Old-Age and Survivors Insurance: A Report on the Retirement Test*

The Social Security Amendments of 1960 (Public Law 86-778) includes a change in the test of retirement under old-age and survivors insurance. In its report[1] on the Social Security Amendments of 1958 the Committee on Ways and Means of the House of Representatives had asked the Department of Health, Education, and Welfare to make a study of the retirement test. In particular, the Committee asked that a study be made of the provision that permits payment of some old-age and survivors insurance benefits in a year even though the beneficiary may have had very high earnings for 1 or more months of the year. In accordance with the Committee's request, the Department studied various proposed changes in the retirement test designed to meet the problem that concerned the Committee. In addition, because of the widespread interest in the retirement test and the criticism often made that it acts as a deterrent to a beneficiary's earning as much as he wants to, the study was expanded to consider the problem of incentives and various proposals for dealing with it. The results of the study were incorporated in reports submitted to the Committee in March 1960 and summarized in the following pages.

The new law provides for a test[1a] of the same general type as one of the proposals discussed in the Department's report. Effective in 1961, a beneficiary who earns more than $1,200 in a year will have $1 in benefits withheld for each $2 of earnings from $1,201 to $1,500 and for each $1 of earnings above $1,500. If a beneficiary earns $1,200 or less in a year, he will, as before, get all his benefits, and no benefits will be withheld for any month in which a beneficiary neither earns more than $100 in wages nor renders substantial services in self-employment.

THE BASIC PURPOSE of the old-age and survivors insurance provisions in the Social Security Act is to provide benefits for workers and their families when the worker's earnings have stopped or have been substantially reduced as a result of his retirement or death.[2] Since many workers neither retire nor suffer a significant reduction in earnings on reaching age 65, the program includes a "retirement test"—a provision intended to restrict the payment of benefits to those among the aged who can be presumed to have experienced a loss of earnings.

DESCRIPTION OF THE RETIREMENT TEST

Under the present retirement test a beneficiary gets all his benefits when his earnings in a year are $1,200 or less (referred to as the "exempt amount"). Anyone making $1,200 or less is, in effect, presumed to be retired.

Ordinarily, a beneficiary has a check withheld[3] for each $80, or part of $80, in excess of $1,200 in earnings. (This $80 figure is referred to as the "unit of excess earnings" or the "excess unit.") Accordingly, a beneficiary gets at least one benefit if his earnings are $2,080 a year or less.[4] In order to avoid a sharp line below which all benefits would be payable for a year and above which

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[1] House Report No. 2288, 85th Cong., 2d sess.

[1a] The BULLETIN for November will carry an article on the 1960 amendments that includes a legislative history. Details of congressional action on the retirement test will appear in that article.

[2] Under the disability insurance provisions, benefits are payable when a worker is disabled to such an extent that he is unable to engage in substantial gainful employment. Since disability insurance beneficiaries are unable to work, there is no retirement test under that part of the program.

[3] When the dependents of a retired worker are getting benefits based on his earnings, their benefits are withheld for any month for which his benefit is withheld.

[4] The figure $2,080 is the result of adding $880 ($80 multiplied by 11) to the $1,200 exempt amount. Thus at least 1 month's benefit is payable when earnings for a full year are $1,200 plus $880 ($80 for each of 11 months).

none would be payable, the law provides for varying the number of benefit payments that can be made in a year with the amount of earnings between $1,200 and $2,080. If the test were not graduated, it would not be uncommon to have the payment of $2,000 or more in benefits depend on a few dollars of earnings.

The law also provides that, no matter what his annual earnings, a beneficiary gets a benefit for any month in which he neither earns wages of more than $100 nor renders substantial services in self-employment. This provision is referred to as the "monthly measure of retirement."

The retirement test does not affect beneficiaries aged 72 or over; after that age, benefits are payable regardless of earnings. The test applies to the earnings of beneficiaries in covered and noncovered work in the United States and covered work outside the United States; a special provision applies when beneficiaries are engaged in noncovered work outside the United States.

PROBLEM RAISED BY THE COMMITTEE

In seeking a solution to the problem raised by the Committee on Ways and Means—the situation in which a person may have very high earnings in a single month and yet get benefits for the remaining 11 months of the year—the Department considered first whether the monthly measure of retirement should be eliminated.

The monthly measure of retirement makes it possible to pay benefits to a retired worker beginning with the first month of his retirement. This is one of its major functions. If there were no monthly measure, a person retiring from full-time work at the end of June, for example, after earning more than $2,080 in the first 6 months of the year, could not get benefits until the following January. Moreover, since people move in and out of employment after reaching retirement age, this "dry period" would not be confined to the year of initial retirement for each beneficiary.

It does not seem reasonable to require that a beneficiary go through the first several months of retirement, and perhaps through several months after the termination of subsequent employment, without getting benefits. Ever since the program started paying monthly benefits, the retirement test has been so framed that a person could get a benefit for any month in which he did not work, regardless of how much he worked or earned in any other month.

Removal of the monthly measure would eliminate the payment of benefits to the beneficiary who earns large amounts of money in a year through only a few days' work. But the straight annual earnings test that would result from eliminating the monthly measure would make it impossible to pay benefits promptly upon retirement and would, of course, be a harsh deliberalization for many beneficiaries.

Other proposals were considered in studying the problem raised by the Committee. One, for example, would provide that a worker who earned $10,000 in a year would get no benefits no matter how little he worked. None was recommended because any one of them would add further complexity to an already complex test.

Because of the deliberalizations that would result and the complexities that would be added, the Department concluded that no action should be taken to remove the monthly measure of retirement or to put an additional earnings limitation on top of the present retirement test.

PROBLEM OF INCENTIVES

An important problem connected with the retirement test arises from the fact that, under the present provisions, a beneficiary's total income can be reduced if he works. The most telling criticism of the test that can be made is that it discourages older men and women from working as much as they can and would like to and therefore keeps them from contributing what they can to production and the economy and from bettering their own situations and leading more satisfying lives.

Many Beneficiaries Prefer To Work

It is easy to exaggerate this effect of the retirement test. Powerful incentives to work now exist for people aged 65 and over. Generally, earnings from work make possible a higher standard of living than most beneficiaries can manage to obtain for themselves in retirement, since earnings generally are much higher than benefits. There are also many intangible satisfactions in work—meaningful activity, social relationships connected with work, and the beneficiary's feeling that he still has a contribution to make to the economy. Actually, most beneficiaries who are not working either are not well enough to work or cannot find jobs.[5]

Nevertheless, many older persons—particularly those who are retired from their regular jobs and would like to find part-time or less demanding employment—would work more than they do if the retirement-test provisions did not operate to reduce the net addition to their income that would result from working.

How Much Work

Under present law it frequently happens that a beneficiary finds that he is better off financially if he has done a given amount of work than if he has done no work at all, but that he would be still better off if he could have restricted his work to a point where he had earned somewhat less than he did. Thus, because of the retirement test, many beneficiaries do limit their work so that they earn less than they could and would like to earn in order to avoid a loss in total income.

An example or two may help to clarify the effect that the test has on incentives to work. Take the case of a beneficiary getting $1,200 a year in benefits and faced with a choice between a job paying $1,800 a year and one paying $1,200. If he takes the $1,800 job he will be only $1,000 better off than if he does not do any work,[6] but if he takes the $1,200 job his increase in income for the year will be $1,200. Obviously, he would do better financially to take the $1,200 job, although he might make more of a contribution to the economy and feel better about his activities if he could afford to and did take the $1,800 job.

As another example, take the case of a beneficiary who has occasion to earn only slightly more than the $1,200 exempt amount and loses a full month's benefit as a result. Usually if he does earn just over $1,200 it is through inadvertence or because his employer has asked that he do extra work. Whether the beneficiary actually does do the extra work and loses a month's benefit, or refuses in order to get full benefits, the test is operating in an undesirable manner, since it either discourages him from work or penalizes him for working. This situation can occur not only at the $1,200 point but at every one of the breaking points from $1,200 to $2,080.[7]

It would be desirable to bring the provisions of the law that now discourage people from working as much as they can and want to work into harmony with the general system of incentives. In other words, it would be desirable to devise a retirement test that would permit a beneficiary to have increased income as a result of increased work.

One point must be kept in mind, however, in connection with any proposal that would eliminate or reduce the disincentive effect of the retirement test. Any such change that can be devised would result in the payment of some benefits to people earning relatively high amounts. Generally speaking, at present no benefits can be paid to anyone who works throughout the year and makes more than $2,080.

The fact must be faced that the retirement test is the center of an unsolvable dilemma. There is, on the one hand, the need to conserve program funds by not paying benefits to people who have substantial work income; on the other hand, there is the need to avoid interfering with incentives to work. Both objectives cannot be fully accomplished. The best that can be done is to accommodate the two so that, while the funds of the system are in large part directed to the most socially useful purposes, at the same time interference with incentives to work is kept at a reasonably low level.

The proposals to improve incentives most frequently made would (1) increase the exempt amount of earnings above the present $1,200 level, (2) increase the unit of excess earnings (now $80), or (3) provide for reducing benefits in proportion to the amount of the beneficiaries' earnings in excess of $1,200.

[5] In the 1957 survey of beneficiaries conducted by the Bureau of Old-Age and Survivors Insurance, about 70 percent of those not working said they were not able to work.

[6] The $600 of earnings in excess of $1,200 causes the withholding of eight benefits of $100 each—$800. Therefore, the worker has $1,800 in earnings and $400 in benefits, or a total of $2,200 for the year—$1,000 more than the $1,200 in benefits he could have gotten if he had not worked at all.

[7] By "breaking point" is meant the point at which the beneficiary loses an additional month's benefit as a result of the operation of the $80 unit of excess earnings; that is, if he earns more than $1,280 he loses 2 months' benefits, if he earns more than $1,360 he loses 3 months' benefits, and so on.

Each of these proposals would improve in some degree the incentives for beneficiaries to work. Some would be more effective than others.

Increasing the Exempt Amount

An increase in the $1,200 exempt amount would result in higher income for many beneficiaries. Those who are able to control their earnings and who now limit them to $1,200 a year would be encouraged to increase their earnings up to the new exempt amount. In addition, many beneficiaries who now earn more than the present exempt amount would be able to get more in benefits than they do under the present law.

There would, however, be no effective incentive for beneficiaries to earn more than the new exempt amount. Moreover, the proposal would not remove any of the problems or inequities of the present retirement test; it would merely change the point at which they occur. If the new amount were $1,800, a man who had a choice between a job paying $2,000 and a job paying $1,800 would generally do better financially to take the lower-paying job. Similarly, for the person who planned to earn exactly $1,800 and inadvertently went just over that amount, the problem would remain; he would lose more in benefits than he would receive in earnings above the exempt amount.

If the exempt amount were raised, an increase in one other element of the test—the monthly measure of retirement (now $100)—would be called for. It is important, for the sake of public understanding of the test, that this monthly measure be one-twelfth the exempt amount. Changes in the test to increase both the exempt amount and the monthly measure of retirement would increase the cost of the old-age and survivors insurance program substantially. If, for example, an $1,800 exempt amount and a $150 monthly measure of retirement were provided for, the cost of the program would be increased by 0.24 percent of payroll.

Increasing the Unit of Excess Earnings

Another way of reducing the effect of the retirement test as a deterrent to work at certain levels would be to increase the amount by which earnings in excess of the exempt amount are divided to determine the number of benefits that must be withheld because of earnings. A month's benefit is now withheld for every $80, or part of $80, in excess earnings. Anyone whose benefits amount to less than $80 has some incentive to work and earn more than $1,200, since in general he would lose less in benefits than the amount of his excess earnings.

If the unit of excess earnings used to determine the number of benefits to be withheld were increased, there would be a somewhat greater incentive to earn more than $1,200 for all beneficiaries whose benefit amounts were less than the amount of the new excess unit. For all other beneficiaries the loss in total income because they earned more than $1,200 would be less than it is under the present law. To eliminate reductions in income as a result of work for the great majority of beneficiaries, a substantial increase in the unit of excess earnings would be necessary. An increase to $125 would mean that 1 million retired-worker beneficiary families—15 percent of all such families—would stand to lose more in benefits than the unit of excess earnings that caused the loss. Actually an increase to $175 or $200 would be necessary to approach a solution to the problem.

An increase in the excess unit, moreover, does not completely solve the problem of benefit losses as a result of earnings, even for the beneficiary whose family benefit is smaller than the excess unit. Whenever a beneficiary makes just over the exempt amount (or just over that amount plus one or more excess units) and consequently loses a month's benefit as a result of having excess earnings amounting to a fractional part of the unit, he can lose in total income. Thus if a beneficiary made the "mistake" of earning $1,201 in a year, he would lose—no matter what the amount of the excess unit—a whole month's benefit for the extra dollar in earnings.

If the amount of the excess unit were to be raised, the long-range cost to the program would, of course, go up, with the amount of the cost increase depending on the size of the increase in the unit. Raising the unit to $175 would cost 0.15 percent of payroll; to $200, 0.19 percent.

Reducing Benefits in Proportion to Amount of Earnings

The Department also considered proposals that would relate the reduction in benefits to the amount of the beneficiary's annual earnings in excess of $1,800. One of these proposals would reduce benefits by the amount of excess earnings, dollar for dollar, instead of withholding the entire amount of a monthly benefit for each $80 of excess earnings. Obviously, under such a proposal the beneficiary would never have less in total income as a result of working (except for the expenses, such as taxes and carfare, that arise out of his work).

Provision for a dollar-for-dollar reduction really would do little to improve incentives for the aged to work. To tell a person that, though he would be no worse off (except for the expenses connected with work) as a result of working, he would be no better off either, does not constitute providing an incentive for him to work. All the proposal really does in this area is to reduce the disincentive that operates under present law. The proposal would cost 0.04 percent of payroll.

Under a proposal that would go farther in the direction of improving incentives for older people to work, $1 in benefits would be withheld for each $2 of earnings in excess of $1,200.[8] Obviously, such a provision would mean that the beneficiary who worked would always be better off financially as a result of working. There would no longer be any reason for beneficiaries to seek out jobs at $1,200 or less or to otherwise limit their work activity, so that the effect of such a change would be to support rather than interfere with the desire of older people to continue to work to the extent that they are able to do so.

The proposed change would furnish a significant incentive to work throughout the entire range of benefits and would avoid the anomalies that arise at the various breaking points in the present test. It would mean, however, that some benefits would be paid to people who were earning high amounts—substantially more than $5,000 a year in many cases. A man and wife getting the present maximum monthly benefits of $180, for example, would still get $100 in benefits for a year if the man's earnings amounted to $5,320. The cost of the proposal would be 0.11 percent of payroll.

The chief disadvantages—higher costs and relatively high earnings levels—would be less if the proposal were to be modified to provide that earnings of more than $2,400 a year would reduce benefits dollar for dollar. If, when earnings reached $2,400 a year, a dollar-for-dollar reduction rather than a 1-for-2 reduction were made, the man and wife getting the present maximum monthly benefit of $180 would get no benefits for the year at the point when the man's earnings reached $3,960.

With this modification the proposal would furnish an incentive to work at all ranges of benefits and for all earnings levels up to $2,400, and it would guarantee against loss as a result of earning more than that amount. Though it lacks the simplicity that makes the straight 1-for-2 proposal attractive, such a provision would nevertheless, like the 1-for-2 proposal, remove the incentive for the beneficiary to seek out jobs paying $1,200 or less and to restrict his work activity to keep within that amount. The cost would be 0.08 percent of payroll rather than 0.11 percent.

CONCLUSION

Analysis of the various proposals for changes in the test shows that all of the proposals for change have both advantages and disadvantages. Any of the proposals considered would involve significant additional cost to the system and would require additional financing.

[8] The 1960 amendments call for a $1 reduction in benefits for every $2 in earnings from $1,201 to $1,500, but a $1 reduction for each $1 of earnings above $1,500.