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THE IMPACT OF LATE-CAREER HEALTH AND EMPLOYMENT SHOCKS ON SOCIAL SECURITY AND OTHER WEALTH

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This study examines how late-career health and employment shocks affect future Social Security benefits. These shocks are fairly common at older ages and often derail retirement savings plans. Health problems typically raise out-of-pocket medical spending and force many workers to retire early, leaving people with less money to save for retirement. Older workers displaced from their jobs often encounter problems finding work, leading to long unemployment spells. Because people typically accumulate much of their retirement savings in the decade or so before they stop working, adverse health and employment shocks in the 50s and 60s can substantially erode retirement preparedness.

Social Security may protect people from health and employment shocks at older ages. The system's disability insurance provides relatively generous retirement benefits to those whose health problems limited their work histories. Social Security also allows people with low lifetime earnings to collect benefits based on their current, divorced, or deceased spouse's work history. Additionally, various features of the benefit formula, such as provisions that base benefits on only the highest 35 years of earnings or replace relatively large shares of pre-retirement lifetime earnings for those with low income, favor beneficiaries with limited lifetime employment and earnings. As a result, pre-retirement health and employment shocks may have smaller effects on future Social Security benefits than on financial holdings.

Traditional employer-sponsored pension benefits, however, may be especially vulnerable to health and employment shocks in the years immediately before benefit take-up. Most traditional defined benefit plans tie benefits to service years and nominal earnings received near the end of the career. As a result, pension wealth tends to grow rapidly in the years just before people qualify for benefits. Many people lose substantial pension wealth if they are laid off from their jobs just before qualifying for benefits or are forced by health problems to retire early.

This study compares the change in Social Security wealth, traditional pension wealth, and other household wealth between 1992 and 2004 for workers ages 51 to 55 at study baseline who experience health and employment shocks and those who do not. Data come from the *Health and Retirement Study* (HRS), a longitudinal survey of older Americans. Health shocks are defined as the onset of health problems that limit the type or amount of work that study respondents can perform, and employment shocks refer to job layoffs. The analysis considers only shocks that occur between 1992 and the year study respondents turn 62, when people can begin collecting Social Security retirement benefits. Social Security

and pension wealth computations are based on Social Security administrative records and detailed characteristics of employer-provided pension plans. Simulations measure how well different features of Social Security, such as the progressive benefit formula and the availability of disability benefits and spouse and survivor benefits, protect workers who develop health problems.

Key findings include the following:

- One-quarter of workers age 51 to 55 in 1992 develop health-related work limitations before age 62 and just more than one-fifth are laid off from their jobs. The incidence of employment and (especially) health shocks declines with educational attainment. Nearly one-third of workers who did not complete high school develop health problems, almost twice the disability rate for college graduates.
- Job layoffs reduce Social Security wealth accumulation by about \$4,700, or 11.9 percent of the average increment between 1992 and 2004, after other factors are held constant.
- Health shocks *increase* Social Security wealth by about \$10,600 over the period, primarily because the system's disability insurance allows some workers with disabilities to collect benefits before age 62.
- If Social Security's disability insurance program did not exist, the onset of health-related work limitations would reduce the growth in Social Security wealth by about \$3,800, equal to 11.6 percent of the average growth over the period. If spouse and survivor benefits and the progressive benefit formula were also eliminated, and the benefit formula instead incorporated the top 40 years of earnings and replaced a constant 45 percent of average indexed earnings for all workers, the negative impact of health shocks would jump to about \$7,900, equal to 18.6 percent of the average wealth change.
- Only 24 percent of workers who develop disabilities between age 51 and 62 ever receive Social Security disability benefits. The onset of work disabilities among workers who do not receive disability benefits reduces Social Security wealth by about \$2,400 and annual Social Security benefits by about \$400.
- Layoffs reduce pension wealth in traditional employer-sponsored defined benefit plans by nearly \$30,000, or 37.1 percent of the average growth in pension wealth over the period. The onset of work disabilities reduces pension wealth by about \$17,800.

The current Social Security system appears to provide some important protections to people experiencing adverse health and employment shocks late in their careers. However, the system's growing financial pressures could soon tear the safety net. Disability benefit costs have been soaring recently, and current projections indicate that Social Security's disability insurance trust fund will be depleted by 2026. Population aging poses a fiscal challenge to the entire Social Security system, with the combined retirement and disability trust fund expected to be depleted by 2041, according to the latest projections. How policymakers address this fiscal challenge has crucial implications for people who experience late-career health and employment shocks. Efforts to control disability insurance costs by tightening eligibility or cutting benefits could erode protections for workers developing disabilities. Raising Social Security's early entitlement and normal retirement ages could significantly erode retirement security for people unable to remain at work into their mid 60s, especially those who do not qualify for disability benefits. Policymakers must carefully consider how reforms designed to improve Social Security's finances could unravel existing protections for disabled and laid-off workers.

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