Effect on Benefits of Earnings at Ages 65 or Older, 1995

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A major policy issue for the Social Security program is the treatment of earnings of persons who have attained retirement age. This article discusses the retirement test and recomputation of benefit provisions, and provides statistical data for 1995.

In 1995, about 806,000 persons aged 65-70 had significant earnings resulting in the withholding of benefits by the retirement test. About 1,659,000 persons aged 65 or older realized an increase in their benefit amount because of their earnings.

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One of the most controversial issues for the Social Security program is the effect on benefits of earnings after the attainment of normal retirement age, currently age 65. The primary object of the controversy is the retirement earnings test, the provision by which benefits are withheld from otherwise eligible persons before their 70th birthday, when their annual earnings exceed the stated threshold; benefits are withheld from their auxiliaries as well. Also controversial, though less so, is the provision for recomputation of benefits, whereby the benefit level is not fixed by career earnings up to the year of attainment of age 65; rather, earnings afterwards are also considered in redetermining the benefit amount.

Dissatisfaction with the earnings test led to the enactment of P.L. 104-121 in March 1996. The new law increases the threshold slightly for each year through 2000, but raises it quite substantially for 2001, and again for 2002. The Office of the Chief Actuary estimated that the legislation would cost about $6 billion over the period 1996-2002. The average annual long-range cost of the legislation, in contrast, is quite small; as will be explained later, benefit amounts not paid because of the earnings test are generally paid out when the beneficiary is older.

This article focuses on the effects on benefit payments of earnings in 1995 in and after the year of attainment of age 65, since 1995 is the latest year for which data were substantially complete. The article describes beneficiaries aged 65-70 with benefits withheld in 1995 because of significant postentitlement earnings, and updates information on this subject that has periodically appeared in the *Bulletin*. In fact, certain comparisons will be made between this 1995 study and the most recently published study, for 1989. However, this article contains information not given in the series of previous studies. Those studies should be consulted for a discussion of the rationale for and history of the test, as well as for historical statistics.

For an analysis of the labor force impacts of the test, see, for example, "The Effects of the Social Security Earnings Test on the Labor-Market Activity of Older Americans: A Review of the Evidence," that appears in the May 1990 issue of the *Bulletin.*

The Earnings Test: Concept and Operation

In 1995, earnings during the year above a threshold of $11,280 for beneficiaries of calendar ages 65-70 (that is, 1995 minus year of birth, regardless of birth month) led to the withholding of Social Security benefits at the rate of $1 of benefits for every $3 of earnings. Thus, if an aged beneficiary's earnings during 1995 were greater than the sum of $11,280 and three times the total yearly benefit subject to the test, no benefits were payable unless other beneficiaries in the family were affected or 1995 was a "grace year" for the beneficiary. If earnings were less, each month's full benefit was withheld until the first month in which earnings were less than the sum of $11,280 and three times the accumulated monthly benefits, for which typically a partial benefit was paid.

This annual test applies to earnings in the United States even if they are earned in employment not "covered" by the program, as well as to covered earnings outside the United States. (Noncovered earnings outside the United States are subject to a monthly test, and are not discussed in this article.)

Certain special payments which are taxable for FICA purposes in the year of receipt are nonetheless excluded from the retirement earnings test in that year. Included are payments not truly for work, such as retirement pay and certain sick pay, and payments for work for years different from those in which the payments were received, such as deferred compensation. Earnings in and after the month of attainment of age 70 are also excluded from the test.

Before the recent legislation, increases in the threshold amount were indexed to the movement of average wages in the economy. Under P.L. 104-121, however, the threshold rose to $12,500 in 1996, $13,500 in 1997, $14,500 in 1998, and $15,500 in 1999. It is scheduled to rise to $17,000 in 2000. Then it will escalate to $25,000 in 2001 and to $30,000 in 2002. The magnitude of the increase can be appreciated by recognizing that $30,000 in 2002 corresponds (after indexing backwards with a series of annual average wages projected to 2002) to about $22,800 in 1995—about double the 1995 threshold.

There is also an earnings test for beneficiaries at calendar age 64 or younger, characterized by a lower threshold ($8,160 in 1995) and a higher withholding rate ($1 for $2). The earnings test at ages younger than 65 is, however, not as controversial, and, in fact, was ignored by recent legislation.

Above-threshold earnings of retired workers are also applied, at the same withholding rate, against the benefits of any of their auxiliary beneficiaries. Above-threshold earnings of auxiliaries or survivors themselves are applied only against their own benefits. (An exception to the earnings test, known as the facility-of-payment provision, is made in the case of certain working auxiliaries whose withheld benefits would otherwise be redirected to other family members, but this exception is rare among working auxiliaries aged 65 or older. The facility-of-payment provision was repealed effective January 1, 1996.) It should be noted that an auxiliary who works can lose benefits on account of both his earnings and the primary beneficiary's earnings, if the primary beneficiary also works.

In dual-entitlement situations, that is, when a person is entitled to both a worker benefit and a larger auxiliary or survivor benefit, the earnings test operates as follows: If the earner above the threshold is the one dually entitled, both benefits are affected. If the dually entitled person is the auxiliary of the earner above the threshold, only the person's auxiliary benefits are affected.

In the grace year, a monthly test applies in addition to the yearly one. Thus, regardless of the yearly amount, benefits are paid during the grace year for any nonservice month—that is, any month in which wage earnings are below 1/12th of the annual threshold ($940 in 1995) and no substantial self-employment is performed. A grace year is generally the first year in which an entitled beneficiary has a nonservice month.

For any month in which an individual between the ages of 65 and 70 does not receive any of the retired-worker benefit for which he is eligible, he earns a Delayed Retirement Credit (DRC). The DRC represents a percentage increase to the benefit the worker (or his widow) can receive, and is effective beginning in January of the following year. For workers attaining age 65 in the year 2008 or later, each DRC is 2/3rds of 1 percent. This level has been determined to be approximately "actuarially fair" in the sense that, with the time value of money and survivorship properly taken into account, the beneficiary can "expect" to receive about the same total benefits over his lifetime whether or not the earnings test affects him. This explains the earlier statement that while the liberalization of the earnings test comes at significant short-term expense to the Old-Age and Survivors Insurance Trust Fund, the long-range cost, which more fully incorporates the DRC effect, is quite modest.

This decade is a transitional period during which the amount of DRC for persons attaining age 65 is increasing towards its ultimate level. For persons aged 65-70 with benefits withheld under the earnings test in 1995, the DRC is worth per month either 7/24ths of 1 percent, 8/24ths of 1 percent, or 9/24ths of 1 percent, according to the year of attainment of age 65. Finally, it should be noted that there is no DRC-type provision for recouping *auxiliary* benefits lost because of either the auxiliary's or primary beneficiary's earnings.

In 1995, the earnings test was administered through obligatory beneficiary reports. That is, the beneficiary was required to estimate the amount of his 1995 earnings and subsequently to adjust the estimate to reflect actual experience if they exceeded the yearly threshold. Furthermore, the agency accesses the beneficiary's earnings record to determine additional benefit reduction commensurate with the amount by which the earnings record figure exceeds the self-reported figure. The self-reported amount is accepted, however, when it is the larger of the two because earnings counted for earnings test purposes need not be identical to earnings counted for FICA taxation purposes. (Very recent changes render this description no longer applicable. Self-reports are no longer required, and the earnings test is administered from the earnings record.)

Benefit Recomputation

A retired worker's base benefit amount, the amount payable if entitlement occurs in the month of attainment of age 65, known as the Primary Insurance Amount (PIA), is a function of his average annual earnings in the "N" years of highest earnings, known as the "computation years." Under the usual computation methods, N is 35 for persons born in or after 1930 and (35 - k) for persons born "k" years before 1930. For persons born after 1916, hence aged 78 or younger in 1995, annual earnings up through age 60 are first indexed upwards, making them comparable with more recent earnings, before averaging is done.

If a worker beneficiary has earnings in any postentitlement year that are larger than the smallest earnings (after indexing, if appropriate) in his/her computation years, the postentitlement year replaces the lowest-earnings year in the computation period, and the recomputed benefit is payable beginning with January of the following year. Thus, benefit recomputation and earnings test withholding become operative under unlike circumstances. Withholding due to the earnings test is precipitated by attainment of some absolute level of post-entitlement earnings, while benefit recomputation is triggered by the attainment of some relative level of postentitlement earnings, that is, in comparison to the lowest (indexed) yearly earnings in the computation period. The recomputation provision is of particular advantage to persons born before 1917 because a current earnings amount is compared to an unindexed amount earned perhaps long ago.

Proposals to restrict the recomputation of benefits, or to eliminate it entirely, are frequently put forth. Typically these proposals do not include a concomitant restriction or elimination of FICA taxation on postentitlement earnings, although certainly an argument can easily be made for a more symmetric treatment of such earnings. We estimate that the elimination of recomputations generated by postentitlement earnings in a given year in or after the year of attainment of age 65 would decrease benefits in the following years by about $300 million annually. Unlike the earnings retirement test provision, the recomputation provision has a significant long-range impact, as well.

Data Sources

Our description of the beneficiary populations with benefits withheld because of 1995 earnings due to the earnings test at calendar ages 65-70 or with PIA recomputation at calendar ages 65 or older is primarily based on a 1-in-100 sample of beneficiary and earnings records. Although past studies published in the *Bulletin* on beneficiaries with benefits withheld under the earnings test are based on data for the entire population of interest, the populations are large enough that 1-in-100 sample estimates are of acceptable precision. (See tables on pages 352 and 353 of the *Annual Statistical Supplement* to the *Social Security Bulletin, 1998,* that provide approximate standard errors for such estimates.) Furthermore, the sampling approach makes it feasible to manually review complex or questionable records.

Beneficiaries with 1995 benefits withheld due to the earnings retirement test were identified from certain codes (work indication code and reason for deduction) for months during 1995, in the benefit history section of their Master Beneficiary Record (MBR). Those receiving recomputations based on 1995 earnings were identified from a change in PIA effective for January 1996, in the PIA history section of their MBR. The first group was identified in September 1997 and the second in December 1997, both several months after the posting of 1995 earnings and the application to those earnings of the earnings test enforcement and automatic benefit recomputation operations were largely complete.

Certain information about persons aged 65-70 with earnings in 1995 above the exempted threshold amount that is not available from program records was obtained from the March 1996 Current Population Survey (CPS) Public Use file. The CPS is a monthly national household survey fielded by the Bureau of the Census with a supplementary inquiry each March into the work experience and income of the population in the preceding year.

Above-Threshold Earners Entitled to Benefits

In 1995, about 806,000 persons at calendar ages 65-70 had above-threshold earnings resulting in the withholding of benefits by the retirement earnings test. The group consisted of 743,000 retired-worker beneficiaries whose above-threshold earnings were applied against the entire family benefit, and 63,000 widow(er) and spouse beneficiaries whose above-threshold earnings were applied only against their own benefit (table 1).

The size of the group has not changed much since 1989—a finding not unexpected, given the wage-indexing of the exempted threshold amount. The comparable study published most recently in the *Bulletin* reported that 758,000 retired-worker beneficiaries and 77,000 widow and spouse beneficiaries at calendar ages 65-70 in 1989 had benefits withheld due to the retirement test in that year because of their earnings.

The numbers of families with benefits withheld from (1) the primary beneficiary only, (2) the primary and one other beneficiary, or (3) the primary and two or more other beneficiaries, due to above-threshold earnings in 1995 of primaries aged 65-70 were 596,000, 140,000, and 7,000, respectively. Altogether, the benefits of 154,000 spouses and children were withheld because of such earnings, and the total number of beneficiaries with benefits withheld in 1995 due to the above-threshold earnings of beneficiaries at calendar ages 65-70 was 960,000.

The 743,000 retired-worker beneficiaries with above-threshold earnings represent about 8.5 percent of all retired-worker beneficiaries at calendar ages 65-70 in 1995. The PIA distribution of the worker beneficiaries with above-threshold earnings suggest that they are more likely than other worker beneficiaries to have had high career average earnings. About 70 percent of worker beneficiaries with above-threshold earnings had PIAs greater than the median PIA for all worker beneficiaries in December 1995.

Table 1 shows the age and sex composition of the above-threshold earners. About two-fifths of above-threshold earners in 1995 were women. The age gradient reflects retirement behavior in this range of ages. Additionally, the number at calendar age 70 is particularly low because earnings in or after the month of the 70th birthday are excluded from the earnings test.

The total amount of benefits withheld because of the above-threshold earnings in 1995 of beneficiaries aged 65-70 was $4.3 billion, of which $4.1 billion was withheld because of the above-threshold earnings of primary beneficiaries. According to the earlier study published in the *Bulletin*, the total amount of benefits withheld in 1989 because of the above-threshold earnings of 758 ,000 primary beneficiaries aged 65-70 was also $4.1 billion.

The median amount withheld in 1995 was $3,596 (table 1), which corresponds to earnings of $10,788 above the threshold of $11,280, or earnings of $22,068. Since, as mentioned earlier, P.L. 104-121 provides for a threshold in the year 2002 that corresponds to a threshold of $22,800 in 1995, its effect is to ultimately reduce the number of above-threshold earners by more than half.

The median 1995 earnings of all beneficiaries aged 65-70 with above-threshold earnings in 1995 is about $25,800 (table 1). The median is about $31,600 for men, and about $20,900 for women.

About 29 percent of beneficiaries aged 65-70 with above-threshold earnings in 1995 received no benefits that year. The others either had above-threshold earnings less than three times the annual benefits to which they (and their auxiliaries) were entitled, attained age 70 in 1995 (in which cases their benefits were not subject to the test beginning with the month of attainment), or were in a grace year.

Table 1.—Above-threshold earners aged 65-70 in 1995 entitled to OASI benefits, by sex

[Numbers in thousands]

Item	Male	Female	Both sexes
Total	490	316	806
Type of entitlement:			
Primary	488	254	743
No dependent	344	252	596
1 dependent	137	2	140
2 or more dependents	7	0	7
Secondary	2	62	63
Benefit withholding:			
Full	164	66	230
Partial	326	249	575
Calendar age:			
65	144	95	239
66	102	68	170
67	83	55	138
68	72	43	115
69	61	40	101
70	28	15	43
Amount withheld:			
5th percentile	$258	$173	$227
25th percentile	1,799	1,005	1,366
50th percentile	4,653	2,534	3,596
75th percentile	10,333	5,191	7,758
95th percentile	16,611	11,138	15,941
Earnings:			
5th percentile	12,228	11,844	12,006
25th percentile	18,597	15,112	16,686
50th percentile	31,546	20,892	25,782
75th percentile	56,698	30,418	44,950
95th percentile	119,500	55,200	93,778

Other Above-Threshold Earners

A complete analysis of the effect of the earnings test must include a discussion of above-threshold earners who because of the test do not even apply for any of the benefits for which they are eligible. The identification of 1995 above-threshold earners who have not applied for primary entitlement benefits for which they are eligible and receive no other program benefits, is not difficult; in fact, there were about 152,000 of these persons at calendar ages 65-70 (including 2,000 persons at calendar age 70 whose benefits at the end of 1995 were not subject to the test!). The difficulty in measuring the effect of the test on the group comes in addressing the question—how often is the failure to apply attributable to the earnings test and how often to other considerations? One rationale for not applying, although some benefits are payable, is that a current declination generates increased future benefits through the DRC mechanism, and although the total future increases—until the DRC reaches its ultimate level—are less than the foregone benefits, the difference may be small after the income taxation of benefits is considered.

We believe that the earnings test is generally the cause of failure to apply for those above-threshold earners whose earnings are so substantial that no benefits would be payable the entire year. According to benefit computations that we performed, almost half of the 152,000 above-threshold earners in 1995 at calendar ages 65-70 who were eligible for primary benefits for which they did not apply, had above-threshold earnings in 1995 greater than three times their potential own benefit for 1995, and thus, had no benefits payable in 1995 unless they would have had auxiliaries, had been eligible for more than one benefit, or if 1995 had been a grace year.

In its estimates of the short-range costs of proposals to eliminate or liberalize the earnings test, the Office of the Chief Actuary assumes that about two-thirds of the eligible above-threshold earners at calendar ages 65-70 who have not applied for their benefits are reacting to the earnings test. For 1995, this assumption yields an estimate of another 100,000 above-threshold earners. Had they applied for benefits before 1995, most would have lost the entire year's benefits because of the test. Others would have received benefits for some months, but for some reason chose not to file an application.

The median earnings of the 152,000 above-threshold earners who did not claim their primary retirement benefit is $43,750 (table 2). More than two-thirds of the group is male, a reflection of its high-earning character.

The analysis was repeated for above-threshold earners in 1991 at calendar ages 65-70 who had not applied for their benefits by the end of 1991, to ascertain their experience through the end of 1997 when the youngest amongst them was age 71. Of the 148,000 in the group, 96,000 began receiving benefits or had died at calendar ages 66-69; 38,000 began receiving benefits or had died at calendar age 70 (the age at which the test ceases to apply); and 9,000 began receiving benefits or had died after calendar age 70. There remain 6,000 yet to apply for their benefits, most of whom earned more than the retirement test threshold in 1996—the last year for which earnings are posted.

Other Characteristics

Keeping the focus on 1991, one may investigate whether there is a health differential between beneficiaries with above-threshold earnings and other beneficiaries aged 65-70, when health is measured by 5-year survivorship, that is, to the end of 1996. The comparison is limited to primary beneficiaries, and direct standardization is used to control for the differing age-sex composition of the two groups. The comparison is more interesting if persons who were ever disability beneficiaries are excluded from the comparison group, because they would have below-average survivorship.

Table 2.—Above-threshold earners aged 65-70 in 1995 eligible for, but not entitled to, OASI benefits, by sex

[Numbers in thousands]

Item	Male	Female	Both sexes
Total number	104	48	152
Calendar age:			
65	41	21	63
66	24	12	36
67	17	7	24
68	13	4	18
69	7	2	9
70	1	1	2
Median earnings	$54,209	$30,980	$43,750

The percent surviving 5 years among primary beneficiaries aged 65-70 with benefits withheld under the earnings test in 1991 is 92 percent. In contrast, the percent surviving 5 years among all primaries in 1991 at ages 65-70, after direct standardization to the age-sex distribution of the above-threshold earners, is 87 percent. Among primaries who had never been entitled to a disability benefit, the percent surviving the 5 years is 89 percent, after such standardization.

Information about the job characteristics of persons employed in 1995 was collected by the Bureau of the Census in the March 1996 Current Population Survey. How do these characteristics differ between persons aged 65-70 (at their last birthday) in March 1996 who earned more than the earnings test threshold value of $11,280 and persons aged 50-59 (at their last birthday) who earned more than that amount?

A big difference is in the percent self-employed: 26 percent for the age 65-70 group, versus 14 percent for the age 50-59 group. Also, members of the older group are more likely to be in farming: 5 percent, versus 2 percent. They are more likely to be employed in retail trade and finance industries, and less likely to be employed in manufacturing industries, than members of the younger group. The older workers are more likely to be employed in a professional specialty or sales occupation, and less likely to be employed as a craftsman or machine operator, than the younger workers.

Earnings Recomputation

Almost 2.0 million primary beneficiaries at calendar ages 65 or older in 1995 with covered earnings in that year realized an increase in their PIA effective January 1996 because of those earnings. About 1.66 million amongst them also realized an increase in the amount of benefit; the others were persons in receipt of two benefits whose total benefit amount did not change because of the recomputation of the primary benefit. The 1.66 million represent about 7 percent of the 24.5 million retired workers aged 65 or older in December 1995.

About 1.1 million of the 1.66 million persons were at calendar ages 65-70 in 1995, and about 450,000 were aged 71-78 (table 3). The remaining 110,000 were born in 1916 or earlier, and hence their benefits are determined by average career earnings without indexing.

As with the earnings test, retired workers aged 65 or older affected by benefit recomputation have higher PIAs on average than those unaffected. While the average PIA in December 1995 for all retired workers aged 65 or older was $730, for those realizing a benefit increase from recomputation the average PIA was $842. Also similar to the earnings test, there were about two females affected by recomputation for every three males affected. However, the earnings distribution for retired workers receiving recomputation, which does not have a threshold value, is quite different from the earnings distribution for retired workers with benefits withheld under the earnings test.

The total increase in benefits, including auxiliary benefits, if any, in January 1996 due to primary beneficiaries aged 65 or older receiving recomputations reflecting 1995 earnings is $25 million, an average of $15 per recomputation. The average increase is $12 for recomputations for primaries aged 65-70, $18 for recomputations for primaries aged 71-78, and $29 for recomputations for primaries in the preindexing group.

As mentioned earlier, earnings triggering a recomputation need not be large, only larger than the smallest (indexed) amount in the computation years. In fact, in 662,000 recomputations, including most of the recomputations for females, the year 1995 replaced a computation year of zero earnings. For the 65-70 age group, the amount triggering a recomputation was below the earnings test exempt amount in 464,000 of the 1.1 million instances of recomputation.

The number of primary beneficiaries at calendar ages 65-70 who were affected by both the earnings test and earnings recomputation because of their 1995 earnings was 594,000—slightly less than the 637,000 affected by earnings recomputation with earnings above the threshold. The difference is explained mostly by the exemption from the test of earnings in or after the month of attainment of age 70, and also by the grace year phenomenon and the treatment of special payments for earnings test purposes.

As with the earnings test, a more complete analysis of the effect of earnings at ages 65 or older on benefit levels encompasses their effect on earners who have not yet applied for any program benefits. There are an estimated 167,000 such earners whose PIA would have been larger because of their covered earnings in 1995. Had they been entitled, their average PIA would have increased from $915 in December 1995 to $936 in January 1996 because of their 1995 earnings.

The Future

The earnings test and the recomputation of benefits are two ways in which earnings after the attainment of normal retirement age affect benefits. The earnings test has been liberalized by P. L. 104-121, and there are several legislative proposals for further liberalization or elimination of the test.

Two recommendations of the 1994-96 Advisory Council on Social Security were: (1) improved incentives for persons to extend their working careers; and (2) revision of the income taxation of Social Security benefits to a way similar to other contributory defined benefit pension plans. The elimination of the earnings test is consistent with the first recommendation, while the elimination of the recomputation of benefits so that the base amount of benefit is determined (except for cost-of-living adjustment) at initial entitlement is consistent with the rationale for the second recommendation, that is, that Social Security benefits be treated similarly to comparable pension benefits. However, the elimination of benefit recomputation is a disincentive to the extension of working careers, although less so if it were coupled with the elimination of payroll taxation on postentitlement earnings.

Table 3.—Earners aged 65-70 realizing an increase in benefits effective January 1996 from recomputation, by sex

[Numbers in thousands]

Item	Male	Female	Both sexes
Total	984	675	1,659
Calendar age:			
65-70	619	482	1,101
71-78	287	161	448
79 or older	78	32	110
Lowest amount in computation:			
Zero	283	379	662
Greater than zero	701	296	997
Increase in family benefits:			
5th percentile	$1.5	$1.3	$1.4
25th percentile	4.5	4.0	4.3
50th percentile	10.8	8.8	9.8
75th percentile	21.3	17.7	19.9
95th percentile	50.3	38.7	45.5
Taxable earnings:			
5th percentile	2,223	1,730	1,968
25th percentile	8,906	5,674	7,200
50th percentile	20,464	10,736	14,639
75th percentile	43,024	20,305	32,031
95th percentile	61,200	43,672	61,200