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Welfare for the elderly: the effects of SSI on pre-retirement labor supply

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Abstract

This paper studies pre-eligibility-age labor market disincentives created by the Supplemental Security Income (SSI) program. Asset and income limits might induce individuals nearing the eligibility age to work less. We exploit states' supplementation of federal SSI benefits to estimate the effects of SSI on pre-retirement labor supply, using SIPP data. We find some evidence that generous SSI benefits reduce the pre-retirement labor supply (and earnings) of men who are likely to participate in SSI after retirement, as they near the eligibility age, especially men who are eligible for early Social Security benefits, which may be used to offset their reduced labor income. © 2000 Elsevier Science S.A. All rights reserved.

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1. Introduction

In recent years, the primary cash welfare program for families with children has been the object of intense scrutiny and debate, culminating in its radical overhaul in 1996. The case of this program, Aid to Families with Dependent Children

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(AFDC), contrasts markedly with that of aid to the elderly poor provided through another welfare program, Supplemental Security Income (SSI), which has received scant attention.[1] A possible reason for this anomaly is that the public is more sanguine about how the contemporaneous work disincentives created by the existence of such a safety net affect the elderly, in contrast with younger groups such as families with children. However, little attention has been paid to the *pre-eligibility-age* labor market disincentives created by such a program. In particular, asset and income limits on eligibility for SSI might induce individuals nearing the eligibility age to reduce their labor supply. There is little if any hard evidence on such incentive effects, and this paper seeks to remedy this situation.

There are two ways pre-eligibility-age work disincentives may arise due to the SSI program. Firstly, SSI's income test discourages work prior to age 65. Since benefits are reduced or eliminated as post-retirement income increases, pension payments (including Social Security) reduce the potential SSI benefit. Some workers may have little incentive to continue working at older (pre-retirement) ages to increase private or public pension wealth further, as the extra post-retirement pension income crowds out SSI income. In addition, since SSI benefits are reduced or restricted on the basis of asset holdings at retirement through the asset test, the additional work needed to finance retirement savings is discouraged. Of course, the same sort of disincentive effects that affect labor supply may also affect saving, especially because of the asset test. In another paper (Neumark and Powers, 1998) we examine the effect of variation in SSI benefits on the saving of those approaching the eligibility age.[2] In this paper, we exploit the variation across states in supplementary SSI benefits to obtain difference-in-difference estimates of the effects of SSI on pre-retirement labor supply.

2. The incentive effects of SSI on pre-retirement labor supply

2.1. The SSI program

The SSI program was begun in 1974 to provide a uniform federal safety net for the elderly and disabled. This paper is concerned with the elderly component of the program, which sufficiently poor individuals may enter at age 65. The federal government sets eligibility criteria and maximum benefit levels for individuals and couples for the federal component of the program. In addition, some states (those with more generous safety nets prior to 1974) were required, and other states

[1] SSI provides cash benefits to both the elderly and the disabled. In 1993 about 36% of those on SSI were enrolled in the program for the elderly. SSI and AFDC were comparable in terms of their total costs (between 25 and 26 billion dollars) (Blank, 1997).

[2] Powers (1998) examines the impact of the asset test applied in the AFDC program. Hubbard et al. (1995) use a simulation model to assess the impact on saving of asset tests associated with US welfare programs collectively.