

Enhancing Social Security benefits for low earners: Effects of reducing eligibility requirements for Social Security retirement benefits

Version of November 14, 2008

A research project for the National Academy of Social Insurance

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Acknowledgements: I wish to acknowledge the National Academy of Social Insurance for its financial support for this project; Martin Holmer for advice and programming assistance with the GEMINI model; Russ Walker and David Weaver of the Social Security Administration for useful tabulations of administrative data; Adam Paul, for research assistance; and the participants in a discussion group organized by NASI for very helpful advice.

Executive summary

Under current law, eligibility for Social Security retirement benefits requires 40 quarters (roughly 10 years) of earnings in covered employment. While individuals with less than 40 quarters of employment may receive benefits based on the earnings record of an eligible spouse, a small number of unmarried individuals fail to qualify for retirement benefits due to a short earnings record. These non-qualified individuals often must depend on Supplemental Security Income (SSI) for support in retirement. However, SSI eligibility requirements limit earnings and asset accumulation, making it more difficult for beneficiaries to work or save.

This paper explores the effects of eliminating the 40 quarters eligibility requirement. Doing so would allow retirement benefit eligibility for individuals with very short work histories and reduce dependency on SSI benefits. The effects of reducing the 40 quarters eligibility requirement are analyzed for the 1950 birth cohort using the Policy Simulation Group's GEMINI and PENSIM microsimulation models of the Social Security population and private pensions.

Eliminating the 40 quarters eligibility requirement would increase benefits for approximately 5.8 percent of individuals. These benefit increases would be concentrated in the bottom three deciles of lifetime earnings, where 15 percent of individuals would receive increased benefits. Average benefit increases for affected individuals in the bottom three deciles of earnings would be around \$2,400 per year. Benefit increases are concentrated among immigrants, whose shorter periods in the labor force increase the likelihood of not satisfying the current 40 quarters eligibility requirement. Due to the relatively small number of affected individuals, increases in total system costs would be modest. The 75-year actuarial deficit would increase from 1.70 percent of taxable payroll under current law to around 1.79 percent of payroll.

While reducing or eliminating the 40 quarters eligibility requirement could increase benefit availability for very low lifetime earners, it would also increase benefits for individuals whose primary earnings were derived from employment not covered by Social Security. These individuals, mostly employees of state and local governments, could receive windfalls if other corrective actions were not taken. However, application of the existing WEP/GPO provisions to newly Social Security eligible state/local government employees could help correct for any

imbalances in relative benefit generosity, although some modifications to WEP/GPO rules to maintain neutrality between covered and non-covered employees may be necessary.

Moreover, increased Social Security retirement benefits could potentially remove individuals from SSI, which could then put at risk these individuals' eligibility for means-tested assistance programs such as Medicaid and Food Stamps. In most cases, however, increased Social Security benefits would supplement SSI rather than eliminate it.

Introduction

Eligibility for Social Security retirement benefits requires an individual achieve "fully insured status." For individuals reaching age sixty-five after the year 1992, fully insured status requires the individual have at least 40 quarters of earnings in covered employment. Effectively, this limits retirement benefit eligibility to individuals with earnings histories of greater than 10 years.

However, this requirement can be seen as regressive. Individuals with fewer than 10 years of covered employment have among the lowest lifetime earnings in the retiree population, yet they are entitled to no benefits despite paying taxes for up to 10 years. Despite having the lowest lifetime earnings, these individuals also have the lowest ratios of Social Security benefits to taxes. While many of these individuals receive retirement benefits based upon the eligibility of a current or former spouse, a small number fail to qualify for retirement benefits.

Individuals who do not qualify for retirement benefits must generally turn to Supplemental Security Income (SSI), a means-tested welfare program providing income assistance to the elderly, blind and disabled. While a valuable backstop, SSI has several important limitations. To qualify, individuals must have less than \$2,000 in liquid assets, a means-test which may prevent some individuals who fail to reach the 40 quarters requirement from receiving SSI. Second, unlike Social Security, SSI reduces benefits on a roughly 1-for-2 basis for any earnings the individual may have, which discourages individuals from remaining in employment. Third, SSI benefits to the aged are not available until age sixty-five, while Social Security benefits are available as early as age sixty-two. Reducing or eliminating the 40 quarters requirement for fully insured status may reduce individuals' dependency on SSI for retirement income, thereby improving incentives to work and accumulate assets since Social Security benefits are based on the level of earnings while working.

This project must consider one important complicating factor. Many individuals who fail to reach the 40 quarters threshold are not lifetime low earners but individuals who spent most of their work lives in non-covered employment, such as in a state or local government. These individuals appear poor from the viewpoint of the Social Security benefit formula, but are in most cases middle class or above. Fortunately, reduction of the 40 quarters requirement need not imply new rules to handle beneficiaries with earnings from non-covered employment. Existing rules included in the WEP/GPO can be applied to any new beneficiaries created through reductions in eligibility requirements.

I simulate a policy scenario in which the 40 quarters eligibility requirement is eliminated beginning in 2009. Using GEMINI, a microsimulation model of the Social Security population developed by the Policy Simulation Group, Inc. (PSG), these changes implementation and their effects on benefit eligibility and benefit levels are analyzed. A second PSG model, PENSIM, is utilized to assist in modeling the WEP/GPO provisions for individuals receiving pension benefits from non-covered employment. Benefits are analyzed for the 1950 birth cohort, who will become eligible for retirement benefits in the 2010s.

Background on Eligibility for Social Security Benefits

As a social insurance program paying “earned” benefits, Social Security differs from a so-called “welfare program” in that eligibility for benefits is not based strictly upon need. Rather, Social Security requires that individuals satisfy certain participation requirements in order to qualify for benefits. Social Security’s eligibility requirements differ by benefit type, and these requirements have evolved through the program’s history.

Eligibility for disability benefits or for survivors benefits for a spouse or child depend upon the family member upon whose record benefits are claimed achieving “currently insured” status. Currently insured status is designed to gauge eligibility for benefits that may occur prior to the individual reaching retirement age. To be currently insured, an individual must have at least six quarters of coverage out of the thirteen quarters prior to the date of death or disability. Being currently insured entitles an individual’s survivors to the lump sum death benefit of \$255.

Eligibility for retirement benefits is based upon a stricter test, known as “fully insured” status. Changes regarding requirements for fully insured status are the object of this analysis. To be eligible for retirement benefits, one must be “fully insured.”

As the Social Security program has matured, the number of quarters of coverage required for fully insured status has increased while, paradoxically, overall requirements have been loosened. Under the Social Security Act as passed in 1935, an individual must have worked in covered employment for at least five years and earned at least \$2,000 in total to qualify for benefits, and was no longer in “regular employment.” For an individual seeking to claim benefits in the early 1940s this was a relatively strict standard. In the 1939 Amendments this eligibility requirement was loosened. To be fully insured as of the 1939 Amendments required wages of at least \$50 (equivalent to around \$1,350 in wage-indexed 2008 dollars) in half the quarters between 1936 and the time the individuals reached age sixty-five.¹

Although several changes were made in 1960 and 1961 that affected contemporary workers (Myers 1993), the basic eligibility requirements with regard to current claimants were established in the 1950 Amendments to the Social Security Act. The schedule included in the 1950 Amendments gradually increased eligibility requirements for fully insured status. Table 1, reproduced from Cohen and Myers (1950), shows that for individuals reaching age sixty-five

Table 1. Quarters of coverage required under 1950 amendments for fully insured status

Year attaining age 65	Quarters of coverage required	Year attaining age 65	Quarters of coverage required
1954 or earlier	6	1963	24
1955	8	1964	26
1956	10	1965	28
1957	12	1966	30
1958	14	1967	32
1959	16	1968	34
1960	18	1969	36
1961	20	1970	38
1962	22	1971 and after	40

Source: Cohen and Myers (1950)

through 1954, six quarters of coverage were required. This requirement increased by two quarters for each year, such that those reaching age sixty-five in 1971 and thereafter needed 40 quarters of eligibility to achieve fully insured status.

Complicating the issue somewhat, “quarters of coverage” are not precisely as advertised, though at one time that was the case. A quarter of coverage represents a calendar quarter in which the individual’s earnings covered by Social Security exceed a specific threshold. Since 1978, the number of quarters of coverage

awarded for a given year is based on total earnings subject to Social Security taxes in that year (Myers 1993). In 2008, earnings of \$1,050 are required to earn one quarter of coverage.

However, an individual who earned multiples of \$1,050 in a year can receive up to four quarters

of coverage even if all those earnings took place in a single quarter. Thus, an individual earning \$4,200 at any time in 2008 will be credited with four quarters of coverage. This is equivalent to roughly 4.5 months of employment at the federal minimum wage of \$5.85 per hour.

Thus, quarters of coverage may more accurately be described as “credits,” such that one credit is earned for each \$1,050 in covered earnings, up to a maximum of four credits per year. This definition of quarters of coverage allows for easier access to fully insured status for part-time or seasonal workers, who may earn reasonably high wages in some parts of the year while being unemployed in others.

Importantly, achieving fully insured status is not the only way an individual may become eligible for retirement benefits. Many uninsured individuals obtain benefit eligibility on a secondary status, as auxiliary beneficiaries of a spouse who has obtained fully insured status on his or her own. Spouses are eligible for an auxiliary benefit equal to 50 percent of the benefit of the primary earner, even if the spouse did not have 40 quarters of coverage. Thus, Social Security benefit rules contain protections for many individuals who do not reach fully insured status. However, a number of individuals reach retirement age without access to retirement benefits, either based on their own earnings or those of a spouse. As the percentage of divorced and never-married retirees increases, the ability of auxiliary benefits to fill the gap caused by the 40 quarters eligibility requirement may decline.

Effect of 40 quarters requirement on Social Security benefit progressivity

The Social Security benefit formula provides for a progressive replacement of lifetime earnings. The claimant’s past earnings are indexed for economy-wide wage growth, the highest thirty-five years are averaged, and this average is replaced on a progressive basis. Thus, a low-wage worker earning 45 percent of the average wage and retiring at the full retirement age would receive a benefit equal to 56 percent of pre-retirement earnings, a ratio commonly called the replacement rate. A medium wage worker receives a 41 replacement rate; a high wage worker earning 160 percent of the average wage receives a 34 percent replacement rate; and a maximum wage worker receives a 28 percent replacement rate (Board of Trustees 2008).

However, the 40 quarters eligibility requirement presents a seeming quirk in the effectiveness of Social Security’s progressivity. To understand this, it is important to understand that the most important cause of low lifetime earnings is not a low wage-rate while working, but

a short earnings record. Social Security collects taxes from individuals who worked for up to ten years but pays these individuals no benefits, thus treating these low earning individuals more poorly than many higher earning workers relative to their earnings. For instance, consider individuals who earn the same wage in each year but differ in the number of years of earnings. Social Security will be progressive from ten years of employment and higher, but regressive from 10 years of employment and lower.

If Social Security incorporated a generous minimum benefit, a strong work requirement would be justifiable. At the time the 40 quarters of coverage requirement was established, Social Security did have a reasonably strong minimum benefit. In the 1939 Amendments to the Social Security Act a minimum benefit of \$10 per month was established. While seemingly quite modest, indexed for average wage growth this is equivalent to around \$275 per month in today's dollars, or \$3,300 per year.² About 6 percent of current beneficiaries receive less than this amount.³

A minimum benefit in the absence of a work requirement for eligibility presents several potential problems. Individuals could collect retirement benefits while spending few if any years in covered employment. This danger applied to the then-larger share of the workforce that engaged in non-covered employment, but also would have detracted from the "earned benefit" basis that was so important to Social Security's founders. At Social Security's founding, President Franklin D. Roosevelt stressed the need for a tight link between contributions and benefits to distinguish Social Security from "relief," and this link served to increase the program's political support. A strong minimum benefit without a work requirement for eligibility could potentially have undermined that character.

Background on the SSI Program

Supplemental Security Income (SSI) is a means-tested program designed to provide income to elderly, blind and disabled individuals who lack other income or assets. SSI was established in 1974 through Title XVI of the Social Security Act. SSI was designed to replace a patchwork of state-based programs. Unlike Social Security, which is commonly considered an earned social insurance benefit, SSI is considered a needs-based welfare benefit.

While SSI is administered by the Social Security Administration, it is funded separately from Social Security through general tax revenues and eligibility for benefits is based upon different criteria. To be eligible, beneficiaries must:

- Be blind, disabled, or age sixty-five or over. Disability is based upon the same standard for Social Security Disability Insurance benefits: that the individual is unable to engage in any substantial gainful activity for reasons of physical or mental impairment which can be expected to result in death or to last for at least 12 months. Substantial gainful activity for year 2008 is defined as \$940 in gross income per month for disabled individuals and \$1570 for the blind.
- Be a legal resident of the United States. Unlike Social Security benefits, which can be collected by eligible individuals residing abroad, SSI benefits can be claimed only when residing in the United States.
- Have income, assets and other resources below given limits. While income rules are complex, countable income is offset dollar-for-dollar with a reduction in SSI benefits. Regarding assets, single individuals may generally have no more than \$2000 in liquid assets while married individuals may have no more than \$3000 in assets.

For 2008, maximum monthly SSI benefits are set at \$637. Importantly, SSI recipients also automatically become eligible for Medicaid health insurance.

The SSI income and asset tests are the most relevant for the current proposals, as they place significant limits on what SSI beneficiaries can earn and save. SSI exempts the first \$65 of monthly earnings and 50 percent of earnings above \$65. Any amounts over this level are deducted from the SSI benefit. After the first \$65 in monthly earnings, this amounts to a 50 percent marginal tax on earned income, in addition to Social Security and Medicare payroll taxes.⁴ Similarly, the asset test effectively prohibits beneficiaries from saving any of their earnings above a very minimal level. Assets in excess of \$2,000 disqualify a single individual from SSI benefits, while a married beneficiary is allowed joint spousal assets of only \$3,000.

While means-tested benefits can efficiently target payments on the needy, they invariably skew incentives and create high implicit marginal tax rates on individuals who seek to work

themselves out of need. To the degree that policy can target low-earning individuals with non-means-tested benefits such as Social Security, incentives to work and save may potentially be improved.

Background on WEP/GPO provisions

Reducing the 40 quarters eligibility requirement is designed to prevent very low earning individuals from being ruled ineligible to receive Social Security retirement benefits. However, it would simultaneously increase the number of individuals with non-covered employment who would become eligible for Social Security benefits. These individuals often appear “poor” from the point of view of Social Security, even if they have lifetime earnings that place them comfortably in the middle class. Individuals with non-covered employment have been a concern since the Social Security system was founded, and the 40 quarters eligibility requirement was enacted in large part to prevent such individuals from receiving both a Social Security pension and a benefit from non-covered employment. However, several additional rules have also been incorporated into Social Security law that allow for reductions in the 40 quarters requirement without inordinately benefitting individuals who derive pensions from non-covered employment.

Approximately 96 percent of the workforce is employed in Social Security covered positions. Of the remaining 4 percent, the vast majority are employees of state and local governments who are not covered by Social Security. These non-covered employees can complicate the calculation of benefits when they or their spouses interact with the Social Security program. Two special provisions of Social Security law – the Windfall Elimination Provision (WEP) and Government Pension Offset (GPO) – have been put in place to correct for distortions in treatment that occur through non-covered employment.

The basic Social Security benefit formula is implicitly designed to function in an environment of universal coverage. It averages the highest thirty-five years of earnings in *covered* employment, and then replaces a progressive portion of this average. However, if an individual or his/her spouse worked primarily in non-covered employment, the formula does not account for a great deal of earnings. This can cause individuals with non-covered earnings to be viewed by the benefit formula as “poor.”

For instance, imagine an individual who earns the economy-wide average wage in each year, but spends half his working life in Social Security covered employment and half in non-

covered employment. At retirement, only his covered earnings will be entered in the Social Security benefit formula. This causes his Average Indexed Monthly Earnings (AIME), an input into the benefit formula, to reflect only half the level of his total covered and non-covered monthly earnings. Since the benefit formula is progressive, such an individual would receive a significantly higher benefit relative to his lifetime earnings than would an otherwise similar individual who spent his entire lifetime in covered employment.

To help equalize treatment of individuals with non-covered earnings, Social Security implements the Windfall Elimination Provision (WEP). Under the WEP, individuals receiving a pension from non-covered employment receive reduced Social Security benefits. For all recipients, the Social Security benefit formula, or Primary Insurance Amount (PIA), replaces earnings by multiplying the AIME by replacement factors over fixed ranges of income. The WEP reduces the usual 90 percent replacement factor in PIA to 40 percent. The 32 and 15 percent replacement factors for higher income levels are not changed. As a result, this produces a uniform \$356 reduction in monthly Social Security benefits for any individual whose AIME exceeds the level of the first PIA bend point (currently \$711). However, the WEP reduction is limited to 50 percent of the non-Social Security pension, thereby retaining some progressivity in the benefit reduction. Moreover, the benefit reduction is phased out for individuals having between twenty and thirty years of earnings in covered employment (Congressional Research Service 2004).

A second provision, the Government Pension Offset (GPO), is designed to equalize treatment for individuals who receive a Social Security benefit based on a spouse's earnings while also receiving a pension derived from non-covered employment. Social Security provides a spousal benefit for the lower earning spouse equal to half that of the higher earning spouse, but this benefit is reduced dollar-for-dollar by the lower-earning spouse's own Social Security benefit. Without correction, individuals with non-covered earnings could receive both a full Social Security spousal benefit as well as a full non-Social Security pension based on their own earnings.

The GPO equalizes treatment between individuals with covered and non-covered earnings by reducing Social Security spousal benefits for individuals who also receive a pension benefit derived from non-covered federal, state or local employment. The GPO reduces the

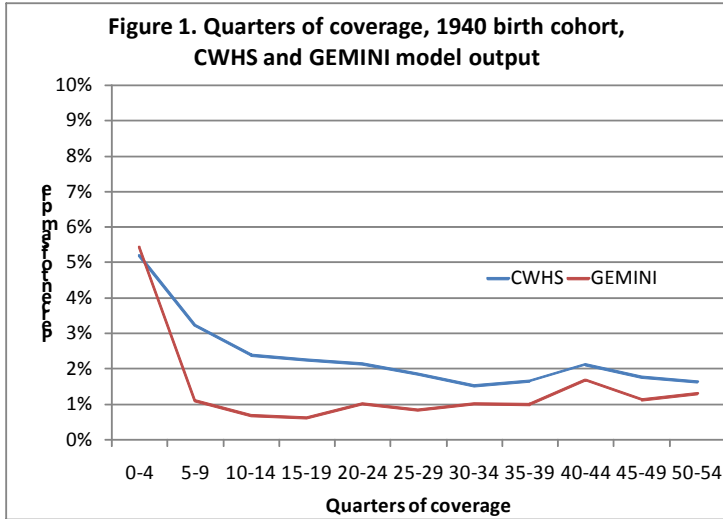
Social Security spousal benefit by two-thirds for individuals who also receive a pension from non-covered employment (Congressional Research Service 2004a).

The PENSIM and GEMINI models

The analysis in this paper is conducted using two microsimulation models developed by the Policy Simulation Group, PENSIM and GEMINI. PENSIM was developed under contract to the Employee Benefits Security Administration at the Department of Labor for use in policy and regulatory analysis of defined benefit and defined contribution pensions. PENSIM creates a synthetic sample of life histories beginning with the 1935 birth cohort, including details on education, employment, immigration and emigration, marriage, child birth, disability, divorce, retirement, and death. As part of a detailed employment record, PENSIM simulates contributions to and eligibility for both defined benefit and defined contribution pensions.⁵ PENSIM has been utilized by both the Department of Labor and the Government Accountability Office for the analysis of pension incomes.⁶

The GEMINI model calculates Social Security taxes based upon the life histories created by PENSIM. For each individual and household, Social Security taxes are collected while working and eligibility is calculated for retirement, survivors, disability and children's benefits. Using GEMINI, it is possible to evaluate the level and distribution of Social Security benefits with regard to variables such as earnings, gender, marital status and education. The GEMINI model is the standard tool for Social Security benefit analysis done by the Government Accountability Office, and the model has been validated against data for past and present beneficiaries as well as other Social Security projection models.⁷

While the GEMINI/PENSIM models have been validated internally as well as by the agencies who are their primary users, in this case it seems appropriate to focus on model output specific to the topic examined here. Data obtained from the Social Security Administration Office of Retirement and Disability Policy focuses on quarters of coverage obtained by individuals in a number of birth cohorts. The data, based upon a one percent sample of the Continuous Work History Sample (CWHS) is restricted to individuals who survive to age 62, did not claim Disability Insurance benefits prior to age 62, and who have at least one quarter of covered earnings. Figure 1 details CWHS quarters of coverage relative to those derived from



GEMINI model output, similarly filtered. The vast majority of individuals have 55 or greater quarters of coverage and are not included in Figure 1.

The figure shows that the GEMINI model projects slightly lower percentages of the population with fewer than forty quarters of coverage than does the CWHS data sample.

Differences between the two derive primarily from differences in quarters of coverage for females. In part this may be attributable to sampling error in the CWHS. For instance, in the 1940 birth cohort 6.3 percent of females the CWHS sample population have 0 to 4 quarters of coverage. However, in the 1936 through 1944 birth cohorts this sample figure varies from a low of 5.1 percent to a high of 7.24 percent. Sampling variation can also affect the GEMINI synthetic population, which is generated using a series of equations to represent the overall population.

Moreover, it is important to point out that the three major Social Security models, maintained by the Social Security Office of the Chief Actuary, the Congressional Budget Office, and the Policy Simulation Group, have over the past year all incorporated major new components for analyzing the effects of immigration and emigration on Social Security finances. Efforts to improve simulations of immigration continue with all three models. Given that immigrants may be major beneficiaries of policies to reduce eligibility requirements, it should not be surprising at this point that differences would exist between the models.

Overall, however, these relatively small differences should not preclude the use of the GEMINI model for these simulations. To the degree that GEMINI understates the percentage of individuals with fewer than 40 quarters of covered earnings, the number of individuals with increased benefit eligibility should be somewhat greater than projected in the simulations that follow.

The GEMINI model now incorporates explicit modeling of the WEP/GPO provisions by utilizing the private pension modeling capabilities of the PENSIM model. PENSIM simulates

private pension income, including pension income derived from non-covered employment. By running PENSIM alongside GEMINI it is possible to model the interactions between non-covered pension income and Social Security benefits through the WEP/GPO provisions, both for beneficiaries under current law as well as under reform provisions. This should allow for accurate simulation of the proposal to eliminate the 40 quarters requirement for retirement benefit eligibility. This proposal, in addition to granting eligibility to workers with low labor force participation, would cause some state and local government employees who would otherwise be ineligible for Social Security benefits to become eligible.

Incorporating the WEP/GPO provisions to the simulations ensures that the two types of newly eligible beneficiaries are treated according to the broad intents of the program. Newly-entitled state and local government employees would be subject to the WEP/GPO provisions in precisely the same manner as are state and local workers who, though covered employment, have obtained eligibility for Social Security retirement benefits. Thus, while additional workers would be subject to WEP/GPO, they would be treated consistently with other workers with non-covered earnings and pension income.

Simulating elimination of 40 quarters eligibility requirement

We here simulate the elimination of the 40 quarters eligibility requirement for fully insured status, assumed to take place between 2008 and 2009. This change would imply that any individual with any covered earnings would be eligible to receive Social Security benefits at retirement. Implementation would be relatively simple and achievable almost entirely through changes in Social Security's computer programs that calculate eligibility and benefits. A modest publicity campaign would be necessary to inform the public of the changes to benefit rules. Administrative costs would increase due to the larger beneficiary population. It is assumed that given current staff and infrastructure and the relatively small number of new beneficiaries the marginal cost would be small, but no attempt has been made to quantify increased costs to the Social Security Administration other than those associated with benefit payments.

The Policy Simulation Group models are used to simulate a reduction in the quarters of coverage requirement for Social Security retirement benefits from 40 quarters to zero quarters, implying that anyone reaching retirement age would be eligible for benefits based upon their pre-retirement earnings. The change is simulated for individuals in the 1950 birth cohort, who would

begin claiming retirement benefits beginning in 2012. The current 40 quarters eligibility requirement is assumed to be phased out beginning in 2009. Benefits are analyzed as of age 70, by which time practically all individuals would ordinarily have claimed benefits.⁸

These simulations provide one “book end” of the benefits and costs of reducing eligibility requirements. In this scenario, the 40 quarters requirement is eliminated entirely over the course of one year, which would maximize both the number of individuals eligible for extra benefits as well as the costs of the provision. More limited reforms are also possible, although – as the results below may indicate – the costs of the provision are small enough that delayed or partial implementation for the purposes of cost control may not be necessary. Some minimum work requirement may be retained for the purposes of administrative efficiency, although these questions are not explored in detail here.

As expected, the share of retirees receiving increased benefits due to the change is modest, at 5.8 percent of the sample population. This is due in large part to the availability of spousal benefits, which can provide benefits to otherwise ineligible individuals. These spousal benefits are often far in excess of what beneficiaries own earnings would entitle them to, even given the progressivity of the benefit formula.

Increases in benefits are almost evenly divided among males and females. Around 51 percent of those receiving increased benefits are female, while 49 percent are male. The largest group of beneficiaries by marital status is the divorced, 13.3 percent of whom receive higher benefits through this provision; 7.5 percent of single individuals, 5.9 percent of married, and 3.5 percent of widowed individuals also receive increased benefits.

The largest and most important factor affecting whether an individual is likely to receive increased benefits through this provision is immigration status. For these purposes, “immigrants” are considered to be anyone who immigrated to the United States after age 25. Individuals arriving in the U.S. prior to age 25 are considered as native born for these purposes.

Individuals who immigrated to the U.S. after age 25 constitute around 22 percent of the population of retirees in the 1950 birth cohort. Native-born Americans and individuals who immigrated prior to age 25 make up the remaining 78 percent. Around 20.6 percent of immigrants would receive increased benefits due to this provision, while only 1.5 percent of native born and pre-age 25 immigrants would be eligible for increased benefits.

In large part, this division between immigrants and native-born is common sense: if current law Social Security is restricted to those with at least 10 years of employment, individuals who entered the U.S. labor force later in life are less likely to achieve that labor force experience than those who spent a full working lifetime here. Eliminating the 40 quarters of coverage requirement would enable a large number of immigrants with modest labor force participation to receive at least a small Social Security benefit in exchange for their payroll tax contributions.

It is possible that some of the immigrants receiving increased benefits through the elimination of the 40 quarters of coverage requirement could already receive partial benefits due to totalization treaties between the U.S. and their country of origin. Totalization treaties are designed to avoid double taxation of individuals who work for a period outside of their home country, and to allow for work records from both countries to count toward pension eligibility requirements. However, the U.S. has totalization agreements almost exclusively with OECD countries whose public pension programs most closely resemble Social Security. The U.S. does not have totalization agreements with major source countries for immigrants, such as Mexico and the countries of Central America, China, and the Philippines.⁹ Totalization agreements are not simulated by the GEMINI and PENSIM models used in this analysis; however, for the reasons outlined above, it is assumed that the effects of totalization agreements would be quite small and generally limited to higher earning individuals.

Table 2: Distribution of effects of elimination of 40 quarters eligibility requirement		
Lifetime earnings decile	Percent affected	Average annual benefit increase
10%	22.3%	\$ 620
20%	1.8%	\$ 2,230
30%	4.4%	\$ 4,420
40%	1.6%	\$ 4,120
50%	1.0%	\$ 3,130
60%	1.3%	\$ 2,640
70%	1.1%	\$ 1,070
80%	1.3%	\$ 1,180
90%	1.5%	\$ 1,500
100%	1.7%	\$ 1,720
Source: Author's calculations, using GEMINI and PENSIM models.		

Table 2 illustrates the distributional aspects of the reform with regard to lifetime earnings. In the bottom 10 percent of the lifetime earnings distribution, 22.3 percent of individuals would receive increased benefits through an elimination of the 40 quarters requirement. This large increase in benefit eligibility is again due to significant portion of immigrants in the lowest earning 10 percent of the population, including many individuals who immigrated to the U.S. at advanced ages. In the bottom 10 percent of the lifetime earnings distribution, 86 percent were individuals who

immigrated after age 25, a large number of whom would not be eligible for retirement benefits under current Social Security benefit rules.

While a large number of low earners would gain benefit eligibility under the proposed reform, the average benefit increase for affected individuals in the bottom lifetime earnings decile is modest, at only \$620 per year. Again, this is due to the extremely low earnings of the individuals in this group. Even given the generosity of the benefit formula to very low earners, individuals with practically no covered earnings – average lifetime earnings among the lowest earning decile were barely 1 percent of the population-wide median – would receive only modest Social Security benefits under a loosened eligibility criteria.

Unfortunately, the bottom decile inclusive of immigrants appears to be a population whose retirement security is not well addressed by any earnings-based government program. While many or most of these individuals will receive support from family members, needs-based approaches such as SSI may be the only government programs that can reliably reach them.

Moving to higher earnings deciles, however, the population – while still poor – has greater qualitative similarity to the typical American household. In the second lifetime earnings decile, 1.8 percent of individuals received increased benefits due to the elimination of the 40 quarters requirement, and the average benefit increase among affected individuals was \$2,230 per year. Among all individuals in the second earnings decile, average annual benefits under current eligibility requirements were \$2,300 per year. Nevertheless, total benefits would remain very low, such that many or most of these individuals might remain eligible for SSI benefits.

In the third decile of lifetime earnings, average annual benefits under current eligibility requirements are \$6,370. Eliminating the 40 quarters requirement would increase benefits for around 4.4 percent of individuals in this group, with the average benefit increase being \$4,420 per year. At higher earnings levels, lower proportions of individuals receive increased benefits through the provision. However, there remain a non-trivial portion of individuals receiving higher benefits due to the provision even among the highest earning workers. These individuals are very likely state and local government employees who attain eligibility through the provision. While subject to the WEP/GPO reductions in Social Security benefits, these reductions may not be sufficient to achieve benefit neutrality.

Effects on system financing, and options for cost-neutrality

Given the modest size of the benefit increases and the low earnings levels of affected individuals, it is unlikely that eliminating the 40 quarters requirement would have a very large effect on system financing. The average benefit increase for individuals in the 1950 birth cohort would be 1.04 percent, indicating a relatively small impact on the overall cost of the program. Note, however, that the average benefit increase as of age 70 may differ from that at other ages, so the comprehensive analysis of system financing should be considered more reliable.

Under current law, Social Security's 75-year actuarial balance is projected to be a deficit of 1.70 percent of taxable payroll, based on 2008 assumptions by Social Security's Trustees and calculations from the Social Security Administration actuaries (Board of Trustees 2008). The GEMINI model projects that eliminating the 40 quarters requirement would raise the 75-year shortfall to 1.79 percent of payroll, an increase of 5.3 percent. The date of trust fund exhaustion, currently projected as the year 2041, would not be changed.

This relatively modest cost could be financed in any number of ways, and is small enough relative to the total shortfall that must be filled as part of long-term solvency-related reforms that it may not be considered necessary to locate specific offsets for such a change.

However, if it were necessary to find specific offsets for implementation of the eligibility requirement reduction as a stand-alone reform one option would be reductions in spousal benefit payments to higher earners. Spousal payments to high earning households reflect neither need nor a fair return on prior contributions and thus reductions might be considered as part of a revenue-neutral policy reform.

In addition, lacking any other changes to current law, part of the cost of increased Social Security benefits would be offset through reductions in SSI payments. These budgetary savings would not, however, automatically accrue to the Social Security program. To the degree that Social Security retirement benefits substitute for SSI payments, individual retirement income would not increase. However, work/saving incentives at the margin would be improved in cases where the new Social Security benefit fully displaced existing SSI payments. To the degree that SSI benefits were layered on top of new Social Security benefits, however, incentives would remain largely unchanged.

Effects of proposal on eligibility for means-test programs

While the proposal to eliminate the 40 quarters eligibility requirement for Social Security retirement benefits is designed to enhance retirement income and, where possible, shift individuals from means-tested programs like SSI to Social Security, the proposal could have negative consequences if it inadvertently restricts access to other social welfare programs such as Medicaid or Food Stamps.

Individuals who qualify for SSI are automatically enrolled in Medicaid, providing them with health care coverage. If a proposal to broaden Social Security eligibility shifted an individual from SSI to Social Security retirement benefits he would likely lose eligibility for Medicaid. However, it is unlikely that this proposal would cause a large number of individuals to lose health care coverage. First, SSI coverage for the elderly begins at age 65, the same age at which Medicare becomes available. Eligibility for Medicare is based upon Social Security eligibility, so the proposal discussed above would increase Medicare eligibility along with Social Security eligibility. That is to say, the most likely outcome would be for individuals to shift from Medicaid to Medicare, not to be denied health coverage entirely. However, as Medicare requires greater cost-sharing than does Medicaid, the change in health care eligibility could imply greater costs for some beneficiaries.

Moreover, the shift from Medicaid to Medicare would take place only if the individual were denied SSI due to increased Social Security benefits. In many cases, replacement of SSI benefits with earned Social Security benefits would be only partial, meaning that individuals would retain eligibility for Medicaid based upon their SSI status.

Food Stamps is a joint state-federal program delivering food vouchers to low income households. Technically called Supplemental Nutrition Assistance Program (SNAP), Food Stamps recipients must meet a number of eligibility criteria pertaining to income, assets and household size. In general, a household of two individuals aged 60 and over could have assets of \$3,000 and an income of \$1,517 per month. Such a household would receive a maximum monthly Food Stamps benefit of \$323.

Increases in household incomes due to lower Social Security eligibility requirements could reduce eligibility for Food Stamps. However, households in which all members are receiving SSI do not need to meet the income eligibility requirement for Food Stamps, implying

that eligibility would be tightened only if the individual were entirely removed from the SSI program.

In sum, a potential danger of lowering eligibility requirements for Social Security benefits is the disqualification for other benefits, in particular Medicaid and Food Stamps. This problem could, of course, be addressed through specific changes in legislation. In any event, the magnitude of the social security retirement benefit increases available from the elimination of the 40 quarters requirement makes it appear that only very few individuals would be forced off SSI entirely. In most cases, increased Social Security benefits would substitute in part for existing SSI benefits.

Foreign experience and private sector comparisons

It is difficult to make direct comparisons to foreign experience, as other countries' pension systems often differ significantly from the U.S. Social Security program in ways other than minimum eligibility requirements. That is to say, even if a foreign country had the same eligibility requirements proposed here, the end result would be a factor of that choice and the existing structure of their pension program.

That said, it is worth noting that the United Kingdom's basic State Pension operates in a similar way to the reform proposed here. The basic State Pension is a flat payment of £90.70 a week for a single person and £145.05 a week for a couple (these equal roughly \$8,422 and \$13,460 per year, respectively, based on current exchange rates). However, the full basic State Pension is payable only to individuals with 30 or more years of employment (also note that the earnings requirements for a year of employment are significantly higher in the U.K. – £4,680 in 2008-2009, equivalent to around \$8,357 – than in the U.S.). A partial basic State Pension is payable based on the number of years of realized earnings divided by 30, the number of earnings years required for the full basic State Pension. In this way, even individuals with low labor force participation would be eligible for at least a partial basic State Pension at retirement (U.K. Department of Work and Pensions 2008).

These provisions to the basic State Pension comprise a very recent reform to the U.K. program. Prior to 2008, 44 years of earnings were required for a male to earn a full basic State Pension.¹⁰ More relevantly to this case, individuals with fewer than 25 percent of a full working career – 11 years of earnings – were ineligible for even a reduced basic Pension. While the UK

reform occurred under a different program design, its similarities to the US policy change proposed here may indicate a shared interest in achieving adequate retirement incomes for individuals with little labor market participation.

The changes in the U.K. may have been spurred by their consideration of a so-called “universal pension” modeled after those in New Zealand. In New Zealand, all residents over age 65 who have lived in the country continuously for 10 years or more are eligible for a state pension. This pension is based upon residency, not earnings or labor force participation. The pension payment is equal to between 62 percent and 72 percent of average earnings economy-wide, equivalent to between roughly \$26,000 and \$30,000 in the U.S., based on the projected 2008 Average Wage Index of \$41,953 (Social Security Administration 2006). Thus, the New Zealand pension program has one feature in common with this proposal – no minimum labor force participation requirement – but differs greatly in not having an earnings-related component.

The proposal to reduce or eliminate the 40 quarters eligibility requirement for fully insured status would shift Social Security at least marginally closer to defined contribution status and away from a traditional defined benefit approach. While these distinctions are commonly made with regard to investment policy, they are also important in terms of the vesting of employee contributions. Private sector defined benefit pensions often have significant work requirements before pension contributions are considered vested. While this can be a significant disadvantage to young or mobile workers, Social Security’s 40 quarter vesting requirement is far less stringent given that it applies to almost all employers in the economy. Like a typical defined contribution pension, Social Security under the 40 quarters reform proposed herein would begin paying benefits on the first dollar of contributions. At the same time, the proposal would be only a marginal change – in terms of investment policy Social Security would more closely resemble private sector defined benefit plans, while retaining a social insurance function through redistribution that most private sector plans of either sort generally lack.

Discussion and conclusions

Eliminating the requirement that individuals attain 40 quarters of covered earnings to be eligible for Social Security retirement benefits is a modest change, as in the current workforce most individuals can be expected to spend at least 10 years in the paid workforce between age 21 and retirement some four decades later. Moreover, most of those who fail to reach 40 quarters of

coverage are either homemakers, who could receive benefits based on their spouse's earnings, or employees of state and local governments who are eligible for non-Social Security pensions.

However, there are a small number of individuals, many of them relatively recent immigrants, who reach retirement without attaining fully insured status who lack access to Social Security spousal benefits or a pension from non-covered earnings. These individuals could potentially benefit from reducing or eliminating the eligibility requirements for retirement benefits. Doing so would not result in large increases in benefits, as Social Security does not currently have a generous minimum benefit for individuals who cross the eligibility threshold. These new beneficiaries would simply have their total lifetime earnings, however low, wage-indexed and divided by 35 to produce an annual indexed amount, 90 percent of which would be replaced through Social Security benefits, assuming claiming at the Full Retirement Age.¹¹

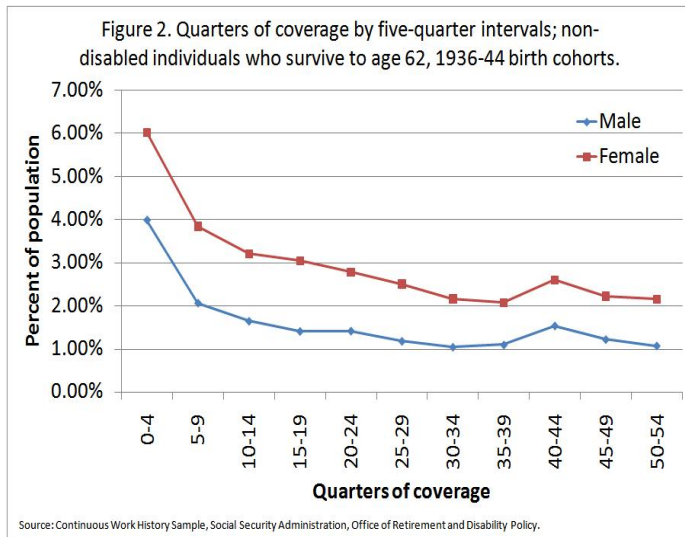
As noted above, the principal beneficiaries of eliminating the current 40 quarters eligibility requirement are immigrants, particularly those who arrived in the U.S. relatively late in life. These individuals are the most likely to fail to achieve 40 quarters of covered earnings. Whether public opinion would support a Social Security reform that primarily benefited immigrants is questionable. However, a case can be made that this reform encompasses Social Security's two founding impulses: equity and adequacy. Equity is satisfied when individuals are given benefits in exchange for their tax contributions; this reform corrects cases where payroll taxes do not currently result in retirement benefit eligibility. Adequacy is satisfied when low earners receive relatively higher benefits than do higher earners. Individuals who fail to reach the 40 quarters of coverage requirement are, with the exception of state/local government workers, almost universally low lifetime earners. There seems to be little in this reform that is fundamentally at odds with Social Security's philosophy or history.

One potential disadvantage of reducing or eliminating the 40 quarters requirement is that it removes the incentives that some individuals have to work extra years in the labor force. That is, the 40 quarters requirement may encourage individuals to remain in the workforce longer than they otherwise might. Lowering or eliminating the 40 quarters requirement might reduce incentives to work at least 10 years. That said, Social Security pays relatively high returns at the margin to individuals whose earnings place them in the 90 percent replacement factor of the

benefit formula, so the program would provide incentives to work even if the eligibility requirements were lowered or eliminated.

To test this, we utilize SSA data referenced above on the distribution of quarters of coverage among the retirement age population. Figures 2 and 3 show the distribution of quarters of coverage based on different ranges of covered quarters. These data are averages derived from a 1 percent sample of the Social Security Administration’s Continuous Work History Sample (CWHS) for non-disabled beneficiaries in the 1936 through 1944 birth cohorts. As with Figure 1, most individuals in the sample have many more quarters of coverage than needed to qualify for retirement benefits, so the percentages shown in the Figures will not sum to 100 percent.

Intuitively, one would expect there will be a spike at 40 quarters, as individuals just short of that amount would often benefit from obtaining eligibility. The larger this spike, the greater the incentive effect the requirement can be presumed to have. It should be noted at the outset that the vast majority of beneficiaries have far more quarters of coverage than needed to qualify for



retirement benefits: 67 percent of women and 82 percent of men have at least 55 quarters of coverage, so only between one-fifth and one-third of the retiree population are represented in these figures.

Figure 2 shows the percentage of individuals with up to up to 54 quarters of coverage, by gender, broken down by five year increments. These data are similar to those in Figure 1, although utilizing data from a larger number of cohorts. Males, shown in the lower line, are less likely than females to have very low coverage results. While the percentage of individuals in any given category is small, there is a small but significant spike in the percentage of individuals with 40 to 44 years of coverage. This may indicate a targeting of the approximate number of quarters required for eligibility, even if for other reasons individuals might continue on the job for a slightly longer period.

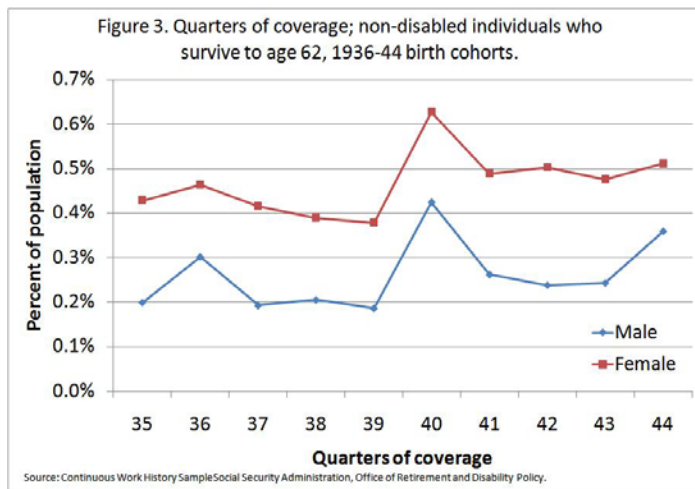


Figure 3 breaks these results down more finely, showing the percentage of individuals with between 35 and 44 years of coverage, shown by single year. There is again a small spike in the number of individuals with precisely 40 years of coverage.

While the policy implications of these results should not be overstated, they do indicate at least some awareness of the importance of the 40 quarters requirement. Spikes at or around 40 quarters indicate that individuals may be targeting this requirement to gain eligibility. Given that incremental benefits for individuals with 40 quarters of coverage would continue to be generous, it seems more likely that such targeting of the requirement increases rather than decreases labor force participation. For that reason, a potential disadvantage of the policy to reduce or eliminate the 40 quarters requirement is that it might reduce labor force participation for a small number of Social Security participants. These effects, while likely small, should be weighed against the increased benefits made available to individuals with low labor force participation by virtue of reducing the current 40 quarters requirement.

Most individuals who would gain benefit eligibility through reducing the 40 quarters requirement would not benefit greatly from many proposed enhancements to benefits for low earners. Many low earner enhancements, such as those from President Bush's 2001 commission, aim at individuals with both low earnings and many years in the labor force. If significantly

higher Social Security retirement benefits for individuals with few years in the workforce were desired, additional steps beyond loosening eligibility requirements or existing low-earner enhancements would be required.

Increased benefits from loosening eligibility requirements for retirement benefits would be larger if the provision were combined with other reform proposals to increase benefits for low earners. In particular, provisions aimed at establishing a true minimum benefit would have the greatest impact if not limited to individuals with at least 40 quarters of covered employment. For instance, a “universal pension” such as that in New Zealand would have the greatest impact on poverty in old age if it were not limited to those satisfying current eligibility requirements but were made truly “universal.”

In conclusion, this paper presents a modest proposal, with modest improvements in benefits coming at a modest cost to the program. For a limited number of individuals, increased Social Security benefits could be sufficient to take them off the SSI program. While this would improve their incentives to work and save, it could also potentially cost them eligibility for means-tested assistance such as Medicaid and Food Stamps. In most cases, however, increased Social Security benefits would supplement SSI rather than replace it. Eliminating the 40 quarters eligibility requirement for retirement benefits would be politically controversial, as much of the increased benefits would flow to immigrants not otherwise eligible for Social Security. However, these new benefits would not be welfare, but be based on the earnings of individuals who otherwise would not receive anything in return for their contributions to the program. Thus, this proposal is not out of step with Social Security’s traditional role as an “earned” social insurance benefit based on work and contributions.

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¹ See (Schmitter and Goldwasser 1939) and (Myers 1993).

² As the Average Wage Index series is not available prior to 1950, I approximated the current wage-indexed amount by assuming that the rate of average wage growth from 1950 through 2006 applied from 1939 through 2006.

³ (Social Security Administration 2006) Table 5 B.6.

⁴ And any federal or state income taxes, although these are likely to be minimal or non-existent.

⁵ For more details on the PENSIM model, see (Holmer, et al 2008a).

⁶ See (Government Accountability Office 2007)

⁷ For more details on GEMINI model and validation, see (Holmer, 2008).

⁸ Under current law a small number of individuals claim retirement benefits after age 70; these are generally immigrants or other individuals who do not satisfy the 40 quarters eligibility requirement as of age 70.

⁹ A totalization agreement between the U.S. and Mexico was signed in 1994 by then-Social Security Commissioner JoAnne Barnhart and Dr. Santiago Levy Algazi, Director General of the Mexican Social Security Institute. However, this treaty has not been submitted to Congress for consideration and therefore has not taken effect.

¹⁰ Previously State Basic Pension eligibility for women required fewer years of earnings than for men, but proposed reforms would gradually equalize requirements between the genders.

¹¹ It is possible that an individual with very high earnings in less than 40 quarters could under this reform have an AIME sufficient to reach into the 32 percent replacement factor, but in practice this would be very uncommon.