

December 16, 2008

Review of Manuscript, "Social Security's Five OASI Inflation Indexing Problems"

I recommend publication of the paper under review. It makes a significant contribution toward our understanding of benefit computation under the Social Security program and analyzes various issues regarding indexation for inflation. The analysis is carefully done and correct.

The paper nicely documents five issues related to indexing for inflation that affect the current computation of the retirement benefit in the Social Security program. Consequently, individuals in the same birth cohort who have different earnings patterns over time or choose to claim benefits at different ages will receive different benefit amounts, and individuals in adjoining birth cohorts with similar earnings patterns may receive different benefit amounts due to patterns of inflation and wage growth. Analysts who want to understand implications of rampant inflation or deflation for Social Security financing as well as for benefit equity and adequacy need to be aware of the consequences of the indexing procedures. The author uses *AnyPIA*, the SSA program for personal computers that calculates benefit amounts, to investigate effects of various patterns of earnings and inflation. The five issues are clearly explained and illustrated.

The reader should note that the paper is strongly based on the view that earnings must be indexed to age 60. Historically, earnings had to be linked to prices and wages a couple of years in the past because of delays in obtaining accurate information on aggregate prices, average wages, and inflation. Hence, when the early retirement age of 62 was implemented, all earnings had to be indexed back to prices, wages, and inflation as of age 60. Lags in collecting relevant data still exist today. But there is no reason why people who claim benefits at later ages must remain tied to prices, wages, and inflation as of age 60. Footnote 15 discusses the possibility of indexing to the year in which a worker claims benefits, paying a provisional benefit amount for a year or two, and recomputing the benefit amount after the aggregate data become available. But if policymakers are interested in encouraging people to work longer and claim benefits later, they might consider indexing wages to prices and inflation as of two years prior to claiming. Thus, a person who claims benefits at age 66 would see his or her high 35 years of earnings indexed to age 64. That person would enjoy four more years of wage indexing and a larger monthly benefit. Changing the benefit computation in such a way obviously would cost the system more, but other changes could be implemented to offset the increased expense.

The last full paragraph on page 23 contains an insightful discussion of factors that influence the growth of the average wage index (AWI). Demographic trends play a significant role, and it would be interesting to investigate the effect of the baby boom on recent growth in the AWI. If, as suspected, the AWI was boosted by baby boomers in their high-earning years over the last decade or so, we might expect a slowdown in the AWI as the boomers retire and are replaced by a smaller cohort of less experienced, younger workers.

