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CAN WORKING LONGER SOLVE OUR BUDGET PROBLEMS?

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P R O C E E D I N G S

MR. BURTLESS: (in progress) -- who's going to chair later sessions and some of my colleagues here at Brookings, and I've also had the good fortune to work closely with Karen Smith at the Urban Institute, who, unfortunately cannot be here today. And that's too bad, because she wrote one of the most important papers for this conference. In her absence, I am going to present her paper along with my own research in the next few minutes.

The good news is that I can integrate the discussion of her work and findings with the work that I did and the work that she otherwise would have presented. The bad news is that you are therefore going to have to listen to me twice as long as otherwise would have been the case.

Let me begin by briefly describing the questions that we're going to be discussing.

- What are the budget impacts that will arise in the average age of retirement, assuming that delayed retirement occurs without any change in current eligibility requirements or benefit formulas, giving people an incentive to retire later?
- How can we and should we take policy steps to encourage Americans to retire later? What would those policy measures look like? How effective would they be? Who would they help and who would they hurt?
- And, finally, can policy be designed in such a way so that the people who may not be able to delay their retirement, either because of disability or because they have the misfortune of working in an industry with very, very bad prospects -- can we treat these people in a humane way under the policies that do induce later retirement among most of us?

The conference is being recorded, and a transcript is going to be made.

We want participants to speak freely, but we also realize that some participants may not have reached final conclusions about the topics that they're going to discuss. Therefore, if you want to directly quote one of the speakers in something that you write, we urge you to contact the speaker before you put anything into print.

In the remainder of my remarks, I'm going to talk about the research that Karen Smith and Rick Johnson did at the Urban Institute and that I have been doing; and I'll treat three basic questions in that discussion. First of all, what is the longer-term record on retirement here in the United States, and what have been the trends in the past few years? Second, how did we in this project formulate alternative projections of what the future is going to look like when retirement age increases? And, finally, what are the budgetary effects and income distribution consequences of an accelerated trend toward later retirement?

There is no reason to keep any of you in suspense about our bottom line. The basic question addressed in our project was: Can working longer solve our budget problems? And the answer is: No. But it's no with an asterisk. Under the delay retirement scenario that the Urban Institute and I examined, plus CBO's long-term estimates of the deficit under its current law baseline, we find that later retirement would eliminate 4 to 7 percent of the deficit over the next decade; it would knock 15 or 16 percent off the deficit in the decade after that; and it would cut the deficit between 2031 and 2040 by about a quarter.

Clearly, the budget problem isn't solved, but delayed retirement takes a pretty big bite out of the problem, especially in the decades after 2020. In 2040, in that precise year, the deficit would be cut by almost 40 percent if in the years leading up to 2040 people were delaying their retirement under the scenario that we examined.

Unfortunately, no one, including CBO, thinks its current law baseline is very realistic. That scenario assumes tax increases and budget cuts currently written into law are actually going to take place. I don't know if any of you are paying attention to this debate. It has made hardly any impression in Washington, I take it, but most people don't think that's going to happen.

If they do take place, if the tax hikes and curbed domestic spending and defense spending go into effect, the country doesn't really face a deficit problem. Under the current law forecast, the federal deficit is only about 1 percent of GDP after 2020. Deficits that size are not problems except in the fevered imaginations of people who have nothing more serious to worry about. And you know who you are. The deficits are small enough so the federal debt, as a percent of GDP, would be shrinking continuously after 2015.

Now, under CBO's alternative and more realistic scenario about what the future deficit outlook is, Congress will extend many of the tax provisions that are supposed to expire. They will relax a lot of the spending constraints that are built into current law. And if we accept that alternative CBO budget forecast, later retirement eliminates just 1 percent or 2 percent of the deficit over the next decade, about 3 percent of the deficit in the decade after that, and just 2 or 3 percent of the deficit in the decade beginning 2031. If Americans retire later, it hardly makes any difference to that budget outlook.

- Later retirement would have other effects, however; besides, it's impaired down the deficit. For example, it can make a difference to the incomes of people who continue to work and to people who are already retired. Some old people will have more income because they're working; others who are retired will have higher income because they deferred collecting their pension.

The Urban Institute's prediction model suggests that some of the largest proportional income gains from delayed retirement would be obtained by the elderly in the lower ranks of the income distribution. That's because the educated and affluent elderly already tend to leave the work force later than do less affluent, less well-educated groups. So, later retirement will not produce such a large proportional impact on the incomes of these well-off people.

For those of you who may be unaware of this fact, and that includes, I think, no one in this room, the average retirement age is already increasing. This trend has been underway for the past two decades. The Social Security Administration assumes it's going to continue. Recent increases in employment among the elderly represent the reversal of a trend that had been going on for more than a century toward earlier retirement for people in paid work careers.

Some people may be under the impression that the trend toward earlier retirement is still underway or was only reversed because people are now facing very bad times because of the weak job markets in the early part of the last decade and since the downturn in 2008. But that's mistaken; both men and women are leaving the labor force at later ages, and that trend has continued through the recession.

What we've done on this project is to answer a straightforward question: Supposed the trend toward later retirement proceeds at a faster rate than predicted by the Social Security Administration. How much difference would that make for government revenues; for government outlays, such as, you know, Social Security and Medicare and Medicaid benefit payments; and for government revenues from the payroll tax, the income tax, from premiums that people have to pay in order to get Medicare coverage? How much difference would it make for national income and for the incomes of the aged?

So, let's start with the long-term trends. There's no single best definition of what retirement is. Obviously, it's the drop-off in how much we work toward the end of our career. Some people say they're retired only after they completely cease working. Other people who are in full-time jobs say they're retired, because the job that they have is less demanding than the job they had at mid-career. And still other people say they're retired when they have a part-time job. So, it's very tough to get this precisely defined.

One indicator of trends in the average retirement age is the trend in labor force participation rates in older ages. Suppose we ask ourselves the question: What's the youngest age, among men, where at least half of them have dropped out of the work force? What is that youngest age?

This has numbers from decennial censuses from 1910 through 1960 and then CPS files from 1965 onward and tries to answer that question. The numbers aren't perfect, but they show a big drop in the average retirement age. Over 50 percent of 73-year-old men were in the work force in 1910. Over 50 percent of 73-year-old men were in the work force in 1910, but less than 50 percent of 74-year-old men were in the work force in that year. So, let's call 74 the average retirement age in 1910.

The average retirement age dropped by four years to age 70 by 1940. It dropped another four years to age 66 by 1960. Notice that half the drop between 1910 and 1960 occurred before anyone received a Social Security Check. The average retirement age dropped another four years to age 62 by 1994, but since that year the average retirement age has been inching up. In 2009, which was a very bad recession year, it reached 65, eliminating three-quarters of the drop that had occurred between 1960 and 1994. And obviously this is a very crude indicator.

We can make finer-grain distinctions by looking at labor force participations at exact years of age and seeing what the trends are. Here are some numbers drawn from exactly the same sources for specific years of age: age 60 for men, age 62 for men, age 64 for men. The top line -- the red line -- is for 60-year-olds, the bottom line, purple, is for men age 70, and you can see these sharp fall-offs in the labor force participation rate of these men.

The recent uptick in older men's participation rate has been more noticeable than that for younger men. At age 60, actually, there's very little sign of any recovery in labor force participation, but at older ages you can see there has been sizeable increases in participation rate.

The situation among women is pretty much the same as that among men. A big difference is that women under the age of 55 have, until recently, had far, far lower rates of paid employment than men have. So, it's tougher to trace out what's happened to their retirement age going back a long way. But here are the numbers since 1965, and you can see that for women, as among men, since the late 1980s there has been an increase in participation rates at older ages.

A common view is that an aging society cannot afford early retirement, because workers live longer beyond the standard retirement age as a result of longevity improvements. This view also tends to overlook the importance, however, of what people are doing before they reach the standard retirement age.

How much do they work then? Odd as it may seem, the drop in labor force participation and employment after age 60 has been far more than counterbalanced by increases in paid employment under age 60. Here are the numbers. For your convenience I have blue indicating where there's been an increase, red indicating where there has been a decline. This is the trend in labor force participation rates by age group, among people, since 1948, since the end of World War II. As you can see, over that period labor force participation among Americans past 65 fell a bit more than 9 percentage points. We also saw a drop in labor force participation rate among 16- to

19-year-olds. But otherwise, the rates are up, and they're up for a simple reason. Women are much more likely to be engaged in paid employment than they were at the end of World War II.

It's worth emphasizing, however, that these trends -- we can divide the post-war era into two different eras: one, between 48 in 1989 in which participation rates were rising strongly in all ages under 55, and past age 65 there was a very sharp falloff in participation rates. Since 1989, however, things have reversed. Participation rates have fallen -- slightly, it's true -- between 25 and 50 but much more sharply for the youngest, 16- to 24-year-olds. But at every age past 50, participation rates have risen, notwithstanding the weakness of the job market in recent years.

Turning back to retirement trends, what can we say about the increases in old-age labor supply we've seen since the late 1980s? This slide poses four questions about the trend, and in this project we try to address them. There's a paper that is out there on the table that you're free to take home that gives detailed answers to these questions. I don't have time to give those detailed answers here, but let me state briefly what we found.

• Do workers who postpone retirement earn below-average wages? No, they don't. Since the late 1980s, much of the increase in work effort among the aged has been concentrated among folks who earn good wages.

• Do late retirees have worse-than-average or better-than-average schooling? Well, given my answer to the previous question you shouldn't be surprised to learn that the answer to this one is obvious. People who delay retirement tend to have better-than-average education. That's where the increases have been.

• How is the delay in retirement divided between full time and part-time work? Well, even back in the 1970s and 1980s at the low point for retirement -- that is, when the early retirement binge was at its high -- even back then, older workers were more likely than younger ones to work on part-time schedules. However, as the average retirement age has increased, there has been a trend toward full-time work among aged worker. Older workers are still more likely than younger ones to be in part-time jobs, but the gap is shrinking.

- How important are breach jobs? How important is having a longer career job in this trend toward later retirement? Both are important, but there has been a significant increase in job retention among older workers who are still in the career jobs they occupied when they were in the middle of their careers. In other words, lengthening work life has meant lengthening career jobs, at least for an important subset of the later retirees. Not everybody who is an older worker is a greeter at a Walmart store. A lot of people still have very significant jobs late into their 60s, the same jobs that they held when they were in their late 40s.

Before moving to our estimates about the impact of a future rise in the retirement age, I'd like to spend a minute on what has been happening to the hourly wages paid to older workers. Remember, there's been a sizeable increase in the proportion of Americans who remain employed until late into their 60s and into their early 70s. In addition, the leading edge of the baby boom generation has reached its mid-60s, increasing the proportion of the potential work force that is aged. So, two things have happened. The slice of the population that is in this older group has gone up, and the proportion of them who are in the labor force and working has gone up to. You might think this would be driving down the relative wages of these older workers, especially if the workers are crowded into particular niches of the labor market.

But quite the opposite has been the case, as this chart makes clear. Here I estimate the average hourly wage of workers within five-year age groups, measured as a percentage of the average wage paid to 35- to 54-year-old workers, that is, prime-age workers.

The age-earnings profile in 1985 to 1991 is shown as that black line. The age-earnings profile in 2004 to 2010 is shown in the red line. From age 25 through 54, there has been virtually no movement in workers' age-earnings profile. At older ages, however, there's been a noticeable improvement in the relative wages earned by these people in older age groups, and the increase has been proportionately larger the older the age group we looked at.

That's the upward trend in old age labor supply. The upward trend in the proportion of population that's old has not led to a relative deterioration in the earnings of old people. Quite the opposite has been true. One of the reasons is that the educational attainment of people who are now old has improved relative to that of prime-age workers, but not all of this improvement is accounted for by that fact. Even adjusting for educational attainment, there's been an upward tilt in the age-earnings profile favoring older workers.

So, now let's turn to our modeling of a higher future retirement age. Social Security trustees already predict that the trend is going to continue into the future. So, to some extent delayed retirement is already baked into the forecast by both CBO and the Social Security Administration of what future government revenues and outlays are going to be. But we're interested in knowing the effects of even faster growth in employment amongst the aged. How do we go about it?

We start with the notion of labor force persistence among older workers. Suppose you have a thousand people who were in the labor force when they were at some given pre-retirement age, say age 57. What percentage of those people are still in the labor force when they're 62? When they're 63? When they're 65? When they're 72?

This chart shows labor force persistence among the generation of men who are in the labor force at age 57 and who attained age 60 in 1975. That's the blue line, mostly at the bottom. Almost 70 percent of these men in this cohort were still in the work force at age 62; 32 percent of them were in the work force when they were 66; 14 percent were still in the work force at age 74.

The chart shows comparable estimates of labor force persistence for men who reached 60 in 1985, for men who reached 60 in 1995, for men who reached 60 in 2005. And you can see that persistence is increasing, especially at ages past 65.

This chart shows how much persistence has risen at each year and age from age 60 up to age 79. I compared the persistence rates in 1988 to 1990 with those in 2008 to 2010, and the increases in persistence are sizeable at every age past 62. In devising a higher retirement age scenario, we decided to assume that labor force persistence is going to continue to increase just as fast over the next 30 years as it has for the previous 22.

Well, that represents faster right of rise in labor force participation rate than the one that the Social Security trustees assume. On the other hand, we do assume that SSA predictions of labor force participation among every age group 55 and younger are exactly right. They're perfect. We don't change those a bit.

So, this chart shows the implications for our assumption for the labor force participation rate of men between 65 and 69. The blue diamonds before 2010 show BLS estimates of exactly those labor force participation rates, the actual ones of men between 65 and 69. The blue diamonds after 2010 show the Social Security trustees' predictions for what that's going to be in the prediction horizon. The red line shows our estimates -- Urban Institute's, mine, Moody's -- of assuming that instead of slowing down, the trend toward increased labor force persistence is going to continue unabated over this time horizon. So, that's men between 65 to 69; this is women between 65 to 69. Really, there's very little difference, because these trends are very similar across the two sexes.

The implications for the size of the labor force that is 55 and older are shown here separately for men and women. You can see that, you know, by the end of the prediction horizon we expect there to be between 13 and 14 percent more men and women employed in the work force than is in the predictions by the Social Security trustees.

So, now you see what we mean by later retirement, an increase in labor force persistence that's just as fast in the coming three decades as it was in the past two and a half decades. We don't claim this is the best prediction of what's going to happen in the future. We just say, well, it's faster than the Social Security trustees assume, and so it's giving us a feeling for how much this will affect government revenues, government outlays.

So, how do we decide who is going to join the work force? We use the Urban Institute's DYNASIM III simulation model. DYNASIM starts with a sample of over a hundred thousand people. It ages them one year at a time, changes things about them to match research findings of how life course proceeds for most people -- births, moving out of the home, becoming employed, getting an education, retiring, claiming a pension, accumulating savings, and so on. DYNASIM's employment earnings and inflation projections are exactly aligned to the 2011 Social Security Trustee's Report, so DYNASIM is already using, as its baseline, what the Social Security trustees predict.

My Urban Institute colleagues and I estimated the desired change in labor force status that would occur under our later retirement scenario, and we did that within each individual year of age, separate by gender group in the population, groups from 55 to 79 years old. Remember, DYNASIM is already aligned to the Social Security predictions. So, Karen Smith's task was to predict which 55- to 79-year-olds would do something different if there was a later retirement scenario.

Okay, suppose there are ten 64-year-old women in her sample in a given future year, and suppose four of them are predicted in the baseline to be in the labor force while six are classified as retired. This is the initial prediction based on the Social Security Administration forecast. Now suppose Karen, in my later retirement scenario, predicts that six of these women will be in the work force and only four will be retired. Karen permitted the DYNASIM model to predict which two of the six initially retired women were closest to the margin of joining the work force. So, she identified those two, then she said okay, so now let's have them join the work force, and now we have six people who are in the work force and four who are retired.

Well, the people who change, you know, they may be unemployed -- I'll get to that in a moment -- but if they do get employed, everything that we know about them in the DYNASIM model permits us to say how much they are likely to work. This is based on their educational attainment, their age, their health status. It's based on what their past prior earnings record has been. So, now we switch them to working. Some of them get jobs; many of them get jobs in most years. The women may accumulate additional earnings as a result of being in the work force. They get additional earnings credits for Social Security, additional earnings credits toward Medicare eligibility, possibly for a bigger employer pension. Depending on their earnings and eligibility status, they might defer collecting Social Security and Medicare or an employer pension.

Now, I know what you're thinking -- and you're right -- what about unemployment? Just because somebody wants a job doesn't mean they're going to get one, especially when the unemployment rate is 8 percent, as it is today. It's ludicrous to think that because some 64-year-old person changes her mind about staying in the work force she's going to land a job. That same thought occurred to us. That's why one of our research collaborators was Moodys.com, a macro-forecasting outfit. This chart shows our initial projection of increased employment. That's the blue line. This is what we predicted. This is the desired extra employment that is generated by our faster retirement scenario, and it shows Moody's estimate of the number of extra workers who could find jobs, given the fact that we have a demand-constrained economy right now. We have a lot of excess unemployment. Moody's estimates, as does the CBO, that the magic moment will someday occur when we're back at full employment. In Moody's estimate, it's 2018. The last time I checked, CBO predicted that it was going to occur in 2017. But, anyway, at some point the gap between these two sets of estimates gets quite small. After that, the percentage increase every year in desired labor force participation -- because we've accelerated the pace of delay in the retirement age -- is going to be the same as the percentage gain in the number of jobs.

Clearly, not every old person who enters or reenters the job market under our delayed retirement scenario is going to end up with a job. Which ones will not get a job? DYNASIM essentially uses a random selection to make this decision. If a hundred people flood into the labor force because of a delayed retirement scenario and Moody's tells us actually only four of them can get a job, those other 96 are going to be randomly assigned to being unemployed.

We used two procedures to allocate the job shortage across job seekers. In one we assumed that all of the additional unemployment is going to fall on the backs of those people who are trying to enter the work force; that is, the old people. In the second one, we said no, it's not; the pain is going to be spread around to the young as well as the old. Okay, that's the setup.

Don't worry; I'm very close to the end.

Let's go to the bottom line. What is the predicted impact on the federal deficit? Here are the year-by-year predictions from DYNASIM under the three different assumptions. Number one, everybody who wants to get a job, with a minor amendment, gets a job. Second, only people get jobs for which there are jobs in a demand-constrained economy, and all of the extra unemployment is suffered by the old job seekers who are flooding into the job market. And, alternative three, there's a constraint in the number of additional jobs, and the pain is spread amongst the young as well as the old.

These estimates of what the impact on the federal deficit are take into account the extra payroll tax revenue generated by higher earnings, the extra income taxes generated by higher earnings, and eventually higher private pensions, higher investment income as a result of added savings, personal savings, and bigger withdrawals out of tax-deferred savings accounts when those withdrawals begin for many people at a later age than they otherwise would. They include the higher Medicare premiums that some recipients of Medicare are going to have to pay either because their retirement income is topped up by earnings or, alternatively, because their retirement income is higher than it would be had they retired earlier. The deficit (inaudible) also account for savings, because Social Security and Medicare benefits are deferred or reduced.

There are a lot of moving parts in this prediction. You need to do a very meticulous job of creating the micro-simulation model to get all of them. One of the surprising things is if there's an additional number of people in the workforce, a lot of the extra people are going to earn below-average salaries -- pay. They're older. They may only have salaries for part of the year because they may be in the midst of retiring sometime during the year. That lowers the economy-wide average wage. That, in turn, affects how high benefits are under the Social Security benefits program.

In particular, Social Security benefits are lowered by a small amount for people who do not change their retirement behavior. They get a little bit less. Why? Because the indexing factors in the Social Security benefit formula grow more slowly and hence Social Security benefits rise more slowly.

So, Chart 15 here shows that as the employment gains from later retirement become more pronounced, the percentage reduction in the federal deficit gets bigger. After about 2018, there's very little difference between the three different forecasts, the alternative 1, 2, and 3 that I described. Not surprising, because employment is no longer demand constrained after we get back to full employment. By 2025 later retirement reduces the deficit by 15 percent compared with CBO's current law baseline, and by 2040 the deficit is reduced by almost 40 percent.

Okay, it sounds big. Unfortunately, CBO's current law baseline forecast is not very realistic, as I already said. This chart shows the DYNASIM estimates under CBO's more realistic alternative projections, which assume that a lot of tax cuts are going to be extended after December 31st, and a lot of constraints on domestic and defense spending get partially removed. Obviously, if this alternative is correct, the delayed retirement scenario is going to do little to restrain the growth in the deficit.

Notice that, you know, the maximum reduction in the deficit that's predicted is less than 3-1/2 percent. The plain fact is that under law, CBO projections, the nation does not face a long-term budget problem. There is no problem to solve. Later retirement will whittle down the deficit by an impressive percentage amount, but there is really no problem here. Under the current law scenario, the government's debt, measured as a percent of GDP, starts to fall in 2015, as I said before, and it just continues to fall.

The comparison is not in any scenario we performed. The difference here is the scenario that the CBO is forecasting, and the green line shows how small the reduction in the deficit is under its realistic projection of future government outlays and revenues. The red line shows much bigger proportional effects on the deficit, but that's because it's a very unrealistically small predicted future deficit.

So, now let me conclude with some more cheerful numbers. The DYNASIM model generates predictions of the income distributional impact of a change like later retirement. My last three charts focus on the population between 55 and 79 years old. What happens to them? They're obviously the group that's most affected by any delay in the retirement age.

This chart shows percentage changes in the incomes of people in the six age group and the age range. The light blue bars refer to our estimates of income gains in 2020; the red bars indicate percentage income gains in 2030; and the green bars show income gains in the last year of our forecast, that is, 2040. The results for the youngest age group are on the left; the results for the oldest age group are on the right. Not surprisingly, the biggest proportional effects on income are for people between 65 and 69. Those are the people who actually -- a lot more of them have earnings instead of relying on retirement income, and they see the biggest boost in their income.

The DYNASIM model suggests that the income gains from delayed retirement are going to be progressive; that is, they will increase the incomes of poorer groups proportionately more than they will increase the incomes of more affluent groups. One way to see this is to show income gains by educational attainment group. Here we divided the population between 55 and 79 into high school dropouts, high school grads, and college grads, although 55- to 79-year-olds in all the groups experienced income gains. In each year, the proportional gain is biggest for the least educated group.

We see the same thing when we look at the income distribution of the population between 55 and 79. Here they are divided into five income groups from lowest to highest. The biggest proportional income gains occur among the aged and near-aged folks who have the lowest predicted incomes before the hypothetical delay in retirement.

And the reason that later retirements tend to reduce inequality among the aged and near-aged is that people with relatively high incomes already tend to work. We're not changing their behavior. They're already working. We're not going to change what they do. Hence, the increases in income associated with an additional delay in retirement will tend to be received by people with lower incomes.

This is not how it would work if instead of finding that it's been the more educated, more affluent people who are deferring retirement we had found instead that it's the least educated, the lowest, most disadvantaged people who were retiring later. But that's not what we found. A retirement delay without any additional change in public policy may do relatively little to curb the deficit, but it does improve the distribution of income amongst aged and near-aged people. And if the DYNASIM prediction of who is going to retire later is accurate, the distributional impact, I think, would be one that is welcome among most people.

I'm going to leave to later speakers to talk about policy steps to encourage later retirement and about the wisdom of taking those policy steps. My results show that later retirement by itself is not going to do much to put a dent in our deficit problem either in the short run or in the long run.

Now, the first discussant of these results, I think, is Joyce Manchester -- isn't that right? Or Gene. Okay, Gene. Gene is an economist at the Urban Institute and is a great authority on these topics. He is going to be followed by Joyce Manchester, who has an inside seat because she's over at CBO, and she has worked in the Social Security Administration and knows a lot about both the CBO and the Social Security forecast.

So, Gene, go ahead.

MR. STEUERLE: All right, thank you. I'm indeed honored to be here undoubtedly because I think this is an extremely important topic but also because I'm honored to be among this very fine set of colleagues and friends whom I've known for many years, and I think they're among the wisest, the nicest, and the smartest group of people I know. So, this is indeed an honor for me to be here.

I'm also going to make a pitch that even independently policy changes -- that I think Gary's understating the real gains we can get from this increased labor force participation he's talking about, and it's partly because I think that despite the great improvements I think that he's made, I think he's actually underestimating the extent to which we'll have these labor force improvements.

Secondly, he hasn't added on the extent to which policy might increase the labor force participation and all the impact we get there.

And then, third, he's talking about only having a modest impact on this deficit under current policy, but that policy is compounding. You know, I guess when we get to 2040 and 2070, you know, we're -- the whole thing is falling off the end of the map because of compound interest rates.

So, one very minor thing I'd suggest, Gary, is convert, like, a 2040 number to what's that in today's dollars relative to the budget? Is it $50 million or whatever?

But for all those reasons I think he's underestimating the impact here.

And I think this is actually one of the most important topics that we should be having with respect to the budget and we're not having it.

In some sense it's sort of the one area, if you want to think about it, in budget policy where there is a free lunch. Now, it's not entirely a free lunch, because we're talking about people working longer. So, I'm dodging the issue of the fact that there's decreased leisure. But if we get additional work, I mean, one has to realize that you can support a larger spending in government at the same tax rate, or if you want to have the same spending you can have that same spending at lower tax rates. It gives you -- at least in a policy sense, it gives you this money that you can deal with a lot of problems. So, it has just enormous gains.

And I'd also, by the way, like to thank the Sloan Foundation, which has supported us over the years on related topics, as well as the support for this one. I think this is just exactly the type of topic we should be examining.

So, Gary's covered this, but I just want to reemphasize why retirement age and labor force participation are such important issues, and they tend to be associated with the Social Security debate, and that's a very narrow framing of what I believe is a much larger debate, which is essentially more of a demographic debate. You know, how do we adjust as a society to changes in fertility and mortality and other rates, as well as commitments that we've made, and as he emphasized you don't want to just look at what's the impact on Social Security. You want to look at impacts on GDP, on personal income, on revenues.

And, by the way, the big impact on revenues if you get more labor force participation -- and Karen Smith, Rich Johnson, and I had done an earlier paper that had some very similar results here, just to let you know about that as well -- the biggest impact that we had, for instance, from buffing up the early retirement age was on the income tax. It had very little impact on Social Security, partly because of -- at least Social Security balances in particular -- because the benefit and the tax changes were roughly the same size. It had a big impact on income tax revenues. And of course then there's the aspect of spending on the budget.

And just to give you an idea about what happens in spending on the budget, this is -- I don't, know, Joyce, if I'm stealing a slide from you, but this is the Congressional Budget Office's slides on the impact of future spending as a percent of GDP how much is due to excess health care cost and how much is due to aging. And you'll see for about the next 20, 25 years -- actually, starting about 2007 -- the aging impact by their estimates is as big or bigger than even the impact of health cost growth. Now, when you go out past then, the health cost growth starts dominating and the reason why the aging impacts are so quick and so dominating early on is actually seen in this graph. If you look at that period -- this is just Social Security -- if you look at the cost of Social Security, what you'll see is from about 2007 to about 2035 basically the cost of Social Security's percent of GDP increases by 50 percent as it goes from roughly a little over 4 to about 6-1/2 percent of GDPs. That's about a 50 percent increase in the impact on Social Security, and you've got similar impacts -- not quite the same but you have similar things going on in Medicare, Medicaid, long-term care, and other aspects of the budget. So, it's that period of time that we're in right now that we get this big impact. This impact, by the way, comes from one aspect of the aging population -- that's the baby boomers retiring. It's the final point at which the decline in fertility finally plays out with respect to Social Security and, as I say, with respect to the rest of the budget.

Now, I want to have a digression here on aging. I mentioned this a little bit earlier. But, you know, the term "aging" I'm actually bothered -- I'm always bothered by the term "aging," because I think it's a very misleading term. It actually has an impact on the policy debate and it actually even has an impact on the research debate. I think both the policy discussion and a lot of research itself are misled if not actually wrong, because we conflate two very different aspects of aging. One is we tend to define the fact that we're living longer as aging. That is not, in my view, aging, at least in terms of percent of the population that might have greater needs in society and the fact that the fertility rate fell, which does mean that there are more people who are in the last half or the last third or the last 10 percent of their lives, and it does have an impact on the distribution of needs and everything in the economy.

Now, the impact on the policy solution is that we tend to then think about how we want to adjust for Social Security and other problems. If you go back to this chart, if you look over the current period, this 25-year hump where the cost increased, that's mainly due to this fertility change. That's mainly the baby boomers now retiring. And so if you look at that period alone and you say, gee, there's not a lot we can do, these are going up in society, we've got more aged people, that's probably right. But if you look over, and I don't have the numbers, but if you had looked over a 100-year period, say from 1940 to 2040, for the impact of aging in the sense of people now living longer, that's had a huge impact on Social Security. It's more gradual, but it's taking place over a very, very long period of time.

We didn't adjust historically. We adjusted slightly in '83, a little bit with the normal retirement age. Henry will emphasize that's not an adjustment in terms of the early retirement age. And we are not adjusting after there. So if you think we didn't do it right in the past, then you think we're not doing it right in the future. Dealing with that living longer problem is different than dealing with the fertility problem.

It also has an impact on the research because I would argue if you're doing any type of time series analysis and you start treating people who are 65 in 1940 as similar to people who are 65 in 2040, you are not doing your analysis right. Technically, you're not sampling from the same set, you know, that you would probably be better off taking people with equivalent life expectancies. And I have a quick couple papers on this. You should be taking people with equivalent life expectancies if you want to find people with probably equivalent needs. Now, that's not pure. You could say maybe it's equivalent relevant life expectancies. It depends on how you want to do it. But it's clearly not equivalent chronological ages. It just doesn't make sense.

In fact, here's just a little graph to try to emphasize this. This is the relationships between the earliest retirement age in Social Security and the average retirement age. In 1940, the average person retired with Social Security at about age 68. And that was pretty close to the earliest retirement age in Social Security, which was 65. Then the earliest retirement age was bumped down to 62 in 1959 and 1962 for women and then men. If people were to retire today, on average, for the same number of years they did in 1940, they'd be retiring on average at age 75. And if you go into the future, if you go towards 2070, and people would retire for the same number of years in the future as they did in 1940, they'd be retiring about age 80.

And this is important, again, in the policy context. Take the recent Simpson-Bowles proposal. They said they're going -- bad framing. Bad framing. They said they're going to increase the retirement age from 67 to 69. And this actually came about; I talked to the staff, because some member of Congress didn't want the number to go beyond 69. That's sort of how they picked it. Well, what actually Steve Goss did, and the actuaries did when they actually did the estimate, they actually designed it so that the relative number of years in retirement actually stayed constant. So at the period of time over that normal retirement age went up from 67 to 69, that 2-year increase, people were actually going to live 3 years longer. So roughly speaking, what Simpson-Bowles did is still allowed more years of retirement to take place, just not at the same pace.

So the next point I really want to get into is interpreting labor force trends. I think we have way underestimated the labor force participation of older individuals for some time. And my main point is I think, again, that the theory conflates retirement with leisure. And I'm not going to go into a lot of details there, but there was this notion that somehow or other because we got to be a richer society we wanted more leisure as opposed as to we just wanted more good things, and that doesn't necessarily mean retirement or that leisure necessarily meant you had to fully retire.

So I'll just give you a quick example of what is especially wrong is that we don't count labor demand. And what do I mean by "labor demand?" Well, if we get a larger and larger portion of the population who are older, then we have fewer people who can meet labor demand from younger age groups. And that is not in any of the ways the projections are done by taking age/sex-specific numbers and just projecting out into the future. So take an extreme case. Suppose fertility falls to 0 and everybody gets to be over 65. Do you think projecting the labor supply of 65-year-olds at that point in the future could be done by looking at the labor force participation of 65-year-olds today? No, because somebody has to fill that labor demand. Now, fertility didn't fall to zero, but it fell a third of the way there.

So let me jump ahead. By the way, this is actually one reason -- this is what I think is right. Karen Smith tried to grab this from her papers with Gary. This is actually if you take all adults 16 and over, this is the Social Security number and this is the Burtless number of the alternative scenario on employment rates. But they still, by the way, have adult employment rates falling. And the question is how much would they fall? My conclusions are that if I take into account labor demand, I think that we're way underestimating the labor force supply of older workers.

And now I'm going to work you through quickly Social Security's projections here. So here's Social Security's projections in '86 and '87 of the labor force participation of 65- to 69-year-olds as you moved out into the future. In '86 and '87 they really believed model, that people wanted more and more leisure. It was an eternal demand for more leisure. Here's where they were in 1992. You'll notice it keeps flattening out. Here's where they were in 2000. Here's where they were in 2005. Here's where they were in 2008. And here's where they were in 2012.

So what you can see is they keep taking this growth in labor force participation that Gary displayed and they keep flattening out for the future. But what's the actual increase in labor force participation? It's actually the black line there. The black line I think supports my notion that this increase in labor demand, along with some of the supply side issues that are going on, too, such as, you know, conversation from defined benefits and defined contribution plans, that's what's going on historically. And the notion that we should keep flattening it out for the future I think is just wrong because of this labor demand.

Now, this has all sorts of policy and policy process questions, one of which is if we're going to be doing Social Security reform should we not be generating from Social Security or from CBO numbers on GDP, on personal income, and other aspects on income tax revenues? As long as we do Social Security reform within the narrow confines of the Social Security Trust Funds, we're ignoring the biggest impacts on the budget.

I've also got some charts here which ask, what are the main influences on early retirement? If we try to ask ourselves what policies should be it's not health care. In fact, the health of 55- to 64-year-olds isn't much different from 65- to 74-year-olds, so that's not really an excuse for early retirement. If we think that this is the point of people reporting poor health, we should be retiring people, then let's retire them at 55. Let's not stop at 62. But most people who are even the 65- to 7-year-olds report fairly good health. It's not the physical demands on jobs; they've declined quite a bit over time. Essentially we've had this system that's been on autopilot for a long, long, long time, so much so that the expected number of years in retirement for a couple is now approaching 30. It's about 27 if you retire at 62; it's going up, as you see, towards 33 as you move out towards the future.

And if we're thinking of policy-wise, I'm dealing with living longer, is that what we really want from a retirement system? Is giving us a 27th and 30th year of retirement benefits the primary objective of our government policy? By the way, children's programs are going into a tailspin at the same time.

And there are all sorts of other implications for Social Security. This includes the fact that we're concentrating benefits more and more upon the relatively less owed. So if we go back just to 1968, at least over half of benefits went to people with less than 10 years of life expectancy. Now the number in 2010 is now closer to a third. So more and more we're putting benefits to younger and younger parts of the population.

So what's my quick summary? I think the demand for older workers is likely to continue rising. I think the estimates that Gary and Karen and their colleagues, I think it's a brilliant attempt, a brilliant effort to see what happens if we taken into account this persistence. But I think even then we're not fully accounting for what's going on in the economy as a whole. I think their papers provide one more piece of evidence that we're going to have an increase in labor supply, and that's partly because I think that almost all the models to date haven't taken into account adequately this labor demand. And my sound bite often in public is that workers or basically older workers in the first half of the 20th century are going to be to the labor force what women were to the last half of the 20th century: the largest pool of underutilized capital in the economy.

As I said, I think defining longer lives as aging is misleading. It's very different from the fact that we have declined in the birth rate, which increases the percent of population that's older.

I think it's quite clear Social Security reform is not just about Social Security. It's really time for the estimators to start giving us some of these impacts, potential impacts, on GDP, income, and revenues. And I'm dodging, Joyce, the dilemma of how does CBO actually allow supply side effects or would demand side effects work into their models. But I think it's extremely important for long-term reform.

And finally, I think there are many, many reasons to restore Social Security to an old age and not just middle-income support. And the potential for labor force participation to actually help solve a number of our budget and personal income problems I think is among them.

Thank you. (Applause)

MS. MANCHESTER: Thank you very much. It's a pleasure to be here today. This is a very important topic, one that I've thought quite a lot about over the years and I'm pleased to be able to speak today.

For most of the talk, I'll be talking as an independent researcher, so at the beginning I'm going to put on my CBO hat just for a moment to tell you that about half of the increases in the labor supply that Gary suggested are already baked into CBO's forecast and its baseline projections. So we thought very carefully about how people would respond to the coming increase in the full retirement age that's already in current law, we looked very carefully at the past evidence on how people had responded to the increase in the full retirement from 65 to 66, and we incorporated that same kind of effect into our projections going forward. So I think you're going to have to rethink just a little bit the effect of your additional rise in labor force on the deficit because that deficit already includes about half of that increase in labor supply.

Okay. So what I'm going to talk today about is how we came to think about the likely effect of the current law increase in the full retirement age on labor force going forward. So the question is what's likely to happen to rates of labor force participation among older people between now and 2040? We saw that the illustrative increase in the labor force suggested by Gary and used in papers by Karen and Rich would take the full trend that occurred between 1988 and 2010 and push that fully into the future. As I said, what we ended up doing is something that's about halfway in between and I'm going to talk about why we chose that change. So, again, it's really important to include these changes in labor force because of the increase in output, the better financial for Social Security, the effects on the Supplemental Security Program, DI Program, and so forth, and also greater resources for individuals in retirement.

So there are lots of good reasons for why the labor force participation rates for men and women at older ages increased between the late 1980s and the late 2000s. Certainly the change in the FRA is one of the key reasons, and I'll talk a little bit more about that in a few moments. But there are also many other things going on at the same time.

For example, the retirement earnings test was changed significantly in 2000. It was relaxed for people from 62 to the full retirement age. It was eliminated entirely for people at the full retirement age and above. There was also an increase in the delayed retirement credit. It's now about 8 percent per year. So if you delay claiming Social Security benefits from your full retirement age -- now 66 -- until 67, you get a bump up in your benefit of about 8 percent.

As you all know, there's been a shift toward defined contribution pensions, away from defined benefit pensions, and also a shift away from providing retiree health insurance. All of those things, again, would increase labor force participation. We also have seen higher educational attainment, and we know that people with higher education tend to work longer. Let's not forget the cohort effects, especially for women, so that now a greater proportion of women with college degrees, for example, tend to stay in the labor force longer. And, of course, we have increased longevity such that in the last 25 years life expectancy at 65 increased about 3 years for men and about 2-1/2 years for women.

Now, the question is do we expect these factor to recur going forward such that they have a similar effect on labor supply going forward? Well, we know that there's a scheduled increase in the full retirement age from 66 to 67. That won't be fully phased in; in other words, people born in 1960 whose age is 67 won't turn 67 until 2027, so that's a bit out in the future. We think that the switch from defined benefits to defined contribution pensions will continue. We're not sure about the pace at which that will continue. The pulling back of retiree health insurance probably likely to continue. Again, it's not clear exactly how quickly. Higher educational attainment seems to have plateaued, so we don't expect further effects. Cohort effects: uncertain. It looks like women's labor force participation rates at middle age and 25 to 34, for example, seem to have leveled off; not clear what that means for the future. Longevity is likely to continue rising. The Social Security actuaries project that life expectancy at age 65 by 2040 will increase about 2 years for men and about 1-1/2 years for women.

So which of those factors is likely to lead to higher labor force participation rates going forward? Well, as we've said, longevity's likely to go up, but I'm going to talk in just a moment about evidence that other folks have looked at concerning increased longevity and labor force participation rates. So it's not exactly clear that there's a direct correlation between those two.

The evidence is quite strong that the further increase in the full retirement age will lead to higher rates of labor force participation, and I'll show you pictures about that. Other factors are likely to have less impact going forward. So, again, it's that change in pensions that seems to have taken place; not clear how much more effect that will have. The higher educational attainment has already reached the plateau. The cohort effects are uncertain.

So let's think for a moment about should we expect older people to work longer as longevity rises? So a very nice paper by Kevin Milligan and David Wise looks at 12 countries over the last 40 or 50 years -- these are 12 OECD countries -- and tries to look at the correlation between longevity and working age. It turns out that there's been a big increase in longevity across all of these countries, but very unclear evidence about what's happening to the age at retirement. So Milligan and Wise use mortality rates as a maker for the health capacity to work at older ages across these countries. They find a very weak relationship between cross-country mortality and changes in work over time. So there's no good solid evidence saying that because people are living longer they're definitely going to work longer.

However, what they do find is a very strong effect of retirement incentives that are in place through public pension programs. And they say that it is those effects that's leading to more work at older ages. Now, you could argue that there's some line of causality from greater longevity to changes in public policy, but the point that they're making is that it takes the change in public policy to effect that change in labor supply.

There is quite strong evidence that suggests changing behavior in response to increases in the full retirement age. So, for example, as the full retirement age increased from 65 to 66, we can look at the number of people who claimed benefits, Social Security benefits, at 62 and we can look at the peak that used to occur at 65 that very clearly moved out in step with the new FRA. And I'll show you a picture, I hope, if my file's not corrupted, I will show you a picture in just a moment.

So the bottom line here is that work and the claiming age, claiming Social Security benefit age, are not exactly linked, but they are closely correlated. There's a tight relationship there.

So, again, putting on my CBO hat for just a moment, what we did at CBO was to look at changes in claiming behavior as the full retirement age changed and changes in labor force participation rates at older ages using the current population survey to give us an idea of the relationship between those two factors.

Ah, so now we have a blank slide. Isn't that interesting? (Laughter)

Okay. So what I wanted to show you is a very nice slide that shows a peak of claiming at age 62 and that peak definitely sank as the full retirement age increased from 65 to 66. Then moving ahead to ages 65 up to 66, we could see a peak that used to exist at 65. And as the full retirement age increased by 2 months per year, the cohorts show a very striking move in that peak at 65 that moved to 65 and 2 months, the next year it moved to 65 and 4 months, and so forth, until the peak has now fully moved out to age 66. And, of course, I had another slide showing the exact same movement for women. I'm sorry you can't see those.

Are they on the handout? Oh, good. Oh, good, that's excellent. And there are more handouts at the back in case you're interested.

Okay. So my point here is that it's not obvious to me at least that the trend that did occur from the late '80s through the late 2000s will continue in full through 2040 for several reasons. One is that the main policy changes occurred between 2000 and 2009. We know going forward that the FRA is already scheduled to increase another full year from 66 to 67. Most of those effects will occur between 2017 and 2027. So, in my view, current law projections of labor force participation rates going forward should reflect the trends of the 2000s stemming from the increased in the full retirement age that we know will happen going forward.

So using that approach, the labor force participation rates for age groups 62 to 64 and 65 to 69 would be about halfway between the trustees' report projections and the Burtless projections by 2040. Now, this is eyeballing on my part, I was not able to do any specific calculations, but it looks like the labor force participation rates would be about halfway between the Social Security projections and the Burtless projections by 2040.

And, therefore, if you believe that effect, you would get implied effects on government finances and individual resources in retirement that are likely to be about half as large as the Burtless projections as well. So, again, putting on my CBO hat, the way that our macro model works is that labor force translates into GDP because we have a relationship between labor and capital that keeps that proportion approximately constant over time. So a 1 percent increase in the labor force, for example, will lead to about a 1 percent increase in GDP. And there's also a relationship between rises in GDP and the increase in revenues. So for every 1 percent increase in GDP, we get about a quarter percent increase in revenues going to the federal government.

So, again, those increases in labor force are already baked into the CBO model. It's also true that when we look at a policy proposal, such as raising the full retirement age from 67 to 70, there's a further increase in labor force that happens as part of our modeling effort. And, again, we get -- we've done this and in an issue brief that's available on our website you will see that the labor force does increase by about a percentage point when the full retirement age goes from 67 to 70. And, therefore, we also find an increase in GDP of about 1 percent and an increase in federal revenues of about a quarter of a percent.

I'll be happy to answer more questions during the discussion. Thank you. (Applause)

MR. BURTLESS: If I understand what Joyce just said, even though Urban Institute and I used as our baseline an estimate of how much labor force will increase in the future because of delayed retirement and we performed all of our calculations in that light, the Congressional Budget Office built into its projections is already assuming half the distance between what the Social Security Administration predicts and what Karen and I used as the basis of our predictions. Therefore, part of the benefits that we are attributing to delayed retirement are already reflected in the CBO long-term projections. That's, as I take it -- is that clear to everybody what -- so the effects that I gave already overstate what the impact will be because we assume the CBO is using the Social Security Administration predictions of future labor force participation, which they are not doing. They're already partway toward our estimate, which is a good thing to know.

Okay. So that means everything you've just heard is too big. (Laughter) But now we have -- but that doesn't hurt me because, you know, I already said this isn't a very big number.

So we have 10 minutes and I think you guys are all hooked up to the microphone. Does anyone have any questions? Yes, Belle. There's a microphone coming.

MS. SAWHILL: I'm confused about -- first of all, I think it's really important and interesting research, and the discussion was terrific. What I don't understand, Gary, is why you put this emphasis on looking at the effects as a percentage of a projected -- you know, the CBO projections of deficits as opposed to just an absolute dollar terms. In other words, how much savings are there associated with this change? Because, as I think Gene said, obviously depending upon which set of assumptions you make, and particularly if you use the current policy instead of the current law baseline, you've got this, you know, incredibly unrealistic explosion of debt and so, of course, it looks small. What am I missing here?

MR. BURTLESS: You're not missing anything. We were just trying to answer directly the question that we interpreted the Sloan Foundation to be interested in, which is how large a portion of the deficit problem would later retirement solve. And measuring that in percent terms seemed to me a very natural way to do it. I could comb through Karen Smith's tables and come up with any alternative measure you prefer with the caveat that Joyce made, that even though our baseline is the Social Security Administration forecast, CBO has already partly rejected that forecast and been more optimistic about the government revenues that would be raised as a result of later retirement and the budgetary savings that would occur from lower outlays. Yes.

MR. STEUERLE: Can I just add, Gary?

MR. BURTLESS: Oh, yes, I'm sorry.

MR. STEUERLE: I mean, as I said in my comments, and I would say this with respect to Joyce's comments, too, is I don't think these types of projections take into account labor demand and the fact that, you know, if more and more people are in this older part of the population, then it's only natural, assuming we want some amount of goods and services, that they're going to be supplying the labor. And any projection -- almost all the projections that I've seen anybody do, whether you or Joyce or anybody else, Social Security, is they tend to take this, what is really an intersection of labor demand and labor supply, which is measured as labor supply over time, when you do the stuff over time, and then they say, gee, what's happened to defined contribution versus defined benefit plans and what's happened to this and what's happened to that? And they make these projections based on how that might play out. But it doesn't take into account this changing weight of people that are older.

As I say, take an extreme example. If the entire population became over 65 because the fertility rate fell to 0, do you really think this type of projection would answer the question? And I'm sure you'd say no. Well, the fertility did fall a third of the way toward zero. It fell from three to two for women. And I think that's the reason that we keep seeing this upward shift in Social Security graphs, and I'm guessing that over time you would see the same upward shift by CBO projections in their graphs.

So I think both of you are really -- I mean, I think what you did was really brilliant in terms of saying what happens -- because it's persistence patterns. I think that's really an addition to the literature. But I don't think it still fully accounts for what else might be going on that has an impact.

Just one minor example. The conversion to DBDC could be endogenous. It could be endogenous because, in fact, firms are gradually -- I mean, there's a lot of other reasons, but firms might be gradually deciding I need some more older workers and retiring these people, especially these early retirement systems that they've all abandoned at 55, just doesn't make sense. We need them. Which would reflect my notion that they are a labor supply you have in the future.

And that comment, by the way, doesn't into account a further aspect, which is the older workers are now -- which we didn't do going in and none of us talked about it -- the older workers are now as educated as the younger workers coming in. so over the last half of the 20th century the reason you could have all these old people retiring is the women came into the labor force that came in, the baby boomers came in, and the population that was coming in was more educated than the population leaving.

MR. BURTLESS: We better take --

MR. STEUERLE: So I think labor demand --

MR. BURTLESS: We better take another question, though. Yes, the first question was posed by Belle Sawhill of Brookings. Can you identify yourself?

MR. ALTMAN: Okay. I'm Fred Altman. I'm just retired. My question is, you know, I've seen there's this real correlation between age of retirement and when you start getting benefits. And you get much better acceptance if you allow the people to select the age at which they retire. So say at age 30 you say, okay, I'm going to work to 70, you pay a certain amount. If you say you're going to retire at 73 or 4, you pay less. And that way people would -- my guess is we would get to a higher average retirement age much faster letting people do their own selecting. And if they feel more as if they were involved it might help move things along there.

MR. BURTLESS: Well, the last time I checked there's not slavery in the United States. You're permitted to retire whenever you want. You can retire at 30 if you want to. (Laughter) Does anyone else have a reaction to that?

MR. ALTMAN: No, it's not when you can retire --

MR. BURTLESS: Can I have the next question? Yes, in the back there?

MR. SIMM: Hi, I'm Randy Simm. Any views on whether the Affordable Care Act will affect exits from the labor force?

MR. BURTLESS: Joyce?

MS. MANCHESTER: So it is clear that the availability of health insurance through exchanges will reduce the need to stay in your career job with your health insurance in order to have access to health insurance. It's unclear what's going to happen with the Medicare eligibility age, but that's going to be an interesting thing to watch. So I think we're not quite sure but it looks like there will be less need to stay on the job to keep your health insurance. So that would suggest people would have more flexibility.

MR. BURTLESS: Yes, I agree with that. I think that the so-called job lock is important for people who do not have sources of affordable insurance; there is a certain proportion of people who are between 58 and 64 who work in order to have access to group health insurance rates. The Affordable Care Act, by making insurance affordable for many of those people, will provide a reason for people to leave work earlier.

MR. PEARLSTEIN: I just want to go back to your first point, Gary, and Belle's first point which is how will this affect the deficit. If you look at this though solely from the point of view of the Social Security system and its financial state -- I just want to make sure -- the implication of what you all are saying is that the Social Security system is probably not as in as bad shape as the Social Security trustees now say it is; we don't have such a big problem --putting aside the deficit thing -- just the Social Security system, is that the correct implication of what you are saying?

MR. BURTLESS: I guess Joyce would the expert on that because CBO -- I presume your forecast must say there is a smaller problem, right?

MS. MANCHESTER: Yes, so CBO does independent estimates of the shortfall in Social Security going forward. Our estimates are a bit smaller than those of the Social Security actuaries; however, it's still a big problem. So it's a bit smaller, still a big problem.

MR. PEARLSTEIN: Why is it only a bit problem -- why is it only small? I don't understand that given what Gary and others had said?

MR. BURTLESS: Well as Gene points out, a large revenue effect that helps the overall deficit is the income tax that comes in. It's not -- see in Social Security if you retire later then you defer collecting a pension. The gain for Social Security isn't that tremendous really.

MR. STEUERLE: I think there is a bottom line here, Steve, that you could design a reform that if people worked longer did not actuarially mean it didn't have any effect on Social Security, whereas if people delay early retirement now the net gain for Social Security is about zero because the benefit increase about offsets the -- falls on the other end and the revenue gains on the income tax.

I just want to do a quick flip note on the Accountable Care Act. My understanding of CBO numbers is that they did project a decline in employment; not a lot, but a few hundred thousand. I've always thought that was older workers retiring a little bit more but disabled. And here's a really interesting question, is disabled workers who apparently often claim they just don't want to get off SSDR or anything else because they're afraid of losing their Medicaid, now they actually have a backdoor way to get health insurance. So it may be very positive for the employment of the disabled population.

MR. BURTLESS: And that brings this discussion to a close because we have a ten minute break and then Henry will reconvene and we'll have a panel discussion on policy responses. There should be some coffee in the back and please be back here at 20 minutes to 11.

(Recess)

MR. AARON: I am going to present very briefly and then we will have comments by three people who are far more knowledgeable about the specific problems in disability and in retirement in general. Rich Burkhauser of Cornell University and Nicole Maestas and --

MS. WHITMAN: Debra Whitman.

MR. AARON: Thank you. Deb Whitman of AARP, apologies.

I'm actually going to modify what I had to say a bit in light of Joyce Manchester's comments in the early session because I think they pose a genuinely intriguing question.

I wanted to begin just by once again summarizing the labor force information, in this case taken directly from the Social Security Administration, a testimony that the actuary Steve Goss gave a year, year-and-a-half ago which shows the trends that Gary described in much less detail and in many ways in a much less informative way than what he did. But what is apparent is that over the four decades following World War II up to 1990, there was a significant drop in labor force participation among men at all age brackets and a dramatic increase in labor force participation among women at all age brackets except among those over age 65, that the second effect overwhelmed the first and that was the effect on aggregate labor supply that Gary presented. That was the story for those four decades.

Then in the succeeding two decades leading up to 2010, male labor force supply in the younger age brackets continued to drop, although perhaps not as at a rapid rate, but the labor force participation rate among men over age 65 reversed and increased. Over that very same period, the flooding in to the paid labor force of women in prime age groups pretty much stopped, maybe reversed a bit among those who were relatively young and the result was basically a wash in the overall change in labor force participation.

Looking into the future, these were the projections that Social Security made. These are much grosser age categories than Gary used in his chart and they, therefore, conceal some offsetting trends.

In particular, the fact that there's no increase in labor force participation over the two-and-a-half decades after 2010. For men, no perceptible increase anyway, is a result in a way of offsetting trends, a slight increase in age-specific rates together with an increase in average age. And a very slow increase in female labor force participation rates so that the trend between 2010 and 2035 is pretty flat.

I actually think that Gary may have given a bit too much ground in the comments on the difference between his projections and what is involved in the Congressional Budget Office numbers. It's important to keep in mind that what we are dealing with here in almost all cases are projections not forecasts. These are arbitrary numbers once one gets beyond the present. All involve in varying degrees assumptions that at least some people regard as unrealistic and in some cases are absolutely impossible. They are contrary to what legally could occur.

So, what Gary was showing was the GDP and revenue implications of the difference between two projections, not two forecasts. The projection that CBO uses was neither of the two that Gary employed and if one is calculating a ratio of the difference as Gary calculated and the ratio of that to a denominator that CBO is using, I think the percentage change that Gary calculated is very close to the correct implications of an increase in the labor force participation rates that he showed.

Now, once again, this also summarizes a bit what Joyce said. The causes of the increase in labor force participation among older workers are well agreed upon. The relative importance and the absolute significance of each of those causes are not agreed upon. We don't have very good estimates of what the impact is of the shift from defined benefit to defined contribution pensions. We don't have very good estimates of the impact of the changes in Social Security provisions on actual labor force participation. We don't have good estimates of the impact of the changes in the nature of work or of educational levels or of the decline in impairments, measured impairments that have been reported. We don't have very good estimates of the impact on labor force participation of the two rather shocking drops in asset values that occurred early in this century.

Now, the effects of all of these provisions is further complicated by a phenomenon that Gary actually called attention to many years ago, which is that people do not respond usually instantly to changes in incentives that they confront. The reason they don't is that they are also influenced by the behavior of colleagues. There are social effects, networks that influence behavior.

The example that Gary used was that when Social Security dropped the age at which benefits could initially be claimed, it took many years before the hump in actual claiming of benefits dropped from the previously legally enforced age to the new lower age at which benefits could be claimed and there is every reason to think that the impact of each of the variables that I just described on retirement behavior would similarly be mediated by social interactions. So, if we don't have really good estimates of what the impacts were historically, it's rather difficult to have much confidence in predicting what the impact is going to be and certainly the timing of the impact of policy changes looking into the future.

The specific problem that one faces that the political system faces in trying to design policies to nudge or encourage people to support a trend toward later retirement if that is one's goal is that it is very, very difficult to design policies that are both sensitive and specific in reaching the target population that reach most or all of the people who it is intended that one wants to encourage and doesn't penalize or do damage to people who one does not want to influence. That problem is endemic in all public policies, but it is compounded in the case of the kinds of policy changes that we’re talking about here by the very strong aversion of the political system to inflicting losses on identifiable groups. One could well imagine exactly as Gene described that if one were recreating the retirement system anew with the life expectancies, educational levels, and impairments that are endemic in the population today, it would be structured rather differently from the legacy system we inherited from past years, but that’s not what we’re doing and the difference is of enormous political importance.

So, with that asymmetry in mind, what does the menu of possibilities for encouraging increased labor supply look like?

The first one that I want to call attention to and spend a bit of time on is raising these so-called normal retirement age or full benefits ago. The reason that this deserves a good deal of emphasis is that from a mathematical or program structure standpoint, that age is almost irrelevant in characterizing Social Security. The actual design of the Social Security System could be more accurately and clearly characterized in a fashion that Gene Steuerle recommended some years ago and that I also agree with. The retirement age in Social Security could be characterized as age 70. That’s the age at which full benefits are actually paid, but you're entitled to claim them in any of the 8 proceeding years, and if you do so, you receive actuarially reduced benefits. If you claim them before age 66, you also face an earnings test, but, again, from an actuarial standpoint that's relatively unimportant because if it binds, you are compensated by additional benefits later on, the value of which for the average claimant is approximately sufficient to compensate you for not having been paid benefits earlier on.

So, what the system really is is a smoothly graded retirement system with the value of the benefit graded to the age at which you claim benefits. I said you could describe it as a retirement age at age 70 with reduced benefits if you claim earlier. You could equally well describe it as an age 62 retirement program with increased benefits if you claim them later. The so-called full benefits age or normal retirement age is from program design and actual economic incentives for many retirees at least, substantially irrelevant.

There's one group for whom it is really important and that is for those who face very strong need or desire or pressure to retire and who are liquidity constrained, who do not have any significant savings. For them, the availability of case does represent a real change in economic circumstances.

But so, the first area of public policy change that I want to emphasize would be an increase in what is called the normal retirement age, but which is, in fact, mostly simply a proportional benefit cut regardless of the age at which you claim benefits. It's called an increase in the normal retirement age. It really isn't. The spike in retirement is at age 62. It still is the age at which most people claim benefits. You can claim benefits thereafter. And, therefore, the behavioral impact is primarily on those how are liquidity constrained and face strong incentives to retire.

A second policy area that has received a good deal of attention is to raise the age at which initial Social Security benefits can be initially claimed. There's a widespread belief backed up by some empirical research that it would be a strong incentive to discourage people from claiming benefits and from actual retirement again by those who are liquidity constrained. You retire at age 62 if you have access to cash, you have no significant savings, Social Security then enables retirement.

The problem with this particular policy change is that while it would reduce government spending some in the near term, it actually would somewhat increase benefits according to the official estimates in the long run. The reason is is that when you actually would be eligible for retirement benefits, they would be increased by enough to compensate you for the shorter claiming period, perhaps more than compensate you given increases in longevity, but it would also encourage some people who otherwise would not have done so to apply for and receive disability insurance benefits which are actually more generous than the early retirement benefits they would otherwise have received.

Now, denying people access to Social Security at age 62, 63, 64, 65, 66 does create potential hardships that are rather significant for many people, and, so, the question arises: If you want to do that, whether it's possible to pair that program change with other actions that would protect those who are really in a difficult situation.

One would be to increase access to Supplemental Security Income, an income-tested program available only to those with demonstrably low incomes or who are able to qualify based on disability status. With respect to the access via disability, one additional problem and are barred to receiving benefits in addition to having more than a minimal amount of income is having more than a derisively small amount of assets, $2,000 worth of assets if you're single, $3,000 if you're a couple, an asset level that hasn't been increased for 23 years and is therefore dramatically more stringent than it was when it was first put in place.

A second possible action which was suggested by somebody who signed-up to attend here today and may, in fact, be in the audience, I don't know, would be to relax a requirement for Social Security Disability Insurance. The requirement that you have worked within 5 of the last 10 years. That's a stricter requirement than exists for retirement benefits and according to this one study, as many as 12 percent of those who claimed early retirement benefits would qualify for disability coverage if they were not subject to this recency of work requirement under Social Security that bars them from disability benefits, that they have other characteristics that would otherwise qualify them.

Now, if with respect to the early retirement age, the early claiming age, an alternative proposal which I would like to put on the table goes partway, but not all the way and it's targeted on people with relatively high earnings. In particular, the suggestion that I would put on the table is that the reduction in benefits that people are assigned for claiming benefits before age 66 be increased but that access to benefits not be eliminated, but that the reduction in benefits apply only to people with relatively high average earnings histories and this table illustrates, shows what the percentage impact would be on benefits for people with different levels of average earnings if they claimed benefits at an early age. The purpose here is to send a specific message that there is a reward in addition to the actuarial adjustment now provided a larger reward for deferring retirement.

I'm going to skip my last chart and go directly on to two other proposals which you will hear more about at lunchtime, but this is simply previews of coming attractions, so to speak, that were suggested by John Shoven as ways to encourage people to remain economically active longer.

One would be to treat workers who have long working lives, 40 years in John's suggestion, as fully paid up with respect to Social Security once they reach age 65. At that point, the payroll tax could be eliminated either on the worker, the employer, or both with the impact on the supply of labor and the demand for labor depending on what one assumes about the distribution of the burden of that tax. And the other similar idea is at a certain age to make Medicare the primary health insurance source for workers say at age 65 or 66, the full benefits age under Social Security, thereby providing either an increase in compensation if the savings are shifted forward in the form of higher compensation for workers or a reduction in employment costs which could increase the demand for older workers by employers.

There are, I think, significant problems with each of those, the most obvious of which, of course, is that they would deepen the already existing shortfall in those two programs, but I want to stop at this point, having been given the sign that I've already passed my time limit and I don't want to set too bad an example for those who will follow.

Who is going to lead off?

SPEAKER: Deb.

MS. WHITMAN: Okay.

MR. AARON: Okay. Your turn. Do you have slides?

MS. WHITMAN: No. So, I want to thank both Gary and Henry for inviting me today.

I'm going to speak on a couple different hats, one current and one former. Currently, I am the executive vice president for policy at AARP, but I spent the last decade on Capitol Hill, and I think when we talk about these issues and I'll talk about some live issues, we need to understand not just how all of us economists think about the impact of policy change, but also the policymakers. And, so, I'll try and educate on a little bit of that, having spent a lot of time with those folks. I'm really excited, actually, about the topic today, too. I'm writing an articled called "The Unsolved Mysteries in Aging Policy."

And number three is how do we encourage people to work longer, but protect those who cannot? And, so, at the end of today's event, I will either move it up to number one or I will cross it off and consider it solved, and I'm not sure where we are quite yet.

We saw the unemployment figures come out today and for the 55-plus, 38.4 percent are employed. That's a slight increase. Overall employment rate in October is at 7.7, and for the 55-plus, men went up slightly to 6.2 percent unemployment and women went down slightly to 5 percent. And we've also had about 250,000 discouraged workers. So, I think this is a live issue not just in a context of do people want to work longer, but really are there jobs out there for them? Do they have opportunities, as well, and, so, we can't lose that side of the equation in our comments.

A couple of comments on Henry's paper. First, I really appreciate when anybody writes about what the real implications are of changing the normal retirement age and I like that Henry uses quotes around normal because we all know and we saw in Joyce's slide most people don't, A, retire at that point and changes to the normal retirement age are really, as Henry points out, an across the board benefit cut.

So, Joyce, you said that increasing the normal retirement age would have a 1 percent change in labor supply, if I heard you correctly. Policymakers don't get that piece at all. In fact, they think that if you change the normal retirement age by a year, people will work a year longer. And, so, the lack of understanding of how that affects benefits, how that will affect the economy is tied into this misunderstanding and I've sat in a lot of meetings with people trying to explain the benefit formula and what the change in the NRA will do.

And I think what's really key, too, is many people don't understand Joyce's other slide, that most people do retire at 62, and, so, those kind of year to year increases in the normal retirement age for the most part will have a really huge impact on the benefit levels that people will live on the rest of their lives.

And I think what the argument that goes around with the changing the normal retirement age is specifically we see life expectancy increasing and we've seen several slides point that out, but I also want to point out that's important is life expectancy isn't increasing for everyone and we have researchers in the room, Hillary Waldron, who's shown for low-income folks, their life expectancy isn't increasing as much as for high-income folks. And Jay Olshansky's recent work showing the life expectancy is actually declining for people with low-income. And, so, as we look at policies that adapt retirement income based on aggregations, we have to be careful about the tales and the impact.

Similarly, there is the assumption that more jobs are less physically demanding, but that's not true for every job, and, so, we need to when we talk about solutions to mitigate my overarching question of how do we help those that can't continue work? We really need to not play on averages; we need to look at specifics.

And then the solutions are really tricky. When I hear policymakers talk about what we need to do, we need to do something and they wave their hand, about those people that can't continue to work. And I think you saw in the Bowles-Simpson plan there was a proposal put forth. I think Steve Goss worked it out in an actuarial sense, but it wasn't for people who can't continue to work, it wasn't to help the 20 percent of the population who have physical work-limiting health conditions. It was really targeted at the people that had long-term, low-income jobs. And, so, again, there's a mismatch between the policies.

Other options -- and we talked about them in the last presentation -- also can be really expensive. And, so, are politically unviable. John Shoven's proposal to change the payroll tax, Medicare to be the primary payer is enormously expensive, and, so, politically, hard to actually push across. And I completely agree with Henry's position on SSI. I think it's a travesty that the asset limits have not been adjusted over time and that the qualifications are so low, but the political issue is that in most states, you also qualify for Medicaid once you're on SSI. And, so, there are many people that don't want to adjust SSI even though they agree on principle that it should be better targeted because those 47 states, there's automatic Medicaid, and in many others, you also qualify.

So, I have a solution. It costs nothing. I can actually perhaps change Joyce's peak at 62 and it's politically viable. And that would be to change the name of early eligibility age into something that's pejorative, but not demanding, and I haven't figured out what this actually would be and I'm looking for suggestions. Minimum isn't quite pejorative enough. Reduced isn't quite where I need it to be. Not unless you have to is not really something you'd see on a Social Security statement. Desperation -- that may be a little too mean. But, again, if you look at behavioral economics and signaling, we actually could change behavior by saying really don't do it at 62 unless you have to in some way just by changing the name and that's the low cost, we have to reprint some statements and some fliers from Social Security, but it's not much more than that.

I want to touch on two issues, the fiscal cliff negotiations that may impact today's discussion. One, of course, was in the House proposal looking to change the indexing of Social Security to the Chained CPI. AARP, we personally think this is probably the worst way you can solve particularly the Social Security deficit because it takes a month's worth of income away from 90-year-olds and everybody knows that 90-year-olds are some of the wealthiest people in the country. They have women at age 80-plus get an average Social Security check of $13,000. So, you're taking a month's worth of that annual income away. They also have 28 percent of their income going to health care expenses; they have of the 50-plus the highest foreclosure rates.

So, as we look at this, we may see a behavioral change in increased work because your benefits going forward would be reduced, but I don't think that the labor supply effects that Joyce would find would be very large and I certainly don’t think they're worth the costs.

The other thing that’s live is changing the Medicare eligibility age and there was a little bit of discussion about whether Medicare has job block. Access to Medicare would cause people to work longer in their current jobs. We hope that once the exchanges are up and running and particularly if we have the current one to three age differentials between premiums for younger workers and older workers hold, and that’s being fought by some in the industry, that it would be affordable to find health care other places.

But changing the eligibility age, again, is a shift from government onto everybody else and it’s a way to increase overall health costs in the economy. Employers would pay trillions more, Medicaid costs would go up, subsidies costs in the exchanges, oh, and by the way, two-thirds of seniors would have an increase in out-of-pocket spending by over $2,000. But there could be some labor supply effect if people liked their employer-sponsored insurance better than what they could get on the exchange. That’s a possibility.

Speaking on other things, I want to say AARP is trying to help, particularly help people find jobs. We have a new initiative called Work Reimagined. We’re using social networks and LinkedIn to try to hook people that are age 50-plus into new jobs. We’ve got commitments from 150 employers and we’re adding to those every day who pledge to actually reach out to older workers and try and recruit them.

We have a Best Employers Program that points out workforce policies that help keep and retain and attract older workers and we’re working with the Small

Business Administration to look to find counseling and training for entrepreneurs age 50-plus because this is the fastest-growing area of self-employed entrepreneurs.

And, finally, we've really tried to work on the information we provide to our members and anybody who visits our Web site to discourage them from taking retirement benefits early, talking about the increases in the annuity value as you age.

So, in conclusion, I guess I think the policy solutions to all of this, whether it's health care, whether it's employment, whether it's Social Security, really needs to be dealt with more with a scalpel and a real surgical cut rather than amputations, and I worry the current debate going on is a lot of amputations.

We need to increase people. We've seen increases in people working not just because of bridge jobs, but primarily because they're staying in the jobs that we have and we think that's a good thing, but we need to find other jobs for the people that lose their jobs and are looking for something new. We know that older workers have a harder time than younger workers once they become unemployed and are less likely to go into the workforce. And, so, that's one of the reasons why AARP is stepping into this role.

We also need to do more education, all of us, on the incentives to delay claiming behavior, even if you're out of work, but to use your other savings, and I think more importantly than anything else, we need to have an overall retirement security discussion in this country because it's not just is Social Security going to have incentives to keep people retiring, but we've seen that the amount that people have saved as their life spans are increasing is nowhere near enough and we need to talk about ways to both increase incentives to save and also increase employers offering workplace retirement systems so they have an opportunity to save. And I'm hoping the tax debate may open up that level of discussion, again, if we're talking about it with surgical precision and not with amputation.

So, thank you for your time. (Applause)

MS. MAESTAS: Thank you, Gary and Henry, for having me and a big thank you to the Sloan Foundation I would say now sort of research agenda spanning lots of researchers across the country on these topics.

I was asked to provide discussant comments on Henry's paper and I will try to kind of do that at a high level, but recognizing, of course, that many of you probably haven't read the paper yet. So, I'll try to kind of play off of Henry's talk as much as possible to kind of keep you kind of understanding where we're at and where exactly the comment is.

The paper itself is a very nice economic analysis of a set of policy proposals that have been offered as ways to encourage older workers to retire later. So, it actually kind of lays them out very systematically and talks about the economic aspects of them and what each of them would try to do, what some of the implications would be, and in some cases even some of the perhaps unforeseen consequences.

So, in my remarks today, I'll offer one big picture comment on that suite of proposals and then follow that with a set of specific comments about some specific issues raised in the paper.

So, I think as a place to start, we really need to sharpen our focus on what exactly is the precise policy problem that we're trying to solve here. Is it that labor supply to older ages is too low by some criteria? It could be by economic efficiency criteria, it could be by some other criteria, but is that the problem? Or is the problem that we think labor supply among the disabled is too low? Or is it really more about the SSDI Program itself and how well it's targeted and how well the benefits are tailored? Or is the problem really that Social Security System is insolvent? Is that what we're trying to solve here? Is it the federal budget deficit? Is that the problem? Or is the problem really about economic growth -- that population aging is expected to slow economic growth?

So, a lot of the policy proposals that are discussed in this paper touch on different aspects of these and have been offered in response to these different problems. And the problems are certainly correlated, but they are not the same. And the solutions that might be tailored to solve one particular problem can actually ameliorate on the one hand but also exacerbate some of the other problems.

And two examples that have been mentioned, one cutting the payroll tax. Well, that might increase labor supply to older ages; that would be good if that's the problem we're trying to solve, but it also decreases program revenue. So, that hurts us in the solvency problem.

Similarly, making Medicare the primary payer for those with employer-sponsored health insurance, that could probably increase labor demand. Again, good for boosting employment at older ages, but it increase Medicare's program costs. So, again, the system solvency issue, we've actually made that worse.

I think a sharp framing -- a very sharp framing of the problem that we're trying to solve here would aid us in deciding who should bear the cost of any given solution because all of these solutions have different costs. Even efficiency enhancing policies, policies where we believe on aggregate we're making the system better off, even those can have consequences that make some people better off and other people worse off.

So, for example, general benefit cuts arising from say changes in the early entitlement age or the full retirement age, those disproportionately hurt low-earners. Targeted benefit cuts that would focus on higher-earners, those disproportionately hurt the high-earners. Restructuring disability benefits could make people with partial disabilities or the less severe disabilities worse off. There will always be somebody who's made better off, somebody who's made worse off, and in order to evaluate what we're willing to tolerate, we have to be clear about what we're trying to do.

Penalties, of course, can have different impacts than rewards and I would ask is it more fair to penalize early retirement or to reward delayed retirement? Again, it's a matter of what we're trying to do and who should bear the incidence of that?

So, a specific comment about the policy option of raising the earliest claiming age, the EEA or Early Entitlement Age. So, one reason this is an attractive policy option is that savings arise because people would claim benefits fewer years. So, it saves the system money in that regard, though it's important to note and Henry points this out in the paper that those savings do erode with further gains in life expectancy. So, unless that early entitlement age is indexed to life expectancy itself, those gains steadily erode over time.

A problem with this approach is it hurts people who would have difficultly working additional years and these are people who not only can't work, but people who could work, but can't find work. This was pointed out by Debra just a few minutes ago. Additional costs to this approach would arise if people seek Social Security disability insurance or SSI benefits instead.

So, one point that Henry makes in the paper is that well, you can make two modifications to SSDI and SSI if you were to increase the earliest entitlement age and these might help. These would be to eliminate the SSDI recency of work requirement at age 62 and the other would be to increase SSI's asset and income thresholds.

I want to make the point here that this would really not be enough. Eligibility for these programs does not hinge upon these two requirements, it hinges upon health. It hinges upon having a severe work-preventing disability.

In some work we did looking at the Health and Retirement Study analyzing the health trajectories over a long period of time of different types of claimants, we found that people who claim benefits, regular Social Security retirement benefits early at age 62 or before the full retirement age, they look more like the later claimants in terms of their health status than they do like disability recipients.

And just to make this point, this shows one of the many, many outcomes we looked at. We looked at health across a variety of dimensions and the story is almost always the same no matter how you look at it, but, here, we're showing Health and Retirement Study data from 1992 through 2006 and we're observing the health status of different types of claimants starting in 1992, that's W1, this is Health and Retirement Study wave one and marching forward two years at a time until we get to 2006. What you're seeing and what we're measuring on, the vertical axis is the sum of functional limitations, activities of daily living limitations and other mobility limitations. And then we're looking at just the average number of limitations among these different types of people.

So, you can see here that the early claimants and the full retirement age in later claimants have just about the same number of functional limitations. It hovers between one and two, and what we're doing is measuring these profiles for the same people over time and just watching how they evolve. The SSDI beneficiaries and even the rejected SSDI applicants, their health profiles are very, very different. They rise much more steeply in the earliest years of the study and then they kind of top out somewhere between four and five functional limitations.

So, my point about this is only that this group of early claimants, this pink line here, this group is probably unlikely to be able to qualify for SSDI and SSI on the basis of disability. If the eligibility age for SSI or if the age at which they could claim SSI on the basis of being aged rather than disabled were moved from 65 to 62, then that would open up the SSI possibility. But, currently, as the programs are currently structured, they would likely not qualify.

So, looking now at the general issue of labor supply to older ages and asking is it likely to keep rising? So, I think we know more about this than is suggested in the draft paper. My reading, and I've published an article in the *Journal of Economic Perspective* in 2010 that tries to really kind of get a handle on this literature and what is the research consensus here? My reading of this consensus is that the primary cause of the trend reversal in the mid-1990s was rising education levels.

Other things were also important, but the primary cause really was education. Technological change leading to less physically-demanding jobs also obviously very important. Labor supply of women also important, but the leading cause, education. The changes in educational attainment that led to this have now plateaued.

What will it look like then in the future? Well, it's important, I think, to realize that pension changes were not a major cause of the trend reversal in the 1990s.

So, why? Well, U.S. pension reforms weren't fully phased in at the time of the trend reversal and, in fact, if you look at other OECD countries, you see the exact same patterns as you see in the U.S., different pension systems. In fact, in these countries, pension reforms have only recently been adopted, let alone implemented. But I do think that pension changes are likely to drive future increases and I think it's very important to look at the timing of things in order to understand when we might expect to see changes actually exerting effects on behavior.

For example, as Joyce pointed out, the scheduled increase in the Social Security full retirement age is actually still underway. We haven't actually seen the full implementation of that. It'll be fully implemented in 2022 and then that lost cohort hits 67, the new age in 2027, I believe.

The restructuring employer pensions actually mostly has affected younger birth cohorts more than it has affected older workers, the people who are retiring today. Why? Well, DB plans were typically only closed to new entrants. They were not terminated and when they were terminated, in most cases, 95 percent of cases according to the Pension Benefit Guarantee Corporation benefits were actually set aside for people. So, in fact, many of the retirees that we're seeing now have been responding to some of the incentives in the DB plans, but it's the future cohorts that don't have those plans where we're going to begin to see these changes picking up momentum and changing behavior going forward.

And, finally, the legal barriers to phased retirement were only recently relaxed. The Pension Protection Act of 2006 takes the first step in this direction.

So, I think it's worth keeping in mind that behavioral responses to these policy changes have generally not been accounted for in the official labor supply forecast except for the CBO forecast, which I'm really, really excited to hear now actually has some of this in it. I do think that these could turn out to be very, very important, but it's important to remember that particularly when looking at the, for example, Bureau of Labor statistics projections that are commonly used in this area.

Other forces that are already in motion, that is we don't have to do anything, they're already in motion, I think are likely to further increase labor supply. What are they? Well, further life expectancy gains will increase labor supply and population aging itself will increase labor demand, and this gets at Gene Steuerle's point from earlier that I think labor demand will be increasingly important and can't be ignored in this at all. So, even if we do nothing, I believe we will continue to see increases in labor supply going forward.

So, back to where I started, what are we trying to do here? If the aim is to boost labor supply at older ages, if that's the goal, then we might favor policies that change the relative desirability of retiring at different ages, policies that facilitate partial retirement in labor force reentry after retirement.

Another big important piece of this, apart from when you claim benefits and start that annuity flow, what about labor force reentry after retirement and making partial retirement more easy to accomplishment, creating those kinds of jobs that older workers are seeking in order to fulfill these kinds of retirement trajectories.

It's important to note that there is momentum behind past policy changes and these natural forces, population aging, for example, that are already in play, this could mean that maybe we should be a little more conservative here. The scalpel approach rather than the amputation, perhaps, if this is the goal.

But if the goal is to improve system solvency, well, then we might favor policies that reduce the desirability of retiring at any age rather than trying to tip retirements toward later, maybe we actually really want full benefit cuts across the board, more aggressive action maybe leaning towards the amputation rather than the scalpel. If it's deficit reduction, then we might want to think about it in a different way.

So, with that, I'll wrap up and happy to take questions afterward. Thank you. (Applause)

MR. BURKHAUSER: So, thanks, Henry and Gary, for the chance to be part of this session. I only got the invitation last week, but having worked on this for about 30 years, I did have a few things in my file that I could think about.

One thing I bring to the table is if you want to see a personification of the Baby Boomer Generation at its oldest, it's me, age 66, born in 1946. So, we're here and you have to deal with us.

So, I actually have some slides, but what I'm going to do is actually talk off some notes that I gathered from the entire discussion because I'd like to talk about both the first session that Gary led us in and then Henry's comments.

And I think I'm always confused about what one person's scalpel is another person's hatchet, but if you're interested in real public policy reform, I think we have a tremendous example of what I think is the single most important policy change with regard to transfer programs in my lifetime anyway and that's the Welfare Reform Act of 1996, where we transformed AFDC into TANF and we did that because it was decided from a social perspective that single moms should work. That happened because married moms were working much more and we had an old system that basically was set up on the notion that if you had young children, you weren't expected to work and that's what AFDC did. So, we had this idea and based on President Clinton's notion that we should make work pay, he came up with a proposal that then was agreed upon by a republican House and Senate. So, it's possible even in a mixed government for major public policies to occur when the reasons are appropriate.

So, what did we do? We said can we make work pay for single moms, and if we can, that will be the key to changing welfare as we know it. Now, what we had was 20 years of data that showed that, in fact, that if you provided those kinds of incentives, single moms could and would work. And if you look at the programs, the Earned Income Tax Credits, child care, other carrots plus sticks, what happened was it was a uniform notion that we wanted single moms to work more and we changed those incentives across a lot of dimensions so that if any one of those things might not have been effective in getting real change, when you change many of them, you did get this powerful change.

So, the question is: Are we ready to seriously talk about reforming old age insurance? I think the answer is yes and I think that it's yes because, fundamentally, what we talked about earlier this morning was, and Gene talked about this, why the heck are we still having an early retirement age of age 62 that was set in 1961 when life expectancy was much different than it is today? And Gene made that point with his example of 14 to 22 years after age 62 for a single person, 19 to 33 years for a person after the age of 62 if you count both the husband and wife.

But would people 62 and over in fact work if we changed incentives? That is could they and would they change their behavior if we changed the policy signals? I think the answer to that is yes, and I think it would be in their interest to do it and here's where Gary's talk comes in, his chart 10 and I think 14.

While raising the early retirement age, for instance, from 62 to 65 or pairing it with changes in the normal retirement age wouldn't save the Social Security System very much money, it would have some impact on overall revenues because of the income tax thing that we talked about.

But, more importantly, and I think this is something Gary mentioned and it hasn't been mentioned that much, it's probably good for most older people age 62 if they can work to work. And what Gary pointed out was that what you do is substitute work for these earlier retirement ages that offsets the benefits that you would have gotten from earlier retirement age, but then the big story comes in is that you then get a yearly benefit that's much higher and that's particularly a problem if we're going up to age 68 or 70 so that the early retirement age at 62 now becomes 50 or 60 percent of what the benefits are going to be at age 70. So, to the degree that we're talking about people who can work, that is their health conditions are such they can work and that they have jobs, it makes a lot of sense to make this happen.

So, this gets to this question of what really drives retirement age. And I think the answer is policy matters. I was filling in for David Wise and David Wise the last 10 years or so has been looking at 12 OECD countries and looking at the patterns of retirement in those countries and showing that those patterns are highly correlated with the incentives that are in their retirement program. So, it shouldn't come as a surprise that when Social Security System sets benefits at age 65 as being the point at which those benefits are at their highest, people will retire at that age and will stop working as the change in the wealth value of their pension falls.

Some of the things we've changed over the last 30 years have, in fact, made the system more neutral in terms of when we retire. And, so, I remember talking about these kinds of issues in the 1970s and that was before we did do things like change the earnings test, provide actuarial fair benefits after the age of 65. So, some of these things do matter and we have some evidence from the literature that shows that these things do, in fact, matter.

So, as I now think about Henry's multiple choices of what we might do to increase work if we agree that we want to do that, the one that I like best is to end the early retirement age or at least at a minimum pair that early retirement age with the normal retirement age which should have happened 30 years ago when one first thought about doing this.

So, what's the problem if you do that? Well, there is a problem and that is that there's a certain percentage of people who take their benefits at age 62 would be substantially hurt by that. But some research that I've done and others at CBO later looked at, using the Health and Retirement Study, we looked at who, in fact, takes benefits at age 62 and then follows them over time and what we find out is that the vast majority of people who are taking benefits at age 62 do not have a work limitation.

Now, some of these people, these are people who are not on the disability program. They don't have a work limitation and they have some form of -- if you look at the people who have both a work limitation and no other sources of retirement benefit, that makes them a very small percentage of the population, taking benefits at age 62. Something in the range of 10 to 20 percent depending on whether you look at my numbers or Smith's numbers. So, what we're talking about is a relatively small percentage of the population who aren't healthy enough or don't have alternatives if indeed they want to retire at 62 and get their Social Security benefits now.

So, I think that suggests that for the vast majority of people my age, and I told you my age, we are healthy enough to work, and in my job since the heavy lifting is limited, we can work. But just comparing me with my dad, my dad was dead for four years by the time he was my age and I think that these kinds of folks are the folks who are going to be most likely to be there in the future when we talk about this.

So, what I want to do is go back to the future by reminding us that in 1978, Alicia Munnell wrote a book called "*The Future of Social Security*," in which what she recommended was to shift out of trying to transfer benefits through the Social Security System to low-income people and to separate the annuity components of the Social Security System from the transfer components. Now, we were able to do this politically because back in the good old days, all politicians loved the Social Security System because they could promise higher benefits without raising taxes so that every cohort as a cohort got more benefits than they paid into the system because the next cohort was paying them upfront for those things. That system is over. The fertility rates have done that, and we're not going to be able to do that in the future.

So, this issue of how to transfer income to needy, high-income people becomes more relevant and does it really make sense to do it through the Social Security System? And what Alicia Munnell recommended was that we go to the SSI System to do that and to make the Social Security System much more actuarially related.

Okay, so, how can you do this now? Now, I'm going to talk about the hatchet rather than the scalpel, but since Henry made this a possibility, well, let's look at what the Manningham report suggests we can avoid raising Social Security payroll taxes over the next 75 years if we simply do one thing, we shift from a wage index to a price index for Social Security.

That certainly has implications. It's a reduction in promises and all the things that I've talked about, as Henry makes the point, are reductions in promises, they're reductions because we've promised these great things. But can we really afford to do them in this context and why not go to a wage index which, as I said, balances the budget, leaves other money flexible to use for other social purposes, and use the SSI program to take care of older people who need the money.

Now, a key point and one that we can get around Nicole's problem is the only way you can do that under the age of 65 is to demonstrate that you have a disability. But all we have to do is simply lower the SSI aging component down to 62 or 60 or whatever it is you want to do to provide a floor for these kinds of folks who we think can't work and then reduce the component of Social Security so we don't have to raise Social Security taxes and can use those for other purposes.

But, finally, let me just go to what I was going to show you and that is to look at another thing, and this has been shown before. So, these are changes in two kinds of things. One is the age population. That's going to increase from 13 percent of the population to 20 percent in 20 years, but another one that's important is the Hispanic and Black populations are going to increase also.

So, when we do this, when we use a shift share analysis, as Gary Burtless did back in 1999, and look at what explains changes in median income over business cycles, what we see is for the business cycle, it's 79 to 89 yearly, a median income increased by .87 percent and almost none of it is caused by changes in the age distribution and the racial, more Blacks and Hispanics with lower incomes explain a very small part of it. In 1989, 2000, when we had great economic growth, aging now is actually positive because of the Baby Boomers are getting into the high income stages and race matters. Between 2000 and 2007, when we had no increase in real median income and actually had a small decline over the business cycle peaks, now age is still positive and -- but race is minus .29. Here's just some numbers that I think are relevant to the future and what we're going to have to look at over the next 20 years and this is another way of doing what Gary was doing.

If you look at the importance of an aging population between 2007 and 2020, we're going to have a drag of about .9 percentage points per year because of the Baby Boomers moving out of the peak earnings periods into retirement. But the racial composition, because we're going to go to Hispanics who have lower job skills, we're going to see a further decline of .34 per year.

In 2020, 2030, we go even further to .17 for again and .35 for racial compositions. That says if we don't do something to change the behavior of older people and provide the skills to Hispanics to offset this straight line of projection, we're going to have serious problems as a society and that gets to the basic point of why do we want to raise the retirement age and get more workers into the workforce? Because of productivity questions.

So, if you're interested in economic growth, this is an easy way to do it and as someone said, I can't remember who said it, older people become the women of the 1930s and ‘40s and ‘50s and ‘60s and whatever when they changed and moved their bodies into the workforce. So, in that way, I think that should happen.

Now, I have one minute so I’ll just say that there is a new literature on disability and we can make reforms in the disability program, too, but if you don’t think that older people can work, you really won't believe this. I believe that a substantial percentage of people who are coming onto disability roles don’t have to do so, they could work if you gave them the proper incentives, and when we think about changing the retirement system, we also better think about changing the disability system because those two systems come into play and have to be thought about as a whole.

Okay, and I’ll end there. Thank you. (Applause)

MR. AARON: In a way, it would be good if some of the panelists from the first session could be part of this discussion, as well. And Joyce Manchester has written extensively on disability insurance and I think could make some useful contributions to the discussion.

I’d like to introduce one fact and then ask a specific question of the panelists before we open it up to those of you who are undoubtedly all chomping at the bit wanting to ask questions of your own.

The first point is to draw attention to findings that first I think came to light from work that Hillary Waldron did from the Social Security Administration, pointing out that the gains in longevity that we’ve been talking about really are very unequally distributed across the earnings distribution within the Social Security System. They have been overwhelmingly concentrated among people with comparatively high earnings; the gains in longevity among those at the bottoms of the earnings distribution are remarkably small.

The companion finding recently published in *Health Affairs* by a large army of coauthors headed by Jay Olshansky pointed out that much the same and rather unsurprising, much the same pattern applies across the education distribution. The longevity is increased a whole lot among those with high levels of education and not at all among those, for example, with less than a high school education.

Now, there are mixed problems because, over time, the composition of these groups changes, but it does have, it seems to me, an important bearing on this discussion about the implications of increasing longevity for the structure of retirement programs. The scalpel versus the bludgeon, I think, comes into play. I just wanted to introduce that as a background fact.

And I would like to put Deb Whitman on the spot and ask her to react to Rich Burkhauser's suggestion. His version I guess of a bludgeon, but maybe better than that, of substantially ending the early retirement benefits under Social Security, but rather significantly expanding the access to Supplemental Security Income starting at age 62.

If you could just give your reaction to that specific change and then I'd like to open it up. Nicole, maybe you might want to comment on it, as well. But then open it up to the floor.

MS. WHITMAN: Well, I agree with Rich on the most important point, the age 62 benefit is not one we want to encourage people to take, particularly if the "normal retirement age," I'll use quotes just to emphasize your paper, does go up because you become a half of a benefit. And, so, it really isn't something to survive.

My problem would be is if SSI would capture all of the folks that need be. And, so, SSI would have to be changed dramatically, which you talked about in your paper, not just the asset tests being so low and not increased over time, but income levels are also very, very low for qualifications.

And, so, I think it would have to be a multi-pronged approach in order to capture the folks that have work-limiting health conditions that couldn't find work. Again, we are in the midst of coming out, hopefully, of a recession, but that doesn't mean that jobs have been available, and, again, for the oldest workers. So, I think the only way you could eliminate the early eligibility is if you had ways to pick up the folks that really desperately needed those Social Security benefits.

But I do agree and as I've said, we're trying to educate people to stay in the workforce longer, through AARP, to not take their benefit even if they go out of the workforce because of the decrease in what's the value at age 62. It's too low already and it's going worse.

MR. AARON: Nicole, did you want to comment?

MS. MAESTAS: Yes. I guess I don't know if we'd have to quite go that far. I think you could just move the age or change the pivot point. It's sort of all the same in the end and probably more a matter of how we label things and how we kind of nudge people towards particular choices rather than others.

So, I'm intrigued by the idea, but I'm pretty sure we could probably accomplish the same thing by raising the age and shifting the full retirement age perhaps up, maybe maybe we pivot around age 70 instead of pivoting in the middle of the sequence right now as we do. And, anyway, just a thought.

MS. WHITMAN: And I'd rather rename it again.

MS. MAESTAS: And rename it, yes.

MS. WHITMAN: To something --

SPEAKERS: (off mic)

MS. WHITMAN: Yes, I like that a lot.

MR. AARON: I want to emphasize that this is really a sea change in the mentality of economists. Ten years ago or fifteen years ago, I think if you had had a group of economists who were asked about the significance of relabeling something that is structurally unchanged, they would have laughed and dismissed it because what counts are the real incentives, not the way they're packaged. This is really a revolution in, I think, the mentality of certainly the policy world. The economists who work in the policy world in recognizing the importance of framing a message that psychologists have been trying to persuade economists about for a very, very long time.

MR. BURKHAUSER: So, behavioral economists is partly that, but it’s also trying to make decisions where you figure out what is probably the best decision for people and then allow people to fall out of that or to come out of that, but if they don't change their behavior, they get that and that’s what I was arguing about, this age 62. I think age 62 really has some very negative long-term effects that we haven't really talked that much about and Gary mentioned some of them, but the other one is what happens to survivors of these people who take their benefits at age 62.

The real major poverty problems among older people are older widows, and in part, that’s because their husbands took benefits at age 62. Think how much better they’d be better off if that was 20 percent higher in terms of their benefit and how 25 percent or 30 percent --

MR. AARON: Or 30.

MR. BURKHAUSER: -- when we get there. So, why not think about moving that part of the program up and moving SSI down to take care of the problems of immediate need between 62 and 65 or 66 or whatever age you're talking about and then remember that’s being paid for by income tax, not by the payroll tax.

MR. AARON: Questions or comments from the floor?

Gene Steuerle.

MR. STEUERLE: Just a quick comment and quick question. What if we were careful about thinking what's going to happen to low-income people versus actually happens?

For instance, when we increased retirement ages for all people, it turns out it did not adversely affect lower-income people more than high-income people, and the reason for it technically was more low-income people were in the disability system who weren't affected. So, you have to be a little careful about making assumptions that because you have an anecdote about a person that, on average, it's going to work out for that group.

But the bigger question I have goes to what Gary showed, which came out of work I've done with Karen before and this one, which is the biggest gains from working longer are for the lower-income population. That's because they have a larger portion of their income and earnings, among other reasons, and I really worry that even some of the proposals we've talked about says okay, we're going to do all these things to protect people at the bottom or the bottom half of the income distribution. If those people stop working and the upper-income people keep working more, the distribution of income among the elderly, even though we think we're being very sympathetic to these groups, is actually going to become worse. That is there is a case going back to this case about analogy with welfare, isn't there a case where actually wanting the low-income people to work more, as well, and don't we need to be careful about solutions that might only solve our work back row labor problem at the higher income and then make the distributional income worse?

MR. AARON: That was a comment rather than a question, but are there any reactions?

MS. WHITMAN: I think the best anti-poverty program for younger persons and older persons is a job. And the better they're off, they're less likely to draw down their savings, they're more likely to have access to health insurance.

There are lots of benefits. Unfortunately, not everybody can find a job or not everybody has the physical capacity to work. And, so, that's that population, whether it's 20 percent or 10 percent that Rich estimated, that we really have to be concerned about.

MR. AARON: Yes, ma'am?

MS. FISHER: Thank you.

MR. AARON: Identification, please.

MS. FISHER: Oh, my name. My name is Annabelle Fisher. I am currently past 62 and retired, professionally trained clinician, but I've also done other jobs.

I just want to make one comment with the AFDC and TANF. You've left out of there that back in I think the '70s, Congress mandated that the fathers of these moms who had children could not be in the home in order to get welfare. And that was a big mistake because what happened, dads had to go out and moms were home alone making more babies. So, that's a very important government mandate that messed up the whole welfare system.

Now, my comment --

MR. AARON: It's not of direct relevance to the elderly. (Laughter)

MS. FISHER: Well, my body may be getting older, but my mouth and my brain are still 25. (Laughter) Now, I refuse to age. A couple of comments and then a question. One, you must differentiate between SSI and SSA no matter what your age. Someone who has a severe disability who has never really worked or paid into the system will be on SSI and receiving those benefits from the taxpayers and that may continue from 16 or 20-years-old up until whomever with severe disabilities.

I do agree that those folks who are receiving SSI -- and I've worked with them. I've done everything but a private practice. Who are getting disability whether it's for health or mental health don't get that much, but the doc has to keep renewing it and they have to keep putting in a claim. Should really think about looking for work if it's not a severe disability and the wages are not that high. I never made that much money.

And the other issue I want to raise, by the way -- I took my Social Security and kept working at age 62 or 63. I get it less, but I get it longer, and it's capped over changing the retirement age and raising it up is not going to change the amount of money one gets from Social Security because it's capped. So, when you get into -- because I kept working and took my Social Security early. I think we have to start looking at means testing for Social Security for those who are in the higher-income brackets.

I think if you talk about policy versus reality, I get a little worried when policymakers or economists, you all are up here setting policies and not talking to those of us who are out there and doing what really is happening. If I have to go back to work today, I will and may have to because of the high costs of Medicare and health care.

So, I think, also, one other question, when you talk about reentry for someone with pension --

MR. AARON: Could you say something that has a question mark at the end?

MS. FISHER: Okay, more comments. I mean, I just find this very confusing and disturbing because you're addressing policies rather than reality.

So, and I don't have a pension. There's a difference between retirees who are federal, state, and local and regular retirees like me and I'm over 70. So, you have to differentiate between this stuff. Means testing for Social Security and the pension plan --

MR. AARON: Okay, very good.

MS. FISHER: Thank you.

MR. AARON: Is there any reaction anybody wants to make?

MS. FISHER: That was a lot, I know.

MR. AARON: I just want to make one comment which is it is not the case that cuts in the full benefits that are paid raising the full benefits age, it is not the case that it does not affect people at all parts of the earnings distribution. It is a proportional benefit reduction for people at all ages and at all earning levels.

The additional point is, and this is one that John Shoven may mention at lunch, but he has worked on extensively, it is demonstrably the case that for most potential claimants who have financial resources of any magnitude, it is in their financial interest to defer claiming benefits as long as they possibly can. There is no other asset that you can buy that is as good as the fully indexed, lifetime, real annuity that you get through Social Security. You cannot buy an asset of that quality at the price that you pay by foregoing benefits for a year. If you have not discovered that, AARP will help you to do so because they are waging a major campaign to educate the public that the spike at claiming benefits at age 62 is for most benefit recipients seriously adverse to their financial interest.

MS. FISHER: Well, I think --

MR. BURKHAUSER: So, I think --

MR. AARON: Go ahead.

MS. FISHER: (Inaudible) by Social Security (inaudible).

MR. BURKHAUSER: I think that's exactly right and it shows you where there is commonality across political views, that Social Security is a major asset against inflation that is part of anybody's portfolio. But that gets us to the issue of if we're going to raise the normal retirement age, do we really want that temptation at age 62 to be there when it's increasingly detrimental in the long run for people to take it at 62? And if we're going to hold the money constant, can't we figure out a way to separate out the needs of people who have to get money at 62 from the normal Social Security System and SSI as an alternative?

MR. AARON: Gary?

MR. BURTLESS: This is an observation. Rich's number one solution to the problem of financing old age security go from wage indexing initial benefits in Social Security to price indexing initial benefits.

In the late 1990s, Barry Bosworth and I wrote an overview. We had it in a book. We wrote an overview of the retirement systems, the five largest industrial countries: the United States, Japan, the United Kingdom, Germany, and France, and we ranked them in terms of well, how big their public pension problem was. And the United States only ranked as having the second best outlook and that's because we have a lot of babies, we don't live as long, and we have, relatively speaking, a meager pension system compared to these other countries.

What was the exception? The exception was the United Kingdom.

What was the difference between the United Kingdom and all of the other industrial countries? In the early 1980s, Prime Minister Thatcher persuaded parliament to price index the public pension benefit. So, really, the public pension system was of trivial importance to the budget outlook of the United Kingdom by 2020 or 2030.

Barry and I said, however, this was going to create an immense political tension because it just didn't look like it was sustainable that you would have publicly-guaranteed pensions that were such a small proportion of the typical living standards of working-age Britons. And we wondered whether this apparent anomaly, Great Britain, would have this very favorable long-term budget outlook hinged on the fact that they price index rather than wage index their benefits.

Well, it took three or four elections, but, finally, there was a labor government elected and they moved away from this. And, so, now Britain is back in the same boat as other industrial -- so, my question, Rich, is do you really think in the long run it is sustainable to index pensions, publicly-guaranteed pensions solely to prices and not to the real living standards of working-age people?

MR. BURKHAUSER: Okay, so, I think the answer I would have is it gives your government much more flexibility. If you go to price indexing, then at some point in the future, you can increase things. So, it's always easier to increase than to decrease. So, it doesn't lock us into a very major guarantee so that future governments can make those decisions. That would be first answer to you.

The second answer is since I spent six months in Australia, I've looked fairly carefully to the Australian system, and they have a very meager public program which is their first tier and it's basically a kind of SSI-level program. And then they have a second tier which is basically a straight annuity program and that is a much more logical way to do it.

So, I guess what I would say, because Henry's done the classic thing. I love Henry and I love all the defenders of the Social Security System, but usually the way they say is you know, Rich, you're really right, but we're stuck with what we've done for the last 50 years, so, we can't change it.

I've got a way to change it. Go to price indexing and then, eventually, we'll get back to the point where we can change it. And what I would do is keep it as a price index for the redistribution and then go to a second tier, which was much more in annuity.

MS. WHITMAN: But, Rich, the Australian system, which I like that they have high contributions of like 14 percent. That's a tax on labor of increase of 14 percent in order to get the annuity part of the benefit. And, so --

MR. BURKHAUSER: Well, that's what the annuities actually cost.

MS. WHITMAN: But then we would have to increase our overall --

MR. BURKHAUSER: Yes, but we would have a real asset that was ours rather than could be adjusted by the government, hopefully. I mean, that's the point.

MR. AARON: I just wanted to say that I think this exchange that we just had illustrates something that we often forget. We're not arguing about constitutional provisions that are written in stone and can never be changed, we're really arguing about in the guise arguing about policy and analytics, we are really arguing about politics.

The question is: What is the default position for which debate will begin? Rich wants to start the debate from one that is really increasingly modest over time in commitments to this form of public expenditure. Some of the rest of us want to start the debate from a higher level of expenditure, both of us recognizing the asymmetry of the politics of raising and cutting benefits. And I think if one is honest, that's the way we would frame the issue.

Are there any other comments standing between -- I don't want to put it in a suggestive way. (Laughter) But standing between you and lunch? (Laughter)

Okay, then I think we can continue private discussions briefly. Please grab your lunch, come back and sit down. I will --

SPEAKER: It's a half hour, Hank.

MR. AARON: Hmm?

SPEAKER: It's a half hour.

MR. AARON: Half hour.

SPEAKER: Hopefully.

MR. AARON: I would still suggest that we come back reasonably quickly. John Shoven is going to speak at lunch. Steve Pearlstein is going to speak in response to John's initial remarks. (Applause)

(Recess)

MR. BURTLESS: If we could resume at the present time, please. I have two really important announcements to make. The first is we have more cookies than we really need, and in particular, cookies are portable. You would do a great deal for waistlines at the Brookings Institution if you would take away as many of those as you possibly can.

The second thing I want to do is very pleasurable. It's an opportunity for me to introduce two people who we either all do know or should know, and whose contributions to this field I'm sure you will appreciate even more after you have heard from them.

The first is an old friend and colleague in many contexts, John Shoven, who is a professor of economics at Stanford University, and who directs now, for the second time, the Stanford Institute for Economic Policy Research, and does so with more skill and grace and effectiveness, I have to say, than any director of a research institution that I know of who is now actively in that job. He agreed to come out and talk to us about some of his ideas that he has developed alone and in collaboration, including with Sita Slavov who is here today, but also in a book with former secretary of almost everything, George Schultz, on the challenge of an aging America.

After John speaks for about 15 minutes, Steve Pearlstein of the *Washington Post* is going to respond and make comments on what John has said and on anything else that his on mind. Steve has been a source of journalistic pleasure to people in the Washington area and wherever else his articles may be reprinted for many, many years. He has also, in recent years, become a professor of economics at George Mason University where he teaches a course that is organized in a rather innovative way, and that has always struck me as a clever and pedagogically effective way, which is to start with some important puzzle or fact from the real world and then use that as a motivation to introduce concepts in economics.

Well, that's enough of the introduction. Let me remind you again, please carry away cookies, and, in the meantime, John Shoven, not too soon, in fact.

MR. SHOVEN: I obviously ate too many cookies. I want to thank the organizers and the Sloan Foundation for supporting this work. Let me start by questioning the fact that people are working to older ages, or that age-specific labor-force participation rates have indeed gone up. To return to an old theme of mine, that depends on how you measure age. The remaining life expectancy of the average retiree has not gone down. Mortality of the average retiree has not gone up. Retirement lengths have been getting longer, not shorter, even in the last 20 years, so in a very real sense, people are not working to older ages.

Now, I recognize by conventional years since birth measures, they are. But I think the readers of your paper should be reminded and some of you have mentioned this already, that while the retirees today are further from birth, they're also further from death. So, it probably is time to think about and continue to think about maybe we're measuring age wrong. Certainly in other fields, like in the speed of data transfer, we've come up with new measures like gigabytes per second, so maybe we should continue to think about how to measure age.

Now I believe that the issue of adjusting institutions for long lifetimes is actually one of the biggest issues of the next half-century right up there with dealing with climate change, dealing with entitlement reform. It's related to entitlement reform and the other big issues. I think it hasn't been given enough attention. That's why I like this kind of work that's going on here.

Let me give you just a couple of facts about demographics, life expectancies and interest rates. I believe that most people underestimate how long their retirement resources are going to need to last. I think Gene had roughly the right numbers. The most recent study I have seen, and actually even today, we saw that the average retiree today, the male is 64 years old when they retire. The women are about 62 on average when they retire.

So, let's say that those two average retirees were married to each other. You have a 64-year-old man and a 62-year-old woman married to each other. How long is their retirement likely to last? And instead of asking what's the life expectancy of the woman and what's the life expectancy of the man, say we ask probably the more meaningful question is how long until both of them have passed away; the second to die, the length of time until the second to die? And if we use the cohort mortality tables of the Social Security Administration, the answer is more than 27 years, 27.38 years, or 27-1/2 years if you want to round. Well, that's a pretty long retirement. The second death for a couple -- 64 and 62 -- is expected in 27-1/2 years if they're just a little bit lucky, if their combined lives is not at the 50th percentile but at the 75th percentile, 31-1/2 years.

That's a long retirement. Certainly that couple wanted to go to an insurance company and buy a second to die annuity. They know that there's some adverse selection. They're going to price that out with 30 years of payments, at least, in mind.

Now, what were the corresponding numbers in 1961 when, for the first time, men had some choice as to when to collect Social Security? Well, the average age of retirement in '61 was not 64 for men. It was 66. We saw that in some figures today. So, say you preserve the 2-year age gap and you ask how long in 1961 would a 66-year-old man married to a 64-year-old woman, how long until they're both passing away in terms of expectation? The average length of their combined lives, 21 years, instead of 27-1/2. I'm claiming that today's retirees have a 30 percent longer remaining lifetime. That's a big change, 30 percent long remaining lifetime than they had 50 years ago.

Now, say the couple wanted to provide for their retirement, and let's abstract from Social Security for a minute. Just ask how much wealth would you have to have if you're doing it on your own to provide for your retirement? Well, if you've got this 27-1/2 year goal, and let's say you thought you needed 75 percent as much as you had in your earnings career, and then you'd want to know the present value of that real stream. Present values have become pretty easy in a world of zero interest rates. What it cost you to finance 27 years of retirement is 27 times what it cost you to finance one year of retirement, so the answer would have just been 75 percent of 27-1/2 years or a little over 21 times your earnings is the wealth that it would take to finance that.

What would it have taken in 1961? Well, you wouldn't have a zero interest rate in 1961. You might even have the 2.9 percent real rate that Social Security often uses to discount, and instead of 21 times multiple of your earnings, it would have been 11.7. In other words, today the present value of financing your retirement, it's up more than 75 percent compared to 1961, and about half of that increase is due to living longer and half is that the interest rates have disappeared, if you think a zero interest rate is sort of a disappeared interest rate.

So, let's go back to today though. The 64- and 62-year-old couple who appear to on average to have about 27-1/2 years left in them, how long could they have possibly have worked? They're 64 and 62. Forty-five years seems like the highest number you could possibly come up with for the working career of a 64- and 62-yer-old couple. So, just ask yourself, with American style savings rates can you finance a 27-1/2-year retirement with a 45-year career? Any way? I mean, with Social Security, with defined benefits, with defined contributions, with all stock portfolio? My answer is that's tough. It basically can't be done, or it seems like it's very, very hard. And my prediction is just from the sort of pension mathematics, how can you save enough as a society or as an individual to finance retirement? It's going to force retirement ages to continue to go up. And what I think is that today's Stanford students, the students I teach, they're going to have to work to 70 as the average. That's my guess. I think the force of this longer lifetime is just going to force them to work longer. Whether this is a bad thing or a good thing, I don't have any value about this. I don't think it's so terrible. In fact, I'm not sure they're going to have to retire that much shorter than today's folks. Most estimates would say that today's young people, 20-year-olds, will live an extra four years or so, four or five years compared to today's retirees, and they may have to devote most of that to work, maybe all of it to work.

Henry mentioned that with co-authors, including Sita Slavov, but earlier George Schultz, I've thought about some policies that might encourage longer work lives or another way to say it is stop discouraging long work lives. Social Security, for instance, in the early part of your career you're actually earning benefits for working, and more work gets you more benefits. But as you know, Social Security only counts 35 years of work, so many people in their, say, sixties, they've had a full career without an interruption, they're paying Social Security taxes but they're not getting any marginal benefit, so we came up with this idea of paid up. And actually, let me just describe it slightly differently than Henry did. What we came up with was after 40 years of covered work, there would be no payroll tax for you, not for Social Security, not for Medicare, not for the employee or the employer. You're paid up. And so, it's really a 15.6 percent, I think, is that the right number, tax that would be removed, and obviously that would give you either a 15.6 percent higher salary or maybe lower cost or split between the two, but that would make a big difference. That's what we proposed.

Secondly, we did propose, as Henry said, switching from Medicare as a secondary payer, to Medicare as a primary payer. By the way, Medicare was a primary payer until about 1983. This was a Reagan change and we're just saying it should be undone, so that under Medicare as a primary payer, if you're 65 and you've got Medicare, you go and you want to work, you go to your employer and say, hey, I've already got my major medical. So, obviously, you're a more attractive employee or you're going to get more, and so forth.

I would say that the best article we have seen on labor supply elasticities by age was by a guy named Eric French of the Chicago Federal Reserve, and that's what we use, and he finds that there's quite a bit of labor-supply elasticity among people in their sixties, and he looks at lifetime labor supply elasticity as well as the elasticity at older ages.

Now, the last thing I want to mention, I'm getting close to done, is Sita and I have been working on claiming strategies for Social Security, and actually it's broader than that. It's really general, what we call is efficient retirement design. How do you design your retirement efficiently? How do you combine your private assets and your

Social Security to maximize retirement resources? And we find that almost everybody who files for Social Security assumes they can, either at 62. Maybe they retired before 62, so they file right at 62 or within a month or two, or whenever they retire. That is, we see almost nobody delaying the commencement of Social Security beyond retirement. And so, what they do then with their private assets, almost by necessity, if you've done that, you collected Social Security as soon as you can, what could you do with your private assets except try to supplement your Social Security benefits with your 401(k) assets or your other private assets? There's really nothing left to be done other than to use your assets as a supplement.

Now, we find, and the most important thing we find really is that this almost universal practice is almost universally a big mistake. Private assets should not be used, first and foremost, to supplement Social Security, but they rather should be used to defer Social Security. The return to deferring Social Security is not determined by market forces. It's determined by legislation, and it's actually determined by legislation a long time ago. And those returns for deferring Social Security are outstanding. They're fabulous. They're way above market; however you want to say it. Today, for some people in some circumstances, not uncommon circumstances, the return for deferring Social Security is 5 or 6 percent real, real rates of return of 5 or 6 percent in a world where real safe rates of return are 0 or negative. So, it's just an outstanding return, outstanding. It's way above alternative returns.

If you wait for collecting Social Security -- I'm not talking about retiring now, I'm just talking -- wait to collect your Social Security and you wait until 70 instead of collecting at 62, the monthly benefit is up by 76 percent. And while you're waiting, you do get those inflation adjustments as well, so it's 76 percent real higher at 70. That's quite a gain.

Now, the gain for deferring depends on your circumstance. It depends. Are you single? Are you married? If you're married, are you the high earner or are you low earner in the marriage? It depends on all those things, but we find that some deferral, some waiting is optimal for everybody, or just about everybody. Obviously, if you're on chemotherapy, you've been diagnosed with cancer, you don't want to defer, but we find it's a very, very small set of circumstances which would cause you not to want to defer. We found that people whose mortality rates are twice the average, so say you're a 67-year-old woman and your mortality is twice the average, like you're a smoker. You still should do some deferral. So, it's that good a deal that even having twice the average mortality is not enough to completely stop deferral.

We find a single male -- by the way, it's a better deal for marrieds, in general, than singles. And it's a better deal for single females than single males. The least favorable one is single males. We find a single male smoker, and by smoker I just mean two times the mortality of average single males, should defer collecting Social Security until 65. Should not collect at 62, should wait 3 years. If that smoker happened to be a woman, she should wait until 68. It's pretty impressive when you think about it. So, obviously, some people's mortality risk is worse than two times but not many.

We find that the gain to optimally claiming your Social Security for couples can be $200,000. As people are leaving $200,000 on the table, this is not a small tip that they just forgot, or it's not like they left a $5 bill and they wish they hadn't. A couple hundred thousand bucks. This is bigger than the average 401(k) account. So, the immediate claiming instead of optimal claiming hurts the resources of widows in particular, and widowers.

And so, anyway, we think it's a big deal and we're writing stuff including -- we've written two articles on this topic, but they're kind of professional articles which aren't going to have a lot of impact like most professional articles don't have a lot of impact, but we're trying to write a booklet, and we have a unique plan of distributing this booklet. The unique plan is free and electronic, so we'll see how that works, but we're going to try to get organizations to give us a link so people can see our stuff.

We're not alone in this. Actually, we're not claiming that our ideas are original. Maybe the whole package has some originality, but interestingly, everybody who looks at this carefully comes to more or less the same conclusion, whether they're academic -- just in the last week or two I ran into, I guess you'd call it a booklet, produced by Prudential, the life insurance company. They had it pretty much right, so we're going to try to gather the forces that are coming up with these ideas and see if we can't get a push to get people to stop leaving a couple hundred thousand dollars on the table and help have more resources in retirement and particularly help widows, because if you defer your benefit, you all know that it's the high earner -- it should be obvious to you, but let me just tell you. If you're in a couple, it's the high earner who really should defer. It's more important for the high earner than the low earner because those high-earner benefits are going to become the survivor benefits. And the low-earner benefits are not going to become the survivor benefits. That's just the way the rules work.

And so, it's actually good if both defer, but there is a priority and the one that really needs to defer is the one whose benefits last for two lifetimes or the maximum -- the second-to-die annuity instead of the other one which lasts as the first to die annuity. That's all I've got. I hope you'll be looking for our stuff because we're going to try to make an impact. (Applause)

MR. PEARLSTEIN: Good afternoon. Thank you, John. A little disclaimer. I'm not an economist. Actually, I don't teach in the economics department at George Mason. As you can imagine, they wouldn't have me. I'm in the government department. And I'm not an actuary and a lot of those tables and that data that we listened to this morning makes my head hurt, so just -- you'll take all of this as the reaction of a journalist. First of all, I'm very happy to know -- my birthday was two weeks ago. I turned 61, but I'm very happy to know that 61 is the new 54.

MR. SHOVEN: There you go.

MR. PEARLSTEIN: So, I'm already feeling better, except that now I also know that my wife should retire and I have to keep working until I'm 70, so.

MR. SHOVEN: Just defer claiming.

MR. PEARLSTEIN: Thanks a lot. I would make a small point which is the point of a non-academic. John's paper, for the sake of analysis, assumes -- or his comments and his papers that he has written, assumes that because the TIP rate is zero that the discount rate is zero for money. In terms of the way real people in the real world think about their retirement savings and perceive it, they don't think that their rate of return is zero. You can invest in a broad portfolio of dividend-paying blue-chip stocks and earn 2 to 3 percent. You can also put your money into the Wellesley Income Fund at Vanguard, and over a long period of time be pretty sure that you're going to earn in excess of 5 percent. So, I don't really think that's the way real people think about their discount rate.

I'd sort of like to step back a little bit because a lot of this has to do with -- John's work has to do with -- or his paper, about how much incentive or disincentive we are giving people to continue to work or not continue to work. And I'd just sort of like to start out with a basic and obvious thing which is some years ago in the '30s and then in the 1960s we decided as a matter of social policy because we felt it was fair, because we wanted some economic security, that we adopted this program called Social Security. And we adopted this program called Medicare, and these are inherently disincentives to working. So, we shouldn't be surprised that there are disincentives for older people to work. We set it up that way, not because we wanted to maximize GDP but because we felt better about it. We liked it. That's what we wanted to do. And in order to do that we set up what was then a small intergenerational transfer which has now become a huge intergenerational transfer because we set these up as pay-as-you-go systems.

Now, it is pointed out by John and others, that because of the tax and benefit system that has grown up around these two programs, we've created marginal tax rates that are now a further disincentive for old people to work that require, according to John, even more, another round of intergenerational transfers in order for us to solve the problem. That is let's let people who work beyond 65 do so without a payroll tax or a payroll tax holiday or let's let them dip into Medicare earlier even while they're working, essentially raising the cost to that program.

Seems to me we're on a slippery slope here, just piling on sort of one more intergenerational transfer to solve a problem created by a previous set of intergenerational transfers, and if you sort of worry about those sort of things, I think we probably want to call a stop to it.

It's also -- I think some of his work raises a philosophical question. Is the lack of an incentive, at least a disincentive? And is every time there is a lack of incentive a disincentive, do we have to have government step in and solve that problem? For example, when you talk about a paid-up program, well, that sounds nice but is the program really paid up? Well, not really. None of us, as far as I know, ever really fully paid for our Social Security benefits or for our Medicare benefits, so we're not really paid up and I think that's a misnomer and I sort of feel uncomfortable about us paying up less.

Now, in his paper, John has a lot of discussions about the incentive effects of implicit marginal tax rates on old people, older workers, and how this will change their behavior. It seems to me, implicit in all this discussion about that and how that affects people is that we are foresightful. We are rational. We are wealth informed, income maximizing economic actors. In other words, we act like economic models say we're supposed to act, and so these high-implicit marginal tax rates are bad because they discourage us from working and then we shouldn't do that.

But John also described to you some very important work that he's done about Social Security and when it is the best time under the current rules for us to retire, and he's basically shown that most of us make this huge mistake when we make our decisions about when to retire for Social Security. And that we are all leaving a lot of money on the table, up to $200,000 a year, which over a 30-year retirement is --

MR. SHOVEN: No, 200,000 (inaudible).

MR. PEARLSTEIN: For a lifetime, rather, which over a 30-year retirement is $6,500 a year roughly, and we're leaving that on the table. Well, it seems hard to me to reconcile, just sort of a step back philosophically, whether you believe that we respond very aggressively to implicit marginal tax rates, and that we're also silly about this other thing. Either we're all silly or we're all rational, but we can't be both at the same time.

I think Henry's already pointed out an obvious problem which I don't consider huge, but John's solutions which are the Medicare first and the payroll tax holiday will weaken the solvency of those two programs. Now, as Gary and Gene pointed out this morning, yes, but people working longer and generating income longer will generate more money for the Treasury and the income tax, but that is a separate pocket of money unless we want to figure out a way to transfer that money back into the systems, then we have a political problem, and everyone in this room is obviously aware of the political problems associated with that.

I'd like to deal a little bit with something Gene said today, which is that we don't have to worry about the demand problem for all this additional labor from older workers. That because of the decline in birth rates during a certain period of time, there will be demand here, and that basically, well, there will be demand. I'm not sure that we can count on that effect. I think we can certainly count on it to a degree, but it doesn't seem to me axiomatic that supply will, in this case, create its own demand as it did when women came into the workforce or when immigrants came or when there was a technology change and suddenly there were excess workers because of productivity increases.

I think that in a global economy where wages and prices are sticky and institutional arrangements favor insiders versus outsiders, I don't think it's necessarily true that labor supply everywhere always creates its own demand. And I think we have micro-examples and anecdotal information that all of us in our own ways have seen this. We have seen long-time youth unemployment and underemployment as a persistent problem in major industrial countries over long periods of time. The system doesn't necessarily clear. I don't exactly know why and each country is a little bit different, but I don't necessarily think it's true that just because old people continue to work that they won't be taking jobs potentially from unemployed young people, at least not in the short and the medium term.

And at the micro level, I think we all work in places where we know that if we were to retire, those of us who are old, and a lot of us in this room are old, that in fact, they would hire somebody younger and cheaper, actually, and they don't, or they're not allowed to force us out. So, at the micro level, we have some evidence or some anecdotal evidence that there would be some sort of displacement, and we know, those of us who have 20-year-olds who are in the inevitable, unending, unpaid internship phase of their career that the system is not exactly working for the 20-something, even those with good educations.

I would also add that whoever this morning cited S&P as saying they were coming to full employment in either 2017 or 2018, that I would be very happy to take the other side of that bet. They always say that, that after some number of years their models say that the system will clear. They just always say that. They have to. They're programmed to say that, but there's really no reason to believe that that is true, and in fact, we know that there are structural problems in our labor markets that probably -- the reason we have high unemployment today and why we will continue to have high unemployment in 2017.

It seems to me the best argument here is the simplest one, which you have made, which is you can't have 45 years of work pay for 30 years of retirement in a slow growing economy where retirement savings are less than 20 percent of your income. That's just math. I don't even think that's economics, and that is a problem.

I'm skipping ahead here. For myself, I guess I would tend not to focus on the macro stuff so much as the micro stuff. My father-in-law just celebrated his 90th birthday. He's a federal judge on senior status, and three times a week he gets up at 6:00 in the morning to go ice dancing, still. And one of the things that I've observed about him -- his name is Bob Sweet, is that the reason he lives longer is because he worked longer, that there is a relationship to living longer and working longer that is a good thing, and that's one reason, by the way, to encourage people to work longer is because they will live longer. And so, there's a sort of self-reinforcing affect here that probably will continue, but I think the best way to try and encourage that is through micro things rather than macro things.

I think the reason people decide to retire or not to retire is not primarily driven by policy. There's all sorts of things: how much money they have, how happy their job is, whether their spouse works, whether their kids live in California as opposed to where they live, or all sorts of other reasons why they've -- whether they have a house or cottage at the lake that they already own that they can go and live in or not. There's all sorts of reasons why people decide when to retire, and I'm not sure that I think it's the most important thing for us to worry about this or try to use policy to affect it. I also think that what drives it a lot are the sort of labor policies or the employment policies of the place where they happen to work. Some places are more flexible about these sort of things and make transitional arrangements and others do not. And that probably is an area that we ought to think about more than thinking about some of the things we were talking about this morning.

The last conclusion I would have after having sit through this morning is that to a surprising degree, markets are working. Seems like if Gene is right, we can expect at least a secular increase in demand for work from older workers. We know that the supply is increasing. We know that the wages of older workers are increasing, and that the retirement age is now starting to rise again. So, it looks to me as if the market is working pretty well. I'm not sure why we have to do anything to solve the problem. There's not necessarily a policy solution to every problem, and perhaps the best policy ought to be neutrality, which is we shouldn't be encouraging people to retire at any particular age. We shouldn't be discouraging them from retiring at any age, but we should simply keep as neutral a policy as we can while, as Dick points out, maintaining an adequate safety net for the poor and the disabled. (Applause)

MR. BURTLESS: Perhaps unsurprisingly, John Shoven has a couple of things he would like to say in response, and I would like to give him an opportunity to say one or two more things in response.

I want to push a little harder on the two suggestions that John made for policy changes, the fully paid- up Social Security and Medicare primary payer. The first question relates to the observation that, at least with respect to the Social Security proposal, this would heavily favor men relative to women, given the fact that women tend to have relatively short working careers.

The second point is that these proposals are, in a fundamental way, incomplete. They cost resources. Certainly within the individual trust funds of the programs, they deepen an already existing deficit that exists in the Medicare Hospital Insurance Trust Fund and in the Old Age Survivors and Disability Insurance Trust Fund. Whether they deepen an overall budget problem is a closer question in light of the possible impact it would have on potential GDP and revenue collections. But at least in the near-term, they're very likely to deepen that problem as well, so to make the proposal complete, you have to combine it with how you pay for it within the Trust Fund and within the overall budget, and you need to make the case that the use of scarce resources, and budgetary resources, God knows, are scarce. Nobody can doubt that these days. You have to make the case that this is really high priority use of budget resources to provide an additional benefit or tax relief heavily slanted toward men rather than women, and that is going to have to be paired with some other things that aren't so much fun to do. So, I begin skeptical on these two proposals, more for that reason than for the reasons that we may have discussed a little earlier.

John, the floor is yours.

MR. SHOVEN: Okay, I'll try that. I mean, I'm not sure I can give definitive answers to these, but let me say a few things, going back to the presentation. Let me start off with the discount rate and say that if you are eligible for Social Security -- say you're 62 or over, you've worked for more than 10 years, you're eligible for Social

Security, or maybe you've even started to collect Social Security. What do you have? Now, I think we all agree you have an asset. You have an asset basically promised by the U.S. Treasury to pay you monthly checks for the rest of your life. It's inflation indexed. So, you have a Treasury inflation-indexed asset. You can call it an inflation-indexed security. Your security happens to be a life annuity and not a bond, but it's a pretty darn close relative to a Treasury inflation-protected security, a TIP. But to me, it seems almost natural what discount rate would you use? Well, you'd use the rate of return paid on assets like what you have: TIPS.

Now, could you use a discount rate that is higher like you could get on a stock mutual fund? Well, sure you could, but you're using a riskier rate of return to discount a safe asset, and any time you do that you're going to get surprising findings. I'm claiming that what we're using, namely a zero real interest rate to be clear, which on your safe assets -- I claim most of you are not getting zero. You're getting less on real safe assets today. So, I do not think this is a -- given the market reality, zero real is a good rate of return. No money market fund is offering that. Every money market fund I know is paying negative real interest rates. No bank is offering on savings deposits. What would it have to be? They'd have to be paying 2 percent, although that's not in the market. So, anyway, I claim that you don't want to use a risky discount rate to discount a safe asset.

On the two policies, the paid-up idea and the Medicare as a primary payer idea, one of the key aspects is when we're thinking about how the government would fare is do we look at the various pockets, or do we look at all the pockets combined and see how the government as a whole loses? Now, I don't think we're claiming necessarily that people are very calculating and figure out their implicit tax rates and everything else. All we're claiming is that people respond to their paychecks, to wages, net wages. And I don't think, by the way, that 45-year-olds are very responsive to wages. You can lower wages, raise wages. Forty-five year olds are going to work anyway. When you're in your sixties, work is a little more optional and the Eric French data is -- there's quite an elasticity that you're dealing with. If they get paid more, they work more, and, in fact, we did a back-of-the-envelope calculation indicating that Medicare as a primary payer would not cost the U.S. Government anything. That is, the extra income tax would exceed the losses to Medicare.

Now, we can't settle whether that's how the government should think. That is, should they look at all their sources of revenue and worry about their budget, or should they worry about each trust fund and make sure that no harm is done to any trust fund? Just to be clear, Medicare would obviously be paying more benefits. Medicare situation would be worse. IRS would be collecting more income tax. Could you develop a system to bail everything out?

Let me talk a little bit about -- it sounded like Henry's concern -- one of his concerns certainly was that if you're going to have this paid-up category, be applicable to people with 40-year careers, that men are more likely to have a 40-year covered earnings record than women due to career interruptions.

Now, I think that's true, although many people when they retire are either married, you have a couple in which case the distinction between the man and the woman is a little bit blurred. For instance, many, many, many widows in this country are not collecting on their own record. They're collecting on their deceased husband's record. So, exactly, the gender roles get a little blurred in that case.

Even single people who retire often can claim on their ex-spouse's record whether that ex-spouse is deceased, or ex-spouse is because of divorce. One strategy in efficient retirement design is to claim your spousal benefits from your ex-spouse or claim your survivor benefit from your ex-spouse, all the while deferring your own record. And at age 70, if it's more, you switch to your own record. But for those first years, you're actually collecting on somebody else's record. Now certainly there are lifetime single women, but those lifetime single women are probably not having the career interruptions that you were thinking of. That is, usually we think the career interruptions are child rearing and so forth, so I don't know. This needs further investigation. All I'm saying is that for many, many people they've got two claims to work with, often one's a man's record and one's a woman's record. And so, it might not be as much of a concern as it appears, but that's just off the top of my head.

The thing that we have to sort out is this issue of do we worry about the trust funds per se or do we worry about the government's budget, or maybe we worry about both. And I'm claiming these policies would not -- at first glance, they do not worsen the government's budget problem. They may worsen the trust funds, and you'll have to figure out whether that's something that can be fixed or not.

MR. BURTLESS: Okay, we're going to open it up if there are any comments or questions. I just want to put in a plug for one piece of research that would bear on a point that Steve Pearlstein made. He said none of us had paid up for Social Security. That's probably not correct. Dean Leimer at the Social Security Administration did a study some years ago, and everything Steve said is right in spades for all age cohorts born up to about the year in which I was born. I'm right at the crossover point, and people born after me, by and large, have paid for their Social Security benefits, cohort by cohort. Of course, there are high earners and low earners. There are couples and single people, but if you average across everybody at an age cohort, people born after 1936 or later have basically paid up for their benefits. And by increasingly more, the younger they are, people born before that point were the beneficiaries of benefits whose present value cohort by cohort was considerably greater than the taxes that they paid, so you're ahead of the game, Steve.

MR. PEARLSTEIN: I'm risk on the cusp.

MR. SHOVEN: Let me just say one thing, and Steve mentioned this as well. There are so many studies including stuff I've done about -- arguing about discount rates and sometimes they're arguing about discount rates that state and local governments use to discount their pensions, and there are people that worry that the DB world had better incentives than the DC world, or whatever. There's so many people working on the details, or for that matter, Social Security reform. I think the big picture is this picture of how do you finance 30-year retirements with 40-year careers. By the way, my 45 was an exaggeration. There aren't a lot of people who have 40 -- the average retiree does not have a 45-year career. So, I think I'm not exaggerating saying we're trying to finance 30-year retirements with 40-year careers, and that's a bigger problem than these discount rates, and the DB versus DC, stocks versus bonds, anything. That's an overriding problem that has to be addressed.

MR. BURTLESS: Comments or questions? Yes, sir.

MR. GREENBLUM: Eli Greenblum. I'm an actuary and just one comment on the discount rates. We're not going to discuss that, but the Society of Actuaries' slogan is risk is opportunity. I agree -- I'm a pension actuary, so Professor Shoven, you're talking my language, and I agree with basically everything you said, so I'm just glad to hear it and your big point, which is 40 years to pay for 30 years, is absolutely true. One of the things the American Academy of Actuaries is doing is trying to provide some push for the legislators to do some signaling because ERISA really will not let you brand a retirement age greater than 65 as your normal retirement age. We'd like Congress to act to allow plans to brand a higher normal retirement age to help at least be in sync with Social Security's full retirement ages.

MR. BURTLESS: You're mentioning your profession. I have to defer things a bit to tell the old story about the difference between economists and actuaries. Economists, like actuaries, are good with numbers, but they don't have enough personality to be an actuary. (Laughter) Are there any comments on the branding point, which I think fits in with the emphasis on the way in which policies are framed? What you're saying is the actual policy may or may not change, but if you identify as the age at which retirement is meant to occur or that is normal or in Deb Whitman's terms, she wants to find a complimentary term for that age and a less complimentary term for earlier ages, but that will actually have a material effect on behavior.

MR. PEARLSTEIN: Could I just respond? My point was simply -- I mean, I'm not telling you as an actuary what discount rate you should use when you're making calculations for whatever it is you make calculations for. What I'm saying is if you are talking about people making decisions about what they want to do and when they retire and they think about what is the value of money that either they have or that they might have and that they might invest, they don't think it's zero. Okay? And so, if you're wondering about their behavior based on their perceptions and their actions, I think you have to ask what they perceive to be their discount rate, not what you know based on a market in TIPS which is dominated by institutional investors looking for places to park money, and not by individuals wondering about how they're going to pay for their retirement.

MR. SHOVEN: Steve, I don't disagree, but I would say the following. Our assumption of zero -- the average person that you're talking about does not think about real interest rates. They think about nominal interest rates.

MR. PEARLSTEIN: Well, there's that, too.

MR. SHOVEN: So, our assumption of zero corresponds to two nominal. That we're not assuming zero nominal.

MR. PEARLSTEIN: Okay.

MR. SHOVEN: So, we're a little closer to your guys.

MR. PEARLSTEIN: Okay. Fair point. Gary.

MR. BURTLESS: I want to turn the discussion back to something that Steve mentioned, and it's come up over the course of today's discussion and that is the assumption in the long run of full employment. So, if there's a desire of older workers to join the work force, then the private market is going to create the employment opportunities for them to do so, and Steve points correctly to the fact that there's long spans of time when that's not been true. If the words Spain 2012, Greece 2012, Europe 1980 to 1995, and the United States of America 1929 to 1940 mean anything, they certainly mean that you can have long periods of time in which there is too little demand for people to work.

The point I would like to make is that in the United States there's a very strong inclination on the part of most neoclassical economists to think that that is a short-run problem. That in the long run, if people want to work, employment opportunities are going to be created for them, and I think that we haven't changed our minds. I'm putting myself in that majority.

In our modeling for this project, we did not assume that there was instantaneous market clearing. We assumed that there was going to be a lot of extra unemployment, and we even made assumptions and looked at alternatives where sometimes it's spread across just the aged, and sometimes it's shared with the non-aged too. But we do think that looking at the long record in the United States, that by and large, eventually policy gets things approximately right, and so this assumption over the time span that we have to think about retirement policy, which is certainly more than 10 or 11 years, it's more than the span of time that Europe had excess unemployment. It can be resolved. And I just want to hear what the counter argument to that is. What evidence over long periods of time in a country like the United States has there been a shortfall in the willingness of employers to create employment opportunities for everybody, whether they're women, they're minorities, they're aged people, to create those jobs?

MR. PEARLSTEIN: Do you want to think? Let me just add one thing.

MR. SHOVEN: I can't go toe to toe on this. I just would ask you to observe what you have observed over the long run in our country -- and this is not Spain and Greece, and it's not Europe. We have much more flexible labor markets and they clear, and we have wages that go down here. Unfortunately, we now can see that happening for a lot of groups. But I think we tend to underestimate the pockets of structural unemployment and that those are real. They don't go away as quickly as we would like or as our models say they would.

And for a long time, economists like here or like across the street say immigration has no effect on wages, has no effect on employment. Trade has no effect on wages; it has no effect on employment. Well, I think we now know that it does have an effect on wages, and I would argue that over even medium terms among certain people, particularly people with certain education, maybe a certain age, it can have some pretty serious effect. And so, from a political standpoint, if nothing else, you want to be careful about saying we need to encourage as many old people as possible to stay in the work force when we have a lot of 20-somethings including 20-somethings with college degrees who are unemployed and under-employed. It's just not a fanciful problem.

MR. SHOVEN: Steve, I don't think you two necessarily disagree. I think what you're saying, Gary, is in the short run you'd have higher unemployment if more elderly wanted to work. And in the long run, you'd have lower wages if more elderly wanted to work. That's the way the market clears, right?

MR. BURTLESS: That's what I think --

MR. SHOVEN: He's not saying you're going to have full employment and no depressed wages. He's just claiming that it's the wage that's going to make the long-term adjustment.

MR. PEARLSTEIN: Okay, so the United States is the example where the wages are less sticky, and my son, and I don't reason everything from own experience, but my son --

MR. BURTLESS: He'll make an exception in this case.

MR. PEARLSTEIN: My son's wage is zero, okay? So, obviously, wages are affected, and that's how we do it in this country. But even so, I would say that we all know there's some stickinesses here and I just -- be careful about assuming things that -- when we make models you have to oversimplify and you assume things, but let's not forget that we've assumed things and assuming away the problems that I'm trying to point out here. That's all.

MR. BURTLESS: Gentleman in the back, or lady. I can't quite see -- the light.

MS. LEE: I just thought that I should mention that David Wise has done a study --

MR. BURTLESS: Would you introduce yourself, please.

MS. LEE: Excuse me? Oh, I'm sorry. My name is Marlene Lee. I work at the Population Reference Bureau as a demographer. And David Wise has done a study that has looked at the displacement effect of employment of older persons on youth and actually found that there was no displacement effect in this -- this was a cross-national study, so --

MR. SHOVEN: And because that's -- and the story behind that is?

MS. LEE: I'm sorry, I don't remember the story behind it, but I do remember the finding. It's been a couple of years since I've read it, and I thought you might be interested in looking it up.

MR. BURTLESS: Okay.

MR. SHOVEN: I think the story has got to be much along the lines that Gary described which is that over the short-run period, if you've got excess supply and you add the supply you're going to make unemployment rates higher. But over the long run, and these are time periods over which even relatively rigid labor markets gradually adjust, it's the capacity limitations that determine how far demand policy can go, and for the bulk of the time periods during which you are at or near full employment, if you have expanded the labor supply pool, you have expanded capacity to produce and very likely actual output as well.

MR. PEARLSTEIN: So, let me just pose just two little wrinkles and then Gene wants to say something. Just consider that over the next 15 years we are going to have a -- tell me if I'm wrong, a macroeconomic fiscal drag. Okay, so that's one thing affecting aggregate demand. Secondly, the extra income, as I was talking to Gene before, earned by older workers, the propensity to spend the marginal dollar by those older workers is not the same as the propensity to spend the marginal dollar for sort of an average middle-aged worker. So, that person is going to spend more of that money; therefore, it's not going to be adding to the same degree to aggregate demand.

So, I'm just posing all sorts of little wrinkles here to the neat little model that it's always going to come out right. But I'm not questioning -- obviously, a lot of women went to work and somehow we got to be a richer, a bigger economy, so we did that. And we got a lot of immigrants and we did that too, but just saying is it always so smooth and easy?

MR. SHOVEN: So, another occasion, roughly 1970 or so, the baby boom hit the labor market. It was delayed a little bit by the Vietnam War, particularly for men, but you could see the short run, the economy had some problem and wages were depressed a bit, as the labor force --

MR. BURTLESS: Yes, $89 a week was my first (inaudible) job.

MR. SHOVEN: I mean, you could sort of see the market working, and with the entry of the baby boomers into the labor market.

MR. BURTLESS: Rich, did you still want in? Rich Burkhauser.

MR. BURKHAUSER: Yes, I just want to take a look at the opposite way of thinking about it, okay? In looking at the unemployment rate as a key parameter, there is a tremendous tendency to reduce the unemployment rate, not by increasing employment but by providing an alternative way of getting those people who are not working not to be unemployed. And I just happen to be involved with this -- the history of the Social Security system enough to know that in 1936 this was one of the major reasons why people were supporting a Social Security system so they would reduce the unemployment rate, and as a result of that in the original rules if you worked at all, $1, you lost all benefits. So, we have to be careful of the sort of notion that we're going to use the disability program or the old age program as a way to hide our unemployment. And I think there's cost to that in the sense that eventually these people can work, should work, and working actually increases GDP.

MR. SHOVEN: I'm just calling for a policy of neutrality. I'm not trying to encourage anyone to work or discourage anyone from working.

MR. BURTLESS: Gene Steuerle.

MR. STEUERLE: I do have a question this time. I do have a comment. I think a lot of people think the current system is not neutral, and we're moving toward neutrality, Steve, so it's a little difference in the changes or the other direction.

But the question I really have is for John and Henry, and I wonder if the debate you're having isn't really the wrong debate in the context of reform where you talk about the changes that John proposed. Actually, I think I suggested Medicare as a secondary payer back 20 years ago in a book. A lot of other people have done that. Seems to me these are horizontal efficiency things. We're saying the system's inefficient, it's not providing equal justice for people who maybe have the same lifetime earnings but very different benefits, and so it's proposing fixes on the efficiency front to promote employment. And then Henry says, oh, but it might cost the system something. And John said, well, maybe it might not cost the system something. And if we're really doing reform, don't we just make other adjustments elsewhere? Can't we just change the rate structure of the benefit formula or 47 other? Isn't that the real way? If we have inefficiencies and what the economists would call horizontal inequities in the system, don't we still want to fix them?

MR. BURTLESS: I couldn't agree with you more. I would like to point out, however, the radical political implications of John's Medicare proposal and root the argument is that treating health insurance cost as part of the compensation package creates distortions in both the labor supply and the labor demand side of the equation, and he proposes basically to take it out of that calculation but only for workers over age 65. It seems to me if the principal is valid, you want to do it for workers at all ages, and that calls for a completely different method of health insurance coverage in the United States than one based on employment, and if one wants to take the principal that John has articulated, I welcome you to the group that favors Medicare for all. (Laughter)

MR. SHOVEN: Let me just say that the idea can't be that radical because the policy I proposed was the policy for 18 years. From 1965 to 1983 we had Medicare as a primary payer.

MS. WHITMAN: Deb Whitman again. John, your estimate of how much people will need in retirement was huge for the coming generation, but you were just looking at a replacement rate, not at rising health care costs, and in particular, long-term care costs. The average nursing home now is $100,000 a year, so how can we incorporate that into what, really, people will need to have for retirement and those types of transfers that would be necessary?

MR. SHOVEN: Well, I don't know the answer to that, but it leads to the same conclusion. I think what Deb's saying is that my assumption that the retired people only need 75 percent of what they had when they were earning might not be right. They might need more than 75 percent, particularly the very elderly who need nursing homes services and so forth, and all that does is make it even more dramatic that you can't finance those last 30 years of life with 40 years of work. We might have to go back to 20-year retirements, which is kind of what we had 50 years ago.

MR. BURTLESS: Are there additional questions from the back? We haven't heard from some people in the audience who I know know an awful lot about this subject and have some fairly strong personal views on it, and it's late in the day but I would love to hear from those who have remained silent. Stan Ross, who definitely fits the mold of a strong opinion and a lot of knowledge.

MR. ROSS: I was Social Security commissioner and the only one who actually reformed the disability program, maybe the only one who ever will, and that is a bridge to the comment I want to make. I did a paper a few years ago looking at all these incentives in the law for early retirement like age 62. They were all one-off amendments from somebody on Ways and Means or Senate Finance to sort of deliver a bobble, a benefit. There was never a single policy discussion. You add them all up as I did in this article, you do have a system that's tilted towards early retirement, and if we could get to neutral, that would be pretty good, much less get to a system that encourages more work in later retirement. Take a lot of legislative engineering to do that, which brings me to my agreeing with John Shoven.

I think the big problem is can you adapt the institutions anymore? We have not seen a major reform of the tax system or the Social Security system in a long time and ideology seems to be replacing policy analysis and evidence that leads you one way or another. I happen to agree with John. I think the real big issue going forward is whether the political system will allow us to adapt the institutions that we have, whether we'll get a tax system and a Social Security system that all of would say, well, that's more suitable than what we have now.

What's your judgment, John, since you've identified this as up there with extreme weather and climate change as to whether we're going to get that turn?

MR. SHOVEN: Well, I mean, I think we haven't really gotten started in the sense that before you're going to have major reform, you have to have a major understanding of the problem. Kind of like how long did it take to lead up to the '86 tax reform? Ten or 15 years.

MR. BURTLESS: At least.

MR. SHOVEN: And so, I think if people understood that there is some commonality between the bankruptcies of several cities in California and the problems of southern Europe. I think these ridiculous, my word, retirement ages are a common element, and once we kind of realize that retiring at 55 if you're going to live to 90 is just nuts, then we might begin to change it. But I actually, probably, over-interpret what I've seen play out the last five years. Oh, by the way, interest to me, this is real completely speculative -- isn't it interesting though that sort of world economy kind of fell apart in 2008, exactly 62 years after the baby boom started? All these retirements -- we were doing fine when nobody was retiring. And then, oh, my God, everything fell apart. Now, I know that's over-interpretation, but I think these pension systems and retirement system and retiree health and everything else, I have problems dealing with these new demographic facts.

MR. BURTLESS: I'd like to pick up on the issue of neutrality, which various people -- Steve is foursquare for neutrality, and also go back to what exactly does neutrality mean? And the reason I pose the question is the first of the major studies, international comparative studies, that with which David Wise was associated in collaboration with Jon Gruber was an international comparison of -- a core element of which was calculating something called retirement force in the retirement systems, and I may be over-simplifying. I may not have this exactly right, but fundamentally it was if you work, does the retirement system tend to raise or lower the net wage that you receive for an additional year of work? You pay taxes, but you acquire some additional benefit rights, so those offset.

What was the measurement in various countries? Well, in a number of European countries, the implicit tax rate was enormous. You worked, you got a wage, but your net wage when you did all these calculations was a small fraction of your stated wage. In the United States it was almost exactly spot on. The retirement system was very, very close to neutral, so if you're the neoclassical economist who believes that people perceive exactly the incentives to which they're exposed and reacts to them, we have neutrality. Now, I don't know what's happened in the years since they did their study, but I don't think anything material. If anything, it's tilted, perhaps, a bit more toward favoring continued work because the retirement side of things has gotten better because of increased longevity, so the accumulation is greater.

So, if you say the system isn't neutral in the United States, you have to be invoking things other than the neoclassical indicators of how the system affects people's behavior. You have to be invoking liquidity constraints. People really want to quit work but they can't because they don't have physical access to cash until they get to be age 62, and then you see the spike to which attention was called in the morning session.

MR. SHOVEN: By the way, let me just let me add one thing, though. Traditional DB plans, which still exist in state and local workers --

MR. BURTLESS: Very strong incentives.

MR. SHOVEN: If you work beyond the normal -- what they call the normal retirement age --

MR. BURTLESS: Absolutely.

MR. SHOVEN: -- you really lose --

MR. BURTLESS: And that's been a big change in the United States. They've diminished in coverage and importance, and they will diminish, in all likelihood, further. And I think most of us regard the, maybe not the loss of defined benefit, but the loss of the incentive to retire as a step forward.

MR. SHOVEN: Right. Right.

MR. BURTLESS: So, I just think it's very important to be clear on what we mean by non-neutrality. Non-neutrality, I think, is sort of qualitative access, a characterization of what normal behavior ought to be, but it isn't the inherent economic incentives in the retirement programs. So, a lot of what's being talked about I do think goes back to the observation that maybe we could find a way of making early retirement just uncool, un-chic.

There are other things along the lines, I think, that Rich has emphasized in the reforms in the structure of disability insurance that could go a long way toward helping people who really could come back to work if given the right services at the right time, if employers were motivated in the right way to help them do that. There are really big opportunities for gain, but that isn't in the sense that we're using the term here neutrality or non-neutrality, it's behaving sensibly in the face of real problems. Gary.

MR. BURTLESS: Well, I would go further, Hank, and I would say that the story of Social Security from the birth that Rich described when there was one retirement age, 65. If you deferred retirement after that, there was no adjustment in your benefit. If you earned any income, any wages, at 65 you were prohibited from collecting a pension. Okay, so putting us on the scale that David Wise and John Gruber described, we were in an extreme tail back then, and the fact that by the time they did their book, we were on the extreme other tail of having a relatively neutral public pension system except, as you say, the suggestion, well, age 62 is the early-claiming age, why not stop working right now? Why not claim a pension right now? But from the point of view of neo-classical economists looking at that, it's neutral.

MR. AARON: Okay. Well, then that's good.

MR. BURTLESS: If anything, as John points out, actually will get you such a big payoff from deferral that maybe we're even more generous, but it is neutral, I think, financially --

MR. AARON: You don't think so, Gene.

MR. STEUERLE: Medicare, that's not true.

MR. AARON: Well, that's because you want to take in Medicare. I was going to get to Medicare in one second. Medicare makes it un-neutral for a perverse reason. It is the root to an affordable group insurance rate to buy health insurance, and it actually keeps you in employment. It's the reverse, right? People have an incentive to stay employed until 65 when they finally have access to an affordable group health plan called Medicare.

SPEAKER: That will less true in 2014.

MR. AARON: Okay.

MR. BURTLESS: We hope.

SPEAKER: I have a question. You guys are talking about one -- Henry, you, and Gary were talking about one type of neutrality, which is, roughly speaking, if you delay from 62 to 70, the Social Security benefit is roughly neutral. John's neutralities were between whether you pay this additional $5,000 Medicare tax for working versus non-working. And he was also talking about the fact that Social Security, for instance, only count -- you pay the extra tax or you only count 35 years. There's a lot of other non-neutralities in the system. You're right, in that the one you two are referring about is roughly neutral. The decision between whether my benefit goes up or down, whether I work another year, but there are a lot -- there's also non-neutrality between the singles and the married. There's the non-neutrality on the Medicare. The non-neutrality on the number of years that the Social Security counts (inaudible) --

MR. BURTLESS: Somebody wrote a book on that.

SPEAKER: Yeah, so that's what I meant. There a lot of non-neutralities.

MR. BURTLESS: I want to say that coming to this point at the conference with the concluding comment that if not more research is needed, certainly more reading is needed, is altogether appropriate. I want to thank you all for hanging in there and staying with us this long. (Applause) And I think this subject is not going to go away.

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