

# MRRC RESEARCHER

*Alan Gustman and Tom Steinmeier  
discuss their MRRC-supported research*

JULY 2005



**Q:** How would you describe your MRRC-supported work?

**A:** For the past decade, we have used the data in the Health and Retirement Study (HRS) to examine how potential changes in Social Security and pensions may change retirement and saving patterns. A distinguishing feature of our research is the use of a model which allows individuals to have differing degrees of impatience regarding current vs. future consumption.

Thanks to the continuing support of MRRC over the past 7 years, we have been able to pursue a coherent research agenda that is most helpful and informative for policy makers and has allowed us to systematically develop and apply models required to fully understand how Social Security affects retirement and saving.

Our work has demonstrated the importance of having models that jointly explain saving and retirement, that allow for differences within the population in taste for saving -- thereby explaining the spike in retirement activity at age 62, that distinguish partial from full retirement, that allow interactions in the retirement decisions of couples and the reluctance of husbands to retire before their wives or if their wife is sick.

With such models—which can only be estimated because of the availability of the HRS—it is possible to simulate retirement effects of provisions under current law. We can also evaluate the likely effects of changes in Social Security policies, such as changes in the early retirement age, earnings test, delayed retirement credit, introduction of personal accounts, allowance for lump sum settlements, etc...

We also have been able to better understand the distributional implications of various policies, especially since SSA allowed Social Security records to be matched with HRS respondents who gave their permission. Providing this information to researchers on a confidential basis protects the respondent.

**Q:** What are some highlights of your findings that are of greatest policy relevance for SSA right now?

**A:** First, changes in the early retirement age are likely to have significantly more impact on retirement than would changes in the normal retirement age. Currently about 15 to 20 percent of each cohort of individuals retires during their 62nd year. Some individuals simply have not saved enough to retire before Social Security eligibility. Others value highly the benefits that would be lost by working and tend to ignore the future benefit increases which would occur as a result, even though the future increases are roughly actuarially fair. In short, they view the lost benefits more as a tax, which discourages work.

Our model indicates that, of those who currently retire at age 62, roughly two-fifths would delay retirement if the early retirement age were increased. If the early retirement age were increased, it is possible that more individuals would apply for disability. However, the number of SSDI male recipients who enter the program at age 60 is only about 18,000, with similar numbers at other ages in the 56-61 age range. Even if the numbers at ages 62 and 63 were to rise to similar levels because of an increase in the early retirement age, it would simply be too small to change the results appreciably.

Second, eliminating the current earnings test would also reduce retirement, though by a smaller amount than increasing the early retirement age. Much of the impact would be that fewer individuals would be working part time and more would be working full time if the earnings test were repealed. However, many more individuals would be collecting benefits at ages 62 through 64, which would be a drain on the finances of the system. This would also reduce the eventual level of benefits that these individuals could collect during their retirement.

Third, increases in the early retirement reduction would also have significant effects. Changing the reduction to the level specified in the President's Commission report would increase the percentage of 62-65 year olds working fulltime by around three percentage points, which is a little less than eliminating the earnings test but nonetheless substantial. Proposals to increase the delayed retirement credit would have much less of an effect, primarily because the earnings test does not apply to individuals above the normal retirement age.

Fourth, potential lump sums can have a large effect on retirement. If lump sums are tied to retirement, individuals may retire earlier in order to gain access to the lump sums, especially if the lump sums are made available at age 62. If the lump sums are not tied to retirement, we can expect a nontrivial fraction of the population to withdraw and spend the lump sums, leaving less income and assets available to support retirement later on. To make matters worse, these are likely to be individuals who have accumulated few other assets for retirement.

Our related work has generated other punch lines relevant to the design of Social Security policies. Despite the progressive appearance of the benefit formula, there is little redistribution among families with different potential earnings levels. Also, high-income immigrant families with short tenures in the U.S. get exceptionally high returns from Social Security, but there is an easy fix for this perhaps unintentional result. Regarding the proposals of the President's Commission, the method used to calculate benefits implies if there were another round of benefit reductions after having adopted the proposals, total benefit reductions would be the same whether a person had chosen a personal account or not. Finally, simulations of the total effects of the Commission proposals would be to reduce the percentage of retired 62 year olds by about four percentage points.

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Alan L. Gustman is Professor of Economics at Dartmouth College and holds the Loren M. Berry Chair in Economics. He has taught labor economics and economic theory at Dartmouth since 1969. He is also a Research Associate at the National Bureau of Economic Research in their programs in Labor Studies and Aging, and serves as a co-PI of the Health and Retirement Study (HRS). Gustman and Steinmeier’s research is

focused on the economic analysis of Social Security, pensions, retirement and saving. Most recently, they have authored a series of articles using the Social Security earnings histories and employer provided pension data from the HRS to examine the importance of pensions and Social Security in the wealth, savings and retirement behavior of those on the verge of retirement.

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