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SOCIAL SECURITY EARNINGS TEST

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

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SOCIAL SECURITY EARNINGS TEST

TUESDAY, MAY 24, 1994

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:12 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Daniel Patrick Moynihan, Chairman of the Committee, presiding.

Also present: Senators Rockefeller, Daschle, Breaux, Packwood, and Durenberger.

[The press release announcing the hearing follows:]

[Press Release No. H–36, May 20, 1994]

FINANCE COMMITTEE SETS HEARING ON SOCIAL SECURITY RETIREMENT TEST

WASHINGTON, DC.—Senator Daniel Patrick Moynihan (D–NY), Chairman of the Senate Committee on Finance, announced today that the Committee will hold a hearing on the Social Security retirement test.

The hearing will begin at *10:00 A.M. on Tuesday, May 24, 1994,* in room SD–215 of the Dirksen Senate Office Building.

Under current law, if an individual files for Social Security retirement benefits and continues to work, his or her benefits may be reduced if earnings exceed a certain amount, called the annual exempt amount. For those age 65 to 69, this exempt amount is $11,160 in 1994. For those under age 65, it is lower. The retirement test does not apply to those age 70 or over. If yearly earnings exceed the annual exempt amount, benefits are reduced by $1 for every $3 of excess earnings.

"The retirement test was a part of the original Social Security Act of 1935," Senator Moynihan said in announcing the hearing. "Its defenders say that the test provides an objective measure of retirement, and that individuals should not receive retirement benefits unless they have, in fact, retired. Critics say that the retirement test may have made sense in the 1930's as a way of encouraging older workers to retire, but that the structure of the current work force makes the retirement test obsolete. This hearing provides the Committee on Finance with an opportunity to hear both sides on this important issue."

OPENING STATEMENT OF HON. THOMAS A. DASCHLE, A U.S. SENATOR FROM SOUTH DAKOTA

Senator DASCHLE. The hearing will come to order. Our Chairman is necessarily delayed downtown and should be here momentarily but has asked that we begin so that our witnesses are no longer inconvenienced.

We appreciate very much having our colleague and friend from Arizona who has put a lot of effort into this issue for many, many years as our lead witness. We welcome him and Mr. Hastert at this time.

I would call on colleague, the ranking member, for any opening comments that he might make.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON

Senator PACKWOOD. I want to congratulate both of our witnesses this morning for the effort that they have put in toward eliminating the Social Security earnings test. We face two problems, however. One is the argument about lost revenue and our witnesses are well familiar with it. We have seen the budget estimates that if we go to total elimination of the earnings test we lose $27 billion as I recall over 5 years.

The argument on the other side, however, is if people work, they make money and they pay taxes which offsets what is paid in Social Security benefits. How much is it offset? We are back to the perpetual problem we have on everything and that is do you do a straight out static estimate and assume no change in behavior or do you assume a change in behavior and if so, how much. And is it enough to pay for the loss that you would otherwise have. I do not know accurately how we know ahead of time. That is the first issue.

The second issue is one of policy. Do we want to encourage retirees to work full time or part time? That is not a financial issue. We severely penalize them now.

I want to read a letter. I have met this woman. I can assure you she is not rich. I met her at a Dairy Queen 1 day and she sent me the following letter. This is Norma Purdy in Oregon.

"I have been working at a Dairy Queen for many years and am still employed. I just entered the Social Security age group and am very grateful for it, but find it troublesome to count every hour I work so I can be productive all year around.

"I have voluntarily cut back my hours so that I just come in during real busy hours. But there are days people call in sick or extra help is needed. I am in good health and really enjoy my job. I have never made very much money. But even going over the earnings limit by perhaps a few hundred dollars and then paying half of it back does not make any sense."

Now I have met this woman. She had worked at Dairy Queen before she retired. I can assure you she does not fall into that category of the alleged "rich Social Security recipients" and she is affected by this. That is not fair. So we are going to have to balance fairness and equity against the possibility of revenue loss and see if we can somehow come up with an equitable solution.

But I want to thank the first two witnesses who are appearing before us today for what they have done to bring this problem to our attention.

Thank you, Mr. Chairman.

Senator DASCHLE. Thank you, Senator Packwood.

Let me call on Senator Breaux for any opening remarks he may have.

Senator BREAUX. I have no statement, Mr. Chairman.

Senator DASCHLE. If there are no other opening remarks, again, Senator McCain, let me welcome you to the committee. We will take your testimony at this time.

STATEMENT HON. JOHN McCAIN, A U.S. SENATOR FROM ARIZONA

Senator MCCAIN. Thank you very much, Mr. Chairman. I would ask that my full statement be made a part of the record.

Senator DASCHLE. Without objection.

[The prepared statement of Senator McCain appears in the appendix.]

Senator MCCAIN. I will just make some relatively brief remarks because this issue is very well known to the members of this committee as it is to the overwhelming majority of our colleagues.

Mr. Chairman, I would like to thank you, and Senator Moynihan, and Senator Packwood, for your agreement to hold this hearing. We have been seeking this for a long time. I know how busy this committee is in the throes of the health care negotiations and I am especially appreciative that this committee would take their time out to at least ventilate this issue and hopefully reach some kind of consensus so that we can move forward in doing away with this very onerous tax on our senior citizens.

I would like to begin, Mr. Chairman, by mentioning I am a little surprised that the representative of the Social Security Administration who works for this President will be opposing this lifting of Social Security earnings test, because in President Clinton's putting people first, which I and all Americans believe was his blueprint for America, says on page 141 it, "Lift the Social Security earnings test limitation so that older Americans are able to help rebuild our economy and create a better future for all."

So now we will have the Social Security Administration coming in and opposing what the President said in his campaign document.

Also, we will have the AARP here who will in some ways oppose it. I might remind the committee, this is the same organization that opposed the repeal of catastrophic health until every Chapter of their organization in my State repudiated them on their position on that as did most of them throughout the country. An organization which I believe has lost contact at least with the seniors in my State because there is no doubt as to what the opinion is of the seniors in my State, which is that an overwhelming majority of seniors want this repealed and I challenge AARP to take a ballot of the members in my State and across America and they will find that the overwhelming majority of the people that they purport to represent are strongly in favor of repeal and in opposition to their stated position today.

Mr. Chairman, we all know that this legislation came about in the depression year when we were trying to discourage senior citizens from working. It may have been appropriate at that time. It may have been when we had 50 percent of Americans out of work. The fact is, the demographics indicate we are going to experience a serious labor shortage in America.

Mr. Chairman, it is not an accident that every major newspaper in America has editorialized in favor of repealing this legislation—the Chicago Tribune, the Los Angeles Times, the Baltimore Sun, the Dallas Morning News, The San Diego Tribune, the Wall Street Journal. The New York Times said, "It is not wrong to encourage willing, older adults to remain in the work force."

The Orange County Register, the Houston Post, Cincinnati Inquirer, The Indianapolis Star, et cetera, et cetera. Everyone who has looked into this issue sees it basically as an issue of fairness.

The Los Angeles times says "why push them out of work. Congress should eliminate outmoded Social Security earnings test."

Mr. Chairman, there is another aspect of this that is patently unfair. Wealthy retirees are not affected by this. People who have a pension, people who have an income off stocks or bonds, they are not affected by this. It is only the senior, sometime between age 65, which happens time after time in my State who experiences some kind of financial problem, usually a health problem, and one or the other has to go out and work.

So they go out and work and they find themselves in the highest tax bracket in America when many of them are working for close to, if not at, minimum wage. It is unfair. It is an unfair discrimination against people who are poor versus those who are rich and retired. I might add, I see no earnings test on members of Congress between age 65 and 69 either. But I would just throw that in as an aside.

The fact is, Mr. Chairman, that we need to get this lifted. Obviously, I feel a sense of frustration because I have been working on it for many years. I will be more than happy to negotiate a gradual lifting of this earnings test if there is a problem associated with an immediate repeal of it.

I would eagerly seek, beg, for the opportunity for us to sit down in a bipartisan fashion and say, okay, let us have a reasonable length of time. My position is full repeal and immediate. I think that is fair. But if necessary for the good of the nation, for the good of these people, I would be more than happy and I know Congressman Hastert feels the same way, to sit down and negotiate some kind of gradual lifting of this.

But it must be done away with. We have to stop doing this to our senior citizens who deserve the right to work and earn a living and many of them tragically more and more often are required to because of unforeseen expenses or tragedies or crises that take place in their family.

Mr. Chairman, one additional point. Company after company has come to me. People like McDonalds, people like Mr. Eisner of Disney and others who have said, our best employees are seniors. Our best employees, the people that we want to be able to hire, but they cannot or will not because of this onerous earnings test. We are depriving the American people of the kind of service, knowledge, background and experience that seniors have and I would urge this committee to move forward in a bipartisan spirit, working together so that we can reduce and remove this over time, this onerous burden on seniors.

I thank the Chairman and I want to thank again Senator Packwood for his interest and concern on this issue. Thank you, Mr. Chairman.

Senator DASCHLE. Thank you, Senator McCain.

Senator MCCAIN. I want to thank Congressman Hastert profusely for his enormous effort over on the House side.

Senator DASCHLE. Thank you again, Senator McCain.

Congressman Hastert, again welcome. We will take your testimony at this time.

STATEMENT HON. J. DENNIS HASTERT, A U.S. REPRESENTATIVE FROM ILLINOIS

Representative HASTERT. Thank you, Senator. Thank you, Mr. Chairman. It is my pleasure to appear before you and certainly the committee today in support of S. 30, the Older Americans Freedom to Work Act.

As many of you know from past discussions of this legislation, seniors who need or want to continue working after they reach the retirement age face one of the heaviest tax burdens of any demographic group. They are needlessly penalized by the Social Security earnings test, a depression era hold over that confiscates a huge share of their Social Security benefits.

Seniors age 65 to 69 who earn more than $11,160 this year are slapped with a 33 percent penalty, forfeiting $1 for every $3 they earn over that limit. When coupled with other Federal taxes, those seniors who earn only $11,000 a year are faced with a 56 percent marginal income tax rate, nearly twice the rate that millionaires pay.

Mr. Chairman, that is just not fair. The earnings penalty sends a message to senior citizens that we no longer value their experience and expertise in the work force. It is age discrimination from my point of view, pure and simple, and it most affects those seniors who need to work in order to meet their expenses for food, for shelter and for health care.

The Social Security earnings penalty was instituted in the 1930's to discourage seniors from working in order to make room for younger Americans in the work force. As the U.S. population ages, however, seniors are becoming an increasingly important segment of our labor force. By the end of this decade there will 1.5 million fewer members of the work force between the ages of 16 and 24.

At a time in our Nation's history when competitiveness has become so critical, policy makers should not preach the gospel of productivity while retaining outdated policies that strip our labor force of thousands of productive and experienced workers.

Just as business leaders must modernize their factories and methods, Congressional leaders must update public policy. Opponents of this proposal have operated under the incorrect assumption that repeal of the earnings test will result in a Federal revenue shortfall.

Mr. Chairman, the opposite is true. Studies that look at both projected tax revenues and the increased outflow from Social Security have found that elimination of the earnings test would actually increase revenue to the Federal Government by over $140 million.

A repeal of the earnings test would assist our economy by encouraging more seniors to rejoin the work force, thereby expanding the tax base and increasing the amount of tax revenue.

Clearly, repeal of the earnings test would give our economy the needed boost. Opponents have also argued that a repeal of the Social Security earnings test is wrong because Social Security is an insurance policy to be allocated only to those who are "retired."

Therefore, if someone is still working, he or she should not receive full benefits. This reasoning ignores the difficulty seniors have encountered in surviving solely on Social Security or working at a low-income job. Seniors frequently need both to make ends meet.

For instance, I would like to tell you the story of Jean Austin from my home State of Illinois. Ms. Austin is currently 68 years of age. She was in the work force for 26 years before she was let go by the company that she worked for at age 60.

Ms. Austin, was then a prime candidate for a program funded by Title V of the Older Americans Act, the Senior Community Service Employment Program. This program is contracted out to organizations like Green Thumb in Illinois. The program helps seniors update their skills and trains them for today's work force. Only seniors who do not earn enough to raise them above the poverty level are able to participate in the Green Thumb program and they must work for nonprofit or government entities.

Ms. Austin got a full-time job after her Green Thumb training and now earns approximately $15,000 a year. As you can see, Ms. Austin falls below the Social Security earnings penalty. She gets no Social Security check——

Listen to this—no Social Security check for the first 4 months of the year. Her lost income from Social Security for the year will be approximately $1,600. These are the very people that we're trying to help by repealing the earnings penalty.

The irony of this story is that the Federal Government spent money to train Mrs. Austin to be self-sufficient. The average amount the Green Thumb spends on a client is $6,000. Yet we then turn around and take back the Social Security benefits she's contributed to for 26 years when she exceeds the $11,160 earning threshold.

Ms. Austin could be using this money for needed repairs to her home or for any number of expenses that could arise. I would also like to read you the story of Teresa McMahon from Anaheim, California.

Her letter gives legislators a taste of the realities working seniors face. Mrs. McMahon states:

> I am 66 years old, healthy, energetic and a widow for the past 11 years. I have tried to support myself for those 11 years. I do collect Social Security and have done so since I was 60 years of age.
>
> I live alone in an apartment in Anaheim, California and my rent runs $600 per month which is normal for my neighborhood. My apartment is under 500 square feet. My Social Security monthly payment is $697. I drive a 1983 Tercell automobile with almost 100,000 miles on it. I can't afford to buy another car.
>
> I work part-time in an insurance office in Fountain Valley and because I am restricted on my income I must return almost $200 to the Social Security Administration by April 15, 1994.
>
> I think this is an unfair burden to place on a senior who wants and is able to work to support herself. Older people have debts and responsibilities too. And to restrict their income because they collect Social Security is a punishment to them.
>
> Perhaps you think at my age I have substantial savings. I live from pay check to pay check. Without my job I cannot be independent. I would love to work for more hours and have been offered them in the office, but it doesn't pay to work for them. I'll be punished by the government for being more productive.
>
> As it is, every fourth day I go to work goes for taxes. Times have changed. It costs more to survive now. Laws need changing too.

Mr. Chairman, working seniors have got it right. The law needs to be changed. In closing, Mr. Chairman, let me reiterate, repealing the earnings penalty is the right thing to do, both for our economy and for our senior citizens.

Thank you very much.

Senator DASCHLE. Thank you, Congressman Hastert.

[The prepared statement of Representative Hastert appears in the appendix.]

Senator DASCHLE. You both make a very compelling case. Obviously, you have given a lot of thought to this and have talked to a number of people around the country who are affected by it.

There is a fundamental question I guess we as policy makers have to make with regard to the design of this system. Is it an annuity or is it a retirement system? There are those who advocate that it remain a retirement system, not an annuity guaranteed at a certain age. How would you respond to that dilemma? How do you define this program, as a retirement rather than an annuity system? And if so, would a person not have to retire to be eligible for the benefits?

Representative HASTERT. Well, the way it is structured now you do not have to retire completely. As a matter of fact, when you look at the reason it was a retirement system in the early 1930's, from my perspective in trying to read history as it happened then, it was because there were an immense number of older workers who held onto jobs and a lot of young people with families who could not get jobs.

So the incentive at the time was to move those people out of the work force to make room for younger people with families or responsibilities to be able to get into the work force. That is not the case today and not the problem that we face.

The serious issue here is that when you put in an earnings test, it only focuses on a select group of working people. It hurts those most who have incomes, under $30,000—those people who have basically worked by the sweat of their brow all their life, who have never been able to accumulate savings or huge pensions or rental incomes or those types of things. When they have to continue to work to lead an average life, all of a sudden the "well, if you are going to retire, you have to retire" thing kicks in.

Those people are forced to either retire or say they are retired. A lot of those people unfortunately end up in an under-the-table economy. They either barter their work or trade only in cash. So we in essence make criminals out of people who just need to survive.

That is lost income to the Federal treasury. That is the result of this, what I would call antiquated, piece of legislation. I think we just need to face reality. We have all talked to businesses of all sizes that rely on older workers with a work ethic or expertise. For instance, tool and die makers—there are not a lot of them left—but they need the work because they've never been high income people and they need to work to make ends meet—suddenly lose their best workers part way through the year. One little shop that I have in mind in South Elgin, IL that depends on these people, finds it is without its work force in October. Businesses are deprived of a very, very important work force.

So, if Social Security is a retirement system without annuity aspects, the burden falls heaviest on those who need the help the most. Those people who want to be independent, who want to take care of themselves, need this little extra boost to make that happen, but are penalized by an antiquated law of Social Security.

I also understand the issue of lost revenue. It is interesting to me when I see CBO, the SBA and others score earning test repeal legislation that they say few people would return to the workforce. The National Center for Policy Analysis study determined 700,000 people would continue working or re-enter the workforce. Common sense tells you people who do not now report their income but are in the underground economy would start paying taxes if they are not penalized. This represents new revenue for the Federal treasury. It represents a $15.4 billion increase in our annual output of goods and services. They refuse to look at what the earnings potential is. The NCPA study indicates the Federal treasury would bring in $140 million if we repealed the earnings test. If the earning limit was set at $39,360—the Federal treasury would take in net revenue of $3.2 billion.

So creating an "annuity" system by repealing the earnings test would not deprive the Federal treasury, but would bolster it. I certainly appreciate your concern. I know the cost has been an argument. I think sometimes it becomes an academic argument and not an argument in reality.

Senator DASCHLE. Well, the figure as I understand it for low earner benefits, for monthly benefits in 1994 of $505, the threshold is $29,340. For the average earner with monthly benefits in 1994 of $829, the threshold is $41,008. And then for a high earner with monthly benefits of $1,147, the threshold is $52,452. That is this year's figure, I guess.

There are compassionate arguments being made, clearly. You have made them so well today—about those people who find themselves in the throes of some very tough economic conditions, although I guess these thresholds would warrant some rethinking as to how serious in some cases the economic conditions would be.

But it really comes down, does it not, to that basic question of what we want this program to be. Do we want it to be an annuity or do we want it to be a retirement system? There is a legitimate case to be made that it ought to be an annuity.

Then that obviously gets into the question, well, how much can we afford. All of us have voted for entitlement caps at various times and recognize how costly entitlement programs become. So, clearly, if we make it an annuity, we recognize that increases in costs for that entitlement become fairly significant budgetarily.

I do not know that we will resolve that question this afternoon or this morning. But, clearly, that is an issue we have to address.

Senator McCain, did you want to respond?

Senator MCCAIN. Let me just take a stab at it, Mr. Chairman. The information I have, and I am reasonably sure it is correct, for every $3 earned by a retiree over the $11,160 limit they lose $1 in Social Security benefits. Now that $11,160 a year is not a lot of money, Mr. Chairman. I think we would all appreciate that.

The other aspect to this is that there are two fundamental unfair aspects to it. One is that wealthy people who have retired on pensions, stocks, whatever it is, there is no penalty imposed on them, Mr. Chairman. So this blurs this annuity or retirement argument.

The fact is that if you are a wealthy retiree, as many of my constituents are, and you get X amount of dollars, $1 million a year, none of that is subject to any kind of earnings test. It is only if you are required to go out and work that this earning test kicks in. So there is a fundamental disparity there.

And, of course, the other aspect of it that is an anomaly is that once a retiree reaches 70 then the earnings test disappears. So you can only draw the conclusion that the law was created in order to be a disincentive for people to work.

Senator PACKWOOD. And at a time when they normally live to 68 or 69.

Senator MCCAIN. Exactly. So, you know, if this earnings test went on for the entire life of a person who is receiving these benefits, then I think this annuity versus retirement argument would have a lot more validity. But it is exposed for what it is. It is a penalty for people to work since it only kicks in between ages 62 and 70, for those who choose that early retirement. So it is clearly a penalty.

Now, Mr. Chairman, if we want to penalize people for working, then why do we not penalize people for not working? Okay? If you want to be fair, and I will probably alienate a lot of my voters right now, if you want to be fair all those people that are making all this money by sitting home and clipping coupons, maybe they ought to be taxed too, rather than the poor devils that Denny Hastert was just talking about who experience an illness in their family. Then they have to go out and work. They have huge medical bills, an issue that this committee is working with and they cannot even make basically a minimum wage because of the taxes that are kicking in.

Senator PACKWOOD. Should we means test Social Security and Part B Medicare?

Senator MCCAIN. Senator Packwood, I do not know if we should or not do that, Senator Packwood. But I say that there is a fundamental unfairness in this particular aspect of the Social Security system.

If we want to address the whole issue of entitlements and means testing, then I would love to come back and testify on another day and start the great national debate. I also would suggest, Mr. Chairman, that in all candor, and I tried to be candid before this and other committees, that we know that Social Security is the third rail of politics. You touch it, you die.

So I would just as soon duck that question. And in the same time though try to focus on the issue of fairness. But having said that, I would be more than happy to work with Senator Daschle who also has a longstanding interest in this in looking at the entire entitlements problem.

My answer, I guess, Senator Packwood, if we are going to means test entitlements, we cannot do that separately from looking at the entire entitlement situation in my view, in a bipartisan fashion.

Senator DASCHLE. Congressman Hastert?

Representative HASTERT. If I may add a comment. Going back in my understanding of the purpose of Social Security when it was started in the 1930's, Social Security was never meant to be a full pension. It was supposed to be a supplement to a pension.

The people who we penalize here are those people who do not have the means other than through employment to be able to supplement their Social Security benefit. Those who have worked hand to mouth in low-wage or part-time jobs—and must still work—should have their Social Security supplement.

Senator McCAIN. We have Members of Congress who are between age 65 and 69. We have our own retirement system. They are working. I wonder if we should impose a $1 tax on every $3 they earn.

Senator DASCHLE. I think we know the answer.

Senator Packwood?

Senator PACKWOOD. No other questions, Mr. Chairman.

Senator DASCHLE. Well, gentlemen, thank you. You have certainly given us a spirited defense of your position, and we appreciate very much your testimony this morning.

Senator McCAIN. Could I ask again, Mr. Chairman, to make one final plea?

Senator DASCHLE. Absolutely.

Senator McCAIN. Could we sit down together, Republicans and Democrats, and work at a solution to this problem, perhaps a gradual lifting of the cap, rather than leaving it as it is.

As you know by my opening statement my position is, obviously, let us repeal it. But it seems to me that we could sit down and work together. Whether the problems that the CBO has are real or imagined, which is a subject of debate, but maybe we could hopefully sit down together and work on this.

Senator DASCHLE. I certainly would be interested in working with you. I know Chairman Moynihan is interested in the issue as well. Let us see if we cannot do that, John.

Senator McCAIN. Thank you, Mr. Chairman.

Senator DASCHLE. You bet.

Senator McCAIN. Thank you very much.

Representative HASTERT. Thank you, Mr. Chairman.

Senator DASCHLE. Thanks for coming.

Our second witness is Hon. Shirley Chater, the Commission of Social Security. If the Commissioner would come to the table at this time, we would be happy to take her testimony.

Mrs. Chater, thank you for being here. If you wish to introduce your colleague at the table, we will take your testimony at this time.

STATEMENT HON. SHIRLEY S. CHATER, PH.D., COMMISSIONER OF SOCIAL SECURITY, WASHINGTON, DC, ACCOMPANIED BY HARRY BALLANTYNE, CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION

Commissioner CHATER. Thank you. I am pleased to join you today to discuss the retirement earnings test and more specifically how we can best serve the interests of the American people on this issue without doing damage, either short term or long term, to the Social Security program.

I have invited Mr. Harry Ballantyne, the Social Security Administration's Chief Actuary, to be with me today. He and his staff have completed considerable research on issues relating to the retirement earnings test.

Much of the analysis that they have done is included in my written statement, which discusses this issue in more detail. I would submit that statement for the record.

[The prepared statement of Commissioner Chater appears in the appendix.]

Commissioner CHATER. To begin my testimony today I would say to you that it really is no wonder that the retirement earnings test is the subject of such vigorous debate. When we talk about this issue, several competing goals come into play.

First of all, one goal, for example, is to allow beneficiaries to supplement their Social Security benefits with a limited amount of earnings. Now this is especially important for many low income workers. In 1990, only about one-third of the nation's retirees between the ages of 65 and 69 had private pensions to accompany their Social Security benefits.

The modifications that have been made over the years to the retirement earnings test have allowed retirees to supplement their benefits with earnings up to a specified level.

Now another goal is that of preserving the incentive and the opportunity for older persons to work. This goal will take on a continuing greater importance to the baby boom generation as it ages and the growth rate of the labor force as it slows.

Third, and still another goal that we have to consider, is society's desire to offer benefits that are as adequate as possible for those who need them the most. These competing goals result in two different conflicting philosophies.

First, some believe the earnings test should be totally eliminated at age 65. Advocates of this position generally argue that workers have paid for their benefits and they should receive them at age 65 regardless of whether or not they have stopped working.

On the other side, there are those who believe that eliminating the retirement earnings test would represent a shift, and an undesirable one, in Social Security's fundamental makeup. They say it would begin to transform Social Security from an earnings replacement form of social insurance into a program more closely resembling an individual annuity.

Let me talk first about eliminating the retirement test. Any debate about eliminating the retirement test must consider the cost and the effect it will have on retirees and on the program itself. In terms of cost, the short-range cost of eliminating the retirement earnings test at age 65 is estimated to be $22.9 billion over the first five fiscal years and $42.6 billion for the first 10 years.

Some have suggested that these costs would be offset by greater tax revenues stemming from a larger work force and increased work activity. But we estimate, however, that only a small net increase in work activity would occur due to the elimination of the earnings test.

And, indeed, the consensus of most research on this issue is that the impact of eliminating the earnings test on aggregate earnings of older workers would really be quite small. What about the effect? Who will feel the greatest impact from the elimination of the earnings test?

A recent Social Security Administration analysis shows that immediately eliminating the test will yield additional benefits for about 700,000 households. However, families with 1995 incomes of less than $21,800 would receive only 1.1 percent of the total additional benefits, after taxes.

Over 50 percent of the net benefit increase would go to families with incomes over $69,000. Thus, eliminating the test would help those beneficiaries who tend to be the most economically advantaged.

I would like now to talk about the administration's position. For the reasons mentioned above, the administration has serious concerns about completely eliminating the retirement earnings test. We do, however, acknowledge that the earnings test can adversely affect the standard of living for many older Social Security beneficiaries who do not have other sources of income.

Therefore, a moderate increase in the earnings test exempt amount that would assist beneficiaries who have lower incomes is something the administration would support.

I would say, however, that a change of this sort should not be done in isolation, without consideration given to the impact it would have on the fiscal health of the Social Security program.

So we support in principal a moderate increase in the retirement earnings test exempt amount for beneficiaries who have reached age 65. But we believe that such an increase should be considered as part of the package. We also believe that any change in the retirement earnings test must be fully offset.

We share with you, Mr. Chairman, the desire to enhance the long term solvency of Social Security and this administration is committed to taking the steps necessary to ensure the stability and the security of the Social Security system as a whole.

So I thank you, Mr. Chairman, for the opportunity to discuss this issue and I look forward to working with you and your colleagues to determine how best to modify the earnings test while also ensuring the financial well-being of the Social Security program.

I think you know, Mr. Chairman, Mr. Harry Ballantyne who is with me today. We will be pleased to answer your questions.

The CHAIRMAN. We well and favorably know Mr. Ballantyne.

May I offer my apologies to you, Dr. Chater and to Senator McCain and Mr. Hastert. There was a memorial service this morning for Lawrence Spivak who founded Meet the Press at least a half century ago. It was a more extensive program than we had realized. Senator Dole and I were speakers. So you can understand why we are late.

Commissioner CHATER. I do.

The CHAIRMAN. Where does that leave us? I see that you state that the challenge facing us is insuring the long term solvency of the program. What quite do you mean by that? Is it your view that the long term solvency of the Social Security program is not insured?

Harry, what do you think?

Mr. BALLANTYNE. Well, I believe that any change that is made in the Social Security program should take account of the effect it would have on the long range actuarial balance of the program.

As you know, we have a deficit now of over 2 percent of taxable payroll—2.13 percent over the next 75 years. And although the long range effect of eliminating the test is very small, we still estimate that it would increase that deficit by .01 percent of taxable payroll.

The CHAIRMAN. .01, one-hundredth?

Mr. BALLANTYNE. One-hundredth of 1 percent.

The CHAIRMAN. Over 75 years?

Mr. BALLANTYNE. Over 75 years, right.

The CHAIRMAN. Help me then. That means I do not understand this well enough. I had always assumed that since there are extra payments after age 70 for income foregone between 66 and 70—

Mr. BALLANTYNE. That is correct.

The CHAIRMAN.—that actuarially it is a wash.

Mr. BALLANTYNE. Well, it would be a wash when the delayed retirement credit, which is what you are referring to, reaches the actuarial equivalent value of 8 percent for each year of delay in retirement.

Right now, for people reaching 65 this year, it is only 4.5 percent. It is scheduled to phase in gradually to 8 percent. More important though, the additional benefits that would result from eliminating the test occur immediately. You start to pay out benefits right away and it is only later that you would begin to save the benefits. It is really because of that that there is the long-range cost over a 75-year period of .01 percent.

The CHAIRMAN. Well then, what would you call, Dr. Chater, a moderate increase in the exempt amount? Do you want to put a number on that?

Commissioner CHATER. Well, we could consider lifting the retirement test by $1,000. If we did that in 1995 we would increase the percentage of the additional benefits after taxes that would be paid to low-income families. It would be 23 percent.

The CHAIRMAN. Well, that is an offer. How are you going to pay for it?

Commissioner CHATER. How are we going to pay for it? Well, we know that——

The CHAIRMAN. What do you think it will cost?

Commissioner CHATER. I beg your pardon?

The CHAIRMAN. What do you think it will cost? Say we were to do it this year.

Commissioner CHATER. We have estimated it would cost $1 billion over the first five fiscal years if we——

The CHAIRMAN. $1 billion?

Commissioner CHATER. $1 billion.

The CHAIRMAN. All right. Can we find $1 billion, Senator Packwood?

Senator PACKWOOD. We will tell you what we are going to do to pass the gantry.

The CHAIRMAN. We could raise tariffs.

Senator PACKWOOD. That is right.

The CHAIRMAN. That is the only way we can think of—tariff legislation.

Senator PACKWOOD. That is the way we got all our money before 1913.

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The CHAIRMAN. Our problem with any elimination of the earnings test is that you are up in the $20 billion range in 5 years.

Mr. BALLANTYNE. Close to $23 billion.

The CHAIRMAN. And then for 10 years it would be what?

Mr. BALLANTYNE. $43 billion.

The CHAIRMAN. $43 billion. That sum of money just is not to be had, unless we were to actually raise payroll taxes. We are locked into the budget agreement of last year, which requires us to make provision for 10 year outlay losses.

With respect to this hugely important trade agreement, the largest trade agreement of its kind in history and a culmination of 60 years of American trade policy, the issue is how to find the money to make up for the loss in revenue that comes about from lowering the tariff rates.

There is no dynamic. We cannot estimate, well, there will be an increase in business activity and, therefore, it will work out. The 10-year rule does not apply to Social Security, but the 5-year rule does. We are in a situation—I do not know how you feel, Senator—but there are just a great many people who do not like this retirement test and think it is somehow wrong. There is this question of, are you moving away from the replacement of earnings to an annuity arrangement, which is a perfectly legitimate point, but not one generally grasped.

The majority of non-retired Americans do not think they are going to get Social Security when they do retire. This seems to be a strongly held view in areas where people go to retire. So when they retire and get it they are not fully conversant with all of its provisions. I guess it is as simple as that. I do not know. What do you think?

Senator PACKWOOD. Well, I have a question I want to ask Mr. Ballantyne.

The CHAIRMAN. Yes.

Senator PACKWOOD. I talked with him on the phone before and find him very helpful. Your $23 billion estimate, if we repeal the earnings test, is a net as I recall.

Mr. BALLANTYNE. Yes, sir.

Senator PACKWOOD. And on that you are only about $1 billion off of CBO's estimate. I think they figure $22 billion, but that is close enough for estimating. What do you know, and I do not know it, about this study cited by Senator McCain and the Congressman, Aldona and Gary Robbins, One Dynamic Realistic Estimate done by the former Trade Department Economist found that abolishing the earnings limit would result in a net increase of $140 million in Federal revenue. What is the difference in the premise?

Mr. BALLANTYNE. Well, the Robbins and Robbins study does have a serious error in the study. The way that it was done considered data that was tabulated by different earnings levels and the width of those intervals of earnings were not equal widths.

Senator PACKWOOD. What do you mean?

Mr. BALLANTYNE. Well, the first interval might have been something like $10,000. The second one—and this is right around the annual exempt amount now—might have been around $1,000—this is illustration—$2,000, $3,000. They are not the same. But the technique that they used to estimate how much additional taxes or induced work effort would come from eliminating the test would be okay for intervals that were the same size.

Senator PACKWOOD. Zero to 5, 5 to 10, 10 to 15 and so forth?

Mr. BALLANTYNE. That's right.

Senator PACKWOOD. All right.

Mr. BALLANTYNE. Using the same data that they used, we take account of the difference in the size of the intervals and we come out then with a much lower estimate. We estimate that only about 4.5 percent of the cost would be offset by induced work effort, through payroll taxes for Social Security and through additional——

Senator PACKWOOD. Let me ask you this. I hear what you are saying and I can picture it in my mind where you do not have equal intervals. How do you chain to the interval so that you make this thing come out positive? Still, whether you go zero to five or whether you go zero to two and two to seven and seven to nine and nine to eighteen, you still have the same number of people in the group.

Mr. BALLANTYNE. Right. The technique that they used did not take account of the fact that the smaller the interval, the smaller the number of people that you would expect to be in that interval.

They assumed that the number of people in the interval was small because of the effect of the retirement test and not because of the size of the interval.

Senator PACKWOOD. Wait a minute. In other words, if you had a million people in the interval of 10,000 to 15,000, they take an interval of 10 to 11 or 10 to 12 and then attempt to equate how many people are in that, even though it is not demographically the number of people that are in it.

Mr. BALLANTYNE. Exactly.

Senator PACKWOOD. Oh, I see.

Mr. BALLANTYNE. They would assume that the number in that interval, if there were no retirement test, would be as large as the number in the larger intervals around it.

Senator PACKWOOD. Oh, I see.

The CHAIRMAN. Could we ask Mr. Ballantyne, and ask Dr. Chater, could you give us a very specific written analysis of this study so we know what you think?

Mr. BALLANTYNE. Yes.

The CHAIRMAN. We are now in a situation where this study shows one thing and we say, well, not necessarily so.

[The analysis appears in the appendix.]

The CHAIRMAN. Do you not think we should have that study?

Senator PACKWOOD. Well, I would appreciate it. I understand what Mr. Ballantyne said. It is an unusual way of putting together a study.

Mr. BALLANTYNE. Yes, it is.

Senator PACKWOOD. I have never heard of one done like that before. You do not need to comment any further. But I agree with the Chairman. I would love to see your analysis of this so at lest if this is cited, we will have something to say, well, but look is this not true this is not zero to 5, 5 to 10, 10 to 15, it is basically skewed.

Mr. BALLANTYNE. Right.

Senator PACKWOOD. Thank you.

The CHAIRMAN. Well, having come from a memorial service for Lawrence Spivak, I think, Senator Packwood, I have to say you did not answer my question. He would never let you get away with that. And I do not think I have answered the question either.

Do we not have a problem here of perception, of people who think this is just not—things ought not to be this way?

Senator PACKWOOD. Oh, yes. You mean, do people who have retired think they ought to be able to work? Yes. Because they are presuming that Social Security is an annuity.

Mr. BALLANTYNE. Yes.

Senator PACKWOOD. It is like an insurance policy. You work and you are entitled to $500 a month and you get it from the insurance company. If you choose to keep on working, you still get your $500 a month. And Social Security is imagined to be like that.

Therefore, that is a very clear perception in people's minds. It does not good really to explain how much you paid into it and how much you are getting back and that this basically still does depend upon the willingness of lots of people working to continue to pay into the fund.

I know there are those who would say, all right, let us compromise. Let us make it voluntary. Let those who do not want to pay in get out now and they will not get any Social Security and we will gradually phase it out. But that does not take into account what may happen if lots of people get out and we do not have the income to pay the benefits for those we have promised to pay the benefits to.

The CHAIRMAN. Yes. I am dispposed to think that when you have a considerable portion of the retired population thinking that some injustice is being done, you respond. You just don't say, well, you know, you should have been an actuary or gone to actuary school and then you would understand. Are there actuary schools?

Mr. BALLANTYNE. Yes. [Laughter.]

The CHAIRMAN. Take a course. Maybe the Social Security Administration could put out a 10-part case history instruction on television. You can sit at home and put it on your television and read the forms and gradually qualify yourself to understand your retirement situation. I do not think that will work.

Is my friend and former Chairman aware that last evening we passed the Independent Agency bill which you and I had on the floor?

Senator PACKWOOD. I was going to ask if the Commissioner had any comment on that.

The CHAIRMAN. Yes, Commissioner, thank you for this testimony and let me say it is a problem we are going to have to work at, but I think it will be a problem which we will be working out from the point of view that Social Security will be an independent agency once again. It must make you all feel some joy of your youth. Here you are with Mr. Altmyer and those great moments of the 1930's.

Are you aware that we did this on the consent calendar last night?

Commissioner CHATER. Yes, sir; I am aware.

The CHAIRMAN. So the President will be signing that bill shortly. We hope to have some balloons and ice cream and generally have a good time in the Rose Garden.

Commissioner CHATER. I look forward to that.

Senator PACKWOOD. We do have a very slight issue with the House, which we have to go to conference on. It is a modest issue.

The CHAIRMAN. Well, with thanks in advance for your analysis of this other matter, Mr. Ballantyne. Thank you, Dr. Chater. We appreciate your testimony very much. You have made us an offer and a very fair minded one. You might take your leave with our saying that the actual rights and wrongs of this case are less important than the perceptions that Social Security began as a mode to replacing income.

But it is perceived as a retirement annuity. And in effect that is what it is and we perhaps ought to respond to that perception. In the real world, perceptions have a reality of their own.

On that, we thank you very much. Again, I apologize for having been delayed.

Commissioner CHATER. Thank you.

The CHAIRMAN. And congratulations to all at Social Security. We will see you at the bill signing.

Commissioner CHATER. We look forward to it. Thank you.

The CHAIRMAN. Now, we are going to have a most distinguished panel of eminences, one of the most eminent who is at this very moment approaching the witness table, Hon. Robert Ball, who was Commissioner of Social Security these many years. Joseph Perkins, who is the vice president of the American Association of Retired Persons. Max Richtman, who is the executive vice president of the National Committee to Preserve Social Security and Medicare. It is nice to see you here. And Eugene Steuerle. Dr. Steuerle is a senior fellow at the Urban Institute and an authority on these matters.

We welcome you all. We will put your statement in the record as if read and proceed exactly as you wish. Commissioner Ball, good morning, sir, and welcome.

STATEMENT ROBERT M. BALL, COMMISSIONER OF SOCIAL SECURITY (1962–1973), WASHINGTON, DC

Commissioner BALL. Good morning, Mr. Chairman, and congratulations on the Independent Agency bill.

The CHAIRMAN. Yes, that is kind of nice. How long have we been at that problem?

Senator PACKWOOD. About 7 or 8 years.

The CHAIRMAN. Only about 7 or 8 years.

Commissioner BALL. Senator Church was the first, I think, to introduce it way back. It has been going on a long time.

The CHAIRMAN. It takes us about 20 years at times. But after all, we are considering a program which projects costs over 75 years.

Commissioner BALL. Mr. Chairman, speaking of time, with your indulgence, I would like to go back into the history of the retirement test a bit and among other things dispel some notions about the retirement test and how it came about.

It is almost a part of folk wisdom now that the retirement test was put in as part of a depression strategy to encourage older workers to get out of the labor force in order to make room for the younger workers, and there is nothing to it. The founding fathers would have had to have been idiots to reason that way because the monthly benefits were first payable in 1942. The Act was passed in 1935. That is 7 years in which it would have had no affect. Then it was extraordinarily gradual.

By 1950 only 15 percent of the elderly were eligible for Social Security benefits. So the idea that that is why it was done in the midst of the Depression really has no validity. I am not saying that somebody on the floor in an argument did not raise it,but that was not the motivation.

The CHAIRMAN. What was the theory?

Commissioner BALL. The theory was it was going to be a retirement system and it was as simple as to say, if it is a retirement system, you do not pay people who are not retired. Without a retirement test it would have cost more. The original Act in 1935 did not specify any amount for the test at all. It was just written so as not to pay people who continued to work.

But the 1939 Act, which was passed before any monthly benefits were paid, got specific and said you could earn up to $14.99 a month and still get your benefits. It was just a sharp cutoff and that was it; people thought that it was impossible to police just trivial amounts of earnings. So they put in the $14.99 test.

I can't think of any other provision of the Social Security Act that has been changed in such a fundamental way as this retirement test. It has just been continually eroded so that there is very little left of the concept of its being a retirement benefit.

When the self-employed were brought in in 1950, the first time for self-employed, the first big change was made. The representatives of self-employed argued that since the self-employed have control over their own retirement decision some of them worked to very advanced years and if you are going to bring them into a compulsory contributory program, you had better make a payment certain at a given time or they would not get anything out of their contributions. Sixty-five and a retirement test may be all right for workers, but self-employed ought to have a definite time for payment whether they work or not.

So that is when the age of 75 came in as a straight annuity, payable at that time without regard to earnings. And to be fair, it had to apply to everybody, not just the self-employed. So you had a straight annuity at 75. As you know, that became 72 and it is now 70. So it is a straight annuity at age 70, really coming out of the coverage or the self-employed.

Another thing that the self-employed brought in was the idea of going to an annual test, because for many self-employed it is not very meaningful to look at monthly earnings. Earning just change too frequently and they do not keep their books that way.

So as an alternative to a monthly test, which the old retirement test used to be, we put in an annual test and then efforts were made as the years went on to bring the self-employed and the wage earner to equal treatment. And now we have an annual test for everybody.

The history of the retirement test from then on is a classic example of the "slippery slope." Every change that has been made since it has been a liberal modification. People have been upset by the large cost if eliminating it entirely, so it has continually be unliberalized in one step after another until the point where you have to say the philosophy has changed because of the accumulations of all these individual steps.

It is obviously an unpopular provision among beneficiaries who can work and, of course, those who do work. This is a minority among Social Security beneficiaries. Most of them do not work; most of them could not get jobs if they wanted to. But the people who do and do want them, mostly the younger elderly, feel very strongly about this and that is understandable.

They are relatively high earners, as the Commissioner said—but let us look at how the test works today. Full benefits are paid to those under 65 if they have annual earnings of $8,040 and then $1 is deducted for each $2. Then at 65 up until 70 there is an exempt amount of $11,160 and then $1 out of $3 is deducted.

So if you have benefits of, say, $1,000 a month, you do not lose them all, even at $47,000 a year. Now that is a long way from the original notion of paying benefits only on retirement. Today you can perhaps best describe Social Security as an annuity program for all at age 70 and an annuity program at early ages for relatively low wage earners because they come under these exempt amounts.

It is really a retirement program only for those that have average or above-average earnings.

The CHAIRMAN. Now, Commissioner, you have just described a proper muddle, right?

Commissioner BALL. Yes.

The CHAIRMAN. It is an annuity program for everybody over 70.

Commissioner BALL. Yes.

The CHAIRMAN. It is an annuity program for persons under 70 who have low incomes and it is a retirement program for those 65 to 70 with above average incomes.

Commissioner BALL. Yes.

The CHAIRMAN. Yes, that is a muddle.

Commissioner BALL. Yes. I think it is the most muddled up thing we have in this Social Security Act, actually. I wish I knew how to fix it. We made it worse from my point of view, maybe better from many points of view, by what we did in the negotiations in 1983.

Toward the end of those negotiations, you may remember, Mr. Chairman, Jim Bakker said he really had to take back to the President something that was truly a change in philosophy in the program. He had to show him something, something that was different philosophically about the change. We had agreed on just about everything else.

I am not very proud of it, but at the time I made a suggestion that financially was practically the equivalent of dropping the test. Under the law, if you did not take your benefits early, then you had a delayed retirement credit and got larger benefits later. I said, well, make that credit the actuarial equivalent of the delay and then it is the same thing as if you had abolished the test financially.

The CHAIRMAN. Yes.

Commissioner BALL. We accepted that in the negotiations and now I would like to try and make amends a little bit. I would like to propose that we freeze the increment where it is. It is now at 4.5 percent, the annual delayed retirement credit. It is scheduled under present law to go up to 8 percent, which is the actuarial equivalent.

If you freeze it at 4.5 percent, you save .06 percent of payroll over the long run. It is not a lot, but it is moving in the right direction. It puts a little emphasis on the system as a retirement system. I tell you one of the things that bothers me most about abolition of the test. The money, of course, is very important. I think $23 billion in costs for the first 5 years is probably enough to prevent abolition of the test.

But I am concerned about it more fundamentally than that. I am concerned about the way it will look. You were speaking of perception a little earlier. How will it look to the public if there is no retirement test at 65 and well paid supervisors and managers with full-time jobs just keep working just as they always have, and suddenly at 65 they start getting Social Security benefits? I do not think that is going to look too well.

I think it gives ammunition to people who think you ought to means test the whole benefit. I think it is better to pay people after they are retired, even if you pay them somewhat more because of their having foregone benefits. That is a tactical consideration related to the future of the program.

I guess I cannot understand why anybody wants to spend $23 billion over 5 years and, $42 billion over ten for this particular purpose, but even beyond that I am concerned about the perception.

Mr. Chairman, that is my general reaction to this problem. I wish I had a good suggestion to make. If I knew how to do it, I would like to get back toward the original idea. I think a retirement benefit is not a bad idea. But we are probably past the possibility of going back.

[The prepared statement of Commissioner Ball appears in the appendix.]

The CHAIRMAN. I think we are, sir. We appreciate your detailed testimony which will be part of the record.

Senator Packwood, how many times in the last year have you been at a meeting on some other subject altogether in which the second most prominent lawyer in town stands up and says, listen, I am chairman of Hopeless, Horace and Spleek and I have an income of $300,000 a year and why should I be getting Social Security?

Senator PACKWOOD. That is common from people making $300,000 a year, age 68.

The CHAIRMAN. Yes.

Senator PACKWOOD. It is not so common from somebody making $12,000.

The CHAIRMAN. No. But those people do not get to those meetings.

Senator PACKWOOD. No, they are not invited to the meetings where that lawyer is.

The CHAIRMAN. Yes. The tendency behind that argument is to say this should be means tested. If that is the case, you say, no, you have paid the money in, you are getting it out. The case is increasingly made that this is something that is given you, that you did not do anything, that it is not in fact an earned benefit, which is I think the greatest principle we have to protect.

I am sure Mr. Perkins thinks that. Good morning, Mr. Perkins, representing the American Association of Retired Persons, the largest lay organization in our Nation, I believe, probably in the world.

STATEMENT JOSEPH S. PERKINS, VICE PRESIDENT, AMERICAN ASSOCIATION OF RETIRED PERSONS, DANVERS, MA

Mr. PERKINS. Good morning. Thank you, Mr. Chairman. Yes, I am Joe Perkins and I am the recently elected vice president of AARP. We appreciate this opportunity to present our views on the Social Security earnings limits.

I am also employed as the Corporate Retirement Administrator at the Polaroid Corporation and have seen the impact of the earnings limit on an older worker's decision to stay in the labor force.

AARP supports an increase in the limit, a liberalization of the limit. We hope this committee will seriously consider raising the amount that working beneficiaries age 65 through 69 can earn without losing any Social Security.

The Association believes an earnings limit increase would improve the lives of many older persons who work, not simply by choice, but out of necessity. Furthermore, we believe that liberalization represents good labor, good social and good economic policy. The increased longevity generally improves health of many older people, as well as the changing definition of retirement leads us to conclude that an increase is overdue.

Furthermore, the prospects of an aging society and a slower growing work force suggests that we must make more efficient use of one of our most valuable, economic resources—the skills and experience of older persons, older workers.

A higher earnings limit would encourage more older workers to increase their time in the labor force. As has been said a number of times this morning, a 65 to 69 year old working beneficiary this year will lose $1 in benefits for every $3 earned above the $11,160 limit. A beneficiary with the average benefit amount, I understand it is about $674 per month in 1994, and only $12,000 in earnings will lose about $280 in benefits.

Even with almost $20,000 of total income, a working beneficiary who lives in an area with high cost of living, high medical or other expenses might run into unanticipated financial problems, and even modest benefit losses can be significant.

On the other hand, a nonworking beneficiary with $20,000 in pension and investment income in addition to Social Security loses no benefits. Is it right to penalize the working beneficiary who tries to improve him or herself economically? Raising the limit would mean less frustration and inconvenience, not only for beneficiaries but also for the Social Security Administration.

The Agency estimates that 60 percent of all overpayments and 45 percent of all underpayments are caused by the earnings limit. Recouping an overpayment from a beneficiary often imposes considerable hardship. Our written testimony speaks of a woman from

Oregon, the state of Oregon, who describes a recent example of the difficulties repayment pose.

I have been in the counseling of older workers and retirees for 20 years and I have many anecdotal situations of which very modest income people, very middle income people, how the earnings test affects them. Despite the fact that many older persons of modest means need extra income and are willing to work for it, some oppose any increase in the earnings limit.

They argue the change in the limit would also benefit some higher income individuals. While this is true, liberalization targets proportionately more relief to moderate and middle income beneficiaries who have limited pensions or other income. For these middle income older people, work offers the only hope of setting aside money to meet current and future needs.

Proponents also argue that a change would be costly to the Social Security trust funds. While there are some short-term costs, the Social Security actuaries estimate that long-term costs to the trust funds are negligible. Offsets can and should be used to reduce the costs of raising the limit and this is consistent with the new rules adopted in the Budget Enforcement Act.

We at AARP strongly believe that raising the limit is both fair and intelligent policy. We urge Congress to move ahead on this issue and I thank you.

The CHAIRMAN. We thank you, Mr. Perkins.

[The prepared statement of Mr. Perkins appears in the appendix.]

The CHAIRMAN. So you would take the offer, if you want to put it that way, from Commissioner Chater as a beginning here.

Mr. PERKINS. Would love to work with the administration for some sort of liberalization. A liberalization.

The CHAIRMAN. A liberalization. We thank you, sir.

Mr. Max Richtman, Speaking on behalf of the National Committee to Preserve Social Security and Medicare. Good morning, sir.

STATEMENT MAX RICHTMAN, EXECUTIVE VICE PRESIDENT, NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE, WASHINGTON, DC

Mr. RICHTMAN. Good morning, Mr. Chairman. Thank you, Mr. Chairman. First of all, I too would like to congratulate you and Senator Packwood on final passage of the Independent Agency legislation. This is something that has been supported by seniors for a long time by the National Committee and by you. So we do congratulate you. We are very pleased about it.

The CHAIRMAN. Well, we accept your congratulations. It is not every day we can get something through the Senate floor unanimously. Everybody is sort of happy about it all. Thank you.

Mr. RICHTMAN. I am here today to speak on behalf of our members and supporters in favor of repealing the Social Security earnings limitation for workers age 65 through 69. Many of our members need or want to work. But they also want to receive the benefits they have earned. They do not understand why they are still tied to an earnings limitation they view as a relic of the Depression era.

Nor do they believe Congress——

The CHAIRMAN. There is the man who was present at the time, but it is the view.

Mr. RICHTMAN. I realize that and I realize that your observation about perception is right on target as well. The perception is that this is a relic of the Depression era and is not fair.

Many of these people also believe that Congress today would take a different approach if it were starting anew. Yet, concern over the short-term cost and the continued use of Social Security trust funds to offset the general budget deficit we feel keeps Congress from relieving workers from the financial penalties of the earnings limitation and the Social Security Administration of its administrative burden in enforcing this earnings limitation.

According to Social Security actuaries and this was testified to this morning, the long term cost of repealing the earnings limitation is negligible, one one-hundredth of a percent. A major goal of 1935——

Senator PACKWOOD. How long is that?

Mr. RICHTMAN. Seventy-five years. Mr. Ballantyne testified to that this morning as well.

Senator PACKWOOD. How much is that?

Mr. RICHTMAN. How much money?

Senator PACKWOOD. Yes.

Mr. RICHTMAN. It is about, as I understand it, $23 billion over 5 years.

Senator PACKWOOD. Over five?

Mr. RICHTMAN. Right.

Senator PACKWOOD. Now what is the .01? I heard Mr. Ballantyne say it, but what is the .01?

Mr. RICHTMAN. Of payroll.

Senator PACKWOOD. Over 75 years?

Mr. RICHTMAN. Right.

Senator PACKWOOD. That's the loss?

Mr. RICHTMAN. That's the loss. That's the cost of repealing the earnings limitation.

Senator PACKWOOD. How much is that over the 75 years?

Mr. RICHTMAN. I tried to find that out last night. As best as I can determine, maybe this is a good way to understand it, if the earnings test—the recent release from the Social Security Administration regarding the solvency of the trust fund was the year 2029.

If the earnings limit were passed tomorrow, by unanimous consent, as I understand it, that would reduce that by 1 year. In other words, it would be 2028.

The CHAIRMAN. Harry Ballantyne is nodding behind you.

Senator PACKWOOD. He is nodding and he is saying, yes, that is right.

Mr. RICHTMAN. I am sure he is saying that. That is my understanding.

Mr. BALLANTYNE. Yes, it would be exhausted 1 year earlier.

Mr. RICHTMAN. One year earlier.

Senator PACKWOOD. If we immediately eliminate the earnings test totally?

Mr. RICHTMAN. That is correct. Right.

As I was saying, it is our belief that in 1935 a major goal of Social Security was to move older workers out of the work force and make room for younger unemployed workers. Availability of Social Security benefits made retirement feasible for workers unable or unwilling to continue working and the earnings limitation encouraged into retirement those who otherwise might have chosen to keep working.

At the time, workers responded to this double-edged incentive and they are still responding. Under existing circumstances, it is hard to imagine why any senior would continue working after reaching retirement age. The truth of the matter is, like younger workers many need the money. Social Security is one element of a three-part retirement income package, savings and pension are meant to provide the remaining two parts.

Almost half of retired men and over 75 percent of retired women have no pensions to supplement Social Security. For many of them additional earnings are not an option. They are often a necessity. Savings, as you know, can be elusive. Investments are not always successful and the decline in interest rates means far less income than anticipated by many at retirement.

Some seniors remain in the work force or reenter the work force to meet extraordinary medical expenses for an ill spouse or perhaps a very aged parent.

Not all seniors work because they need the money. Many seniors enjoy their work and the association that comes with work. They receive satisfaction from continuing to be productive and creative.

It seems that instead of a national policy to encourage the continuing use of this talent and energy, this earnings limitation does just the opposite—discourages it.

Whether the senior works out of the need for extra income or the satisfaction of working, the combination of payroll taxes, income tax, loss of Social Security if the earnings limitation is reached exacts a high price. Retirees who want to work quickly figure out that they are basically working to pay additional taxes and get very little benefit.

Some beneficiaries, age 65 to 69, with earnings between $10,000 and $30,000 have marginal tax rates approximately twice as high as non-beneficiaries. This disparity we feel not only prejudices the decision to work by beneficiaries age 65 to 69, but also is contrary to principles of fairness.

Some opponents of raising the earnings limit center their arguments on the advantage eliminating the earnings test would have to the "wealthy who do not need Social Security"—the $300,000 a year lawyer you were talking about.

High income workers have paid for their benefits. Need is not supposed to be a factor. This position we feel is nothing more than means testing in another form and we are opposed to means testing Social Security.

When the delayed retirement credit—and this was discussed earlier as well—is actuarially fair in the year 2008, high income workers will not even lose any lifetime benefits. The delayed retirement credit is gradually being increased as of now.

High income individuals often have another advantage over those with lesser income and assets. Unearned income from savings and investments provide substantial supplement to Social Security.

Senator McCain, I think, made a very clear and reasoned argument about this this morning before you arrived, Mr. Chairman. Unearned income never affects the right to benefits. In other words, a person can have as much income through interest and dividends from investments, stocks and that will not reduce the amount of Social Security benefits. This to us raises a real question of equity.

Over the years Congress has increased the earnings limitation and reduced the penalty. This has been a big help to many seniors. But the current limit of $11,160 a year for those age 65 to 69 certainly could not be considered generous, especially in metropolitan areas like New York, Chicago, Los Angeles, where the cost of living is high.

I do not believe raising that by $1,000, as was proposed by the Commissioner would really make that much of a difference.

Eliminating the retirement test and benefit recomputations would also save $50 to $100 million a year in administrative expenses according to the Social Security actuaries.

The many appeals that result from misunderstanding of the retirement test and the waivers of repayment for those that cannot pay back overpayments would also be eliminated. Each year work generates endless paperwork not just for the Social Security Administration but also the beneficiary.

Mr. Chairman, older workers do indeed appreciate your leadership on Social Security matters over the years. Times have changed and we believe the rules must change. Allowing Social Security beneficiaries 65 to 69 to work without limitation benefits these individuals and benefits society.

We believe that the freedom to work and be independent is still a hallmark in our society and I thank you for this opportunity to testify.

The CHAIRMAN. We thank you, sir, very much, indeed.

[The prepared statement of Mr. Richtman appears in the appendix.]

The CHAIRMAN. I would note something that continues to interest me. The majority of our work force has retired by age 65. A majority actually retire by age 62. And by age 65 two—thirds, which suggests a lot of things. It suggests you have a retirement home and a pension and you retire or there is no work for older people. Probably a mix of things.

I am sure the Social Security Administration knows more than it has told us about the subject. But we will pursue it.

Now Gene Steuerle, the distinguished scholar and Senior Fellow at The Urban Institute. Good morning, sir, welcome back.

STATEMENT EUGENE STEUERLE, PH.D., SENIOR FELLOW, THE URBAN INSTITUTE, WASHINGTON, DC

Dr. STEUERLE. Thank you, Senator Moynihan, Senator Packwood, Senator Rockefeller. It is good to be before you again today.

Most of the budgetary issues facing this committee are centered around issues of retirement and health policy. Perhaps it is not hard to understand. While retirement health and disability occupied less than 10 percent of Federal outlays in 1950, today they occupy about one-half.

After you take out interest payments, the remainder—defense, foreign affairs, welfare, education, environment, transportation, housing, Justice, almost all the things we think of as government or we used to think of as government—soon will take up less than one-third of Federal outlays.

The continuing growing share of the budget spent on retirement and health undoubtedly is deterring us from using resources toward reducing poverty rates among children, fixing our educational system, reforming welfare and dealing with many other problems.

Now, will such demographic changes with the retirement of the baby boom population just around the millennial corner, these budgetary shifts are only going to increase, as are the problems associated with them.

Now I realize that this committee today is discussing the earnings test and you may think of my initial remarks be a bit off the subject. I am not going to pretend before you that eliminating the earnings test will deal with these larger budgetary and societal questions.

Indeed, as noted already, its repeal initially may reduce revenues or increase the deficit. However, I am going to argue before you today that elimination of the earnings test is a small piece of a much larger reform strategy. Although not a sufficient component, it may be a necessary one.

More specifically, I believe that reform of retirement age rules in general is becoming a budget necessity if we want to direct resources to the greatest needs of society, that we should stop wasting and discouraging the productive capabilities of many of our near elderly and elderly, that the government should not simultaneously forbid age discrimination among private parties and promote such discrimination in tax and Social Security laws, and that the earnings test is one of those obstacles to these broader reforms.

Mr. Chairman, I believe that our society sends many signals to our elderly and near elderly today, signals that they should retire and retire early. Again, I list several of them in my testimony and I will not repeat them here. But the earnings test is one among many of these signals.

I believe all these signals send a powerful message to the near elderly and elderly. They set a social standard that is really hard for any one individual to ignore. Most were designed a long time ago, in an industrial, not a technological and service sector economy, and at a time when there was a fear there were too few jobs to go around, rather than too few workers to support a retirement system.

The simple fact is that the earnings test is a tattered remnant of a by gone era. Even independently from its strong anti-work sentiment, it violates almost all standards of efficiency and equal treatment of equals under the law.

For example, it helps maintain a tax system in which households with equal incomes are taxed very differently. Elderly workers often pay much more tax than nonelderly workers who in turn pay much more tax than elderly nonworkers. In addition, the earnings test can be thought of as an annual means test, but one based upon earnings.

Given enough adjustments in delayed retirement credits, actuarial adjustments, and so on, some of these equity and efficiency problems could be resolved. All these additional offsets, however, cannot solve a more basic issue. The earnings test would remain one of the many signals that our society, as well as our government, sends to citizens when they have a life expectancy of as long as 20 years or more: "You should retire. You are old. We do not want you to work. We will penalize you quite heavily if you do work."

Even with all the actuarial adjustments in the world, I do not believe that this signal, this very bad and confusing signal, can be removed entirely without eliminating the earnings test as one step. As you said, Mr. Chairman, we cannot send all of the elderly to an actuarial school.

My testimony also covers in some detail the various rationales for the earnings test. I will not go through all of them. But I would like to deal with two of them that have been laid before you today.

Mr. Ball reinforced one argument—an argument used by many of the best and finest experts in the system—for an earnings test. That is that Social Security should provide benefits to people because they are retired, not just because they are old. I believe that this is misleading.

Social Security is a program designed at its core to meet the needs that often accompany old age. Both old age or years after birth and retirement at best are proxies, often poor proxies for measuring those needs. Whereas, a substantial number of people do cite health or disability as reasons for retirement, it is clear that many retirements are voluntary in nature.

In these cases, the difficulty with any retirement test is that it is under the control of the individual regardless of need. It creates great inequities between two persons in equal situations, one of whom decides to work and one of whom does not.

Another argument made, and this one was made by the administration in earlier testimony to defend the earnings test, is that it enhances progressivity. Elimination of the earnings test is usually shown to increase net income mainly for those in middle or upper middle income ranges.

As applied to the earnings test, I believe this argument is also misconstrued. One could also deny businesses deductions for the cost of running business or we could tax individuals three times on their dividend income and we could argue that the net result was progressive. But we obviously would not enact such a policy because it would not make sense under the normal rules of equity, that is, that we treat equally all persons with equal ability to pay or equal income or equal need, and that we not distinguish on the basis of an arbitrary criteria such as whether their income came from work.

In summary, I believe that eliminating the earnings test at all ages would probably be the simplest way to reduce many of the perverse incentives of the existing system. It would also greatly simplify the administration of the system, something that might enhance the ability of the new Social Security administration to function more efficiently since the earnings test is the largest source of errors in benefit calculations.

Many corrections in benefit amounts are required as earnings change over time and taxpayers are extraordinarily confused about what is occurring. As we move toward the 21st Century, changes may need to occur in the work patterns of the near elderly and the young elderly. Perhaps even the tendency to define old age with such arbitrary criteria is the year 65, a signal that can be traced back well over a century will itself——

The CHAIRMAN. That is Bismarck.

Dr. STEUERLE. Bismarck's time; at least in the United States to the establishment of the Baltimore and Ohio Railroad Co. plan in 1880, Senator.

It can only be called increasingly into question. No one knows for sure, and I am not going to pretend before you that I do, how work behavior will change in the future. But it seems unrealistic to maintain an earnings test that announces somewhat loudly that most people should retire at age 65 or 62 and stay retired.

In the end, we are never going to know until some of these walls start coming down. Thank you.

The CHAIRMAN. Thank you very much, Doctor. That is a very cogent argument.

[The prepared statement of Dr. Steuerle appears in the appendix.]

The CHAIRMAN. Bob, you have been losing.

Commissioner BALL. I expected it. I seem to just be the historical record here. Bismarck actually had an age 70 proposal and not 65. Maybe we should go back to that. That would make Gene's point, I think, much better if we raised the retirement age. That would be a signal to people that they should work longer.

But what abolishing the retirement test does primarily is not change people's behavior. What it is going to do is pay a benefit to a lot of people who would be working anyway and at good wages.

Now that may not be a bad thing, but it is an expensive thing. And the problem that I have with it, as I said earlier, but maybe not clearly enough, is that I think the public reaction to paying Social Security benefits to people earning good salaries is, gee, "This is a strange thing for Social Security to be doing."

If you wait until they are retired it seems more reasonable. And the reason you distinguish between income from interest, dividends and work, of course, is we are trying to get at a test of retirement, which is related to earnings, not at a test at income. Thus you make that distinction. And, sure, if you look at it in a different way, it raises equity questions between people who do work and people who have interest and dividends. But if your purpose is to try to define what retirement is, you have no right to look at anything but earnings.

So I am concerned more than anything else, Mr. Chairman, with the public perception of a Social Security program that pays benefits at relatively early ages, 62 to 70, to people who are going on earning just as they always have been and are high earners.

I think that is going to look like a very strange thing to do.

The CHAIRMAN. That is a fair point. Can I just say that Senator Packwood and I—and I am sure Senator Rockefeller would also agree—as we move to an independent agency, the Social Security Administration is going to make a lot more effort to tell people about the system early in their working careers, to send an annual statement of what you paid in, what you would receive in the way of disability benefits, and what survivors' benefits would be.

We have that in the statute. It starts in about 2 years, does it not, Dr. Chater?

Commissioner CHATER. One year. Yes, at age 60.

The CHAIRMAN. But only at age 60. It ought to start at age 30.

Commissioner CHATER. I think you have in the statute it becomes lower later.

The CHAIRMAN. Yes.

Senator PACKWOOD. I think we do a test right now. In fact, I think we are involved in the test right now. It is only three or 4 years before we are starting to do it for everybody, I think.

The CHAIRMAN. Right. You know, these statements are things you will throw away when you are in your twenties, and you will lose in your thirties. In your forties there will be a drawer somewhere in the house where you put these things and you look at them from time to time. That is my money. That is what we are going to get.

A lot of teaching about the program could be accomplished in the text of those statements. I am looking forward to it.

Commissioner BALL. I think, Mr. Chairman, if I could interrupt, that that is probably the single most important thing that can be done to restore the confidence of people in the Social Security system.

The CHAIRMAN. Good for you. I see some Social Security Administration people nodding agreement.

Commissioner BALL. That getting it every year, a statement like you do from TIA/CREF and so on, that you have paid in and this is what you are entitled to if you continue to work at this level makes it very concrete for people. I think that is one of your great contributions to this program, having insisted on that.

You have now got two major contributions mentioned today—the statement and the independent agency. You had many more, of course, back in 1982 when you defended the system against attack.

The CHAIRMAN. Thank you, sir.

Senator Rockefeller?

Senator ROCKEFELLER. Thank you, Mr. Chairman. Just a quick comment. One, I understand that conferees have just been appointed on the separate Social Security Administration and that is fabulous news, and this bill is on its way. I congratulate the Chairman. I see the Social Security Administrator sitting back there also.

Just one comment, I guess I would make, and that is that it appears from a chart that those who would benefit by the repeal, not liberalization, but from the repeal of earnings test, 21 percent of them would make between $42,000 and 42 percent of them would make $42,000 or more income.

Now I am not sure if, given the expenses older Americans face, it would be fair to say that mostly upper income people would benefit most by repeal as opposed to others. And I am not prepared to make that statement. I think it is worth noting that that is the case.

The CHAIRMAN. These are the attorneys that continue to practice.

Senator ROCKEFELLER. Right.

The CHAIRMAN. The doctors.

Senator ROCKEFELLER. Right. Then also I think the point that the Chairman made about educating people about Social Security is incredibly important. It is basically the same theory as we were talking in an earlier meeting about living wills, durable powers of attorneys, advanced directives. You confront people with what it is they expect to be paying into something. That does not have to do with advanced directives. But what they are paying in, what they would be getting out.

Gradually they will familiarize themselves so the Social Security and what one receives from Social Security. What one put into Social Security and what one gets out of it will cease to be sort of a myth and more of an established understanding. While I don't really have a question, I think that those are two points to note for the record, and I thank the Chairman very much.

The CHAIRMAN. Thank you, Senator Rockefeller.

Senator Packwood?

Senator PACKWOOD. No questions, Mr. Chairman.

The CHAIRMAN. We have learned a lot. We congratulate Commissioner Chater on the independent agency. We appreciate your coming forward with a proposal in this matter.

We thank you all for clear and persuasive testimony and we will get to the bottom of it. Bismarck's program began at 65, did it not?

Commissioner BALL. No, 70.

The CHAIRMAN. It was 70, when everybody was dead. Yes.

Commissioner BALL. The public perception is 65, Mr. Chairman.

The CHAIRMAN. All right.

Commissioner BALL. And the historians probably should keep quiet.

The CHAIRMAN. You are probably the one that thought up 75—you or your colleague and former actuary.

Commissioner BALL. Well, Bob makes a big, big point of it every time anybody mentions Bismarck and 65. I thought I had to do it for him. I mean, we try to get things straight in this committee. Every so often we do.

Again, thank you very much indeed.

[Whereupon, at 11:49 a.m., the hearing in the above-entitled matter was concluded.]

APPENDIX

Additional Material Submitted

Prepared Statement of Robert M. Ball

Mr. Chairman and Members of the Committee: My name is Robert Ball. I was Commissioner of Social Security from 1962 to 1973. Prior to my appointment by President Kennedy, I was a civil servant at the Social Security Administration for nearly twenty years. Since leaving the government, I have continued to write and speak about Social Security, health insurance and related programs. I was staff director of an Advisory Council on Social Security to this Committee in 1948 and a member of statutory advisory councils in 1965, 1979 and 1991. Together with the Chairman and several members of the Committee on Finance, I served on the National Commission on Social Security Reform. This was the Commission chaired by Alan Greenspan and whose recommendations served as the basis for the important 1983 amendments to the Social Security Act. I am currently Chair of the Board of Directors of the National Academy of Social Insurance, but I will testify today solely on my own behalf, and the views I express are not necessarily those of any organization with which I am associated.

When the Social Security program was passed in 1935, old age benefits were to be paid only to those who were not working. Before monthly benefits actually began, the law was changed in 1939 and made more explicit so that an otherwise eligible individual could earn up to $14.99 a month and still receive full benefits. It did not seem practical to withhold benefits for tiny amounts of earnings, but the philosophy and purpose of the program was clear: the retirement benefits were to be paid only to people who had retired, and the purpose of the benefit was to partly make up for wage income that was lost because of retirement. It was not an annuity payable at a specified age regardless of whether or not people continued to work. It was a *retirement benefit.* Had Social Security been set up as an annuity program, it would have cost considerably more.

This concept of a retirement benefit, while still present to some degree, has been eroded over the years by one change after another, each change defensible in its own right, but accumulating to a tremendous modification of the original idea. When the self-employed were first brought into the program in 1950, the case was made that many of them, since they were in charge of their own retirement decisions, worked to advanced ages and, unless they were paid at some point without regard to a test of retirement, would get nothing for their contributions. So an annuity at age 75, without regard to current employment, was introduced and, to be fair, it had to be applied to everyone, not just the self-employed. Coverage of the self-employed was also responsible for introducing an annual earnings test as an alternative to the monthly wage test then in effect. Monthly earnings for the self-employed are frequently quite meaningless. Their income has too many ups and downs in the course of a year. Later, it seemed only fair to bring the treatment of wage earners and the self-employed as close together as possible and the monthly test was dropped for wage earners except for the first year of retirement when it is used to determine when benefits should start.

The history of the retirement test from there on has been a classic example of the slippery slope. An obviously unpopular provision among beneficiaries who continue to work at their old jobs or can get new ones after retiring from regular work and one of the more complicated of Social Security provisions, it has been the target of constant pressure for change. And change after change has been made so that many people today can continue at their regular jobs and start to get benefits at 65 or even 62. The ones now ruled out by the test are relatively high earners, and, in any event, the straight annuity feature that started at 75 when the self-employed were brought in, was first reduced to 72 and is now age 70.

Today full benefits are paid to those under 65 who have annual earnings of $8,040 or less and above this exempt amount $1 is deducted from benefits for each $2 of earnings. At ages 65 to 70, the exempt amount is $11,160 and $1 is deducted for each $3 of earnings. For example, beneficiaries entitled to benefits of, say, $1,000 a month don't lose all their benefits until they earn somewhat over $47,000 a year. We have come a long way from the concept of paying benefits only to those who are fully retired.

The program today can, perhaps, best be described as an annuity program for all at age 70, and an annuity program at earlier ages for relatively low wage earners, but before age 70, it can be described as a *retirement* program only for those who have average or above average wages.

There has been an erosion of the philosophy of a "retirement test" from another direction as well. Beginning with the 1972 amendments, if benefits have been withheld in an earlier period, they are increased when paid later. Thus instead of sticking with the idea that a worker was entitled to payment only if retired, the notion was gradually introduced that if he or she "gave up benefits" by postponing retirement, they should get more when they did retire. In the past, this increase has been worth considerably less than the foregone benefits, but in the negotiations of the National Commission on Social Security Reform (and as later included in the 1983 Amendments) the final step was taken. Gradually the increment paid to those who postpone retirement is moving up to the actuarial equivalent of receiving full benefits at age 65. That is, although benefits for those who work and earn substantial wages will start later and thus be paid for a shorter period of time, on average, they will be enough higher to equal the smaller amount that would be paid at 65 but over a longer period. If this provision in present law is allowed to stand, the long range cost of eliminating the retirement test is only about 0.01 percent of payroll, since the provision is practically the financial equivalent of dropping the test.

Specifically, those attaining age 65 today get a 4.5 percent increase in their basic benefit for each year they delay retirement between ages 65 and 70. This is up from 1 percent for those attaining age 65 in 1982. The increase will gradually go up until it reaches 8 percent in 2009, providing a benefit level that is approximately the actuarial equivalent of receiving a benefit at 65. (Another change going on at the same time is that the first age of eligibility for full benefits will be rising so that by 2009 it will be 66 under present law, and later this so-called "normal retirement age" will rise to 67. The explicit delayed retirement credit applies only to years between the normal retirement age and 70).

We have set in motion changes that will make it cost very little in the long run to drop the retirement test as compared to the way the retirement test will work under present law. There is a substantial short range cost, however: nearly $23 billion from 1995 through 1999, and year by year costs continue for about 25 years after that. There is, however, another fundamental consideration in addition to cost. Do we want to pay people at 65 even though they are earning substantial amounts or is it better to postpone paying benefits until an earner retires.

I prefer the latter course, partly because I do not like to see the Social Security program characterized in public debate as one that pays benefits to people who have high paying jobs and are earning, in some instances, as much as they ever did. I fear this characterization might add to the pressure to means-test the benefits generally and pay only those who have very little except Social Security, thus changing the program into welfare. In this argument, I would like to retain the perception that at least for the higher paid, benefits before age 70 are paid only on retirement.

In fact, far from getting rid of the retirement test, I have considerable doubt about the direction we have been taking. If I knew how to do it, I would be glad to go back part way to the original idea of paying retirement benefits only to those who are retired. Realistically, for at least the near term, though, we are stuck with an annuity at age 70 paid regardless of earnings and, I suppose, stuck for a long time if not forever, with at least the level of benefit increases already granted for postponing retirement. Even so, as we look for minor cutbacks to help balance the cost and income of the system several decades from now (when under current estimates there will be a shortfall), this area seems to me like a good hunting ground. At the very least, why not cap the increment for delayed retirement at the present 4.5 percent a year and drop the provision that moves this up to the actuarial equivalent of 8 percent a year? Why do we want to increase the benefits of those lucky enough to hold jobs from age 66 to 70 by a whopping 32 percent? This seems to me to be carrying the equity principle way too far for a social insurance system. And I feel guilty about having been somewhat responsible for this result in the 1983 negotiations. I would like to make amends.

Capping at 4.5 percent per year would reduce the long range cost of the system by 0.06 percent of payroll with most of the savings, of course, coming in the next century. Not a lot of reduction, perhaps, but moving in the right direction. Maybe if we do it gradually enough we could get back to the idea that retirement benefits are for retirees and that the benefits are intended to partly make up for a loss of earnings resulting from retirement. Perhaps if given a long enough lead time, people would accept the idea that annuities regardless of earnings at age 65, or their equivalent in delayed retirement credits, are not the best way to spend Social Security money. I don't think we should be as strict as the original provisions, but if there were a way to avoid paying benefits to those who are continuing in their regular career jobs and still pay those who want to do some work after retirement, I would be for it. I just don't see how to do it.

I know that any change in the direction of tightening up on the retirement test would be very difficult to accomplish. It is true that there is a good side to what we have been doing. The retirement test makes people mad. The government seems to be saying that it doesn't want older people to work and I don't like that. And many think they have been paying for an annuity not a "retirement benefit" and feel cheated if the benefit isn't paid when they work. And the test does reduce the work effort of older people. It is complicated and many people feel it is just safer to keep their earnings under the exempt amount and not get tangled up with changes in their benefits with reports flowing back and forth with the government. This does reduce the amount of work offered by older people, as does combining a calculation for the benefit reduction from the retirement test with state and Federal taxes on earnings somewhat above the exempt amount. Such a calculation can show in some instances that you keep little of what you earn. The test is hard to administer and prone to error. These are all good reasons to stay on the course we have selected (or drifted into).

Still it seems to me a matter of very low priority to pay more retirement benefits to people who haven't retired. Let's at least keep the remnant of the test we have and cap the delayed retirement credit where it is. I would like to work back toward a tougher test over a long period of time and save the money that will go to the higher paid in these delayed retirement credits, or even worse in abolishing the retirement test altogether, but I admit I have no concrete proposal to make. We could work up from 70 to 72 for the straight annuity as the "normal retirement age" is raised, but little money is saved. Anyway let's think about it and avoid the further liberalization already scheduled in present law or the even further liberalizations proposed by many, Above all, it is very difficult for me to see why people want to spend nearly $23 billion just from 1995 through 1999 on abolishing the test.

PREPARED STATEMENT OF SHIRLEY S. CHATER

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to be here today to talk about the Social Security retirement earnings test. As you know, the earnings test is an issue which affects many Social Security beneficiaries and has been the focus of much debate and discussion. In fact, more than 15 bills to either eliminate or change the earnings test have been introduced in the current Congress.

Certainly, the Administration shares the concerns expressed by you, Mr. Chairman, and other Members of this Committee, about the impact of the retirement test on our beneficiaries. I think that this hearing can be helpful in focusing the debate on this issue and I commend you for holding it.

To facilitate our discussion today, I will begin by briefly reviewing the philosophy behind the earnings test, and how that philosophy--and the test itself--has evolved over time. Finally, I will discuss the Administration's views on eliminating or modifying the retirement earnings test.

History of the Earnings Test

In order to evaluate whether to eliminate or modify the current retirement test, it is helpful to understand the goals and underlying philosophy of the test and of the Social Security program itself.

Social Security was designed as a social insurance program under which workers and their dependents are insured against the loss of earnings as a result of the retirement, disability, or death of the worker. Benefits are intended to partially replace the earnings that are actually lost due to these risks. In that context, the retirement earnings test was designed as an objective measure of the extent to which earnings are lost due to retirement.

As you know, Mr. Chairman, the Social Security program has always had an earnings test to measure this earnings loss, although the way in which it has been applied has changed over the years. Under the original Social Security Act of 1935, no benefits were payable for any month in which a beneficiary had any covered earnings whatsoever. This provision was akin to private pension plans, which generally require the pensioner to have a qualifying event such as retirement as a condition of receiving benefits.

However, even before the first benefits were paid in 1940, this strict "all-or-nothing" test of retirement was modified so that a beneficiary could earn up to $14.99 in covered earnings before losing benefits for that month. In fact, over the years since 1940, the retirement earnings test has been modified many times.

The Social Security Amendments of 1950, for example, exempted people age 75 and over from the earnings test. In 1954, the retirement test was broadened to include non-covered wages, and the age at which the test no longer applied was lowered from 75 to 72. The concept of reducing benefits by $1 for each $2 of earnings above the exempt amount was introduced in the Social Security Amendments of 1960, and the 1972 Amendments provided that the earnings test exempt amount be automatically increased with increases in average wage levels.

The Social Security Amendments of 1977 further increased the exempt amount for beneficiaries age 65 and over. Effective in 1983, the age at which the test no longer applies was lowered from 72 to 70.

The last major change in the test took effect in 1990, when the withholding rate of $1 of benefits for each $2 of earnings was changed to $1 for $3 for beneficiaries aged 65 to 69.

The Current Retirement Test

For beneficiaries ages 65 through 69, the earnings test reduces benefits by $1 for each $3 of earnings above the annual exempt amount, which is adjusted each year to reflect increased wage levels. The 1994 annual exempt amount for these beneficiaries is $11,160. Beneficiaries under age 65 lose $1 for each $2 of earnings over an exempt amount of $8,040. Unearned income--such as interest income, dividend payments, private pensions and the like--is not counted for purposes of the retirement test.

In addition, workers are exempt from the test when they reach age 70. The test does not apply to disability beneficiaries, who are subject instead to a substantial gainful activity test. It does apply to dependents of disability beneficiaries.

A worker's earnings above the exempt amount affect not only his own benefits, but also the benefits of family members receiving benefits on his earnings record. The earnings of a dependent or survivor beneficiary can affect only that beneficiary's payments.

About 925,000 beneficiaries lose some or all of their benefits as a result of the test that applies at age 65. Of this group, about 880,000 are retired-worker beneficiaries aged 65 to 69 or their dependents (any age) receiving benefits on the same record. About 45,000 are dependent or survivor beneficiaries age 65 to 69 who are affected by the test due to their own earnings.

Competing Objectives

As I have discussed, despite the original principle that benefits should be paid only to those who are fully retired, the earnings test has been modified over the years so that it is no longer such a strict test of retirement. These changes have come about from the desire to support several competing goals.

One such goal has been to allow beneficiaries to supplement their Social Security benefits with a limited amount of earnings. This option is especially important for many lower-income workers, as well as for some women and for others whose work experience has been uneven, and is consistent with the concept that Social Security was meant to function as "one leg of a three-legged stool" that is also supported by private pensions, and individual savings and investments. Modifying the strict retirement test originally in the law has allowed retirees to supplement benefits with earnings up to a specified level, without any loss of benefits.

The second competing goal is that of preserving incentive and opportunity to work among the aged. Given the demographics of our nation, this goal is likely to take on added importance with the aging of the baby-boom generation and the anticipated slowing in the growth of the labor force. The earnings test discourages some beneficiaries from working because the cost of working--taking into account the test itself, Social Security taxes, and Federal, State, and local income taxes, and work-related expenses--can be substantial for working beneficiaries aged 65 to 69.

The third competing goal is the desire to offer benefits that are as adequate a possible to those who need them most.

Thus, in the way it has developed over the years, the retirement test represents a balancing of several inherently competing goals:

- o to restrict benefits to those who have truly retired;
- o to allow beneficiaries to supplement their benefits with limited earnings;
- o to reduce work disincentives; and
- o to offer benefits that are as adequate as possible to those who most need them.

Considering the natural tension between these competing goals, it is no wonder that the retirement test is often the subject of debate.

Some people believe that the earnings test should be eliminated totally at age 65. Those who take this view generally hold that workers have "paid for" their Social Security benefits, and that they should receive benefits at age 65 regardless of continued work or earnings.

Others, however, believe that eliminating the retirement test would represent a fundamental and undesirable shift in the philosophy of the program away from the earnings replacement form of social insurance, and toward an individual annuity. Moreover, eliminating the test would help those beneficiaries who tend to be the most economically advantaged.

In fact, a recent SSA analysis shows that immediately eliminating the test would mean that approximately 700,000 families would receive additional benefits. However, families with 1995 incomes of less than $21,800 would receive only 1.1 percent of the total additional benefits, after taxes. By contrast, just over 50 percent of the net benefit increase would go to families with incomes over $69,000. (See Attachment A for additional information on the distributional effects of eliminating the retirement test.)

The short-range cost of eliminating the test at age 65 is estimated to be $22.9 billion to the Social Security and Medicare trust funds over the first 5 fiscal years. The cost for the first 10 years would be $42.6 billion. (Attachment B provides additional cost information.)

Some of those who support the elimination of the earnings test think that such a change would pay for itself because increased work activity resulting from a larger labor force would generate additional income taxes and Social Security payroll taxes which would offset most of the cost of the additional Social Security benefit payments.

We estimate, however, that only a small net increase in work activity would occur due to the elimination of the earnings test. Indeed, the consensus of most scholarly research is that the impact of eliminating the earnings test on aggregate earnings of older workers would be quite small.

As shown in Attachment C, we estimate that 20 percent of the additional benefit payments would be offset by additional income and payroll taxes, administrative savings, and reduction in Medicare costs. In other words, of every additional benefit dollar paid out, about 20 cents would be recovered: about 11 cents would be recovered by the Social Security trust funds, 6 cents by the Medicare trust fund, and 2 cents by the general fund of the Treasury. It is worth noting that only about a quarter of the 20 percent offset would be attributable to a net increase in work activity. We also understand, however, that none of these offsets would be scorable under the Budget Enforcement Act.

Administration Views

The Administration has serious concerns about totally eliminating the retirement earnings test. We recognize, however, that the earnings test can constrain the choices of employment and affect the standard of living for older beneficiaries who do not have other sources of income. Consequently, the Administration would support, in principle, a moderate increase in the retirement earnings test exempt amount for beneficiaries who have reached age 65. We believe that raising the exempt amount would be a sensible and practical approach to refining the balance among the competing program goals I mentioned earlier in my testimony.

A moderate increase in the exempt amount would allow us to keep the short-range costs within reasonable limits, while helping to ensure that those beneficiaries who most need to do so have the opportunity to supplement their Social Security benefits with earnings. Further, unlike complete elimination of the earnings test at age 65, a moderate increase in the exempt amount would direct more of the additional benefits toward low and middle earners, and not unduly advantage high earners.

Still, as I have indicated, Mr. Chairman, even modifying the retirement test would have a short-range cost to the program. Thus, we think that such a change must be considered within the context of a commitment to the financial health of the Social Security program--a commitment I know we share with you, Mr. Chairman. Given the challenge facing us in ensuring the long-term solvency of the program, and given the immediate short-range cost of modifying the retirement test, we believe that a proposal to increase the earnings test exempt amount applicable at age 65 should be considered only as part of a package. It is the Administration's view that any proposal to increase the earnings test limits must be fully offset.

Conclusion

In closing, Mr. Chairman, I would like to thank you again for the opportunity to discuss the Administration's views on the Social Security retirement test. We look forward to working with you and the other Members of Congress to determine how best to modify the retirement test, while also ensuring the financial well-being of the Social Security program.

Attachments

Attachment A

EFFECTS OF ELIMINATING THE RETIREMENT EARNINGS TEST (RET)

The table below presents a simulation to eliminate the Social Security RET for beneficiaries ages 65-69.

The table below shows the distribution in 1995 of aggregate net benefit increases 1/ by family income for earner families 2/ (column A) and percent paid to families with incomes above the upper limit of decile interval (column B).

	Eliminate RET ages 65-69 1995 (percent)	
	(A) Distribution	(B) Total Above Upper Limit
TOTAL	100.0%	
By Decile of Number of Families		
Less than $15,802	0.0%	100.0%
$15,802 - 21,795	1.1	99.0
$21,796 - 26,610	3.2	95.8
$26,611 - 32,204	2.1	93.7
$32,205 - 37,819	6.6	87.1
$37,820 - 45,190	10.2	76.9
$45,191 - 54,927	12.6	64.3
$54,928 - 68,969	10.9	53.4
$68,970 - 96,838	22.2	31.2
$96,839 or more	31.2	

1/ Aggregate net benefit increase is the total increase in Social Security benefits paid minus the aggregate increase in Federal personal income taxes that the beneficiary must pay as a result of the additional benefit payments.

2/ Earner famlies are families with at least one earner aged 65-69.

Source of Information: Social Security Administration, Office of Research and Statistics

Attachment B

Estimated Changes in OASDI Income and Outgo for Fiscal Years 1995-99 Resulting From Eliminating the Retirement Earnings Test (RET) for Beneficiaries Ages 65-69

ELIMINATE THE RET FOR BENEFICIARIES AGES 65-69		FISCAL YEAR (In billions)					TOTAL
		1995	1996	1997	1998	1999	1995-99
a).	Increase in OASDI benefit payments	$3.8	$5.8	$6.0	$6.1	$6.1	$27.8
b).	Net reduction in OASDI administrative expenses	1/	.1	.1	.1	.1	.3
c).	Increase in OASDHI revenues from taxation	.5	.8	.8	.8	.8	3.8
d).	Estimated offsets due to increased work activity 2/	.1	.2	.2	.2	.2	.7
e).	Net total increase in OASDHI cost	3.2	4.8	4.9	5.0	5.0	22.9

1/ Net change is less than $50 million.

2/ Amounts shown reflect an increase in OASDHI payroll taxes and a reduction in Medicare Health Insurance benefit payments due to primary payment by private health insurance. The exact size of the induced work activity resulting from the elimination of the earnings test at ages 65-69 is uncertain. Actual amounts could be substantially different.

Note: Totals may not equal sum of components due to rounding.

Attachment C

ESTIMATED OFFSETS–ELIMINATION OF RETIREMENT EARNINGS TEST FOR PERSONS AGED 65 TO 69

(Offsets as Percentage of Additional OASDI Benefit Payments)

Reason for Offset	Fund Receiving the Offset Amount			
	OASDI	HI	GENERAL FUND	TOTALS[1]
Reduction in administrative expenses	1%	—	—	1%
Increased OASDI and HI revenues resulting from the taxation of benefits	8%	5%	—	14%
Net increase in work activity resulting in:				
An increase in OASDI and HI payroll taxes	2%	0.5%	—	2%
A reduction in HI expenditures[2]	—	0.5%	—	0.5%
An increase in Federal income taxes	—	—	2%	2%
Totals	11%	6%	2%	20%

Totals may not equal the sum of components due to rounding.

This reduction would be due to increases in primary payments made by private health insurance for a portion of the HI beneficiaries who would remain in (or return to) the work force.

Criticism of the Net Revenue Estimates in Robbins and Robbins, "Paying People Not to Work"

Overview

In a report issued in September 1989, Aldona Robbins and Gary Robbins estimated that elimination of the Social Security retirement test for persons aged 65 to 69 would result in enough Social Security taxes and income taxes from induced work efforts to more than offset the additional benefit cost. Their estimate of the total budget effect was a net gain in Federal revenues of $140 million in the first calendar year. This estimate is flawed by a serious error in the interpretation and use of the data on which the estimate is based.

- The correctly interpreted data provide no basis for the extent of additional work effort predicted by Robbins and Robbins as a result of eliminating the retirement test.

- Without this estimate of a large increase in work effort, there is no basis for expecting any significantly large increases in new revenues to offset the new benefit outlays.

<u>The Robbins and Robbins procedure</u>

Graph 2 of the Robbins and Robbins report (reproduced below as Figure 1) is the basis of their claim. Graph 2 is constructed as follows:

- The distribution of workers by 1990 earnings intervals, is plotted as the dotted line. The number of workers is plotted at the midpoint of each earnings interval. The curve shows a sharp drop at the earnings limit amount ($9,360); there is an apparent increase at the earnings level at which the earnings test phases out.

- Based on the <u>assumption</u> that, in the absence of the retirement earnings test, the number of workers would decline smoothly over the interval from a point below the earnings limit to the phaseout level of earnings, Robbins and Robbins fit a smooth curve between these points. This curve is plotted as the solid line in Graph 2. Robbins and Robbins describe this curve as representing the number of workers in each earnings interval if the earnings test is eliminated.

- They then estimate the number of new workers as the difference in height between the two curves. For example, in the interval from $9,360 to $11,345 (midpoint $10,352), approximately 238,000 additional workers would be in the labor force.

<u>The Error</u>

There is a serious methodological error in plotting and fitting Graph 2. The technique used by Robbins and Robbins is appropriate only if the earnings intervals are all of equal size, for example, all $5,000. But the earnings intervals in the tabulation used by Robbins and Robbins are unequal in size, with the narrowest intervals near the annual exempt amount and wider intervals further from the exempt amount. The intervals and their sizes are added at the bottom of Graph 2.

- In any tabulation that uses unequal intervals, narrow intervals will tend to have fewer workers. If the number of workers is counted who have earnings between $6,600 and $10,000, this number will clearly be larger than the number tabulated for the earnings interval between $6,600 and $8,000. Shrinking the size of an earnings interval will shrink the count of the number of workers in that interval.

- Robbins and Robbins did not allow for this fact; they interpreted the small number of workers in the narrow intervals near the exempt amount of earnings as evidence of an earnings test effect. Their procedure is wrong; their interpretation is wrong.

The Correct Procedure

The correct approach is to adjust the distribution of workers for the unequal size of the earnings intervals. This is done in Figure 2. The data used by Robbins and Robbins are used to plot the number of workers per $1,000 of 1983 earnings ($1,418 of 1990 earnings) for each earnings interval (the bars in Figure 2). The number of workers is calculated by multiplying the height of the bar by the size of the earnings interval. For example, for the interval $9,360 to $11,345, which has an interval size of $1,985 or 1.4 times the unit interval ($1,418), there are 81,400 workers per unit interval; multiplying 1.4 by 81,400 gives 114,000 workers. This is also shown by the area of the bar.

- Clearly, the distribution of workers declines smoothly over all earnings intervals except that from $6,977 to $9,360 (midpoint $8,168); there is no evidence of the discontinuous pattern shown in Figure 1 (Graph 2). The apparent decline in the number of workers near the exempt amount disappears when the distribution is corrected for the unequal size of earnings intervals.

- The small increase in the number of workers in the interval immediately below the exempt amount may be due to the retirement earnings test. A number of studies have shown a clustering of workers at or near the annual exempt amount.

- If the Robbins and Robbins estimated distribution is corrected for the different widths of earnings intervals, what appears as a smooth curve in Figure 1 now appears as a sharp hump, as shown by the dotted lines in Figure 2. The Robbins and Robbins procedure results in an enormous overestimate of the number of workers in the interval near the exempt amount who are estimated as new entrants to the labor force.

No Basis for Revenue Increase

Since there is no basis for claiming that removing or liberalizing the retirement earnings test would induce a large number of older persons to enter or remain in the labor force, there is equally no basis for projecting a sizeable increase in tax revenues as a result of increased earnings.

SUMMARY

The Robbins and Robbins study claims that raising or eliminating the earnings limit would essentially be cost neutral in the first year, because the resulting increase in the number of older workers would raise enough tax revenues to more than offset the cost of additional benefit outlays.

- Properly analyzed, the data in the Robbins and Robbins report do not support that claim.

- Nor do numerous other studies of the effect of the earnings limit.

It is theoretically reasonable--and appealing to common sense--to argue that the retirement test causes some older workers to cut back on their work or drop out of the labor force altogether. But, a growing body of evidence suggests that the earnings limit plays a smaller role in work decisions of older workers than some other factors.

o Private pensions, health, and the size of the potential Social Security benefit for workers who retire all seem more important to labor supply decisions.

o It is very difficult to disentangle statistically the actual contribution of the earnings limit from the contribution of these other factors. However, increasingly sophisticated studies are trying to do so.

o The general conclusion of these serious studies is that removing the retirement earnings test would result in only a small increase in the number of workers, and that the associated increase in tax revenues would be substantially smaller than the cost of increased benefit outlays.

o We estimate that about 20 percent of the additional benefit cost over the first 5 years would be offset by additional taxes, lower administrative expenses, and savings in Medicare costs. Of this 20-percent offset, new taxes on the additional benefit payments are estimated to offset 14 percent of the cost. Additional payroll and income taxes, as well as reduced Medicare costs, resulting from additional work effort are estimated to offset only about 5 percent of the cost. The additional 1 percent of the offset is due to reduced administrative expenses.

Social Security Administration
June 7, 1994

Figure 1 (Graph 2 of Robbins and Robbins)

EARNINGS DISTRIBUTION FOR RETIRED WORKERS AGES 65 TO 69 UNDER PRESENT LAW AND IF EARNINGS TEST WERE ELIMINATED

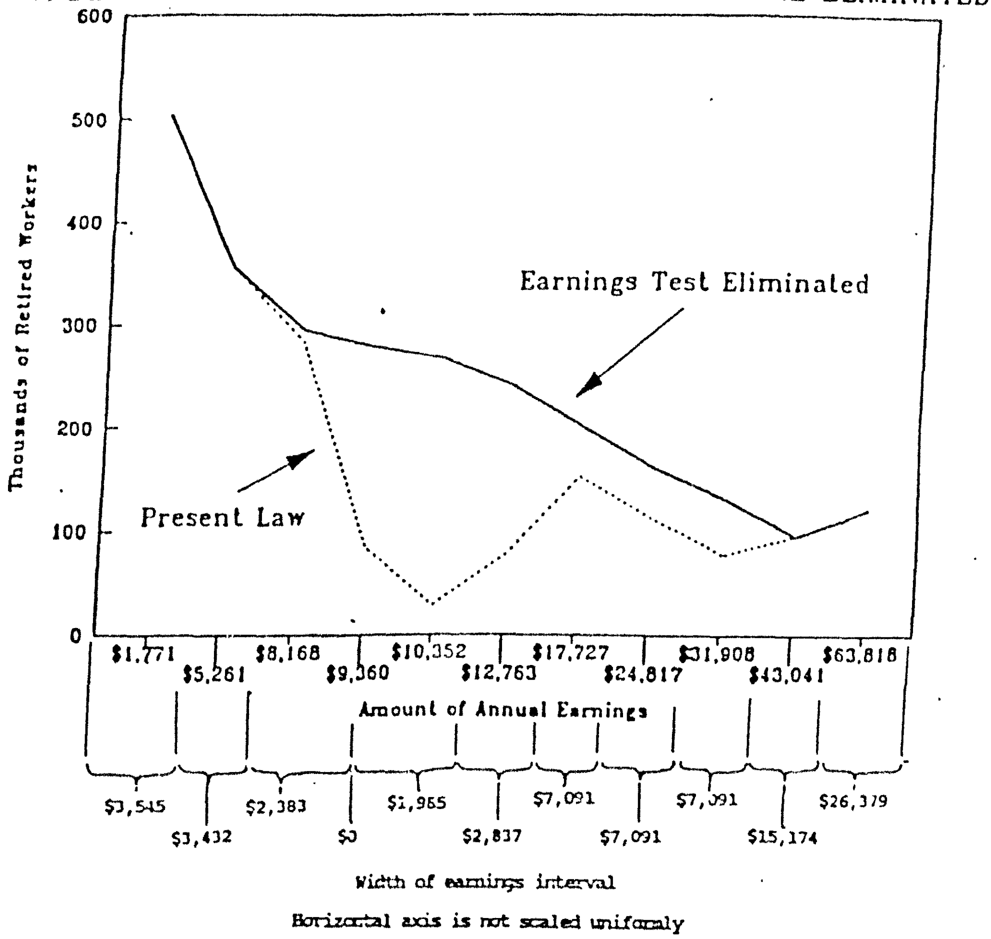
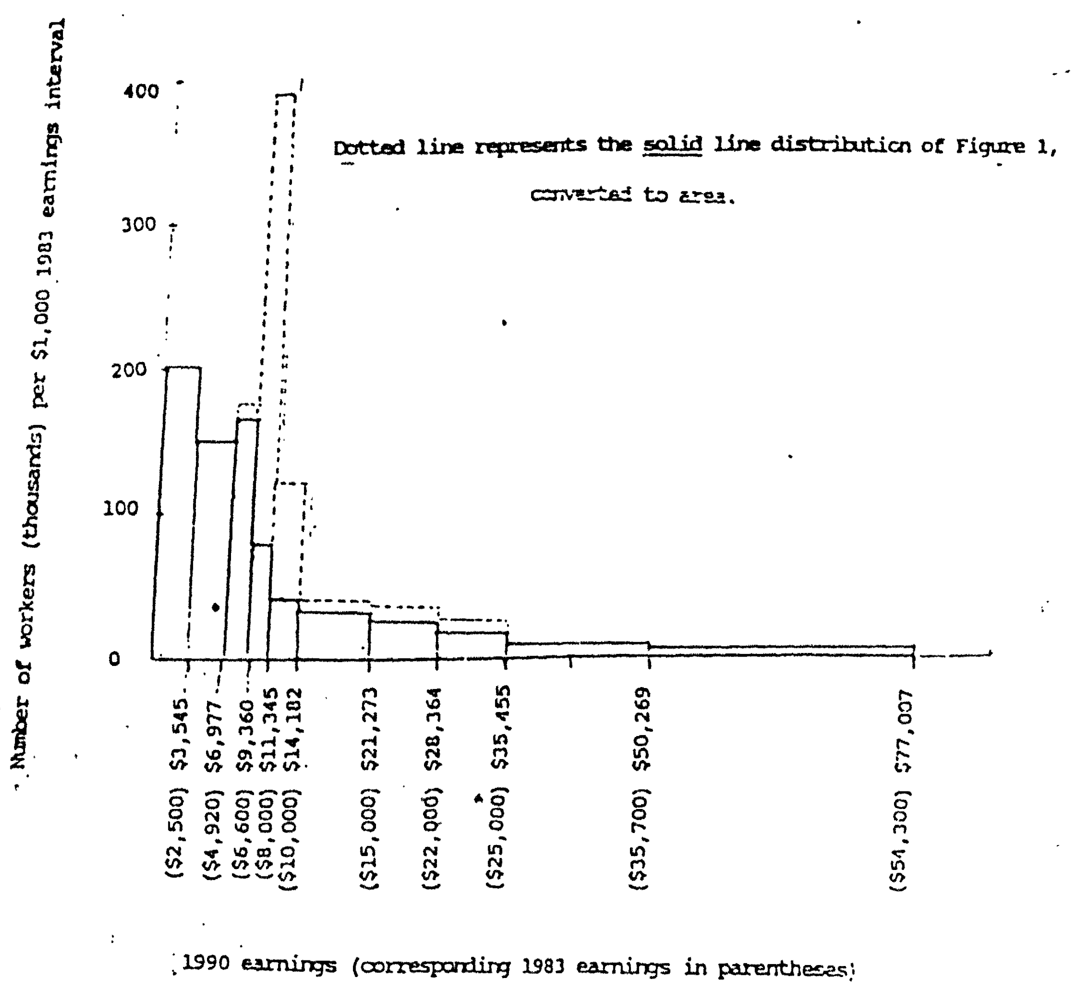


Figure 2.

Number of workers represented by area over the interval.

(Equal areas represent equal numbers of workers.)



Attachment.

ORS WORKING PAPER SERIES, NUMBER 41

[David Pattison,[1] Division of Economic Research, January 1990, Social Security Administration, Office of Policy, Office of Research and Statistics]

A REVIEW OF THE NET REVENUE ESTIMATES IN ROBBINS AND ROBBINS, "PAYING PEOPLE NOT TO WORK"

This note discusses the net revenue estimates in the report "Paying People Not to Work: the Economic Cost of the Social Security Retirement Earnings Limit," by Aldona Robbins and Gary Robbins.[2]

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[2] "Paying People Not to Work: the Economic Cost of the Social Security Retirement Earnings Limit," by Aldona Robbins and Gary Robbins, with an introduction by Congressman Dick Armey, September 1989. Cosponsored by The Institute for Policy Innovation, Lewisville, Texas, and The National Center for Policy Analysis, Dallas, Texas. Robbins and Robbins reissued their

Elimination of the retirement earnings test (RET), or partial elimination through the raising of the annual exempt amount (AEA), would increase the benefits paid to some working beneficiaries and would therefore raise the total benefits that the Social Security trust funds must pay. At the same time, however, the partial or total elimination of the RET might encourage some beneficiaries to work more or to retire later than they would have without the elimination, and tax revenues to the Treasury would go up because of individual income taxes and Social Security payroll taxes on the increased earnings. The net revenue to the government of the RET reform is this increase in tax revenues minus the increase in total benefit payments. Most studies of the cost of RET reform have found the net revenue to be negative: although there might be some increase in Treasury revenues from the reform, the revenues will not be nearly enough to offset the cost in increased benefit payments.[3]

In their report, Robbins and Robbins (RR) make their own estimates of the net revenues from RET elimination.[4] They reach two striking conclusions. The first is. that if the RET were to be eliminated completely for workers aged 65 to 69, the cost in increased Social Security benefits would be approximately offset by the taxes on the increased earnings (in 1990, $4.8 billion in larger benefits, $4.9 billion in larger revenues, for a net revenue increase of $0.1 billion). The second conclusion, featured prominently in a graph at the beginning of the report, is that partial elimination of the RET, in the form of an increase in the AEA, could capture much of the new revenues while avoiding most of the cost in benefits. Robbins and Robbins estimate that the maximum net revenue is achieved with an increase in the AEA to $39,360 from its scheduled 1990 amount of $9,360; such a modification would increase revenues by almost $5 billion while increasing benefits by less than $2 billion, for a 1990 net revenue increase of $3.2 billion. Modifying the AEA is thus billed as a deficit reduction measure.

Evaluating the estimates is difficult because Robbins and Robbins provide few details on how they arrive at their results. I have been able, however, to replicate their earnings and revenue estimates very closely. The replication indicates that these estimates incorporate a serious flaw and are of no value. I have not been able to replicate the benefit estimates, but there are strong indications that these estimates, too, are seriously flawed.

The details of the RR estimates and my replication of the estimates are discussed more fully in the appendix to this note. The discussion here draws on that appendix.

The RR estimates of the revenue increases from taxes on increased earnings are derived from an estimate of potential new elderly workers that embodies an error in the analysis of the earnings distribution. The RR analysis is based on a table of data on the number of 1983 elderly workers by earnings interval. The earnings intervals used to tabulate the data were of very uneven widths, with the narrowest intervals ($1,680 or less) used for earnings just below and above the 1983 AEA of $6,600, wider intervals ($2,000 to $2,500) used for other earnings below $10,000, and much wider intervals ($5,000 and higher) used for earnings above $10,000. (See Table A.1.2 in the appendix.) The tabulated counts of workers in the narrow intervals are, as can be expected, much lower than the counts in the nearby wide intervals. Robbins and Robbins conclude from these low counts that the earnings distribution is depleted near the AEA, and that the reason that workers are missing from that part of the distribution is that they would rather retire than continue in jobs that would cause their benefits to be partially offset by the RET. Their technique for estimating the number of workers who would work if there were no RET is to raise the number of workers in these low-count intervals to an interpolated average of the counts in the higher-count intervals.

In fact, the low counts in those intervals are due to the different widths used to tabulate the intervals. If the differing widths are taken into account, the sharp pattern that Robbins and Robbins believe they have found disappears entirely, leaving no basis for an estimate of new potential workers. The RR estimate of new workers actually introduces a sharp hump in the earnings distribution at earnings just above the AEA.

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report in September 1990. Except for the preface and introduction, the 1989 and 1990 reports are identical.

[3] For a recent review of such studies, see Michael Leonesio, "The Effect of Social Security's Retirement Earnings Test on the Labor Market Activity of Older Americans: a Review of the Evidence," unpublished manuscript, Office of Research and Statistics, Social Security Administration, December 1989.

[4] The Robbins and Robbins report also discusses marginal tax rates for older workers. This note does not discuss that aspect of the report.

The RR procedure is illustrated in two different ways in Figures 1 and 2 of this note.[5] In Figure 1 the number of workers in each interval is plotted as a point at the midpoint of the interval, with the height of the point indicating the number of workers in the interval. If the intervals were all of equal width, this would be an adequate representation of the distribution of workers. The intervals in this data, however, are of substantially different widths. It can be seen that the solid line in the graph has three very low points at and just above the 1990 AEA of $9,360. These three points represent counts of, respectively, 90 thousand, 30 thousand, and 80 thousand workers found in three earnings intervals with midpoints $9,360, $10,352, and $12,763. These three points together represent the earnings interval from $9,360 to $14,182 (the earnings intervals represented by the midpoints can be found in Table A.1.3 in the appendix). The three intervals when combined have a total of 200,000 workers. The midpoint of the combined intervals is $11,771. If the three low points were replaced by a single point of 200,000 workers at $11,771, the dip in the graph would disappear. The sharp drop in the counts of workers near the AEA is therefore due to the use of smaller intervals near the AEA.

It should be obvious that these data cannot be used to analyze the distribution of earnings, until some sort of correction is made for the different widths of the intervals. Yet Robbins and Robbins deal with the data as if they need no such correction. They assume that in the absence of the RET the distribution of workers by earnings would decline smoothly between $5,261 and $43,041 and therefore estimate a curve, the dotted line in Figure 1, between these two points. This line lies well above all the intermediate points on the solid line, particularly the three low points near the AEA. Their estimate for the number of new workers is simply the difference between this fitted line and the observed counts of workers.

The three low points, for example, representing 90 thousand, 30 thousand, and 80 thousand workers, are increased to, respectively, 280 thousand, 270 thousand, and 240 thousand workers. The total count of workers in the three low intervals is thus increased from 200 thousand to 790 thousand workers, an increase of 590 thousand workers. If the three intervals had been represented by one interval with the same 200 thousand workers, this technique would have increased the count at the midpoint of that interval to about 250 thousand, an increase of only 50 thousand workers. The estimate produced by the RR technique is thus entirely dependent on the number and size of the earnings intervals used to define the data, and the estimate can be drastically altered simply by varying the number of earnings intervals.

To get an accurate picture of what is going on, a representation of the earnings distribution must be used that does not incorporate the effects of different-sized earnings intervals. In lieu of a new tabulation of the data using equal intervals, the data we have can be corrected through interpolation or other methods to give an approximation of what the tabulation from equal intervals would have shown. Figure 2 shows one such method of adjusting the data.[6] In this figure, an estimate is made of what the distribution would look like if the 1983 data were tabulated by $1,000 earnings intervals or, since the estimates are being made for 1990, by corresponding 1990 intervals of $1,418, determined by adjusting the $1,000 1983 intervals up by the growth in the AEA from 1983 to 1990 ($1,000 x $9,360/$6,600 = $1,418). The estimates are made simply by dividing the count of workers in an interval by the number of $1,418 intervals in the tabulating interval. For example, the 80,000 workers at midpoint $12,763 in Figure 1 represent the earnings interval from $11,345 to $14,182. The width of the interval is $2,837, or 2.0 times $1,418. There are therefore about 40,000 workers per $1,418 earnings interval in this interval (80,000 divided by 2.0). The next interval to the right has 150 thousand workers in an interval of width $7,091, or about 30,000 workers per $1,418 interval. Thus, while there are more workers in the interval to the right (150,000 compared with

[5] In both figures, the horizontal axis displays the earnings intervals in both 1983 dollars and the equivalent 1990 dollars. (The 1990 dollars are calculated from the 1983 dollars by multiplying the latter by the projected growth in the AEA from 1983 to 1990). The original 1983 data used the 1983 earnings intervals shown here. The RR report used the corresponding 1990 figures. Unless otherwise noted, the discussion of the report will also use the 1990 figures.

Figure 1 corresponds to Graph 2 in the RR report, except that the solid and dotted lines are reversed; the solid line in Figure 1 represents the present-law distribution and the dotted line represents the RR estimate of the distribution in the absence of the RET. The horizontal axis in Figures 1 and 2 has also been scaled in proportion to earnings, so that the uneven earnings intervals are represented by an uneven spacing of the points, unlike RR Graphs 1 and 2, which space the points evenly.

[6] The horizontal axis in Figure 2 has the same scale as the horizontal axis in Figure 1, but Figure 2 shows the endpoints of the intervals rather than the midpoints. The $9,360 to $11,345 interval in Figure 2 represents two of the intervals in Figure 1: the $9,360–$9,361 interval with midpoint $9,360, and the $9,361 to $11,345 interval with midpoint $10,352.

80,000), there are fewer workers per $1,418 of interval (30,000 compared with 40,000). The higher number of workers in the interval to the right is therefore due entirely to the greater width of the interval.

In Figure 2, the earnings distribution is graphed (solid line) as a histogram, or bar chart. The width of each bar equals the width of the earnings interval. The height gives the number of workers per $1,418 1990 interval. The area of the bar, which equals the height times the width, or the number of workers per $1,418 interval times the width of the interval, represents the number of workers in the earnings interval. The bar-graph representation in Figure 2 therefore gives a meaningful representation of the frequency distribution of earnings. The height of the distribution falls to very low levels on the right-hand, high-earnings side, indicating the relative scarcity of high-earnings workers.

In contrast to Figure 1, there is no evidence at all in Figure 2 of a sharp drop in the number of workers near the AEA. In fact, there is a slight rise in the Figure 2 solid-line distribution just below the AEA, which might be evidence of the clustering of earnings at the AEA that has been observed in other studies.[7] Because there is no depleted region in the observed distribution, there is no basis for imputing any number of missing workers. The dotted line in each figure represents the number of workers that Robbins and Robbins estimated would exist in the absence of the earnings test. This dotted line, which was a smooth curve in Figure 1, shows a large hump in Figure 2. The RR technique, instead of filling in a depleted region of the distribution, actually adds a enormous number of workers to an area that was not depleted to begin with.

It is clear that the RR estimates of the number of workers are entirely the result of a misreading of the data. A different tabulation of the data, using a different number of earnings intervals or a different set of interval sizes, could give quite different results. It would be easy to construct a tabulation of these data that would show, if the RR technique were carried out on it, a large *decrease* in the number of elderly workers if the RET would be eliminated. But neither that result, nor the result that Robbins and Robbins arrived at, would have any bearing on what would actually happen if the RET were eliminated.

The RR estimates of the revenues accruing from the removal of the RET are based on this mistaken estimate of the number of new workers. The revenue estimates, therefore, are no more valid than the employment estimates. (The appendix contains a discussion of some of the procedures used in calculating the revenue estimates.)

Robbins and Robbins also claim that estimates of revenues from new workers in the labor-force should be augmented by an estimate for increased revenues from the resulting increased productivity of capital. Their estimate of the augmented revenues is apparently based on a production-theory argument that the earnings shares of labor and capital maintain roughly constant proportions as national output changes. It can be shown, however, that according to this theory wage rates will fall at the same time that payments to capital rise, and that the RR estimate of increased labor earnings is actually an estimate of the increase in combined payments to labor and capital. If a production-theory correction is to be made, the estimate of labor earnings will have to be reduced by as much as the estimate of capital earnings is increased. If we assume, as Robbins and Robbins do in their estimates, that income from capital is taxed at a lower rate than income from labor, then the effect of apportioning some of the labor earnings increases to capital income would be to *reduce* the estimate of total revenues.

The RR contention that raising the AEA without eliminating the RET can achieve most of the revenue gains without incurring much of the benefit costs relies on some estimates of the rise in benefit costs as the AEA is raised. The procedure for making these estimates of benefit costs is undocumented and cannot be directly evaluated, but it appears to be inconsistent with the RR estimates for the earnings distribution and the expected level of 1990 benefits. Robbins and Robbins estimate (RR pp. B–4, B–5) that 100 percent of the potential revenue gains will be achievable by raising the AEA to $43,041, while only 36 percent of the increased benefit costs will be incurred at that level. The data that Robbins and Robbins used for their earnings and revenue estimates, however, indicate that there are only about 183,000 workers with earnings above $43,041, yet their estimate of potential benefit costs allocates $3.1 billion in increased benefits to these workers. This is an average of $16,800 per worker, which is extremely implausible. The projected maximum benefit for 1990 is $11,700. A beneficiary couple could receive just over $16,800 if the worker receives the maximum benefit. The average beneficiary couple, however, will receive considerably less than this amount. Furthermore, to fully offset a benefit of $16,800, each

[7] See Leonesio, *op. cit.*

of the 183,000 workers with earnings above $43,041 would have to have earnings in excess of $90,000. The average earnings figure used by Robbins and Robbins for workers in this group is less than $63,818.

In summary, the Robbins and Robbins estimates of tax revenues from the total or partial elimination of the RET are wholly without foundation, based as they are on an erroneous technique for estimating the number of new workers. Their argument that their estimate of revenues from increased labor earnings should be supplemented with an estimate of increased revenues from capital earnings is faulty. Their claim that raising the AEA would capture much of the potential revenues without incurring much of the potential costs in higher benefits is undocumented and suspect.

Robbins and Robbins make virtually no reference to the work of other researchers who have studied the possible effects of the RET on the earnings of elderly workers. There is good reason to believe that the existence of the RET might cause some elderly workers to cut back on their work or drop out of the work force entirely, but it has proven very difficult in practice to make a confident estimate of the magnitude of such a response. A reasonable conclusion from the existing body of studies is that the labor-supply effect of the RET is far smaller than that estimated by Robbins and Robbins.[8]

[8] See Leonesio, *op. cit.*

Appendix

How the RR estimates were made

Sections A.1 through A.5 in this appendix present the Robbins and Robbins (RR) estimates of existing workers, new workers under RET removal, new earnings, new revenues, and new benefits, along with my conjectured replication of the methods used to arrive at some of these estimates. For the earnings and revenue estimates, the correspondence between the replicated estimates and the RR estimates is close enough that we can confidently assume that we understand their procedures and can criticize their estimates. I have not been able to replicate the RR benefit estimates, because Robbins and Robbins give little explanation of how they made these estimates. Nevertheless, the benefit estimates that are presented can be analyzed for consistency with the worker and earnings estimates and with the expected level of benefits. Sections B.1 through B.5 criticize the estimates in the corresponding A sections.

A.1: Distribution of workers under the current-law RET

Robbins and Robbins use as a basis for their calculations an estimate of the 1990 earnings distribution of workers aged 65-69 who are eligible for Social Security benefits. This distribution is presented in Graphs 1 and 2 of their report. The numbers are not given in the report, but a rough estimate can be made from visual inspection of the graphs (Table A.1.1).

These figures, according to Robbins and Robbins, are derived from 1983 Continuous Work History Sample (CWHS) data by "adjusting the class intervals for the growth in average wages." SSA has provided 1983 CWHS data on the number of workers in response to several requests in the last few years, and the RR figures closely match the numbers provided by SSA. The SSA figures, giving the number of workers (in thousands) aged 65 through 69 in 1983, are given in Table A.1.2.

Although one row in the CWHS data seems to have been split into two rows in the RR data (114,000 into 87,000 and 30,000), the numbers in most of the rows of Table A.1.1 are very close to the corresponding ones in Table A.1.2, and we can be reasonably confident that the RR figures were derived from either these or very similar CWHS data.

The RR 1990 earnings intervals and midpoints can be derived by making the following series of adjustments to the 1983 values:

- o Assign the highest interval of the CWHS table a midpoint of $45,000, so that it represents a range from $35,700 to $54,300.

- o Split the $6,600 to $7,999 group of 114,000 workers into a group of 85,000 workers at $6,600 and a group of 29,000 workers in the $6,601 to $7,999 interval. (This split is made in order to replicate as closely as possible the RR fourth and fifth row values of 87 and 30.)

- o Convert these 1983 intervals and midpoints into 1990 values by multiplying by the ratio of the 1990 earnings limit to the 1983 earnings limit ($9,360/$6,600). (This gives a much closer replication of the RR midpoints than would the ratio of projected 1990 average wage to 1983 average wage ($21,585/$15,239)).

Table A.1.3 shows the resulting 1983 and 1990 earnings ranges and midpoints, along with the original CWHS number of workers (with the $6,600 group split into two groups) and the estimated RR figures.

This series of calculations replicates the RR earnings midpoints exactly. The $43,041 value used by Robbins and Robbins is apparently the result of a calculation like that given here (i.e., the multiplication of $30,350 by 9,360/6,600), despite RR footnote 17 on p. 10, which states that $43,041 was calculated as the point where the maximum 1990 benefit of $11,712 would be fully phased out. At a $1 for $3 phaseout rate above an earnings limit of $9,360, the maximum benefit would be fully offset at an earnings of $44,496.

The CWHS-derived numbers in column 3 are close to the RR numbers in column 4. Some lack of agreement can be expected even if the RR procedure has been replicated exactly, because the fourth column has been estimated from visual inspection of RR Graph 2. Some of the differences might also be due to the fact that Robbins and Robbins have in some unspecified way incorporated projections of the number of retired workers in 1990.

The replicated numbers in column 3 are graphed as a solid line in Figure 1. This corresponds to the solid line in RR Graph 1 and the dotted line in RR Graph 2. Figure 1 differs from the RR graphs in that the horizontal axis is correctly scaled in Figure 1, making the different earnings interval sizes more apparent.

A.2: Number of new workers if the RET is removed

In their next step, Robbins and Robbins attempt to determine what the earnings distribution would have looked like in the absence of the RET by fitting a "smooth decline" to the graph. This is done by "estimating a logarithmic function based upon a change in earnings between $1,771 and every other earnings class." Apparently, what was done was to fit the equation

$$N = a + b*\log(E-1771),$$

where N is the number of workers in an earnings interval and E is the earnings at the midpoint of that interval, to the two points given by E=5261, N=361 and E=43041, N=104. This gives values for a and b resulting in the function

$$N = 1210 - 104.05 * \log(E-1771).$$

The fitting and calculations were done without regard for the size of the earnings intervals that determine N and E. The resulting estimates are reported in the column 3 of Table A.2.1. This table also reports, in column 4, the resulting estimate of the change in the number of workers and, for comparison, in column 5, the actual RR estimate of the change in the number of workers. The numbers in column 5 are close enough to the numbers in column 4 to indicate that the replication is close to the actual RR procedure, although there are some puzzling discrepancies.

The fitted data of column 3 are shown in Figure 1 as the dotted line. This corresponds to the solid line in RR Graph 2.

A.3: Total new earnings

The total new earnings figure estimated by Robbins and Robbins is calculated by taking the number of new workers in each group and multiplying by the midpoint earnings for that group. For total removal of the RET, all the affected earnings groups are added together. For an increase in the earnings limit, only those affected workers in groups with earnings under the new limit are included. Because their distribution fitting technique predominantly increases workers in the low earnings groups, most of the potential earnings increases will be attributed to small increases in the earnings limit.

A.4: Increases in Federal government revenues

The RR estimates of increased earnings are converted into estimates of increased Federal taxes by multiplying the earnings estimates by factors representing the marginal tax rates of the new earners. For one set of estimates this marginal rate is .303, representing a .15 individual income tax bracket rate plus a .153 combined employer-employee FICA tax rate. For another set the marginal rate goes as high as .433, representing the RR estimates of the proportion of workers at higher earnings levels who will be in the .28 or .33 income tax brackets. No attempt is made to adjust for the taxation of benefits, which would increase the estimates of new revenues. It is not clear from the discussion whether an adequate attempt is made to allow for the proportion of new-earner beneficiaries whose taxable non-earnings income is low enough that a .15 marginal tax rate over-estimates the average tax on their new earnings. For a beneficiary couple with only benefit income, $10,000 dollars or so of any new earnings will be exempt from taxation because of the standard deduction and personal exemptions. This will lower the tax on the new earnings well below the marginal rate of 15 percent.

Robbins and Robbins augment their estimate of additional earnings with an estimate of additional capital income stimulated by the increased labor earnings. Their justification is given in footnote 24 on p. 12:

> In general, we cannot experience an increase in income from labor without also experiencing an increase in income from capital. For example, if new elderly workers begin working in a previously empty office building, the building owners will receive a new rental income. If the workers use computers, there will be new income to the owners of computers.

Robbins and Robbins note that for the economy as a whole, each $1 of labor income tends to be associated with about 50 cents in capital income. Accordingly, an adjustment for revenues from new capital income is made by assuming that each $1 of new labor income will generate $.50 of new capital income, and that this new capital income will be taxed at a marginal rate of .15. The capital revenue factor on new earnings is therefore .075. When this is added to the personal tax factor of .303 (in the lower set of estimates), the result is that new revenues total 38 percent of the estimated new earnings.

A.5: Total new benefits

The RR report assumes, without stating the source (p. 11, 12), that raising the earnings limit $1,000 will cause $37 million in new benefits to be paid, and that raising the limit $3,000 will cause $110 million in new benefits to be paid. (Slightly different figures are given in RR Table B-II.) For complete elimination of the RET, they accept an SSA Office of the Actuary estimate that the cost in new benefits would be $4.8 billion.[8] For intermediate earnings limits, some sort of interpolation is made (RR Table B-II, p. B-4). At a relatively high earnings limit of $63,818 this interpolation gives a benefit cost of $2.7 billion, or only 56 percent of the cost of total elimination.

(I have not been able to replicate the interpolations made by Robbins and Robbins in going from their values in RR Table B-II to their values in RR Table V-A. In RR Table B-II the maximum

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8. The Office of the Actuary actually estimates costs on the order of $5.3 billion a year. Their 1990 calendar-year estimate, however, for technical reasons having to do with the timing of Social Security payments from the Trust Funds, includes only 11 out of 12 months of increased benefit payments, yielding the slightly lower figure of $4.8 billion.

net revenue is at an AEA of $43,041, but in RR Table V-A the maximum is at $39,360. The tables contradict each other in other ways. RR Table V-A also contradicts RR Table IV, as Robbins and Robbins mention in a footnote (footnote 2 on pp. 15 and 16), but the footnote is puzzling, since it tries to explain why a number is larger in one table than in the other table when it is in fact smaller.)

Table A.5.1, giving estimated benefit increases by AEA level, is taken from RR Table B-II on p. B-4 of the report.

Criticism of the RR estimates

B.1: Distribution of workers under the current-law RET

Graph 1 in the Robbins and Robbins report (and the corresponding Figure 1 of this note) is simply a graph of the number of workers against the earnings midpoints, with no adjustments to the data for the different widths of the earnings intervals. A graph of this sort, giving the numbers of workers in widely varying earnings intervals, is very deceptive.

Because increasing the size of the income range will increase the number of workers in the range, graphs or histograms cannot be usefully made from data within uneven intervals until an adjustment is made for the uneven intervals. With the above data, the numbers can be adjusted to give the number of workers within each thousand dollars of income interval by dividing by the number of thousands of dollars in the income range. The first row of Table A.1.2, for example, which contains an income interval of 2.5 thousand (1983 $), would be divided by 2.5. Column 4 of Table B.1.1 gives the results.

Column 4 of this table is graphed as a solid line in Figure 2. Figure 2 is plotted as a histogram, with equal areas indicating equal numbers of workers, and with the base of each histogram bar spread over the earnings interval. This is the most informative way of representing distributions when the data come from uneven intervals. Except for the rise in workers in the $4,920 to $6,600 1983 interval, this graph shows a uniform decline in the number of workers as earnings increase.

The rise in the interval just below the 1983 AEA of $6,600 might well be evidence of an RET response. Eyeballing the graph, we can estimate that a smoother distribution would put the height in that interval at about 110,000 workers per $1,000 interval, or about 57,000 less than the observed value of 167,300. The difference, multiplied by the width of the interval in thousands (1.68), gives an estimate of 96,000 workers who have reduced their earnings because of the RET. Even if we assume this to be true, the data are not refined enough to tell us how much these workers would have been earning in the absence of the RET. There are 807,000 workers with earnings of $6,600 or more; the estimate of 96,000 affected workers thus represents about 12 percent of the above-the-limit work force. An estimate of how the earnings of these workers would change if the RET were eliminated would require distributing them to points above the earnings limit, but the data do not tell us how far above the limit they should go. In addition, the corrected graph shows no evidence of a "gap" in the distribution, and therefore gives no foundation for making estimates of how many workers might return to work.

Some other statements made by Robbins and Robbins about the existing earnings distribution are unsupported by the data:

On p. 10 they state that "About 400,000 elderly workers earn annual wages within 10 percent of the earnings limit." No supporting evidence is given for this figure other than a reference to a graph. The range of earnings within 10 percent of the limit would have been $5,940-$7,260 in 1983, and will be $8,424-$10,296 in 1990. If the 1983 range is extended to the range $4,920-$7,999, i.e., from 25 percent below the limit to 21 percent above the limit, then 395 thousand workers are included. But if an estimate of the number of workers within 10 percent of the earnings limit is made by interpolation (by using the factor [6600-5940]/[6600-4920] to reduce the number of workers in the lower range and the factor (7260-6600)/(8000-6600) to reduce the estimate of the number of workers in the upper range) then only about 165,000 workers are estimated to be within 10 percent of the earnings limit, less than half the figure given by Robbins and Robbins. An estimate by the Office of the Actuary a few years ago put the figure for workers within 10 percent of the earnings limit at 174,000.

On the same page, Robbins and Robbins state that "within the range of $31,908 to $43,041 the number of wage earners begins to rise--reflecting the fact that the retirement earnings penalty at this point no longer influences the decision about how much to earn." The range from $30,000 to $44,000 corresponds roughly to the range over which the average to maximum benefits in 1990 will become fully phased out. But the data on the distribution of workers come from 1983, rather than 1990, and in 1983 the phase-out rate was one-half, rather than one-third, so that the earnings at which benefits were fully offset was substantially lower in 1983. The maximum benefit in 1983 was $8,514, yielding a full-offset earnings of $23,628, with a 1990 equivalent of $33,509. If there is to be a rise in the number of workers in the range of earnings for which the average to maximum benefit becomes fully phased out, it would therefore be more appropriate to look for it in the $28,364 to $35,454 range (in 1990 $) represented by the $31,908 point, rather than in the $35,455 to $50,628 range represented by the $43,041 point. Yet in the RR graph, the number of workers is still falling at the $31,908 point. *But these rises and falls in the graph are moot anyway, given the mistake Robbins and Robbins have made in dealing with the unequal earnings intervals. When correctly graphed, the number of workers falls steadily through both points.

<u>B.2: Number of new workers with the RET removed</u>

The second step of the RR estimate, "fitting" a non-RET distribution, is invalid for several reasons:

- Again, no account is taken of the different earnings interval widths used to define the distribution. Their estimated function, for example, gives a value of 238,000 workers for the interval centered on $10,352 (1990$) without considering how wide that interval is. This would not be a problem if all the earnings intervals were of the same width, but they are not. In particular, the two bracketing intervals used to define the logarithmic curve, the interval centered around $5,261 and the interval centered around $43,041, are both wider than the intervals in the estimated part of the curve adjacent to them. (The $5,261 point represents the $2,500 to $4,920 interval in the 1983 data, for an interval width of $2,420. The immediately following intervals have widths of $1,680 and $1,400. The $43,041 point represents the $25,000 to $35,700 interval in the 1983 data, an interval width of $10,700. The immediately preceding intervals have widths of $5,000, $5,000, $5,000, and $2,000.) As a consequence, the estimated points will be elevated above a true logarithmic fit between the two selected endpoints. This is not a trivial error. Even if the actual earnings distribution were logarithmic, the correct fit of the distribution would give estimated numbers substantially lower than those estimated by Robbins and Robbins. The numbers they estimate, in fact, bear no meaningful relation to a correct logarithmic fit.

Just as the original data can be corrected for the varying earnings intervals, so can these "fitted" values of numbers of workers be corrected. The RR fitted estimates, transformed into thousands of workers per $1,000 earnings interval, are given in the final column of Table B.1.2.

The adjusted RR figures are graphed as a dotted line in Figure 2. It can be seen in Figure 2 that the RR technique has inserted a huge lump in the distribution of workers in the $4,920 to $10,000 interval of 1983 earnings, the intervals surrounding the 1983 AEA.

o The RR technique does not take into account the behavioral incentives of the RET. These incentives affect both the choice of working or not working and the choice of how many hours to work. Any given worker near retirement can be thought of as making both choices at the same time: a $20,000 a year worker, for example, can be thought of as choosing between staying at $20,000, dropping to some lower amount, say $19,000, or retiring completely. The RET affects both the choice between $20,000 and $19,000 and the choice between $20,000 and $0, but in different ways.

For the choice between $20,000 and $19,000, the effect of the RET can be dealt with through its effects on <u>marginal</u> tax rates, i.e., the rates showing how much out of each extra dollar in earnings the worker gets to keep after taxes. For earnings between the AEA and the level at which benefits are fully offset, the RET in 1990 will add 33 percentage points to the marginal tax rate that the worker pays on additional earnings. (Workers really face a lower rate than this, because some of the offset benefits are returned after retirement in the form of delayed retirement credits.) At earnings either below the AEA or above the full-offset level, the RET will contribute nothing to the marginal tax rate. In between these two levels, however, the RET adds significantly to the tax rate, and we can expect that it causes some workers to reduce their earnings somewhat. The effect of the RET on counts of workers at a given earnings level, at $20,000, for example, will be the net effect of a loss of workers who decrease their earnings from $20,000 to lower amounts and a gain of workers who decrease their earnings to $20,000 from higher amounts. This net effect on the count of workers might be small. At or just below the AEA, however, there is a net gain of workers from higher levels with no net loss to lower levels, so that we can expect to find a higher count of workers at and just below the AEA. This in fact has been observed in some studies. This marginal-tax effect of the RET does not affect the total count of workers; it only shifts them around in the distribution. Because changing the RET has no effect on the marginal tax rate of workers above the full-offset point, the effect of an RET elimination on such high-earnings workers would be limited to a possible "income-effect" as high-earnings workers reduce their earnings in response to the larger benefits that they would be allowed to receive. (The income effect can also operate on workers in the phase-out range, moderating the effect that operates through marginal tax rates.)

The second type of RET effect, that operating on the decision whether to work for $20,000 or for $0 dollars, affects the total number of workers. For this decision, the RET operates not through its effect on the marginal tax rate but through its effect on the total tax. This effect on the tax is measured, if we leave aside the complications of benefit taxation and delayed retirement credits, by the amount of benefits offset. This amount starts at zero at the AEA, grows larger as earnings increase above the AEA, reaches its maximum at the level of earnings where benefits are fully offset, and stays at that maximum for higher earnings. Unlike the marginal tax effect of the RET, which is approximately constant between the AEA and the full-offset level, and zero outside that interval, the total tax effect of the RET grows gradually over the interval and does not drop to zero above the interval. The effect of RET removal is potentially positive at all earnings levels above the AEA, although, just as for the marginal earnings effects, there is a possible "income effect" that could cause some workers to retire earlier (e.g., at age 68 rather than age 69) in response to the higher benefits they could receive after age 65 while they are still working.

The RR estimates appear to be a hybrid of these two effects. In the RR report there is much discussion of the RET as a marginal tax, and the estimate for new workers is made only for earnings below the full-offset point, which indicates that they are thinking of the effects that operate through the marginal earnings decision. Yet their estimates add workers to the labor force, rather than shift them around in the earnings distribution, which indicates that they are thinking of the decision to work or not work. There is no indication in the paper that they have sorted these effects out. Their estimate of an <u>increase</u> in the number of workers below the AEA in response to an RET removal cannot be justified under either effect.

- o Robbins and Robbins tend to forget that they are dealing with 1983 data. They fit a zero change in the number of workers at the $43,041 point because at those earnings the 1990 maximum benefit will be fully offset. In 1983, however, when the offset rate was still $1 for each $2 of earnings above the earnings limit, the offset region was shorter, so that the estimate of the non-RET distribution should be fitted differently. This would lower parts of the upper (solid) line in Graph 2. In addition, the estimate of the 1990 effect of removing the RET should start with an adjustment of the 1983 data to reflect the fact that the 1990 RET is already substantially smaller than that observed when the data were gathered. This would raise parts of the lower (broken) line in Graph 2. With the upper line being lowered, and the lower line being raised, the estimates for the 1990 effects would be reduced, wholly aside from all the other problems with this technique.

Robbins and Robbins claim that their estimate of the number of new workers is plausible, given what is known about worker elasticities:

> "...we project an overall increase in aftertax earnings of 122 percent and an increase in the number of elderly workers of 38 percent. This implies a labor supply elasticity of 0.31 (0.38/1.22) for elderly workers. Note that this estimate is conservative. Labor supply estimates for the U.S. labor force as a whole range from 0.1 to 0.45, and it is generally believed that the labor supply elasticity is much higher for elderly than for younger workers." (p. B-1)

No definition is given for "taxable earnings", nor can I find any place in the report where some net-of-taxes earnings or wage is calculated to rise 122 percent. For the elasticity calculation being made here--the responsiveness of the number of elderly workers--the appropriate price variable is not the after-tax hourly wage rate, which would be appropriate for the analysis of changes in hours worked by workers who are already working, but the annual earnings net of taxes and benefit offsets. If we take the extreme case of a worker with enough non-earnings, non-benefit income that all of his earnings will be taxed at the 28 percent income-tax bracket rate, then the total income tax and payroll tax on his earnings will be about 35 percent of earnings.

The RET tax on the earnings will depend on how far a worker is above the AEA. For a worker with earnings of $10,352 in 1990 (this is the earnings level at which Robbins and Robbins estimate the highest response in new workers), the RET tax will be $331, or 3.2 percent of earnings. The rise in after-tax earnings is therefore from 62 percent of earnings to 65 percent of earnings, a 4.8 percent increase, far below 122 percent. The number of workers in this group increased by 820 percent (29,000 to 268,000). The implied elasticity is therefore 820/4.8, or 170, hardly a conservative elasticity. (Not all economists would agree that even an elasticity of 0.31 is a conservative elasticity.)

At the other extreme, assume that a worker with $44,000 of earnings has a fully-offset benefit of $11,000. The RET tax is therefore 25 percent of earnings. If the RET is eliminated, his after-tax earnings go from 40 percent of earnings to 65 percent of earnings (ignoring the complications of benefit taxation), a rise of 62.5 percent. Yet Robbins and Robbins simulate no new workers at this earnings level. They seem to ignore this group because they focus entirely on marginal tax rates for small changes in earnings, rather than on the tax rates which apply to the decision of whether to work or not. For workers whose benefits are fully-phased out, the RET has no effect (aside from a possible income effect) on the decision between earning $44,000 or $45,000, but it does affect the decision between earning $44,000 or $0.

B.3: Total new earnings

Because the estimate of the number of new workers in each earnings interval is wrong, the estimate of total new earnings is also wrong.

It is a curious feature of the RR procedure that 19 percent of the potential new earnings are achieved without raising the earnings limit from its scheduled value. (See Table A.3.1, row 4, column 5.) The RR "curve fitting" technique raises the number of workers even below the 1990 exempt amount. If they had tried to avoid this problem by fitting the curve from the $9,360 point (the 1990 AEA) rather than the $5,261 point, the procedure would not have yielded such a increase in workers; in fact, as can be seen from RR Graph 2 or my Figure 1, if the fitted curve had started at the $9,360 point rather than at the $5,261 point, there would have been a negligible effect on the total number of workers, perhaps even a reduction.

B.4: Increases in revenues

The argument that the estimate of new earnings needs to be supplemented with an estimate for increased income to capital seems to be based on an inadequate understanding of the interaction between labor payments and capital payments in neoclassical production theory. In that theory, if new workers enter the labor force, not only must they draw capital away from competing uses, but they themselves must compete with existing workers. As a result, the average payment to capital will rise, but the average wage will fall. Robbins and Robbins argue for including the rise in capital payments, but neglect to include the corresponding fall in the average wage.

More technically, let Y denote total national output, which is equal to the sum of the total payments to labor, W, and the total payments to capital, R:

$$Y = W + R.$$

Historically, W has remained at about two-thirds of Y and R at about one-third of Y even as Y has changed. Some versions of neoclassical production theory support this relationship:

$$W = .67 * Y, \text{ and}$$

$$R = .33 * Y.$$

This gives

$$R = .50 * W.$$

The relation between W and Y can be inverted:

$$Y = 1.5 * W.$$

This relation also holds among changes in W, denoted dW, changes in R, denoted dR, and changes in Y, denoted dY:

$$dY = d(W+R) = 1.5 * dW.$$

If the size of the labor force is denoted L, and the average wage is denoted w, then total payments to labor are given by

$$W = w * L.$$

If a change in the RET causes the size of the labor force to change by dL, then a crude estimate of the change in total labor payments would be given by multiplying this change by the average wage:

$$dW = w * dL.$$

Robbins and Robbins argue that the historical relationship between labor payments and capital payments should be maintained in their estimates by supplementing this crude estimate of increased labor payments with an estimate for increased capital payments of half that amount:

$$dY = d(W+R) = 1.5 * dW = 1.5 * w * dL.$$

These estimates, however, ignore the effect of the new workers on the wage rate w. The new workers will cause the average wage for all workers, including those already in the labor force, to fall slightly, by an amount dw, so that the total change in labor payments is

$$dW = w * dL + L * dw.$$

Because dw, the change in the average wage, is negative, this corrected estimate for total wage payments will be smaller than the crude estimate.

According to the theory that supports the two-thirds/one-third split in labor and capital payments, the fall in the average wage will be just enough that total wage payments will only rise by $.67*w*dL$ instead of by $w*dL$. The total change in payments to labor will therefore be

$$dW = .67 * w * dL.$$

At the same time, according to this theory, total payments to capital to will rise so that

$$dR = .33 * w * dL$$

$$= .50 * dW.$$

The total effect on combined labor and capital payments will be

$$d(W+R) = .67*w*dL + .33*w*dL = w*dL.$$

Thus, the theoretical estimate for the change in total payments is equal to the crude estimate for the change in labor payments. If Robbins and Robbins want to make this kind of production-theory correction, they should multiply their estimate of earnings increases by .67 to get a corrected estimate of new earnings, and then take half of this estimate of new earnings to estimate the new payments to capital. If, as Robbins and Robbins assume in their estimates, capital income is taxed at a lower rate than labor income, then this correction will decrease their estimate of total revenues, rather than increase it.

B.5: Total new benefits

The allocation of much of the potential new benefit payments to very high AEA increases is unconvincing. New benefit costs come from two sources: the reduction in benefit offsets for current beneficiaries, and benefits paid to new claimants who had not applied under the lower earnings test. By the assumptions that Robbins and Robbins are using, $693 million of the $4.8 billion in potential benefit costs is attributable to new claimants (footnote 2, p. B-4). This leaves $4.1 billion attributable to reduced offsets. The projected maximum benefit in 1990 is $11,700. The maximum combined worker/spouse benefit will therefore be on the order of $17,550. This maximum benefit would be fully offset in 1990 at an earnings of $62,010. Workers with benefits below the maximum will on average reach the full-offset earnings at a far lower level. We can expect, then, that if the AEA were raised to above $62,000, almost all of the beneficiaries who would be receiving offset benefits under the $9,360 AEA would no longer have offsets. Almost all of the cost of full RET elimination that is attributable to the elimination of offsets on already-entitled beneficiaries ($4.1 billion) should therefore be incurred under partial elimination by the time the AEA is raised to $62,000. (A portion of the $0.7 billion in benefits to new claimants should also be incurred by that level.) Yet Robbins and Robbins estimate that raising the AEA to $63,818 will cost only $2.7 billion in larger benefit payments (Table A.5.1, column 2).

The disparity between the benefit cost estimates and the revenue estimates can be illustrated in another way. In the RR estimate of the existing distribution of earnings, there are 120,000 workers in the $50,629-and-over earnings interval (Table A.1.3, column 4). Assume that half of these, or 60,000, have earnings over $63,818. Raising the AEA to $63,818 is estimated by Robbins and Robbins to cost $2.7 billion in larger benefit payments. The cost of total removal is estimated to be $4.8 billion. At an AEA of $63,818, therefore, there still remains $2.1 billion of offset or unclaimed benefits attributable to workers with earnings above $63,818. For 60,000 workers, this is an average unpaid benefit of $35,000 per worker, much higher than the projected maximum 1990 benefit of $11,700 or the combined worker/spouse benefit of $17,550. To offset $35,000 in worker and spouse benefits at an AEA of $63,818, each of the $63,818-and-over workers would need to have earnings of at least $168,000, which is plainly unrealistic. (In the main body of this note, I have made a similar calculation for the estimates of the cost of raising the AEA to $43,041, the point at which Robbins and Robbins estimate the maximum net revenue.)

A more realistic interpolation procedure would allocate a much higher proportion of the potential benefit costs to much smaller increases in the earnings limit. This, however, would invalidate the graph that was so prominently featured in the RR paper, which shows large revenue gains relative to benefit costs for relatively modest increases in the AEA.

Table A.1.1

Reconstruction of RR estimate of existing workers

(1) 1990 earnings	(2) Workers (000's)
$ 1,771	505
5,261	355
8,168	283
9,360	87
10,352	30
12,763	80
17,727	152
24,817	115
31,908	75
43,041	100
63,818	120
Total	1,902

Notes:
- o Column 1: From Graph 2 of the Robbins and Robbins report.
- o Column 2: From visual inspection of Graph 2.

Table A.1.2

CWHS workers aged 65-69 in 1983

(1) 1983 earnings range	(2) 1983 earnings midpoint	(3) Workers (000's)
$ 1- 2,499	$ 1,250	508
2,500- 4,919	3,710	361
4,920- 6,599	5,760	281
6,600- 7,999	7,300	114
8,000- 9,999	9,000	81
10,000-14,999	12,500	168
15,000-19,999	17,500	125
20,000-24,999.	22,500	84
25,000-35,699	30,350	104
35,700+	-----	131
Total		1957

Notes:
- o Source: SSA's Office of the Actuary, from tabulation of the 1983 CWHS.

Table A.1.3

Summary table: 1983 and 1990 earnings intervals and midpoints, with CWHS and RR estimates of number of workers

(1) Earnings midpoint 1983	1990	(2) Earnings range 1983	1990	(3) CWHS workers (000's)	(4) R&R workers (000's)
$1250	1771	$ 1- 2499	$ 1- 3544	508	505
3710	5261	2500- 4919	3545- 6976	361	355
5760	8168	4920- 6599	6977- 9359	281	283
6600	9360	6600	9360	85	87
7300	10352	6601- 7999	9361-11344	29	30
9000	12763	8000- 9999	11345-14181	81	80
12500	17727	10000-14999	14182-21272	168	152
17500	24817	15000-19999	21273-28363	125	115
22500	31908	20000-24999	28364-35454	84	75
30350	43041	25000-35699	35455-50628	104	100
45000	63818	35700-54300	50629-77007	131	120
Total				1957	1902

Notes:
- o Column 1, 2: See text.
- o Column 3: Same as Table A.1.2, column 3, with 114,000 row split into two rows.
- o Column 4: Same as Table A.1.1, column 2.

Table A.2.1

Estimates of differences between raw and fitted distributions of numbers of workers: replicated and RR

(1) 1990 midpoint	(2) Workers in 000's: Raw	(3) Fitted	(4) Change	(5) Robbins' change
$1771	508	508	0	0
5261	361	361	0	0
8168	281	298	18	12
9360	85	280	195	194
10352	29	268	238	238
12763	81	242	161	164
17727	168	203	35	49
24817	125	165	40	49
31908	84	137	53	53
43041	104	104	0	0
63818	131	131	0	0
Total	1957	2696	740	759

Notes:
- o Column 2: Same as column 3 in Table A.1.3.
- o Column 3: For midpoints $5,261 through $43,041, value given by 1210-104.05*log(E-1771), where E is the column 1 value.
- o Column 4: Column 3 minus column 2.
- o Column 5: Calculated from Table B-1 (p. B-3 of the Robbins and Robbins report) by dividing the estimate of added revenues by the marginal tax rate, then dividing by the earnings interval midpoint.

Table A.3.1

RR estimate of new earnings

(1) 1990 midpoint	(2) New workers (000's)	(3) New earnings millions	(4) Cumulative new earnings	(5) % of Cum.
1771	0	0	0	0
5261	0	0	0	0
8168	12	94	94	1
9360	194	1812	1907	19
10352	238	2468	4375	43
12763	164	2097	6471	63
17727	49	865	7336	72
24817	49	1216	8553	83
31906	53	1703	10255	100
43041	0	0	10255	100
63818	0	0	10255	100
Total	759	10255		

Notes:
- Column 2: Same as column 5 in Table A.2.1. This gives the actual Robbins and Robbins estimates for the change, rather than our replicated estimates. Using the replicated estimates would give similar results.
- Column 3: Column 1 times column 2. In the actual calculations, the figure in column 2 had more significant digits than are displayed here.

Table A.5.1

RR estimates of new benefits as AEA is raised

(1) 1990 AEA	(2) Additional Benefits ($millions)	(3) Percent of maximum
$ 9,360	$ 0	% 0
10,352	0	0
12,763	37	1
17,727	125	3
24,817	553	12
31,908	1,133	24
43,041	1,719	36
$63,818	2,658	56
Remove	$4,773	%100

Notes:
- Source: Robbins and Robbins, Table B-II, p. B-4.

Table B.1.1

Number of 1983 workers, calculated as workers per thousand-dollar interval

(1) 1983 Earnings	(2) Workers (000's)	(3) 1983 Interval ($000's)	(4) Workers per $1,000 1983 interval
1-2499	508	2.50	203.2
2500-4919	361	2.42	149.2
4920-6599	281	1.68	167.3
6600-7999	114	1.40	81.4
8000-9999	81	2.00	40.5
10000-14999	168	5.00	33.6
15000-19999	125	5.00	25.0
20000-24999	84	5.00	16.8
25000-35699	104	10.7	9.7
35700-54300	131	18.6	7.0

Notes:
- o Column 1: From Table A.1.2, column 1.
- o Column 2: From Table A.1.1, column 3.
- o Column 3: Interval width divided by 1000.
- o Column 4: Column 2 divided by column 3.

Table B.1.2

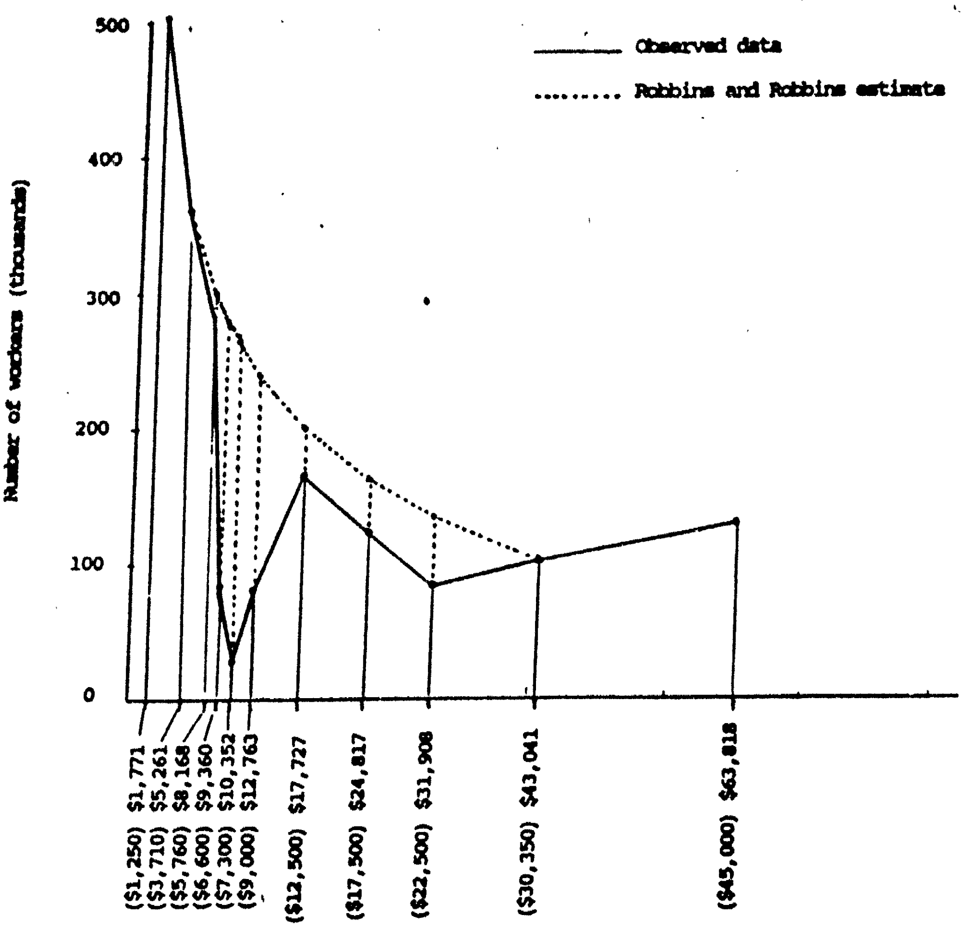
RR fitted number of 1983 workers by interval, calculated as number of workers per thousand dollars of interval

(1) 1983 Earnings	(2) Workers (000's)	(3) 1983 interval ($000's)	(4) Workers per $1,000 1983 interval
1-2499	508	2.50	203.2
2500-4919	361	2.42	149.2
4920-6599	298'	1.68	177.4
6600-7999	548	1.40	391.4
8000-9999	242	2.00	121.5
10000-14999	203	5.00	40.6
15000-19999	165	5.00	33.0
20000-24999	137	5.00	27.4
25000-35699	104	10.7	9.7
35700-54300	131	18.6	7.0

Notes:
- o Column 1: Same as Table A.1.2, column 1.
- o Column 2: Same as Table A.2.1, column 3, but with $9,360 and $10,352 points combined.
- o Column 3: Interval width divided by 1000.
- o Column 4: Column 2 divided by column 3.

Figure 1: NUMBER OF AGED WORKERS, BY UNEVEN EARNINGS INTERVALS

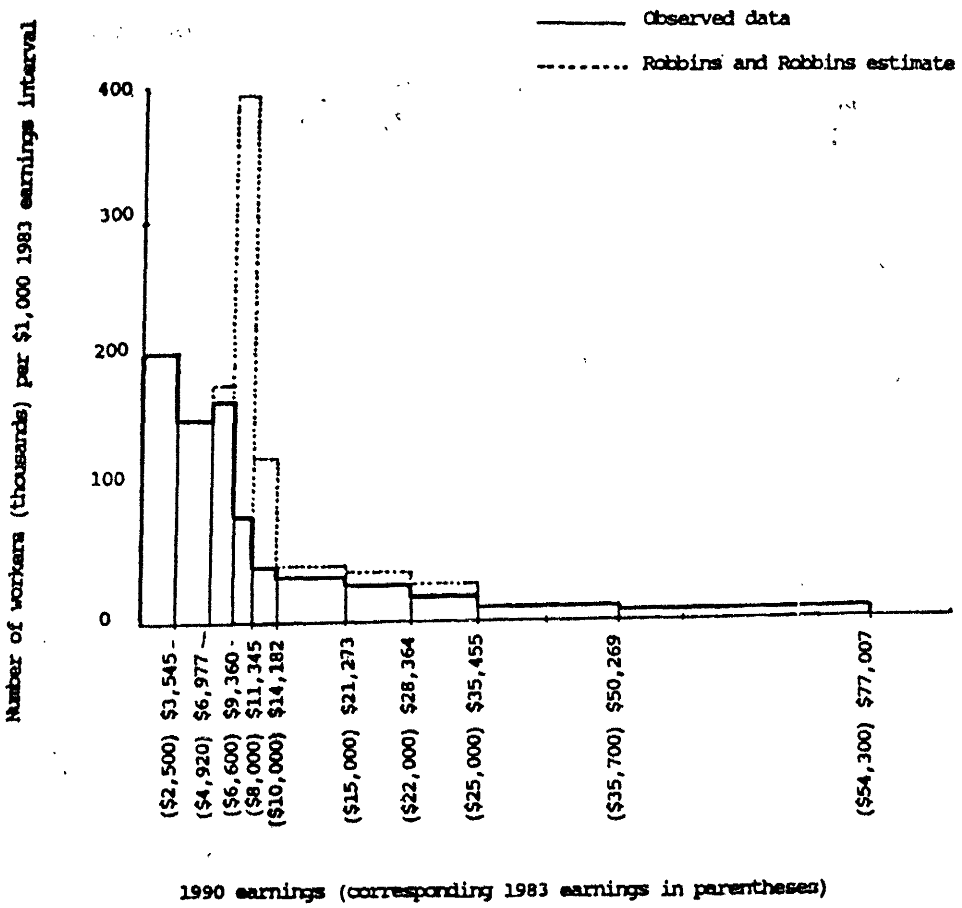
Number of workers in interval plotted as height above midpoint of interval



1990 earnings (corresponding 1983 earnings in parentheses)

Figure 2: HISTOGRAM OF AGED WORKERS, BY UNEVEN EARNINGS INTERVALS

Number of workers in interval represented by area of rectangle above the interval



PREPARED STATEMENT OF CONGRESSMAN J. DENNIS HASTERT

Thank you, Mr. Chairman. It's my pleasure to appear before you and the Committee today in support of S. 30, the Older Americans Freedom to Work Act.

As many of you know from past discussions of this legislation, seniors who need or want to continue working after they reach the retirement age face one of the heaviest tax burdens of any demographic group. They are needlessly penalized by the Social Security Earnings Test, a Depression-era holdover that confiscates a huge share of their Social Security benefits.

Seniors aged 65 to 69 who earn more than $11,160 this year are slapped with a 33 percent tax penalty, forfeiting $1 in benefits for every $3 they earn over that limit. When coupled with other Federal taxes, these seniors who earn only $11,000 a year are faced with a 56 percent marginal income tax rate—*nearly twice the tax rate of millionaires.* Mr. Chairman, that is just not fair.

The Earnings Penalty sends a message to our senior citizens that we no longer value their expertise and experience in the work force. It is age discrimination, pure and simple. And, it most afflicts those seniors who need to work in order to meet their expenses for food, shelter and health care.

The Social Security earnings penalty was instituted in the 1930's to discourage seniors from working, in order to make room for younger Americans in the work force. As the U.S. population ages, however, seniors are becoming an increasingly important segment of our labor force. By the end of this decade, there will be one and a half million fewer members of the work force between the ages of 16 and 24.

At a time in our nation's history when competitiveness has become so critical, policy-makers should not preach the gospel of productivity while retaining outdated policies that strip our labor force of thousands of productive and experienced workers. Just as business leaders must modernize their factories and methods, Congressional leaders must update public policy.

Opponents of this proposal have operated under the incorrect assumption that repeal of the Earnings Test will result in a Federal revenue shortfall. Mr. Chairman, the opposite is true. Studies that look at both projected tax revenues and the increased outflow from Social Security have found that elimination of the Earnings Test would actually increase revenue to the Federal government by $140 million.

A repeal of the Earnings Test would assist our economy by encouraging more seniors to rejoin the work force, thereby expanding the tax base and increasing the amount of tax revenue. Clearly, repeal of the Earnings Test would give our economy a needed boost.

Opponents have also argued that a repeal of the Social Security Earnings Test is wrong because Social Security is an insurance policy, to be allocated only to those who are "retired." Therefore, if someone is still working, he or she should not receive full benefits.

This reasoning ignores the difficulty seniors have encountered in surviving solely on Social Security or working at a job; seniors frequently need both to make ends meet.

For instance, I would like to tell you the story of Jean Austin, from my home state of Illinois. Ms. Austin is currently 68 years old. She was in the work force for 26 years before she was let go by the company she worked for at age 60. Ms. Austin was then a prime candidate for a program funded by Title V of the Older Americans' Act, the Senior Community Service Employment Program. This program is contracted out to organizations like Green Thumb in Illinois. The program helps seniors update their skills and trains them for today's work force. Only seniors who do not earn enough to raise them about the poverty level are able to participate in the Green Thumb program and they must work for non-profit or government entities.

Ms. Austin got a full time job after her Green Thumb training and now earns approximately $15,000 per year. As you can see, Ms. Austin falls under the Social Security earnings penalty. She gets no Social Security check for the first four months of the year. Her lost income from Social Security for the year will be approximately $1,600. These are the very people we are trying to help by repealing the earnings penalty.

The irony of this story is that the federal government spent money to train Ms. Austin to be self-sufficient. The average amount Green Thumb spends on a client is $6,000. Yet we then turn right around and take back the Social Security benefits she has contributed to for 26 years when she exceeds the $11,160 earnings threshold. Ms. Austin could be using this money for needed repairs to her home or for any number of expenses that could arise.

I would also like to read you the story of Theresa McMahon from Anaheim, California. Her letter gives legislators a taste of the realities working seniors face. Ms. McMahon states:

> I am 66 years old, healthy, energetic, a widow for the past 11 years, and have tried to support myself for those 11 years. I do collect Social Security and have done so since I was 60. I live alone in a senior apartment in Anaheim, California and my rent runs $600 per month, which is normal for my neighborhood. My apartment is under 500 square feet. My Social Security monthly payment is $697. I drive an '83 Tercel car with almost 100,000 miles on it. I can't afford to buy another car.
>
> I work part time in an insurance office in Fountain Valley and because I am restricted on my annual income, I must return almost $200 to the Social Security Administration by April 15, 1994.
>
> I think this is an unfair burden to place on a senior who wants and is able to work and support herself. Older people have debts and responsibilities too and to restrict their income because they collect social security is a punishment to them.
>
> Perhaps you think at my age I have a substantial savings. I live from paycheck to paycheck and without my job, I could not be independent . . . . . . I would love to work more hours and have been offered them in the office but it doesn't pay to work them. I'll be punished by the government for being more productive. As it is, every fourth day I work goes for taxes.
>
> Times have changed. It costs more to survive now. Laws need changing, too.

Working seniors have got it right. The laws need to be changed. In closing, Mr. Chairman, let me reiterate repealing the earnings penalty is the right thing to do—both for our economy and for our senior citizens.

PREPARED STATEMENT OF SENATOR JOHN MCCAIN

Mr. Chairman, Senator Packwood, thank you both for agreeing to hold this important hearing on the repeal of the Social Security Earnings Test. Your commitment to seeing that this issue is fully addressed is appreciated by senior citizens throughout the country.

Repeal of the Social Security Earnings Test will bring an end to an injustice being perpetrated against one segment of our nation's seniors—those who must or want to work.

This is not a new issue to most of the members of this Committee, as this issue has been debated on the floor in the past. The Senate adopted a repeal of the earnings test in the form of an amendment to the Older Americans Act Reauthorization Bill. At that time, the Senate could have used procedural tactics to derail the amendment, but—as we know—the Senate correctly did not.

Additionally, on July 28, 1992, the Senate RE-AFFIRMED its commitment to overturning the Earnings Test. On that date, the Senate voted for an amendment which acknowledged that:

> "The Senate finds that [the earnings test] penalizes these recipients and reduces their incentive to work:
>
> [And that the Senate finds that] This penalty and disincentive should be eased as quickly as possible."

During the 102nd Session of Congress, the Senate did what was right. Unfortunately, the House had the amendment stripped in conference. My colleagues may remember the tactics used by Congressman Rostenkowski to once again give our nation's elderly the short end of the stick.

It is time that this onerous and antiquated law be repealed.

S. 30, legislation I introduced and cosponsored by Senators Bryan, Burns, Coats, Cochran, DeConcini, D'Amato, Durenburger, Exon, Gorton, Heflin, Helms, Lott, Mack, Pressler, Reid, Roth, Shelby, Smith, Stevens, and Warner will fully repeal the Social Security Earnings Test for older Americans between the ages of 65 and 69. This legislation would provide freedom, opportunity and fairness for our nation's senior citizens.

Let me point out, this legislation PAYS FOR ITSELF. In fact, over time, repeal of the earning's test could potentially result in surplus income for the government. Some who will testify here today will question if repeal of the earnings test will cost the government money or will jeopardize the stability of the Social Security Trust Funds. I would hope that any questions they raise would be answered by today's hearing.

Statistics which will show that repeal of the earnings test will result in costs to the government are wrong. Those statistics are based on static, not dynamic models.

Those statistics are based on no change in human behavior. However, I can assure the members of the Committee that if we repeal this onerous law, human behavior will change.

Company after company has approached me and said:

"Senator, repeal the earnings test so that we can hire these seniors."

Now is the time to do exactly that.

As I have stated, the fact is that repeal of the earnings test will raise revenue for the government. One model prepared former Treasury Department economists found that abolishing the Earnings Limit would result in a **net increase of $140 million in federal revenue.**

Also, seniors who work will not jeopardize the Social Security Trust funds. The general liability owed to these seniors, working or not, remains relatively the same. Stating that the trust funds might be harmed by the repeal of the earnings test is a scare tactic and it is not accurate. I and other advocates for repeal of the earnings test are willing to take any necessary steps to assure that the Social Security Trust fund is in no way adversely effected by the repeal.

Mr. Chairman, most people are amazed to find that older Americans are actually penalized for their productivity. For every $3 earned by a retiree over the $11,160 limit, they lose $1 in Social Security benefits. Due to this cap on earnings, our senior citizens—many of whom are forced to survive on low incomes—are effectively burdened with a 33.3 percent tax.

Combined with Federal, State and other Social Security taxes, it will amount to a shocking 55–65 percent tax bite, and sometimes even more—Federal tax—15 percent, FICA—7.65 percent, earnings test penalty—33.3 percent, State and local tax—5 to 10 percent.

Unquestionably, this is an issue of fairness. No American should be discouraged from working. Unfortunately, as a result of the earnings test, Americans over the age of 65 are being punished for attempting to be productive.

The earnings test doesn't take into account an individual's desire or ability to contribute to society. It arbitrarily mandates that a person retire at age 65 or face losing benefits. It is plainly age discrimination. It is plainly wrong.

There are **40 million Americans age 60 or older** who have over 1 billion years of cumulative work experience—all going to waste. Three out of five of these people do not have any disability that would preclude them from working. Furthermore, almost half a million elderly individuals who do work limit their annual incomes to within 10 percent of the earnings test. They are struggling to get ahead without hitting the limit. If not for the earnings test, many more would work, but the system is coercing them into retirement and idleness.

Perhaps most importantly, the earnings cap is a serious threat to the welfare of low-income senior citizens. Once the earnings cap has been met, a person with a job providing just $5 an hour would find the after tax value of that wage dropping to only $2.20. A person with no private pension or liquid investments—which, by the way, are not counted as "earnings"—from his or her working years may need to work in order to meet the most basic expenses, such as food, shelter and health care.

Let me emphasize that point. Poor seniors who are forced to work to make ends meet are being penalized, while wealthy seniors with millions in liquid investments are paying no extra taxes. Again, we are making it harder for the poor and easier for the wealthiest.

Finally, it is simply outrageous to pursue a policy that keeps people out of the work force who are experienced and want to work. We have been warned to expect a labor shortage. Why should we discourage our senior citizens from meeting that challenge? Seniors are a precious national resource whose talents should be encouraged and used for the benefit of society.

As the U.S. Chamber of Commerce, which strongly supports this legislation, has pointed out, "retraining older workers already is a priority in labor intensive industries, and will become even more critical as we approach the year 2000."

America cannot afford to pursue any policy that adversely effects production or effectively prevents our citizens from working.

Repeal would also save the taxpayer over $200 million a year in reduced compliance costs. According to the Social Security Administration, the earnings test is its largest administrative burden. Sixty percent of all overpayments and 45 percent of benefit underpayments are attributable to the earnings test.

It is time to act and eliminate this confiscatory and antiquated law. As President Clinton stated:

"[We must] lift the Social Security Earnings Test limitation so that older Americans are able to help rebuild our economy and create a better future for all."

The President is correct.

Attachment.

SOCIAL SECURITY EARNINGS TEST—FACT SHEET

[Senator McCain and Congressman Hastert]

HOW DOES THE EARNINGS LIMIT WORK

Age	Earnigs limit	Penalty
62–64	limit = $8,040	lose $1 in benefits for every $2 earned over the limit
65–69	limit = $11,160	lose $1 in benefits for every $3 earned over the limit
70+	NO LIMIT	no penalty—can earn unlimited amount

The earnings limit is indexed automatically to the average wage increase. It is expected that the Earnings Limit will increase about $400 a year without any congressional action.

WHAT WOULD THE OLDER AMERICANS' FREEDOM TO WORK ACT DO?

This bill would eliminate the Social Security Earnings Limit for people who reach normal retirement age (currently age 65). Essentially, it lowers the exempt age from 70 to 65.

FAIRNESS ISSUE

No American should be discouraged from working. Unfortunately, one demographic group in the United States is severely penalized for attempting to be financially independent and making ends meet. When seniors 65–69 work in order to pay for the high cost of health care, pharmaceutical, housing, etc. they are penalized more than any other group in our society.

SPURRING ECONOMIC GROWTH

Seniors have a wealth of expertise gained through 30–40 years of productivity in the work place. Companies hiring seniors have also noted their strong work ethic, punctuality, and flexibility. Their participation in the workforce can spur billions of dollars in our annual output of goods and services. To remain competitive in the global marketplace, we must reform our labor laws to meet the challenges of the future.

LABOR SUPPLY EFFECT

The U.S. Labor Department has warned of shortages in the labor market. Employers are having difficulties in hiring experienced, dependable workers. By the end of the decade, 1.5 million fewer workers between 16 and 24 years of age will have entered the workforce. At the same time, 5 million older Americans will be retiring.

The Earnings Limit was created during the Depression to force older workers out of the labor force and create job opportunities for younger workers. Obviously, this situation no longer exists and it is time to sunset this depression era policy.

ADMINISTRATIVE COSTS

The SSA spends approximately $200 million per year on enforcement of the earnings limit. This money could and should be used to help seniors meet living expenses and not wasted on shuffling paper.

Implementing the Earnings Limit is a complicated procedure requiring seniors to estimate their earnings for the upcoming year so SSA can reduce their check. If the senior estimates incorrectly and earns more than the limit, he/she faces lump sum reductions in benefits. Seniors who may barely be able to make ends meet may have to employ tax accountants to determine the changes in their tax rates under these circumstances.

HIGHER EFFECTIVE MARGINAL TAX RATES

When a senior works above the Earnings Limit, he/she faces an additional effective tax of *33 percent* from the Earnings Limit ($1 of every $3 over the limit earned goes toward the Earnings Limit penalty).

A senior who earns just over $11,000 annually will face an effective marginal tax rate of *56 percent*—TWICE THE TAX RATE OF MILLIONAIRES!

EXAMPLE

Federal Income Tax	=	15.00%
FICA Tax	=	7.65%
Earnings Penalty	=	33.00%
TOTAL TAX RATE	=	55.65%

NOTE: The above example does NOT take into account state tax.

This means a senior working at a job paying $5.00/hour will only net $2.20/hour after he/she works one hour past the $11,160 limit.

MYTHS ABOUT THE EARNINGS LIMIT

Myth No. 1: Social Security is a Form of Socialized Insurance

Social Security is a pension, not an insurance policy. Insurance offsets unforseen circumstances, but a pension is a fixed sum paid regularly to retirees. Social Security is a planned savings program to supplement income during an individual's senior years. It was not designed to fully support seniors. Social Security was designed to supplement other sources of income. However, the earnings test punishes those who seek to support themselves by working.

Myth No. 2: Repeal of the Earnings Limit is too Costly

It is true that the Congressional Budget Office (CBO) estimates that repealing the Earnings Limit will cost $3.6 billion in the first year and $26.2 billion over five years. This estimate, however, is unrealistic and is based on static revenue models, assuming no change in human behavior.

One dynamic, realistic estimate done by Aldona and Gary Robbins, former Treasury Department economists, found that abolishing the Earnings Limit would result in a net *increase of $140 million* in federal revenue.

It is impossible to accurately estimate the amount of economic activity that would result if the Earnings Limit were eliminated, especially in light of the current underground economy where seniors are paid "under the table." However, studies have estimated that 700,000 seniors would enter the workforce generating an $15.4 billion increase in our annual output of goods and services.

Any CBO or Social Security Administration (SSA) revenue estimate does not tell the whole story. Their studies do not factor in behavioral changes which will occur in the real world.

Myth No. 3: Repeal Favors Only the Rich

Nothing could be further from the truth! A full two-thirds of those who would benefit from repeal would have an earned income of less than $40,000.

The wealthiest individuals have been able throughout their career to save and invest a portion of their income. A person living paycheck to paycheck, however, does not have that advantage.

When the SSA determines the Earning Limit, it does not include interest or dividends from the investments of the wealthy. It only includes wages. Therefore, it is the person who earns $11,160 while working to subsidize their income whom will be hit with full force by this penalty. Currently, the system discriminates against the low and middle income worker, and favors the wealthy.

With the current high cost of living, especially health care costs, many seniors have no option but to supplement their income. It is unfair that the government taxes seniors for attempting to be financially independent.

Prepared Statement of Joseph Perkins

The American Association of Retired Persons (AARP) appreciates this opportunity to present its views on the Social Security earnings limit (retirement test). The Association has long supported increasing the limit to improve the economic situation of older Americans, one means to that end is through work. We are pleased that this committee is examining an issue of considerable importance to millions of AARP members.

The earnings limit reduces the Social Security benefits of working beneficiaries who exceed an earnings threshold, $11,160 for those over 65. Many of those currently losing benefits must work in order to maintain their standard of living or to help their families become more financially secure in the future.

Current law discourages older people from remaining in the work force and sharing their experience, knowledge, and skills with younger workers. Given the increased longevity and generally improved health of many retirees, the prospect of an aging society, and a slower-growing work force, it is important that we find ways to better tap one of our most valuable and underutilized economic resources: older workers.

THE EARNINGS LIMIT IN PRACTICE

The earnings limit not only restricts the amount a beneficiary can earn from employment without losing some or all of his/her Social Security, but it also can affect the benefits a spouse and other dependents receive. The retirement test is different for beneficiaries under 65 than for those age 65 through 69. In 1994, beneficiaries age 62 through 64, lose $1 in benefits for every $2 in earnings above $8,040. For those age 65 through 69, the 1994 exempt earnings level is $11,160. They lose $1 in benefits for every $3 in excess earnings.

Benefits for a retired worker under age 70 are payable for all months in a year if annual earnings from all types of employment (whether or not covered by Social Security) are equal to or less than the exempt amount. A special monthly test applies in the "initial year of claim" if it produces a more favorable result than the annual test.

HISTORY OF THE EARNINGS LIMIT

Although the Social Security program has always had a retirement test, it has been modified to narrow the category of affected persons. For example, the age at which the test no longer applies has been reduced to 75, then 72, and is currently 70. It was changed from a simple monthly test to one that measured both monthly and yearly earnings. In 1960, the penalty for excess earnings above a threshold was altered from a total loss of monthly benefits to a reduction in benefits. Since 1972, the law has provided for an automatic, annual updating of the threshold in accordance with changes in annual wages. The 1983 Social Security Amendments further eased the penalty for excess earnings. Since 1990, beneficiaries age 65 through 69 face a benefit reduction of $1 for every $3 of excess earnings.

These modifications provide ample precedent for reevaluating the retirement test to better reflect the changes in our population, our work force, our retirement patterns, and our economy.

EPFECT ON BENEFICIARIES

Most beneficiaries are not in the paid labor force and will not be affected by any change in the earnings limit. Social Security Administration (SSA) statistics indicate that 73 percent of retired workers age 65 and over did not report any income from earnings.

However, a considerable number of persons 65 ad over would benefit from a change in the limit. According to the Committee on Ways and Means, in 1992 about 10 percent of all beneficiaries age 65–69 were affected by the earnings limit. An additional 17 percent had earnings below the limit. Still others elected not to apply for benefits because of the test. (SSA believes about 100,000 workers age 65–69 would file for benefits if the retirement test were eliminated.)

Many of those who avoid the test by holding their earnings to the limit and many whose earnings are slightly above the threshold are middle income older persons who rely upon Social Security benefits as a major retirement income source. They often lack adequate savings and have little or no pension income. For those who are capable and have the desire to earn more than the current earnings limit, the additional income from a liberalization will make a considerable difference. Continued or increased employment may be the only option to meet current expenses, repay debts, or set aside some income for a time when they will no longer be able to work.

Many affected older workers are perplexed by the penalty on earnings while nonworking beneficiaries with substantially larger incomes—generated from pensions, savings and investments—do not have to forego any benefits. Many working beneficiaries feel they are being punished for their initiative. The argument that Social Security is intended as a partial replacement for income lost due to retirement, and that the earnings limit is designed to measure retirement, does not put lost dollars back in their pockets—dollars that they may need today.

PROBLEMS CREATED BY THE EARNINGS LIMIT

A. Administrative

The retirement test creates administrative problems for the Social Security Administration. SSA spends over $200 million a year to monitor and annually update earnings levels. The agency estimates that 60 percent of all overpayments and 45 percent of all underpayments result from the earnings limit.

A substantially higher earnings limit also would mean less frustration and inconvenience for working beneficiaries. Our members consistently report that agency-provided explanations of the earnings limit are confusing, especially regarding the first year of retirement. Misunderstandings about the earnings limit create financial and emotional hardships when overpayments have to be recouped, especially if the beneficiary relies exclusively on Social Security benefits coupled with earnings.

Just last week, a 67 year old widow with a heart condition called AARP from Oregon in tears because Social Security notified her they were suspending her benefits until she repaid $3,000 for excess earnings in the previous year. She was having financial difficulties because she had been laid off for six months and her newly acquired job was lower paying. SSA's overpayment request was causing her distress. She was working, she said, to make ends meet and to have a "little dignity." She wondered "how Social Security could get blood from a turnip?"

Even an underpayment, usually the result of overestimating projected earnings, creates a financial hardship. The beneficiary who has earned less than anticipated may have to forego some needed items in order to live on this smaller-than-expected income. While the beneficiary will not lose these benefits permanently, the temporary reduction in benefits will be a hardship.

Additionally, some beneficiaries incur a substantial penalty for failing to file a report of estimated earnings in a timely manner. Some who lose a benefit check may not have been aware of the annual filing requirements, especially if their return to the labor force came some time after filing for initial benefits. (Generally, information about estimating future earnings is given to worker/retirees when they first file for their Social Security.) The loss of one benefit check represents a financial hardship for many persons, particularly when the penalty was not anticipated or if the beneficiary no longer works.

B. Decreased Productivity

The earnings limit poses other problems for our nation. Social Security is intended as a partial replacement of income lost due to retirement, disability or death of the worker. However, the definition of retirement has evolved to accommodate changing work patterns and increased longevity. Many older individuals choose to ease out of the work force rather than drop out entirely, and some have to continue working full-time or part-time because they need additional income. Still others are eased out of full-time work because of employer layoffs or downsizing.

As our society continues to age and the pool of future workers fails to keep pace with the demand, older workers will be needed in the work force more than ever. This is especially true for workers with marketable skills. Not only will the economy benefit from utilizing more older workers, but studies show that those over 65 who work have a more positive mental outlook.

CONCERNS ABOUT CHANGING THE EARNINGS LIMIT

A. The Cost Concern

Some oppose changing current law because it could be costly to the Social Security trust funds over the short term. This is true. However, SSA actuaries estimate that the long-term costs to the trust funds are negligible because the value of the total benefits paid to an individual does not change over his or her lifetime. This is the case because an individual whose post-65 earnings result in a loss of benefits will receive a delayed retirement credit (DRC). With a liberalization, that same beneficiary will receive benefits now and no subsequent DRC. Thus, the trust funds actually pay the individual the same amount of total benefits; it is simply that the payout schedule differs.

Congressional Budget Office (CBO) cost estimates for a change may be overstated because they disregard the added revenue generated by additional work. (SSA estimates the additional revenue would offset between 10 and 15 percent of the cost of repeal.) An absolute projection of the revenue gains from increased workforce participation is difficult because of uncertainties about the number of beneficiaries who will increase their work effort and the amount of their increased earnings. However, it is clear that *some additional federal revenues will be collected.* The primary sources are the income tax, the payroll tax and revenue from increased taxation of Social Security benefits.

B. Benefit Distribution Concern

Opponents are reluctant to repeal the earnings limit outright because upper income beneficiaries who currently forego benefits will begin receiving them. However, these worker/retirees will pay taxes on up to 85 percent of their benefits. In addition, once they turn 70, they are entitled to receive full benefits regardless of the level of their earnings.

Liberalizing the earnings limit will not have a dramatic impact on low-income older Americans, many of whom do not work. Also, those 65 and over who work forty hours at the minimum wage do not reach the current earnings threshold. However, an hourly wage of $6.00 would push a full-time older worker above the limit and trigger a loss of almost $280 annually in benefits. Since the average benefit for a retired worker is $674 ($8,188 annually), the beneficiary's total income from both earnings and Social Security would be $19,908. With less than $20,000 in income, a beneficiary in a high-cost-of-living area or with unanticipated financial or medical expenses may easily run into financial difficulty. A beneficiary at that income level could become understandably frustrated about losing even a modest amount of Social Security.

AARP believes the reluctance to provide larger benefits to upper-income beneficiaries should not stand in the way of raising the limit to a more reasonable level—an approach that targets relief to those working out of necessity. Simply put, middle income working beneficiaries, whose productivity contributes to society, should be allowed to keep more of what they have earned. For these older workers even a modest increase in the earnings limit will have an immediate and beneficial effect.

The working beneficiaries' prospective needs to be recognized. They are trying to cope with changed economic circumstances and the prospect of increased longevity. However, they are not as fortunate as others who have additional sources of income which do not reduce the level of their Social Security benefit. What other options do those working beneficiaries have to increase their income and prepare for a time when ill health and/or advanced age force them out of the work force? Yet, the earnings limit acts as a disincentive to those who would help themselves.

CBO has found that a liberalization of the limit would exempt many moderate-income beneficiaries, especially women and widows, without providing as much of a benefit to those with higher-incomes. According to a 1986 CBO study, doubling the 1986 earnings limit (to $15,600) would have exempted virtually all people with incomes below three times the poverty threshold ($15,765 for a single person and $19,890 for a couple). However, almost two-thirds of those with incomes above four-times the poverty threshold ($21,020 for a single person and $26,520 for a couple) would still face benefit reductions. Also, the additional dollars that a moderate income beneficiary would receive from liberalization generally represent a greater proportion of his or her total income than is the case for beneficiaries with considerably higher incomes.

C. Availability of Jobs Concern

The final argument for retaining current law relates to job availability. Although rarely argued in an explicit manner, the earnings limit is sometimes defended as a means of improving the employment prospects of younger workers. Under this rationale, the earnings limit is presumed to open up positions for younger workers by keeping retired workers from re-entering the labor market to compete for jobs. This concern is simply no longer relevant today.

ADDITIONAL REASONS FOR LIBERALIZATION

A. Improving the Economy

If older Americans can earn more without penalty, they can more easily set aside some money to better keep pace with inflation, and to help meet rising medical care costs meet current and future needs. It also means more money will be pumped into the economy. And, it even could save the government money because of decreased Medicare costs. If an older worker is covered under his/her employer's medical plan, Medicare becomes the secondary payor. That means fewer Medicare dollars will be spent. Also, there could be some indirect savings. Employed people tend to remain healthier, which means they could well use Medicare less frequently.

B. Marginal Tax Rates

The high marginal tax rates working beneficiaries face have been used to argue for a change in current law. Working beneficiaries age 65–69 who exceed the limit resent having to return ⅓ of their benefits to the government (the equivalent of a marginal tax rate of 33 percent). When the returned benefits are combined with payroll taxes, federal income taxes, and a possible tax on benefits, marginal tax rates are considerably higher, and the disincentive to work can be enormous.

Effective this year, some working beneficiaries will be taxed on up to 85 percent of their benefits. The combined effects of the earnings limits and taxing up to 85 percent of benefits can result in marginal tax rates in excess of 100 percent (see testimony of Jonathan Forman before Senate Finance Committee, May 4, 1993 pp. 24–41). This is particularly true for individuals with incomes close to the phase-in range for the higher tax. This circumstance makes additional work financially unjustifiable. While those age 65–69 who lose some of their benefits receive a delayed retirement credit that partially compensates for lost benefits, they are not made whole because the DRC is not actuarially equivalent to the lost income. Indeed, better public policy would be to provide incentives, not disincentives, to continued work.

OPTIONS FOR CHANGE

If the number of bills introduced in any Congressional session to change the earnings limit is a barometer of public support, then the change has widespread backing. Over the last several years, some proposals to liberalize the limit have been adopted by one house or the other, but subsequently dropped in conference. Continued failure to enact any change is especially disappointing to the Association and to affected beneficiaries.

Congress has been reluctant to change the limit, in part, because of the costs. Furthermore, the Budget Enforcement Act of 1990 provides for specific points of order against proposals that would reduce the size of the Social Security trust funds. Unless the points of order are waived, supporters of increasing the earnings limit increase must "offset" the cost of their change within the Social Security program.

Over the past several years, AARP has supported earnings limits liberalizations that were trust fund neutral. A review of the proposed financing mechanisms used to offset these liberalization shows that many were eventually "hijacked" for non-earnings limit purposes.

AARP continues to prefer a liberalization of the earnings limit that *also* helps maintain the integrity of the Social Security trust fund. However, as the Committee is aware, the number of options to offset the cost is limited. In order to provide some relief to working beneficiaries, the following less costly alternatives have been proposed.

1. Accelerating the Delayed Retirement Credit (DRC)

Under current law, those age 65 through 69 who do not collect Social Security receive an adjustment when they begin collecting benefits. The 1983 Social Security Amendments phased-in an increase in the DRCs from 3 percent to the actuarially correct, 8 percent level, beginning in 2008. However, until the phase-in is completed, working beneficiaries will not be properly compensated for foregone benefits.

An immediate increase in the DRC to 8 percent has been proposed as an alternative to changing the limit because it is less costly. Starting in 2008, when the DRC reaches 8 percent, the earnings limit essentially becomes irrelevant because any benefits lost due to excess earnings will be restored fully upon retirement. Thus, the working beneficiary is made whole.

While an 8 percent DRC may be actuarially fair, it offers little consolation to a beneficiary who needs the income currently. If an 8 percent DRC were adopted in lieu of or in conjunction with raising the current limit, a strong educational campaign would be needed to inform the public of the benefits of this change.

2. Raising the Earnings Limit and Decreasing the Benefit Reduction Factor

In the 102nd Congress, then-Senator Bentsen proposed legislation to reduce the penalty on the first $5,000 of excess earnings for beneficiaries 65 through 69. The legislation, which also would have doubled the earnings limit, lessens the penalty for $1 for every $4 in excess earnings. This more modest penalty on earnings closest to the threshold is another way to target relief to those who need to maximize their earnings.

CONCLUSION

AARP believes a substantial liberalization of the earnings limit for persons age 65 through 69 is long overdue. It would improve the lives of many worker/retirees and it is good labor, economic, and social policy for an increasingly older society.

The Association recognizes that a liberalization should have some offsetting savings, and we are prepared to work with the committee to design a reasonable proposal. We urge Congress to move ahead on this issue.

PREPARED STATEMENT OF MAX RICHTMAN

Mr. Chairman and Members of the Committee, I am Max Richtman, Executive Vice President of the National Committee to Preserve Social Security and Medicare. I am here today to speak on behalf of our members and supporters in favor of repealing the Social Security earnings limitation for workers ages 65 through 69.

Many of our members need or want to work, but they also want to receive the benefits they have earned. They do not understand why they are still tied to an earnings limitation they view as a relic of the depression years. Nor do they believe Congress today would sanction such a provision if they were starting new.

Yet concern over the short-term cost and the continued use of Social Security trust funds to offset general budget deficits keeps Congress from relieving workers from the financial penalties of the earnings limitation and the Social Security Administration of its administrative burden.

According to Social Security actuaries, the long-term cost is negligible, only .01 percent of payroll over 75 years. We would be happy to work with the Committee to find offsetting long-term savings.

A major goal in 1935 was to move older workers out of the work force to open up jobs for younger, unemployed workers. Even in 1935, the concept that there was a one-for-one tradeoff between entrants into and departures from the workforce represented a misreading of the dynamics of the economy. Nevertheless the availability of Social Security benefits made retirement feasible for workers unable or unwilling to continue working and the earnings limitation encouraged into retirement those who might otherwise have chosen to keep going. Workers wisely responded to the double-edged incentive.

Assuming for the sake of argument that the economy of the 1930s and the post-World War II 1940s required extreme measures to get older workers out of the workforce, those conditions do not exist today. Yet the earnings limitation stays in place, still encouraging older workers into retirement and financially penalizing those who do not retire.

Under existing circumstances, it is hard to imagine why any senior would continue working after reaching retirement age. The truth of the matter is that, like younger workers, many need the money. Social Security is often depicted as one element of a three-part retirement-income package. Savings and pensions are meant to provide the remaining two-thirds.

It is a national disgrace that almost half of retired men and over 75 percent of retired women have no pensions to supplement Social Security. For them additional earnings are not an option-they are often a necessity. For those who do have pensions, lack of cost-of-living adjustments after retirement mean a continuing decline in the purchasing power of those pensions. They, too, may need to return to the work force.

Savings can be equally elusive. Investments are not always successful and for those who chose bank or savings accounts to avoid the risk of a loss of principal, the decline in interest rates means far less income than anticipated at retirement. Some have seen life savings wiped out by medical expenses not covered by Medicare or incurred before becoming eligible for Medicare. Younger spouses of retired workers, particularly those with preexisting conditions, for example, can find themselves without health insurance protection and unable to buy it. These seniors, too, may find it necessary to work to add to other available retirement income.

Other seniors remain in the work force or reenter the work force to meet extraordinary medical or nursing care expenses of an ill spouse or an aged parent.

Statistics compiled by the Social Security Administration from the Census Bureau Current Population Survey demonstrate that seniors who work have approximately twice the median total money income of seniors who don't work (see chart 1) and are one-fifth less likely to be poor (see chart 2).

Not all seniors work because they need the money. Many seniors enjoy their work and the associations that come with work. They receive satisfaction from continuing to be productive and creative. Instead of a national policy to encourage the continuing use of talent and energy, this nation discourages it.

Research by the Commonwealth Fund's Americans over 55 at Work Program identified 1.6 million Americans between the ages of 65 through 69 who were ready and able to work. Interestingly, the largest group of seniors 55 or older who pronounced themselves ready and able to work were in the 65 through 69 age group. This is the group who are not only discouraged from trying to supplement retirement income, they are penalized with a lifetime loss in Social Security benefits. Even though they continue to pay Social Security payroll taxes, the delayed retirement credits they earn when they lose benefits are still insufficient to make up for the loss.

Whether the senior works out of the need for extra income or the pleasure of working, the combination of FICA payroll taxes, income tax and the loss of Social Security if earnings exceed the limitation exacts a high price.

Retirees who want to work quickly figure out they are "basically working to pay additional taxes with very little benefit." Charts 3 and 4 show that marginal and average tax rates are much higher for beneficiaries age 65–69 than they are for non-beneficiaries.[1] Beneficiaries age 65–69 with earnings between $10,000 and $30,000 have marginal tax rates approximately twice as high as non-beneficiaries. As a result, average tax rates are also much higher at all earnings levels above $12,500. Results are similar for married couples. These disparities not only prejudice the decision to work by beneficiaries age 65–69, they violate the principle of fairness.

Opponents of raising the earnings limit center their arguments on the advantage eliminating the earnings test would give to the wealthy who "don't need Social Security." Upper income workers have paid for their benefits. Need is not supposed to be a criterion. This attitude is nothing more than means testing in disguise.

When the delayed retirement credit is actuarially fair in 2008, upper income workers won't even lose any lifetime benefits. The delayed retirement credit is gradually being increased.

High income individuals have another decided advantage over those with lesser income and assets. Unearned income from savings and investments often provide a substantial supplement to Social Security. But unearned income never affects a right to benefits. A question of equity arises in this situation:

> *"Between this work and my monthly Social Security I still fall far short of having enough to pay my expenses" wrote Eloise Boshers-Ross in 1990 when she was 65 and working part-time 30–35 hours a week. "In addition I am penalized for working by Social Security for having made more than the allowable amount . . . . If every time I earn over 'the amount' I have to give up part of my hard earned wages to Social Security, how am I ever going to get out of this vicious circle and rut that I am in?"*

We used this quote from Ms. Boshers-Ross, a widow from Camillus, New York, in testimony before the House Ways and Means Social Security Subcommittee in May of 1991. We recontacted her yesterday. Fortunately, the earnings limitation no longer applies this year because she turns 70 next month. But she isn't out of the "vicious circle" yet. She will still be paying off past overpayments until next March and then she will have to pay off loans she has taken out for taxes and work around the house. She now works 40 hours a week, not 30–35 hours, to keep up with her expenses and the Social Security overpayments.

Over the years, Congress has increased the earnings limits and reduced the penalty. This has been a big help to many seniors. The current limit of $11,160 a year for those age 65–69 may even seem generous. But it certainly isn't generous in metropolitan areas like New York, Chicago or Los Angeles where the cost of living is high. And it is hardly a princely sum in many other communities.

Joe Lojewski does not believe it is sufficient in Amarillo, Texas. Mr. Lojewski learned his lessen well in the first year of retirement when his earnings exceeded the limit. He had to ask that all benefits be ceased until he was out of debt. But to make up for the loss of Social Security income, he needed to increase his earnings over those intended. Again, he went over the limit and lost three more checks the following year. In June of 1995, he will reach age 70. Until then he will continue to keep his earnings right at the limit.

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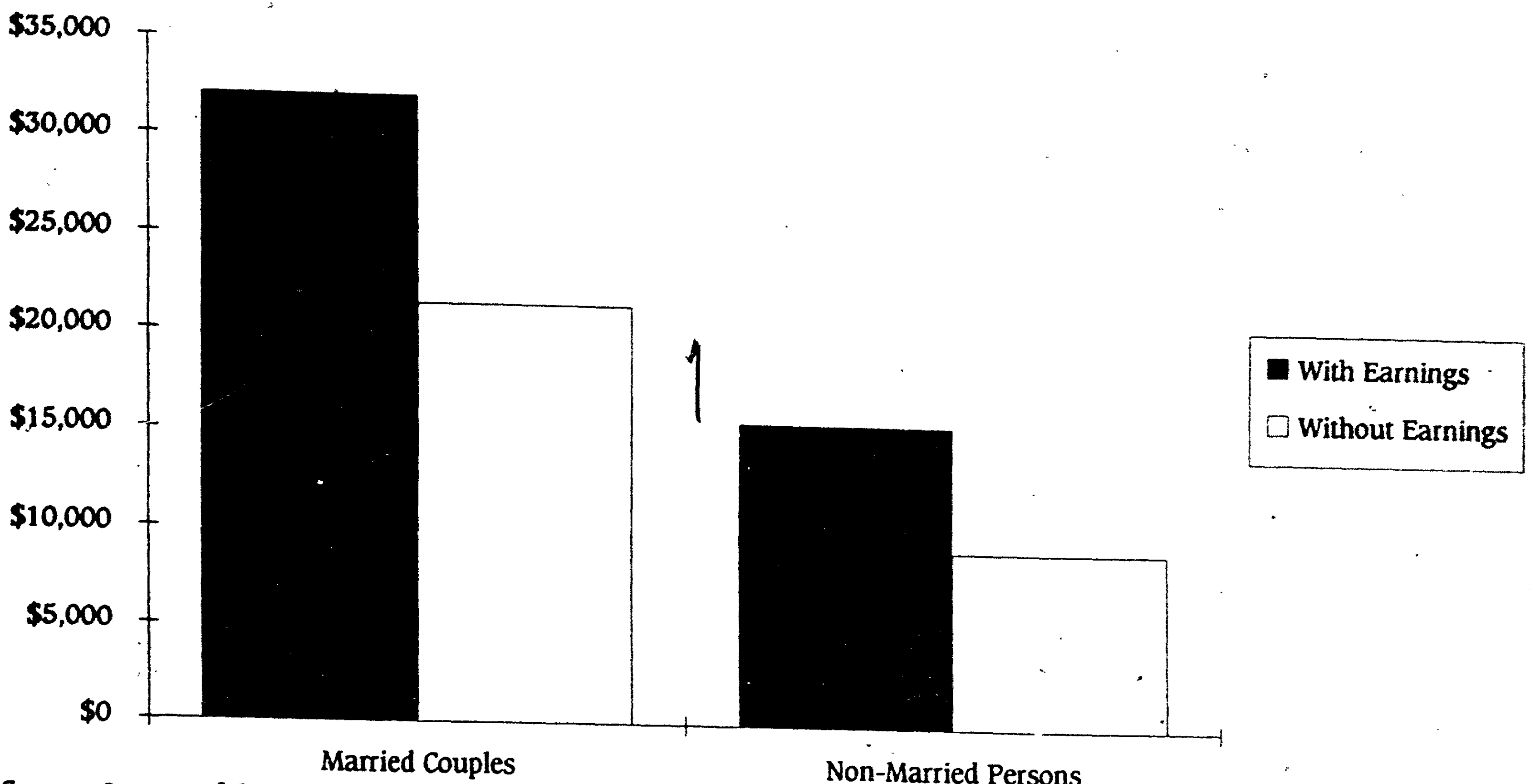
[1] Chambers Associates: The Marginal and Average Tax Rates America's Seniors Pay, January 1993. Based on applicable tax rates in 1991 with the exception that 85 percent of Social Security benefits was assumed to be taxable above the AGI threshold of $25,000 for a single individual. Current law taxes 50 percent of benefits above the AGI threshold of $25,000 and 85 percent above the AGI threshold of $34,000.

For a salary equal to the earnings limitation, I agreed to work from 8:00 a.m. to noon. Now I work from 6:30 a.m. to noon, but my pay is the same. . . . I would like all of them (Members of Congress) to get $900 in Social Security and be limited in what they can earn over that. . . . We need to raise the cap to $20,000 now. Taxes, insurance and utilities have been raised. All we want to do is live like human beings.

Eliminating the retirement test and recomputations would save $50 to $100 million a year in administrative expenses according to Social Security actuaries. No longer would claims representatives have to calculate benefit withholding based on earnings estimates, under- or over-payments at the end of the year based on actual earnings and the new benefit taking into account both new earnings and months of benefits withheld. The many appeals that result from the misunderstanding of the retirement test and the waivers of repayment from those who can't pay back the overpayments would also be eliminated. Each year of work generates endless paperwork not just for the Social Security Administration but also for the beneficiary. These are resource intensive administrative operations.

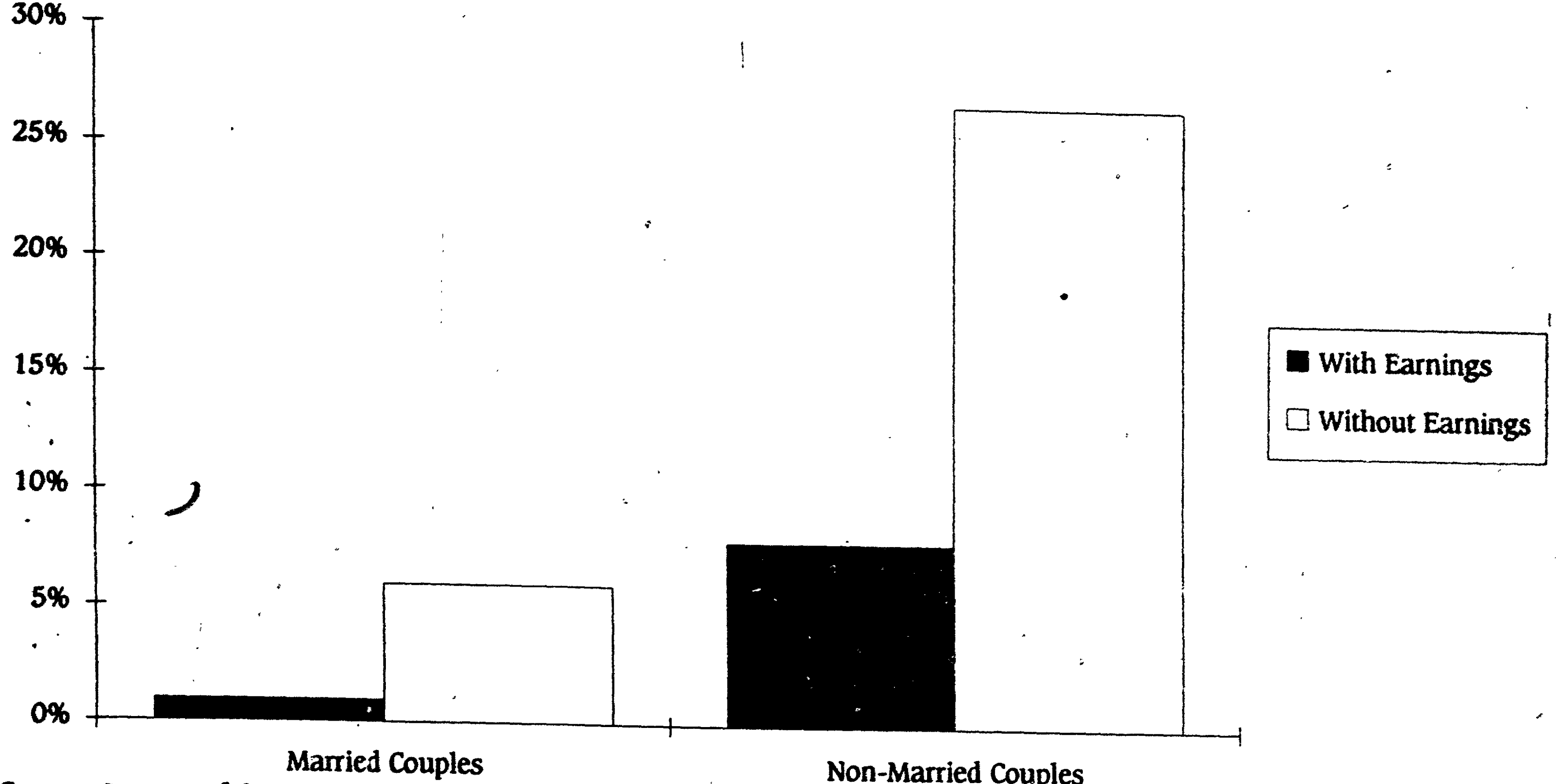
Mr. Chairman, older workers appreciate your leadership in Social Security matters. Times change and therefore rules must change. Allowing Social Security beneficiaries 65–70 years of age to work without limitations benefits individuals as well as society. Freedom to work and be independent is still a hallmark in American society.

Chart 1. Median Annual Income, Age 65-74, 1990



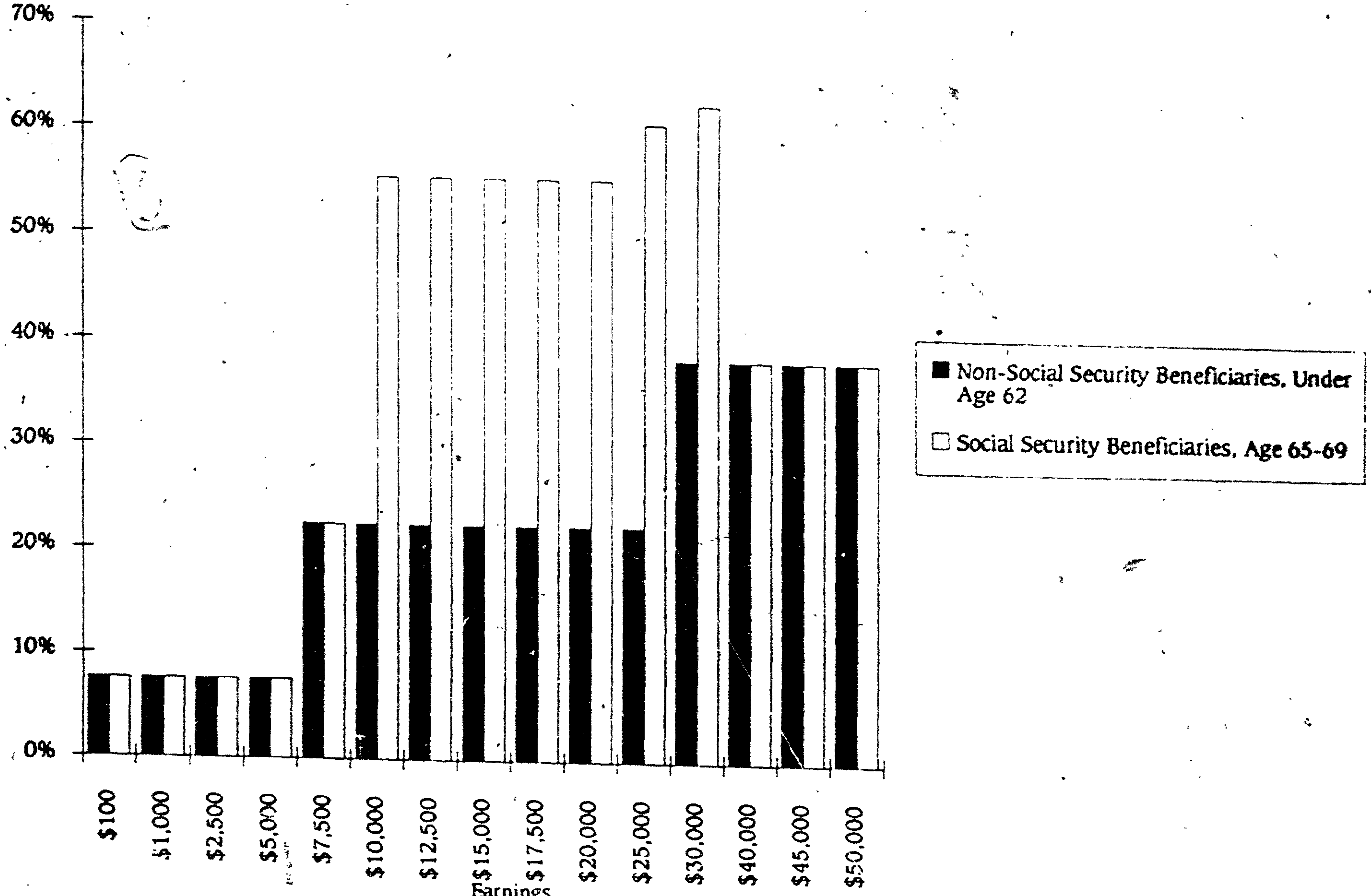
Source: Income of the Population 55 or Older, 1990, Social Security Administration, April 1992

Chart 2: Percent of Units Age 65-74 Below Poverty Line, 1990



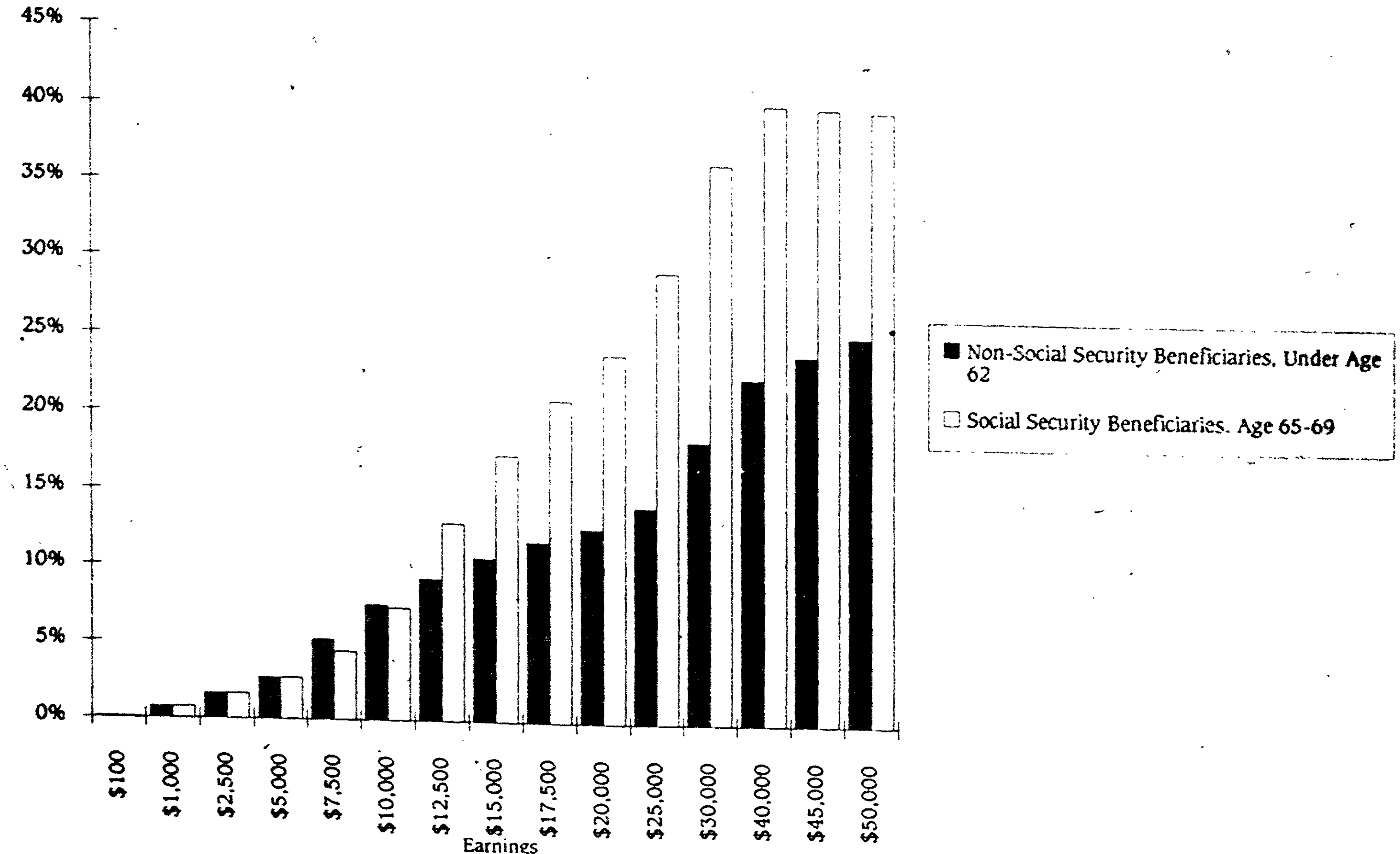
Source: Income of the Population 55 or Older, 1990, Social Security Administration, April 1992

Table 3. Marginal Tax Rates for Single Individuals



Source: Chambers Associates: The Marginal and Average Tax Rates America's Seniors Pay, January 1993

Table 4. Average Tax Rates as a Percentage of Earnings and Social Security Benefits for Single Individuals



Source: Chambers Associates: The Marginal and Average Tax Rates America's Seniors Pay, January 1993

PREPARED STATEMENT OF SENATOR WILLIAM V. ROTH, JR.

Thank you, Mr. Chairman. I commend you for holding today's hearing on the Social Security earnings limitation.

I firmly believe that the earnings limitation is a work disincentive that makes little sense in this day and age. I do not think that seniors should be penalized for continuing to work whether it is to remain active or to make ends meet. This restriction in the Social Security system is a burden to Social Security recipients; for many, an economic load that is difficult to bear.

I am glad that the Chairman called the hearing today to explore this issue and I will work to repeal the earnings limitation and lessen this burden on America's seniors. Thank you.

PREPARED STATEMENT OF C. EUGENE STEUERLE

Mr. Chairman and Members of the Committee: Most of the large budgetary issues facing this Committee today center around retirement and health policy. Promised retirement and health expenditures are far in excess of any taxes due to be collected, and all of the Social Security trust funds are far out of balance. Whereas retirement health, and disability occupied less than 10 percent of outlays in 1950, today they are at about half of the total. After subtracting out interest payments, the remainder—defense, foreign affairs, welfare, education, transportation, environment, housing, justice, and everything else—will soon take up less than one-third. The continually growing share of the budget spent on retirement and health undoubtedly is deterring us from using resources toward reducing poverty rates among children, fixing our educational system, reforming welfare, and dealing with many of the problems endemic in some of our central cities.

With such demographic changes as the retirement of the baby boom population just around the millenial corner, of course, these budgetary shifts against greater investment in our youth and toward greater consumption by tomorrow's near-elderly and elderly are only going to increase. The rapidly aging population of the next century, with its dramatic drop in number of workers per retired person, implies the need for a different type of system than one centered partially around the Great Depression of the 1930s.

I realize that the Committee's focus today is on the *earnings test*. I am not going to pretend that simply eliminating this test would deal with these larger budgetary and societal questions. Indeed, its repeal initially would increase federal expenditures on retirement—although those could be offset easily in ways that would make the Social Security System fairer and equally progressive, such as slight changes in the benefit formula or in the taxation of benefits.

I will argue that elimination of the earnings test is a small piece of a larger reform strategy. Although not a sufficient component, it may be a necessary one. More specifically, I believe that reform of retirement age rules is becoming a budget necessity if we want to direct resources to the greatest needs in society, that we should stop wasting and discouraging the productive capabilities of many of our near elderly and elderly, that government should not simultaneously forbid age discrimination by private parties and then promote such discrimination in tax and Social Security laws, and that the earnings test is an obstacle to those broader reforms.

The cost of programs for the elderly have not risen because of increases in the rate at which Social Security replaces the annual wages of former workers. Costs have risen, among other reasons, because of the dramatic increase in number of years of retirement support given. To take one example, a couple retiring at age 62 today can expect, on average, to receive Social Security payments for 25 years (that is, until the death of the longer living of the two).

Among those institutions and social signals that have supported this trend toward more and more years in retirement are the following:

- government and private pension specification of a normal retirement age, rather than a normal number of years of support in retirement—that is, a definition of need that is defined by years since birth rather than expected number of years until death;
- an early retirement age specified at 62;
- similar, if not earlier, retirement ages for private pensions;
- seniority pay systems that poorly accommodate declining, but not zero, productivity in later years;
- government private pension, health, and labor laws that indirectly require employers to pay older workers higher total compensation than younger workers for the same work, and, hence, push companies to retire workers early;

- a health "earnings test"—a requirement that Medicare be the secondary payor for those elderly who work for employers providing health insurance to employees— that restricts the hiring of older workers and would be exacerbated under many types of health reform; and
- the OASDI or Social Security earnings test, itself.

All of these signals send a powerful message to the near-elderly and elderly. They set a social standard that is hard for any individual to ignore. Most were designed a long time ago—in an industrial, not a technological and service sector economy, and at a time when the fear was there were too few jobs to go around, rather than too few workers to support a retirement system. Suppose we decide, therefore, that there are greater needs in society than supporting more and more years in retirement among a group of near elderly and younger elderly who by a variety of standards are often better off than children, young adults, and the older elderly. The adjustment process still would not necessarily be easy. It would involve reversing a trend of at least 60 years and probably could not be done without tackling a whole host of institutional arrangements and societal signals, including the earnings test.

The simple fact is that the earnings test is a tattered remnant of a bygone era. Even independently from its strong anti-work sentiment, it violates almost all standards of efficiency and equal treatment of equals under the law. For example, it helps maintain a tax system in which households with equal incomes are taxed very differently: elderly workers often pay much more tax than non-elderly workers who, in turn, pay much more than elderly non-workers.

Given enough adjustments in delayed retirement credits, actuarial adjustments in benefits, and a variety of other reforms, some of the equity and efficiency problems eventually could be resolved even while retaining the test itself. Congress, indeed, has been moving in that direction over the years.

All of these additional offsets, however, cannot solve a more basic issue: the earnings test would remain one of many signals that our society, as well as our government, sends to our citizens when they still have a life expectancy as long as 15 or 20 years or more. "You should retire. You are old. We do not want you to work. We will penalize you quite heavily if you do work." Even with all of the actuarial adjustments in the world, I do not believe that this signal, this very bad and confusing signal, can be removed entirely without eliminating the earnings test as one step.

In the remainder of my testimony, I will elaborate on these points.[1]

RATIONALES FOR EARNINGS TEST

The original design of the Social Security system included clear and powerful financial penalties for working during old age. Until 1951, for example, a person would lose all of his or her Social Security benefits in any month during which he or she earned $15 or more. Penalties of this sort were tolerated, in part, because there was a naive but strong belief among many that the economy could support only a limited number of workers. Earlier retirement of individuals, therefore, was viewed by some as a way of opening up more positions to the young.

William Graebner presents a well-documented case that this belief was a crucial source of early political support for the Social Security system.[2] He offers evidence that in the 1930s key congressmen, at least a few members of the Council on Economic Security, and President Franklin Delano Roosevelt shared this view. Council member Barbara Armstrong, for example, noted in her memoirs that "the interest of Mr. Roosevelt was with the younger man. And to that extent, I went along." With regard to the strict earnings test that allowed only $15 per month of earned income, she contended that it was in response to the scarcity of jobs during the Depression: "That's why that little ridiculous amount of $15 was put in . . . Let him earn some pin money, but it had to be on retirement. And retirement means that you've stopped working for pay" (quoted in Graebner 1980:186). Council member Murray Latimer's testimony before Congress "surveyed the disruptive impact of older workers, employed and seeking employment, on wage rates, efficiency, and work prospects of younger elements in the labor market. He was distressed at the legislation then being considered because the level of pensions provided, 'even if raised considerably above existing standards, would not be high enough to induce any consider-

[1] Most of the remainder of this testimony is taken from C. Eugene Steuerle and Jon M. Bakija, *Retooling Social Security for the 21st Century: Right and Wrong Approaches to Reform*, Washington, DC: Urban institute Press, 1994.

[2] Willam Graebner, *A History of Retirement: The Meaning and Function of an American Institution, 1885–1978*, New Haven, CT: Yale University Press, 1980.

able voluntary withdrawals from the labor market; nor would employers be able to retire superannuated employees without friction'" (quoted in Graebner 1980:188).

This, of course, represented poor economics. Elderly workers increase production and income in the economy and with their additional income demand goods and services from other workers. They do not take jobs away from the young. In any case, the rapidly aging population of the 21st century, with its dramatic drop in number of workers per retired person, implies the need for a different type of system than one centered around the Great Depression of the 1930s.

Although few today are willing to defend the earnings test on grounds that early retirement should be encouraged, a number of other rationales are frequently cited by its supporters. One argument made in favor of the earnings test is that Social Security should provide benefits to people because they are retired, not just because they are old. This is misleading. Social Security is a program intended to meet the needs that often accompany old age. Both old age and retirement at best are proxies for measuring those needs. Whereas a substantial number of people do cite poor health or disability as reasons for retirement, it is clear that many retirements are voluntary in nature. In these cases, the difficulty with any "retirement test" is that it is under the control of the individual, regardless of need. It creates great inequities between two persons, equally situated, who make different choices between work and leisure.

A political argument is also made that Social Security retirement benefits should only be paid to those who are retired so that the system does not "appear" to be providing benefits to high-income, working individuals. If actuarial adjustments were made properly, of course, this would merely be a fiction, as the returns to high-income individuals would be the same regardless of when actual benefits are paid. The fear, however, is not that the lifetime value of the pension would be too high, but that Congress would respond to benefits going to higher-income individuals by enacting welfare-like means tests. While I oppose an annual means test for Social Security cash benefits, the political argument by itself is an inadequate justification for the efficiency and equity costs of the current design. In many ways, moreover, this argument turns inward on itself. The earnings test, after all, has all the markings of a means test, although a perverse one based upon earnings rather than total income.

A final argument often used to defend the earnings test is that it enhances progressivity. Elimination of the earnings test is usually shown to increase net income mainly for those in middle- or upper-middle-income ranges. After all, the test doesn't even begin to apply until someone has earned enough to push himself or herself above the poverty level, and an older worker with that amount of earnings typically has other additional sources of income, including Social Security itself.

As applied to the earnings test, the progressivity argument is misconstrued. One could also deny businesses deductions for the cost of running a business or tax individuals three times on their dividend income; since business deductions and dividend income are more concentrated in upper-income groups, the net result would probably be progressive. But it wouldn't make sense because the normal rules for equity require that we treat equally all persons with equal ability or need and not distinguish on the basis of arbitrary criteria, such as whether their income came from work. Progressivity is no excuse for treating equals unequally.

Not every program needs to be progressive in every provision for government itself to be progressive. There are a variety of ways to achieve the same general level of progressivity while improving the system's fairness and efficiency. One could eliminate the earnings test and simultaneously change the benefit formula slightly. Or one could substitute higher-income taxes on all kinds of income for the tax on employment earnings in the current earnings test. Recent estimates suggest that repealing the earnings test would cost about $6 billion per year, with perhaps 10 percent of this cost being offset by higher payroll tax revenues. In the longer run, some of the cost would also be offset by reduced delayed retirement credits and larger actuarial reductions for early retirement.

DOES THE EARNINGS TEST AFFECT BEHAVIOR?

There is a fair amount of evidence that the existence of a Social Security system—or, more generally, growth in retirement assets and income—has over recent decades induced people to retire earlier than they otherwise would. Indeed, the labor force participation rates of older men have declined dramatically, at the same time that Social Security was covering a growing portion of the population and granting increasingly valuable benefits. The availability of private pensions, some of which pay retirement benefits even before age 62 (and which often are designed around Social Security), also plays an important role.

In the presence of these fairly strong relationships between greater resources near old age and earlier retirement, what is the impact of particular retirement rules of Social Security, such as the earnings test, on the retirement decision? Most statistical studies on this question have examined behavioral responses to marginal changes in the earnings test or related rules, and have typically found only a small impact. In general, they have concluded that retirement decisions seem to be determined mainly by other factors, such as total income available in retirement. The logic is not hard to understand. Most individuals today retire completely and do not even work up to the earnings threshold at which the earnings test begins to apply. Only a small percentage of the population (11.6 percent in 1991) work past age 65 at all, even though the earnings test exempts several thousand dollars' worth of wages. Given the failure to work of many near- and young-elderly even at income levels where no earnings test applies, it is usually concluded that the earnings test has only a minor impact on the choice to work. Recent reductions in the tax rate implicit in the earnings test also seem to have had little effect on the decision not to work.

One difficulty with this literature is that it cannot separate out the "social" effects of the signals sent by the system as a whole from marginal changes in behavior due to marginal changes in tax rates. That is, if people tend to react as a group to the signals they detect, then the issue centers as much upon the type of signal sent by an earnings test as upon the exact tax rates that are employed. If most of one's cohort of workers retire and take up new life styles, one may want to follow them regardless of minor differences in the effective tax rates one faces. On top of this, employers may respond by setting retirement ages and designing pension plans in ways that follow the signals set by both Social Security retirement ages and the apparent penalties in the earnings tests.

These socialization effects, of course, would occur in response to several signals, not just the earnings test. The maintenance of a Normal Retirement Age of 65, for instance, may be the main signal and the earnings test merely a principal reinforcement. Eliminating the earnings test by itself, therefore, might have only a modest effect on labor supply, especially in the initial years.

The fact that most people do not fully understand the subtleties of Social Security rules only reinforces the importance of signals. OASI beneficiaries who work tend to clump unnecessarily around the earnings test threshold. The clustering of earnings around the earnings limit, by the way, might also be a sign of underreporting of income or cheating—which is often easy to accomplish with self-employment earnings, where the taxpayer, rather than a separate employer, keeps the books of account. This, of course, does not speak well to the behavioral incentives of the earnings test, either.

REPEALING THE EARNINGS TEST

Partly because of its ambivalence toward the earnings test, Congress over time has continued to chip away at its application by increasing exempt amounts, lowering benefit reduction rates, and introducing the delayed retirement credit. The test now applies to only a minority of retirement years—albeit the first years, when the signal is most powerful and most likely to have an effect on labor supply decisions.

Eliminating the earnings test at all ages would probably be the simplest way to reduce many of the perverse incentives in—the existing system. It would also greatly simplify the administration of the system, since the earnings test is the largest source of errors in benefit calculations. Many corrections of benefit amounts are required as earnings change over time, and taxpayers are extraordinarily confused about what is occurring. The delayed retirement credit would then become unnecessary in most cases, although it should still be made available to those who choose voluntarily to forgo benefits after the Normal Retirement Age.

As we move toward the 21st century, significant changes may need to occur in the work patterns of the near-elderly and the young-elderly. Society may not desire the ratio of workers to beneficiaries to decline so dramatically as now expected. Perhaps even the tendency to define old age with the year 65—a "signal" that can be traced back well over a century—will itself be called increasingly into question. The rising proportion of jobs in service industries and increasing life spans are bound to affect choices. In the end, no one knows for sure how work behavior will change in the future, but it seems unrealistic to maintain an earnings test that announces somewhat loudly that most people should retire at age 65 or 62 and stay retired.

Removing the earnings test, by itself, would probably not have a large impact on behavior. In combination with other changes such as increases in the Normal and Early Retirement Ages and elimination of the health earnings test (the requirement that Medicare be a secondary payor), it could eventually have a significant impact on the work patterns and behavior of the near-elderly and young-elderly. Such reforms, moreover, could serve as an important first step in a transformation of social attitudes. In the end, however, we're never going to know until the walls start coming down.

COMMUNICATIONS

STATEMENT OF CITIZENS FOR A SOUND ECONOMY

Mr. Chairman and Members of the Senate Finance Committee, thank you for the opportunity to express our views and research findings on the Social Security Earnings Limit. My name is Paul Merski, and my testimony is on behalf of the 250,000 members of Citizens for a Sound Economy (CSE), a non-profit, non-partisan citizens advocacy group based in Washington, D.C. Our members throughout the country have fought long and hard to help preserve and advance individual economic freedom. We give full support to the repeal of the unfair earnings test limit imposed on Social Security recipients that amounts to nothing more than a punitive tax on those who choose to work.

The earnings test constitutes a dangerously flawed policy because it discourages work effort by depriving elderly workers of a significant part of each additional dollar earned. It hurts those seniors who need extra income to supplement their Social Security benefits.

Judging from its policies, the federal government seems to prefer that older persons be dependent on it for assistance rather than be able to finance their own needs. This attitude is reflected in the way taxes are levied on the elderly and in the way benefits are provided. Unfortunately, whatever its objectives, the federal government's treatment of the elderly results in two adverse outcomes: (1) the aged become dependent on Washington for an increasing portion of their income; and (2) the federal government and taxpayers are hit with soaring costs of assistance to the elderly.

While the reduction of marginal income tax rates has been one of the foremost accomplishments of tax reform in the 1980s, retired Americans can bear extraordinary high tax burdens. Because of the effect of the earnings test, many elderly Americans face marginal tax rates above 50 percent, far in excess of the rate levied on even the wealthiest taxpayers. The elderly who choose to work are severely penalized. Beneficiaries under age 65 will be denied $1 in benefits for every $2 earned above a meager $8,040—the equivalent of a 50 percent tax rate. Elderly workers 65 to 69 lose $1 in benefits for every $3 earned over the $11,160 limit for 1994.

The punitive treatment of seniors is also compounded by the tax treatment of their promised benefits. Since 1983, half of Social Security benefits have been treated as taxable income for single taxpayers making more than $25,000 per year and for households with income in excess of 32,000. Since enacting this scheme, Uncle Sam has collected back more than $55 billion from Social Security beneficiaries. Unfortunately, President Clinton's tax hikes passed last year retroactively targeted seniors even further, making 85 percent of benefits taxable. The taxable income thresholds are not even indexed for inflation, which means that each year more working elderly will have their benefits taxed.

Simple stated, if the elderly choose to work after retirement they lose benefits; if they save before retirement, they face taxation of 50 to 85 percent of their benefits. These punitive policies only force more individuals to become dependent on an already strained Social Security system. Too many elderly are forced to forgo work or savings opportunities in order to protect their promised benefits or to ease their tax burden. In essence, the federal government subsidizes people not to save or work.

The federal government should not fear increased spending due to the repeal of the earnings test. Increased work-related tax revenues would more than offset increased Social Security benefits payout. As the level of U.S. unemployment continues to decline, the elderly play an increasingly important role in the labor market, providing the expertise gained through decades of productivity in the work place.

The punitive earnings test should be repealed. Future demographic trends, labor force pressures, and longer life expectancies dictate that we have policies that encourage, not discourage, experienced workers to remain active and productive in the labor market. Employing the vast resource of experienced elderly workers has the potential to add billions of dollars to our annual economic output while providing new earnings-related tax revenues for the federal, state, and local governments.

STATEMENT OF THE NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS

On behalf of its 20,000 independent accountant members and the 5 million small businesses and individuals they serve, the National Society of Public Accountants (NSPA) would like to thank the Chairman and the members of this honorable committee for the opportunity to speak out in favor of the repeal of the Social Security earnings test. As accountants, NSPA members see firsthand the damage done by this test as it forces taxpayers to choose between continuing to contribute as members of the American work force and giving up as much as half of their annual Social Security benefit. As individuals, many NSPA members who retire from full time employment but maintain a small tax practice see their benefits eaten into by this discriminatory tax.

The National Society advocates repeal of the Social Security earnings test for two reasons. First, the test discriminates against seniors between the ages of 62 and 70, penalizing the younger Social Security recipients while allowing those 70 and older to work without fear of compromising their benefits. Second, the test discourages seniors from working and its repeal will allow seniors to contribute their valuable insights to a younger work force and their tax dollars to the federal government.

DISCRIMINATION

According to the Social Security Administration's Publication 65-008, updated most recently in August of 1993, "Social Security benefits are meant to replace, in part, earnings lost to an individual or family because of retirement, disability or death." This book goes on to explain that, "The amount of Social Security benefits which a beneficiary under age 70 may receive each year depends on whether the beneficiary is fully or partially retired. The earnings test . . . is used to measure the extent of a beneficiary's retirement and to determine the amount, if any, to be deducted from monthly benefits."

What this publication fails to do is justify why those between the ages of 62 and 70 must be fully retired in order to receive full benefits while those 70 and older may work without penalty. Nowhere in the public record has anyone been able to explain why working seniors below the age of 70 should forego up to half of their benefits while those 70 and above may retain their full Social Security check. This is an arbitrary age set during the Depression to force workers into retirement earlier.

Since the time of the test's enactment, the cost of living in America has increased dramatically. We now live in an age where seniors face an ever-increasing cost of living on a fixed income. Limiting the Social Security benefits of those between 62 and 70 unfairly handicaps them as they attempt to remain self-sufficient.

DISINCENTIVES

In addition to addressing the discriminatory aspects of the earnings test, NSPA supports repeal of the earnings test in order to remove this economic disincentive which forces seniors out of the work force. By discouraging seniors between the ages of 62 and 70 from working, the earnings test robs younger workers of the chance to benefit from the experience of senior coworkers and robs the federal coffers of the tax revenue that these men and women could generate.

Companies hiring seniors have repeatedly noted their strong work ethic, punctuality and flexibility. Working side-by-side with the younger members of America's work force, seniors set an excellent example that cannot help but influence the next generation of America's workers. By reducing senior participation in the work place or even curbing the enthusiasm of those who do continue to work, the earnings test unfairly reduces this intangible benefit to America's youth.

Beyond the youth who lose out on the benefit of working seniors' advice and examples, the entire country loses out on the tax revenue that these men and women could generate. By continuing this archaic, Depression-era disincentive, the federal government costs the country a substantial amount of tax revenue that these productive seniors could be generating. In addition, the Social Security Administration spends millions of dollars annually enforcing a test that costs the federal government tax revenue.

For these reasons, NSPA supports the repeal of the earnings test. We commend Senator McCain for his efforts toward this goal, and we urge this honorable Committee to support S. 30, The Older Americans Freedom to Work Act, to repeal the Social Security earnings test.

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