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Executive Summary

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HOLDING OUT OR OPTING OUT? DECIDING BETWEEN RETIREMENT AND DISABILITY APPLICATIONS IN RECESSIONS

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Working adults age 55 and older with chronic health conditions are often faced with a difficult choice: keep working as long as possible and claim Social Security retirement benefits when they are available, or apply for benefits from either Social Security Disability Insurance (SSDI) or Supplemental Security Income (SSI). By remaining in the workforce and "holding out" for retirement benefits later, the individual likely raises his eventual benefit level, but may increase stress and worsen his health. "Opting out" of the workforce by applying for SSDI benefits allows for more time to address health issues and includes earlier access to Medicare coverage, but disability application is uncertain and carries substantial costs: time, effort, pecuniary, and emotional.

The incentives to apply to SSDI or SSI change when the potential applicant is already eligible for, or receiving, Social Security retirement benefits. Individuals age 62 or older can more easily drop out of the labor force with retirement benefits available as a backstop. If the individual claimed Social Security retirement benefits before his Full Retirement Age (FRA) – 65 for most cohorts in this study – successful SSDI application unwinds the actuarial adjustment for early claiming. If SSDI application costs are low, this suggests that SSDI application becomes more attractive after age 62, even without earlier access to Medicare (Benitez-Silva and Yin 2011).

Labor market conditions directly and indirectly affect the decision to seek benefits from the retirement or disability programs. When unemployment rates are high, the near-elderly worker himself, or a family member, is more likely to lose a job. Declines in financial markets may deplete the assets available to cushion income shocks. Recessions also may narrow his health insurance options and directly influence his health.

This paper estimates the influence of national and state unemployment rates on the decision to apply for public disability benefits, conditional on the current, or imminent, availability of Social Security retirement benefits. While a rich literature has found that disability applications (Autor and Duggan 2006), retirement rates (Coile and Levine 2007), and retirement benefit claiming (Coile and Levine 2011) increase with the unemployment rate, few previous studies have looked at how retirement and disability programs' *interaction* is influenced by labor market conditions.

Data and Methodology

This project uses the *Survey of Income and Program Participation* (SIPP) *Gold Standard File*, which links the SIPP household survey to Social Security administrative records on earnings and benefit claiming. The sample consists of nearly 30,000 SSDI-insured individuals sampled by the SIPP between their 55th and 62nd birthdays between 1984 and 2009.

The regression analysis estimates three different hazard models; in each case, the dependent variable is an indicator for whether the individual applied to SSDI and/or SSI in that month.

In the first model, which includes all months between age 55 and one's FRA, the key independent variables are the state or national unemployment rate, indicators for the availability or receipt of Social Security retirement income, and their interactions.

The second model focuses on the months before turning 62. To test whether potential disability applicants are willing to hold out until their 62nd birthdays, this model includes a function of the number of months remaining until age 62 and its interaction with the national or state unemployment rate.

Finally, the third model addresses the concern that individuals who have already claimed their retirement benefits are fundamentally different from those who are eligible (age 62 or older) but have not yet claimed retirement benefits in ways not captured in the data. This model focuses on the months after one turns 62, and uses spouse's age to instrument for the potential endogeneity of retirement claiming.

Results

The probability of an SSDI application increases steadily until peaking at age 61, the last year before most workers become eligible to claim their retirement benefits. Although the SSDI application rate falls substantially between ages 61 and 62, the proportion of 62-year-olds applying for disability remains high, but then falls off quickly.

The SSDI application rate increases when the unemployment rate rises for most groups, especially for those under age 45. But SSDI applications among those who are ages 60 to 62 are almost completely uncorrelated with national labor market conditions. The relationship between SSDI application and the unemployment rate is only slightly positive for those who are at least 62 but have not yet claimed their available retirement benefits, but retirement beneficiaries in particular seem to exhibit no cyclical pattern.

The hazard model analysis including all months between 55 and FRA finds that individuals who have not yet reached age 62, while more likely to apply overall, are no more or less likely to apply when the unemployment rate is high. The pre-62 model is consistent with this latter finding: the probability of applying to SSDI or SSI neither decreases nor increases as one's 62nd birthday approaches, with no change in this pattern as the unemployment rate increases.

The first model also estimates that retirement beneficiaries are less likely to apply to SSDI or SSI than non-beneficiaries over age 62. When the unemployment rate increases, retirement beneficiaries are even more likely to apply to SSDI, while eligible individuals who have not yet claimed benefits are even less likely.

Once the model controls for the endogeneity of retirement claiming, however, retirement beneficiaries are far *less* likely to apply to a public disability program. In contrast to the reduced form estimates, neither group increases their disability application rate in response to an economic downturn.

Conclusions

Contrary to existing studies that find a definitive cyclical pattern in disability application, the results of this project indicate that older individuals do not apply to SSDI or SSI in substantially greater numbers when the unemployment rate is high. Individuals under age 62 do not increase their application rates when the unemployment rate is high, nor do they seem to "hold out" for retirement benefits in any macroeconomic setting. Though reduced form estimates suggest that retirement beneficiaries are more likely than eligible non-recipients to apply to SSDI or SSI, especially in times of high unemployment, any evidence of a differential response to high unemployment rates goes away after accounting for unobservable differences between the two groups.

The lack of cyclicality among older individuals is surprising given that, in aggregate, disability applications increase substantially when the economy is weak. While younger adults in a weak economy may fall back on SSDI or SSI due to stagnant earnings or weak job prospects, older adults have other options:

clinging to their current jobs, readily-available Social Security retirement benefits, pensions, and financial nest eggs. Older individuals may also find the cost of disability application more prohibitive, especially if wait times are long or the prospect of re-employment after unsuccessful application is weak. Even retirement beneficiaries, who have left the labor force and thus already paid the most substantial cost of applying, may not find the extra benefits worth the effort and uncertainty.

Taken together, these results suggest that the peak in the raw number of disability applications at age 61 is due mostly to health declines associated with age. In sharp contrast to prime-age adults, there is little evidence that the availability of retirement benefits or the macroeconomic context matter for older individuals.

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