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Key Findings

DIRECTOR'S CORNER

John Laitner

The financial crisis that has unfolded in the last few months, and government commitments and expenditures initiated to address it, exacerbate Federal budget deficits, which were already substantial. Now, more than ever, taking sensible steps to address imminent shortfalls in Social Security program finances seems critical not only to protect elderly Americans but also to ease general budgetary pressures to the greatest extent possible.

Over the last five years, the MRRC has sponsored research on Social Security reform. Such work adds to the national stock of knowledge, which can augment the menu of options for policy makers. For example, Laitner and Silverman, MRRC WP 2006-142, proposes and studies a simple reform in which a household's OASI payroll tax would be lifted following a long vesting period (e.g., 34 years). The analysis suggests that average retirement ages might rise as much as a year and that even if the reform were calibrated to be revenue neutral for the Social Security system itself, Federal income tax revenues might be enhanced. The MRRC Key Findings on Social Security Reform, www.mrrc.isr.umich.edu/publications/findings/pdf/SOCIALSECURITY.pdf, summarizes other MRRC research on related topics.

As a new administration in Washington begins work on the challenges facing the Nation, it seems inevitable that it will be interested in exploring the role and continued strength of Social Security. The Michigan Retirement Research Center will be eager to play a part in informing that discussion.

FOR YOUR INFORMATION:

Payment Dates to Pencil In

Does anyone ever ask you when their next Social Security or Supplemental Security Income (SSI) payment is coming? Questions like this arise when usual pay dates fall on holidays or weekends. Figuring out when benefits will be paid does not have to be a guessing game. Just visit the Social Security Administration's handy, online payment calendar. The calendar shows payment dates for the entire year of 2009, for Social Security benefits and SSI payments. You'll want to bookmark this page because the calendar at this web address is updated each year with the New Year's payment schedule.

Take a look at the 2009 payment schedule by visiting www.socialsecurity.gov/pubs/calendar.htm

RETIREMENT WEALTH ACROSS COHORTS: THE ROLE OF EARNINGS INEQUALITY AND PENSION CHANGES

by Ann Huff Stevens

Wealth and income at retirement are the result of many forces that accumulate over the lifetime: labor force participation, wage levels, public policies, and savings decisions, among others. As a result, changes in any of these factors may affect the retirement wealth of cohorts in future years. Major changes in the United States' labor market over the past 30 years - most notably increasing wage and earnings dispersion - predict changes in the resulting distribution of wealth for cohorts now on the verge of retirement. This study investigates how changes in earnings during the 1970s, 80s, and 90s translate into differences in the level and distribution of retirement wealth for birth cohorts now approaching retirement.

This study uses data from the Health and Retirement Study (HRS) to compare two birth cohorts whose prime earnings years differ substantially in terms of the level and dispersion of earnings. The first cohort, initially observed in 1992, was born between 1936 and 1941. The second cohort, the youngest of the baby boom generation, is initially observed in 2004, and was born between 1948 and 1953. For each of these cohorts, I use lifetime earnings measures from the HRS averaged over ages 36 to 51 and estimate the relationship between lifetime earnings and three measures of retirement wealth. The study asks what the wealth distribution of the later cohort would have been if they had retained the same distribution of lifetime earnings that prevailed during the working years of the earlier cohort. This provides an estimate of the degree to which changing earnings distributions can explain changes in wealth.

I examine three different components of overall retirement wealth: (1) private, nonpension wealth, (2) the sum of private pension wealth and non-pension wealth, and (3) expected wealth from Social Security benefits. Both the underlying mechanisms (how do changing earnings lead to changes in wealth?) and the size of the effect (how much of the wealth changes can be attributed to earnings changes?) depend on the specific component of wealth considered.

Table 1
Distribution of Wealth and Lifetime Earnings (\$1992)

	Men		Women	
	Cohort 1	Cohort 2	Cohort 1	Cohort 2
Born:	1936-41	1948-53	1936-41	1948-53
Observed:	1992	2004	1992	2004

Household Non-pension Wealth

Percentile

10th	5,000	0	2,623	0
25th	23,000	11,114	19,850	8,543
50th	63,450	47,734	57,000	43,796
75th	135,150	149,703	137,000	129,272
90th	275,000	355,126	282,500	342,867

Lifetime Average Annual Earnings

Percentile

10th	2,358	4,287	2,539	3,557
25th	15,403	11,869	6,243	8,285
50th	29,232	25,295	12,724	14,889
75th	42,880	42,487	20,973	24,391
90th	49,552	56,042	30,177	35,665

Note: Data from waves 1 and 7 of the HRS, weighted using household level weights.

Comparing Wealth Earnings Across Cohorts

Starting with the wealth measure that includes only non-pension, non-Social Security wealth, Table 1 shows the increased dispersion in the distribution of wealth among the second cohort, and the corresponding increase in dispersion in lifetime earnings. Among men, the ratio of wealth at the 25th percentile of the distribution to that of the 75th is approximately .17 among the earlier cohort, and falls to .07 in the later cohort. Among women, dispersion also increases, with the ratio of wealth at the 25th to 75th percentile falling from .14 to .07.

Earnings and Non-pension Wealth

Next, I ask how much of this change in wealth is related to the changes in earnings that occurred over the last three decades. To do this, I predict what the distribution of wealth for cohort 2 would have been if they had faced the same distribution of lifetime and current earnings as cohort 1. Table 2 summarizes this

analysis. The first row shows that 23% of cohort 1 men had wealth below \$19,300, but among cohort 2 this figure had risen to nearly one-third, or 32%. The third column shows that, if cohort 2 had experienced the earnings distribution of the earlier cohort, the fraction with very low wealth would still have risen, but not by as much, to 29%. Looking at the fraction with wealth levels below \$53,000, there continues to be an increase across cohorts (from 48 to 54%), but now holding earnings constant at those of cohort 1 suggests that half of the observed change is related to earnings changes. Among women, there is a similar increase in the fractions with low wealth across cohorts, but very little of this is explained by changing earnings. This is because women's lifetime earnings rose substantially between these cohorts, and so it is not surprising that rising earnings are not connected with falling levels of wealth.

Table 2
Retirement Wealth & Earnings

	Men			Women		
	Cohort 1	Cohort 2	Counterfactual	Cohort 1	Cohort 2	Counterfactual
			Cohort 2 no earnings change			Cohort 2 no earnings change
Non-pension wealth per person						
Wealth < \$19,300	23%	32%	29%	25%	36%	35%
Wealth < \$53,000	48%	54%	51%	49%	56%	55%
Non-pension + pension wealth per person						
Wealth < \$24,000	23%	30%	24%	26%	34%	34%
Wealth < \$82,500	48%	51%	45%	55%	60%	61%
Social Security wealth per person						
SS Wealth < \$147,000	23%	23%	21%	47%	32%	37%
SS Wealth < \$188,000	49%	38%	35%	73%	50%	54%

Earnings and Total Wealth

The next panel of table 2 summarizes the same exercise, but adds the present value of expected pension wealth to the previous non-pension wealth measures. When pension wealth is included, earnings play an even larger role in explaining the increased fraction of baby boomers with low wealth. Almost the entire change in those men with total wealth below \$24,000 (and more than the observed change in those with total wealth below \$82,500) is explained by the changes in earnings. While we would expect individuals to adjust their non-pension savings behavior to earnings changes, it may seem surprising that the effect of earnings grows when pension wealth is added. The probable mechanism here, however, is unlikely to involve individual savings or investment behavior. Instead, this reflects the strong correlation between earnings and non-wage compensation, including pensions. Men in cohort 2 who faced declining earnings also appear to have faced reductions in their employer-based pension wealth.

Earnings and Social Security Wealth

Finally, how might Social Security wealth be affected by changing earnings distributions? Note that, holding lifetime earnings constant, Social Security

benefit levels will increase across cohorts, because the benefit formulas are designed to hold replacement rate roughly constant. Thus, as average earnings rise, Social Security benefits rise as well. This is reflected in the final row of Table 2, which shows that the fraction of men and women with Social Security wealth below \$188,000 will fall from 49% (for men) and 73% (for women) among cohort 1 to just 38% (for men) and 50% (for women) among cohort 2.

The story is somewhat different when we look at the fraction of men with lower levels of expected Social Security wealth. Twenty-three percent of men in each cohort are expected to have total Social Security wealth of less than \$147,000. The lack of a reduction in the fraction of men with very low wealth (compared with rising Social Security wealth at higher points in the distribution) reflects the fact that declining earnings among this segment of men is just offset by the growth in benefits expected over time with constant real earnings. Among women, in contrast, there is a substantial reduction in the fraction of the cohort with very low wealth, driven by both rising earnings and the benefit formulas.

Conclusion

It should come as no surprise that the major expansion in inequality over the last three decades of the twentieth century would show up in the accumulated wealth levels of individuals whose working lives were centered around these years. On the other hand, much economic research shows that relatively little of the variation in wealth can be related to individuals' lifetime earnings. This study shows that earnings changes are, in fact, strongly associated with changes in wealth for those cohorts who are now close to retirement. For men in the bottom half of the earnings distribution, reduced earnings (relative to earlier cohorts) are reflected in lower levels of wealth accumulated prior to retirement. Changes in pension values appear to be strongly correlated with these earnings changes, so that the effects of earnings are even larger when pensions are added to the wealth measures.

Finally, Social Security wealth continues to grow across cohorts, but earnings changes also affect this source of wealth. For males at the bottom of the earnings distribution, real growth in Social Security benefits expected at a given level of lifetime earnings is just offset by the decline (in real terms) in their earnings relative to earlier cohorts.

Ann Huff Stevens is Associate Professor of Economics at the University of California, Davis. Her past research on retirement and aging includes studies of the responsiveness of retirement expectations to pension plans and Social Security, the effects of worker knowledge about pensions on retirement timing, and the effects of job loss on older workers' employment, earnings and wealth.

Changes to Social Security in 2009

The 5.8 percent cost-of-living adjustment (COLA) will begin with benefits that over 50 million Social Security beneficiaries receive in January 2009. Increased payments to more than seven million SSI beneficiaries will begin on December 31.

Other changes: In 2008, the maximum taxable amount was \$102,000. Beginning in 2009, the maximum taxable amount will be \$106,800. This change will affect about 10 million of the 164 million workers who pay Social Security taxes. The tax rate remains the same: 6.2 percent for employers and employees, and 12.4 percent for the self-employed.

In 2009, it will take \$1,090 in taxable earnings for a credit of Social Security coverage, up from \$1,050 in 2008. All workers can earn up to four credits in a year. The average retired worker will receive \$1,153 per month in Social Security benefits in 2009, up from \$1,090 in 2008.

To learn more about Social Security changes coming in 2009, visit the Social Security online fact sheet at www.socialsecurity.gov/pressoffice/factsheets/colafacts2009.htm.

HRS INVITES IDEAS FOR NEW MODULES

The HRS investigators welcome suggestions for experimental modules from the research community for the 2010 wave of HRS. Ideas for modules should be sent to the committee on experimental modules at the address below. You may provide specific survey questions if you wish, though this is not necessary; just the basic analytic idea, with some indications of the variables that the module should try to measure, is sufficient. It is also helpful to include references to recent publications on the topic, other studies that have treated the topic, names of persons familiar with the topic, or specific survey instruments. Priority will be given to modules that enhance HRS content to provide the greatest overall benefit to the research community. All modules must conform to the same overall design limitations (described below). Module data are released to the public at the same time as all other data from that survey wave (typically by June of the year after data collection). The HRS investigators will make the final decision about which modules to include in each wave of interviews.

Experimental modules are administered to randomly-selected sub-samples of HRS self-respondents, after the main interview is completed, with a strict limit of two to three minutes in average length. Each respondent is randomly assigned to one and only one module. Respondents can refuse to participate in any module before assignment, and can refuse to answer questions in the module to which they are randomly assigned, but interviewers cannot offer nor can respondents choose to respond to a module other than the one selected at random. The sample size for each module depends on the number of modules included. For example, in 2006 there were 10 experimental modules divided among 17,209 self-respondents, yielding an average of about 1720 persons asked to do each module. Response rates to modules have averaged about 80-85% in prior waves, which would leave about 1400 responses in each module.

In order to preserve the random selection of participants in all modules, it is essential that each module be designed for the entire HRS sample. Modules that target specific groups by age, sex, health status, or any other variable do not fit well within this structure. If one module were asked of all 51-56 year olds, for example, then the other modules would not represent that age group, with negative consequences for all of them. It is possible, however, to construct different sequences of questions for different groups within a module. For example, a module about cancer knowledge could ask women about breast cancer and men about prostate cancer. Also note that because individual respondents are assigned randomly, it is not possible to require husbands and wives to answer the same module.

The timetable for module development for the 2010 interview wave is as follows:

February 16, 2009: Proposals due
March 16, 2009: Final selection by HRS co-investigators
June 8, 2009: Final question text and specifications due
May, 2011: Preliminary release of data from HRS 2010

Suggestions for modules should be sent via e-mail to: hrequest@isr.umich.edu. Please include the word "module" as the first word in your subject heading.

If you prefer to submit written suggestions, they may be sent to:

HRS Committee on Experimental Modules
Institute for Social Research
University of Michigan
426 Thompson St., Rm. 3050
Ann Arbor, MI 48106-1284

If you have any questions, please send an e-mail to hrequest@isr.umich.edu.

KEY *Findings*

Key Findings provide highlights from MRRC Working Papers

How Much Do Respondents in the HRS Know About Their Tax-deferred Contribution Plans? A Cross-cohort Comparison by Irena Dushi and Marjorie Honig WP 2008-201

- Younger cohorts were more likely to report accurately that they were included in a tax-deferred plan.
- However, identical proportions (70 percent) of respondents in both the older and the younger cohorts accurately reported whether they made a contribution during the interview year. Both cohorts' self-reported contributions are systematically larger than the true values.
- Both self-reported and W-2 contributions are significantly larger among respondents in the younger cohort.

Does the Rise in the Full Retirement Age Encourage Disability Benefits Applications? Evidence from the HRS by Xiaoyan Li and Nicole Maestas WP 2008-198

- As the Social Security full retirement age (FRA) rises, the relative generosity of Social Security retirement benefits compared to disability benefits is declining, raising the incentive for insured people to apply for disability benefits.
- We find that an average four month increase in the FRA slightly increases the two-year DI application rate by 0.04-0.30 percentage points.
- The effect is greater among those with a work limiting health problem (0.22-0.89 percentage points).

The Optimal Design of Social Security Benefits by Shinichi Nishiyama and Kent Smetters WP 2008-197

- Progressivity in the Social Security benefit structure provides risk sharing against shocks that are difficult to insure privately. On the other hand, progressivity introduces various marginal tax rates that distort labor supply.

- We find that the best U.S. Social Security replacement rate structure is fairly "flat." The relatively long averaging period used in the benefit formulation already provides some insurance against negative wage shocks but in a manner that is more efficient than explicit redistribution.

The Labor Supply Effects of Disability Insurance Work Disincentives by Nicole Maestas and Na Yin WP 2008-194

- The Social Security Disability Insurance (DI) program imposes strong work restrictions on beneficiaries.
- DI benefits are payable only until full retirement age (FRA), at which point they are converted to retired worker benefits, and the program's implicit high marginal tax rate on earnings is abruptly relaxed.
- We find a relative increase in labor force participation at FRA for DI beneficiaries of 10.4 percentage points, and argue that this is likely a lower bound estimate on the labor supply disincentive effects of the DI program.

Labor Market and Immigration Behavior of Middle-Aged and Elderly Mexicans by Emma Aguila and Julie Zissimopoulos WP 2008-192

- Compared to short-term, long-term Mexican migrants to the US are more likely to have US Social Security benefits and are less likely to have Mexican Social Security benefits and public health insurance coverage.
- Receipt of U.S. Social Security benefits increases retirement rates among return migrants. Return migrants are more likely to report being in poor health than non-migrants and this also increases the likelihood of retiring.
- A Social Security Agreement between the US and Mexico would likely have important implications for retirement behavior.

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