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The Policy Challenges of Increasing Longevity: Paying for the Costs of Living Longer

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The Policy Challenges of Increasing Longevity

Paying for the Costs of Living Longer

Increases in life expectancy for males and females in the United States are expected, yet the financing of neither private pensions nor Social Security explicitly address them. My book, *Longevity Policy: Facing Up to Longevity Issues Affecting Social Security, Pensions, and Older Workers,* focuses on public policy issues concerning Social Security, pensions and work at older ages that arise because people are living longer. It draws on international experience to recommend solutions of these issues. (See p. 9 for information on how to order the book.)

The premise of the book is that public policy should recognize longevity policy as a distinct area that affects many programs and policies. Longevity policy is best treated as a unified policy area because of the interrelationships between work at older ages, Social Security, and pensions. Rather than treating the issues raised by life expectancy in policies toward the employment of older workers separately from policies concerning Social Security and pensions, a unified approach would facilitate making needed changes in each of the areas. Because of interconnections between these three areas, policy will be more effective if it incorporates them together.

In the long term, increases in longevity are the main aspect of demographic change that increases Social Security's costs. A key parameter in determining the costs of providing Social Security benefits is the dependency ratio, which is roughly the ratio of the number of individuals over 65 (potential beneficiaries) to the number of individuals aged 15–64 (potential tax payers). A study by the Social Security Administration Office of Actuaries indicates that if a baseline of 2008 is chosen, increases in life expectancy after that date have little effect on program costs through changes in the dependency ratio for the first 20 years, but after 2030 they are projected to account for all the changes in the dependency ratio (Goss 2010). Thus, in the long term, increases in life expectancy are key determinants of financing.

The international evidence suggests that life expectancy in the United States will continue to increase. In 2005, life expectancy in the United States at age 65 for women and men were 19.0 and 17.0 years. In that year, the figures in France were 19.8 and 18.2. In Japan, they were 23.4 and 18.5. In all, the life expectancy figures were higher for women in at least 17 countries and higher for men in at least 13 countries (National Center for Health Statistics 2009).

Policy Recommendations

As Table 1 notes, my book offers five major policy recommendations; three in the area of Social Security, one for 401(k) plans, and one for defined benefit pension plans. My first recommendation in the area of Social Security is to index benefits by life expectancy just as defined contribution pensions do when annuitizing benefits. This would reduce annual benefits (but not expected lifetime benefits) to offset the increases in lifetime benefits that accompany increases in life expectancy. A desirable side effect of this policy would be the likelihood that its reductions in replacement rates over time might induce individuals who are able and willing to do so to work longer.

Given the widespread antipathy toward raising Social Security contributions, and the improvements in the ability of people to work in their early sixties, my second recommendation for Social Security would be to raise the early retirement rate from 62 to 63. Any change in the early retirement age would presumably take effect 15 or more years in the future, with a phase-in period starting at that point. It should be noted that whereas the early retirement age currently is 62, when President Franklin Roosevelt signed the Social Security Act into law, and for more than 20 years at the start of Social Security, it was 65.

The question can be raised as to why the Social Security early retirement age should be raised given that Social Security allows workers to postpone retirement and rewards that behavior with increased annual benefits. Social Security provides incentives for workers with longer than average life expectancy to postpone retirement because the increased benefits they receive are for more than the expected number of years of life. However, the actuarial adjustment for postponed receipt of benefits is insufficient to provide such incentives to people with shorter than average life expectancy. In any case, regardless of the incentives for taking or postponing receipt of benefits, many people are shortsighted and take benefits at age 62, the earliest age they are available, even though they would financially be better off by postponing benefit receipt.

Policy discussions about raising the retirement age in Social Security are often confused and misleading. Often, those discussions refer to the normal retirement age, which is the age at which a person can receive what are considered to be full benefits. For people currently age 62, that age is 66, but changes already in law raise it to age 67 for people born in 1960 and later. When my book refers to raising the retirement age in Social Security, it is referring to the early retirement age.

Life expectancy indexing of benefits and raising the early retirement age are hard choices. But retirement income policy is fundamentally about making hard choices, both by individuals and national policymakers. An alternative to working longer is to increase savings and contributions to Social Security and pension funds to pay for retirements that are lengthened by improving life

Table 1 Overview of Major Policy Recommendations

Policy area	Policy	Goal
Social Security	Life expectancy indexing of benefits	Help restore solvency
Social Security	Raise early retirement age from 62 to 63	Raise benefit level to offset benefit cuts
Social Security	Longevity insurance benefit payable at age 82	Provide better targeting of benefits, offset benefit cuts
401(k) plans	Require that annuities be offered when a defined benefit plan is not also offered	Encourage annuitization of 401(k) plans
Defined benefit plans	Life expectancy indexed defined benefit plan	Encourage provision of defined benefit plans

SOURCE: Author's recommendations.

expectancy. Whatever changes are made in public policy, the option of increasing personal savings to finance early retirement remains for individuals. Individuals who wish to retire early can plan to do so by raising their savings. That said, many individuals find retirement planning, with its long time frame, difficult to do.

My final major recommendation for Social Security is a proposal for a new benefit, called longevity insurance, that would be payable starting at age 82. It focuses on two vulnerable groups: 1) workers who retire at age 62 in poor health, with poor work prospects and little in retirement resources other than Social Security; and 2) retirees in their 80s who have spent down their non-Social Security assets and rely primarily on Social Security benefits.

It is important to have private pensions take into account life expectancy increases as well. My main recommendation for 401(k) plans is to encourage more people to annuitize their 401(k) plan account balances, taking into account insights from behavioral economics. For example, annuities could be purchased in units while working, rather than being purchased as a single lump sum at retirement.

My first recommendation in the area of Social Security is to index benefits by life expectancy just as defined contribution pensions do when annuitizing benefits. It would de-risk defined benefit plans of most of the longevity risk that plan sponsors still bear, which could encourage the provision of defined benefit plans.

Conclusions

The premise of my book is that public policy should recognize longevity policy as a distinct policy area. Policy should be developed that is directly related to the effects of increasing life expectancy. Rather than separately treating the issues raised by life expectancy concerning Social Security, pensions, and work at older ages, a unified approach should be developed that recognizes the interrelationships. A unified approach that included policy toward work at older ages, policy strengthening pensions, and policy strengthening Social Security would arguably facilitate the needed changes in each of the areas. Dealing with only one area may be more difficult and less effective than dealing with all the areas at the same time. Together, the policies recommended in this book would encourage work at older ages, move Social Security toward solvency, provide better targeting of Social Security benefits, increase annuitization of 401(k) accounts, and encourage employers to provide defined benefit plans.

References

Goss, Stephen C. 2010. "The Future Financial Status of the Social Security Program." *Social Security Bulletin* 70(3): 111–125.

National Center for Health Statistics. 2009. "Deaths: Final Data for 2006." *National Vital Statistics Reports* 57(14): 1–136.

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Upjohn Press Book Wins Richard A. Lester Award

Stephen A. Wandner's *Solving the Reemployment Puzzle: From Research to Policy* has won the Richard A. Lester Award for the Outstanding Book in Industrial Relations and Labor Economics for 2010. The award is given by Princeton University's Industrial Relations Section and heads up the yearly list of "Noteworthy Books" chosen by the Section.

In the book, Wandner, a former official in the U.S. Department of Labor, provides a detailed insider's view of the process for creating workforce-related policy during the Clinton and Bush administrations, and discusses how rigorous scientific research was used (or not) to develop and implement that policy.

Read more about the book at http://research.upjohn.org/up_press/205/.

Also on the list of "Noteworthy Books" for 2010 from the Upjohn Press is *Mothers' Work and Children's Lives: Low-Income Families after Welfare Reform* by Rucker C. Johnson, Ariel Kalil, and Rachel E. Dunifon. In it, the authors examine the impacts welfare reforms have had on the work-family balance of low-income working mothers.

"[This] study makes a valuable contribution to our understanding of low-wage work. It would be an excellent supplemental text to any social science course on poverty or social welfare policy." *–Journal of Economic Literature*

Read more about the book at http://research.upjohn.org/up_press/10/.