MICHIGAN RETIREMENT RESEARCH CENTER

MRRC Newsletter
Volume 1, Issue 2
December 2000

With profound sadness, we announce that Lee A. Lillard, Director of the Michigan Retirement Research Center, senior research scientist at the University of Michigan Institute for Social Research, and professor of economics, died December 2nd at his home in Ann Arbor after a heart attack. An applied econometrician and labor economist, Lillard made important contributions to the study of life cycle earnings, marriage, fertility, divorce, mortality, intergenerational mobility, and a variety of other issues.

Before joining the U-M in 1998, Lillard spent 20 years at RAND, where he held a variety of positions. "As the founding director of RAND's Center for the Study of Aging, he established one of the leading research programs on aging in the world," said James P. Smith, a friend and RAND colleague. While at RAND, he received a National Institute on Aging MERIT Award, the most prestigious award given by the National Institutes of Health.

"Lee was well known in the fields of economics and demography as an incredibly energetic researcher who was always eager to expand into new fields," said David Lam, U-M professor of economics and director of the Population Studies Center at the ISR. "He was also a great collaborator who was committed to interdisciplinary research. We were very fortunate to have attracted him to the University of Michigan, and we will greatly miss his enthusiastic personality and his exceptional research abilities."

While at the U-M, he also served as a member of the steering committee of the Health and Retirement Study, directed by economist Robert J. Willis. "Lee was my friend, collaborator, and colleague for more than twenty-five years," said Willis. "Throughout his career he made significant and immediate contributions to his profession with his keen intellect and intense commitment to doing the best possible social science research. His leadership of the Michigan Retirement Research Center reflected his commitment to giving public policy a firm basis in social science."

“The Social Security Administration initiated the Retirement Research Consortium (RRC) in 1998 to serve as a national resource fostering research, communication, and education on retirement income policy,” according to Paul N. Van de Water, Associate Commissioner for Research, Evaluation, and Statistics at SSA. “We were very fortunate to have Lee Lillard lead the center at the University of Michigan. Lee truly reflected all of the characteristics SSA envisioned for the RRC: being committed to high-quality research, applying his knowledge to important questions of public policy, and training young scholars to do the same. Lee organized a group of colleagues committed to the same goals together to create the Michigan Retirement Research Center. His accomplishments as director and scholar will be widely remembered. We at Social Security will miss him greatly."

Alicia H. Munnell, a colleague who directs the RRC center at Boston College affirms Lillard’s commitment to good science as the foundation for policy. "During his distinguished career, Lee made many valuable contributions to economics and public policy. Lee believed that policy decisions should be informed by first class analysis and he devoted his life to that principle. Lee also took on a major administrative role as Director of MRRC. In that capacity, he encouraged other scholars – including established researchers, junior faculty, and graduate students – to write on retirement issues. Lee's presence will be sorely missed."

A memorial service is planned for January 27, 2001 at RAND, Santa Monica. For more information about the service, please contact Dr. Constantijn Panis at Stan_Panis@rand.org or the MRRC at mrrc@isr.umich.edu.

Regular Features:

Inside this Issue:

Join us in New Orleans!

Visit the MRRC Booth at the Annual Meeting of the Allied Social Science Association in New Orleans, January 5-7, 2001.

We’ll have a new look for the board and copies of the complete working papers for our first two Issues In Brief.

Issue in Brief

Retirement Responses to Early Social Security Benefit Reductions

by Olivia S. Mitchell and John W.R. Phillips

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

(Continued on page 4)

News Notes

MRRC Conference Booth debuts at GSA

Of the multiple efforts now underway to get the word out about the MRRC, the latest to debut is the MRRC conference booth. This method of disseminating information is widely used at annual meetings of professional associations. The first MRRC booth appeared at the annual meeting of the Gerontological Society of America (GSA). The booth was staffed by two MRRC affiliates who responded to various queries from conference attendees. In addition to a presentation board, the booth will regularly contain materials for distribution including copies of MRRC working papers, a full listing of research topics, the center newsletter, brochures about the center and the Sandell dissertation award, and other products as they become available. The MRRC booth will next appear at the Annual Meeting of the Allied Social Science Association in New Orleans, January 5-7, 2001.

Olivia Mitchell winner of 1999 Samuelson Award with John Geanakoplos and Stephen Zeldes

Professor Olivia Mitchell of The Wharton School, co-author of the research brief highlighted in the issue, was the 1999 winner of TIAA-CREF's Samuelson Award for Outstanding Scholarly Writing on Lifelong Financial Security. The Samuelson Award is named after Nobel economics laureate and former CREF trustee Paul A. Samuelson and comes with a $20,000 honorarium. Dr. Mitchell's collaborators in the award-winning research and co-awardees are John Geanakoplos of Yale University and Stephen Zeldes of Columbia University. The authors argue that Social Security privatization has transaction costs and risk levels that have not been fully accounted for in various privatization proposals. They also propose that the transition costs associated with any shift toward privatization have not been given sufficient attention.

Reminder!

The deadline for submitting a proposal for the Sandell Dissertations Award is February 1, 2001. Please visit our website for application instructions and to download a copy of the application.

http://www.mrrc.isr.umich.edu

For Your Information

Qualifying for Social Security Disability benefits

Social Security Disability Insurance is, in effect, early retirement for workers who become so disabled that they are no longer able to work. In order to be eligible for Social Security Disability insurance, a worker must have earned at least 40 credits (or 40 quarters of coverage) and at least 20 of those credits must have been earned in the past ten years. Thus, in order to obtain disability benefits, he or she must be fully *and* recently insured. Disability under Social Security is based on the inability to work. A determination of disability is made if the worker cannot do work he or she did before and cannot adjust to other work because of his or her medical condition(s). The disability also must last or be expected to last a year or to result in death. Workers 31 and younger are insured if they worked half the years after age 21. After normal retirement age, 65, there is no disability insurance because full normal retirement benefits are in effect at that time.

Source: Social Security Administration Web Site, 2000 (http://www.ssa.gov)

Issue in Brief continued from page 2

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.

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.

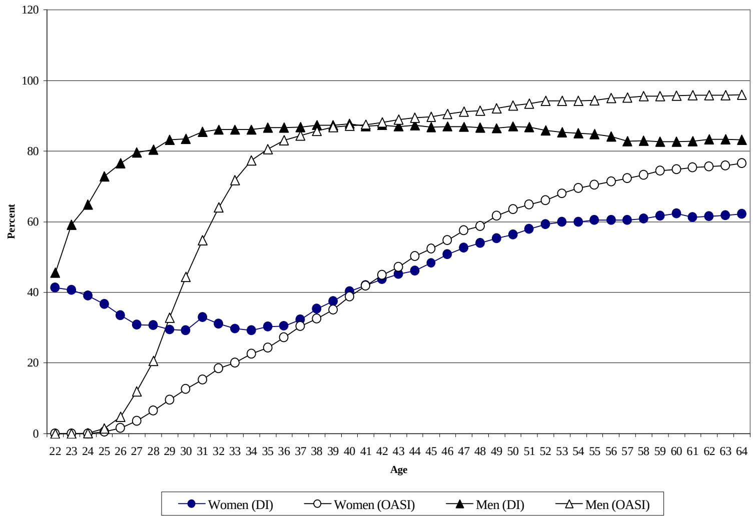
Effect of Reducing or Eliminating Early Social Security Benefits on Retirement Pathway

- The hypothetical reduction of $25,000 in ER benefits would be expected to change retirement patterns:

(Continued on page 5)

Issue in Brief continued from page 4

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



- ◊ 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.

Olivia S. Mitchell is the Executive Director of the Pension Research Council, at the Wharton School of the University of Pennsylvania, Philadelphia, PA 19104 (mitchelo@wharton.upenn.edu). John W.R. Phillips is an Economist at the Social Security Administration's Division of Policy Evaluation in Washington, DC (john.phillips@ssa.gov). Fine research assistance was provided by David McCarthy and Dan Silverman, and very helpful computational assistance by Mike Nolte. Useful comments were provided by Courtney Coile, John Gruber, Howard Iams, and Kalman Rupp. This research was conducted with support from the Michigan Retirement Research Center (MRRC) at the University of Michigan, the Population Aging Research Center at the University of Pennsylvania (Mitchell and Phillips), and the Pension Research Council at the Wharton School (Mitchell); and part of the NBER programs on Aging and Labor Economics. Support for the MRRC comes from the Social Security Administration (SSA)

Michigan Retirement Research Center

University of Michigan
Institute for Social Research
426 Thompson Street
3026 ISR
Ann Arbor, MI 48106-1248

Phone: 734-615-0422
Fax: 734-615-2180
Email: mrrc@isr.umich.edu

http://www.mrrc.isr.umich.edu

Mail S/C 040937

The MRRC would like to start sending out the newsletter to as many people as possible through email. By doing this, we can get the newsletter out to more people with each new issue. If you are currently receiving the newsletter through the mail, please take a few moments and visit our website to sign up to receive the email version of the newsletter (www.mrrc.isr.umich.edu). Or you can email us at mrrc@isr.umich.edu. Please include your name and email address in your message.

We will still be happy to send copies of the newsletter through the mail, if that is preferred.