In this brief, we examine how gradual increases in the retirement age to account for longer life spans would affect Social Security's trust fund balances. Social Security actuarial reports indicate that indexing the program for future gains in longevity would significantly improve Social Security trust fund balances in the long term while having little or no effect in the near term and only moderate effect in the medium term. Baby Boomers are rapidly retiring, and the gains from slowing or eliminating currently scheduled expansions to Social Security in years of retirement support would compound gradually over time. Most proposals to index Social Security's full retirement age (FRA) would kick in only after the modest increase in the FRA, enacted in 1983, ends in 2022.

Why is this issue still so relevant? Social Security, now approaching its centennial, has always had a long-term perspective. When first enacted in 1935, Social Security waited a few years to pay benefits, and at the time it provided only limited payments to a population that excluded many workers, but it was scheduled to mature over time. Although Social Security actuaries have long projected that trust funds are inadequate to deal with the demographic shifts now weighing down the system, most or all of Social Security’s shortfalls would have been eliminated at today’s tax rates if Congress from the beginning had simply adjusted retirement ages for longer life spans. Alternatively, those benefit expansions from ever more years of retirement could have been spent on other important objectives, such as keeping a larger share of older adults out of near-poverty.

Thus, although proposals such as indexing for longevity only modestly correct Social Security imbalances in the near term, they have important implications for Social Security’s long-term balances. They can also raise employment, national output, and the share of retirement benefits that go to older individuals (for example, those in the last 15 years of life expectancy, who are more likely to have health problems), instead of to younger, healthier beneficiaries.
In this brief, we compare the impact on Social Security finances of two ways of indexing retirement ages, using data generated by the Social Security actuaries (box 1). Measuring at the 75th year of enactment, the first proposal would keep the average number of retirement years roughly constant; the second would hold the share of adult life spent in retirement roughly constant. Both options would significantly improve trust fund balances, but the first option would have a larger effect because it would no longer grant future retirees more years of benefits than current retirees.

**BOX 1**

**Two Proposals**

**Hold the number of retirement years constant:** After the FRA reaches 67 for those age 62 in 2022, this proposal would increase the FRA two months per year until it reaches 69 for people turning 62 in 2034. Thereafter, it would increase the FRA at the same rate as expected increases in life expectancy (assumed by the actuaries to be one month every two years). After 75 years, this proposal yields approximately the same average number of retirement years as new retirees experience today, though it slightly accelerates the process in the first 12 years.

**Hold the ratio of retirement years to work years constant:** After the FRA reaches 67 for those age 62 in 2022, this proposal would index the FRA to maintain a constant ratio of expected retirement years (life expectancy at FRA) to potential work years (FRA minus 20).

**Effects of Indexing for Longevity on Income, Costs, and Trust Fund Balances**

Figures 1 and 2 show Social Security Administration projections of the trust fund balances for Old Age, Survivor, and Disability Insurance (OASDI) relative to taxable payroll (which is total annual cash earnings of all covered workers below the taxable cap, equal to $128,400 in 2018) for the two proposals. The trust fund annual balance equals the difference between the annual income rate and annual cost rate. The income rate is the ratio of all noninterest OASDI revenue to the OASDI taxable payroll for the year. (Once the trust funds are exhausted, interest income disappears.) The cost rate is the ratio of program outlays to the taxable payroll for the year. Income rates under both current law and the indexing options proposed here are projected to remain approximately constant over time, even though the income taxation of Social Security benefits adds modestly to the main source of revenues: a constant Social Security tax rate applying to taxable payroll. Costs relative to income under current law grow substantially as Baby Boomers move toward full retirement and the worker-to-retiree ratio falls to about 2:1 by the mid-2030s, a level currently projected to remain roughly stable thereafter.

This discrepancy between income and cost is reflected in a steadily decreasing annual OASDI fund balance, represented by the yellow lines in figures 1 and 2. The blue line in each figure shows the fund’s balance under the proposed law, and the growing gap between the yellow and blue lines shows how
much the future balance (relative to taxable payroll) can be improved simply by slowing down or removing the growth in benefits from ever more years of benefits.

Although these proposals would slow or stop the growth in benefits from more years of benefits, annual and lifetime benefits still increase because annual benefits are wage indexed, raising benefits to future retirees as workers’ earnings grow.

FIGURE 1
Annual Balance of the OASDI Trust Fund with Indexing for Constant Number of Retirement Years and under Current Law

Source: Board of Trustees, 2018.
Notes: OASDI = the Old-Age, Survivors and Disability Insurance program. The annual balance is calculated as the income rate minus the cost rate. The income rate is the ratio of all noninterest revenue to the OASDI taxable payroll for the year. The cost rate is the ratio of program outlays to the taxable payroll for the year.
After 75 years, indexing Social Security for longevity would reduce the annual deficit between benefits and taxes quite significantly, from about one-third to one-half depending upon the proposal. Those compounding effects would continue further into the future because much of the projected growth in Social Security costs relative to taxpayer payroll in the later years comes from continual increases in years of retirement support. That is, the fraction of imbalance reduced or avoided by either proposal alone increases even more after that 75th year. At the same time, any change in the indexing factor would have only a modest short-term effect on the trust fund balance even if the FRA rises. These proposals would not go into effect until after 2022.

Actuarial balances are often calculated for the entire 75-year period going forward, excluding from the calculation imbalances expected for years after the 75th. For these two proposals, the gains in 75-year actuarial balances range between about one-fifth to two-fifths.
Other Considerations

Trust fund balances reflect only one consequence of indexing retirement ages for longevity.

First, many gains from additional work accrue outside of Social Security. The largest gains from additional work years come in the form of higher personal income to individuals and higher income and other tax revenues to government that are not calculated by the Social Security Administration or shown in our charts (Butrica, Smith, and Steuerle 2006).

Second, although we rely upon Social Security Administration estimates here, the program’s actuaries have consistently underestimated the growth in older adults’ labor force participation (Steuerle and Quakenbush 2012). Consequently, their estimates here may also understate how much indexing retirement ages might expand the potential labor force, raise revenues, and further improve trust fund balances.

Third, these estimates do not account for how other possible reforms might be designed to promote work. They show only one possible piece of a larger puzzle of how work incentives might be applied to broader Social Security reform. Here again, more work would raise revenues that could finance larger lifetime benefits for any tax rate decided in some future Social Security reform. Such proposals include increasing the early entitlement age; allocating a larger share of total lifetime benefits to older ages when needs are greater and a smaller share to years when most people are in good or excellent health; and changing the benefit formula to credit more than 35 work years without reducing its progressivity.

Fourth, Congress could automatically adjust the index based on actual changes in mortality rates rather than rely solely on what eventually will turn out to be decades-old estimates. That type of automatic amendment would reduce potential forecasting errors because, on the one hand, medical advances could continue to raise longevity; on the other hand, a recent decline in longevity, partly caused by higher levels of obesity and opioid use, have raised new questions about future mortality trends (Goss and Glenn 2017; Kochanek et al. 2017).

In a future brief, we will address the distributional impact of retirement age changes. Factors to be examined include higher mortality rates among lower earning recipients who survive to old age and the extent to which indexing may have no impact on many lower-earning recipients who die or receive disability benefits before old age.

Of course, even longevity indexing can be modified to a pace faster or slower than discussed here.

Conclusion

Indexing Social Security’s retirement age for increases in life expectancy can significantly reduce the program’s long-term deficits. Holding average retirement years constant would have a larger impact than holding the relative number of years constant. Whatever the size of lifetime benefits in the future, reformers need to decide whether the costs and revenue losses from providing ever-more years of
retirement support represent the best way to allocate scarce retirement resources. This is an important issue for the long-term direction of Social Security even if it only modestly affects trust fund balances in the near term. Although not examined here, the same type of short-run versus long-run distinction needs to be made for almost all Social Security reforms that only gradually phase in over time as Baby Boomers retire and the worker-to-retiree ratio, as has been long predicted, quickly drops to a much lower level.

Notes

1 Certain jobs, such as some state and local government employment, are not covered by Social Security.

2 Most OASDI revenue comes from payroll taxes, but the system also collects revenue from the income taxation of Social Security benefits.

References


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Acknowledgments

This brief was funded by the Alfred P. Sloan Foundation. We are grateful to them and to all our funders, who make it possible for Urban to advance its mission.

The views expressed are those of the authors and should not be attributed to the Urban Institute, its trustees, or its funders. Funders do not determine research findings or the insights and recommendations of Urban experts. Further information on the Urban Institute’s funding principles is available at urban.org/fundingprinciples.