# Retirement plans and actions: Some implications of the 1983 social security amendments

by Richard V. Burkhauser

Richard V. Burkhauser, an Associate Professor of Economics at Vanderbilt University, has recently coedited, with Karen C. Holden, an Institute monograph on future directions for the social security system (*A Challenge to Social Security: The Changing Roles of Women and Men in American Society* [New York: Academic Press, 1982]) and is the coauthor, with Robert Haveman of the Institute, of two new books on national disability policy (*Disability and Work: The Economics of American Policy* [Baltimore: Johns Hopkins University Press, 1982] and, with Victor Halberstadt as third author, *Public Policy toward Disabled Workers: Cross-National Analyses of Economic Impacts* [Ithaca: Cornell University Press, 1984]).

Economic analysis of public policy has centered on the incidence of government tax and benefit policy and the behavioral response that individuals make with regard to it. Economists have long argued that in attempting to redistribute income, policymakers should be sensitive to the impact such efforts have on work, savings, and other economic behavior and should gear their programs to achieve redistributive goals with a minimum of such distortions.

A major development in public policy analysis over the last decade has been the integration of life-cycle theory into program analysis. For those economists looking at the effect of social security policy on redistribution, this has meant that single-period analyses, which considered current recipients as net gainers and current taxpayers as net losers, had to be modified to recognize the link between social security taxes paid at younger ages and benefits received at older ages. One result of such a life-cycle view is that to this point in its history social security (OASI) has primarily redistributed income from younger to older generations with rich and poor sharing equally.[1]

Because of the link between taxes paid in one period and benefits received in another, those studying behavioral responses elicited by social security also must consider its multiperiod relationships. For instance, the true marginal social security payroll tax is *not* necessarily equal to the tax rate in a given year. Its effect is offset to the degree future benefits increase with earnings and hence with the payment of the tax. As a result, at some ages increases in expected benefits make the payroll "tax" a subsidy to work.[2]

This may also be the case with regard to the social security earnings test. The 50 percent "tax" on work for those who are eligible to receive social security benefits is offset to some degree by the additional benefits related to continued work and by actuarial adjustments associated with postponed acceptance of benefits.[3]

A life-cycle view of policy stresses the point that individuals make work and saving plans across their lifetimes and that a social security policy which changes tax or benefit rules at older ages will affect the immediate behavior of both old and young.[4]

The firestorm of protest which greeted the 1981 Reagan administration proposals to increase the actuarial penalty for early retirement and to push back normal retirement age to 68 in 1982 was in part caused by the speed with which these proposals were to be implemented. Such abrupt and unexpected changes in policy were said to be an unfair hardship for workers who had made retirement plans under the old rules. In contrast, the 1983 social security amendments were passed with bipartisan support, yet beginning in the year 2003 they will do much the same thing.

After the turn of the century normal retirement age will begin to rise, increasing by two months in each of six years until it reaches age 66 in the year 2009. Another set of increases over a subsequent six-year period will bring the full-benefit age to 67 in the year 2027. The earliest age at which benefits are permitted will remain 62, but the new law will change the maximum reduction at age 62 from its current level of 20 percent to 25 percent in 2009 and to 30 percent in 2027.

Clearly, part of the reason for the broad support for these changes was the long period between enactment and implementation. Policymakers holding a life-cycle view would argue that this was necessary to allow younger workers to adjust their plans. A more cynical view would argue that it permitted the short-run financial crisis in social security to be solved through immediate tax hikes at the cost of only a promise to begin reducing system liabilities in 20 years—an ample time period for those opposed to such reductions to form a consensus preventing their implementation. If this latter view is correct, those opponents of future reductions in benefits risk undoing the advantages that advance warning of changes in government policy give to those who are affected by it.

In a new paper two colleagues and I argue that this is not a trivial point.[5] Using a life-cycle rational expectations model we test the relationship between planned and actual retirement behavior. We show that people can predict their true retirement age years in advance, and further, that the differences between actual and planned retirement can be traced to unexpected intervening events. Using data from the Retirement History Survey, we find that retirement plans made in 1969 by workers age 58 to 63 and carried out over the next decade were fairly accurate. In our sample of 1580 men who were working in 1969, we found that 57 percent who in 1969 had planned to retire at a specific age did in fact retire at that age; 24 percent retired earlier and 19 percent later than planned. Hence there is clearly some relationship between planning and subsequent behavior.

More important, we found that actual retirement was also affected in a systematic way by expected events—changes in social security, in personal health, and in local labor market conditions—over the decade after retirement plans were made.

Table 1 presents the results of our multinomial logit equation. In it we look at those factors which explain whether a worker retires earlier than planned (column 1) or later than planned (column 2). Real social security benefits remained virtually constant between 1959 and 1968. Expectations based on this experience greatly understated actual changes in benefits over the next decade. Our social security variable measures the difference between the actual wealth value of benefits at planned retirement age and what social security wealth would have been, based on expectations of zero real growth. We argue that the greater the change in total wealth caused by this unexpected change in social security policy, the greater the difference between actual and planned retirement. We find that changes in total wealth caused by social security policy both increase the probability of earlier than planned retirement and decrease the probability of later than planned retirement.

**Table 1**
**Factors Affecting Retirement Decisions: Multinomial Logit Results**
(Early, On Time, Late; N = 1580)

| Variables (Mean) | Earlier than Planned | Later than Planned |
|---|---|---|
| Constant | −4.16** | −0.54** |
| | (11.45) | (2.34) |
| Change in total wealth ($39,000) | 0.45* | −0.88** |
| | (1.91) | (3.53) |
| Health got better (14.5 percent) | 0.21 | −0.04 |
| | (1.39) | (0.27) |
| Health got worse (25.8 percent) | 0.48** | −0.37** |
| | (4.11) | (3.10) |
| Unemployment difference (2.8 percent) | −0.35** | 0.25** |
| | (10.2) | (8.11) |
| Years away from retirement (4.2 years) | 0.54** | −0.31** |
| | (15.2) | (9.04) |
| Mandatory retirement on job (51.8 percent) | 0.36** | −0.42** |
| | (3.10) | (3.64) |
| Tenure with the firm (19.7 years) | 0.85** | −1.44** |
| | (1.98) | (3.45) |
| Pension with the firm (75.8 percent) | 0.24* | −0.65** |
| | (1.70) | (5.34) |

**Source:** K. H. Anderson, R. V. Burkhauser, and J. F. Quinn, "Do Retirement Dreams Come True? The Effect of Unexpected Events on Retirement Age," IRP Discussion Paper (in press).
**Note:** t-statistics in parentheses.
*Significant at the 10 percent level.
**Significant at the 5 percent level.

Our findings provide some evidence that workers make retirement plans across time which are sensitive to government policy. Those who complained that the sudden change in social security policy in 1981 would have substantially affected the plans of older workers were probably correct. Likewise those who argue that the long-run changes made in 1983 will allow for a smoother transition in work and leisure choices for younger workers are also probably correct.

Unfortunately, the uncertainty caused by even aborted attempts to repeal the 1983 amendments is likely to increase the difficulty of planning future work effort and thus may dissipate much of the advantage of their early enactment. As the baby-boom generation reaches peak labor force participation age in the 1990s, the short-term financial crisis that precipitated the major reforms in social security will ebb. This will happen even faster if the present economic recovery continues.

I am concerned that growing surpluses in the social security trust fund may give a false signal that the long-run crisis in system liabilities has been overcome. This may embolden those who have long opposed any type of reduction in social security benefits to push repeal of the 1983 reforms. It would then be a difficult task for policymakers not to take short-run advantage of such huge and apparently growing reserves. Yet I believe that such a move would confuse a brief respite with a reprieve from the consequences of the inevitable demographic shift in the age distribution in the United States population and would be a long-term disaster for the system and those whose retirement plans depend upon it.

My review of the evidence leads me to conclude that the trend toward early retirement which our social security and pension systems encouraged over the last three decades cannot be sustained. Calls for repeal of the long-term changes made in the 1983 amendments to the Social Security Act merely increase uncertainty and will make the ultimate change in labor supply prescribed by the graying of the baby-boom generation that much more difficult. ■

*(notes on following page)*

# International conferences on social policies

A conference titled "Income Transfer Policies and the Economic Well-Being of the Poor" will be held at the Rockefeller Foundation's Bellagio Center at Lake Como, Italy, in May 1984. Organized by Sheldon Danziger and Eugene Smolensky of the Institute, the conference will explore the effects of changes in social welfare policies on the economic well-being of the poor in the United States and several Western European countries.

For decades after World War II, most Western democracies rapidly expanded public programs designed to raise the income share of the poor. As a result of the worldwide recession that followed the first oil embargo of 1973, however, critics of these programs, who have argued that they have important adverse effects on economic growth by reducing work effort and private savings, have had increasing influence on policy. Public income transfer programs are being—or have been—cut back in the United States, the United Kingdom, Germany, and even the Netherlands and Scandinavia. Only France seems to be resisting this trend, while Switzerland has been unaffected by either the rapid expansion of the earlier period or the retrenchment of today.

The conference will investigate how these policy retrenchments affect the economic well-being of the poor, and will also attempt to explain differences that may exist from one country to another. Participants will provide estimates of how income transfer policies in the late 1970s affected income inequality in their own country and estimate what effects these changes in social policies will have on the work effort and incomes of the poor.

Among those presenting papers at the conference will be Danziger, Peter Gottschalk, Robert Lampman, and Smolensky from the United States, Denis Kessler, André Masson, and Dominique Strauss-Kahn from France, Carmela d'Atice and Alessandra del Boca from Italy, Philip de Jong and Kees Goudswaard from the Netherlands, René Frey and Robert Leu from Switzerland, and Michael O'Higgins from the United Kingdom.

The conference is being supported by the Council for European Studies and by the University of Wisconsin International Studies Program. The Rockefeller Foundation is providing the facilities.

A second conference will be held at the Institute for Research on Poverty, November 1 and 2, 1984. Sponsored by the French Centre d'Étude et de Recherche sur l'Épargne, les Patrimoines et les Inégalités of the Centre National de la Recherche Scientifique, it will consist of papers given by American and French social scientists on the topic "Social Policy and Individual Behavior." It will explore the responses of individuals—changes in work effort and savings, for example—to changes in transfer programs. The conference is being organized by Denis Kessler of the University of Paris, Nanterre. Professor Kessler presented a lecture, "French Economic and Social Policy since Mitterrand," at the Institute on November 1, 1983. ■

**Retirement plans,** notes

[1]See Richard V. Burkhauser and Jennifer L. Warlick, "Disentangling the Annuity and Redistributive Aspects of Social Security," *Review of Income and Wealth, 27* (1981), 401-421.

[2]See for example Richard V. Burkhauser and John A. Turner, "Is the Social Security Tax a Tax?" Vanderbilt University Working Paper no. 81-W20, 1981.

[3]See for example Alan Blinder, Roger Gordon, and Donald Wise, "Reconsidering the Work Disincentive Effects of Social Security," *National Tax Journal, 33* (1980), 431-442.

[4]See Richard V. Burkhauser and John A. Turner, "A Time Series Analysis on Social Security and Its Effects on the Market Work of Men at Younger Ages," *Journal of Political Economy, 86* (1978), 701-716 (IRP Reprint no. 307).

[5]Kathryn H. Anderson, Richard V. Burkhauser, and Joseph F. Quinn, "Do Retirement Dreams Come True? The Effect of Unexpected Events on Retirement Age," IRP Discussion Paper (in press).