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STRANGE BUT TRUE: CLAIM AND SUSPEND SOCIAL SECURITY

BY ALICIA H. MUNNELL, ALEX GOLUB-SASS, AND NADIA KARAMCHEVA*

Introduction

With the current financial crisis wreaking havoc on retirement savings, many older people have had to reassess their retirement plans – they may decide to work longer or, if already retired, to re-enter the workforce. For those currently in the labor force, working longer increases monthly Social Security benefits. Social Security benefits are actuarially adjusted so that, on average, lifetime benefits remain the same whether a person retires at any age between 62 and 70. So the later a person retires, the higher the monthly benefit. For those thinking of re-entering the workforce, Social Security provides for higher benefits later in exchange for withholding benefits while they are employed. For those under the Full Retirement Age (currently 66), this adjustment is accomplished automatically through the annual retirement earnings test. For those over the Full Retirement Age, the adjustment can be made through the voluntary option of “claim and suspend.”

The “claim and suspend” strategy also enhances the claiming options of one-earner couples. For example, a husband who reaches the Full Retirement Age may elect to claim and immediately suspend benefits, allowing his wife to receive a spousal benefit based on his earnings record. The husband is then

free to continue working and receive delayed retirement credits, which increases not only his monthly benefit but also his wife’s survivor benefit. By using “claim and suspend” in this way, the couple can enhance the value of their lifetime benefits.

This *brief* discusses the “claim and suspend” strategy. The first section outlines the provision and its application for individuals re-entering the workforce. The second section describes how this provision applies to the claiming behavior of married couples and uses data from the *Health and Retirement Study* to calculate the cost to Social Security. The final section concludes that the gains of “claim and suspend” to those who must work longer could be quite significant in terms of higher monthly benefits for life and that the potential cost is modest (probably less than \$1 billion per year).

“Claim and Suspend” and Re-Entrants

Unlike past recessions, the labor force participation rate of older men has increased during this financial crisis (see Figure 1 on the next page). This pattern

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suggests that some people are re-entering the labor force as they find their retirement resources to be inadequate. For those re-entering, Social Security has two provisions that allow workers to enhance future benefits by having benefits withheld while they work.

FIGURE 1. INDEX OF LABOR FORCE PARTICIPATION RATES FOR MEN AGED 55 AND OLDER, BY MONTHS INTO RECESSION



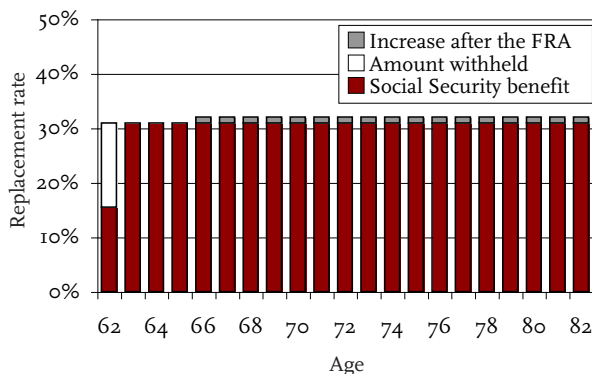
Source: Authors' calculations based on U.S. Bureau of Labor Statistics (2009).

The Annual Retirement Earnings Test

Those under the Full Retirement Age will find their Social Security benefits automatically reduced when they go back to work. In 2009, for each dollar of earnings in excess of \$14,160, benefits are reduced by \$1 for each \$2 earned. Many economic studies have shown that this test discourages work because most beneficiaries are unaware that the reduction in benefits while working triggers an increase in benefits later.¹ In fact, benefits foregone while working are in effect rolled forward to increase people's Social Security benefits after they reach the Full Retirement Age.²

An example might help. Assume that the person started to collect Social Security at age 62, but continued to work and only retired for good at 63. If that person earned so much that half his benefits were withheld, at the Full Retirement Age his benefit would be raised to what it would have been if he had claimed at age 62 and a half (see Figure 2). On average, the benefit a retiree receives is equal to the amount he would have received if the annual earnings test were never applied.

FIGURE 2. IMPACT OF ANNUAL EARNINGS TEST ON REPLACEMENT RATE PROVIDED TO MEDIUM EARNER, BY AGE



Source: Authors' calculations based on the 2008 Social Security Trustees Report; assumes an individual claims at age 62 and works until age 63 earning a salary that reduces his Social Security benefit by half.

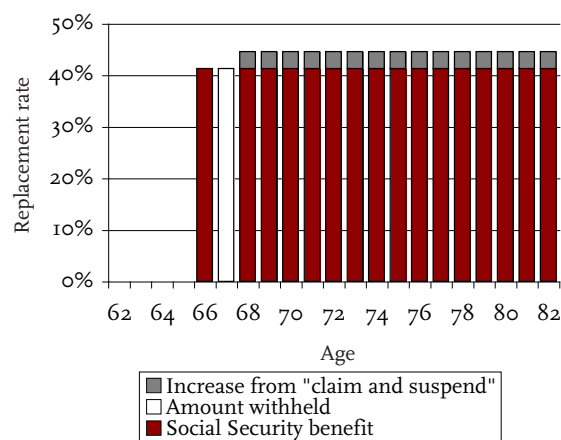
"Claim and Suspend"

Those over the Full Retirement Age who go back to work have a much more flexible option. As a result of the Senior Citizens' Freedom to Work Act of 2000, they are no longer subject to the annual earnings test but rather can voluntarily "claim and suspend." That is, they can either work and receive full benefits or voluntarily suspend payments. If they choose to suspend, they forfeit current benefits but earn delayed retirement credits (DRCs) for a permanent increase in their future monthly benefits (see Figure 3 on the next page). This strategy is very helpful to those who earn enough to support themselves, because it allows them to increase the amount of future monthly Social Security benefits – a special kind of income that is fully inflation-adjusted and payable for life.

Similarities and Differences

In essence, "claim and suspend" is a continuation of the annual earnings test. In both cases, the retiree forgoes benefits while working for an actuarially increased benefit in the future.³ The two strategies differ in that one is mandatory and one is voluntary.⁴ The notion is that the benefit at the Full Retirement Age is the target amount; workers with earnings should be building towards this goal rather than receiving benefits when they do not really need them.

FIGURE 3. IMPACT OF “CLAIM AND SUSPEND” ON AVERAGE REPLACEMENT RATE PROVIDED TO MEDIUM EARNER, BY AGE



Source: Authors' calculations based on the 2008 Social Security Trustees Report; assumes an individual claims at age 66 and suspends benefits between the ages of 67 and 68.

Once workers have achieved the target amount, they are free to receive the benefit whether they need it or not.⁵ The important point is that Social Security has provisions for people to defer benefits if they go back to work so that they can have higher monthly benefits later. Before 2000, a retired individual re-entering the labor force after the Full Retirement Age could effectively defer benefits through the temporary reduction caused by the annual earnings test. After the repeal of the annual earnings test in 2000 for individuals above the Full Retirement Age, he would no longer have had this option without the addition of the “claim and suspend” provision.

“Claim and Suspend” and Claiming Strategies

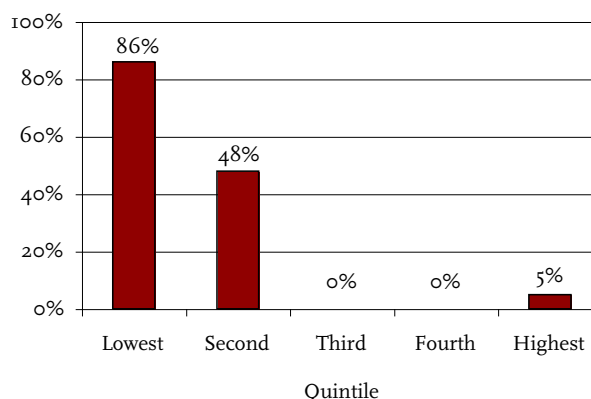
“Claim and suspend” also enhances the claiming options for married couples and thereby increases their potential lifetime benefits. Earlier studies have shown that couples maximize their expected lifetime benefits by having the wife claim early and the husband claim late.⁶ The intuition is that the wife will receive her relatively low spousal benefit and/or benefit based on her own earnings only over the relatively short expected lifetime of her husband rather than over the relatively long expected life of the average woman. Therefore, the wife – like any beneficiary with an expected short life – should claim early. The wife’s survivor benefit, which she will receive once

her husband dies, depends on her husband’s actual benefit. To get as high a survivor benefit as possible, the husband should continue working as long as possible. Thus, the optimal claiming ages for the husband and wife are 70 and 62, respectively.

For the typical couple where the wife is three years younger than her husband, this optimal claiming strategy is reasonably feasible with “claim and suspend.” The husband can claim his benefits at today’s Full Retirement Age of 66, allowing his wife age 63 to start collecting her spousal benefit.⁷ He can then suspend his benefit and increase the monthly amount by working to age 70. Without “claim and suspend,” however, the typical couple cannot achieve this optimal strategy. The wife would have to wait until 67 before she could claim. Thus, the couple’s options would be constrained.

To understand the cost implications of the “claim and suspend” strategy, we use the 2006 *Health and Retirement Study* (HRS) and focus on the joint claiming decisions married couples must make when the eldest member is 62.⁸ The goal is to compare the lifetime benefits of couples when they can take advantage of “claim and suspend” to the lifetime benefits under the old rules when the wife could not claim until the husband retired. As expected, only a small portion (28 percent) of couples benefit from “claim and suspend.” The beneficiaries are either single-earner couples or those where the wife’s earnings are very small relative to the husband’s (see Figure 4).

FIGURE 4. PERCENT OF COUPLES USING AN OPTIMAL CLAIMING STRATEGY WHO WOULD “CLAIM AND SUSPEND” BY RATIO OF LOW TO HIGH EARNER PIA*



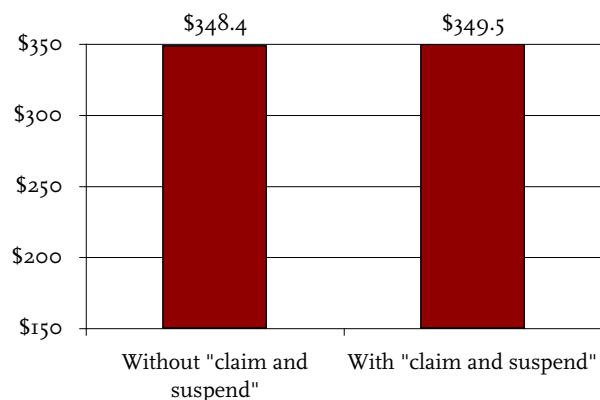
* The PIA (Primary Insurance Amount) is the base amount used in computing Social Security benefits; it is equivalent to the amount payable to a retired worker who begins receiving benefits at the Full Retirement Age.

Sources: Authors' calculations based on University of Michigan, *Health and Retirement Study* (HRS), 2006; and U.S. Bureau of Labor Statistics, *Current Population Study* (CPS), 2006.

After all, wives with significant earnings could always claim in their own right and were never dependent on the claiming decision of their husbands.

The gain to these essentially one-earner couples from moving from a constrained optimizing claiming strategy to a virtually unconstrained strategy with “claim and suspend” is relatively small – roughly \$1 billion per year (see Figure 5). Moreover, this estimate assumes that couples follow an optimal claiming strategy, and evidence suggests that many do not.⁹ (See Appendix for details on the calculations.)

FIGURE 5. MAXIMUM LIFETIME BENEFITS PAID TO COUPLES TURNING 62 IN 2006 UNDER OPTIMAL CLAIMING STRATEGIES WITH AND WITHOUT “CLAIM AND SUSPEND,” 2006 DOLLARS (BILLIONS)



Sources: Authors' calculations based on 2006 HRS and 2006 CPS.

Conclusion

Since the beginning of the economic collapse, more people have been reentering the workforce in an attempt to shore up their retirement savings. The labor force participation rate for men aged 55 and older has risen substantially since October 2007 – the peak of the stock market. Many of these men have already claimed Social Security and will be looking to build a sturdier retirement outlook. After experiencing the recent volatility, individuals will undoubtedly be placing a greater premium on dependable streams of income like Social Security. “Claim and suspend” allows individuals to increase their level of dependable income in the future.

Claim and suspend also offers one-earner couples more flexibility in executing their optimal claiming strategy. The higher earner can claim at 66, allow his spouse – typically three years younger – to claim and then suspend his benefits while he continues to work and build up his monthly benefits. Fortunately, the cost to Social Security of enhancing the claiming strategies for one-earner couples is modest – probably less than \$1 billion per year given actual claiming behavior. This annual cost is swamped by the benefits of allowing people to increase their ultimate Social Security check. The challenge is to make sure that everyone knows that “claim and suspend” is an available option.

Endnotes

1 Before the introduction of early retirement, the annual earnings test was effectively a tax in that benefits lost one year did not produce a gain in benefits in later years. Until recently, it partially retained the characteristics of a tax for employment after the Full Retirement Age, as the increase in benefits was not actuarially fair.

2 In some instances, the annual earnings test causes individuals to be worse off than had they not claimed before the Full Retirement Age. Consider an individual who claims benefits at 62 but continues working until age 63. If his salary is so high that his benefits are completely withheld, upon reaching the Full Retirement Age he will be treated as if he claimed at 63. However, the recalculation will not take into account the fact that the individual did not receive a higher benefit for the time between when he stopped working and the Full Retirement Age.

3 In both cases, if the individual has a spouse, the survivor benefit is increased to the extent that it is based on the higher earner's actual benefit.

4 They also differ in the timing of the increase. Under the annual earnings test, higher benefits are provided only once the worker attains the Full Retirement Age. Under "claim and suspend," higher benefits are payable as soon as the worker re-claims.

5 If the individual has a spouse, "claim and suspend" leaves the spousal benefit unaffected, but the annual earnings test will reduce spousal benefits that are based on the worker's earnings record.

6 See Munnell and Soto (2005). The text refers to the typical situation, in which the wife's earnings are low relative to the husband's earnings. But the optimal claiming strategy for a given couple depends critically on the difference in ages between the two spouses and the difference in their relative earnings.

7 Under current law, the Full Retirement Age is increasing gradually from the traditional age of 65 to age 67. An individual's date of birth determines his or her Full Retirement Age.

8 Because of the low number of couples reaching age 62, we augmented our sample size to get a more reliable estimation. See Appendix for further explanation.

9 Sass, Sun and Webb (2008) estimate that couples leave upwards of 4 percent of their potential benefits on the table.

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APPENDIX

Appendix: The Cost of the “Claim and Suspend” Strategy

The analysis is based on 1,006 couples with the eldest member aged 62-70 in the 2006 *Health and Retirement Study* (HRS). The HRS restricted and self-reported earnings data make it possible to calculate Social Security’s primary insurance amounts (PIAs). The PIA is used to calculate the cumulative lifetime benefits earned by couples based on their joint retirement ages. (To estimate steady state annual costs, we assumed a Full Retirement Age of 66 and delayed retirement credits of 8 percent for each year benefits are postponed.) The analysis also assumes individuals attempt to maximize benefits paid to their household and consequently couples make cooperative claiming decisions.

The first step is to determine each couple’s optimal claiming ages and subsequent lifetime benefits under conventional claiming methods – without the use of the “claim and suspend” strategy. We adjust each couple’s circumstances to evaluate their claiming decisions as if the oldest member were 62 in 2006. We then compute potential benefits at each age discounted for probability of survival and interest. Based on 1948 cohort life tables, we then used relative mortality rates for 12 gender-race-education categories from Brown, Liebman, and Pollet (2002) to calculate the total expected benefits paid to each household at each combination of possible claiming ages, taking expected survivor benefits into account as well.

For the husband’s claiming age of i and the wife’s claiming age of j , total expected benefits, $TotB_{ij}$, is equal to

$$(1) \quad TotB_{ij} = \sum_{x=i}^{120} (BenH_i * probH_x * probW_x + Surv_{ij} * ((1 - probW_x) * probH_x)) + \sum_{y=j}^{120} (BenW_j * probW_y * probH_y + Surv_{ij} * ((1 - probH_y) * probW_y)),$$

where $BenH_i$ is the benefit received by the husband, $probH_x$ is the probability that the husband is alive at time x , $Surv_{ij}$ is the survivor benefit paid to the surviving spouse, $BenW_j$ is the benefit received by the wife, and $probW_y$ is the probability that the wife is alive at time y . If an individual is eligible for both personal and spousal benefits, he or she will receive the larger of the two. We then identify the couple’s combination of claiming ages that yield the highest expected lifetime benefits, and assume it to be their optimal claiming strategy under conventional behavior.

The second step is to determine each couple’s optimal claiming ages and subsequent lifetime benefits when using the “claim and suspend” strategy. To introduce this strategy, we restrict one member of the couple from claiming benefits until he or she reaches age 66 and permit the spouse to claim a spousal benefit once the restricted member reaches the Full Retirement Age, regardless of whether or not he has claimed. (It is important to note that a large share of individuals claim as soon as they become eligible and do not follow the optimal behavior assumed in our estimates.) When the husband is the restricted member, the total expected benefits paid to the household, $TotB'_{Hij}$, will be

$$(2) \quad TotB'_{Hij} = \sum_{x=66}^{120} (BenH_i * probH_x * probW_x + Surv_{ij} * (1 - probW_x) * probH_x) + \sum_{y=j}^{120} (BenW_j * probW_y * probH_y + Surv_{ij} * (1 - probH_y) * probW_y)$$

If the husband’s age is greater than the FRA when the wife’s age is y , her benefit, $BenW_{yy}$, is the greater of her retired worker benefit and the spousal benefit she is entitled to based on her husband’s earnings record. If the wife is the restricted member, the total expected benefits paid to the household, $TotB'_{wij}$, will be

$$(3) \quad TotB'_{wij} = \sum_{y=66}^{120} (BenW_j * probW_y * probH_y + Surv_{ij} * (1 - probH_y) * probW_y) + \sum_{x=i}^{120} (BenH_{ix} * probH_x * probW_x + Surv_{ij} * (1 - probW_x) * probH_x)$$

If the wife's age is greater than the FRA when the husband's age is x , his benefit, $BenH_{ix}$, is the greater of his retired worker benefit and the spousal benefit he is entitled to based on his wife's earnings record. We assume the couple will use whichever strategy yields the higher expected household benefit.

The third step involves, for each couple, subtracting the expected lifetime benefits paid under the conventional claiming strategy from the expected lifetime benefits paid under the "claim and suspend" strategy. If the difference is negative, we assume the couple will not use the strategy and there will be a zero net cost to Social Security. If the difference is positive, we assume the couple will use the strategy and the gain over the conventional claiming behavior is the cost incurred by that couple to Social Security. (Of course, currently, many people do not follow optimal strategies, so our estimates essentially produce an upper boundary of the cost to Social Security.)

Finally, the HRS weights were then applied to calculate average gains made by couples when using this strategy. The total cost to Social Security is then found by multiplying those averages by the actual number of couples in which the eldest member is aged 62 from the 2006 *Current Population Survey*.

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