Older Americans' Economic Security

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Working for a Good Retirement

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Workers who delay retirement can save more and contribute more to the economy. Urban Institute simulations show that someone who works an extra five years could increase retirement spending by more than half. Also, work-inducing reforms—rather than reforms that simply reduce benefits—help close the Social Security funding gap.

Delayed Retirement Could Ease Logjam

An aging population and the approaching retirement of the largest birth cohort in U.S. history could mean a shortfall in promised Social Security benefits in 2017. After that, with baby boomers retiring in hoards, Social Security would be required to redeem bonds held by its Trust Funds. According to current projections, all Trust Fund assets will be depleted by 2041.

This brief examines how changes in retirement behavior and reforms that encourage workers to stay on the job longer could ease the long-term funding logjam. The effectiveness of these changes is gauged using projections of retirement age, Social Security take-up age, pensions, Social Security benefits, taxes, and other significant sources of income in retirement from the Urban Institute's Dynamic Simulation of Income Model (DYNASIM3).[1]

Workers, according to DYNASIM3, could increase their annual income by an average of 5 percent from age 50 onward for one additional year of work, and 25 percent for five additional years of work. This added net wealth, if at retirement, could increase consumption by 9 percent per year—or by 56 percent per year after five extra work years.

Lower-income workers have the most to gain from working longer. Workers in the bottom fifth of earners could increase their spending ability at retirement by 16 percent with one extra work year, and by 98 percent with five more earning years.

The earnings generated from one year of work are almost equal to the entire 2045 Social Security shortfall. The additional Social Security taxes generated by five years of work would equal more than half the Social Security shortfall in 2045. If additional income tax revenues are taken into account, there would be no shortfall and the government could fully pay promised benefits.

Reforms Should Encourage More Work

The increase in Social Security's normal retirement age, the shift from defined benefit to defined contribution pensions, and the scaling back of retiree health insurance are already in place and should encourage more work at older ages. Other reforms are still likely to be required to avert long-term imbalances. Some—such as decreasing early Social Security benefits and increasing delayed Social Security benefits, or eliminating the requirement that employer health plans provide primary coverage for workers eligible for Medicare—are much more likely to increase work effort than are others.

Many incentives for early retirement fall outside the Social Security system. Regulatory barriers and the Age Discrimination in Employment Act discourage phased retirement. Some regulations prevent workers from collecting their defined benefit pensions while continuing to work, forcing a choice between retiring or losing pension wealth.

Conclusion

When to retire is one of the most important choices most workers will make—significantly more important than whether to invest their 401(k)s in stocks or bonds. Working longer improves retirees' long-term security. For society, the additional work years can improve economic productivity, generate additional payroll and income tax revenue, and reduce the Social Security deficit. Future Social Security reforms should consider that workers do better when work is encouraged and worse when only benefit cuts are involved.

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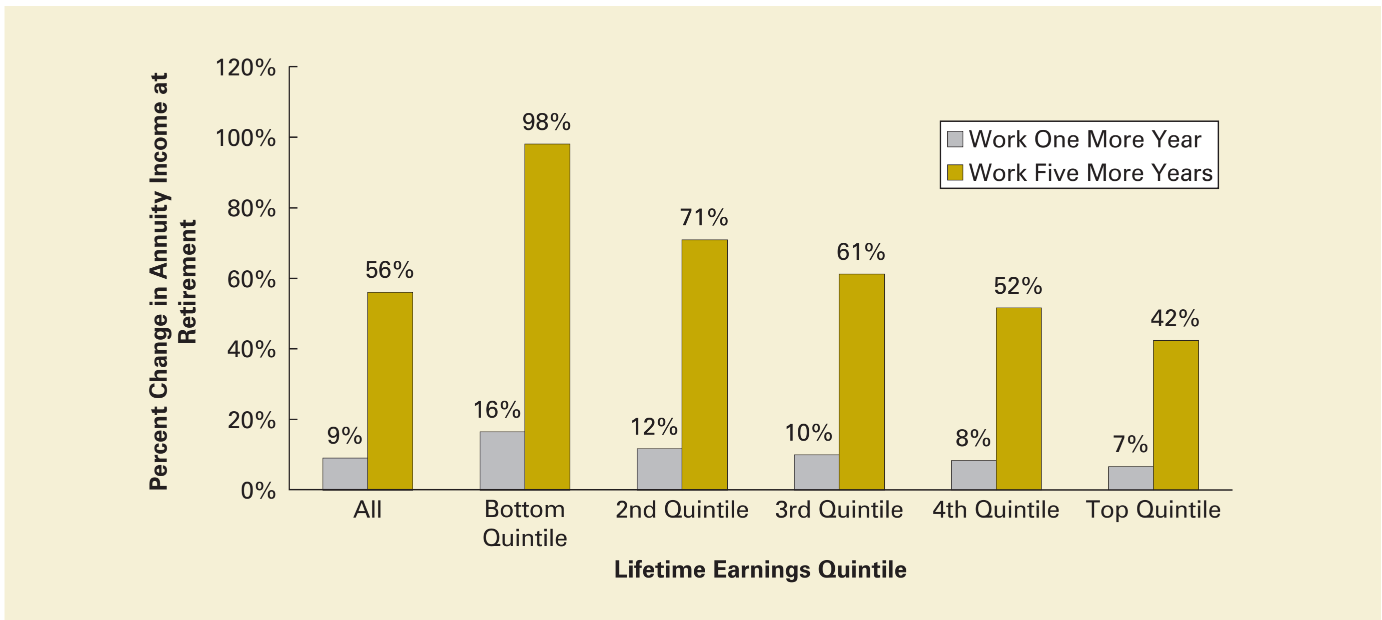
FIGURE 1. Percent Change from Baseline in Average Annuity Income at Retirement by Lifetime Earnings Quintile and Additional Work Effort



Source: Urban Institute tabulations of DYNASIM3.

Notes: Based on 17,547 observations of persons who are retired and receiving Social Security benefits by 2049. Lifetime earnings are the average wage-adjusted individual earnings from age 22 to 62 in the baseline simulation.

Notes

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1. DYNASIM uses 2005 economic and demographic assumptions, including labor force participation rates, average earnings, and mortality, from the Office of the Chief Actuary (2005).

Reference

Butrica, Barbara A., Karen E. Smith, and C. Eugene Steuerle. 2006. "Working for a Good Retirement." Washington, DC: The Urban Institute. Retirement Project Discussion Paper 06-03. http://www.urban.org/url.cfm?ID=311333. (Accessed October 5, 2006).