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The Social Security Earnings Test and Retirement

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Key Findings and Policy Implications

While considerable past research has studied the impact of the Social Security earnings test in reducing work hours or earnings, this paper examines the effect of the Social Security earnings test on decisions about whether to work at all. It uses data from the Benefits and Earnings Public Use File (BEPUF), a 1 percent extract of OASI beneficiaries in 2004. The data contain a complete longitudinal earnings history from 1951 to 2003 with yearly information on earnings; the type and amount of yearly Social Security benefits a claimant receives; year of birth; the year that claiming began; gender; and other variables. The paper finds that:

- Among Social Security claimants at age 63, there is a sharp kink in the relationship between retirement (zero earnings) and pre-Social Security earnings that occurs at the level of income that is exempt from the earnings test. Below the exempt amount, the probability of retirement declines with pre-Social Security income. Above the exempt amount, the probability of retirement rises with pre-Social Security income. This kink in the effect of pre-Social Security earnings on retirement, occurring at the exempt income level, suggests that the earnings test has a significant effect on people's decision about whether to work at all.
- These results are reinforced by the fact that no such reversal of slope occurs in any of three "placebo" samples that are not affected by the earnings test: 61-year olds, 63-year old non-claimants, and individuals in the years prior to claiming OASI. In all three reference groups, the proportion who are retired (have zero earnings) continues to slope downward steadily throughout the entire range of earnings.
- While the decision about whether to work appears to be affected by the earnings test, the paper found no effect of the earnings test on the decision to claim Social Security benefits. This is plausible if individuals are unaware of the rules of the earnings test prior to claiming (but later respond in their participation decisions because they become aware of the rules through experience), or if claiming decisions at age 62 are inelastic for another reason.

The findings have significant policy implications; reinforcing and extending a substantial literature on the how Social Security policy characteristics and incentives affect labor market behavior at older ages.

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