Comments on:

"Impact of Social Security Reform on Labor Force Participation Rates of Pensioners and Non-Pensioners: Evidence from Chile"

by

Edwards and James

AEI Seminar
November 13, 2009

General Comment

- Received two versions: The latest version
  - Reaches the same (or similar) conclusions
  - But it is executed more carefully

- The paper is really well done…passes all the usual tests for an empirical study

Questions about Paper

1. Issues well motivated and discussed -- question(s) to be answered

2. Data set appropriate and prepared properly?
   - What does a cursory look at the data tell us?

3. Econometric tests appropriate? – (no-brainer—use Probit)
   - Results?

4. Estimates biased for some reason? Robustness checks?

5. Take-away message explained?

Conclusions of Study

- Under Chile's 1980 Social Security Reform
  - Elimination of pensioner payroll taxes (also for non-pensioners after age 65) provided an especially strong work incentive
  - Making early retirement constraints tighter induced/forced later pensioning
    - Pensioning subject to adequate accumulation in IA (or age 65/60 with MPG)
  - Increasing actuarial fairness induces people to remain in LF
    - Effect is weak – pension is actuarially fairer than before, but not fully fair

Applicable to the US?

- Chilean reform held out as a shining example by promoters of a US Social Security reform with personal accounts.
- But case for personal accounts promoted mainly on "higher rate of return" argument – well known that it doesn't work
- US system is different from the pre-1980 Chilean system which was fragmented and involved considerable tax evasion
  - But we also have features that encourage pensioning and discourage work at older ages
  - US also faced with declining contributions relative to benefits—not because of evasion but because of demographics and lower projected wage growth
- This study's lesson: Potential for reducing labor market distortions could be large for the US also—an important reason for reforming Social Security
  - Chile: Increased LFP, along with other structural and fin. markets reforms—probably increased asset returns and promoted the success of personal accounts

Reform endogeniety?

- Chile: If people, especially younger cohorts, knew before 1980
  - that the old system is failing
  - that they would have to work longer
  - that a reform is likely to happen soon (several attempts prior to 1980)

  The reform that finally emerged may have been suited to maximizing its supporters' benefits from a longer expected working life cycle (?)

- US: Incipient trend toward working longer
  - Old system approaching insolvency
  - Growing anticipation among workers that they must work longer

  → Would we also adopt a reform (perhaps with Chilean features) as a result?

  → and not work longer *because* of the reform

- Not sure if this possibility could be disentangled from the Chilean data--
  - Was Chilean pre-retirement LFP increasing at some ages even before 1980?

Comments on:

"Social Security and Marginal Returns to Work Near Retirement,"

by

Reznik, Weaver, Biggs

AEI Seminar
November 13, 2009

Motivation

- Correct observation
  - Most studies focus on average Social Security returns, but marginal returns matter for retirement decision—at end of career

- Examine how costly Social Security is at the margin during participants' final career years (and full careers)
  - Similar to Chile pre-reform—increased contributions provide less than commensurate increases in benefits

- Mindful that Social Security marginal returns are a part of overall "work disincentives" under the full fiscal system—(which could be even larger at some income levels)

Lifetime IRRs w/ Shared Payroll Taxes and Benefits

- Three major ways of allocating benefits and taxes within families
  1. Taxes by payer and benefits by direct recipient
  2. Taxes and benefits to person whose earning generates them
  3. Taxes and benefits shared equally between spouses (children? survivors?)

- Authors prefer #3 (computational convenience?)
  - I would recommend #1
  - That's what "the system" (including qualifying on the basis of someone else's earnings record) provides to each participant in terms of benefits

- Decisions about sharing benefits within the family (equally or otherwise) is a personal decision over which Social Security has no control

- Evidence suggests sizable correlation in the distributions of income and consumption within families – Lazear and Michael (1986), Woolley (2000), Cutler and Katz (1992), Thomas (1990), Bourguignon et al (1993).
  - *"income is not evenly distributed within the family and theoretical models and policy decisions should not continue to be based on the assumption that it is."*
  - *Income is not pooled: Allocation to mothers vs. fathers determines how it is spent.*

Validation?

- The paper does not adequately defend its estimates
  - Necessary because it's a simulation and not a direct econometric analysis of administrative or survey data

- At a minimum, mention independent studies that show similar findings

  - Leimer (1994): 1945 birth cohort (65 in 2010) have IRR of 2.2%
  - Leimer (2007): updates estimate to 2.71%
    - But Leimer distributes secondary benefits by recipients (not shared)

- This paper: average (shared) IRR=2.6 percent (Table 1) –
  - Different enough from Leimer to warrant validation exercise?

Perhaps…?

- Relative to benefit allocation by recipient (as in Leimer), shared allocation would
  - Reduce low earners' (dependents/survivors) IRRs--by a lot
  - Increase high-earners IRRs -- by a little

- On net, population average IRRs would be reduced
  - →2.6 is reasonable

Metrics

- Choice of Measure: I prefer calculating average and marginal net tax rates: (PVT-PVB)/PVE
  - Public economics
    - theorems about how welfare costs are related to marginal tax rate changes
    - theorems about minimizing aggregate welfare loss via tax smoothing within and across generations
  - Combined with evaluating the rest of the fiscal system
    - Could judge potential for tax rate smoothing via Social Security (NBER WP 9096) under the net tax rate metric

Marginal IRRs

- Hugely negative values – especially for men – on marginal IRRs -- not surprising--follow directly from the benefit formula
  - Benefits are based on AIME – an average over highest 35 career earnings
  - Would get same result over first 9 years of career – before "fully insured" status – and age < 22
  - Marginal returns highest in 10th year of work in SS covered occupation—less than 3% benchmark soon thereafter
- Critique: Social Security is a *lifetime* program—unfair to calculate Marginal IIR annually—Incremental IRRs are more appropriate
- But it remains true that LFP pensioning/retirement decisions at career-end are influenced by marginal cost-benefit considerations

Results--Incremental IRRs

- More women have negative IIRRs compared to men—expected
  - Relatively lower earnings and more auxiliary benefits
- (Minor point?) Interaction of Social Security with income taxes on benefits?
  - Leimer ignores this also—but may be significant for marginal calc.
- Interaction with rest of the fiscal system?

Conclusion

- Both studies make important contributions
- They measure Social Security's contribution to marginal work disincentives during late career stages
- Suggest potentially sizable postponement of pensioning and increases in LFP from appropriate Social Security reforms