



Michigan Retirement Research Center

QUARTERLY *Newsletter*

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Directors Corner

Differences in debaters' political viewpoints may have complicated the nation's ability to make progress on Social Security reform, including reducing solvency concerns. Some discussions of tax rates and private accounts have been especially fractious. Suspecting that there may be more common ground than public discourse has revealed so far, Treasury Secretary Henry Paulson finds reason for optimism that partisan wrangling can be surmounted.

Toward that end, Secretary Paulson recently announced that the Treasury Department would release a series of Issue Briefs "that will focus on areas of common ground, and provide straightforward analysis of the challenges facing Social Security and the implications of potential reforms." The first brief in the series describes the magnitude of the problem and explains why prompt action can lead to more equitable sharing of burdens across generations.

We look forward to the Treasury Department's upcoming series with special interest, since the Michigan Retirement Research Center has always perceived its role to be helping to build the scientific basis for policy analysis of Social Security, Social Security reform, and related topics. The 2007 Conference of the Retirement Research Consortium, summarized in this issue of the MRRC Newsletter, underscored, we believe, recent contributions to the knowledge base from RRC research projects.

Visit the Department of Treasury website to access its first Issue Brief.

<http://www.treas.gov/press/releases/reports/post.pdf>



KEY *Findings*

The Effect Of Retirement Incentives On Retirement Behavior: Evidence From The Self-Employed in the United States and England *by Julie M. Zissimopoulos, Nicole Maestas, and Lynn A. Karoly WP 2007-155*

- The higher labor force exit rate of wage and salary workers compared to self-employed workers is due to defined benefit pension incentives created by the public and private pension systems.
- Higher rates of labor force exit at ages 55 and older in England compared to the United States are due in part to the availability of publicly provided health insurance.

A Longitudinal Analysis of Entries and Exits of the Low-income Elderly to and from the Supplemental Security Income Program *by Todd Elder and Elizabeth T. Powers WP 2007-156*

- The SSI (Supplemental Security Income) participation rate in the aged is strongly positively associated with eligibility spell length.

- The take-up rate among those who have been eligible for SSI for three years or more is nearly 80 percent, suggesting that those who are persistently poor are being helped by the program.

Financial Literacy and Retirement Planning: New Evidence from the Rand American Life Panel *by Annamaria Lusardi and Olivia S. Mitchell WP 2007-157*

- By every measure and in every sample examined, financial literacy proves to be a key determinant of retirement planning.
- Financial literacy is higher when respondents were exposed to economics in school and to company-based financial education programs.

Children and Household Wealth *by John Karl Scholz and Ananth Seshadri WP 2007- 158*

- The distribution of retirement wealth is much more dispersed than earnings. Explaining the dispersion in wealth has been a

longstanding challenge.

- Children have a large effect on household's net worth and consequently are an important factor in understanding the wealth distribution.

Subjective Survival Probabilities in the Health and Retirement Study: Systematic Biases and Predictive Validity *by Todd Elder WP 2007-159*

- Individual's subjective survival forecasts show bias relative to life table data. Many fail to account for increases in yearly mortality rates with age.
- Recent cohorts of the elderly do not appear to revise survival forecasts to match increases in longevity.
- Despite these shortcomings, subjective survival probabilities predict actual mortality and portfolio choice.

For more
Key Findings
visit our
website

www.mrrc.isr.umich.edu

NEW AWARDS

Are All Americans Saving Adequately for Retirement (UM08-01)

John Karl Scholz and Ananth Seshadri

Immigrant-Native Fertility and Mortality Differentials in the United States (UM08-02)

Purvi Sevak and Lucie Schmidt

How Does Modeling of Retirement Decisions at the Family Level Affect Estimates of the Impact of Social Security Policies on Retirement? (UM08-03)

Alan L. Gustman and Thomas L. Steinmeier

The Effect of Medicare and Social Security Benefits on the Timing of Retirement (UM08-04)

Wojciech Kopczuk and Jae Song

How Much Do Respondents in the Health and Retirement Study Know About Their 401(k)s? A Cross-cohort Comparison (UM08-05)

Marjorie Honig and Irena Dushi

Time, Expenditure, and Retirement Decisions (UM08-06)

Mark Aguiar and Erik Hurst

Early Social Security Claiming and Cognitive Resources (UM08-07)

Robert J. Willis and Adeline Delavande

Individuals' Uncertainty about Their Future Social Security Benefits (UM08-08)

Adeline Delavande and Susann Rohwedder

Early Retirement, Labor Supply, and Benefit Withholding (UM08-09)

Hugo A. Benítez-Silva and Frank Heiland

Marital Histories and Economic Well-Being (UM08-10)

Julie Zissimopoulos, Amy J. Rauer and Benjamin Karney

Adequacy of Economic Resources in Retirement: Model-Based Estimations (UM08-11)

Michael Hurd and Susann Rohwedder

Financial Literacy and Financial Behavior Across the Life-Cycle (UM08-12)

Annamaria Lusardi

Labor Supply Effects of the Interaction Between Social Security Disability and Retirement Benefits (UM08-13)

Nicole Maestas

Labor Market and Immigration Behavior of Middle-Aged and Elderly Mexicans (UM08-14)

Emma Aguila and Julie Zissimopoulos

How Do Low-Income Families Think about Retirement? (UM08-15)

Helen Levy and Kristin S. Seefeldt

Pension Reform in Mexico: The Effect of Personal Retirement Accounts on Preparation for Retirement (UM08-16)

Emma Aguila, Michael Hurd and Susann Rohwedder

The Impact of Fatness on Disability Insurance Application by the Non-

Elderly (UM08-17)

Richard V. Burkhauser and John H. Cawley

Retirement Wealth Across Cohorts: The Role of Earnings Inequality and Pension Changes (UM08-18)

Ann Huff Stevens

The Optimal Design of Social Security (UM08-19)

Kent Smetters and Shinichi Nishiyama

The Efficiency of Pension Plan Investment Menus: Investment Choices in Defined Contribution Pensions (UM08-20)

Olivia S. Mitchell

Are Early Retirees Less Healthy?

The Role of Health in Social Security Claiming Decisions (UM08-21)

Nicole Maestas and Xiaoyan Li

How Pension Rules Affect Work and Contribution Patterns: A Behavioral Model of the Chilean Privatized Pension System (UM08-22)

Petra Todd, Viviana Vélez-Grajales

Work and Retirement Choices of Women: The Impact of Social Security Rules in Chile (UM08-23)

Estelle James and Alejandra Cox Edwards

The Impact of Social Security Benefits on Household Life Cycle Asset Allocation and Asset Location (UM08-24)

Raimond H. Maurer

Andrew Biggs Addresses *RRC Conference*

Remarks by Andrew G. Biggs, Deputy Commissioner, Social Security Administration, at annual conference of the Retirement Research Consortium, August 9 2007, Washington D.C.

Thanks very much, and on behalf of the Social Security Administration I would like to thank you not simply for attending this conference, but for all the hard work throughout the year that brings you here today.

The annual RRC conference is always a highlight for of my own summer. This says something about me, which may not be altogether flattering, but it also says something that is flattering about everyone who attends and participates. This meeting never fails to be enjoyable, informative, and collegial, and it is thanks to your hard efforts that year after year we're able to put on such a successful show. Each year has been better than the last, and I'm confident this year will be no exception.

I'd like to especially thank the RRC directors, Alicia Munnell from Boston, David Wise from the NBER, and John Laitner from Michigan, for all the work they and their colleagues do. In particular I should thank John and his staff, who are responsible for organizing this year's conference and put together such a great agenda for us. Thank you, John.

Today I'd like to talk about how the work of people like you, and policy, actuarial and economic work in general, contributes to what we here in Washington do. In a sense, people in my position and policy staff throughout Washington

serve as Greek-English translators. We take the Greek symbols, coefficients, logarithms, superscripts, subscripts and so on found in research papers and explain to policymakers how all that seeming gobbledygook has something truly significant to say about the world around us and the way we live our lives. And more importantly, how this work has the potential to improve life for ourselves and for future generations.

I can't overemphasize the importance of the role of these translators – even if, in the process, I am implicitly saying that I can't overemphasize my own importance. This being Washington, that shouldn't be unexpected.

The work we do isn't purely academic. We're not like astronomers, who study the movements of the stars and planets but have no pretense to try to change them. Rather, we analyze how people plan their lives and interact with government programs and the private sector in order to formulate and – importantly – help implement policies that will change things for the better. We can't be the tree that falls in the forest or, to put it another way, the sole Greek speaker in a sea of English speakers. We need to make our work accessible, so that people who think in terms of words rather than numbers will understand and act upon it.

This is often a challenge, and I've found personally that as I've gotten better on the technical end I've gotten progressively worse at being able to explain what it is that I'm doing. But we should constantly bear in mind two points: first, how important economic insights are for retire-

ment planning and analysis; but second, how difficult it is for ordinary Americans, including staff and elected officials in Washington, to grasp these insights in the way we generally present them.

However, when we manage to meet the challenge of making complex ideas accessible we have the potential to bring the best public policy analysis to the policymakers who must implement it. Looking back at the Social Security reform debate over the past several years, I can think of a number of instances where academic and policy research directly impacts the Social Security policy arguments people in Washington have. Here I will discuss only a few, which is necessarily selective and incomplete. But I hope these examples illustrate the need for the work that you do and the ways your work can contribute.

One of the most important issues in Social Security policy is simply convincing people that a problem exists and that it will require some difficult choices to address. As they say, it's hard to solve a problem until you comes to terms with the fact that you have one. This denial of Social Security's problems manifests itself in different ways in different parts of the political spectrum.

On the left, there's sometimes a fairly pure form of denial, namely that Social Security's financing problem are merely the result of pessimistic assumptions by Social Security's Trustees. If the economy grows faster than projected, as these folks seem sure it will, then Social Security's funding shortfall will waft away. Why bother fix-

ing a problem that likely doesn't exist?

On the right, there's a slightly different form of denial. It's not a denial that a problem exists, but rather that fixing it will involve any real sacrifice. Rather than a combination of increased taxes and reductions in future benefits, these folks argue that all we need to do is borrow a few trillion dollars at nice low government interest rates, invest that money in stocks at nice high interest rates, institute a guarantee to protect individuals against market downturns, and – as they say in the trade – Shazam!, problem solved.

Both of these arguments are very appealing, since they propose that what had been seen as a large problem regarding painful policy changes will in fact be easily dealt with. And if you don't think a lot of people here on Capitol Hill accept these arguments, you haven't talked to many Congressional staffers. For those who work entirely within the academic community and don't follow policy discussions in Washington, it's hard to understand the corrosive effects these arguments have on attempts to build a consensus for reform.

For instance, there are many on the left who don't dispute the size of the Social Security shortfall and the need to address it in a timely fashion. But their efforts are undercut by those who claim that any action is premature, and that to engage in policy changes is a trap to cut a program that is essentially healthy.

Likewise on the right, it's my personal belief that the President's efforts in 2005 to improve Social Security's financing by slowing the growth of benefits to high earners was undercut by those who whispered that any talk of benefit reductions or tax increases was not only politically radioactive but unnecessary, and that pain-free options existed that guaranteed everyone full benefits with-

out tax increases or market risk. Obviously this is a very attractive argument, and it hasn't failed to attract supporters. Personally I like to think I was never really in this camp, but looking back it was something we all should have steered a lot further from than we did.

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Together, these arguments – one from each side – narrow the spectrum of those willing to discuss reform. When significant portions of either end of the political spectrum fail to even acknowledge that difficult choices will even be necessary, the chances of making the even more difficult compromises needed to reach consensus are significantly reduced.

But I think we are moving in a more healthy direction, in part because policymakers are – albeit slowly – taking

on board the sorts of information that policy analysts make available to them.

The annual Trustees Report is a great resource for looking at whether we really do have a funding shortfall ahead of us. The Trustees Report contains a wealth of data and analysis. For instance, it can tell us whether the Trustees past projections have been pessimistic. The answer is that they haven't; since 1983, their projections have been, if anything, somewhat optimistic. If we look back at their annual projections for where we would stand today, in terms of either the annual balance of taxes and benefits or of the ratio of trust fund assets to annual obligation, their “high cost” projections have often been closest to the mark. Or it can tell us whether the Trustees project lower wage growth for the future than the past. They don't; in fact, the projected real wage growth rates of 1.1 percent above inflation exceed average wage growth since 1960. Or whether plausibly higher economic performance would fix Social Security's problems. It wouldn't; increased wage growth improves the 75-year actuarial balance on a roughly one-for-one basis, meaning that average wage growth would need to rise from the projected rate of 1.1 percent to around 3 percent for the program to balance. This isn't plausible, in my view.

But one shouldn't think that the other side of the spectrum gets off easier. The free lunch argument for personal accounts – the no tax increase, no benefit cut, no risk approach – has also fared badly. The Mitchell, Geanakoplos, Zeldes paper showed that after accounting for transition costs and market risk, the rate of return on a personal accounts-based system is the same as on the current program.

Transition costs, which are essentially equal to the net subsidies paid to early participants, account for the

rate of return difference between Social Security and the government bond rate. Market risk accounts for the rate of return difference between bonds and stocks. Between transition costs and market risk, the seemingly large difference in returns between Social Security and market investments – which many advocates for personal accounts, including myself, have cited – is almost wholly accounted for.

Likewise, more recent work on pricing benefit guarantees by Mitchell and LaChance, Smetters and others has shown that the cost of a personal accounts-based system with the same benefits and risk profile as the current program will be the same as the current program. While personal accounts may have a role to play in terms of prefunding future benefits and diversifying workers' total retirement portfolios, you can't get more for less.

Once both forms of denial are accounted for, we see that we have a problem which is very unlikely to go away by itself, and which can't be solved through money manipulation and arbitrage.

While denial and wishful thinking are natural human characteristics that are unlikely to go away anytime soon, the serious policy work conducted by the people here today helps to broaden the spectrum of policymakers willing to confront Social Security reform.

But it isn't simply in breaking down the wall of denial where we've made great strides. We also have better techniques for analyzing the current program and assessing potential policy changes. In particular, great progress has also been made in methodology, in thinking about the ways we measure and perceive the Social Security program, its finances and benefits, and how they fit into the larger context of retirement security.

In the past, the primary focus on Social Security's finances – and in the press, sometimes the sole focus – was the

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trust fund, and in particular the year in which the fund was projected to become insolvent. The trust fund measure is obviously important from the point

of view of Social Security's finances in isolation from the rest of the government budget, and from the legal standpoint of the program's authority to pay benefits. If the trust fund is insolvent, legally we can't pay the full benefits scheduled under current law.

But over time we've included other measures that provide greater detail from a budget-wide or economy-wide perspective. For instance, the closed group unfunded obligation shows that past and current participants in the program will receive \$14.4 trillion more in benefits than they paid in taxes, while future participants, even under scheduled benefits, will receive almost a trillion dollars less in benefits than they pay in taxes. In other words, despite the stereotype, Social Security's financing problem isn't due to overgenerosity to future retirees, who are sometimes disparaged in the press, but to past ones, who are treated gingerly.

Now we can argue whether the generous treatment of early participants was appropriate. It is likely, for instance, that a large part of that \$14 trillion subsidy was paid to higher earning individuals, who “invested” larger amounts at the above-market returns offered to almost all early participants. But nevertheless it is a sunk cost. It may be an interesting counterfactual to ask where we would be today had we instituted a funded system rather than a pay-as-you-go program back in the 1930s. But since we can't reclaim these windfalls, our only choices are to decide how to service the implicit debt we have inherited and how to distribute future net taxes within and between generations.

And we have a number of other newer measures that are helpful to policymakers in charting that path for the program's future.

Over time, analysts have begun to look

beyond the traditional 75-year projection period to craft policies that will keep the system robust beyond that period. What they're trying to avoid is a situation like that created after the 1983 reforms, in which the program was made solvent for 75 years but faced large and growing deficits in the 76th. The measures created by SSA's trustees and actuaries have helped in those tasks. For instance, we have the infinite horizon actuarial balance, which better accounts for the projection that future shortfalls are expected to be permanent rather than temporary. We also have a measure of sustainable solvency, which tracks the level and change in the trust fund ratio as a means to project whether a reform is likely to remain solvent beyond 75 years. Together, these measures will help policymakers prevent a financing scenario in which the program faces a "cliff" similar to that we face in the 2040s.

A focus on sustainable solvency will also improve the relative treatment of different generations. Even if we imposed a 75-year solvency solution today, it wouldn't seem like much of a solution to the person who paid those higher taxes all his life and retired in the 76th year, right when the solution fell apart.

And while a focus on sustainable solvency is necessary, it's not sufficient to produce a viable solution on the financing side. It's also important to remember that so-called "permanent solvency" isn't merely about the time period, it's also about the program's ability to withstand a variety of demographic or economic outcomes. The inclusion of the stochastic analysis of system financing beginning with the 2003 Trustees Report has given analysts a better picture of the level of uncertainty facing Social Security's finances, and it is my hope that future tax and benefit policies can be devised with that uncertainty in mind. Uncertainty is a cost both to the government that administers the Social

Security program and the taxpayers and beneficiaries who participate in it. Autopilot policies could benefit the government by reducing uncertainty, while smoothing any necessary changes over individual's lives and across cohorts. Improved methodology has also played a role on the individual end. At the time I was a staffer for the 2001 Social Security commission chaired by Senator Moynihan and Richard Parsons, individual benefit analysis was usually conducted using stylized workers earning given percentages of the average wage in each year. We did not account well for marriage and divorce, and the ways in which couple's relative earnings interact with the program's auxiliary benefit rules to potentially create very different benefits for households with equal lifetime earnings.

Today, policy work is regularly analyzed with microsimulation models like the SSA's MINT (Modeling Income in the Near Term) model, which creates a detailed picture of the population including earnings and retirement, the formation and dissolution of households, and the accumulation and decumulation of wealth. While MINT has long been used for research purposes, over the past several years it has also become an invaluable tool on the policy development side. Literally hundreds of simulations were undertaken with the MINT model as Social Security policy was developed in 2005, and the results were presented at the highest levels of government.

Now we're extending the approach further. Speaking only to work I have been involved with, we are using the model to analyze different measures of retirement income adequacy, how marginal returns to work can affect incentives to retire, and to introduce more comprehensive measures of the program's progressivity. And as a working tool, all of these can be applied not only to the current program, but to potential policy changes as well.

Needless to say, these enhanced tools hardly guarantee policy success. But Social Security analysts, aided by the people in this room, have made great strides in understanding how the program works, how it interacts with the larger economy, and the types of steps that could restore solvency over different periods of time and under different types of conditions.

What I would like to do here is put forward two additional areas in which the existing toolbox available to economists may help policymakers better understand Social Security financing, its impact on the public, and the choices we face in coming years.

Interestingly, both of these areas derive from a methodological parallel between Social Security policy and the debate over whether, how and when to confront the challenge of global climate change.

Policy questions over Social Security and other entitlements are in important ways similar to questions of how to tackle global warming. But for those with their political antennae up, there is a certain irony in how climate change and entitlement reform are treated in the political process.

Stereotypically, at least, those on the right claim there is an imminent crisis in entitlements that should have been solved yesterday, while arguing for caution regarding global warming, and waiting until a consensus is reached. Those on the left do the opposite, mentioning the long time horizon and considerable uncertainty regarding Social Security projections but citing the precautionary principle in arguing for immediate action on climate change. Now, it may be that both sides are right – or wrong, for that matter – for reasons going beyond the similarities between the issues. But it is worth pointing out those similarities since the two fields may inform each other.

Both climate change and entitlements are a relatively benign issue for current generations but potentially severe for future ones, with considerable uncertainty regarding the potential effects. These lead to both philosophical and technical questions, which the people in this room are among the best equipped to inform policymakers and the public.

For anyone who follows debate over the economics of climate change, last year there was considerable discussion over the role of the discount rate in the U.K.'s Stern Commission report, which concluded there were large costs to global warming and large gains from averting it. A typical person hearing about this would assume the conclusions derived principally from scientific projections regarding how temperatures would change or how sea levels would rise. Someone in this room, on the other hand, would probably just mutter "low discount rate."

And, in fact, these results were generated in large part from utilizing a low discount rate of around 1.4 percent for intergenerational welfare comparisons, and much debate ensued over whether that was the proper discount rate. What's important here is that few typical policymakers, much less ordinary people outside this room, realize the dominant role the discount rate can play in these very long-term calculations.

For Social Security's internal finances we utilize the trust fund interest rate, which seems appropriate given the important legal role the trust fund plays. And in cases where we're actually transferring assets or debts over time, it also makes sense to think in terms of market rates.

But for calculations balancing intergenerational well-being – which, after all, is what Social Security reform ultimately comes down to – it's not clear to me that the government bond rate

is necessarily more appropriate than the rate of wage growth, per capita GDP growth or some such measure. This seems to me to be an area that's both ripe for academic investigation and potentially very useful for presentation to policymakers. People in Washington, and throughout the country, have a gut feeling that entitlement reform comes down to balancing the well-being of your grandparents and your grandchildren, but lack a rigorous framework within which to think these questions through. I'm not saying that we should send every American an index card with the Ramsey formula on it and ask them to fill in their pure rate of time preference and return to Washington for tabulation.

Nor would such a formal framework guarantee success. After all, economists do have a rigorous framework and still they disagree. But they have a much clearer idea about what it is they disagree about, and better knowledge on how these disagreements determine their conclusions. This can only help as we think more about these problems.

There's a second way in which Social Security projections resemble those for climate change, which is the considerable uncertainty inherent in both. A literature survey undertaken by the Congressional Budget Office showed a wide range of estimates for the potential effects of global warming, with the possibility that the net effects on GDP would actually be positive. Of course, there's also the possibility of a – literal – meltdown scenario.

Likewise, as I mentioned previously, since 2003 the Social Security actuaries have included a stochastic analysis of system financing in the annual Trustees report. While some seize on this uncertainty as a reason not to act, in fact uncertainty isn't an argument for delaying action so much as an argument for acting even sooner. There is an

insurance value in protecting against an unwanted outcome, even if the chance that this outcome will occur is small.

Remember, the Trustees don't project that either there will a Social Security deficit of roughly 2 percent of payroll or there won't be a deficit at all. Rather, the Trustees projection is the median outcome, with about as much chance the deficit will be double the current project as that there won't be a shortfall at all. So in our policy minds, outcomes in the worst 1 percent of the distribution should play more heavily than those in the best 1 percent.

Finally, like climate change, Social Security policy is effectively permanent. It is difficult to undo changes to the global environment, which is why advocates argue that action should be taken immediately. Likewise, the below market returns to future generations are a function of subsidies to past and present ones. While technically we can change the benefit formula however we wish, we cannot change the underlying financing constraints of a pay-as-you-go program which effectively "invests" in the growth of aggregate wages via labor force growth and productivity increases. The decisions we make about the treatment of participants in the present and near future constrain the treatment of cohorts in the more distant future, just as choices we make about the environment today may dictate outcomes for generations who will follow us.

It seems to me that within our existing tool box, we can take a good stab at all these questions. Clarifying how to value future generations relative to our own, how to value risk versus certainty in our projections, and when is the ideal time to act, could make policymakers and the public more aware of the choices that they face. I'm confident that if we apply ourselves to these tasks, we can soon achieve the

desired result: a rock concert dedicated to raising awareness of Social Security reform, replete with the aging 80s rock stars my wife chastises me for listening to. I will, however, leave it to the fertile imaginations of my audience to compose the sing-along theme song for this event.

With that, it's clear that my comments have gone well off track. However, I would like to thank you once again for coming, and for all the work that you do. You should know that your work does not simply move ahead the store of academic knowledge on retirement secu-

ity. Rather, you are performing a valuable service to your government and to Americans, both today and in the future.



Andrew Biggs, Ph.D., became Deputy Commissioner of Social Security on April 4, 2007. Biggs serves as the principal deputy to the Commissioner of Social Security as well as the Secretary to the Social Security Board of Trustees.

Dr. Biggs continues to serve as the Acting Deputy Commissioner for Policy, a position he held prior to his appointment as Deputy Commissioner. In addition, he served as Associate Commissioner for Retirement Policy from April 2003 to March 2007.

Before joining the Social Security Administration, he served as a staff member for the House Committee on Banking and Financial Services, as an analyst at the Cato Institute and as a staff member to the President's Commission to Strengthen Social Security. He holds a bachelor's degree from the Queen's University of Belfast, Northern Ireland; a master's from Cambridge University; and a Ph.D. from the London School of Economics and Political Science.

The Michigan Retirement Research Center sadly notes the passing of Ned Gramlich, following his courageous battle with leukemia. At our request and with his characteristic generosity, Ned delivered a lunchtime address at the 2004 annual meeting of the Retirement Research Consortium, wrote an article for the MRRC on remedies for Social Security solvency problems, and joined the MRRC Board of Outside Scholars. His expertise on Social Security issues was tremendous. Learn more about Ned Gramlich's distinguished career. http://www.fordschool.umich.edu/news/Ned_Gramlich.php

Q & A

David Weir and Helen Levy discuss their MRRC supported research

Q: What motivates your interest in retirement security?

A: Two important issues in thinking about retirement security come to mind. The first has to do with thinking of aging as something that couples do. Most people prepare for and enter retirement as part of a couple, and yet must be aware that one or the other is likely to face widowhood at some point. So how do you think about that, prepare for that, and cope with that as time goes on? That's something that's very much a part of the logic of the Health and Retirement Study (HRS). The HRS starts with the couple in the household and follows them both over time. The couple is the analytical unit. This same logic is built into the Social Security system. Marriage has always been an important component of the system in terms of how benefits are designed. As an aside, I'd like to see a return to more work on reform proposals that take the couple into account.

The other important issue is risk—what are people worried will happen as they age. Important areas of concern are health and financial well-being. The HRS collects extensive couples-level information on these inter-related concerns. Health is a big source of economic insecurity because of potential health care costs—nursing home costs, hospitalization, and prescription drugs. For some people, these can be a pretty large share of total income. This broadens the arena of policy concern beyond Social Security to Medicare and other kinds of health insurance in general.

Q: Related to these issues, what were the findings of your early MRRC papers?

A: Bob Willis and I began looking at these issues before there was an MRRC. Using the baseline (1992) data from the HRS, we found that married women were a little better insured against the risks of widowhood than we expected. There were significant changes in the prior thirty years that may have had an effect. For example, pensions were a little more equitably allocated and had better insurance properties to them. Life insurance was maybe a little more widely held. But a big part of it was that women had worked more, so they had better pension and Social Security benefits themselves.

Our first MRRC project then used the longitudinal data from HRS and AHEAD to look directly at the consequences of a husband's death on the economic well-being of women. We found substantial losses of income and wealth, and increases in poverty rates as a result of widowhood. Another important point is that death is not random. Poor households in their 50s are much more likely to suffer a death than wealthy ones. So women in households that don't have a lot of resources are more likely to become widowed in those years, and then have that tough stretch before Social Security kicks in and they become eligible for Medicare. This led us in our second project to

wonder about the effects of widowhood and divorce on health insurance—that is, as a precipitating factor in the loss of health insurance. What we found is that the situation is quite complicated.

We had expected there to be a strong relationship because many women's health insurance comes from their husband's job. If the husband dies, they lose their coverage. Indeed, we see that this happens, but it isn't the whole story. There are other ways to continue coverage, COBRA for example. The upshot is that people seek out health insurance. By and large those who need it tend to seek it out, and those who do not seek it tend to be those who at least think they don't need it or could do without it. While it is certainly a problem overall for our society that there are so many people without health insurance, when you look at the people you would be most worried about losing it, they seem to find it. Importantly, there is Medicaid coverage for those with really low resources.

Q: Talk about your work with Helen Levy on Medicare Part D.

A: While all eyes have been on Social Security reform, the impact of reform is not really going to affect today's elderly. Prescription drug coverage, on the other hand, is something that affects them right now. Medicare Part D was interesting because it is a model of how you can add a government subsidy without undermining the private market. The HRS saw this as something of great interest that we would want to study for a long time to come. So we were able to go into the field with questions about Part D even as the policy was being implemented. We were interested in who took-up the benefit and who didn't. There is also a subsidy program which pays Part D premiums and drug co-payments for low-income folks, and we were interested in whether people signed up for that also. Social Security runs the subsidy and was charged in part with public information, getting information out there about the program, accepting the applications and reviewing them, determining who was eligible and who wasn't. For most people, if you're in a Part D plan, your premium is deducted from your Social Security check. Ideally, in the future we will be able to take the self-reported information we have from the HRS and link it to the Social Security administrative records to know for sure who enrolled in what.

The information we gathered in the HRS allows us to at least take a first look at how this program has worked. In 2005, we asked people what they knew about Part D just as it was rolling out. In 2006, we began to ask what they had actually done. We did a mail survey to get people to tell us specifically what drugs they take, how they pay for them, how their coverage works. We will be going back to ask them again about specific drugs, so we will be able to see what impact the program has had on that. We've also done an internet survey to try to get a little more complex information that doesn't work as well with either an interview or the mail survey method.

In 2005, we asked people how they felt about what was happening with Medicare, about the choice issues. It's critical to the whole idea of these kinds of policies that you rely on the market to be efficient and cut costs. For the market to work, people have to make choices. Even with the on-line tools that were and are available to help, it is still a pretty complicated decision to make the best choice for you. So we found in 2005 that most people were aware that this was coming along, but many said they didn't know much about it and were generally confused. Then in 2006, we asked them, what did you do and how did you feel about it, and people by and large are pretty happy.

This was a bit surprising but not that difficult to understand. It is often the case that there is anxiety

about the unknown, and that may be some of what we're seeing here. Secondly, people saw only complexity going into Part D. It turns out that many people didn't have to do anything. Retired people with good coverage from their employers mostly stayed put, and people on Medicaid were automatically enrolled into Part D. And for people who actually needed coverage and didn't have it, there's a big gain. So once people began to realize this, they began to feel better about it. The hardest decision faced people who had to choose among the many private plans. What differentiates the plans most is which drugs they cover or which drugs they treat as high co-pay or low co-pay. However, because of Medicare's requirements for coverage, most people could adapt to any plan by changing the brand of drug they took. So most people really couldn't go wrong with any of the plans available.

Going forward, we're asking people to rate different features of their plan. We have some of this from 2005, and it seems clear that people who report that their plan doesn't cover certain drugs have much lower satisfaction. It may be that people would rather spend a little more per month to have that choice. We ask "do you feel that you are taking the best drug for this problem?" As we gather more information about the drugs people are taking, we'll be able to see if they are feeling that their choices are constrained.

Q: Who didn't sign up? Are there people who got left out?

A: For the most part, people who didn't enroll in Part D are those who don't use prescription drugs. This may be a rational economic choice, because there is a premium somewhere around \$400 a year. The subsidy looks different – many low-income respondents say they didn't sign up or don't know anything about it - and we are working right now to try to figure out how much is problems with self-report and how much is real. The administrative data suggest that many people who were eligible for the subsidy are not getting it. The HRS data tend to support that, but what's interesting is that many of them did sign up for Part D but not for the subsidy—something that the aggregate numbers can't tell you. It all suggests that even though there is satisfaction with how things turned out, there may still be a lack of understanding of all the details involved.

We are going to try another way of asking about the subsidy in 2008. We'll be using questions modeled on the Medicare Current Beneficiary Survey that ask if the respondent knows that there is a program that can help with costs and then whether or not they have applied for it. However, even though our counts appear to be low, the Social Security administrative data suggest that there's not enough people in this program based on estimates of eligibility. So there's a lot of work to be done to find out what is happening with those who are eligible for the subsidy. We did ask people who said they didn't apply why they didn't and some said because they didn't want hand-outs. I think part of the success of Social Security and Medicare take-up has been that people do not perceive these programs as hand-outs. It's a bit of a conundrum in social welfare policy generally. You want to be sure that the poorest people are being covered. But as soon as a program is means-tested, there is stigma and political vulnerability.

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In September, Social Security extended the quick disability determination (QDD) process to all State disability determination services. The QDD process identifies applications where there is a high potential that the claimant is disabled and where evidence of the person's allegations can be quickly and easily obtained. In New England, where QDD began on a test

basis, cases constituted slightly less than 3 percent of all new cases. Of those, 97 percent of the cases identified have been decided within 21 days and the average decision time is 11 days. Since the model does not yet incorporate as many diseases as it can, Commissioner Astrue has committed to expanding the number of cases that can be identified while maintaining the same level of accuracy.

Commissioner Astrue said, "I also am proud of our improvements with pending disability cases that have reached 1,000 days waiting for an appeal hearing. We have aggressively worked on these cases and now have fewer than 600 pending,

down from more than 63,000 cases in October of last year."

"The length of time many people wait for a disability decision is unacceptable," Commissioner Astrue said. "I am committed to a process that is as fair and speedy as possible. While there is no single magic bullet, with better systems, better business processes and better ways of fast-tracking targeted cases, we can greatly improve the service we provide this vulnerable population."

For more information about Social Security's disability programs, go to www.socialsecurity.gov

Challenges and Solutions for Retirement Security



Dissemination display



Deputy Commissioner Andrew Biggs



Press Club conference room

The 9th Annual Conference of the Retirement Research Consortium was held in August at the National Press Club in Washington DC. With the conference's growing popularity, attendance this year was well over three hundred. The conference was organized this year by the Michigan Retirement Research Center in consultation with the RRC. Its theme addressed challenges and potential solutions to retirement security.

Deputy Commissioner Andrew Biggs delivered the luncheon address on Thursday, and his comments are included in this issue of the newsletter. Chairman of the Social Security Advisory Board, Sylvester Schieber, gave an address at Friday's luncheon.

Over the two days, researchers from each of the three consortium centers presented papers on current projects. The topics covered in the eight panel sessions included papers on retirement behavior now and in the future; demographic change and family behavior; measuring well-being in retirement; examining the motives and reasons for retirement; and how health influences retirement.

Two panels addressed preparedness for retirement, one with a focus on managing financial and mortality risk and the other on private pensions. An invited paper by Olivier Bontout and Georg Fischer, of the European Commission, discussed trends in European pension reform.

The RRC Sandell Award provides funding to young scholars or those new to the area of retirement research. Sandell papers were presented by Colleen Medill; Till von Wachter; and Richard Evans and Rüdiger Fahlenbrach. Papers presented at the conference are available on the MRRC website. www.mrrc.isr.umich.edu

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