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Do stronger age discrimination laws make Social Security reforms more effective?☆

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ABSTRACT

Supply-side Social Security reforms intended to increase employment and delay benefit claiming among older individuals may be frustrated by age discrimination. We test for policy complementarities between these reforms and demand-side efforts to deter age discrimination, specifically studying whether stronger state-level age discrimination protections enhanced the impact of the 1983 Social Security reforms that increased the full retirement age (FRA) and reduced benefits. The evidence indicates that, for older individuals for whom early retirement benefits fell and the FRA increased, stronger state age discrimination protections were associated with delayed benefit claiming and increases in employment, with benefit claiming pushed from 65 to the new FRA, and increased employment after age 62 and age 65 that is then curtailed at the new FRA.

1. Introduction

In coming decades the share of the population aged 65 and over ("seniors") will rise sharply – from 17% of those aged 20 and over in 2000, to 28% in 2050 (projected) – and will approach equality with the share aged 45–64 by the middle of the century (Neumark, 2008). This aging of the population will pose fundamental public policy challenges. Most significantly, the very low employment rate of seniors implies slowing labor force growth relative to population, and a rising dependency ratio. This creates an imperative to increase the employment of older individuals, thereby lowering dependency ratios, raising tax revenues, and – as programs are currently structured – decreasing public expenditures on health insurance, retirement benefits, and income support.

Population aging and the need to increase employment of seniors are most strongly tied to the solvency of Social Security, leading to numerous reforms intended to increase the employment (or hours) of those who would otherwise retire, including: reforms that lowered benefits at the early retirement age of 62 and raised the full retirement age (FRA) at which full benefits are available from 65 to 67 beginning with the 1938 birth cohort that reached age 65 in 2003, with the FRA rising fairly quickly to 66 for the 1943–1954 birth cohorts (American Academy of Actuaries, 2002; Munnell et al., 2004); and changes in taxation of benefits including reductions in the marginal tax rate on earnings of Social Security recipients in excess of the earnings cap, increases in the exempt amount of earnings (the cap), and broadening of the ages not subject to the earnings test (Friedberg, 2000). Additional changes are likely to be considered as part of efforts to shore up the solvency of Social Security or to reform the system.

Efforts to delay Social Security claiming and retirement of older workers, however, may be frustrated by age discrimination. In particular, if age discrimination deters the employment of older workers, especially beyond what has until recently been the "normal" retirement age of 65, then supply-side incentives – via changes to Social Security as well as other policies – may be rendered less effective or ineffective. Research shows that the federal Age Discrimination in Employment Act (ADEA) and state age discrimination laws have increased employment of protected workers (Neumark and Stock, 1999; Adams, 2004). This motivates the key question this paper addresses — whether there are policy complementarities between supply-side efforts to increase labor supply and demand-side efforts to deter age discrimination. Specifically, we study whether stronger age discrimination protections at the *state* level enhanced the impact – in terms of delaying claiming Social Security benefits and encouraging continued employment – of the 1983 Social Security reforms that took effect in the last decade, increasing the FRA and reducing benefits when they are claimed before the FRA. State-level variation in age discrimination laws allows us to compare responses to these reforms in states with different age discrimination protections.

It might be natural to expect this kind of positive complementarity, but the reality is more complex. There is evidence suggesting that age discrimination remains pervasive, especially with regard to hiring older workers (e.g., Adams, 2002, 2004; Bendick et al., 1996, 1999;

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Hirsch et al., 2000; Hutchens, 1988; Johnson and Neumark, 1997; Kite et al., 2005; Lahey, 2008a).[1] Because in hiring cases it is difficult to identify a class of affected workers, and economic damages are smaller than in termination cases, age discrimination laws may not be effective in combating discrimination in hiring. And if age discrimination laws mainly raise the costs of terminating older workers, they could end up deterring hiring (Bloch, 1994; Lahey, 2008b; Posner, 1995).[2]

In this scenario, given that a good share of increased employment among seniors might be expected to come from new employment in part-time or shorter-term "partial retirement" or "bridge jobs," rather than from continued employment of workers in their long-term career jobs (e.g., Cahill et al., 2006; Johnson et al., 2009), age discrimination laws might not enhance the effects of the Social Security reforms.

2. The potential effects of the 1983 Social Security reforms on benefit claiming and employment

The basic empirical strategy is to ask whether the Social Security reforms that lowered benefits at the early retirement age of 62 and raised the full retirement age (FRA) at which full benefits are available had stronger effects on claiming or employment where state age discrimination laws provide greater protections to older workers. The strategy therefore rests on the effects of the Social Security reforms on claiming and employment.

The original Social Security Act of 1935 set the FRA – the minimum age for receiving full Social Security retirement benefits – to be 65, but the 1983 Social Security reforms implemented increases in the FRA starting with people born in 1938 or later (Svahn and Ross, 1983). Beginning with this cohort, the benefits available at the early retirement age of 62 were reduced, and the FRA – when full benefits were payable – was slated to gradually increase by two months per birth year until it reaches 67. The sample period we study covers most of the first round of phased increases in the FRA to 66.

The implications for benefits of this first round of changes are shown in Table 1, beginning with the cohort born in 1931 (the oldest in our sample) and ending with the 1943 cohort (the youngest in our sample). Column (2) shows the FRA for each cohort, and column (3) converts this into months after age 62. Column (4) shows the reduction in benefits when they are claimed before the FRA. Through the 1937 birth cohort, the reduction is 0.556% of the Primary Insurance Amount (PIA) for each month, implying a 20 percent reduction for claiming at age 62 versus the FRA. For subsequent cohorts, there is a reduction of 0.556% of the PIA for each month prior to the FRA up to 36 months, and then an additional reduction of 0.417% per month for each month earlier than the FRA minus 36 months. Thus, for example, for the 1938 birth cohort the reduction for claiming at age 62 is 20.83%, climbing to 25% for the 1943 birth cohort. Note that this implies a slight convex kink in the budget constraint at 36 months prior to the FRA for the affected cohorts. Column (5) then shows the increase in benefits for claiming benefits after the FRA (the delayed retirement credit, or DRC). This increases over the cohorts considered. Through the 1938 cohort the DRC creates a concave kink at the FRA (very slight by the time we get to the later cohorts); beginning with the 1939 cohort the kink at the FRA becomes convex.

These changes in Social Security benefit computations and the FRA can influence decisions about when to claim benefits and when to stop working.[3] The most clear-cut effect of the changes in Social Security benefits from the point of view of the standard theory of labor supply is the reduction in the expected discounted value of Social Security benefits, which should exert a negative income effect, assuming that leisure is a normal good. This will lead to later retirement, and presumably also later claiming. Given the widely-documented spike in benefit claiming and labor force exit at age 62 – usually attributed to liquidity constraints – the impact of the cut in benefits might be most apparent for those aged 62.

In contrast, the changes in the FRA and in the benefit computation around the FRA do not create any economic reason for sharp changes in behavior around the FRA, based on standard labor supply considerations. As Table 1 shows, roughly coincident with the increase in the FRA, the concave kink at the FRA was eliminated, which could reduce clustering of claiming and retirement at age 65. But there is no simple economic reason for those delaying claiming or retirement to cluster at the new FRA. Then again, as many researchers have pointed out – perhaps most recently, Behaghel and Blau (2012) – it has always been difficult to explain the spike in claiming and retirement at age 65 other than through appealing to the FRA as a norm that many people follow, for behavioral economics reasons such as a social norm or a reference point for agents with loss aversion and reference dependence.[4] Behaghel and Blau also develop a stylized labor supply model that can be interpreted as a model of lifetime labor supply that shows explicitly that reference dependence and loss aversion with a norm of retirement at the FRA generates a spike at the FRA, and predicts that an increase in the FRA will raise the average age of retirement.[5] Indeed, because there are some economic reasons why cohorts unaffected by the increase in the FRA may have clustered at age 65 – including the kink in the budget constraint, defined benefit pension rules, and Medicare – but no reason to expect affected cohorts to cluster at the new FRA, Behaghel and Blau's study tests for such clustering as demonstrating that behavioral factors are an important reason why people claim and retire at the FRA.[6] Their key empirical result is that for cohorts affected by the increase in the FRA, the spike in claiming (and the smaller spike in employment) shifted from age 65 to the new FRA; the claiming results are echoed in Song and Manchester (2007).

Based on theoretical considerations – including behavioral ones – and these results for cohorts affected by the Social Security reforms, in exploring how stronger state age discrimination protections influenced responses to the Social Security reforms, we focus on how these protections influenced changes in claiming and employment behavior at or near age 62, age 65 and the FRA. Given that the empirical strategy rests on the effects of increases in the FRA on Social Security benefit

[1] The evidence is not cut and dried, however. See Neumark (2008) for a thorough review.

[2] This argument about discrimination laws deterring hiring has been made generally with respect to anti-discrimination laws, and it has perhaps appeared natural to assume that it applies to older workers as well (e.g., Lahey, 2008b). The argument may, however, have less force for older workers. Even if age discrimination laws increase termination costs, such costs may not weigh heavily in employers' decisions because many older workers may not plan on remaining at the employer for very long.

[3] This discussion closely follows Behaghel and Blau (2012). They also depict graphically some of the same budget constraint features documented in Table 1.

[4] Indeed Behaghel and Blau (2012) discuss ways in which the Social Security Administration's framing of the FRA as well as the advice other groups (like AARP) provide can reinforce the FRA as the norm. As an example, even after the FRA increased above age 65 the FRA was described this way in personalized Social Security statements; for the 1939 birth cohort, for example, the statements say "The earliest age at which you can receive an unreduced retirement benefit is 65 and 4 months" (quoted in Behaghel and Blau, footnote 10).

[5] In contrast to the predicted changes in behavior from liquidity constraints and norm or reference effects, in a model with perfect foresight (so that the reforms are taken into account in choosing a utility-maximizing life-cycle profile of labor supply and retirement) and no liquidity constraints (so that all that matters is the present discounted value of Social Security benefits) – such as in Laitner and Silverman (2012) – there is no reason to expect spikes in retirement at age 62 or the FRA, or, consequently, changes in the behavior at age 62 or the old or new FRA in response to the reforms. Rather, there are just income effects and substitution effects from changes in the present value of benefits and the marginal taxation of earnings. (See the discussion of retirement at age 62 in. e.g., Kahn (1988), and the discussion of retirement at the FRA in Behaghel and Blau (2012).)

[6] There were changes in the earnings test in 2000, after which it only applied to those between age 62 and their FRA (Pingle, 2006). This can generate incentives to delay claiming benefits to the FRA for those who would be subject to the test (and view this as a tax, not realizing that benefits are increased later to make up for the tax). However, because this change affected some cohorts for which the FRA remained 65, it is possible to test separately for the effects of the elimination of the earnings test at the FRA and increases in the FRA, and Behaghel and Blau (2012, Table 1) show that the change in the earnings test does not account for the spikes in claiming and in exiting employment at the FRA.