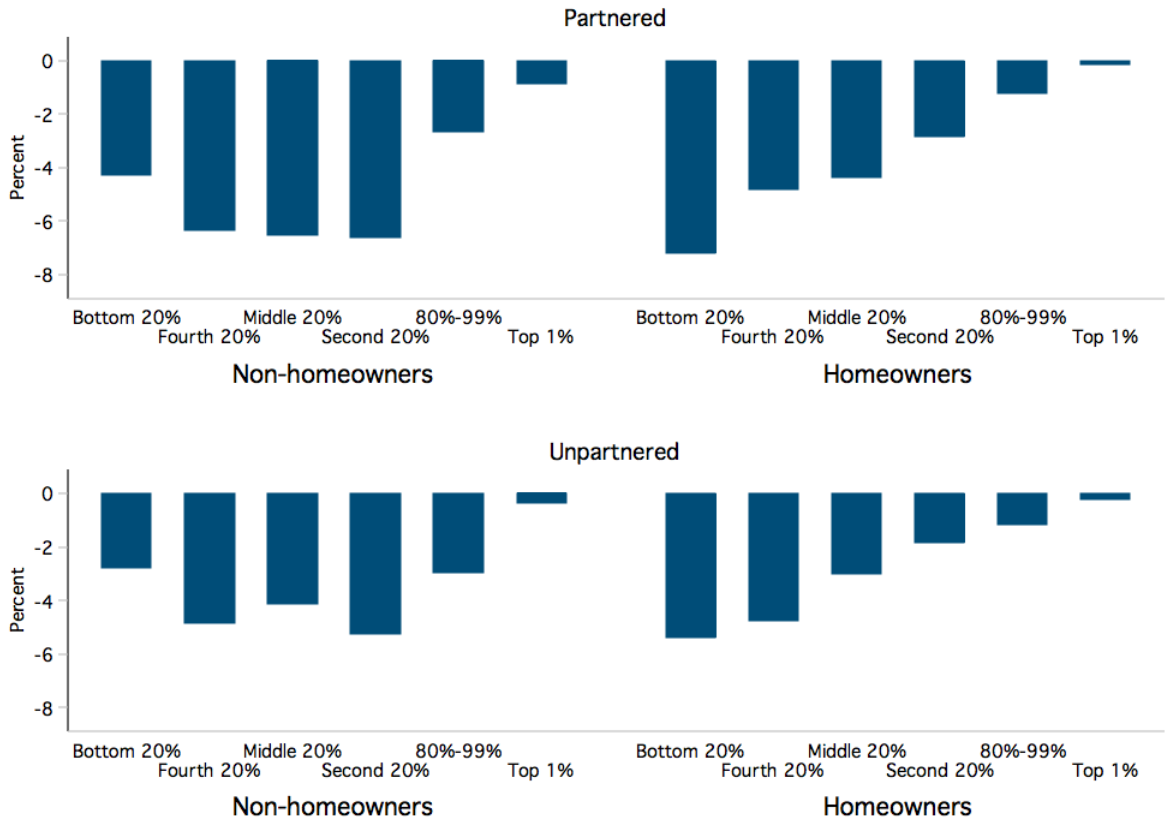
FIGURE 4A
Percent Change in Mean Net Worth by Group Quintile From Increase in Normal Retirement Age to 70, Householders Aged 55-64 in 2012



Source: Authors' analysis of 2007 Survey of Consumer Finances

In Figure 4B – for households aged 45-54 in 2012 – we see much the same effect, although the cuts are deeper and the mitigating effect of current benefits among the less-wealthy households is not as strong.

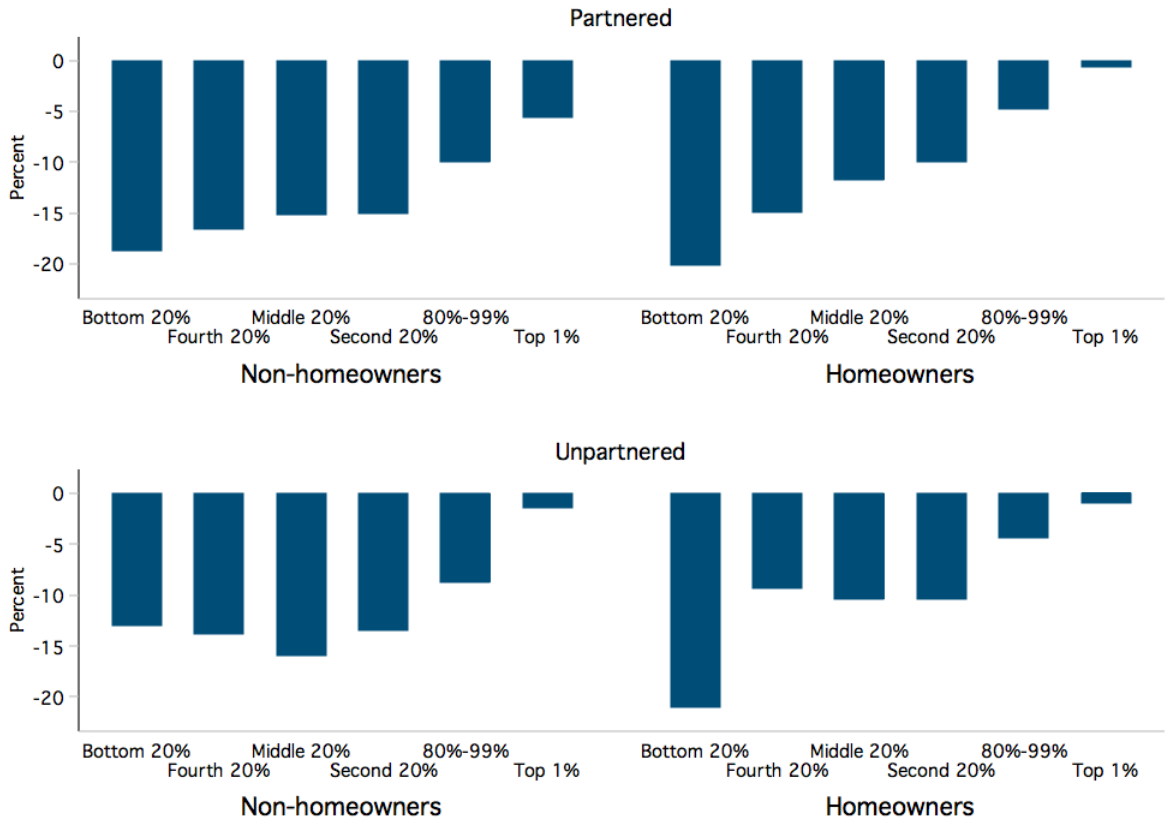
FIGURE 4B
Percent Change in Mean Net Worth by Group Quintile From Increase in Normal Retirement Age to 70, Householders Aged 45-54 in 2012



Source: Authors' analysis of 2007 Survey of Consumer Finances

By the time the oldest workers in the 35-44 age group (Figure 3C) would be eligible for benefits, the retirement age would be 69 – two years beyond current law. At whatever age a worker would choose to collect benefits, the cut would be considerable.

FIGURE 4C
Percent Change in Mean Net Worth by Group Quintile From Increase in Normal Retirement Age to 70, Householders Aged 35-44 in 2012



Source: Authors' analysis of 2007 Survey of Consumer Finances

Conclusion

The value of future Social Security benefits is by far the largest source of wealth for households who are not in the top quintile of the income distribution. The vast majority of workers approaching retirement in the next two decades will not have defined benefit pensions. Most have accumulated little in 401(k)s or other defined contribution retirement plans. Those near retirement have lost much of the equity they had in their homes, due to the collapse of the housing bubble. As a result, future Social Security benefits are the main source of wealth that they will be able to rely upon in retirement.

Raising the normal retirement age amounts to a cut in benefits. Since low- and middle-income households are far more dependent on Social Security than households in the top quintile, this cut would imply a substantial upward redistribution of wealth.

Appendix: Sources, Methods, and Data Tables

The primary source in this paper is the 2007 Survey of Consumer Finances (SCF).[7] Based on the publicly available micro-data[8], we calculated the net worth of households in 2007, breaking out stocks, housing, and housing-related debt based on the SAS source code provided by the Federal Reserve.[9] All respondents with current wage, salary, or social security income – regardless of type of home – were considered.

In addition we extracted the age, sex, regular annual wage, and income from Social Security for the head of household[10] and for any partner. Based on the age of the head, households were divided into ten-year cohorts, starting with those aged 30-39 in the survey (and 35-44 in 2012.)

The Average Wage Index[11] (AWI) for 2011-22 and Cost-Of-Living-Adjustments[12] (COLA) for December 2012-22 are taken from CBO's January 2012 baseline.[13] After 2022, COLA is assumed to remain 2.3 percent, while the trend AWI is assumed to continue thereafter.

We then estimated the present value of remaining lifetime benefits from Social Security to the head of household and to any partner as follows. If either individual reported any social security income, then we assume that their benefits, if any, will not change over time except for regular COLA increases each December. Otherwise, if neither individual was age 75 in 2007, the individual is assumed to retire in January of the year he or she turned age 63, with an assumed birthday on January 2nd, or otherwise at the earliest possible date consistent with zero Social Security income in 2007 – that is, January 2008. It is assumed that the individuals live through at least year 2011, and the individuals' expected present value of benefits are calculated based on life tables provided by Social Security. For same-sex partners the benefits are calculated separately for each partner, but for mixed-sex partners, the worker and spousal benefits are calculated based on each individual record and we assume the greatest available combination of benefits. The benefit for any eligible worker is computed assuming a complete work history with an annual wage indexed in proportion to the AWI.

Finally, we project alternative benefits from Social Security assuming that the scheduled increase in the retirement age from 66 is accelerated to begin with those eligible to retire in 2013 (those born in 1951, hence age 58 in 2007). In addition, the retirement age is assumed to continue to grow beyond age 67 at the rate of two months for every year of birth until the retirement age reaches 70 years.

Net worth outside of Social Security in 2012 is computed as follows. Positive SCF net worth, less stocks, housing, and housing debt is assumed to grow by 5 percent of household wage income

7 http://www.federalreserve.gov/econresdata/scf/scf_2007.htm
8 http://www.federalreserve.gov/econresdata/scf/scf_2007survey.htm
9 http://www.federalreserve.gov/econresdata/scf/files/bulletin.macro.txt
10 For purposes of the survey, the Federal Reserve defines the head of household as "either the male in a mixed-sex couple or the older individual in a same-sex couple." We accept this definition for convenience and as with the Federal Reserve, "indicates no judgment whatsoever about the arrangements of individual families." See codebook documentation for variable X8000. http://www.federalreserve.gov/econresdata/scf/files/2007_codebk2007.txt
11 http://www.ssa.gov/oact/COLA/awiseries.html
12 http://www.ssa.gov/oact/COLA/colaseries.html
13 http://www.cbo.gov/publication/42902

annually from September 2007 to December 2011. Housing debt is assumed constant in nominal terms. The nominal value of stocks follows the change in the S&P 500 from the month's open in September 2007 to the month's open in December 2011.[14] Similarly, the nominal value of housing follows the change in the Case-Shiller 20-city index from September 2007 to December 2011.[15]

DATA TABLE FOR FIGURE 1
Median Household Net Worth by Age, Partnership Status, and Homeownership, 2007 and 2012
(thousands of 2012 dollars)

		Non-homeowner		Homeowner	
		Partnered	Unpartnered	Partnered	Unpartnered
35-44	2007	11.44	4.36	153.59	52.71
	2012	19.15	11.06	88.60	27.42
45-54	2007	20.81	7.84	291.93	215.02
	2012	28.98	9.80	209.86	140.63
55-64	2007	8.93	19.63	413.71	233.00
	2012	20.14	23.08	305.88	169.44
65-74	2007	8.06	8.12	507.60	221.67
	2012	10.41	8.85	391.64	178.58
75-84	2007	4.37	9.47	321.99	212.05
	2012	4.01	8.69	227.76	158.42
85-100	2007	12.37	6.75	344.76	287.57
	2012	11.36	6.20	253.72	195.38

DATA TABLE FOR FIGURE 2
Projected Median Social Security Share of Expanded Net Worth, by Age, Partnership Status, and Homeownership, 2012
(percent)

	Non-homeowner		Homeowner	
	Partnered	Unpartnered	Partnered	Unpartnered
35-44	89.84	91.49	73.32	82.13
45-54	86.79	91.63	56.84	57.35
55-64	92.66	88.12	51.73	52.59
65-74	91.92	94.12	34.89	50.77
75-84	84.23	93.53	30.82	37.19
85-100	85.54	90.44	13.88	18.85

14 http://finance.yahoo.com/q/hp?s=%5EGSPC&a=08&b=4&c=2007&d=11&e=1&f=2011&g=m
15 http://www.standardandpoors.com/indices/articles/en/us/?articleType=XLS&assetID=1245214507706

DATA TABLE FOR FIGURE 4A
Percent Change in Mean Net Worth by Group Quintile From Increase in Normal Retirement Age to 70, Householders Aged 55-64 in 2012

	Non-homeowner		Homeowner	
	Partnered	Unpartnered	Partnered	Unpartnered
Bottom 20%	-2.19	-0.14	-2.11	-1.43
Fourth 20%	-2.5	-0.7	-1.56	-1.17
Middle 20%	-2.39	-1.14	-1	-0.69
Second 20%	-2.82	-1.42	-0.74	-0.41
1%-20%	-1.81	-0.79	-0.23	-0.36
Top 1%	-0.01	-0.28	-0.03	-0.04

DATA TABLE FOR FIGURE 4B
Percent Change in Mean Net Worth by Group Quintile From Increase in Normal Retirement Age to 70, Householders Aged 45-54 in 2012

	Non-homeowner		Homeowner	
	Partnered	Unpartnered	Partnered	Unpartnered
Bottom 20%	-4.27	-2.77	-7.22	-5.38
Fourth 20%	-6.36	-4.86	-4.8	-4.74
Middle 20%	-6.53	-4.13	-4.35	-3.02
Second 20%	-6.6	-5.24	-2.85	-1.83
1%-20%	-2.66	-2.96	-1.24	-1.16
Top 1%	-0.88	-0.34	-0.13	-0.23

DATA TABLE FOR FIGURE 4C
Percent Change in Mean Net Worth by Group Quintile From Increase in Normal Retirement Age to 70, Householders Aged 35-44 in 2012

	Non-homeowner		Homeowner	
	Partnered	Unpartnered	Partnered	Unpartnered
Bottom 20%	-18.74	-12.94	-20.16	-21.04
Fourth 20%	-16.59	-13.84	-14.89	-9.31
Middle 20%	-15.17	-15.96	-11.76	-10.34
Second 20%	-15.05	-13.4	-9.92	-10.36
1%-20%	-9.93	-8.76	-4.81	-4.35
Top 1%	-5.54	-1.45	-0.64	-0.93