



# Social Security Retirement Earnings Test: How Earnings Affect Benefits

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## Summary

Under the Social Security Retirement Earnings Test (RET), the monthly benefit of a Social Security beneficiary who is below full retirement age (FRA) is reduced if he or she has earnings that exceed an annual threshold. In 2012, a beneficiary who is below FRA and will not attain FRA during the year is subject to a \$1 reduction in benefits for each \$2 of earnings above \$14,640. A beneficiary who will attain FRA in 2012 is subject to a \$1 reduction in benefits for each \$3 of earnings above \$38,880. The annual exempt amounts (\$14,640 and \$38,880 in 2012) generally are adjusted each year according to average wage growth.

If a beneficiary is affected by the RET, his or her monthly benefit may be reduced in part or in full, depending on the total applicable reduction. For example, if the total applicable reduction is greater than the beneficiary's monthly benefit amount, no monthly benefit is payable for one or more months. If family members also receive auxiliary benefits based on the beneficiary's work record, the reduction is pro-rated and applied to all benefits payable on that work record (including benefits paid to spouses who are *above* FRA). For example, in the case of a family consisting of a worker beneficiary who has earnings above the annual exempt amount and a spouse and child who receive benefits based on his or her work record, the benefit reduction that applies under the RET is charged against the total family benefit.

The RET has been part of the Social Security program in some form throughout the program's history. The original rationale for the RET was that, as a social insurance system, Social Security protects workers from certain risks, including the loss of earnings due to retirement. Therefore, benefits should be withheld from workers who show by their earnings that they have not "retired." The RET does not apply to Social Security disability beneficiaries who are subject to separate limitations on earnings.

If a beneficiary is affected by the RET, his or her monthly benefit is *recomputed*, and the dollar amount of the monthly benefit is *increased*, when he or she attains FRA. This feature of the RET, which allows beneficiaries to recoup benefits "lost" as a result of the RET, is not widely known or understood. The benefit recomputation at FRA is done by adjusting (lessening) the actuarial reduction for retirement before FRA that was applied in the initial benefit computation to take into account months for which benefits were reduced in part or in full under the RET. Any spousal benefits that were reduced because of the RET are recomputed when the spouse attains FRA. For a spouse who has already attained FRA, however, there is no subsequent adjustment to benefits to take into account months for which no benefit or a partial benefit was paid as a result of the RET.

The Social Security Administration estimates that elimination of the RET for individuals aged 62 or older would have a negative effect on the Social Security trust fund in the amount of \$81 billion from 2012 to 2018, although it would have no major effect on Social Security's projected long-range financial outlook.

This report explains how the RET works under current law. In addition, it provides benefit examples to illustrate the effect of the RET on Social Security beneficiaries who are below FRA and family members who receive benefits based on their work records. It also briefly discusses policy issues, including recent research on the effect of the RET on work effort and the decision to claim Social Security benefits. This report will be updated periodically.

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## Introduction

Social Security benefits received before a person attains full retirement age (FRA)<sup>1</sup> are subject to an actuarial reduction for early retirement and also may be reduced by the Social Security Retirement Earnings Test (RET) if the beneficiary has earnings that exceed an annual threshold. Under the RET, a beneficiary who is below FRA and will not attain FRA during the calendar year is subject to a \$1 reduction in benefits for each \$2 of earnings above an annual exempt amount, which is \$14,640 in 2012. During the calendar year in which a beneficiary attains FRA, he or she is subject to a \$1 reduction in benefits for each \$3 of earnings above a higher annual exempt amount, which is \$38,880 in 2012.<sup>2</sup>

This report explains how the RET is applied under current law and provides detailed benefit examples to show how the RET affects both the worker beneficiary and any family members (auxiliary beneficiaries) who receive benefits based on the worker beneficiary's record. The report points out features of the RET that are not widely known or understood, such as the recomputation of benefits when a beneficiary attains FRA to adjust (increase) benefits to take into account months for which no benefit or a partial benefit was paid as a result of the RET. Finally, the report discusses policy issues related to the RET, including recent research on the effect of the RET on work effort and the decision to claim Social Security benefits.

Key points discussed in the report include the following:

- Benefits may be reduced in part or in full for one or more months as a result of the RET.
- Benefit reductions under the RET apply both to the worker beneficiary and to any family members (auxiliary beneficiaries) who receive benefits based on the worker beneficiary's record. This would include, for example, a dependent child and a spouse who may have already attained FRA.
- When a worker beneficiary and family members are subject to a benefit reduction under the RET, the reduction is pro-rated and applied to each person's benefit in proportion to each person's original entitlement amount. (The total amount of the reduction remains the same, but the reduction is pro-rated across more people.)
- An auxiliary beneficiary may be subject to a reduction in benefits under the RET both on the basis of the worker beneficiary's earnings above the exempt amount and on the basis of his or her own earnings above the exempt amount.
- Benefits "lost" as a result of the RET may be recouped by the beneficiary. When a beneficiary attains FRA and is no longer subject to the RET, his or her benefits

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<sup>1</sup> The Social Security FRA is increasing gradually from age 65 to age 67 for workers born in 1938 or later; it will reach age 67 for workers born in 1960 or later. The FRA is 66 for workers who attain age 62 in 2012 (workers born in 1950) and workers who attain age 65 in 2012 (workers born in 1947). A person who claims benefits at FRA will receive full (unreduced) benefits. Workers may claim retirement benefits as early as age 62; however, a worker who claims benefits before FRA is subject to an actuarial reduction to benefits for early retirement that is unrelated to the RET.

<sup>2</sup> The Social Security Administration defines "excess earnings," for people who are below FRA and will not attain FRA during the calendar year, as 50% of earnings above the annual exempt amount. For people who will attain FRA during the calendar year, "excess earnings" are defined as 33 1/3% of earnings above the annual exempt amount (20 C.F.R. §404.430(b)). This definition is helpful for understanding the method of charging excess earnings against monthly benefits as described in the regulations (20 C.F.R. §404.434(b)).

- are adjusted upward to take into account months for which no benefit or a partial benefit was paid as a result of the RET.
- The Social Security Administration (SSA) estimates that elimination of the RET for individuals aged 62 or older would have no major effect on Social Security's projected long-range financial outlook. In the short run, however, SSA estimates that eliminating the RET would have a negative effect on the Social Security trust fund in the amount of \$81 billion from 2012 to 2018.
  - The RET raises several policy issues, including the effect of the RET on labor supply (how many hours to work and when to retire) and its effect on when workers claim Social Security benefits.

## Historical Background

In general, Social Security benefits are meant to replace, in part, earnings lost to an individual or family because of retirement, disability, or death. The rationale for the RET was outlined in the 1935 report of the Committee on Economic Security, which recommended that no benefits be paid before a person had “retired from gainful employment.”<sup>3</sup>

The original Social Security Act barred payment of benefits for any month in which a beneficiary received wages from “regular employment.”<sup>4</sup> This provision never went into effect, however, because the Social Security Board and many other analysts thought it would be nearly impossible to determine what was “regular” employment in different industries and occupations. Instead, the board recommended a specific monetary amount to simplify administration. In 1939, Congress incorporated these recommendations in amendments to the Social Security Act.<sup>5</sup> Starting with the first benefits paid in 1940, benefits were withheld for months in which covered earnings were \$15 or more.

The RET has evolved from a monthly test to an annual one (with the exception of the “grace year” as discussed below) and from a provision that initially affected all worker beneficiaries to one that affects beneficiaries who are below the FRA. The most recent legislative change to the RET was in 2000 when Congress eliminated the RET for beneficiaries beginning with the month they attain FRA. This change was made under the Senior Citizens Freedom to Work Act (P.L. 106-182). Before the change in 2000, the RET applied to beneficiaries until they attained the age of 70.

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<sup>3</sup> Committee on Economic Security, *Report of the Committee on Economic Security*, Washington, DC, January 1935, <http://www.socialsecurity.gov/history/reports/ces5.html>, in the section entitled “Contributory Annuities (Compulsory System): Outline of Plan.”

<sup>4</sup> P.L. 74-271, the Social Security Act of 1935, §202(d), <http://www.ssa.gov/history/35actii.html#Old-Benefit>.

<sup>5</sup> P.L. 76-379, the Social Security Act Amendments of 1939, §203(d)(1) and §203(e), <http://www.socialsecurity.gov/history/pdf/1939Act.pdf>.

## Current Law

### Social Security Worker and Auxiliary Benefits

Social Security benefits are based on the average of a worker's highest 35 years of earnings. A worker's primary insurance amount (PIA) is computed by applying the Social Security benefit formula to the worker's career-average, wage-indexed earnings. The benefit formula replaces a higher percentage of the pre-retirement earnings of workers with low career-average earnings than for workers with high career-average earnings.

A worker's initial monthly benefit is equal to the worker's PIA if he or she begins receiving benefits at FRA. A worker's initial monthly benefit will be *less* than his or her PIA if the worker begins receiving benefits *before* FRA, and it will be *greater* than his or her PIA if the worker begins receiving benefits *after* FRA.<sup>6</sup> For a more detailed explanation of the Social Security benefit computation and the actuarial adjustment to benefits claimed before or after FRA, see **Appendix A**.

Social Security also provides auxiliary benefits to eligible family members of a retired, disabled or deceased worker. Benefits payable to family members are equal to a specified percentage of the worker's PIA. For example, a spouse's benefit is equal to 50% of the worker's PIA, and a widow(er)'s benefit is equal to 100% of the deceased worker's PIA. The total amount of benefits payable to a family based on a retired or deceased worker's record is capped by the maximum family benefit amount, which varies from 150% to 188% of the retired or deceased worker's PIA. For more information on auxiliary benefits and the maximum family benefit amount, see **Appendix B**.

### The RET Applies to Beneficiaries Below the Social Security Full Retirement Age

The RET applies to beneficiaries who are below the Social Security FRA and have earnings that exceed a specified dollar amount (an annual exempt amount). The RET does not apply to worker beneficiaries who are at or above FRA (the RET no longer applies beginning with the month the beneficiary attains FRA) or to those who are disabled.<sup>7</sup> In addition, the RET does not apply to

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<sup>6</sup> For workers who claim benefits before FRA, the monthly benefit amount is decreased by an adjustment that is roughly actuarially fair. The purpose of the actuarial reduction is to ensure that the worker receives roughly the same total lifetime benefits regardless of when he or she claims benefits between age 62 and FRA (assuming he or she lives to average life expectancy). Benefits taken before FRA are reduced about 6.7% per year for the first three years of benefit entitlement before FRA (i.e., the first 36 months from age 62 to age 65) and 5% per year thereafter. For example, for a worker whose FRA is 66, claiming benefits at age 62 results in an initial monthly benefit that is 25% lower than his or her PIA ((6.7% \* 3 years) + (5% \* 1 year)). Workers who delay filing for benefits until after FRA receive a delayed retirement credit (DRC). The DRC applies beginning with the month the worker attains FRA and ending with the month before he or she attains age 70. Starting in 1990, the DRC increased until it reached 8% per year for workers born in 1943 or later (i.e., starting with those who attained age 62 in 2005 or age 66 in 2009).

<sup>7</sup> Beneficiaries of Social Security Disability Insurance (SSDI) are subject to different rules and limitations regarding earnings. The limitations on earnings for SSDI beneficiaries are referred to as substantial gainful activity (SGA) amounts. The SGA differs from the RET in that a disability beneficiary whose earnings exceed the SGA threshold, after a trial work period, will lose eligibility for Social Security disability benefits. By contrast, a person whose earnings exceed the annual RET threshold may receive partial or full Social Security benefits for any months of the (continued...)

beneficiaries living outside the United States whose work is not covered by the U.S Social Security system; in this case, the “foreign work test” is applied. Self-employed persons are subject to the RET if they have performed “substantial services,” which are determined by the nature of the service performed rather than by profit or loss.

## **The RET Reduces Social Security Benefits**

For beneficiaries who are below FRA and will not attain FRA during the calendar year, Social Security benefits are reduced by \$1 for each \$2 earned above the exempt amount. For beneficiaries who will attain FRA during the calendar year, Social Security benefits are reduced by \$1 for each \$3 earned above the exempt amount.<sup>8</sup>

Earnings above the exempt amount are charged against monthly benefits beginning with the first chargeable month of the year, at the applicable rate of \$1 for each \$2 or \$3 of earnings above the exempt amount, and continue to be charged each month until all earnings above the exempt amount have been charged against the worker’s benefits and any benefits payable to family members on his or her work record. A partial benefit is paid when the charge to a given month is less than the monthly benefit.

## **The RET Exempt Amounts**

The RET applies only to wage and salary income (i.e., earnings from work). It does not apply to income from pensions, rents, dividends, interest, and other types of “unearned” income.

The RET annual exempt amounts in 2012 are \$14,640 for beneficiaries who are below FRA and will not attain FRA in 2012, and \$38,880 for beneficiaries who will attain FRA in 2012. The RET

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(...continued)

year after the RET charge has been applied. In addition, the benefit recomputation at FRA results in an upward adjustment of the Social Security benefit amount to reflect any months in which benefits were withheld in full or in part under the RET. In 2012, the SGA amount for non-blind beneficiaries is \$1,010 a month (net of impairment-related work expenses). For blind beneficiaries, the SGA amount is \$1,690 a month. Both amounts generally increase with the increase in average wages. For purposes of SSDI, a “disability” is defined as the inability to engage in substantial gainful activity by reason of a medically determinable physical or mental impairment expected to result in death or last at least 12 months. For more information, see CRS Report RL32279, *Primer on Disability Benefits: Social Security Disability Insurance (SSDI) and Supplemental Security Income (SSI)*, by (name redacted).

<sup>8</sup> Beneficiaries who will attain FRA during the calendar year are treated differently as a result of a compromise reached when the RET structure was modified in 2000. Before 2000, there were two RETs, one for beneficiaries below FRA and one for beneficiaries between FRA and age 70. The RET for beneficiaries between FRA and age 70 was more generous; the exempt amount was higher and the reduction to benefits was \$1 for each \$3 of earnings above that amount. By comparison, the RET for beneficiaries below FRA applied a lower exempt amount and the reduction to benefits was \$1 for each \$2 of earnings above that amount. In 2000, when Congress eliminated the RET for beneficiaries beginning with the month they attain FRA, there was a concern that beneficiaries who would attain FRA in 2000 would be worse off. The concern arose because, under pre-2000 law, the more generous RET applied to beneficiaries starting in January of the year they attained FRA. Therefore, eliminating the more generous RET would cause these beneficiaries to be subject to the lower exempt amount and the 50% offset during that year. To address this concern, the House version of the legislation, for 2000 only, allowed beneficiaries attaining FRA in 2000 to be subject to the more generous RET in the months preceding attainment of FRA. A Senate Manager’s Amendment extended this provision to all future beneficiaries for the year they attain FRA. In April 2000, President Clinton signed the legislation, which became P.L. 106-182.



exempt amounts generally increase each year at the same rate as average wages in the economy.<sup>9</sup> **Appendix C** shows the annual exempt amounts under the RET from calendar years 2000 to 2012.

## **Grace Year**

A “grace year” applies during the first year of benefit entitlement (or, for dependent beneficiaries, in the last year of benefit entitlement). During the grace year, the RET is applied effectively on a monthly basis. A beneficiary may receive full benefits for any month during which his or her earnings do not exceed one-twelfth of the annual exempt amount, regardless of the total amount of earnings for the year.

As an example, consider a worker aged 62 who (1) has \$60,000 in earnings from January through June 2012, (2) claims Social Security retirement benefits on July 1, 2012, and (3) has no additional earnings for the remainder of the year (July through December 2012). Because this person does not have earnings above the 2012 monthly exempt amount of \$1,220 in any month from July through December 2012, full benefits are paid for each month of the second half of the year. This is the case even though this person’s total earnings for 2012 are \$60,000, an amount higher than the 2012 annual exempt amount of \$14,640.

## **The RET May Affect Social Security Benefits Received by Spouses, Survivors and Other Dependents**

There are two ways in which a person who receives Social Security auxiliary benefits (benefits paid to spouses, survivors, and other dependents) could be affected by the RET. First, benefits paid to spouses and dependents are affected by the RET when the benefits are based on the record of a worker beneficiary who is subject to the RET (i.e., the worker beneficiary is below FRA and has earnings above the exempt amount). This includes benefits paid to spouses who are below FRA as well as to those who are *above* FRA. An exception is made for auxiliary benefits paid to divorced spouses. If a divorced spouse has been divorced from the worker beneficiary for at least two years, the auxiliary benefit is not affected by the worker beneficiary’s earnings.

Second, benefits paid to spouses (including divorced spouses) and dependents are affected by the RET when the auxiliary beneficiary is below FRA and has his or her own earnings above the exempt amount. Auxiliary beneficiaries are subject to the same annual exempt amounts and benefit reduction rates that apply to worker beneficiaries.

## **Dually Entitled Beneficiaries**

A person receiving spousal benefits who is affected by the RET based on his or her own earnings above the exempt amount may be simultaneously (dually) entitled to a retired-worker benefit based on his or her own work record. A dually entitled beneficiary receives his or her own retired-worker benefit first, plus any spousal benefit remaining after the spousal benefit is reduced based on the retired-worker benefit. In effect, the total benefit payable to a dually entitled beneficiary is capped at the higher of the retired-worker benefit and the spousal benefit.

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<sup>9</sup> The annual exempt amounts are not increased in a year during which no Social Security cost-of-living adjustment is payable.

In the case of a dually entitled beneficiary, his or her own earnings above the exempt amount affect both his or her own retired-worker benefit and the spousal benefit.<sup>10</sup> In addition, if the worker beneficiary on whose record the spousal benefit is based has earnings above the exempt amount, the spousal benefit is affected by those earnings as well. When a dually entitled beneficiary attains FRA, each benefit that was affected by the RET (the retired-worker benefit or the spousal benefit) is adjusted upward to take into account months for which no benefit or a partial benefit was paid as a result of the RET.

An example is provided later in the report to show how benefits paid to a non-working spouse are affected when the worker beneficiary has earnings above the exempt amount. In addition, an example is provided to show how spousal benefits are affected when both the worker beneficiary and the spouse have earnings above the exempt amount.

## **Benefits Withheld Under the RET are Restored Starting at FRA**

When a beneficiary has had benefits fully or partially withheld under the RET, benefits “lost” as a result of the RET are restored starting at FRA. Specifically, the worker’s benefits are recomputed—and increased—when he or she attains FRA. In the benefit recomputation at FRA, the actuarial reduction for benefit entitlement before FRA that was applied in the initial benefit computation is adjusted (the actuarial reduction for early retirement is lessened) to reflect the number of months the worker received no benefit or a partial benefit as a result of the RET.<sup>11</sup>

In the initial benefit computation, retirement benefits are reduced for early retirement by a fraction of the worker’s PIA for each month of entitlement before FRA. Retirement benefits are reduced by five-ninths of 1% (or 0.0056) of the worker’s PIA for each of the first 36 months of entitlement before FRA. Stated another way, the actuarial reduction for early retirement is about 6.7% per year for the first three years of entitlement before FRA (i.e., from the age of 62 to 65). For each additional month of entitlement before FRA (up to 24 months), retirement benefits are reduced by five-twelfths of 1% (or 0.0042) of the worker’s PIA, for an actuarial reduction of 5% per year (i.e., from the age of 65 to 67).<sup>12</sup>

Stated generally, if a worker’s benefits are reduced in the initial benefit computation to reflect  $x$  months of early retirement, and the worker subsequently has benefits withheld under the RET for  $y$  months, the benefit recomputation at FRA will reflect an actuarial reduction for  $x$  minus  $y$  months of early retirement, resulting in a higher monthly benefit amount starting at FRA.

As an example, consider a worker who starts receiving Social Security retirement benefits at the age of 62, although his or her FRA is 66, and he or she has earnings above the RET exempt

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<sup>10</sup> The dually entitled beneficiary’s earnings above the exempt amount will not affect the retired-worker benefit received by the worker on whose record the spousal benefit is based.

<sup>11</sup> In addition, if a beneficiary continues to work, the Social Security Administration automatically checks the person’s record each year to determine if the additional earnings will increase his or her monthly benefit. For example, earnings for 2012 would be included in a recomputation effective January 2013. See Social Security Administration, *Program Operations Manual System* (Washington, DC), RS 00605.401, <http://policy.ssa.gov/poms.nsf/links/0300605401>.

<sup>12</sup> Under current law, the maximum reduction for early retirement ranges from 20% for a worker whose FRA is 65 to 30% for a worker whose FRA is 67.

amount. Because the person claims retirement benefits four years before attaining FRA and has earnings above the RET threshold, he or she will be subject to both the actuarial reduction for benefit entitlement before FRA and benefit withholding under the RET. The actuarial reduction is equal to about 6.7% per year for the first three years of benefit entitlement before FRA and 5% per year thereafter. In this example, the total actuarial reduction in the person's initial monthly benefit is 25% ((6.7% \* 3 years) + (5% \* 1 year)). In addition, the person continues to work throughout the four-year period from the age of 62 to 66 and has earnings high enough to cause a reduction in his or her monthly benefit under the RET.<sup>13</sup> If the RET results in a 50% reduction in Social Security benefits in each of the four years from the age of 62 to 66, the person would have benefits withheld for six months each year, for a total of 24 months.<sup>14</sup> The benefit recomputation when the person attains FRA will take into account that the person received no benefits for 24 months as a result of the RET. Specifically, the reduction factor for benefit entitlement before FRA will be adjusted from 48 months to 24 months. Starting at FRA, the person's monthly benefit will be increased to reflect an actuarial reduction for benefit entitlement before FRA of about 13.4% (6.7% \* 2 years), instead of 25%. The person receives a higher monthly benefit because benefits withheld under the RET are restored starting at FRA.

If spousal benefits are withheld under the RET (as discussed in section "The RET May Affect Social Security Benefits Received by Spouses, Survivors and Other Dependents"), they will be adjusted upward when the spouse attains FRA (not when the worker beneficiary attains FRA). For a spouse who has already attained FRA, there is no subsequent adjustment to benefits to take into account months for which no benefit or a partial benefit was paid as a result of the RET.

## Worker Beneficiaries with Earnings in 2006

**Table 1** shows the number of worker beneficiaries who had earnings in 2006, the most recent year for which data are available. About 1.3 million worker beneficiaries who were below FRA during all or part of 2006 had earnings.

With respect to the data shown in **Table 1**, it is important to note that not all worker beneficiaries with earnings are affected by the RET. For example, those who have earnings below the exempt amount are not affected by the RET. In addition, those who are in the first year of entitlement may benefit from the "grace year" provision and are not subject to the RET during any months in which they have earnings that are lower than the monthly RET exempt amount (i.e., the annual RET exempt amount divided by 12).

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<sup>13</sup> To simplify the example, it is assumed that the person was born on January 1. Therefore, there is no need to take into account the different annual exempt amount and benefit reduction rate that apply during the calendar year in which a beneficiary attains FRA. It is also assumed that the person both works and collects benefits over each full calendar year, so the "grace year" provision does not apply.

<sup>14</sup> For example, a person who has earnings of \$26,640 in 2012 (i.e., \$12,000 above the exempt amount) and a monthly Social Security benefit of \$1,000 (or \$12,000 in annual benefits) would be subject to a 50% reduction in Social Security benefits in 2012 under the RET. The person's benefits would be fully withheld for the first six months of 2012.

**Table 1. Number of Worker Beneficiaries with Earnings in 2006**

Earnings	Below FRA Throughout 2006 <sup>a</sup>	Attained FRA in 2006 <sup>b</sup>
\$1 - 4,999	356,000	117,500
5,000 - 9,999	226,500	69,900
10,000 - 14,999	213,500	60,900
15,000 - 19,999	72,800	35,800
20,000 - 24,999	39,200	17,100
25,000 - 29,999	17,600	9,700
30,000 - 34,999	10,200	7,800
35,000 - 39,999	6,300	6,000
40,000 - 44,999	5,600	2,100
45,000 - 49,999	3,600	1,700
50,000 - 54,999	2,500	1,500
55,000 - 59,999	2,100	1,300
60,000 - 64,999	1,800	700
65,000 - 69,999	1,300	800
70,000 - 74,999	1,300	500
75,000 - 79,999	1,000	700
80,000 - 84,999	800	600
85,000 - 89,999	900	400
90,000 - 99,999	900	800
100,000 or more	5,400	3,100
<b>Total with Earnings</b>	<b>969,300</b>	<b>338,900</b>

**Sources:** Social Security Administration, Office of Research, Evaluation and Statistics: 2007 1 Percent Continuous Work History Sample and 2006 Employee and Employer File. Data provided by the Social Security Administration to the Congressional Research Service on February 24, 2011.

**Note:** Table includes individuals who were awarded retired-worker benefits by December 2005.

- a. The exempt amounts for persons who were below FRA throughout 2006 were \$12,480 annually and \$1,040 monthly.
- b. The exempt amounts for persons who attained FRA in 2006 were \$33,240 annually and \$2,770 monthly.

## Application of the Retirement Earnings Test

**Table 2** illustrates the application of the RET to a single person who receives benefits based on his or her own work record. The table illustrates the effect of the RET on single worker beneficiaries in two different age groups, reflecting the application of different annual exempt amounts and benefit reduction rates under the RET for beneficiaries who will remain below FRA throughout the calendar year and beneficiaries who will attain FRA during the calendar year. The two single worker beneficiaries in the examples have the following characteristics:

***Single Worker Beneficiary Who is Below FRA Throughout the Calendar Year.*** This example shows a worker beneficiary with a monthly benefit amount of \$2,000 (this amount has already been adjusted for retirement before FRA) and \$40,000 of earnings in 2012. Because this worker beneficiary is below FRA throughout the calendar year, he or she is subject to a \$1 reduction in benefits for each \$2 of earnings above the annual exempt amount of \$14,640 in 2012.

***Single Worker Beneficiary Who Will Attain FRA During the Calendar Year.*** This example shows a worker beneficiary with a monthly benefit amount of \$2,000 (this amount has already been adjusted for retirement before FRA) and \$40,000 of earnings in 2012. Because this worker beneficiary will attain FRA during the calendar year, he or she is subject to a \$1 reduction in benefits for each \$3 of earnings above the annual exempt amount of \$38,880 in 2012.

**Table 2. Application of the Retirement Earnings Test to a Single Worker Beneficiary with Earnings Above the Annual Exempt Amount, 2012**

Step	Worker Beneficiary is Below FRA Throughout Calendar Year	Worker Beneficiary Will Attain FRA During Calendar Year
1. Social Security monthly benefit	\$2,000	\$2,000
2. Calculation of earnings above annual exempt amount		
Earnings in 2012	\$40,000	\$40,000
RET exempt amount in 2012	\$14,640	\$38,880
Earnings above annual exempt amount	\$25,360	\$1,120
3. RET charge (= one-half of earnings above exempt amount for beneficiary below FRA, or one-third of earnings above exempt amount for beneficiary who will attain FRA during calendar year)	\$12,680	\$560
4. Application of the RET. The benefit paid each month equals the monthly benefit amount of \$2,000 minus the remaining balance of the RET charge. The RET charge for a given month cannot exceed the benefit for that month, but it may reduce the benefit to zero in some months. A partial benefit is paid if the remaining RET balance is less than the monthly benefit amount.		
January monthly benefit	\$0 <sup>a</sup>	\$1,440 <sup>b</sup>
February through June monthly benefits	\$0 <sup>a</sup>	\$2,000
July monthly benefit	\$1,320 <sup>b</sup>	\$2,000
August through December monthly benefits: full benefits paid	\$2,000	\$2,000, plus increase resulting from benefit recomputation at FRA to take into account months for which no benefit or a partial benefit was paid due to the RET

**Source:** Congressional Research Service.

**Notes:** In this example, it is assumed that the worker beneficiary receives benefits based on his or her own work record only. The starting benefit amounts are assumed to include reductions for retirement before FRA, and to exclude other reductions that may apply. The example has been constructed so that the year” provision does not apply, by assuming that the beneficiary both works and collects benefits over the full calendar year. (See “Grace Year” section.) Alternatively, under the grace year provision, a beneficiary who is in the first year of entitlement is not subject to the RET in any month during which he or she has earnings that do not exceed the monthly exempt amount (the annual exempt amount divided by 12), regardless of the beneficiary’s total amount of earnings for the year.

- a. No benefit is paid this month because the beneficiary’s RET balance is larger than the monthly benefit amount, so the RET charge for this month is equal to the benefit amount.
- b. A partial benefit is paid this month because the beneficiary’s RET balance is smaller than the monthly benefit amount.

As discussed above, certain auxiliary benefits (benefits paid to the worker's family members such as a spouse or children) are subject to withholding under the RET if either the worker beneficiary or the auxiliary beneficiary has earnings above the exempt amount. When the worker beneficiary has earnings above the exempt amount, these earnings are charged against the total family benefit, that is, the total of benefits paid to the worker beneficiary and auxiliary beneficiaries who receive benefits based on the worker beneficiary's record. (When the auxiliary beneficiary has earnings above the exempt amount, these earnings are charged only against the auxiliary beneficiary's benefit, as discussed below.)

**Table 3** provides an example of a worker beneficiary who is entitled to a monthly retirement benefit of \$2,000 (this amount has already been adjusted for retirement before FRA). In addition, the worker beneficiary's spouse and child are each entitled to a monthly auxiliary benefit of \$1,000 based on the worker beneficiary's record. Therefore, the total monthly family benefit is \$4,000.<sup>15</sup>

If the worker beneficiary is below FRA and has earnings above the exempt amount, reductions under the RET are pro-rated among family members in proportion to each family member's original entitlement amount, before any adjustment for the family maximum or for retirement before FRA.<sup>16</sup> The total amount of the reduction remains the same, but the reduction is pro-rated across two or more people. If reductions under the RET are large enough to exceed the total family benefit for one or more months, no benefits are payable to the family for those months. If a partial benefit is payable for a given month, reflecting a reduction under the RET for that month that is less than the total family benefit, the partial benefit is pro-rated among family members.

In **Table 3**, benefits for the illustrative family are shown under two cases of the RET. The first case shows a family headed by a worker beneficiary who is below FRA throughout the calendar year and is subject to a benefit reduction under the RET equal to one-half of earnings above the lower exempt amount of \$14,640 in 2012. The second case shows a family headed by a worker beneficiary who will attain FRA during the calendar year and is subject to a benefit reduction under the RET equal to one-third of earnings above the higher exempt amount of \$38,880 in 2012.

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<sup>15</sup> A family's total benefits are subject to a cap known as the "family maximum," as discussed in **Appendix B**. For purposes of illustration, this example is simplified and does not include the family maximum.

<sup>16</sup> Social Security Administration, *Program Operations Manual System* (Washington, DC), RS 02501.110, <http://policy.ssa.gov/poms.nsf/links/0302501110>.

**Table 3. Application of the Retirement Earnings Test to a Family Consisting of a Worker Beneficiary with Earnings Above the Annual Exempt Amount and Auxiliary Beneficiaries (a Spouse and a Child), 2012**

Step	Worker Beneficiary is Below FRA Throughout Calendar Year	Worker Beneficiary Will Attain FRA During Calendar Year
1. Social Security unreduced total monthly family benefit	\$4,000	\$4,000
<i>of which:</i>	<i>of which:</i>	<i>of which:</i>
Worker beneficiary's unreduced benefit	\$2,000	\$2,000
Spouse's unreduced benefit	\$1,000	\$1,000
Child's unreduced benefit	\$1,000	\$1,000
2. Calculation of worker beneficiary's earnings above the annual exempt amount		
Worker beneficiary's earnings in 2012	\$40,000	\$40,000
RET exempt amount in 2012	\$14,640	\$38,880
Worker beneficiary's earnings above the annual exempt amount	\$25,360	\$1,120
3. RET charge (= one-half of earnings above the exempt amount for worker beneficiary who is below FRA, or one-third of earnings above the exempt amount for worker beneficiary who will attain FRA during calendar year)	\$12,680	\$560
4. Application of the RET to the total family benefit. The total family benefit paid each month equals the monthly family benefit amount of \$4,000 minus the remaining balance of the RET charge, where the RET charge is pro-rated across family members by original benefit amount (shown in notes to the table). The RET charge for a given month cannot exceed the total family benefit for that month, but it may reduce the family benefit to zero in some months. A partial benefit is paid if the remaining RET balance is less than the monthly family benefit amount.		
January total monthly family benefit	\$0 <sup>a</sup>	\$3,440 <sup>b</sup>
February and March total monthly family benefit	\$0 <sup>a</sup>	\$4,000
April total monthly family benefit	\$3,320 <sup>c</sup>	\$4,000
May through December total monthly family benefit	\$4,000	\$4,000, plus increase resulting from benefit recomputation at FRA to take into account months for which no benefit or a partial benefit was paid due to the RET

**Source:** Congressional Research Service.

**Notes:** In this example, it is assumed that the worker beneficiary receives benefits based on his or her own work record only, and that the spouse and child beneficiaries receive auxiliary benefits based on the worker beneficiary's record only. The starting benefit amounts are assumed to include reductions for retirement before FRA, and to exclude other benefit reductions that may apply, such as those related to receipt of a non-covered pension and the maximum family benefit amount. The example has been constructed so that the "grace year"



provision does not apply, by assuming that the beneficiary both works and collects benefits over the full calendar year. (See “Grace Year” section.) Alternatively, under the grace year provision a beneficiary who is in the first year of entitlement is not subject to the RET in any month during which he or she has earnings that do not exceed the monthly exempt amount (the annual exempt amount divided by 12), regardless of the beneficiary’s total amount of earnings for the year.

- a. No benefit is paid this month because the beneficiary’s RET balance is larger than the monthly benefit amount, so the RET charge for this month is equal to the benefit amount.
- b. A partial benefit is paid to each family member in January because the RET balance is smaller than the total family benefit amount for the month. The RET balance of \$560 is pro-rated and charged against all beneficiaries in proportion to their original entitlement amounts. One-half of the RET charge (\$280) is applied to the worker beneficiary and one-fourth (\$140) each is applied to the spouse and child. Therefore the worker beneficiary receives a January benefit of \$1,720 (\$2,000 - \$280) and the spouse and child each receive January benefits of \$860 (\$1,000 - \$140).
- c. A partial benefit is paid to each family member in April because the remaining RET balance is smaller than the total family benefit amount for the month. The remaining RET balance of \$680 is pro-rated and charged against all beneficiaries in proportion to their original entitlement amounts. One-half of the RET charge (\$340) is applied to the worker beneficiary and one-fourth (\$170) each is applied to the spouse and child. Therefore the worker beneficiary receives an April benefit of \$1,660 (\$2,000 - \$340) and the spouse and child each receive April benefits of \$830 (\$1,000 - \$170).

The preceding examples illustrate cases in which the worker beneficiary has earnings above the exempt amount. In some cases, both the worker beneficiary and an auxiliary beneficiary (such as a spouse) may have earnings above the exempt amount. **Table 4** shows an example of a couple in which (1) one member, the worker beneficiary, receives a retired-worker benefit based on his or her own work record, and (2) one member, the auxiliary beneficiary, receives a spousal benefit only. Both beneficiaries are assumed to be below FRA throughout the calendar year and to have earnings above the RET exempt amount.<sup>17</sup> Because neither beneficiary will attain FRA during the calendar year, both are subject to the same RET exempt amount and benefit reduction rate. Benefit reductions under the RET are applied to the couple in the following order:<sup>18</sup>

- First, the worker beneficiary’s RET charge is pro-rated and applied to both the worker beneficiary’s retired-worker benefit and the auxiliary beneficiary’s spousal benefit.<sup>19</sup>
- Second, if there is a balance remaining on the spousal benefit (if the spousal benefit has not been reduced to zero), the auxiliary beneficiary’s RET charge is applied to (and further reduces) his or her spousal benefit only (the auxiliary beneficiary’s earnings above the RET exempt amount do not affect the worker beneficiary’s retired-worker benefit).

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<sup>17</sup> An example of such a couple would be a worker beneficiary who receives a retired-worker benefit based on his or her own work record and an auxiliary beneficiary (a spouse) who is currently working but does not receive his or her own retired-worker benefit. This may be the case, for example, because the auxiliary beneficiary (the spouse) does not have enough Social Security-covered employment to qualify for a retirement benefit.

<sup>18</sup> 20 C.F.R. §404.434(b)(3).

<sup>19</sup> If the auxiliary beneficiary in this example (spouse #2) were dually entitled to a retired-worker benefit based on his or her own work record and a spousal benefit, the worker beneficiary’s RET charge would apply only to the spousal benefit, and not the retired-worker benefit, received by spouse #2.

**Table 4. Application of the Retirement Earnings Test to a Couple Consisting of a Worker Beneficiary and an Auxiliary (Spousal) Beneficiary, Both of Whom Have Earnings Above the Annual Exempt Amount and Are Below FRA Throughout the Calendar Year, 2012**

Step	Spouse #1: Worker Beneficiary	Spouse #2: Auxiliary Beneficiary
1. Social Security retired-worker benefit, based on own work record	\$2,000	
2. Social Security auxiliary (spousal) benefit		\$1,000
3. Calculation of earnings above annual exempt amount		
Earnings in 2012	\$25,000	\$25,000
RET exempt amount in 2012	\$14,640	\$14,640
Earnings above annual exempt amount	\$10,360	\$10,360
4. RET charge (= one-half of earnings above the exempt amount for both worker beneficiary and auxiliary beneficiary, both of whom are below FRA throughout the calendar year)	\$5,180	\$5,180
5. Application of the RET		
January benefit: Worker beneficiary's RET charge is applied to total family benefits of \$3,000.	\$0	\$0
February benefit: Balance of worker beneficiary's RET charge (\$2,180 = \$5,180 - \$3,000) is prorated between worker beneficiary and auxiliary beneficiary in proportion to their original entitlement amount (a ratio of two to one): \$1,453 is applied to the worker beneficiary and \$727 is applied to the auxiliary beneficiary. In addition, \$273 of auxiliary beneficiary's RET charge is applied to the auxiliary beneficiary's benefit only, reducing it to zero.	\$547	\$0
March through June monthly benefits: Worker beneficiary receives full monthly benefits. Auxiliary beneficiary's monthly benefit is reduced to zero by his or her own RET charge (worker beneficiary is not affected).	\$2,000	\$0
July monthly benefit: Worker beneficiary receives full monthly benefit. Auxiliary beneficiary's RET balance of \$907 (\$5,180 - \$4,273) is charged to his or her benefit.	\$2,000	\$93
August through December monthly benefits: full benefits paid to both spouses	\$2,000	\$1,000

**Source:** Congressional Research Service.

**Notes:** In this example, both beneficiaries are assumed to be below FRA throughout the calendar year and therefore are subject to the same RET exempt amount and benefit reduction rate. It is assumed that the worker beneficiary receives benefits based on his or her own work record only, and that the auxiliary beneficiary (spouse) receives benefits based on the worker beneficiary's record only. The starting benefit amounts are assumed to include reductions for retirement before FRA, and to exclude other benefit reductions that may apply, such as those related to receipt of a non-covered pension. The example has been constructed so that the "grace year" provision does not apply, by assuming that the beneficiaries both work and collect benefits over the full calendar year. (See "Grace Year" section.) Alternatively, under the grace year provision, a beneficiary who is

in the first year of entitlement is not subject to the RET in any month during which he or she has earnings that do not exceed the monthly exempt amount (the annual exempt amount divided by 12), regardless of the beneficiary's total amount of earnings for the year.

More complex situations may exist in which, for example, a person is dually entitled to a retired-worker benefit (based on his or her own work record) and a spousal benefit (based on a different work record) and the person has earnings above the exempt amount. In the case of a dually-entitled beneficiary, his or her earnings above the exempt amount affect both his or her own retired-worker benefit and the spousal benefit that he or she receives. The dually entitled beneficiary's earnings above the exempt amount do not affect the retired-worker benefit received by his or her spouse because that benefit is based on the spouse's work record.

**Table 5** summarizes the applicability of the RET to worker beneficiaries and auxiliary beneficiaries when either type of beneficiary has earnings above the exempt amount.

**Table 5. Applicability of the Retirement Earnings Test to Worker Beneficiaries and Auxiliary Beneficiaries**

Beneficiary Type	Worker Beneficiary Has Earnings Above the Exempt Amount	Auxiliary Beneficiary Has Earnings Above the Exempt Amount
<b>Worker Beneficiary</b>	Worker beneficiary's own benefit is reduced.	Only the auxiliary benefit is reduced, not the worker beneficiary's benefit.
<b>Auxiliary Beneficiary: Spouse</b>	Auxiliary benefits to spouses are reduced for the worker beneficiary's earnings above the exempt amount, which are charged against the total family benefit.	Only the auxiliary benefit is reduced, not the worker beneficiary's benefit.
<b>Auxiliary Beneficiary: Divorced Spouse</b>	A divorced spouse's benefit is not reduced for the worker beneficiary's earnings above the exempt amount if the couple has been divorced at least two years.	Only the auxiliary benefit is reduced, not the worker beneficiary's benefit.
<b>Auxiliary Beneficiary: Child</b>	Auxiliary benefits to children are reduced for the worker beneficiary's earnings above the exempt amount, which are charged against the total family benefit.	Only the auxiliary benefit is reduced, not the worker beneficiary's benefit.
<b>Auxiliary Beneficiary: Mother or Father with Qualifying Child in Care</b> (child under age 16 or disabled)	Not applicable (worker beneficiary is deceased).	The mother's or father's benefit is reduced.
<b>Auxiliary Beneficiary: Widow(er)</b>	Not applicable (worker beneficiary is deceased).	The widow(er)'s benefit is reduced.
<b>Auxiliary Beneficiary: Parent</b>	Not applicable (worker beneficiary is deceased).	The parent's benefit is reduced.

**Source:** Social Security Administration, *Social Security Handbook*, revised November 19, 2007, [http://www.ssa.gov/OP\\_Home/handbook/handbook.18/handbook-1806.html](http://www.ssa.gov/OP_Home/handbook/handbook.18/handbook-1806.html).

**Notes:** A worker beneficiary's spouse or child who is receiving mother's/father's benefits or child's benefits based on a third person's work record is deemed entitled on the worker beneficiary's record. Therefore, the worker beneficiary's earnings above the exempt amount would be charged not only against his or her own benefits and the benefits of those entitled on his or her record, but also against the spouse's or child's benefits

that are based on a third person's work record. As noted previously, disabled beneficiaries are subject to different rules and limitations regarding earnings.

## Policy Issues

Policymakers have asked questions about the RET's impact on labor supply and on the timing of Social Security benefit claims. Some argue that the RET is perceived as a "tax" on work effort, and that it induces workers to work fewer hours, or even to retire completely from the workforce. Another line of enquiry is whether the RET causes workers to delay claiming Social Security benefits. Both of these effects could have important implications for the retirement security of workers, their spouses and their survivors.

Quantitative studies have found mixed evidence concerning the RET's impact on work hours, retirement and the timing of Social Security benefit claims. Although the RET has been found to have a substantial effect on the labor supply of workers at or just above the annual RET threshold, the impact on workers with higher wages and salaries is more ambiguous. There is somewhat stronger evidence that the RET causes workers to delay claiming Social Security benefits.

## The RET and Work Incentives

The impact of the RET on work hours varies by income level. At wages and salaries that are at or just above the annual RET threshold, the RET may encourage workers to work fewer hours, to keep wages or salaries just under the RET threshold. This effect is known as "bunching" or "clustering" under the RET threshold. A 1999 study found that a subset of workers do cluster at earnings levels just below the RET threshold.<sup>20</sup>

At higher earnings levels, the RET's impact on work hours is more ambiguous. Some workers perceive the RET as a tax on work effort (despite the recomputation of benefits at FRA). Moreover, other workers who are aware of the recomputation may place a relatively low value on future income. To the extent that the RET is perceived as a tax on earnings, it may induce some workers to reduce their work hours or even to retire completely from the workforce. Other workers, however, may respond to the RET reduction to Social Security benefits by working more, not fewer, hours to reach their income goals or requirements. For these workers, eliminating the RET would increase total income (income from labor plus income from Social Security). This has led some to argue that eliminating the RET would benefit some higher earners because the additional Social Security benefits that would become available would permit higher earners, if they wished, to reduce their work hours.

One study of the period from 1973 to 1998 found that the RET had little or no effect on the aggregate work hours and earnings of men aged 62 and older, although there is somewhat stronger evidence that the RET had an impact on women's earnings (no evidence was found for an impact on women's work hours).<sup>21</sup> However, a study of Social Security beneficiaries' response

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<sup>20</sup> Leora Friedberg, *The Labor Supply Effects of the Social Security Earnings Test*, National Bureau of Economic Research, Working Paper No. 7200, Cambridge, MA, June 1999, <http://www.nber.org/papers/w7200>.

<sup>21</sup> Jonathan Gruber and Peter Orszag, *Does the Social Security Earnings Test Affect Labor Supply and Benefits Receipt?*, National Bureau of Economic Research, Working Paper No. 7923, Cambridge, MA, September 2000, <http://www.nber.org/papers/w7923>.

to the 2000 removal of the RET for beneficiaries at or above FRA found that, when workers are segmented by earnings level, fairly large effects on earnings are found, with the effects on earnings concentrated just below and above the RET threshold. (The study did not examine how work hours were affected by the 2000 change in the RET.)<sup>22</sup> Research has not found the RET to have a large effect on labor force participation, that is, a worker's decision to retire or remain in the workforce. This is perhaps in part because the RET is a relatively small part of the larger retirement decision that includes other factors such as pension rules and the worker's health, and also because it is difficult to separate the RET's impact from the trend toward later retirement that is already under way.

## **The RET and Incentives to Claim Social Security Benefits**

Because the RET applies to persons who are younger than FRA, it may discourage persons below the FRA from claiming benefits. As noted earlier, some workers perceive the RET as a "tax" on benefits received before FRA, even though the recomputation of benefits at FRA (which results in a higher monthly benefit starting at FRA) allows the worker to recoup benefits withheld under the RET.

The quantitative evidence that the RET has an impact on the decision concerning when to claim Social Security benefits is somewhat stronger than the quantitative evidence for the RET's impact on work and earnings. For example, the Gruber and Orszag study that examined persons aged 62 and older during the period from 1973 to 1998 estimated that a \$1,000 increase in the RET threshold could increase the share of men aged 62 and older who receive Social Security benefits by 0.7% to 1.6%, while eliminating the RET could increase that share by 5.2% to 13.5%.<sup>23</sup> A more recent study that examined the 2000 elimination of the RET for men and women at or above FRA found a 2 to 5 percentage point increase in benefit claims among men and women aged 65 to 69, and a 3 to 5 percentage point increase among men and women who reach the age of 65.<sup>24</sup>

## **The RET, Retirement Security and Early Benefit Claims**

Some argue that, to the extent the RET causes some workers to delay claiming Social Security benefits, this can be beneficial for the worker as well as for his or her spouse or survivor. Claiming Social Security benefits before the FRA can reduce a worker's Social Security benefit amount in two ways, as noted earlier: (1) through the RET, although when the worker attains FRA his or her benefits are recomputed and a higher monthly benefit amount is payable starting at FRA; and (2) through the actuarial reduction for early retirement which, although it is intended to be actuarially fair to the individual over his or her expected lifetime, causes a permanent reduction to the worker's monthly Social Security benefit amount.

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<sup>22</sup> Jae G. Song and Joyce Manchester, "How Have People Responded to Changes in the Retirement Earnings Test in 2000," *Social Security Bulletin*, vol. 67, no. 1 (2007), <http://www.ssa.gov/policy/docs/ssb/v67n1/v67n1p1.pdf>.

<sup>23</sup> Jonathan Gruber and Peter Orszag, *Does the Social Security Earnings Test Affect Labor Supply and Benefits Receipt?*, National Bureau of Economic Research, Working Paper No. 7923, Cambridge, MA, September 2000, <http://www.nber.org/papers/w7923>.

<sup>24</sup> Jae G. Song and Joyce Manchester, "How Have People Responded to Changes in the Retirement Earnings Test in 2000," *Social Security Bulletin*, vol. 67, no. 1 (2007), <http://www.ssa.gov/policy/docs/ssb/v67n1/v67n1p1.pdf>.

As discussed, the RET applies to spousal benefits. (See section “The RET May Affect Social Security Benefits Received by Spouses, Survivors and Other Dependents.”) Spousal benefits that have been reduced by the RET are restored starting when the spouse attains FRA. Spousal benefits are not restored, however, when the RET is applied to the benefits of a spouse who is already at or above FRA. (See “Benefits Withheld Under the RET are Restored Starting at FRA.”)

Survivors’ benefits may be permanently affected by the worker beneficiary’s decision to claim benefits before FRA. Under a provision in the Social Security Act called the *widow(er)’s limit provision*, the widow(er)’s benefit may be reduced if the widow(er)’s benefit payable on the worker’s record exceeds the benefit the worker was receiving (including any actuarial reduction for early retirement that may have reduced the worker’s benefit) before his or her death.<sup>25</sup> If a worker has benefits withheld under the RET and he or she dies before attaining FRA (when the worker’s benefit would have been recomputed), for purposes of determining the limit on the widow(er)’s benefit, the worker’s benefit is recomputed at the time of the worker’s death to take into account months for which no benefit or a partial benefit was paid as a result of the RET.

Elderly widows, in particular, may face reduced living standards if their spouses claim benefits before FRA, because of the actuarial reduction to benefits described above. Women tend to outlive their husbands and are therefore more likely than men to receive Social Security survivors’ benefits. In addition, individuals and couples are more likely to deplete other assets later in retirement, leaving the couple or surviving spouse more reliant on Social Security.

## Other Policy Issues

Some argue that eliminating the RET would have positive budget and economic effects because people would work more and pay more Social Security payroll and other taxes. The effect of the RET on labor supply is probably modest, however, as discussed above.

A common complaint among beneficiaries affected by the RET is that they are being denied a benefit they have “bought and paid for.” A related argument is that the RET resembles a form of needs testing, making benefit receipt contingent on demonstrating “need” for this earned benefit. Supporters of the RET counter that Social Security is intended as a form of insurance against the risks of retirement and disability; just as the program does not pay disability benefits to those who are not disabled, it should not pay retirement benefits to those who are not retired.

The recomputation of benefits at FRA to restore benefits withheld under the RET is not widely known or understood. As noted previously, if a beneficiary has benefits withheld under the RET, his or her benefit is recomputed when he or she attains FRA to take into account months for which no benefit or a partial benefit was paid due to the RET. The recomputation results in a higher monthly benefit amount starting at FRA and allows the worker to recoup the value of any benefits “lost” under the RET, assuming he or she lives to average life expectancy. As a result, some observers argue that the RET should not be perceived as a “tax.”<sup>26</sup> However, for some

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<sup>25</sup> Under the *widow(er)’s limit provision*, the widow(er)’s benefit is limited to the higher of: (1) the benefit the worker would be receiving if he or she were still alive and (2) 82.5% of the worker’s PIA. For more information, see David A. Weaver, *The Widow(er)’s Limit Provision of Social Security*, Social Security Administration, Office of Policy, Research, Evaluation and Statistics, Working Paper Series Number 92, June 2001.

<sup>26</sup> Adam Paul, “The Tax That Wasn’t,” *The American: The Journal of the American Enterprise Institute*, December 17, 2009, <http://blog.american.com/?p=8363>.

workers with shorter lifespans, the recovery of benefits may be incomplete. Conversely, for those who live longer than average, the recomputation may result in higher lifetime benefits that more than make up for the initial benefit reductions under the RET. Because life expectancy is linked to income, some argue that the RET may be regressive on a lifetime basis.<sup>27</sup>

Critics of the RET argue that it discriminates against claimants who must continue working to supplement their benefits. In contrast, claimants with no earnings who have other forms of income, such as private pensions or investment income, can receive full Social Security benefits. Supporters of the RET counter that eliminating the RET would provide a bonus to people who are fortunate enough to be able to continue working after becoming entitled to retirement benefits, and the additional Social Security benefits may allow or encourage some individuals to reduce their work hours.

## **Financial Effect of Repealing the RET on the Social Security Trust Fund**

Under current law, the RET has no major effect on Social Security financing over the long run because, *on average*, the RET has “no significant effect” on lifetime benefits.<sup>28</sup> Therefore, the Social Security Administration’s Office of the Chief Actuary (OCACT) estimates that elimination of the RET for individuals aged 62 or older would have no major effect on Social Security’s projected long-range financial outlook.<sup>29</sup>

In the short run, however, OCACT estimates that elimination of the RET would have a negative effect on the Social Security trust fund in the amount of \$81 billion from 2012 to 2018. The trust fund would experience a projected cash-flow deficit of \$12.1 billion in 2012, and a projected cash-flow deficit of \$10.4 billion in 2018. OCACT notes: “In the first several years after elimination of the retirement earnings test, benefit payments are projected to increase substantially, because benefits are paid under the proposal where such payments would be withheld, or the individual would have not applied for benefits yet, under current law.”<sup>30</sup>

In summary, OCACT notes that the projected financial effects for the Social Security program of eliminating the RET are due to “(1) some individuals no longer having their benefits withheld, (2) some individuals who would apply for Social Security benefits earlier because of the earnings test elimination, and (3) a small net increase in earnings for individuals currently subject to the earnings test.”<sup>31</sup>

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<sup>27</sup> Jonathan Gruber and Peter Orszag, *What To Do About The Social Security Earnings Test?*, Center for Retirement Research, Boston, MA, July 1999, p. 5, [http://crr.bc.edu/images/stories/Briefs/ib\\_1.pdf?phpMyAdmin=43ac483c4de9t51d9eb41](http://crr.bc.edu/images/stories/Briefs/ib_1.pdf?phpMyAdmin=43ac483c4de9t51d9eb41).

<sup>28</sup> Social Security Administration, Office of the Chief Actuary, *Estimated Long-Range OASDI Financial Effect of Repealing the Retirement Earnings Test at Ages 62 and Later*, April 30, 2010, p. 1 (hereinafter *SSA Cost Estimate for Repeal of the RET*).

<sup>29</sup> *SSA Cost Estimate for Repeal of the RET*. The estimate assumes that the RET would be eliminated starting in 2012 and is based on the intermediate assumptions of the 2009 Social Security Trustees Report. OCACT estimates that the policy change would reduce Social Security’s projected long-range (average 75-year) funding shortfall from an amount equal to 2.00% of taxable payroll to an amount equal to 1.99% of taxable payroll.

<sup>30</sup> *SSA Cost Estimate for Repeal of the RET*, p. 2.

<sup>31</sup> *SSA Cost Estimate for Repeal of the RET*, p. 1.

## Appendix A. Computation of the Social Security Retired-Worker Benefit

To be eligible for a Social Security retired-worker benefit, a person generally needs 40 earnings credits, or 10 years of Social Security-covered employment (among other requirements). A worker's initial monthly benefit is based on his or her 35 highest years of earnings which are indexed to historical wage growth (earnings through the age of 60 are indexed; earnings thereafter are counted at nominal value). The 35 highest years of indexed earnings are divided by 35 to determine the worker's career-average annual earnings. The resulting amount is divided by 12 to determine the worker's average indexed monthly earnings (AIME). If a worker has fewer than 35 years of earnings in covered employment, years of no earnings are entered as zeros.

The worker's basic benefit amount (i.e., before any adjustments for early or delayed retirement) is the primary insurance amount (PIA). The PIA is determined by applying a formula to the AIME as shown in **Table A-1**. First, the AIME is sectioned into three brackets, or levels, of earnings. Three progressive factors—90%, 32%, and 15%—are applied to the three different brackets of AIME. The three products derived from multiplying each factor and bracket of AIME are added together. For workers who become eligible for retirement benefits (i.e., those who attain age 62), become disabled, or die in 2012, the PIA is determined as shown in the example in **Table A-1**.

**Table A-1. Computation of a Worker's Primary Insurance Amount in 2012  
Based on an Illustrative AIME of \$5,000**

Factors	Three Brackets of AIME (2012)	PIA for Worker with an Illustrative AIME of \$5,000
90%	first \$767 of AIME, plus	\$690.30
32%	AIME over \$767 and through \$4,624, plus	\$1,234.20
15%	AIME over \$4,624	\$56.40
<b>Total Worker's PIA (rounded down)</b>		<b>\$1,980.00</b>

Source: Congressional Research Service.

### Adjustment to Benefits Claimed Before or After FRA

A worker's initial monthly benefit is equal to his or her PIA if he or she begins receiving benefits at FRA (i.e., FRA is the earliest age at which full (unreduced) retirement benefits are payable). A worker's initial monthly benefit will be *less* than his or her PIA if he or she begins receiving benefits *before* FRA, and it will be *greater* than his or her PIA if he or she begins receiving benefits *after* FRA. As noted previously, FRA ranges from the age of 65 to 67 depending on the person's year of birth.

Retirement benefits are reduced by five-ninths of 1% (or 0.0056) of the worker's PIA for each month of entitlement before FRA up to 36 months, for a reduction of about 6.7% a year. For each month of benefit entitlement before FRA in excess of 36 months, retirement benefits are reduced by five-twelfths of 1% (or 0.0042), for a reduction of 5% a year. Workers who delay filing for benefits until after FRA receive a delayed retirement credit (DRC). The DRC applies beginning



with the month the worker attains FRA and ending with the month before he or she attains the age of 70. Starting in 1990, the DRC increased until it reached 8% per year for workers born in 1943 or later (i.e., starting with those who attained age 62 in 2005 or age 66 in 2009).<sup>32</sup>

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<sup>32</sup> Other benefit adjustments may apply, such as those related to simultaneous entitlement to more than one type of Social Security benefit, receipt of a pension from work that was not covered by Social Security (a non-covered pension), the Social Security maximum family benefit, and the Social Security Retirement Earnings Test which is the focus of this report. For more information on the various benefit adjustments, see House Ways and Means Committee, 2008 Green Book, §1, Social Security: The Old-Age, Survivors, and Disability Insurance (OASDI) Programs, pp. 1-59 to 1-68, <http://waysandmeans.house.gov/media/pdf/111/ssgb.pdf>.

## **Appendix B. Social Security Auxiliary Benefits (Benefits for the Worker's Family Members)**

Social Security provides benefits to eligible family members of a retired, disabled or deceased worker. Benefits payable to family members are equal to a specified percentage of the worker's PIA, subject to a maximum family benefit amount.

Social Security provides a monthly benefit to the spouse or divorced spouse (if the marriage lasted 10 or more years) of an entitled retired or disabled worker equal to 50% of the worker's PIA.<sup>33</sup> A monthly survivor benefit equal to 100% of the deceased worker's PIA is payable to the surviving spouse or surviving divorced spouse of a worker who was fully insured at the time of death.<sup>34</sup> Benefits for spouses, divorced spouses and surviving spouses are reduced if claimed before FRA. In addition, these benefits are reduced or fully offset if the beneficiary receives his or her own Social Security retired-worker benefit or a pension from a job that was not covered by Social Security (such as certain federal, state or local government jobs).

The child of a disabled or retired worker is eligible for 50% of the worker's PIA. The child of a deceased worker is eligible for 75% of the worker's PIA.<sup>35</sup> Social Security also provides a monthly mother's or father's benefit, equal to 75% of the worker's PIA, to a surviving parent of any age who cares for the deceased worker's child, when that child is under the age of 16 or disabled.

**Table B-1** provides a summary of Social Security auxiliary benefits for the family of a retired, disabled or deceased worker, including eligibility requirements related to age and other factors.

### **Maximum Family Benefit Amount**

The total amount of benefits payable to a family based on a retired or deceased worker's record is capped by the maximum family benefit amount. The maximum family benefit varies from 150% to 188% of the retired or deceased worker's PIA, and the maximum family benefit cannot be exceeded regardless of the number of beneficiaries entitled to benefits on the worker's record. If the sum of all benefits based on the worker's record exceeds the maximum family benefit amount, each dependent's or survivor's benefit is reduced in equal proportion to bring the total amount of benefits within the family maximum. For the family of a worker who attains age 62 in 2012, or dies in 2012 before attaining age 62, the total amount of benefits payable is limited to

- 150% of the first \$980 of PIA, plus
- 272% of PIA over \$980 and through \$1,415, plus

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<sup>33</sup> The qualifying spouse must be at least age 62 or have a qualifying child (a child who is under age 16 or disabled) in his or her care. A spouse's benefit is reduced if he or she begins receiving benefits before FRA.

<sup>34</sup> The surviving spouse must be at least age 60 (or at least age 50 if disabled) and must not have remarried before age 60 (or age 50 if disabled).

<sup>35</sup> The child must be (1) under age 18; or (2) a full-time elementary or secondary student under age 19; or (3) a disabled person aged 18 or older whose disability began before age 22.

- 134% of PIA over \$1,415 and through \$1,845, plus
- 175% of PIA over \$1,845.

The dollar amounts in the maximum family benefit formula are indexed to average wage growth, as in the primary benefit formula. A separate maximum family benefit formula applies to the family of a worker who is entitled to disability benefits.

**Table B-1. Social Security Auxiliary Benefits**

Basis for Entitlement	Basic Eligibility Requirements	Basic Benefit Amount Before Any Adjustments
Spouse	At least age 62  The worker on whose record benefits are based must be receiving benefits.	50% of worker's PIA
Divorced Spouse  (if divorced individual was married to the worker for at least 10 years before the divorce became final and is currently unmarried)	At least age 62  Generally, the worker on whose record benefits are based must be receiving benefits. However, a divorced spouse may receive benefits on the worker's record if the worker is eligible for (but not receiving) benefits and the divorce has been final for at least two years.	50% of worker's PIA
Widow(er) & Divorced Widow(er)  (if divorced individual was married to the worker for at least 10 years before the divorce became final and did not remarry before age 60)	At least age 60	100% of worker's PIA
Disabled Widow(er) & Divorced Disabled Widow(er)  (if divorced individual was married to the worker for at least 10 years before the divorce became final and did not remarry before age 50)	At least age 50  The qualifying disability must have occurred:  (1) before or within seven years of the worker's death; or  (2) within seven years of having been previously entitled to benefits on the worker's record as a widow(er) with a child in his or her care; or  (3) within seven years of having been previously entitled to benefits as a disabled widow(er) that ended because the qualifying disability ended (whichever is later).	100% of worker's PIA
Mothers and Fathers	Surviving parent of any age who cares for the deceased worker's child, when that child is either under the age of 16 or disabled. Eligibility generally ceases if the surviving mother or father remarries.	75% of deceased worker's PIA  (subject to the maximum family benefit amount)

<b>Basis for Entitlement</b>	<b>Basic Eligibility Requirements</b>	<b>Basic Benefit Amount Before Any Adjustments</b>
Parents	At least age 62 and has not married since the worker's death. The parent must have been receiving at least one-half of his or her support from the worker at the time of the worker's death or, if the worker had a period of disability which continued until death, at the beginning of the period of disability.	If one parent is entitled to benefits: 82.5% of deceased worker's PIA  If two parents are entitled to benefits: 75% of deceased worker's PIA (for each)  (subject to the maximum family benefit amount)
Child	A child (including a dependent, unmarried biological child, adopted child, stepchild, and, in some cases, grandchild) of a retired, disabled, or deceased worker who was fully or currently insured at the time of death. The child must be:  (1) under age 18; or  (2) a full-time elementary or secondary student under age 19; or  (3) a disabled person aged 18 or older whose disability began before age 22.	50% of worker's PIA for child of a retired or disabled worker  75% of deceased worker's PIA for child of a deceased worker  (subject to the maximum family benefit amount)

**Source:** Congressional Research Service.

**Notes:** The maximum family benefit may apply, reducing the benefit received by each family member on a proportional basis. The maximum family benefit varies from 150% to 188% of a retired or deceased worker's PIA. For the family of a worker who is entitled to disability benefits, the maximum family benefit is the lesser of 85% of the worker's AIME or 150% of the worker's PIA, but no less than 100% of the worker's PIA.

## Appendix C. Annual Exempt Amounts Under the Social Security Retirement Earnings Test, Calendar Years 2000-2012

The RET annual exempt amount is indexed to average wage growth in the economy. An exception, however, is that the annual exempt amount is not increased in a year during which no Social Security cost-of-living adjustment (COLA) is payable. In 2010 and 2011 there was no Social Security COLA, therefore the RET exempt amount did not increase in these years.

The RET applies only to wage and salary income (i.e., earnings from work). It does not apply to “unearned” income, such as income from pensions, rents, dividends, or interest.

**Table C-1. Annual Exempt Amounts Under the Social Security Retirement Earnings Test, Calendar Years 2000-2012**

Calendar Year	Prior to Year of Attaining FRA	During Year of Attaining FRA
2000	\$10,080	\$17,000
2001	\$10,680	\$25,000
2002	\$11,280	\$30,000
2003	\$11,520	\$30,720
2004	\$11,640	\$31,080
2005	\$12,000	\$31,800
2006	\$12,480	\$33,240
2007	\$12,960	\$34,440
2008	\$13,560	\$36,120
2009	\$14,160	\$37,680
2010	\$14,160	\$37,680
2011	\$14,160	\$37,680
2012	\$14,640	\$38,880

**Source:** Social Security Administration, <http://www.socialsecurity.gov/OACT/COLA/rtea.html>.

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