Offer Partial Social Security Benefits as a Work-Longer Incentive

By Eugene Steuerle *Thu, Jun 18, 2020*

Why not give older Americans the flexibility to turn their Social Security benefits off and on during their 60s? asks our guest columnist, a fellow at the Urban Institute and former Treasury official.

Workers often face uncertainty about their jobs, but not since the Great Depression have so many been unemployed or worried about becoming unemployed. Some have been laid off temporarily but don’t know if their job will come back. Others find themselves without a job and searching in a labor market with few openings.

These problems hit older workers especially hard, as research shows they have the toughest time getting a new job and, once reemployed, have great difficulty restoring their former pay level. Their problems will be with us for some time as we recover from the COVID-19 pandemic and recession.

I have a simple suggestion to help older workers that would cost the government little money because it mainly changes how and when older workers receive their Social Security payments, with adjustments that keep their value actuarially fair. The goal is to give people much more flexibility to adapt to changing financial needs and employment prospects.

Social Security could make it easier for those eligible for old age benefits after age 62 to opt in and out of benefit receipt and collect partial benefits, with each delay in benefit receipt boosting future annuity payments through delayed retirement credits and related adjustments, similar to what is already sometimes allowed.

Older workers hoping to get back in the labor market can then adjust as their opportunities and needs change. This approach would grant older workers, whether retired or not, flexibility to use some of their Social Security benefits to buy a very good annuity at variable levels over time.

The ability for some eligible beneficiaries to opt in and out of the system and a mandated system of partial benefits for others already exists, though the process is confusing. Consider those older than the full retirement age (or FRA, age 66 and 2 months for those born in 1955). Technically, they can receive benefits, suspend them, and resume collecting. But Social Security doesn't broadcast this ability, so few know it exists.

For every year these workers delay collecting benefits until age 70, they receive an 8% increase in their annuity, plus inflation adjustments. Thus, if I were born in 1955 and delay benefit receipt 46 months after the full retirement age, from 66 and 2 months to age 70, I can get about a 31% higher annual benefit every year after age 70. But I could also take benefits at age 66 and 2 months, stop receiving them completely for two full years at ages 67 and 68, then start receiving them again at age 69, thereby increasing my future annual annuity by 16%.

Why not make this system simple and transparent? Why not allow workers simply to take a partial benefit that works the same way? And why not give them the option not just to opt in and out of the system periodically, but also to cut back on some benefits in exchange for later actuarial adjustments?

For instance, we could allow people to take half their benefit in a given year and receive half the delayed retirement credit, then receive no benefit the next year in exchange for a full delayed retirement credit, and switch again to a full benefit in a third year. This would allow people to adjust over time according to their needs and work prospects—a particularly valuable option during the ups and downs of recession and recovery.

The language surrounding credits and adjustments for delayed benefit receipt confuses even financial advisers. It derives from a long history in which delayed benefit receipt was defined by an earnings test that took back Social Security benefits as beneficiaries earned more. Congress removed the earnings test for those past the FRA, but as the FRA increases toward age 67 for those born in 1960 and later, more older workers are quickly becoming subject to it and fewer for the delayed retirement credit.

A variation on a historically much stricter earnings test remains for those retiring between age 62 and the FRA. In essence, in 2020, Social Security is reducing benefits by one-half of earnings above $18,240 for beneficiaries between age 62 and the FRA, although a different formula applies to the year when the FRA is reached. But benefits lost in those early years are offset by a little more than 7% per year increase in later payments.

The point to remember is that those between age 62 and the FRA essentially are often forced to take something similar to a delayed retirement credit. The amounts involved are fixed by an earnings-related formula, not their financial needs. One survey found three out of five respondents incorrectly viewed the earnings test as a permanent tax on work, so it also deters work, especially for those in their early 60s.

Getting $.07 or $.08 every year of remaining life on every $1.00 deposited, plus an inflation adjustment, is a great annuity rate for those with average or better life expectancies, better than anything available in the private market, especially now that the Federal Reserve has cut interest rates to nearly zero. The main losers in the mandated system are those younger than the FRA with chronic health problems that would lead to an early death; they would be better off not purchasing an annuity.

This simple reform would enable people to make adjustments according to their own financial needs in times of reduced income or unemployment and to buy the decent annuities the system offers over time and in variable amounts.

Although congressional action would be necessary to allow beneficiaries to take partial benefits before the FRA, the Social Security Administration needs no authority to clarify the existing opportunity to opt in and out for those older than the FRA. The sooner it can adapt, the sooner workers—including those forced to retire earlier than planned during economic downturns—can adapt according to their own needs and future opportunities.

As our population gets older, we are moving into a world where the worker-to-beneficiary ratio in Social Security falls from 4:1 in 1965 to 3:1 in 2010 to close to 2:1 in 2040. At the same time, older people recently have increased their rate of participation in the labor market, and their employment rate actually increased during the last recession.

Even if the COVID-19 crisis had not swelled the number of older workers and retirees in need of greater flexibility, Congress could make this convoluted system of actuarial adjustments salient and transparent for millions of current and future Social Security beneficiaries.

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