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Does Eliminating the Earnings Test Increase the Incidence of Low Income among Older Women?

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The Social Security retirement earnings test (RET) establishes a threshold for which wage earnings in excess of the threshold cause a reduction in benefits. The Senior Citizens' Freedom to Work Act of 2000 repealed the RET for beneficiaries who had attained the full retirement age (FRA) and made the RET less stringent in the year an individual reached the FRA.

The RET is viewed as a tax (Liebman and Luttmer, 2011), despite the fact that the lost benefits are provided in the future. Consequently, the predicted effect of the removal of the RET on labor supply (and earnings) depends on where the beneficiary was on the budget constraint prior to the elimination of the RET (Haider and Loughran, 2008). Beneficiaries choosing low hours prior to 2000 should be unaffected by the elimination of the RET. Among those affected, beneficiaries whose labor supply led to the elimination of all their Social Security benefits experience an income effect, likely decreasing their hours worked. Those bunching just below the RET threshold should increase their hours worked through the substitution effect. And for those receiving reduced benefits due to earnings above the threshold, there is both an income and a substitution effect, so the net effect is ambiguous.

Concomitant with changes in labor supply, however, are effects on benefit claiming. Men or women working enough to be subject to the RET have an incentive to delay claiming, and conversely to claim earlier when the RET is eliminated or reduced, resulting in lower monthly Social Security benefits. In particular, with the 2000 policy changes, there should be some people who move the age of claiming benefits from above the FRA down to the FRA, because the RET was eliminated for those attaining the FRA. Looking at reforms in the 1980s, Gruber and Orszag (2003) find this for men, and Figinski (2013) also finds that women – both primary and spousal beneficiaries – claim benefits earlier when the RET was eliminated in 2000, for certain age groups. (See also Song and Manchester, 2007.) Those who claim benefits early and continue to work will be able to supplement their wage income with Social Security benefits. Yet these individuals may not save for the time when they can no longer work and would benefit from the higher Social Security payments they would have been receiving had they not claimed benefits earlier in response to the elimination of the RET for those who have attained the FRA. As explained below, this problem may be particularly severe for older women.

As a consequence of these responses, removing the RET could have the unintended effect of increasing poverty – or the incidence of low-income more generally – among much older individuals. Gruber and Orszag (2003) were the first to point this out, suggesting that the removal of the RET for younger beneficiaries “could produce a nontrivial increase in elderly poverty” (p. 771).

In this research, we explore this potential for longer-term response of changes in the RET. We know from past work (e.g.,

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Sandell and Iams, 1997) that old-age poverty is common among women, beginning around age 75, and that this may stem, in part, from how Social Security benefits change with early claiming, such that women, who generally outlive men, will face actuarially unfair benefit reductions from early claiming (by them or their husbands).

We focus on women, in particular, because they generally outlive men. Hence, women – and especially older women – are more likely to reach the point where reliance on Social Security benefits is higher. In this case, the lower benefits from claiming earlier are more likely to outweigh the higher earnings or saving from increased labor supply in response to the elimination of the RET.

EMPIRICAL ANALYSIS

The fundamental goal of the empirical analysis is to test whether the 2000 reforms eliminating the RET had adverse consequences for the incomes of much older women whose own behavior or spouse's behavior was affected by the elimination of the RET.

To touch base with the existing literature, we begin by estimating models for age at claiming and for Social Security benefits, in which we identify the effect of the elimination of the RET from intercohort changes. Our main analysis focuses on estimating the effects of the elimination of the RET on poverty or low-income.

We focus on estimates for women. And we also estimate models that capture the effects of the elimination of the RET for both them and their spouses, since both can affect benefits, depending on whether the woman is claiming her own benefits (“entitled”) or spousal/survivor benefits.

We use data from the Health and Retirement Study (HRS). When we want to incorporate information on husbands' claiming behavior, we create a sample that contains only women who can be matched to a unique husband; observations that report multiple husbands complicate matters because it is unclear which husband's age affects the woman's benefit.

FINDINGS

First, we confirm past findings that the elimination of the RET led to earlier claiming of benefits for women, by eight to nine months. Correspondingly, we find that Social Security benefits at the individual and family level are generally lower as a result of the elimination of the RET; at the family level, the effect is to lower benefits annually by around \$1,500.

Finally, we study effects on whether women have incomes below 150 percent or 200 percent of the poverty line. The findings suggest that the elimination of the RET is associated with higher incomes and hence of lower incidence of low family incomes initially – when women are around age 70 – but higher incidence of low income as women reach their mid-70s and beyond. These findings suggest that, for older women, poverty, and low income more generally, may have been increased by the elimination of the RET, with the effect arising at later ages when these women are more likely to have been widowed, and when there may no longer be higher income from increased labor supply at earlier ages.

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