THE NEW SCHOOL Schwartz Center for Economic Policy Analysis

POLICYNOTE

WORKING LONGER CANNOT SOLVE THE RETIREMENT INCOME CRISIS

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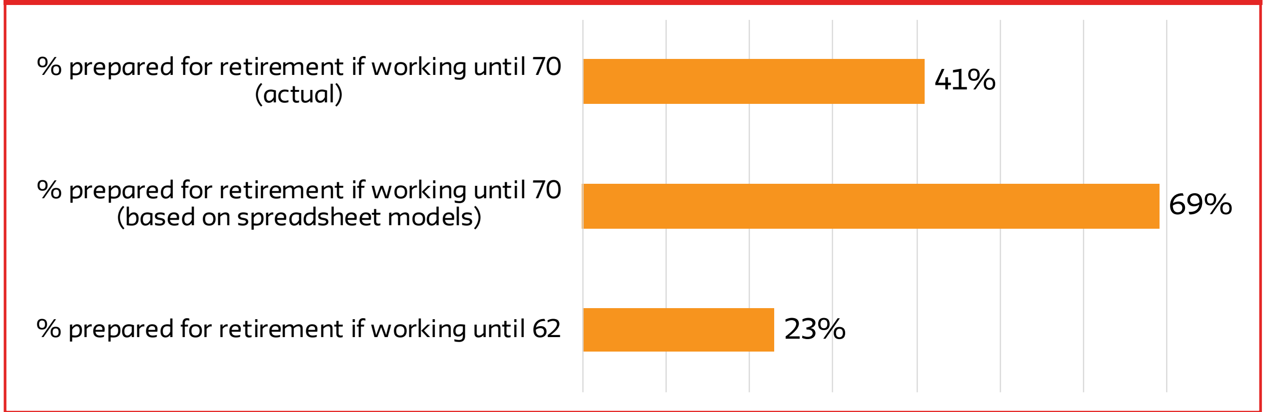
ELEVATOR PITCH

Working longer is often proposed as the solution to the retirement crisis caused by older workers' lack of retirement assets. Spreadsheet models used by advocates of delaying retirement assume older workers delay claiming Social Security to accrue additional benefits. But in reality, by age 65, most older workers have already claimed Social Security, often to supplement low wages, and working longer does not increase their Social Security benefits. Working longer increases retirement savings significantly less than predicted by spreadsheet models, which don't reflect older workers' real experiences in the labor market. Finally, the drastic job loss experienced by older workers in the wake of the Covid-19 crisis reveals the risk older workers face when working longer is the policy substitute for an effective retirement security system.

KEY FINDINGS

- Working from age 62 to age 70 increases the share of workers financially prepared for retirement by only 18 percentage points, compared to the 46 percentage point increase predicted by spreadsheet models using overly optimistic assumptions.
- More than two-thirds of the predicted retirement income shortfall is because most older workers claim Social Security benefits and miss out on the Delayed Retirement Credit.
- More than half (54%) of those claiming benefits while working do so to supplement low wages.

Figure 1: Work at Older Ages Does Little to Increase Financial Preparedness for Retirement



Source: SCEPA calculations using Health and Retirement Study data.
Note: Figure reports the projected and actual shares of workers in the 1931-47 birth cohort able to retire and maintain pre-retirement living standards, using the Georgia State RETIRE Project replacement rate yardstick (Palmer, 2008).

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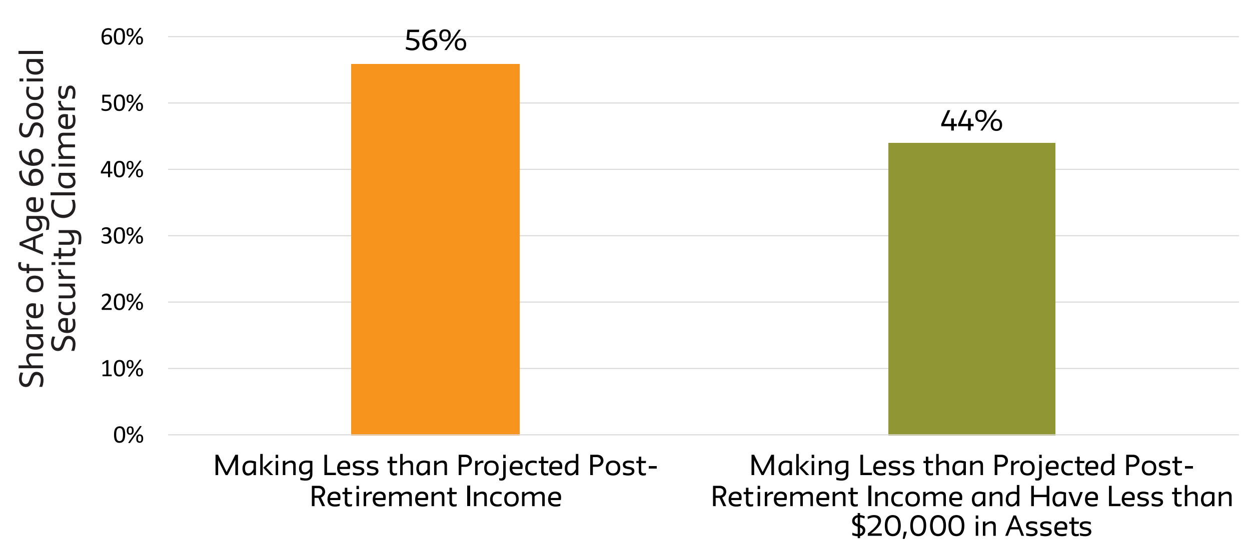
OLDER WORKERS CANNOT AFFORD TO SAVE

Advocates of the benefits of work at older ages argue it gives workers additional opportunities to save for retirement – either directly by contributing to their retirement plans or indirectly by delaying claiming Social Security. However, for most people who claim Social Security benefits early, delaying is not the rational choice. By age 66, more than half (56%) of workers who have claimed Social Security have labor market earnings that are lower than their projected post-retirement income from Social Security benefits and other retirement assets (Figure 2). If they postpone claiming, they have to live with lower income that they would earn in retirement. These households are using Social Security to smooth consumption over time, just as economic theory says they should. Many earn so little that they can't get by without claiming.

Some low earners might be better off delaying claiming Social Security by tapping financial assets to make up their consumption shortfall. But most have minimal financial assets. By age 66, almost half (44%) of workers who claim Social Security earn less than their projected post-retirement income and have less than $20,000 in financial assets. For them, the decision to claim is both simple and correct. Even if they manage to keep working until age 70, only 41 percent will maintain their pre-retirement standards of living after retirement (Figure 1).

Figure 2: Workers Who Claim Social Security Do So Because They Need the Money



Source: SCEPA calculations.
Notes: See Figure 1. Sample comprises workers age 66 who claimed Social Security. Current earnings and projected post-retirement income are calculated at the household level and assume immediate retirement.

NOT BECAUSE THEY ARE LIVING BEYOND THEIR MEANS

If workers who claim benefits were living it up, then the focus of public policy should be on financial education to discourage workers from claiming before they retired. We find no evidence that workers are living it up – using Social Security and financial wealth to enjoy a level of consumption before retirement that they will not be able to sustain subsequently. In fact, older workers who claim benefits spend less than they could afford. At the median, they spend $42,000 compared with the $49,000 they could afford.

Figuring out how much households can afford to spend:

We assume households want to spend the same amount each year throughout the remainder of their lives – they do not want to be poor while working and well-off in retirement, or vice versa. For full details on how this calculation is conducted, see the Appendix.

WORKING LONGER WAS SUPPOSED TO BE THE SOLUTION TO THE RETIREMENT CRISIS

Working longer for practical reasons is anchored in a number of what we call spreadsheet studies, which are mechanistic models based on ideal behavior. In particular, one such study by Munnell, Orlova, and Webb in 2013 was optimistic about the benefits of working longer. It projected the wealth and Social Security benefits of workers in their 50s and concluded that if only workers could remain in the labor force until age 70 or even their late 60s, most would be financially prepared for retirement. They found that a small share of people at age 62, only 11 percent, could maintain their pre-retirement standard of living if they retired at age 62. But a substantial share, 72 percent, could reach financial security if they waited to retire at age 70. However, their optimistic predictions are not supported by the data.

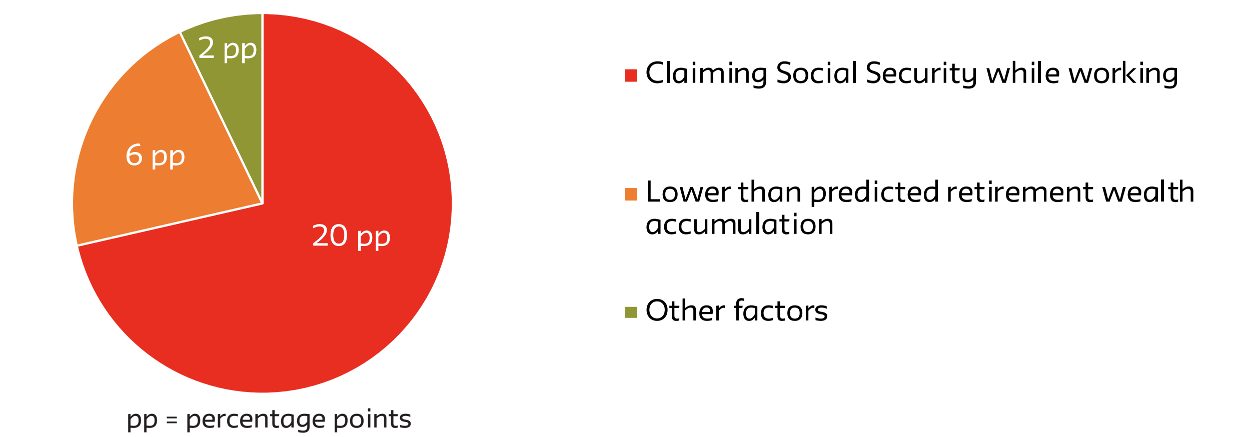
WORK AT OLDER AGES INCREASES FINANCIAL PREPAREDNESS BY LESS THAN PREDICTED

Work at older ages increases financial preparedness by less than predicted by spreadsheet models like Munnell, Orlova and Webb (2013). Using data from the Health and Retirement Study, a nationally representative sample of older Americans, found that work from age 62 to age 70 increased the share of workers financially prepared for retirement by only 18 percentage points, 28 percentage points less than predicted by the Munnell, Orlova, and Webb (2013) study.[i]

1. OLDER WORKERS ARE CLAIMING SOCIAL SECURITY BEFORE RETIREMENT

Two thirds (20 percentage points) of the 28 percentage-point gap between the predicted and the actual increase in the share of workers prepared for retirement is because most workers do not delay claiming Social Security (Figure 3).

Figure 3: Claiming Social Security While Working Explains Most of the Gap Between Predicted and Actual Increase in Preparedness



Source: SCEPA calculations.
Notes: See Figure 1. Figure 3 decomposes the 28 percentage-point difference between actual and projected increase in the share of workers financially prepared for retirement from age 62 to age 70 into the effects of 1) Social Security claiming prior to age 70, 2) lower than projected retirement wealth accumulation, and 3) other factors.

By age 65, more than half (51%) of remaining workers in the 1943-47 birth cohort claimed Social Security, and by age 66, 89% have claimed.[ii] Workers who claim Social Security before they retire miss out on the Delayed Retirement Credit that increases benefits by 8% per year. Workers with a college degree are less likely to claim early than non-graduates – 42% compared with 61% at age 65. But by age 67, almost all workers have claimed benefits, regardless of education.

We identify a trend towards later claiming. The average age at which workers claimed benefits increased by one year between the 1931-37 and 1943-47 birth cohorts, from 64 to 65, identical to the one-year increase in the Social Security Full Retirement Age. But maximum benefit is obtained by working to age 70, and preparedness shares are lower at younger ages. It seems inconceivable that average claim ages might increase an additional five years, all the way to age 70, or that those who currently retire at younger ages would be able to work to age 70.

2. OLDER WORKERS HAVE SUB-PAR RETIREMENT SAVINGS

A further 6 percentage points of the 28 percentage-point gap between predicted and actual increase in the share of workers prepared for retirement because increases in retirement plan balances fall far short of projections that assume consistent contributions, low fees, and zero pre-retirement withdrawals. This shortfall is not too surprising, because studies (for example, Biggs, Munnell, and Chen, 2019) show that people's actual retirement savings accumulation from age 25 to age 60 similarly fall far short of projections.

COVID-19 JOB LOSS EXACERBATES THE RETIREMENT SAVINGS CRISIS

The recession has worsened an already bleak situation for many millions of older workers approaching retirement. Prior to the recession, the median retirement savings account balance for those nearing retirement was $43,000 (Davis, Radpour, Ghilarducci, 2020). Prior to the outbreak of the coronavirus, inadequate retirement savings would have put 16 million middle- and high-earning older workers and their spouses at risk of poverty when they retire at age 65 (Papadopoulos, Fisher, Ghilarducci & Radpour, 2020).

Beginning in March 2020, nearly 5 million workers ages 55 to 70 lost their jobs in the recession resulting from the virus. Post-pandemic job loss coupled with early withdrawals puts an additional 3 million people in older households at risk of poverty in old age. The COVID-19 also affects workers who have kept their jobs. In a weak labor market, workers will find it harder to remain in secure and well-paid work until their planned retirement age.

POLICY RECOMMENDATIONS

Work at older ages does not improve financial preparedness for retirement by as much as proponents claim because many older workers earn so little they cannot afford to delay claiming or save for retirement. Most often, low earnings reflect not a lifestyle choice to step down to a less demanding job but poor health (Johnson, Mermin, & Resseger, 2007).

Moreover, the recession put millions of older workers out of a job. Many unemployed older workers are now at risk of never finding another job, a risk they continue to face the longer the economy takes to recover. The purported solution of working longer ignores the effect of the recession by doing nothing for jobless older workers, while deflecting from the need for comprehensive policy reform to ensure retirement security. We detail needed policies to address the retirement crisis below:

(For a detailed list of policies addressing the pandemic and needed reforms in the retirement system, see our report, "A Policy Agenda for the Biden Administration: Protecting Older Workers & Strengthening Retirement Security.")

1. REINSTATE EARLY WITHDRAWAL PENALTIES

Retirement assets have a specific purpose: to provide workers with income in retirement. Using these assets when facing financial difficulties and other emergencies may help workers in the short run but hurts their retirement security. Instead of lifting the early withdrawal penalty, Congress should enact measures to deal with disasters such as the Covid-19 pandemic and effects on people's jobs and lives by adopting policies such as lowering the Medicare eligibility age, increasing and extending unemployment benefits, and requiring employers to provide paid sick leave for all workers. Otherwise, workers are forced to choose between suffering from disasters now or hurting their future income by tapping into their retirement assets. Additionally, by equating early withdrawals with emergency savings, Congress ignores the needs of the majority of workers who do not have access to a retirement savings plan or any liquid retirement savings.

2. EXPAND SOCIAL SECURITY

As we show in this report, many workers do not have access to workplace retirement plans and receive over three quarters of their retirement income from Social Security (also see Ghilarducci, Papadopoulos, & Webb, 2018). Increasing the Full Retirement Age — which cuts Social Security benefits for everyone — especially hurts those unable to work longer and those who supplement low wages by claiming Social Security benefits while working. Expanding Social Security can make up for benefit cuts, ensuring no one faces poverty in retirement after a lifetime of work. This supports not only the most vulnerable — senior citizens, the disabled, people of color and those in densely populated areas — but also helps the overall economy by increasing aggregate demand.

3. ADVANCE OLDER WORRKERS' BARGAINING POWER

Working longer does not help many older workers prepare for retirement because they are paid low wages. Older workers are losing bargaining power on the job, requiring federal efforts to protect institutions and policies that support workers' rights, including stronger anti-age discrimination regulations and enforcement, protection of rights to labor representation and collective bargaining, and to properly classify workers in gig and alternative work as employees. However, due to the low levels of union membership, minimum wage hikes are also necessary to ensure living wages for older workers who are highly represented in low-paying jobs such as food service, retail, and care work.

4. CREATE GUARANTEED RETIREMENT ACCOUNTS

Going forward, Congress should ensure all workers have retirement plans that are protected against recessions through the creation of a public option retirement plan known as Guaranteed Retirement Accounts (GRAs) (Economic Policy Institute, American Federation of Teachers, & SCEPA's Retirement Equity Lab, 2019). GRAs are universal, individual accounts funded by employer and employee contributions throughout a worker's career along with a refundable tax credit (see Economic Policy Institute, American Federation of Teachers and Schwartz Center for Economic Policy Analysis 2019). The plan is portable as a worker changes jobs or if a worker loses their job. GRAs give workers access to a secure and accessible way to save for their retirement and supplement their Social Security benefits.

APPENDIX

The methodology for this study comes from Ghilarducci, Papadopoulos & Webb (2019).

Consumption Target Calculation:

To figure out whether households are overspending, we proceed in four steps.

Step 1 involves figuring out the lifetime resources available to each household in our sample. Resources comprise the value of financial assets, and the expected present value of remaining lifetime labor market earnings, income from Social Security and defined benefit retirement plans. We ignore housing wealth because households rarely trade down or tap a reverse mortgage.

Step 2 is to calculate the household's consumption target. This is the level lifetime income the household's resources can produce. Although households rarely annuitize and are unable to purchase annuities with future labor market earnings, we use current joint life and survivor annuity rates as a proxy for the lifetime income the household's resources can produce. If lifetime resources are $1 million and the annuity rate 5%, the household can spend $50,000 a year. We calculate the median consumption target for all households.

Step 3 is to calculate the household's consumption while working. This equals labor market earnings, pension income, and investment returns, minus (plus) the increase (decrease) in the value of financial assets. We divide by the number of years worked to arrive at annual average consumption. We again calculate the median for all households.

Step 4 is to compare median consumption calculated in step three with the median consumption target calculated in step two.

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ENDNOTES

[i] Our analysis is based on Health and Retirement Study data for the 1931-47 birth cohort matched to administrative data on claim ages and lifetime earnings. See Ghilarducci, Papadopoulos, and Webb (2019) for further details. Munnell, Orlova, and Webb (2013) used the same dataset and definition of preparedness, similar birth cohorts, but projected preparedness from a baseline of ages 51-56.

[ii] These data are for the 1943-47 birth cohort, the most recent cohort for which we possess claims histories that are most complete and mostly based on administrative data and therefore can be compared with data for previous cohorts.

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