



Retirement Responses to Early Social Security Benefit Reductions

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Executive Summary

It has been suggested that cutting early Social Security retirement benefits might lessen the solvency problems of Social Security, since most Americans retire early by filing for Social Security benefits at age 62. Many policymakers appear to believe that retirement patterns (workers' age at retirement and type of benefit applied for) would change if early social security benefits were reduced. Officials of the U.S. General Accounting Office as well as the Social Security Trustees have offered the opinion that raising the early retirement age would lead to an increase in the number of workers applying for disability benefits. However, there is very little research evidence on the size and direction of potential changes in workers' retirement patterns in response to reductions in early retirement benefits. Nor is there much evidence on who would be affected and how. This is important information for policymakers weighing the relative merit of such a policy change.

In this Issue in Brief, we summarize analyses that examine who would be affected by reductions in early Social Security benefits and what changes workers might make in their retirement plans based on this altered policy. To do this, we consider three different pathways into retirement:

- Workers who applied for disability retirement (DR) prior to age 65
- Workers who took early retirement (ER) at or between ages 62 and 64
- Workers who took normal retirement (NR) at or after 65

Because we have no actual experience of early benefit reductions, our analysis employs a policy experiment in which we use information obtained from older workers to estimate what the effects might be of specific reductions on their retirement options and choices. We also employ a life cycle approach, which means that we consider the entire work history as well as the stream of expected future benefits (over several years) as influencing retirement decisions.

Eligibility and Benefits under the Old-Age, Survivors, and Disability Insurance system (OASDI)

Eligibility for Social Security retirement benefits requires that a worker must have earned 40 quarters of coverage in order to be fully insured. If this is accomplished by age 62, then early retirement is permitted. Eligibility for disability insurance includes a requirement that the worker must have earned 20 quarters of coverage during the last 40 calendar quarters ending in disability. The benefit calculated by Social Security is the Primary Insurance Amount (PIA); however, the actual amount paid out depends on the worker's age at retirement. If the worker is 65, currently the normal retirement (NR) age, then his benefit equals the PIA. If he is less than 65 years old, the benefit is reduced 5/9 of a percent for every month below that age. Workers taking early retirement (ER) thus receive 80 percent of the full PIA. If the worker is eligible for Disability Retirement (DR) then his benefit equals his PIA and may be paid out earlier than age 65.

The Data

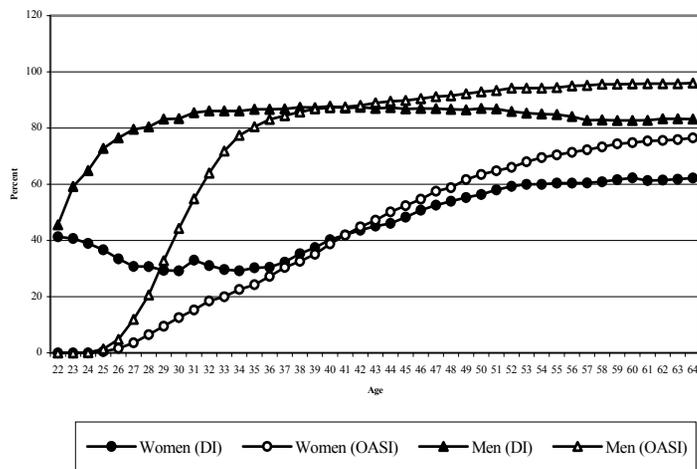
To understand the impact of these rules and changes to them on the behavior of real workers, we used data from the University of Michigan Health and Retirement Study (HRS), a nationally representative panel survey of older Americans. These data can be linked to social security records, allowing us to compute respondents' eligibility status for benefits as well as the likely benefit amounts workers would receive for selecting the retirement pathways we consider (ER, NR, and DR). We are also able to include information on employer benefits (pension, health and disability insurance), personal wealth, and health status.

Summary of Major Findings

Characteristics of Workers Selecting Different Retirement Pathways

- Older workers are not universally eligible for Social Security old-age benefits, and those with little retirement wealth are the least likely to be insured (Figure 1: OASDI Insured Status for HRS Respondents by Age and Sex).
- Workers selecting early or normal retirement (ER or NR) are both healthier and better educated than those who ended up on disability retirement. Those who took ER are demographically similar to those who took NR.
- The amount of benefit workers can anticipate from social security is very similar for those selecting NR and ER but is far lower for those who become DR retirees. DR retirees have less housing wealth and fewer financial assets even before they retire on disability.

Figure 1: OASDI Insured Status for HRS Respondents by Age and Sex



Effect of Reducing Early Social Security Benefits on Retirement Wealth

- Putting together all sources of retirement wealth, workers in the median 10 percent of wealth could anticipate a present value of DR wealth of \$451,000; by contrast, the ER path is worth about \$522,000 and the NR path around \$611,000.
- To simulate a reduction in ER benefits, we recalculate these numbers assuming that the value of ER benefits was reduced by \$25,000 while other sources remained the same. We find the largest percentage decrease in expected

retirement wealth is for workers with the lowest retirement wealth.

- The hypothetical benefit cut would have the largest impact on the poorest workers, who, in this sample, are more likely to be black, have less education, and be in poor health.

Effect of Reducing or Eliminating Early Social Security Benefits on Retirement Pathway

- The hypothetical reduction of \$25,000 in ER benefits would be expected to change retirement patterns:
 - Fewer workers would elect ER
 - More workers would be likely to elect DR and NR, but of those choosing these alternatives, more than twice as many workers would choose NR as DR.
- Overall, given a rather large hypothetical benefit reduction, the magnitude of the anticipated change in retirement pathways is quite small.
 - If ER benefits were to be cut entirely, the same pattern is observed. As in the benefit reduction experiment, workers would be three times more likely to opt for NR as DR.
 - Under these hypothetical scenarios, workers likely to move to DR instead of NR are more likely to be in poor health, reflecting the fact that they are more likely to be medically eligible for DR benefits.
 - Workers with employer health and disability insurance are less likely to opt for DR. However, workers

with retiree health coverage and pensions are more likely to move to DR.

Conclusion

Our policy experiment indicates that early Social Security benefit cuts would have relatively small effects on the likelihood of early retirement. If early retirement benefits were to be eliminated, more than twice as many workers in this sample would be likely to work to normal retirement age as opposed to filing for disability retirement. Thus, we conclude from these findings that Social Security early retirement benefit cuts would induce more workers to delay benefit acceptance rather than opt for disability retirement.

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