The Minimum Wage and Incentives for Full-Time Work under the Social Security Retirement Earnings Test

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The Social Security earnings test determines how work affects the time path of payments to beneficiaries. For annual earnings above a threshold amount, benefits are clawed back. Although the benefit reductions are returned with an actuarial adjustment in future years, the test is widely viewed as a pure tax on earnings. For this reason, there has been long-standing interest in the extent to which the Social Security earnings test affects the labor supply of Social Security beneficiaries.

The Senior Citizens Freedom to Work Act of 2000 abolished the test for individuals who are at or above the Full Benefit Age (FBA), traditionally 65, but currently 67. This generated a series of studies on the impact of the law change on labor supply and earnings for those 65 and older. Overall, these studies found that the repeal of the test increased earnings by 8-20% and annual hours by 5-16% for men over the FBA, with comparable estimates for earnings for women claiming on their own earnings histories. In contrast, there has been little empirical work done on individuals under the FBA, primarily because there is no policy variation at the federal level that differentially affects individuals who claim early. In this paper, we present new evidence on the impact of the earnings test on men who have claimed benefits early by exploiting variation in the threshold number of annual hours at which the test just binds, induced by state and federal changes in the real value of the effective minimum wage.

We make three primary contributions to the literature. First, we use data from 1982-2016 from the Current Population Survey (CPS) and 1992-2014 from the Health and Retirement Study (HRS) to document that a large fraction of men who claim early and continue to work have hourly wages close to the minimum wage. Second, for any fixed earnings-test threshold amount, an increase in the hourly wage at which a beneficiary can work reduces the number of annual hours needed to hit the threshold. Hence, labor-market policies that target hourly wages may interact with the structure of the earnings test to affect equilibrium hours and employment for beneficiaries. Third, we exploit this feature of the test and use substantial state-by-calendar year variation in the real effective minimum wage—the higher of the state and federal minima—from increases in the minimum wage, which lower the threshold level of hours at which the earnings test binds, to identify the impact of the test on labor supply on the intensive and extensive margins for men who claim early.

Finally, most studies analyze the earnings test for an individual beneficiary under a standard static unitary labor supply model, with a linear budget set, and no saving. In this
framework, individuals can smoothly alter their labor supply—there are no adjustment costs and no labor-market rigidities. However, we present evidence from the HRS that a substantial proportion of 62- to 64-year old men report rigidities in their choice of hours, which implies that the earnings test may have asymmetric impacts on labor supply around full-time, full-year hours. We then present empirical evidence to support this view. When the minimum wage increases and pushes threshold hours below full-time, full-year hours, the likelihood of working full-time, full-year falls by 30 percentage points; when the minimum wage decreases and pushes threshold hours above full-time, full-year hours, the likelihood of working full-time, full-year rises by 20 percentage points. There are similar asymmetric effects around full-time, full-year hours for annual hours and employment, respectively.

Overall, the estimates imply economically large impacts of the earnings test on the hours and employment for men who claim Social Security benefits early. We temper this conclusion with the following caveat: although economically meaningful, the estimated impacts are in some cases imprecise enough that firm conclusions cannot be drawn, especially when we use men of a similar age who have not claimed benefits, and thus are not subject to the earnings test, as a comparison group. In this dimension, our study is somewhat underpowered, and some of our results bear further investigation.