IMPROVING SOCIAL SECURITY WORK INCENTIVES

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

FEBRUARY 15, 2000

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IMPROVING SOCIAL SECURITY WORK INCENTIVES

TUESDAY, FEBRUARY 15, 2000

House of Representatives,
Committee on Ways and Means,
Subcommittee on Social Security,
Washington, D.C.

The Subcommittee met, pursuant to notice, at 9:07 a.m., in room 1100 Longworth House Office Building, Hon. E. Clay Shaw, Jr. (Chairman of the Subcommittee) presiding.

[Advisories announcing the hearing follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SOCIAL SECURITY

FOR IMMEDIATE RELEASE CONTACT: (202) 225-9263
February 8, 2000
No. SS–10

Shaw Announces Hearing on Improving Social Security Work Incentives

Congressman E. Clay Shaw, Jr., (R–FL), Chairman, Subcommittee on Social Security of the Committee on Ways and Means, announced today that the Subcommittee will hold a hearing on improving Social Security work incentives. **The hearing will take place on Tuesday, February 15, 2000, in room B–318 of the Rayburn House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include academics and policy experts who have studied Social Security work disincentives, including the current Social Security earnings test; other witnesses will include seniors affected by this earnings test. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

Social Security has included a retirement earnings test since the 1930s. Under this provision, working seniors with earnings above a certain threshold lose part or all of their Social Security benefits in the year of the earnings.

In calendar year 2000, recipients aged 65 (currently the normal retirement age) through 69 can earn up to $17,000 without penalty; seniors earning more than that amount lose $1 of benefits for every $3 of earnings above the limit. Some people believe that this provision discourages work, especially among seniors who reach the normal retirement age. A separate earnings test applies to beneficiaries under the age of 65; which reduces benefits by $1 for every $2 of earnings above $10,080 in 2000.

The aging of the population has implications for productivity and economic growth. Providing seniors with the appropriate incentives and opportunities to work will be important to the future prosperity of the country.

In announcing the hearing, Chairman Shaw stated: “Welfare Reform and the new Ticket to Work law cleared the path to work for millions of poor parents and disabled individuals. This hearing will investigate remaining Social Security barriers to work, including the earnings penalty affecting some 400,000 hardworking seniors each year. Especially in a strong economy, Social Security rules should encourage seniors’ contributions, not force them to the sidelines.”

FOCUS OF THE HEARING:

The hearing will focus on work disincentives in Social Security programs, including the current Social Security earnings penalty.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should *submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, with their name, address, and hearing date noted on a label*, by the close of business, Tuesday, February 29, 2000, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Social Security office, room B–316 Rayburn House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, typed in single space and may not exceed a total of 10 pages including attachments. **Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.**

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at http://waysandmeans.house.gov.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

*****NOTICE-CHANGE IN TIME AND LOCATION *****

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SOCIAL SECURITY

FOR IMMEDIATE RELEASE CONTACT: (202) 225-9263
February 11, 2000
No. SS–10-Revised

Change in Time and Location for Subcommittee Hearing on Improving Social Security Work Incentives

Tuesday, February 15, 2000

Congressman Clay Shaw, Jr., (R–FL), Chairman of the Ways and Means Subcommittee on Social Security, today announced that the Subcommittee hearing on improving Social Security work incentives, previously scheduled for Tuesday, February 15, 2000, at 10:00 a.m., in room B–318 of the Rayburn House Office Building, **will now begin at 9:00 a.m. in the main Committee hearing room, 1100 Longworth House Office Building.**

All other details for the hearing remain the same. (See Subcommittee press release No. SS–10, dated February 8, 2000.)

Chairman SHAW. If everybody could take their seats, we will proceed with what I think is going to be a most fruitful and successful hearing for everybody, and particularly for American seniors.

Good morning. In recent years, this Committee has focused a great deal of energy on reforming government programs to encourage work. That was the focus of the historic welfare reforms we passed in 1996. It was also the point of Ticket to Work bill that passed last year to help disabled Americans enter the work force in greater numbers. Today we will explore how Social Security rules actually discourage work for some seniors.

Currently, Social Security takes away benefits from hard-working seniors who make more than the annual limits allow. Those are limits arbitrarily set by government. This earnings penalty has been in place since Social Security started in the thirties, but that does not make it right.

Many of you will recall that in 1996 we eased this penalty for seniors who reached the full retirement age. As a result, seniors 65 through 69 now can earn up to $17,000 a year without experiencing a cut in their benefits. While that certainly was a positive step, many of us have long felt that it is wrong to punish hard-working seniors, period.

What message does this send? That senior contributions are no longer needed? That seniors should head for the sidelines of the economy due to age alone? That seniors don't deserve the benefits that they paid for simply because they continued working?

I don't think any of us feels that way on any of those questions. So today we will hear from a broad spectrum of witnesses, including Social Security's Commissioner and AARP, who support repealing the earnings penalty for seniors who have reached the full retirement age. Tomorrow we will mark up H.R. 5, which is a bipartisan bill that eliminates this penalty.

We are pleased today to welcome Sam Johnson, the bill's author, and Collin Peterson, the lead Democrat cosponsor, who are here, and they will testify at our hearing.

We were encouraged to hear the President say yesterday that he would sign a bill similar to H.R. 5 if it reaches his desk. I have a feeling that it is going to reach his desk. We intend to hold him to that pledge.

Eliminating the earnings penalty is the right thing to do for seniors. They have spent a lifetime working for their Social Security benefits, and they should not be deprived of one penny. They should get all the benefits they earn and all the benefits that they paid for, regardless of whether they keep working or not. Hopefully, before too much longer, Social Security rules will reflect as much.

I was asked yesterday at a news conference in which we unveiled the hearing process by a reporter that said: Isn't this taking away one of the sweeteners that will lead eventually to Social Security reform? Well, I am disappointed that we are not getting fully to Social Security reform. However, it is wrong to hold back something as important as this where we take a dollar out of each $3 that a senior earns simply because they decided to work. That is simply wrong. And whereas I would like this to be part of a larger bill, I have no intention of holding it hostage and holding those seniors hostage until we finish the political wrangling and political bickering across the aisle and down Pennsylvania Avenue with the President.

Again, I would say that the President knows my phone number. He can find me readily if he would like to broaden this to a wider reform. However, I think that it is time that we expedite this bill, that we move it forward, get it to the President's desk, get it signed, and say that the seniors now beginning the first of this year are no longer penalized because they choose to or, in many instances, they have to work to support their families and take care of their loved ones.

With that, I will yield to my friend, Mr. Matsui. It is going to be a great pleasure to work in a very positive way with you on this bill, as I would certainly anticipate that you are going to be joining with us on the Republican side in order to get this done.

Mr. MATSUI. Thank you, Mr. Chairman. I appreciate your comments, and I appreciate the fact you are holding the hearing on this bill today and a quick markup tomorrow. I believe it is at 4 o'clock in the afternoon, if I am not mistaken. And I would imagine it would go to the Full Committee soon, and I doubt if a vote could be taken this week, but perhaps as soon as we get back from the recess, we will be able to get this to the floor.

As all of us know, the earning limitation issue has been a thorn in the side of senior citizens for quite a number of years. My father, when he was past 65, was actually told by his employer, whom he had worked with for almost 50 years, that he is going to be penalized significantly if, in fact, he was making the same income. And so they actually cut his hours way back and dropped his salary at that time down to $14,000, what the earning limit was. And he put in probably the same number of hours that he always did, but he was obviously paid at a much, much significantly lower rate.

And so this earnings limitation has really affected senior citizens in a number of perverse ways. Many retire—in fact, we have had a report by Leora Friedberg from the University of California at San Diego, that says that by eliminating the earnings test, you will probably see an increase of seniors in the work force by 5.3 percent. And, in addition, I think some employers would not suggest to employees that they take a wage cut and have the employees continue to work for the same number of hours that they had.

This legislation is much needed. The President has endorsed it. Leader Gephardt has endorsed. The entire Republican leadership has endorsed it. And so it has very, very strong and wonderful bipartisan support.

It is my hope that in the days ahead—and I still speak in the spirit of bipartisanship—perhaps the Senate could do this, the other body, or perhaps the House could do it before it hits the floor, perhaps it could be taken under separate legislation. But we do have the problem of senior citizen women who are single. Married women, their poverty rate when they receive Social Security is 5 percent. Married women on Social Security is 5 percent. Overall, seniors over 65 have a 10 percent poverty rate. But single women on Social Security have between 18 and 20 percent as their poverty rate. And, undoubtedly, we need to do something about this. Maybe that will be a comprehensive bill. Perhaps it could be looked at some time later this year.

Another issue is, a few years ago in the midnineties we decoupled the threshold on the earnings test, which was at $14,000. We raised it to $17,000 for seniors, but we did not do it for the blind, who at that time were coupled with seniors. And with the minimum wage going up—we hope it will go up again this year—undoubtedly that has an impact on the ability of seniors to earn a livable wage by continuing the earnings limit to $14,000.

I understand that the costs over a 5-year period by raising the earnings limit on the blind from $14,000 to $17,000 would be in the range of $1 billion to $2 billion over 5 years. And it would be my hope that we can find some way to deal with this problem. It is not a significant revenue item, but deal with this problem and really give the incentive not only for seniors but also the blind as well.

Mr. Apfel will testify that this earnings test for the blind and for senior citizens adds a great deal of complexity to the Code and certainly to the Social Security Administration, I think he will testify in the range of $750, $760 million a year additional administrative costs. And so obviously this is an issue that all of us from a fiscal point of view have to be aware of.

One other comment I would like to make is that this bill must remain clean. The President has indicated he wanted a clean bill.

My understanding was that last week when we moved the marriage penalty relief bill, there were some other items on it that we are finding out about now—I could be wrong about that; these are only rumors—pension benefit changes, and we are checking into that right now. Thank goodness the bill hasn't been moved in the Senate and sent to the President. We want to keep these bills as clean as possible so that there is no misunderstanding about what members are voting for. It is very important that we keep this legislation clean as well.

So, Mr. Chairman, I want to thank you in the spirit of bipartisanship. Certainly we want to work with all of you, and we look forward to getting this to the President so that the President and all members can be part of a signing ceremony.

Thank you.

Chairman SHAW. Thank you. It took us a year to get here, but we are here and we are here together.

I would like to welcome our first panel: Sam Johnson, esteemed Member of this Committee, and Collin Peterson, who has also been a leader with regard to getting rid of the earnings penalty on Social Security. We have both of your full statements. You may proceed as you see fit, and you are welcome before this Committee. Mr. Johnson?

STATEMENT OF HON. SAM JOHNSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. JOHNSON. Thank you, Mr. Chairman, and if Mr. Matsui will listen, I will tell him, we have a clean bill filed. We have a clean bill filed, and that is the way we want it, too.

Last year Collin Peterson and I introduced H.R. 5, the "Senior Citizens' Freedom to Work Act of 1999," to eliminate the Social Security earnings penalty. Under current law, senior citizens age 65 through 69 can earn only $17,000 before they lose $1 in Social Security benefits for every $3 of earnings. This limit is unfair, outdated, and bad for our economy. The Social Security earnings penalty must be eliminated.

As we all know, our seniors have earned Social Security benefits through a lifetime of contributions to the program, and seniors are entitled, in my view, to their full benefits. It is their money. It doesn't belong to Washington, D.C. It should not be taken away from them just because they choose to work after their normal retirement age.

This Social Security earnings penalty is simply unfair, un-American, and plain wrong. CBO estimates that nearly 500,000 seniors who reach the normal retirement age will lose benefits because of the earnings penalty just this year. It discriminates against our senior citizens who must work in order to supplement their benefits, and that is just not right.

The earnings penalty is also outdated and bad for the economy. It is a Depression-era law whose time has long since come and gone. In the thirties, the earnings penalty was used to force seniors out of the work force. Today, with unemployment at record lows, seniors are needed in the work force.

The disincentive effect is magnified when viewed in light of other taxes. Senior citizens who work not only lose a large percentage of their Social Security benefits due to the Social Security earnings penalty, but they must continue to pay Social Security, Medicare, Federal tax, and State tax as well. Combined, the earnings penalty and these taxes force our seniors to face a total marginal tax rate as high as 80 percent in some cases.

In addition to being complicated and difficult for the individual senior citizen to understand, the Social Security earnings penalty is complex and costly for the Federal Government to administer. For example, the earnings penalty is responsible for more than one-half of the retirement and survivor program overpayments. Social Security estimates that administering it costs $150 million a year. Therefore, an earnings penalty repeal would help minimize the administrative expenses and help our seniors better understand their benefits.

I firmly believe that repealing the Social Security earnings penalty will aid our country's economy. Our senior citizens would be more likely to continue to work, and the American economy would benefit from their experience and skills. The combined increase in the amounts that they would pay in Social Security and other taxes, as well as the additional contribution to our gross national product, will quickly offset any temporary cost. In fact, according to the Social Security Administration actuaries, the repeal of the Social Security penalty will not affect Social Security's financial status over the long run.

Yesterday, the President agreed to sign this bill, and I am pleased that he has decided to help us remedy this blight on our Social Security system.

You know, I fought for freedom in two wars, and I believe that freedom entitles our seniors to the freedom to work without a penalty. America's seniors want, need, and deserve the repeal of this outmoded Social Security earnings penalty.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of Hon. Sam Johnson, a Representatives in Congress from the State of Texas

Mr. Chairman, last year, Collin Peterson and I introduced H.R. 5, the "Senior Citizens'; Freedom to Work Act of 1999." This legislation will eliminate the Social Security earnings penalty. Under current law, our senior citizens aged 65–69 can earn only $17,000 before they lose $1 in Social Security benefits for each additional $3 of earnings. This limit is unfair, outdated, and bad for our economy. The Social Security earnings penalty must be eliminated.

As we all know, our seniors have earned Social Security benefits through a lifetime of contributions to the program. Seniors are entitled to their full benefits. It's their money. It should not be taken away from them just because they choose to work after their normal retirement age.

This Social Security earnings penalty is simply unfair. CBO estimates that nearly 500,000 seniors who reach the normal retirement age will lose benefits because of the earnings penalty in 2000. It discriminates against our senior citizens who must work in order to supplement their benefits. That's just not right.

The earnings penalty is also outdated and bad for the economy. It is a Depression-era law whose time has long since come and gone. In the 1930's, the earnings limit was used to force seniors out of the workforce. Today, with unemployment at record lows, seniors are needed in the workforce.

The disincentive effect is magnified when viewed in light of other taxes. Senior citizens, who work, not only lose a large percentage of their Social Security benefits due to the Social Security earnings penalty, but they must also continue to pay Social Security, Medicare, federal taxes and probably state income taxes as well. Combined, the earnings penalty and these taxes force our seniors to face total marginal tax rates as high as 80%.

In addition to being complicated and difficult for the individual senior citizen to understand, the Social Security earnings penalty is complex and costly for the federal government to administer. For example, the earnings penalty is responsible for more than one-half of retirement and survivor program overpayments. SSA estimates that administering it costs $150 million a year. Therefore, an earnings penalty repeal would help minimize administrative expenses and help our seniors better understand their benefits.

I firmly believe that repealing the Social Security earnings penalty will aid our country's economy. Our senior citizens would be likely to work more and the American economy would benefit from their experience and skills. The combined increase in the amounts that they would pay in Social Security and other taxes, as well as the additional contribution to our Gross National Product, will quickly offset any temporary cost. In fact, according to the Social Security Administration's actuaries, the repeal of the earnings penalty will not affect Social Security's financial status over the long run.

Yesterday, the President agreed to sign this bill. I am pleased that he has decided to help us remedy this blight on our Social Security system.

I fought for freedom in two wars and, I believe that freedom entitles our seniors the ability to work without a penalty.America's seniors want, need and deserve the repeal of the Social Security earnings penalty.

Chairman SHAW. Thank you, Sam.

Collin.

STATEMENT OF HON. COLLIN C. PETERSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. PETERSON. Thank you, Mr. Chairman, and I want to thank you and the Subcommittee for inviting me to be with you today to go over this important issue.

The Social Security earnings limit is a law that America's seniors love to hate, and for good reason. About 1.4 million retirees lose part or all of their current Social Security payments each year because they earn more than this law allows. And you have all done a good job of pointing out how it works.

The earnings test, as you know, has been a part of the Social Security program since its inception. You know, with the backdrop of the Great Depression and unemployment, the rationale for this test probably made some sense. Social Security was viewed to protect worker from certain risks, specifically loss of income due to retirement. Therefore, their benefits were withheld from workers who made a significant income and reserved for those who actually retired.

Additionally, earnings limits were included to encourage retirees to leave the work force, making more jobs available to young people and to the unemployed.

However, today's economy bears no resemblance to the American economy of the mid20th century, and Social Security earning limits have outlived their time.

Mr. Chairman, I am here today to say in unequivocal terms that the earnings limits are a bad policy and should be repealed. H.R. 5, which eliminates the earnings limits for retired workers between 65 and 69 just makes good economic sense.

As I stated, today's economy is drastically different than when Social Security became law. For instance, currently American cities and rural areas alike are experiencing historic labor shortages, and that includes my district where, in spite of the fact that we have got a tremendous farm economic disaster, we have got shortages in all of our little cities. Seniors are living longer and are more skilled than in the past and could help this labor shortage significantly. However, as you know, this limit prevents or discourages a lot of seniors from playing a critical role in that economy.

In 1930, 54 percent of males continued working after 65, and in 1997, only 18 percent of senior males continued that work. And I think that is in large part because of this law.

When I asked the folks back home if repealing the Social Security earnings limit would help the economy in St. Cloud, Minnesota, in my district, Teresa Bowman, the president of the St. Cloud Chamber, responded with a resounding "yes." She added that the St. Cloud Chamber of Commerce views the work force shortage as the number one problem in their area, and they think H.R. 5 would be of significant help in providing them relief of that problem.

David Martin, who represents the Chamber of Commerce of Fargo-Moorhead, a community that is a bit more rural than St. Cloud up on the Minnesota-North Dakota, David also stressed the problems they are experiencing due to the labor shortage. Last year, according to a Newsweek article, the Fargo-Moorhead area had the highest labor shortage rate in the country. David said that the chamber of commerce is concerned that the tight labor pool will make it very difficult for their economy to grow, and he believes H.R. 5 would give their area and areas like it a big boost so their economy could continue to grow into the 21st century.

In addition to being sound economic policy, eliminating the Social Security earnings limit I think is a matter of fairness. Social Security benefits have been earned by a lifetime of work and contributions to this program, and I think seniors should expect that they should get those benefits when they retire.

Also, as Mr. Johnson pointed out, these seniors are paying some of the highest, maybe the highest marginal tax rates of any of our taxpayers, and that is something that clearly we should solve.

Last, I would like to talk about two other things that are not really in this bill, but I think I want considered by this Committee. One of them is kind of related to this. The IRS—and they have been kind of doing this ever since I was back practicing accounting and doing tax returns—have got an interpretation that if a farmer rents his land to somebody, to his son or neighbor, that they are considering that rent to be earned income, self-employment income. And when they audit some of these farmers, they are going in and making them pay self-employment tax on the farm rent, saying that they are significantly contributing to the decisionmaking and, therefore, you know, they are having earned income.

You can write it up any way you want, and they will come in and interpret that if you sit at the kitchen table and give your son advice, that triggers this all being self-employment income. So not only do they have to pay the 15.3 percent, they get tied up in this earnings limit problem because that then becomes earned income.

So I would like this Committee to look at that. I have co-sponsored a bill, introduced by Mr. Nussle, to address this issue. This is an interpretation that has been made by the IRS, and I think it is something that we ought to look at and correct because it is driving a lot of farmers crazy. And right now they do not need this kind of a hassle with all the other problems that they are having and they don't need to have to pay that extra tax. So I wish you would look at that.

Then, last—and this is not related to this bill either, but the National Federation for the Blind has talked to me, and I think to others, about that they have got some concerns with the earnings limit as it affects those folks. As I understand it, there is some revenue implication from that, but I think that is something else that we ought to look at because these folks, a lot of them are trying to work and be productive members of society, and we ought not penalize them the way we do either.

So thank you very much, Mr. Chairman. I hope that we can work together on this and have a successful outcome and all be at the White House someday at a signing ceremony.

Thank you.

Chairman SHAW. Thank you. Thank you both.

Do any of the members seek recognition for questioning? Mr. Collins?

Mr. COLLINS. Mr. Peterson, I would like for you to go back to the issue of the blind. What would you recommend in that area?

Mr. PETERSON. On the what?

Mr. COLLINS. What would you recommend the Congress do in the area of the blind and the earnings limit?

Mr. PETERSON. Well, if I had my way, I think I would take the earnings limit off.

Mr. COLLINS. Totally off? No ceiling, just totally off?

Mr. PETERSON. Let them work.

Mr. COLLINS. I am sorry?

Mr. PETERSON. I said let them work.

Mr. COLLINS. Yes, I understand.

Mr. PETERSON. But it would be costly. But I think, as Mr. Johnson said, these earnings limits create a lot of bureaucracy, a lot of complications in the system. That is one reason why it would be easier if you just took it off rather than try to adjust it up. You know, that would be my suggestion. But, you know, anything that we could do to improve it, of course, would be helpful.

Mr. COLLINS. Well, I have had some suggestions both ways, some to totally take it off and some to maybe still leave some type of ceiling in place where there would not be a cliff added that would stop.

Thank you.

Chairman SHAW. Mr. Matsui?

Mr. MATSUI. I just want to thank the panel for their testimony. Thank you.

Chairman SHAW. Did anyone seek recognition on the Republican side or the Democrat side?

[No response.]

Chairman SHAW. Well, I would like to thank you and, Collin, to comment on part of the issue that you raised with regard to parents handing down the business, the farming business to their youngsters.

Perhaps since we have the Commissioner here, we should question him with regard to that—you could take the same argument with regard to voting proxies. That doesn't make any sense at all.

Mr. PETERSON. Right.

Chairman SHAW. And, of course, as far as the earnings limit, that will become history at a very early date, I am hopeful. But I can tell you that if we can't get some satisfaction with regard to that problem, we will certainly look into it, because that is flat wrong.

As a father, I hope my kids do listen to me, and I have a lot of advice, as all fathers do. And I think that the ability to tap into our matured population to get advice as to how to run businesses and what to do from an economic standpoint is tremendously important and should never be discouraged. Because I have seen so many instances where kids have taken over businesses and run them right into the ground, and I think it is very important that their parents keep tabs on what is going on with the businesses that they helped to create. So our Committee will look into that.

Mr. PETERSON. Well, that would be great because I can tell you that this is driving the farmers crazy, and my old partners in my CPA firm, every time I talk to them, this is the number one thing they bring up. They do a lot of farm work, and, you know, if the IRS gets more auditors, this is going to be a bigger problem. The only thing that is saving them now is that they don't have enough people out there to audit enough people to catch them. But it is a big issue, and as I said, it is not a law that was passed by Congress. This is just an interpretation. They have been after this for a long time, but since 1996, they have really stepped up the effort to try to turn all of this rental income into self-employment.

Chairman SHAW. Well, you can tell your farmers that you got the attention of the Ways and Means Committee.

Mr. PETERSON. Great.

Chairman SHAW. Thank you both for testifying.

Chairman SHAW. Now we are pleased to invite our second witness, who is Hon. Kenneth Apfel, who is the Commissioner of the Social Security Administration, and, Commissioner, I would ask that as part of your remarks if you would comment on the point that Mr. Peterson made if you are prepared to do so. If not, you could come back to us in writing and make a note of his concern.

STATEMENT OF HON. KENNETH S. APFEL, COMMISSIONER OF SOCIAL SECURITY, SOCIAL SECURITY ADMINISTRATION

Mr. APFEL. Good morning, Mr. Chairman, Congressman Matsui, and Members of the Committee.

You indicated the importance of individuals listening to their parents. Well, I must tell you that my father told me, "Get rid of that earnings test." So I do listen to my father, and it is one of the reasons why I feel so strongly about eliminating the earnings test.

On the issue of the farm situation, I must say I was unaware of the entire issue, so we will have to respond to that in the record. I will be talking to the IRS about that because it is brand-new information to me.

To begin with, Mr. Chairman, the President's budget provides a framework for locking away the entire Social Security surplus each and every year. An estimated $1.7 trillion over the next 10 years, under Social Security Trustees' assumptions, would be devoted solely to improving the balance sheet of the Federal Government and strengthening Social Security.

The President's framework provides for transfers in years 2011 through 2050 of the interest savings that would result from setting aside the Social Security surpluses. Under Social Security actuary projections, these transfers would total $99 billion in 2011 and grow to $205 billion by 2016. The transfers would extend the solvency of the trust funds to about 2050.

Also, beginning in 2011, the framework calls for investing a sensible and measured proportion of the transfers in broad equity market indexes by private managers and not the government. This would further extend trust fund solvency to 2054, compared to the current projected date of 2034.

Solvency of Social Security is vitally important to the economic security of everybody, particularly older women.

In this regard, we need to be aware that Social Security reform proposals can have very different effects on the benefits received by women compared to men. Women tend to have lower lifetime earnings, work fewer years, and live longer in retirement than men. Elderly women often are more dependent on Social Security because they are less likely to have pensions and more likely to outlive assets. The specific issues faced by elderly women need to be addressed within the framework of Social Security reform.

Which brings me to the retirement earnings test. Under current law, for beneficiaries age 65 to 69 in 2000, benefits are reduced $1 for every $3 of earnings above $17,000 a year. For those between 62 and 65, benefits are reduced $1 for every $2 of earnings above $10,080 annually. Workers are exempt when they reach age 70, and delayed retirement credits are provided to compensate workers age 65 to 69 whose benefits are withheld under the RET.

The President has said that we should eliminate the retirement earnings test. The retirement earnings test is both confusing to beneficiaries and difficult to administer.

Eliminating the retirement earnings test could affect the choice of older workers regarding whether and how much to work. Although the benefit withholdings under the RET are roughly offset by higher benefits later on, many people perceive the retirement earnings test as a tax on their labor income.

Eliminating this perceived disincentive would have two effects: One, some people would choose to remain in the labor force or continue to work full-time because they would not face the same reduction in their current Social Security benefits; and, two, some people would choose to work less, making up for lower earnings with higher current Social Security benefits.

With a limited amount of evidence on the overall effect of the RET on labor supply, it is impossible to form a definitive conclusion. However, it seems very plausible that eliminating the retirement earnings test would lead to a modest increase in work activity.

And, additionally, widows of workers who retire before full benefit retirement age also get permanently reduced benefits. Thus, elimination of the retirement earnings test at 62 could negatively impact the number of elderly women living in poverty. And my written statement, which I would ask to be included in the record, goes into more detail on this point.

The Administration, therefore, believes that we can make a substantial downpayment on Social Security reform with two simple, clear bipartisan steps.

The first step is to pass a straightforward bill to repeal the retirement earnings test at the normal retirement age. If Congress sends the President a clean bill to repeal the retirement earnings test at the normal retirement age, with no extraneous, non-Social Security matters whatsoever, he will sign it.

The second simple step is for Congress to pass and send a bill to the President that would extend the solvency of Social Security to at least 2050 and include significant measures to reduce poverty among elderly women. The President has given Congress straightforward legislation that would simply assure that we devote the interest savings earned by paying down the publicly held debt to making Social Security stronger. By agreeing to this simple step, we can extend the life of Social Security to the middle of the next century.

Just as the administration and the Congress worked together to successfully tackle the economic challenges facing this Nation and put our fiscal house in order, we can also work together to eliminate the retirement earnings test in the right way. And I believe that we can work together to resolve the long-term Social Security solvency issues as well.

I will be happy to answer any questions the members may have at this time.

[The prepared statement and attachment follow:]

Statement of Hon. Kenneth S. Apfel, Commissioner of Social Security, Social Security Administration

Good morning, Mr. Chairman and Members of the Subcommittee. Thank you for inviting me to appear this morning to discuss issues related to the Social Security retirement earnings test (RET). First, I would like to discuss the President's framework for Social Security reform. Then, I will discuss another major concern of the Administration; the importance of Social Security to the economic well-being of elderly women and the need to improve their protection under the program. Finally, I will explain how the Social Security retirement earnings test has changed over the years and discuss the implications of eliminating the test.

The President believes that it is important to modernize the system by eliminating the outdated retirement earnings test at normal retirement age (NRA). The President would also like to work together to use the benefits of debt reduction to extend the solvency of Social Security to about 2050 and improve the effectiveness of Social Security in combating poverty among elderly women. He remains committed to working together with Congress on a bipartisan basis to enact reforms that make Social Security solvent for at least 75 years.

President's Budget Framework

Let me begin today by discussing the President's budget proposal as it pertains to Social Security reform. I strongly support the President's proposal. Maintaining fiscal discipline and paying down the debt gives us an historic opportunity to meet the challenges of the future. The President proposes to devote the Social Security surpluses to improving the balance sheet of the Federal government, and to transfer the resulting interest savings to the Social Security trust fund. In addition, his plan calls for investing a limited amount of the trust fund in equities as a prudent and workable solution for extending the life of the trust fund yet further into the future. This budget proposal is an important first step towards crafting a bipartisan agreement between the President and Congress that will keep faith with future generations of Americans.

As you know, the Social Security program faces a long-range deficit of 2.07 percent of taxable payroll under the intermediate assumptions of the 1999 Trustees Report. Because Social Security is fundamental to the economic well being of our aged population, ensuring the long-range solvency of the Social Security program must be one of our highest priorities. That is why the President's budget framework to preserve and strengthen Social Security is so very important. The President has proposed the following specific actions:

First, the President's framework provides for locking away the entire Social Security surplus each and every year. All Social Security surpluses, an estimated $1.7 trillion over the next 10 years under Social Security Trustees assumptions, would be devoted solely to improving the balance sheet of the Federal government and strengthening Social Security (under Administration assumptions, the Office of Management and Budget projects a $2.2 trillion Social Security surplus over 10 years). This framework will ensure that we achieve substantial public debt reduction, helping to prepare the government and the Nation for the retirement of the baby boomers.

The framework provides for the transfer of interest savings based on the cumulative amount of Social Security surpluses we actually experience over the next 15 years. The President's framework provides for transfers in years 2011 through 2050 to Social Security. The Social Security actuaries project that the interest savings that would result from setting aside the Social Security surpluses (assuming all the new resources are invested in government securities) would total $99 billion in 2011 and grow to $205 billion by 2016. Total transfers between 2011 and 2015 would be $690 billion. The transfers would extend the solvency of the trust funds until 2050.

Also, beginning in 2011, the framework calls for investing a sensible and measured proportion of the transfers in the equity market to achieve higher returns for Social Security. The equity investment would be limited to 50 percent of the cumulative transfer amounts, to the degree that these did not exceed 15 percent of the trust funds. The Social Security actuaries project that the Trust Fund's equity holdings would represent, on average, about 3 percent of the stock market over the 30-year period 2011–2040. Funds would be invested in broad market indexes by private managers, not the government. This would further extend the solvency of the trust funds to 2054, compared to the current projected exhaustion date of 2034.

Now is the time for action. If we act now, before there is a Social Security financing crisis, and while we enjoy the first budget surpluses in a generation, we can prevent a financing crisis from ever occurring. If we delay action for a generation, the size of the financing problem will grow. We have an historic window of opportunity to meet the challenge facing Social Security. . . and we must not let this opportunity slip away.

Importance of Social Security for Women

I now want to talk about the importance of Social Security in the economic security of women and why any comprehensive reform of Social Security must address the high incidence of poverty among elderly women.

For 60 years, Social Security has provided a solid floor of financial protection in the event of a worker's retirement, death, or disability. It has allowed the great majority of Americans to retire with the dignity that comes from financial independence, without fear of poverty or reliance on others.

No government program has had a more positive impact on the lives of older women than Social Security. There can be no doubt—Social Security is a vitally important element in the retirement income security of our sisters, our mothers, our grandmothers, and our great grandmothers.

The President is committed to helping elderly women, who typically have higher poverty rates than other elderly. On numerous occasions, the President has made it clear that he wants to address their situation as part of the effort to close the long-range deficit in Social Security. He has stated that "We should reduce poverty among elderly women who are nearly twice as likely to be poor as our other seniors."

Even though Social Security does a good job of keeping most elderly families above the poverty threshold, poverty rates vary greatly between different groups. For example, poverty rates are higher among nonmarried women than married women beneficiaries.

Only 5 percent of aged married women are poor; in contrast, 22 percent of divorced, 20 percent of never-married, and 18 percent of widowed women age 65 and older are poor.

> Widows account for the largest proportion (66 percent) of poor aged beneficiary women. There are 1.2 million aged widows who receive Social Security benefits and have incomes below the poverty line ($7,818 for an aged individual in 1998).

Social Security Reform and Women

We need to be aware that Social Security reform proposals can have very different effects on the benefits received by women compared to those received by men. These differences stem from the fact that, although Social Security program rules are gender neutral, individuals are affected differently because of their lifetime earnings patterns and life expectancies differ.

Women tend to have lower lifetime earnings and work fewer years in covered employment than men and, because of their longer life expectancies, will spend more time than men in retirement. Therefore, the possible differential effects of any proposed program changes on women need to be closely reviewed as we discuss the options and trade-offs of ways to ensure the solvency of Social Security.

Income security remains an elusive goal for many elderly women. This is why a comprehensive Social Security reform package must not only achieve solvency but include provisions to protect elderly women. Elderly women often are more dependent on Social Security because they are less likely to have pensions and sometimes outlive their assets. Almost three-quarters of Social Security beneficiaries over age 85 are women. It is essential that we work together in a bipartisan effort to ensure that they have the best protection that society can provide.

The Retirement Earnings Test

Now, I will discuss the issue of the retirement earnings test (RET). Let me begin by briefly reviewing the philosophy behind the earnings test and how that philosophy, and the test itself, have changed over the years.

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

The Social Security program has always had an earnings test. However, the "all-or-nothing" test in the original 1935 Social Security Act has been modified numerous times to allow retirees to supplement benefits with earnings up to a specified level. Even before the first benefits were paid in 1940, the test of retirement was modified so that a beneficiary could earn up to $14.99 in covered earnings before losing benefits for that month.

Since 1940, many other changes to the retirement earnings test have been made. 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 for the earnings test exempt amount to be increased automatically with increases in average wage levels. In 1983, the age at which the test no longer applies was lowered to 70. In 1990, 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 most recent change to the retirement earnings test occurred in 1996. With the strong support and leadership from the President, the annual exempt amounts for beneficiaries aged 65 to 69 was legislated to rise annually. This year the annual exempt amount is $17,000; in 2001, it will be $25,000, and by 2002, it will reach $30,000. This increase gives many older Americans the opportunity to supplement their Social Security benefits while remaining productive members of the workforce.

The Current Retirement Test

Under current law, for beneficiaries age 65–69 in 2000, benefits are reduced $1 for every $3 of earnings above $17,000 per year. For beneficiaries between the ages of 62 and 65, benefits are reduced $1 for every $2 of earnings above $10,080 per year. Unearned income, such as interest income, dividend payments, private pensions and the like, is not counted for purposes of the retirement earnings test.

In addition, workers are exempt from the test when they reach age 70. For a worker below age 70, his or her earnings above the exempt amount affect not only his or her own benefits, but also the benefits of family members receiving benefits on the worker's earnings record. However, if a dependent or survivor beneficiary has earnings above the exempt amount, those earnings can affect only that individual's payments.

Delayed retirement credits (DRCs) are provided to compensate workers age 65–69 whose benefits are withheld under the retirement earnings test. The DRC increases the worker's retirement benefit for each month that benefits are fully withheld after the full benefit retirement age, now age 65 but scheduled to rise to 67 by 2022. The DRC is currently 6-percent per year for workers age 65 in 2000. The DRC percentage will increase 0.5 percentage point every two years until it reaches 8 percent per year for workers reaching age 65 in 2008 and later. When the DRC is 8 percent per year, benefits lost due to the retirement earnings test and/or delayed retirement generally will be offset in an actuarially fair manner by the increase in benefits resulting from DRCs.

The present-law actuarial reduction provisions, in conjunction with the earnings test for workers aged 62-to 65, are designed to provide the early benefit claimant who works, on average, with the same total lifetime benefits as would be received if benefits had started at age 65. A person who files a Social Security claim before reaching the full benefit retirement age receives a reduced benefit. However, once the person reaches age 65, the benefit payment is adjusted upward to account for any benefit amounts withheld due to earnings prior to age 65. The effect of this procedure is that whenever a monthly check, otherwise payable to someone between 62 and 65, is partially or totally withheld under the earnings test, the amount "lost" is repaid, on average, over the course of the beneficiary's remaining lifetime beginning at 65.

In 1999, an estimated 1.2 million beneficiaries had some or all of their benefits withheld for some portion of the year under the earnings test due to work at age 62 or above. About 800,000 beneficiaries lost some or all of their benefits under the test as a result of their work at ages 65–69. The benefits of 150,000 auxiliary beneficiaries are also limited or withheld due to the earnings of the primary beneficiary. With respect to beneficiaries aged 62–64, about 230,000 working beneficiaries had all or part of their benefits withheld, and 25,000 auxiliary beneficiaries are affected.

Issues Associated with Eliminating the Retirement Earnings Test

As I indicated earlier, the President has said that we should eliminate the retirement earnings test. However, an important issue is whether the RET should be eliminated at age 62 or at the normal retirement age, currently age 65, scheduled to gradually rise to 67. (For example, workers born in 1938 and eligible for early retirement at age 62 this year, have a normal retirement age of 65 and two months.) This issue involves important trade-offs. On one hand, the RET is confusing to beneficiaries, and probably reduces their work effort to some degree. It is also difficult to administer. Eliminating the test would end these problems. On the other hand, eliminating the RET at age 62, by itself with no other changes, would likely increase poverty for many older beneficiaries—particularly elderly women—and would increase the long-range program deficit by a small, but measurable amount. Eliminating the test at the normal retirement age would have a negligible impact on poverty for older beneficiaries and would not result in a long-range program cost. Let me elaborate on these points.

Eliminating the RET could have an effect on the choice of older Americans of whether and how much to work. Although the benefit witholdings under the RET are roughly offset by higher benefits later on, many people perceive the RET as a tax on their labor income. Eliminating this perceived disincentive would have two effects: (1) some people would choose to remain in the workforce or to continue to work full-time because they would not face the same reduction in their current Social Security benefits; and (2) some people would choose to work less, making up for lower earnings with higher current Social Security benefits.

There is only a limited amount of evidence on the overall effect of the RET on labor supply and it is impossible to form a definitive conclusion. It does, however, seem plausible that eliminating the RET would lead to a modest increase in work activity, an assumption that is reflected in the Social Security actuaries' estimates of the impact of eliminating the RET on Social Security solvency.

Eliminating the RET below the normal retirement age might also change the risks that older Americans face down the road. Eliminating the earnings test would result in more workers electing to receive benefits as soon as they become eligible (about 60 percent of workers already claim benefits at age 62). The decision to claim benefits earlier reduces these individuals' monthly Social Security benefits. The lower benefit is intended to be actuarially fair so that, over their lifetimes, beneficiaries receive, on average, the same total benefits. However, many people do not perceive that these benefits are paid back to them over their lifetime. Once beneficiaries who claimed reduced benefits stop working, they may not have sufficient outside resources to offset this reduction in Social Security benefits.

And I want to emphasize this point: the widow(er)s of workers who retire before full benefit retirement age also get permanently reduced benefits due to the worker decision to retire early. Thus, elimination of the RET at 62 could also have a negative impact on the number of elderly women living in poverty in the future. The poverty impact of eliminating the RET between age 62 and the NRA is dependent on changes in filing behavior and changes in work/retirement decisions, and cannot be predicted exactly.

At present, most women who have ever been married ultimately receive benefits based on their deceased husband's earnings record. Age reductions in the deceased worker's benefit are generally passed on to the widow(er)'s benefit. Thus the worker's decision to take benefits at 62 would result in lower, perhaps inadequate, benefits for his survivor many years later. A very likely consequence of eliminating the earnings test for those below NRA, if no other changes were made, would be an increase in the number of elderly widows who are poor.

The Administration believes that the best policy is to eliminate the earnings test at NRA. Eliminating the RET at age 62 raises serious concerns about increasing poverty among elderly women, and we would not want to consider it without at least making sizeable changes to the program to mitigate these deleterious effects.

Next Steps

The Administration believes that we can make a substantial down payment on Social Security reform with two simple, clear bipartisan steps:

The first step is to pass a straightforward bill to repeal the RET. If Congress sends the President a clean bill to repeal the RET at NRA, with no extraneous, non-Social Security matters whatsoever, he will sign it.

The second simple step is for Congress to pass and send a bill to the President that would extend the solvency of Social Security to about 2050 and include significant measures to reduce poverty among elderly women. The President has given Congress straightforward legislation that would simply ensure that we devote the interest savings earned by paying down the publicly-held debt to making Social Security stronger. By agreeing to this simple step, we can extend the life of Social Security to the middle of the next century.

Conclusion

The President has shown strong leadership in providing a framework for preserving the financial well-being of the Social Security program. If adopted, this framework would take us a long way towards closing the long-range actuarial gap of 2.07 percent of taxable payroll. It gives us a solid foundation on which to preserve our social insurance program throughout this century. And it does much more: President Clinton's approach would pay down the publicly held debt, thereby increasing national savings and promoting economic growth, which will reduce burdens on future generations.

Just as the Administration and the Congress worked together successfully to tackle the economic challenges facing this nation and put our fiscal house in order, we can also work together to eliminate the RET in the right way. And I believe that we can work together to resolve the long-term Social Security solvency issues as well. We have an opportunity that we could not have imagined just a few years ago. We can begin to deal with the future, and address long-term generational challenges. We must seize this moment and focus on strengthening and protecting the Social Security system for future generations of Americans.

I will be happy to answer any questions the Members may have.

Treatment of Self-Employment Income for Farmer Landlords

Present Law:

The Internal Revenue Code and the Social Security Act provide that rental income from real estate shall be excluded from net earnings from self employment (NESE) unless it is income (1) derived under an "arrangement" (between the owner and another individual) that provides that such other individual shall produce agricultural or horticultural products on the land *AND* (2) that there be material participation by the owner in the production of these products, and that such participation actually occurs.

Background:

- In 1954, the Social Security Act first covered self-employed farmers but rental income from crop shares was excluded. In 1956, Congress included the "material participation" exception to the exclusion of real estate rental income, so that such rental income would become NESE if the owner participated in a substantial way in the farm activities.

- The elements for material participation were set forth in the 1956 Senate report and are still used in making determinations as to the landowner's participation. Material participation is met only if the owner performs at least 3 of the following:

 Periodically advises and consults with his/her tenants;
 Periodically inspects the production activities;
 Furnishes a substantial portion of the machinery, equipment and livestock; or
 Assumes responsibility for a substantial portion of the production expenses.

Issue:

- Representative Peterson's earlier remarks reference a bill, which he supports, that was introduced by Representative Nussle (H.R. 1044). This bill would exclude certain farm rental income from NESE if the taxpayer enters into a "lease agreement" relating to such income that is silent on the question of material participation.

 In the statement Representative Nussle made when he introduced H.R. 1044, he expressed concern that "IRS is using a 1995 Tax Court Ruling and one of its own nonbinding memorandums to make a farmer liable for SE tax on income derived from an arrangement between the tenant farmer and his landlord. That means that IRS is levying the SE tax not only on the cash rental income from the land, but also on any partnership or corporation a farmer has established to manage the farm with their spouse, children or other relatives."

- The treatment of rental income in these cases is consistent with its treatment in other cases—that is, income is subject to SECA tax only if it is derived in the course of a person's trade or business. That is why rental income is generally not subject to Social Security tax. However, if the person does more than merely rent the land—if the person materially participates in the farming activity—then the income is subject to SECA tax.
- Representative Nussle's bill would reduce the amount of NESE that certain farmers would report—provided they have a lease agreement that is silent regarding material participation of the farmer. From a Social Security coverage standpoint, the effect would be lower taxable earnings, which in turn would decrease the amount of Social Security benefits payable to the farmer and his/her dependents.

Chairman SHAW. Mr. Johnson, do you have any questions?

Mr. JOHNSON. Maybe one. Thank you, Mr. Chairman.

Good morning. Thanks for being here.

Mr. APFEL. Good morning.

Mr. JOHNSON. We are glad you support this. I know you have a relative that was affected by this from what we read from last year.

Mr. APFEL. That is correct.

Mr. JOHNSON. And I think that this is an important step in making the Social Security Administration easier for you to operate, maybe. Would you care to comment on that?

Mr. APFEL. Yes. I think that repeal of the retirement earnings test would simplify the program administratively for the Social Security Administration and also simplify the program for individuals who are already receiving benefits.

There is a lot of misunderstanding about the Social Security retirement earnings test and its implications over the long term for individuals. So eliminating the retirement earnings test would make it simpler for beneficiaries to be able to continue to work.

Mr. JOHNSON. Yes, but you have had some overpayments as a result of that, haven't you?

Mr. APFEL. Yes.

Mr. JOHNSON. What is the cost of that?

Mr. APFEL. I was going to continue to point that out. Administratively, it costs us somewhere in the vicinity of 1,500 workyears each year to administer the retirement earnings test for working beneficiaries age 62–69. We also have overpayments of about $780 million a year. These overpayments occur because we learn about the accurate amounts of earnings after the fact, so there is always a lot of administrative work that needs to be done. Eliminating the retirement earnings test at the normal retirement age would eliminate the vast amount of that work for us. So it would simplify the administration of the program and I think simplify it for the American public as well.

Mr. JOHNSON. Does that mean you can downsize your agency?

Mr. APFEL. Well, Mr. Chairman, I——

[Laughter.]

Mr. APFEL. Mr. Johnson, I would say the answer to that is no. The Social Security Administration faces enormous pressures, particularly as we look to the long-term future and the retirement of the baby-boom generation. There are areas that we could improve service delivery if we had more resources. If we could free up 1,000 work years from administering the RET for those age 65–69, we could provide better service to the American public with that activity, which I think would be very important to do.

Mr. JOHNSON. Eliminate the backlog, right?

Mr. APFEL. Pardon me, sir?

Mr. JOHNSON. Eliminate the backlog?

Mr. APFEL. That is what we are aiming toward doing, and we would be able to do more activities both in disability but also in our field offices.

Mr. JOHNSON. Good for you.

Thank you, Mr. Chairman.

Chairman SHAW. Mr. Matsui?

Mr. MATSUI. Thank you, Mr. Chairman.

Thank you very much, Mr. Apfel, for your testimony. If we eliminate the earnings test for seniors—and I am venturing out here, and maybe I am getting into an area I shouldn't. But I would imagine you are going to have to coordinate more with the Internal Revenue Service—obviously there is a privacy issue—because there will be perhaps—people who now might be avoiding their earnings test by receiving cash and other forms of income. And it is my hope that you coordinate with Mr. Rossotti and others in the Service and Treasury Department because there may be some way then to recapture some of that lost income in terms of within the stream of total GDP in the economy, and obviously the implications in terms of tax collection and making sure that average citizens who pay their taxes don't get penalized because others avoid the system.

I think that is an issue we really have to get into, and I know the Service right now is going through some—they don't know whether they are a customer service agency or collection agency, and they think they can do both, which hopefully they will be able to do. But I would hope that there is some level of coordination there. I have to believe there is a lot of avoidance going on because of that earnings test.

Second, I understand that there is a revenue implication for the first 5 or 10 years of $23 billion—10 years, I believe; is that correct? Or 5 years?

Mr. APFEL. Eliminating the retirement earnings test at the normal retirement age would cost $17 billion over the first 5 years and $26 billion over the 10 years. But I should point——

Mr. MATSUI. Well, let me ask you, this delayed retirement credit which they receive when they retire to make up for the amount that they have been paying in under the earnings test, a lot of folks don't even know about that. My father didn't know about that.

Mr. APFEL. Neither did mine.

Mr. MATSUI. Yes. Had he known about it, he might have just said, no, keep the same income level, I will continue the same hours, and then obviously when he reached 70, he would have been able to collect significantly more benefits.

But it is my understanding that after a period of time, this proposal essentially, because you will eliminate the delayed retirement credit, will be revenue neutral. Is that correct?

Mr. APFEL. It is roughly revenue neutral over the long term. If we go back to the last time that we raised the retirement earnings test age, we were dealing at that point in time within the context of needing short-term offsets for those added costs. In other words, there were changes made to Social Security to make it budget neutral in the short term, and we don't need to do that now given the change in the fiscal picture. But it is also very important, Mr. Matsui, that the cost in the long term is negligible. It is virtually zero. Because of the changes to the delayed retirement credit, an individual will receive basically the same total lifetime benefits and the system will receive the same amount of resources over the long term, and it does not have a negative impact on Social Security's solvency.

Mr. MATSUI. And I appreciate that comment. Just so that everyone really understands that, this is not an issue of taking from the general account or even from the Social Security money that will be walled off, because essentially this is a revenue-neutral proposal over the life that we are talking about in terms of dealing with the solvency issue of Social Security. Is that correct?

Mr. APFEL. That is absolutely correct, Mr. Matsui.

Mr. MATSUI. Thank you.

Let me ask one more question, Mr. Chairman. I don't want to take too much time. There is a long schedule today. But in terms of the issue of the blind and other disabled receiving SSI disability benefits, they were decoupled—or at least the blind were decoupled in the mid-nineties. They are still receiving at $14,000 and not at $17,000.

Is there a way—and I ask this question sincerely because I think it is a legitimate issue that those that have concerns about the issue of moving the blind up from $14,000 to $17,000, it is a legitimate issue, but what about the other disabled that are in the work force? How would one distinguish that and treat the blind separately than the other disabled? Do you have a response to that?

Mr. APFEL. Well, yes, under current law we have two different income thresholds—one for the disabled and one for the blind. The blind receive a higher income threshold before their benefits are reduced than other disabled individuals on the disability rolls. And one of the issues is whether the income that a person on disability can receive from outside sources, from work, could be higher before losing their Social Security benefits. A separate issue is whether the blind should be able to work more without losing their Social Security benefits.

Both of those issues do have long-term and short-term costs associated with them. I know that eliminating the level of substantial gainful employment for the blind would cost $2.5 billion over 5 years, and it would reduce the long-term solvency of Social Security.

So I think within the context of looking at an overall long-term solvency package, I think these are options that need to be considered, but they do have long-term costs to the system.

Mr. MATSUI. Thank you.

Thank you, Mr. Chairman.

Chairman SHAW. Mr. Collins?

Mr. COLLINS. Thank you, Mr. Chairman.

Commissioner, I found with interest that you said you have about 1,200 staff that deal with the earnings limit?

Mr. APFEL. About 1,000 have to administer the RET provision for those age 65–69, that is correct.

Mr. COLLINS. Then you followed that up saying if we could free up 800 of them. What would you do with the other 400?

Mr. APFEL. The other roughly 500, these are estimates—are involved in administering the retirement earnings test for those age 62 through 64. Remember there are two retirement earnings tests, and the proposal before us, which I strongly support, is to eliminate the retirement earnings test at the normal retirement age. We would still have administrative implications for those age 62 through 64 where we have a separate retirement earnings test and one that eliminating would have a significant poverty impact, I might point out. So those other 500 people, somewhere in that vicinity, would be working on the retirement earnings test for those age 62 through 64.

Mr. COLLINS. Well, I appreciate your explaining that. We had a hearing last week and had a report on the future needs of the Social Security Administration and how you are going to handle the influx of those of us who were born during or right after World War II, because there are a lot of us. And it was brought up, too, in that same hearing that—maybe it was in the 103d Congress—we passed the independent act dealing with the Social Security agency and that there was to be a report in 2 years on the work force analysis by the administration.

I think you need to follow up on that because, if I remember correctly, we have not received that report, and that would help explain a lot of the needs and also the question that I just asked you about the difference in the 1,200 and the 800 or the 400 or the 300, or whatever it is. You know, we seem to be kind of scrambling for the number there.

So I think it would be helpful if you would follow up on that work force analysis report that was supposed to have been submitted about 3 or 4 years ago, and we need to take a look at that based on the fact of the needs of Social Security and how you are going to handle the baby boomers.

Mr. APFEL. Well, Mr. Collins, I am unaware of a requirement for a time-certain specific report, but I will say we need to do just what you just said. We are in the process of developing a long-term framework as well as what the implications are for our work force over the medium term.

I will be testifying, I would assume, within the next week or two on that, and I will provide more details at that time. But overall we clearly have sizable long-term challenges that we face as an agency as the baby boomers retire and as the baby boomers enter the disability-prone years of their fifties. So, clearly, dealing with this issue now is the right thing to do, and we will provide more detail.

Mr. COLLINS. Well, as they went through some of the problems that exist today, current problems, and how those current problems are going to escalate over the next few years, I mean, it was just as plain as the nose on your face it is a people problem. You know, a lot of people recognize that, and the management at Social Security needs to also recognize that and work with the Congress and give us some reports on it.

We thank you. Thank you for your work.

Mr. APFEL. Thank you, Mr. Collins. And I would point out that it is not only a people problem, it is also an automation problem. It seems to me that the two areas that are going to take a tremendous amount of work in the course of the next 3 to 4 years is the retirement of our own work force as well as the importance of moving aggressively in the automation area so that we are able to deal with these added workload challenges in the long term. I think those are the two critical issues that I will be coming before the Committee on in the future.

Mr. COLLINS. Good. Thank you.

Chairman SHAW. Mr. Tanner?

Mr. TANNER. Thank you, Mr. Chairman.

Commissioner, I just have one question, and I will be brief. I think Mr. Matsui touched on it, but since this proposal is one that moves the timing of the effect the law has on the Social Security benefits across the board, this proposal does not have an adverse effect on the solvency of the Social Security system. Am I correct in that?

Mr. APFEL. That is correct, Mr. Tanner.

Mr. TANNER. Thank you, Mr. Chairman. I told you I would be brief. Thank you.

Chairman SHAW. Thank you.

Mr. Hayworth.

Mr. HAYWORTH. Thank you, Mr. Chairman. And I would like to thank my friend from Texas for introducing this legislation. It is something we have been talking about for a long time, and I am pleased to be a cosponsor of this bill. And I, too, have heard from the homefront, from my folks and others in the community concerned about what is patently unfair to people who remain productive members of society, much valued, much honored members of the work force, and I believe it is imperative that we eliminate this earnings limit for all working seniors.

But I would like to highlight the importance of this legislation for small businesses and self-employed seniors. The Social Security earnings limit hits small business really on both ends:

First, when labor is in such short supply, the earnings limit restricts the abilities of a small business to acquire and retain qualified workers. It discourages qualified seniors from either seeking employment or from working additional hours once they reach the statutory caps. Finding qualified help ranks with rising health insurance costs as the most difficult challenges facing small business owners today. It seems to me that Federal laws should encourage work and productivity, not discourage it.

Second, many seniors are self-employed and are subject to both the dollar caps under the earnings limit and a more subjective and invasive self-employment test. This substantial services test audits self-employed workers to determine how many hours they work each month, the type of work they do, the depth of their business involvement, and other subjective factors designed to determine the value of their work.

If they run up against either the wage caps or the self-employment restrictions, well, then, their Social Security benefits are reduced or eliminated.

In other words, small business owners face an earnings limit squeeze. The situation is made worse when you consider that self-employed workers pay a higher rate into Social Security than do other workers. They pay more into the system, they face a more stringent limit, and they endure a worker squeeze.

I want to make sure that this legislation addresses self-employed seniors. Sir, does the current language in this legislation apply to self-employed seniors of full retirement age so their benefits will no longer be reduced due to their earnings?

Mr. APFEL. Yes.

Mr. HAYWORTH. That is good to know, and I am glad we have it in the record, and it comes as good news for so many seniors in the 6th District of Arizona and across America who are working hard. And I thank you for that brief answer, and, Mr. Chairman, I thank you for the time.

Chairman SHAW. Mr. Hulshof?

Mr. HULSHOF. Thank you, Mr. Chairman.

Mr. Apfel, welcome. I think, as you can sense from the questions, there is a lot of unanimity regarding the repeal of the earnings limit, and I, too, am proud to be a cosponsor of Mr. Johnson's bill.

Essentially, I think it is useful, especially as Mr. Hayworth mentioned those town meetings back home, it is useful to remind folks that Social Security was not intended to be a welfare program; that you pay into the system, you play by the rules, you know, that you are entitled to get out of that system what you put in. And yet because of the earnings limit, what the system is telling seniors is that it is OK if you are semi-retired, if you have a low-paying job, or if you work part-time, but if you use those skills that you have used a lifetime to develop, look out because your benefits are going to be reduced. And so I think, you know, this is clearly the right step forward, very much like this Subcommittee took in the Ticket to Work and work incentives program, again, looking for ways to remove those barriers, those disincentives that hinder people from returning to work because we want them all to be productive.

Along that vein, Mr. Commissioner, I want to follow up on what Mr. Matsui inquired of and maybe where there is a little more difficulty in the issue, and that is regarding the blind and the non-blind disabled. I guess first I want to ask you regarding the disability benefits, what is substantial gain activity?

Mr. APFEL. Well, under regulations that existed before I became Commissioner, an individual could earn up to $500 a month before losing their benefits, and we changed that through regulation to $700 a month, a very significant increase, to enable individuals to continue to work more before they started losing their benefits, as a greater incentive to work. I think it was a very important change, and it is one that we should maybe even do more on in the future.

Mr. HULSHOF. But specifically regarding the population of disabled, is that right?

Mr. APFEL. Yes, that is the overall disabled population.

There is a separate—and I don't have the specific number; I will provide that for the record. For the blind, there is an SGA limit as well that is higher than it is for the other disabled population.

Mr. HULSHOF. And, if you would, Mr. Apfel——

Mr. APFEL. For the blind, it is $1,170 a month.

Mr. HULSHOF. Thank you.

Mr. APFEL. It is $700 a month for the non-blind disabled.

Mr. HULSHOF. OK. And, if you would, could you contrast that definition you have just given on substantial gain activity and how that differs from the earnings limit that we are discussing here today?

Mr. APFEL. Well, the earnings limit, again, applies to the retired population, not the disabled population, and under current law the level of $17,000 in 2000 is somewhat higher than it is for the blind which is applied on a monthly basis. The RET is on an annual basis, $17,000 for those age 65–69 in 2000. And the proposal before this Committee that we strongly support would eliminate the earnings test entirely for those individuals above the normal retirement age.

Mr. HULSHOF. Mr. Apfel, you have already indicated that the way the system is presently, the blind beneficiaries qualify, I guess, for higher income thresholds that non-blind disability beneficiaries do not receive. Are there any other benefits that blind beneficiaries receive that the non-blind do not other than that income?

Mr. APFEL. I am unaware—in the title II Social Security program, I believe that is the only special work incentive all blind beneficiaries receive. It is a higher level of earnings that is available to the blind than for the non-blind disabled. There are other work incentives that apply to blind SSI beneficiaries

Mr. HULSHOF. A question that I have had, and I have asked constituents of mine, blind constituents, the Americans with Disabilities Act—I was not here then, either, Mr. Apfel, when the ADA was passed. But didn't the ADA essentially say that we want to treat all those with disabilities the same? And is this something that squares with or doesn't square with what we have been talking about as far as the higher income thresholds?

Mr. APFEL. I think the ADA was aimed at ensuring those with disabilities' entry into the labor force, and I support there being a higher threshold of income for the blind disabled than for all disabled. I think it would be a mistake to roll back the differential so that the blind would receive the same threshold as all disabled. I think that it is appropriate to have a separate and a higher threshold for the blind. And I don't think that is inconsistent with the ADA.

Mr. HULSHOF. Well, let me ask a final question if the chairman will indulge me, probably the toughest question. What are your views on re-linking blind substantial gainful activity with the age 65 and older earnings limit?

Mr. APFEL. If we link it back up to the age 65—to the normal retirement age, it would eliminate the threshold entirely. Such an impact would cost about $7 billion over 10 years, and it would lead to lower long-term solvency in Social Security.

The difference between the proposal that is before this Committee for those at normal retirement age and the blind is that the normal retirement age elimination has a negligible impact on the long-term solvency of Social Security. If we link the blind or the disabled groups to this, it would have a long-term cost. So I think we would have to view that within the context of a broader reform endeavor to be able to look at those issues.

Mr. HULSHOF. So I guess the answer—I understand the implications of re-linking as far as the budgetary impact, but do I take it from your answer that you don't have a position as to re-linking? I understand the consequences, but——

Mr. APFEL. Well, I think that within the context of this piece of legislation, which is a straightforward piece of legislation that has a negligible cost to the Social Security system over the long term, that is the right way to go at this time.

If we are going to address the long-term solvency issue, I think these are very legitimate issues to be viewed within that context. But because they do have costs—also, if we look at, say, widow poverty, there is a tremendously compelling need to be able to do something, but it has cost to the system. We are not here today to add a widow poverty proposal into this legislation because it would have that long-term cost.

Mr. HULSHOF. Right.

Mr. APFEL. So what we ought to do is view that issue of the blind and the disabled within the context of the broader reform endeavors.

Mr. HULSHOF. Thank you, Mr. Apfel.

Mr. Chairman, thanks for the additional minute or so.

Chairman SHAW. Just very briefly, you and I have worked together, and I think we have had a very good relationship since you have become Commissioner and I have become chairman. And looking at the complexity of the Code and the regulations—and it is interesting to watch these questions evolve as to the complexity of the regulations. And then you compound that by seeing that seniors are confronted with this and trying to figure out what they are doing. I noticed your answer with regard to what is going to happen to the 1,200 employees, in reply to Mr. Johnson's question. I would preface this by saying that the Congress has carved out your agency as an independent agency to try to depoliticize as much as we possibly could. And I think it is paying off. Obviously we have disagreements on some things, and you certainly have a certain allegiance to the President who made your appointment. But I think our working relationship has been very good.

But talking about the complexity of the Code the way it is, how many pages are there in the regulations that you work with?

Mr. APFEL. Our Social Security regulations?

Chairman SHAW. Does anybody have that answer? I understand it is about that thick.

Mr. APFEL. There are a lot—about 1,000 pages. There are lots—one of the issues here is that the Social Security law is quite a complex law, and benefits are very tightly prescribed by law. And, clearly, there is a lot of need for very detailed regulations to carry out those laws, particularly in the area of disability. So it is a very large document. And our interpretations of those are even larger.

Chairman SHAW. I think that the Members certainly up here realize this, but the Commissioner's term may transcend to whoever the next President is. It is not a question of your dropping off the edge of the Earth with the end of the administration.

Mr. APFEL. Well, actually, my particular term as Commissioner ends in 1 year. The next Commissioner, whether that be me or someone else, has a 6-year term that does go beyond individual Presidencies. The next Commissioner, whoever that may be, if serving their full term, will serve two—could serve potentially two different Presidents from two different parties.

Chairman SHAW. The independence of your agency and the definition of the Commissioner's term—in your opinion, what effect does that have as far as your getting involved in the political struggle that certainly is going to take a lot of our time between now and November?

Mr. APFEL. Well, one of the important aspects of the Social Security independence legislation was the creation of a 6-year term within Social Security, so Commissioners serve across Presidential terms. Because of that, I think it is inappropriate for the Commissioner to engage in direct political activities or to endorse individual political candidates. I think it is important to keep that degree of separateness from the political process.

At the same time, that does not mean that the Commissioner of Social Security should not be voicing his views on the appropriateness of certain policy actions that relate to Social Security.

Chairman SHAW. I understand that.

Mr. APFEL. So if there was a proposal to fully privatize the Social Security system, I would say that I think that would be wrong for the country, a wrong step for the country. But I do think it is important for the commissionership and the agency that the Commissioner not engage in direct political activities or endorse candidates.

Chairman SHAW. I would like to work with you and your staff to try to simplify that code. In looking at this and seeing the complexity of what we were dealing with, it is very difficult to understand exactly all the complexities, and I am sure that the fact that you have to have such long regulations would certainly say that the present code is up to some interpretation which is not the best way to go.

So perhaps, with your good office and our staff here on Ways and Means, we can work to try to take a step which is going to take us a long time in order to simplify the entire code.

Mr. APFEL. We will be looking forward to working with you, Mr. Chairman, in those endeavors to try to simplify the program.

Chairman SHAW. OK. Thank you.

Mr. Doggett.

Mr. DOGGETT. Commissioner, I support this legislation, but like you, I am disappointed that it is not part of a broader reform package, and I have a few questions about that.

On December 15 of this past year, just a couple months ago, Speaker Hastert and Majority Leader Dick Armey wrote the President and asked him to "lock away 100 percent of the Social Security surplus in your 2001 budget proposal and commit those surplus funds to reducing the national debt."

Now, this bill conflicts and is contradictory with that letter of 2 months ago, isn't it?

Mr. JOHNSON. Will the gentleman yield?

Mr. DOGGETT. I will as soon as I get the Commissioner's response as to whether this bill conflicts with the request that we "lock away 100 percent of the Social Security surplus in your 2001 budget and commit those funds to reducing the national debt."

Mr. APFEL. Mr. Doggett, the costs of this are costs to the Social Security trust fund, so part of the Social Security surpluses would be, in the short term, used to pay for the short term costs of this legislation.

I would point out that all of those costs come back to the Social Security system over the life of the program.

Mr. DOGGETT. Sure, and I understand your testimony to be that over 75 years it is neutral. But whether it is neutral or plus or minus——

Mr. APFEL. It is a minus for about twenty-eight years.

Mr. DOGGETT [continuing]. It is inconsistent with and contradictory of the request made by the Republican leadership within the last 2 months, that instead of using it to put more money in the pockets of Social Security recipients, we should, as they say, commit 100 percent—"lock away 100 percent" is their words—of the Social Security surplus and use it all to pay down the debt. This doesn't do that, does it?

Chairman SHAW. Would the gentleman yield?

Mr. DOGGETT. As soon as I get the answers, I will be glad to yield and within the limits of my time.

Mr. APFEL. Mr. Doggett, it is true that this would reduce in the short term the amount of Social Security surpluses, and if we did not get back that money in the long term to the system, it would fully violate the notion of reserving all that money. But because it does come back to Social Security over the long term so that it is a negligible cost over the long term, I think it lives within——

Mr. DOGGETT. And I understand that goal as far as to save Social Security first is an appropriate conclusion, and as I said, I support the bill. But it does not use 100 percent of the money to pay down the national debt, does it? It is inconsistent with that statement.

Mr. APFEL. It does not use 100 percent to pay down the debt in the short term. That is correct.

Mr. DOGGETT. And——

Mr. APFEL. But in the long term, it does.

Mr. DOGGETT. OK. And with reference to the overall issue of how we address reform and what our priorities are, we have among our retiree population a wide range of individuals in terms of their health and in terms of their wealth, do we not?

Mr. APFEL. Yes, we do, sir.

Mr. DOGGETT. Some are single women who are not in very good health and millions who rely on essentially nothing but their Social Security check to get by.

Mr. APFEL. That is absolutely the case.

Mr. DOGGETT. And some are—fortunately, an increasing number—relatively healthy, especially in their early ages, and they are able to be much more productive and be involved in the work force.

Mr. APFEL. Very much so.

Mr. DOGGETT. And as far as which group this particular part of the reform helps, while it is a desirable reform, basically this is an approach of beginning the reform to help from the top and work down whether than to begin at the bottom and work up, isn't it?

Mr. APFEL. Well, I think it is a very important question, and I would like to spend a minute answering that because I think it is a very, very important question.

Does the elimination of the retirement earnings test affect different income groups differently? And the answer is yes. In the short term, those in the top quintile of income would receive added resources in the short term from such a repeal.

Over the long term, it has no differential impact because individuals that receive their Social Security benefits because of RET elimination will receive lower Social Security benefits later in life and the same total benefits over their lifetime. So while it is true in the short term that it affects upper-income elderly positively, in the long term it has zero impact on the elderly at the upper-income.

I would also point out, because I think it is an important part of this, that if we look beyond the repeal at the normal retirement age and look to repeal earlier, say at 62, which is one of the other proposals, that would have a very significant differential and a major poverty impact.

If we repeal the retirement earnings test at age 62, we don't know how many people would change their behavior, would file for benefits earlier. If all persons over age 62 had started filing at age 62 for benefits, upward of 700,000 additional people would have been put in poverty for 1993 because their benefits would have been lower for subsequent years. So if no one changed their behavior, the effect would be zero. But we believe that somewhere in between those two extremes of zero to 700,000 would be the poverty effect of changing the retirement earnings test at age 62. For cost purposes, the actuaries assume that about half of the people would change their behavior, which corresponds to about 350,000 additional people moving into poverty.

I think this is a very critical point. Eliminating the retirement earnings test at age 62, which this legislation does not do, would have a sizable poverty impact. It is not clear exactly how much it would be, but the only way to deal with this issue would be in the context of women.

You asked about women. About three-quarters of the people who would be affected negatively by being put into poverty due to RET elimination at 62 would be women, and about half are widows. So, clearly, there would be a sizable poverty impact from eliminating the RET at 62. It is a negligible poverty implication at age 65 and at the normal retirement age.

But, again, the last point, to go back to the first one, there is a short-term benefit for those at the highest quintile over the course of the first few years, but because of the delayed retirement credit and the loss of the delayed retirement credit when benefits are paid, it has a zero impact on benefit income over a lifetime for those at the top.

Mr. DOGGETT. Mr. Chairman, may I ask just one more question?

Chairman SHAW. One more, and then we will move on.

Mr. DOGGETT. Many commentators looking at the long-term Social Security solvency issue have emphasized how painful it may be to resolve that hard choices will have to be made, and they have raised a variety of alternatives about how to minimize the hurt.

Doesn't beginning at this place in terms of Social Security reform where you actually put more money in the pockets of some Social Security recipients, as desirable as that may be, represent kind of an eat-dessert-first approach to reform?

Mr. APFEL. Mr. Doggett, I would certainly prefer and I think many would prefer that we were dealing with the entire universe of reforms to ensure Social Security's long-term solvency. That hasn't been easy, and I have little scars that have come through that process, and we continue to work for it.

I would have serious reservations if the long-term costs of this proposal were not negligible. But because they are negligible, I find it very acceptable to see this as a downpayment on the long-term efforts that we need to do. I would prefer, in other words, to see us deal with the entire panoply of issues before us. But I don't think it is inconsistent to deal with this issue separately because it does not have an effect on the long-term solvency of the system. And I would certainly have a different opinion if the earnings test was being eliminated at age 62 because of that poverty impact, which is very major. And we can provide more for the record on that, if you would like. But because it is at the normal retirement age and because the costs are virtually zero, I think this is a legitimate separate step.

[The following was subsequently received:]

THE IMPACT OF REPEALING THE RETIREMENT EARNINGS TEST ON RATES OF POVERTY

This paper summarizes an analysis of the implications of potential changes in filing behavior that might result from changes in the retirement earnings test (RET). In general, the earlier one files for Social Security benefits the lower his or her monthly benefit. Elimination of the RET might lead to some individuals filing for Social Security benefits at an earlier age than they otherwise might, and thus could lead to reductions in individual incomes and increases in the number of people in poverty. Using matched 1994 Current Population Survey and Social Security Administration administrative data, this analysis examines the potential changes in individual income and the number of people in poverty that could have resulted for beneficiaries in 1993 from earlier elimination of the RET at either the normal retirement age (NRA), which is currently age 65, or at age 62.

In general, we find that even if individuals accelerate their filing for Social Security benefits as a result of elimination of the RET at age 65, there would be little or no change in the number of people below the poverty line. However, if the RET were eliminated at age 62 and individuals accelerate their filing for Social Security benefits, the number of people below the poverty line would increase. This analysis provides a range of estimates for the impact of eliminating the RET on rates of poverty, which illustrates the implications of potential changes in the RET.

Specifically, this paper:

- Explains how the RET works, focusing on the differences between the test for beneficiaries at the NRA and above and for beneficiaries aged 62 through NRA;
- Describes the approach used to estimate the poverty effects of repealing the RET;
- Provides poverty estimates for repealing the RET at NRA and the RET at 62; and
- Provides detailed demographic profiles on the population likely to get moved into poverty if the RET at 62 were eliminated.

How the Retirement Earnings Test (RET) Works

The Social Security Act of 1935 specified that beneficiaries would lose all their benefits if they had any earnings. Over the years, however, Congress has eased the RET's restrictions (allowing beneficiaries to supplement their benefits with earnings) by increasing the amount of exempted earnings, reducing the age of exempted beneficiaries, and liberalizing the formulas for reducing benefits.

The RET affects the timing of a person's benefits but has little effect on total benefits received over a lifetime. The details differ depending on whether a beneficiary is above or below the NRA (It does not apply to beneficiaries aged 70 and above). In both cases, however, the earlier a person begins to draw benefits, the smaller his or her monthly benefit will be.

Retirement Earnings Test at the Normal Retirement Age

Under current law, beneficiaries aged 65 through 69 in 2000 have $1 in benefits withheld for every $3 earned above $17,000. This threshold will increase in stages to $30,000 in 2002 and increase automatically thereafter with the average wage in the U.S. economy.

Delayed retirement credits (DRCs) are provided to compensate workers at the NRA through age 69 whose benefits are withheld under the RET. The DRC increases the worker's retirement benefit for each month that benefits are fully withheld after the NRA. The DRC is 6 percent per year for workers age 65 in 2000, and it will increase 0.5 percentage points every two years until it reaches 8 percent per year for workers reaching age 65 in 2008 and later. At that time, benefits lost due to the RET and/or delayed retirement generally will be offset in an actuarially fair manner by the increase in benefits resulting from DRCs. (See example 1.)

Example 1

How the Retirement Earnings Test Affects Beneficiaries at the Normal Retirement Age and Above

In 2000, a worker files for benefits at age 65 (the normal retirement age) and receives his/her full benefit of *$1,000* per month. If this worker had delayed filing for benefits for one additional year, his/her benefit would have been increased by 6 percent to $1,060 per month. This increase reflects the fact that he/she had not received benefits for one full year for which he/she was entitled. This "delayed retirement credit" amounts to 6 percent of the full annual benefit amount each year in 2001 and later.

If this beneficiary files for benefits at age 65 and continues to work, he/she may be affected by the RET as follows:

Scenario 1: His/her earnings never exceed the RET earnings threshold, so the RET has no effect on his/her benefit and he/she continues to receive his/her full benefit amount of $1,000 per month for the rest of his/her life.

Scenario 2: His/her earnings exceed the RET earnings threshold to the extent that *all his/her benefits at age 65 are withheld*. As a result, he/she receives a delayed retirement credit of 6 percent, which increases his/her benefit to $1,060 per month, accounting for the fact that he/she received no benefits at age 65 due to the RET.

These scenarios represent the extreme cases. If the worker receives partial benefits, then the delayed retirement credit adjusts his/her benefit accordingly. Also, a worker could have earnings after age 65, which could increase his/her full benefit. Annual cost-of-living adjustments would also raise his/her benefit.

Retirement Earnings Test at Age 62

In 2000, beneficiaries between age 62 and the NRA have $1 in benefits withheld for every $2 earned above $10,080. (This amount is adjusted annually to reflect the growth in the average wage in the U.S. economy.) Beneficiaries also have their benefits actuarially reduced for each month that they receive benefits before the NRA. For example, a person born in 1938, who starts to collect benefits at age 62, receives 79.2 percent of what he or she would have received at age 65 and 2 months (his or her NRA). If benefits are withheld before the NRA because of the RET, the actuarial reduction is adjusted at the NRA to exclude those months, so there would be no permanent reduction for those months. (See example 2.)

Example 2

HOW THE RETIREMENT EARNINGS TEST AFFECTS BENEFICIARIES AGE 62 THROUGH THE NORMAL RETIREMENT AGE

In 2000, a worker files for Social Security retirement benefits at age 62 rather than waiting until age 65 and 2 months (his/her normal retirement age). Had he/she waited to file until age 65 and 2 months, his/her full benefit amount would have been *$1,000 per month*. Because he/she chose early retirement benefits at age 62, his/her benefits are reduced by 20.8 percent to *$792 per month.*

This reduction accounts for the fact that this beneficiary will receive benefits for 38 additional months. However, over his/her lifetime, he/she is expected to receive the same total amount of benefits (based on actuarial projections of life expectancy and adjustments for interest).

If this beneficiary continues to work after filing for benefits at age 62, he/she may be affected by the RET as follows:

Scenario 1: His/her earnings never exceed the RET earnings threshold, so the RET has no effect on his/her benefits, and he/she continues to receive *79.2 percent* of his/her full monthly benefit amount for the rest of his/her life—$792.

Scenario 2: His/her earnings exceed the RET earnings threshold to the extent that his/her *benefits are partially or fully withheld* in every month before reaching his/her NRA. As a result, his/her benefits are recomputed at age 65 and 2 months as *100 percent* of his/her full benefit amount of $1,000 per month, accounting for the fact that he/she never received full benefits earlier due to the RET.

These scenarios represent the extreme cases. If the worker receives partial benefits before he/she reaches age 65, then the adjustment to his/her benefit at age 65 will reflect that benefit payment in an actuarially fair manner. Also, a worker could have earnings after age 62, which could increase his/her full benefit. Annual cost-of-living adjustments would also raise his/her benefit.

APPROACH USED TO ESTIMATE POVERTY EFFECTS OF ELIMINATING THE RET

To analyze the poverty effects of eliminating the RET, data from the March 1994 Current Population Survey—a nationally representative survey—are matched with Social Security Administration administrative records. These data indicate how much each person received in Social Security and other income in 1993.

These data are used to determine the Social Security benefit amount the person would have received in 1993 had there never been an RET at 62 and over or an RET at NRA and over. Essentially, this approach calculates the effects of changes in filing behavior on poverty. It is assumed that many people would have claimed benefits earlier had the RET never existed and that, for many, this would mean lower Social Security income (because, for example, benefits claimed before the NRA are permanently reduced). Once the difference in Social Security income is estimated, it is possible to determine whether this would change the person's poverty status and to report how many more people would be in poverty if the RET had never been in effect.

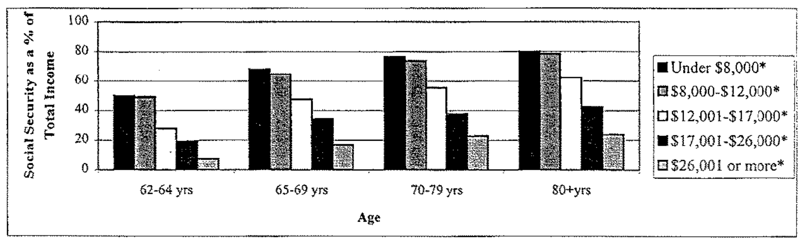
Historical Approach

This is an historical approach, which examines the Social Security population at a point in time in the recent past and asks how Social Security income and poverty status would be different assuming that the RET had never existed. It does not take a cohort of people approaching their retirement years and forecast the poverty effects from repealing the RET at 62 or the RET at NRA.

There are limitations and advantages to using an historical approach. Limitations include not fully reflecting the recent increases in women's labor force participation, real increases in Social Security benefits, or increases in the number of beneficiaries retiring earlier—suggesting that estimates for 1993 may be somewhat larger than for future years. Advantages include being able to know definitively at what age people in the sample claimed benefits and to determine how their Social Security income would have been different if benefits had been claimed earlier. Another advantage of using an historical approach is that it measures effects on people of all ages within the Social Security population. This is important because, as beneficiaries age, they exhaust other income sources, and the importance of Social Security to total income rises (See chart 1 for cross-sectional data on the importance of Social Security by age).

Chart 1

Social Security Benefits as a % of Total Income Rises with Age, Across Income Groups



Source: Social Security Administration, Office of Retirement Policy tabulations of the March 1998 Current Population Survey. Data are for 1997.
*Income groups rounded to the next highest thousands.

Only Accounts for Changes in Social Security Income

This approach does not measure changes in income (other than Social Security) that could have occurred if the RET at 62 or the RET at NRA had never existed. For example, it is plausible that people would choose to work and earn more in the absence of an earnings test. However, economic research has found that the RET has only modest effects on aggregate labor supply. This could be because workers take account of a number of factors when making work and retirement decisions (the availability and size of private pensions, health status, job characteristics, personal preferences, etc.).

Assumes Benefits Received Early Will Not be Saved

The elimination of RET at 62 is likely to cause people to file for permanently reduced benefits. However, it is not known what such people would do with these reduced benefits. They may save or invest a portion of them and have higher asset income later in life. While this analysis does not take such effects into account, economic research suggests that individuals at or near the poverty level are not likely to save this additional income.

POVERTY ESTIMATES FOR ELIMINATING THE RETIREMENT EARNINGS TEST

Eliminating the RET is likely to encourage some beneficiaries to apply earlier for benefits and, as a result, receive a lower monthly benefit in the long run. Depending on the amount of a beneficiary's income from other sources, this reduction in monthly benefits may reduce his or her total income below the poverty threshold ($7,990 a year for an aged individual and $10,070 for an aged couple in 1999).

If the RET were eliminated at the NRA (currently age 65), the increase in the incidence of poverty would be small for several reasons: Few people currently delay receipt of Social Security benefits beyond age 65; those who do typically have incomes well above the poverty level; and accelerating the receipt of a worker's benefit to age 65 would generally not lower benefits enough to cause the beneficiary (or the beneficiary's survivor) to become poor. Eliminating the RET at age 62, however, would cause the income of some beneficiaries to fall below the poverty level.

Retirement Earnings Test at the Normal Retirement Age

Elimination of the RET at NRA may encourage some who now plan to retire later than the NRA to file for benefits at the NRA, but the poverty effects stemming from elimination of the RET at NRA are estimated to be minimal. The most important reason for this is that benefits to a surviving spouse (widow or widower) would not generally be reduced below the deceased worker's full benefit as a result of eliminating the RET at the NRA.

In 1998, 9 percent of insured workers started receiving retired worker benefits at age 65 and 1 month or later. It is unclear to what extent insured workers would change their filing behavior, so poverty estimates are provided based on four separate filing scenarios (See table 1).

Table 1

FILING SCENARIOS FOR REPEAL OF THE RETIREMENT EARNINGS TEST AT THE NORMAL RETIREMENT AGE THROUGH AGE 69

Filing Scenarios	Assumed Percentage of People Currently Filing for Benefits after Age 65 Opting to File by Age 65 and 0 Months
Scenario A	0%
Scenario B	20%
Scenario C	50%
Scenario D	100%

There would be a negligible effect on poverty under Scenario A, and only about 2,000 people aged 62 and older would be moved into poverty under Scenario D in 1993 (See table 2).

Table 2

POVERTY ESTIMATES BASED ON DIFFERENT FILING SCENARIOS FOR ELIMINATING THE RETIREMENT EARNINGS TEST AT NORMAL RETIREMENT AGE

Number of People Age 62+ Moved into Poverty	Aged 62+ Poverty Rate Before and After Change
	Before 12.0%
Alternative Scenario	*Alternative Scenarios*
A Negligible effect	A 12.0%
B 500	B 12.0%
C 1,000	C 12.0%
D 2,000	D 12.0%

Source: Social Security Administration, Office of Policy, February 2000.

Eliminating the Retirement Earnings Test at 62

Eliminating the RET at ages 62 through 69 could raise the number of beneficiaries in poverty. Much of this effect would be due to more workers filing for benefits earlier and receiving benefits permanently reduced below the full-benefit level. Evidence suggests that the effects of increased work efforts would be unlikely to offset these reductions.

Filing for benefits before the NRA is advantageous in the short run for workers, but it can be disadvantageous later on—particularly for their surviving spouses. The lower benefit for a worker filing at age 62 in 2000 rather than waiting until his or her NRA (reduced 20.8 percent in 2000 and 30 percent when the NRA increases to 67 in 2022) is intended to be actuarially fair so that beneficiaries, on average, will receive the same total lifetime benefits as they would have received if they filed for benefits at the NRA. In the future, however, much of this reduction below the full-benefit level would pass through to surviving spouses and could make their benefits inadequate.

In 1998, 48 percent of insured workers opted for benefits at either 62 and 0 months or 62 and 1 month, and 79 percent of insured workers opted for benefits before age 65. It is unclear how the 52 percent of individuals who currently file for benefits after age 62 and 1 month would change their filing behavior, so estimates are provided under four scenarios. (See table 1 for scenarios. These scenarios are based on the percentage of people who currently file for benefits after age ″″62 and 1 month who are assumed to file by age 62 and 1 month).

Based on these assumptions about how filing behavior would be affected, eliminating the RET at age 62 could have moved up to about 700,000 people aged 62 and older into poverty and increased their poverty rate from 12.0 percent up to 13.9 percent in 1993 (See table 3).

Table 3

POVERTY ESTIMATES BASED ON DIFFERENT FILING SCENARIOS FOR ELIMINATING THE RETIREMENT EARNINGS TEST AT AGE 62

Number of People Age 62+ Moved into Poverty	Aged 62+ Poverty Rate Before and After Change
	Before 12.0%
Alternative Scenario	*Alternative Scenarios*
A Negligible effect	A 12.0%
B 140,400	B 12.4%
C 351,100	C 12.9%
D 702,200	D 13.9%

Source: Social Security Administration, Office of Policy, February 2000.

DEMOGRAPHIC PROFILES OF POVERTY EFFECTS OF ELIMINATING RET AT 62

Detailed demographic breakouts of who could have been affected in 1993 by eliminating the RET at 62 are summarized below.

Gender—Up to 500,000 women could be moved into poverty, accounting for 71 percent of the total moved into poverty. Their poverty rate could increase from 14.8 percent up to 17.1 percent (See table 4).

Marital Status—Widow(er)s could account for 55 percent of the total moved into poverty (up to 387,000). The poverty rate for widow(er)s is 19.6 percent; it could increase to 23.2 percent. Married couples could account for 34 percent of the total moved into poverty (235,000), and their poverty rate could increase from 5.8 percent up to 6.9 percent (See table 4).

Benefit Type—Beneficiaries receiving worker-only benefits could account for 55 percent of the total moved into poverty. Up to 238,000 surviving-spouse beneficiaries could be moved into poverty (34 percent of the total), and their poverty rate could rise from 19.2 percent up to 22.9 percent (See table 4).

Age—Fifty percent of the total moved into poverty could be aged 70–79. The poverty rate for this group could rise from 11.4 percent up to 13.8 percent. Beneficiaries aged 80–89 could account for 36 percent of the total moved into poverty. Their poverty rate could increase from 17.5 percent up to 21.9 percent (See table 4).

Table 4

Estimated Poverty Effects of Eliminating the Retirement Earnings Test at Age 62 and Above, by Selected Demographic Characteristics

Demographic Characteristics	Number Moved into Poverty — Percentage of People Currently Filing for Benefits after Age 62 Opting to File at Age 62 (Alternative Scenarios)				Poverty Rate Before	Poverty Rate After — Percentage of People Currently Filing for Benefits after Age 62 Opting to File at Age 62 (Alternative Scenarios)			
	A 0%	B 20%	C 50%	D 100%		A 0%	B 20%	C 50%	D 100%
Total	[1]	140,400	351,100	702,200	12.0%	12.0%	12.4%	12.9%	13.9%
Gender									
Men	[1]	40,400	100,900	201,800	8.2%	8.2%	8.5%	8.8%	9.5%
Women	[1]	100,100	250,200	500,400	14.8%	14.8%	15.2%	16.0%	17.1%
Marital Status[2]									
Married	[1]	47,000	117,600	235,200	5.8%	5.8%	6.1%	6.4%	6.9%
Widowed	[1]	77,300	193,300	386,700	19.6%	19.6%	20.3%	21.4%	23.2%
Divorced/Separated	[1]	10,200	25,500	51,000	23.7%	23.7%	24.1%	24.7%	25.6%
Never Married	[1]	5,900	14,600	29,300	22.5%	22.5%	22.8%	23.4%	24.3%
Benefit Type[3]									
Worker-Only	[1]	76,600	191,400	382,900	9.1%	9.1%	9.4%	10.0%	11.0%
Spouse	[1]	13,100	32,800	65,500	8.1%	8.1%	8.3%	8.7%	9.4%
Surviving Spouse	[1]	47,600	119,000	237,900	19.2%	19.2%	20.0%	21.1%	22.9%
Age									
62–69	[1]	12,300	30,900	61,700	10.0%	10.0%	10.1%	10.2%	10.4%
70–79	[1]	69,700	174,200	348,400	11.4%	11.4%	11.9%	12.6%	13.8%

Estimated Poverty Effects of Eliminating the Retirement Earnings Test at Age 62 and Above, by Selected Demographic Characteristics—Continued

Demographic Characteristics	Number Moved into Poverty				Poverty Rate Before	Poverty Rate After			
	Percentage of People Currently Filing for Benefits after Age 62 Opting to File at Age 62 (Alternative Scenarios)					Percentage of People Currently Filing for Benefits after Age 62 Opting to File at Age 62 (Alternative Scenarios)			
	A 0%	B 20%	C 50%	D 100%		A 0%	B 20%	C 50%	D 100%
80–89	[1]	50,900	127,300	254,600	17.5%	17.5%	18.3%	19.7%	21.9%
90+	[1]	7,500	18,700	37,500	19.1%	19.1%	19.9%	21.0%	22.8%

Source: Social Security Administration, Office of Policy, February 2000.
Notes:
[1] The effect would be negligible.
[2] Respondents to the Current Population Survey indicated their marital status at the time of the survey. These individuals may or may not be receiving a benefit based on their marital status.
[3] Some people affected by this proposal are not beneficiaries (they share a household with a beneficiary), so rows do not add up to the total number of people affected. The ‘‘Spouse’’ category includes divorced spouse beneficiaries and dually-entitled spouse beneficiaries, and the ‘‘Surviving Spouse’’ category includes surviving divorced spouse beneficiaries and dually-entitled surviving spouse beneficiaries.

Mr. DOGGETT. Thank you.

Thank you, Mr. Chairman.

Chairman SHAW. There are a couple of points I think that should be made at this point: One, that the leadership on the Republican side clearly set aside the surplus and locked it away and said that it can be used, however, for Social Security reform. This is a small part of Social Security reform. But it is reform. It is bringing fairness to the system, and this was a very unfair situation that we had.

In fact, when Social Security originally was put into law, that earnings test grabbed hold, I believe, after $15 of earnings.

Mr. APFEL. It was actually at zero in the beginning.

Chairman SHAW. We have been chipping away on that, and now it is the time to absolutely eliminate it.

There are a couple of other things that I think need to be brought to light here. One, I think the Commissioner made it very clear that it is revenue-neutral because you start getting those benefits that you lost back after 70 and beyond. But I think more than that, look at the effects it is going to have on certain parts of the population. Life expectancies, to take an example, for African-Americans are less. So if you are whacked with the earnings penalty and then don’t live long enough, you never get back what you were penalized. And that is something that I think we have to also think about.

Absolutely this present system is terribly unfair, and we are going to get rid of it once and for all, and I am pleased to hear that everybody—even you, Mr. Doggett, though you have some criticism—is going to vote for it because I think this is a most important bill.

Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman. And my friend from Texas, Mr. Doggett, I sure am glad you are for this bill; otherwise, the questioning would have been real tough.

Mr. Commissioner, you said a few minutes ago that you support the disparity between the earnings limit, if you will, for non-blind disabled and blind disabled. What is the rationale for that differential?

Mr. APFEL. The rationale—which goes back to the 1977 Social Security Amendments—is that the problems facing the blind are very severe in terms of employment and a higher incentive was viewed back then and always has been to provide employment opportunities for the blind. And I think that is right and it should continue.

Mr. MCCRERY. We shouldn't try to provide employment opportunities for non-blind disabled?

Mr. APFEL. Oh, I think we should as well, but I believe the history here of a more liberalized system for the blind makes sense because of their intense employment needs.

Now, again, my recent regulation for the non-blind disabled was to greatly expand the amount of income that that group could continue to earn without losing benefits. I think that we need to—as I testified before this Committee earlier this year—we need a whole lot of thinking about what steps are going to be necessary to assure more of the disabled enter into the work force. The Ticket-to-Work legislation I think, was a very important first step. I am not here to make a series of new proposals yet. The ink is still drying on the new one.

Mr. MCCRERY. So you are considering the possibility of bringing the non-blind disabled up to the level of the blind disabled?

Mr. APFEL. I am considering whether we should find some way to raise somewhat higher the levels for the disabled, and there is no definitive decision on that yet, but it is one of the areas that I am considering to provide greater incentives yet again.

Mr. MCCRERY. How much would it cost to bring the non-blind disabled up to the same income level as the blind disabled?

Mr. APFEL. If we brought the non-blind disabled up to the blind disabled—I am going to have to provide that for the record, sir. I don't have that information, but we will provide that.

[The information follows:]

Proposal:

Raise the SGA level for non-blind disabled to the SGA level for the blind disabled.
Cost over First 5 Years: $2 billion
Long-Range Cost: 0.09 percent of taxable payroll

Mr. MCCRERY. OK. I think it is worth looking at. We do want to try to encourage work in this country, and we have gone to great lengths with welfare reform and Ticket to Work and now this legislation to encourage work. So I think that we ought to look at——

Mr. APFEL. Mr. McCrery, I would love to work with you on that. The reality is that we need to create greater incentives for work, and that is true in the disability community, it is true in the welfare population, and I think the steps that were taken last year by this Committee were very important. But we need to do more, and we would love to work with you on that in the years ahead.

Mr. MCCRERY. Thank you.

Yesterday the President endorsed this legislation, basically, but he also mentioned a couple of other things. One would be overall

Social Security reform and the other, he talked a bit about bringing women out of poverty. But would you clarify that he did not make his approval or his decision to sign this legislation that is before the Committee today contingent upon our acting upon the other two items, did he?

Mr. APFEL. No. What the President said—and I support this endeavor—is a two-step process. Step one would be the elimination of the retirement earnings test at the normal retirement age, a simple, straightforward bill without a lot of extraneous activities around it; and, two, moving to the next step on the long-term solvency of Social Security. The President has proposed transferring on-budget surpluses, based on the interest savings to Social Security, as well as benefits for women.

I would very much like to see those done this year as well. Certainly that is what the President said yesterday.

Mr. MCCRERY. But he is not going to hold up signing this bill until——

Mr. APFEL. He absolutely did not say that that would be held up from this legislation. He has supported the retirement earnings test repeal for some time, as Mr. Johnson knows. And we can do this separately, but we ought to also do the other steps that are necessary to move us closer to long-term reform.

Mr. MCCRERY. Do you know what the President's proposal is on women on Social Security?

Mr. APFEL. Well, the specific proposal has not been articulated in terms of one particular piece of legislation. There are a series of options that have been discussed before this Committee and other places about whether to expand benefits for women, whether to find ways to provide stronger spousal benefits. We could provide for the record a listing of four or five potential inclusions—not only in Social Security but also in the SSI Program. SSI is another program provides a very important poverty benefit, and there could be liberalizations in that as well.

There is not one specific proposal, Mr. McCrery, but I will provide for the record a listing of a half-dozen proposals that all should be considered.

[The information follows:]

While the Administration has not endorsed any specific proposal designed to improve the economic condition of elderly women at this time, we are examining a variety of proposals that have been developed by numerous groups, including:

1. Increasing Social Security Benefits for Widow(er)s

Under current law, survivors receive the higher of their own worker benefit or a surviving spouse benefit based on their deceased spouse's primary benefit. This benefit generally ranges from 50 percent to 67 percent of the amount the couple would be receiving if both were still alive. Recent research shows that a single person needs about three-quarters of a couple's income to maintain the same standard of living. While Social Security is generally only one part of retirement income, it accounts for a much larger proportion of the retirement income (in some cases all) of the poorest individuals.

The widow(er)'s benefit could be increased in many ways. One way is by making it a larger percentage of the couple's benefit. This increase could be limited to a specific threshold to control costs and to target it more effectively. For example, it could be limited to the benefit paid to steady maximum earners or to the average retired worker benefit. In addition, it could be effective immediately for all current beneficiaries or phased in gradually for newly-eligible beneficiaries. Examples of these types of options include:

• Increasing widow(er)'s benefits to 67 percent of the couple's benefit, effective for all widow(er) beneficiaries immediately, and limited to the benefit paid to steady maximum earners or limited to the average retired worker benefit (see attached memorandum).

• Increasing widow(er)'s benefits to 67 percent of the couple's benefit, gradually phased in for new eligibles, and limited to the benefit paid to steady maximum earners or limited to the average retired worker benefit (see attached memorandum).

• Increasing widow(er)'s benefits to 75 percent of the couple's benefit, effective for all widow(er) beneficiaries immediately, and limited to the benefit paid to steady maximum earners or limited to the average retired worker benefit (see attached memorandum).

• Increasing widow(er)'s benefits to 75 percent of the couple's benefit, gradually phased in for new eligibles, and limited to the benefit paid to steady maximum earners or limited to the average retired worker benefit (see attached memorandum).

Widows are at risk of poverty in later life, especially when their spouse files for benefits before the normal retirement age (NRA) and receives an actuarially reduced benefit. A provision of current law—the widow(er)'s limit—operates as a ceiling on widow(er)'s benefits. Under the widow(er)'s limit, the widow(er)'s benefit can not exceed the greater of the reduced benefit the deceased worker was receiving or 82 of the deceased worker's primary insurance amount (PIA). For example, a married man who filed for benefits at age 63 in 1999 would have received 86.7 percent of his PIA. If he dies after she reaches the NRA, her widow(er)'s benefit will be 86.7 percent of his PIA. Without the limit, she would have received 100 percent of his PIA, because she began to receive widow(er)'s benefits after the NRA.

For example, one option would be to abolish the widow(er)'s limit ceiling and permit widow(er)s, whose spouse retired before the NRA, to receive up to 100 percent of their spouse's PIA, depending on when the widow(er) filed for benefits.

2. Increasing Social Security Benefits for Low Earners—Most of whom are Women

Under current law, a special minimum benefit exists that provides a guaranteed minimum benefit for persons who worked at least 11 years in covered employment. Workers must meet a minimum earnings amount to qualify for a year of covered earnings ($8,505 in 2000). The current minimum benefit would pay a worker with 30 years of covered earnings a monthly benefit of $580.60 (in December 1999), while the all-ages poverty threshold was $722.20 in that same year.

Only 143,390 retired workers (0.50 percent of all retired worker beneficiaries) received special minimum benefits in December 1999; 76 percent were women.

There are various ways to increase the special minimum benefit, including 1) revising the indexing mechanism so the real amount of the benefit grows in the future or 2) structurally changing the benefit. Examples of these types of options include:

• Indexing the special minimum benefit to wage growth rather than inflation. (Benefits under the regular benefit formula are wage-indexed before eligibility and thus reflect wage growth.)

• Increase the benefit payment to workers with many years of low earnings by changing the existing special minimum benefit so that 30 years of covered earnings results in a benefit at 100% of poverty threshold; 40+ years results in a benefit at 130% of poverty threshold, scaled between 30 and 40, and scaled down to 10 years.

3. Making Changes to the Supplemental Security Income (SSI) Program

Under current law, the dollar amount of monthly Social Security benefits excluded in the computation of SSI benefits (the general income exclusion) has remained constant at $20 since 1974. If the $20 had been raised to its inflation-adjusted equivalent in January 2000, the dollar amount would be $80.

Women are especially affected by this exclusion because they are far more likely to have low enough retirement benefits to qualify for SSI. In December 1998, 34 percent of women retirees received less than $500 per month in Social Security benefits compared to 12 percent of men.

The general income exclusion could be raised in any increment above the current $20. For example, one option would be to increase the SSI general income exclusion from $20 up to $80 and possibly adjusting it annually thereafter to keep pace with inflation.

SOCIAL SECURITY
May 28, 1999

MEMORANDUM

Harry C. Ballantyne, Chief Actuary
Subject: Estimated Long-Range OASDI Financial Effects of Provisions to Increase Benefits Paid to a Widow(er)—INFORMATION

Background

Under current law, a surviving aged spouse (age 62 or older) may be eligible to receive either (1) an aged surviving spouse benefit based on the earnings of the deceased spouse, (2) a retired worker benefit based on his/her own earnings, or (3) his/her own retired worker benefit plus a dual entitlement excess benefit equal to the excess (if any) of the aged surviving spouse benefit over his/her own retired worker benefit. Effectively, a surviving aged spouse is eligible for a Social Security monthly benefit equal to the higher of his/her own retired worker benefit and the aged spouse benefit payable based on the earnings of the deceased spouse.

The 1994–6 Advisory Council on Social Security considered provisions to modify the nature of the benefit payable to an aged surviving spouse of a married couple. The Individual Account (IA) Plan and the Personal Security Account (PSA) Plan both included a provision to pay an aged surviving spouse 75 percent of the benefit that would be payable to the couple if they were both still alive, if higher than the benefit otherwise available. The 75-percent benefit amount was limited in both cases based on the retired worker benefit that would be payable to the survivor had she/he been a steady worker with earnings consistently at or above the OASDI contribution and benefit base. The IA plan, in addition, included a provision to reduce the benefit payable to an aged spouse based on their spouses earnings from 50 percent to 33 percent of the spouses primary insurance amount (PIA).

The PSA provision would increase the benefit payable to survivors of both one-earner and two-earner couples, with a larger increase for two-earner couples. The benefit for the survivor of a one-earner couple would be about 112.5 percent of the worker's retirement benefit (0.75 x 1.50 = 1.125), compared with 100 percent of the worker's retirement benefit under current law. For a two-earner couple where both spouses had the same PIA, the benefit would be 150 percent of the survivor's retired worker benefit, compared with 100 percent of the retired worker benefit under current law.

The IA plan combined this provision with a reduced spouse benefit (both spouses alive) so that the survivor of a one-earner couple would not be helped (0.75 x 1.33 = 1.0).

Description of Provision

Provisions currently being considered focus on the proposal to provide an aged surviving spouse benefit equal to 67 percent, 75 percent, or more of the benefit payable to the couple if they were still both alive without any reduction in the benefit payable to the spouse of a living worker.

The table below provides estimates of the effect on the long-range OASDI actuarial balance of provisions to increase the benefit of an aged surviving spouse to 67 or 75 percent of the amount that would be payable to the couple if they were both still alive. This benefit option would be available as of the date upon which both the surviving spouse has attained age 62 and the deceased spouse would have attained age 62 (i.e., the date at which both could have been eligible for retired worker or aged spouse benefits). The couple benefit for this purpose would reflect any actuarial reductions (or DRC) earned by either spouse up to the date of death of the deceased spouse. If the deceased spouse had not yet become entitled to a retired worker or aged spouse benefit, then the deceased would be deemed to have become entitled at the date of death, or at the date age 62 would have been attained, whichever would occur later. Reduction (or DRC) for the survivor would be based on the age of first entitlement to a retired worker, aged spouse, or aged surviving spouse benefit (but not less than 62).

Provision	Estimated change in OASDI actuarial balance (percent of taxable payroll)
67 Percent of Couple Benefit—Effective for all in 2000 +.	
Limit to Steady Maximum Earner	−0.12
Limit to Average Retired Worker Benefit	−0.03
67 Percent of Couple Benefit—Phased in for New Elig 2000–09	
Limit to Steady Maximum Earner	−0.09
Limit to Average Retired Worker Benefit	−0.02
75 Percent of Couple Benefit—Effective for all in 2000 +	
Limit to Steady Maximum Earner	−0.46
Limit to Average Retired Worker Benefit	−0.10
75 Percent of Couple Benefit—Phased in for New Elig 2000–09	
Limit to Steady Maximum Earner	−0.33
Limit to Average Retired Worker Benefit	−0.07

Based on intermediate assumptions of the 1999 Trustees Report.

The table provides estimates for two possible limits on the amount that the provision may increase the benefit of a surviving spouse. First, the retired worker benefit that would be payable to the surviving spouse if he/she had earnings consistently at or above the OASDI contribution and benefit base (from age 22 through age 61). Second, the retired worker benefit that would be payable to the survivor if she/he had a PIA equal to the average PIA for all retired worker beneficiaries in current payment status for December of the year prior to the year in which the survivor first exercises this benefit option. In both cases, the limit reflects any actuarial reduction (but not DRC) that would apply to the survivor's retired worker benefit with initial entitlement at the age of first entitlement to a retired worker, aged spouse, or aged surviving spouse benefit (but not less than 62).

The table also provides estimates for two possible effective dates. First, all persons eligible for this benefit option as of January 2000 are affected. This means that all persons eligible for an aged surviving spouse benefit who otherwise qualify, would receive the benefit of this option for all benefits payable for January 2000 and later. Second, the benefit option would be phased in over 10 years for persons newly eligible for the option. Persons first eligible for the option in 2000 would receive 10 percent of the potential increase under the full provision, 20 percent for those first eligible in 2001, and 100 percent for those first eligible in 2009 and later. First eligibility occurs when the survivor could qualify for the benefit option, regardless of whether the individual has filed for any OASDI benefit at that time or not. This gradual phase in for newly eligible beneficiaries is intended to minimize the extent to which individuals newly eligible in any year will benefit less from this provision than do individuals newly eligible in the following year.

STEPHEN C. GOSS,
Deputy Chief Actuary

Mr. MCCRERY. Thank you.

Chairman SHAW. Mr. Weller?

Mr. WELLER. Thank you, Mr. Chairman.

Commissioner, good to see you. Good morning.

Mr. APFEL. Good to see you.

Mr. WELLER. First, let me just begin by commending my colleague, Sam Johnson, as well as the Speaker of the House, Dennis Hastert, for their leadership—and Clay Shaw, our chairman, for their leadership repealing the earnings limit, the earnings penalty on seniors who want to continue working after they turn 65. It is a fairness issue, and I am very, very pleased that the President has made a decision to support the legislation as well.

Now, it is interesting that 800,000 Americans over the age of 65 lose $1 of their Social Security for every $3 in outside income that they earn above $17,000. I think of seniors that I know back home, some who may not have been able to save a lot for their retirement or their pension income isn't quite what they thought it would be, and so they are forced to work. And, of course, this legislation will help them in their later years. So I really am very, very pleased that this is a bipartisan effort today.

I also note the President's comments that he says he will sign a bill to repeal the earnings penalty as long as it is not littered with a lot of unrelated other things. And I hope that the President's friends in the Senate will keep that in mind as we move our legislation to address another issue of fairness, the marriage tax penalty. There are threats by some in the Senate, of course, to put extraneous provisions on our effort to wipe out the marriage tax penalty for 25 million married working couples.

We have had the leadership here in the House send a standalone bill, a clean bill that only does one things, to the Senate and we hope we can keep it that way and put it on the President's desk and that he will sign that legislation into law.

Commissioner, a lot of times during debate and a lot of the rhetoric, there is always the rich versus poor, what is the definition of middle class. Last week I was told by some of my friends that a married couple making $62,000 who happen to own a home are rich. And that was their definition of wealthy.

The L.A. Times today has on the front page a couple examples of a couple seniors who are forced to work or want to work after they are 65, and I just want to kind of get a feel what your thoughts are about where they stand on the economic ladder.

You have Ida, 66. She works as a cashier. Her monthly benefit from Social Security is $417. She has annual earnings of $18,500, and, of course, this year the earnings limit is $17,000 So her earnings in excess of the limit are $1,500, and according to this example of the L.A. Times, under the current system, under the current earnings penalty, she will lose $500 as a result of the earnings penalty.

Is Ida wealthy making $18,500?

Mr. APFEL. Well, I don't know what her other income is, but if that is her only income, she is certainly not wealthy, and the reason we need to repeal the earnings test is to provide a greater work incentive for that individual because she would be able to keep her Social Security benefits.

Mr. WELLER. Then the second example that they give is a gentleman by the name of Fred. He is 67 years old. He is an auto mechanic, and he currently has a monthly benefit of $1,000. He has annual earnings of $32,000, and after the $17,000 earnings penalty for this year, his earnings in excess are $15,000. And the current earnings penalty costs Fred, who is 67 years old, working as an auto mechanic, $5,000 a year.

Now, under the administration's definition of rich, is Fred, who makes $30,000 and suffers a $5,000 earnings penalty, is he defined as rich by your administration?

Mr. APFEL. I am not sure where we are going, Mr. Weller. The administration proposes to eliminate the retirement earnings test so that that individual could continue to work without losing Social Security benefits.

From what you have described, this does not appear to be an affluent individual. The repeal of the retirement earnings test, once it phases fully up to $30,000, will, among others, affect the top quintile of earners in this country, in other words, the top fifth of earners, as I was pointing out to Mr. Doggett.

However, those individuals will receive, therefore, lower Social Security benefits later on over their lifetime. So the elimination of the retirement earnings test would affect those in the top quintiles.

Mr. WELLER. So this auto mechanic making $32,000, suffering a $5,000 penalty, is not rich. You believe that he is not a wealth individual.

Mr. APFEL. It doesn't sound like a rich——

Mr. WELLER. Because I remember back in 1993 the administration pushed through a tax increase on seniors making about $33,000. You may recall that tax increase on their Social Security benefits, and they were defined as rich at that time. So that definition has changed. So I hope this is——

Mr. APFEL. Well, Mr. Weller, I am not certain that I would—if you remember the history on that legislation, that was made to help strengthen the Medicare Program, and those were resources that were provided to the Medicare Program—just as back in 1983 with the bipartisan support of this Committee changes were made to provide for taxation of benefits to help strengthen the Social Security system. So I don't know whether that person is rich or not, but those were changes that were made to help strengthen both the Social Security system back in 1983 and the Medicare system in 1993.

Mr. WELLER. Just quickly in response, reclaiming my time, Commissioner, back in the South Side of Chicago and the south suburbs in Illinois, an auto mechanic making $32,000 or $35,000 struggles to get by, even with their Social Security benefits. And that is why this legislation is so important, to help seniors in their later years live a quality lifestyle. They have health care concerns at that age. Of course, we want to address that this year. And, of course, Bill Thomas is doing a terrific job as he works to put together a prescription drugs component for Medicare. And I look forward to working with you.

But thank you, Commissioner, and thank you, Chairman.

Mr. APFEL. Well, I think it is a very important piece of legislation, and we strongly want to see it enacted.

Chairman SHAW. Mr. Levin?

Mr. LEVIN. I was just trying to refresh my recollection of whether the House and the Senate have passed bills since 1994 to reverse the 1993 provision on taxation of Social Security benefits. I forget. Has that been acted on by both the House and the Senate, sent to the President?

Mr. APFEL. I do not believe it has, sir.

Mr. LEVIN. I don't think so.

Mr. APFEL. If legislation was enacted to do it, it would reduce Medicare solvency and would reduce Social Security solvency.

Mr. LEVIN. So I am a bit mystified why Mr. Weller would raise that, since there was control of this Congress and no effort on both sides to repeal it. But, anyway, I guess we fight old battles around here. But let's concentrate on the new one.

We support the provision proposed here. In your testimony, though—and I had a chance to read it, though I am sorry I missed some of the earlier back and forth. In your testimony, you talk about the need to be aware that Social Security reform proposals can have very different effects on the benefits received by women compared to men.

Just elaborate a bit about this issue, if you would.

Mr. APFEL. Any one of the reform proposals will have a differential effect on men and women, as it will individuals in different income groups. With respect to the effect of eliminating the retirement earnings test at the normal retirement age, about 40 percent of those individuals are women and about 60 percent are men. And the impact on poverty is negligible from such a change at the normal retirement age.

That is not the case, as I indicated to Mr. Doggett, for eliminating the test at age 62. If the proposal were to eliminate the retirement earnings test at an earlier age, at 62, the poverty impact would be substantial, and primarily for women. If we look at the statistics on this, the effect of eliminating the retirement earnings test at age 62, is that if everyone retired at age 62, the long-term poverty effect could be as high as 700,000 people.

Now, clearly, not everyone would retire at age 62, although about 60 percent now do. If no one changed their behavior, the effect would be zero. Some will change their behavior, and there will be some poverty impact. The actuaries have assumed somewhere about one-half will change their behavior, which corresponds to about 350,000 additional people moving into poverty.

If we look at the individuals who might potentially be affected by poverty, about three-quarters of those are women and about half are widows, a few widowers. So there would be a significant impact for women to eliminate the retirement earnings test at age 62.

If the RET is eliminated at the normal retirement age, again, which this legislation does, there is really a negligible impact. And it also creates some modest incentives to work, which I think are good.

So I think we need to look at all of the proposals before us in the future for Social Security, both in terms of differential for women and men, as well as different income groups. And Mr. Doggett talked about the implications for upper-income for this particular piece of legislation, and in the short term it would provide a benefit for primarily men, primarily upper-income or those in the top quintiles. But over the long term, because their benefits would not be as high, it has a zero income effect.

So there is a very big difference between the elimination of the retirement earnings test at the normal retirement age and if it were eliminated at the early retirement age. And so I am pleased that the bill before the Congress deals with it at the normal retirement age and not the early retirement age.

Mr. LEVIN. Thank you, and we are proud of all your talented efforts, Mr. Commissioner. Thank you.

Chairman SHAW. Mr. Matsui, you indicated that you had another question.

Mr. MATSUI. Thank you very much, Mr. Chairman, for allowing me to ask this one question.

I don't think there is, but is there a notch problem here at all? Would there be? Not at all?

Mr. APFEL. No, sir.

Mr. MATSUI. OK.

Mr. APFEL. If an individual, say, turns 65 halfway through the year, the benefit income would be affected by the earnings test for the first half of the year by the lower earnings test, and by the last half of the year not at all. So there is not a notch effect that is created by this legislation.

Mr. MATSUI. OK. Thank you.

Mr. LEVIN. It is the magic word.

Mr. APFEL. I know. It is a magic word. I don't need another notch.

Chairman SHAW. Thank you, Commissioner. You are always welcome before this Committee, and it is nice to have you again.

Mr. COLLINS. May I ask a question?

Chairman SHAW. Oh, Commissioner, we have one more question for you. I am sorry.

Go ahead, Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman, and we won't hold you long, Commissioner.

There has been a lot of reference to the Social Security surplus. I have some concern about using the word "surplus." Having been in small business for about 35 years, knowing that I had a lot of obligations facing me as far as amortizations and such, I considered the very similar situation that we have with the payroll tax today to be more of a positive cash flow at this point in time than I do a surplus, because is it not true that within the next 14, 15 years that positive cash flow will reverse and we will have a negative cash flow, and we will need all of the positive aspects of the payroll tax today to meet that obligation?

Mr. APFEL. I think that is a fair way to look at it, Mr. Collins. I think the Social Security surplus is a very important asset for the long term for Social Security. We have a positive cash flow in the Social Security system for about the next 13 to 14 years; then we do go negative. And it is very, very important how we handle this issue over the short term to ensure that we can pay benefits in the long term.

I think it is very appropriate to lock away those Social Security surpluses and pay down the debt with them, because that is real savings. That is real savings for the economy. I would also think an important step would be when the Congress decides what to do about that non-Social Security surplus, I would certainly hate to see us have all of that resource be gone before we have figured out the share for Social Security. I think the Social Security system and the President's proposal to provide on-budget transfers to Social Security is very important to meet those long-term obligations that we have.

So the Social Security surplus is important, but also the on-budget surplus is very important. And I am going to be watching how that money gets used because I would hope that we are in a position where some of that on-budget surplus is used as well to strengthen Social Security for the long term.

Mr. COLLINS. Well, there have been a lot of ideas expressed as to how any type of positive cash flow should be used. In fact, we heard quite a bit of that the other night.

But, now, this earnings test that we are addressing here with Mr. Johnson's bill, it doesn't affect payroll tax, does it, in a negative way?

Mr. APFEL. No. Actually, it affects the payroll tax income in a slightly positive way.

Mr. COLLINS. That is right. So this positive cash flow/surplus won't be affected by this.

Mr. APFEL. The outlays from the Social Security trust fund increase in the short term from this proposal. But those revenues come back in over the long term into the system because of lower benefits that individuals receive by not receiving delayed retirement credits.

Mr. COLLINS. But those are not FICA taxes. This is actually a penalty. The earnings test is a penalty. It is a tax in the form of a penalty, not a tax in the form of payroll taxes.

Mr. APFEL. That is a fair assessment. It is very much a perceived penalty because individuals do not realize that if they do take this penalty in the short term, then under the current law their benefits are higher in the future. So it is perceived in the short term very much as a penalty, and elimination of that will mean that individuals have higher benefits in the short term but somewhat lower benefits in the long term. But that is how it stays cost-neutral.

But I would also point out, Mr. Collins, that there is some payroll tax increase to this. I had given the figures of $17 billion over 5 years and $26 billion over 10 years as the cost of this proposal. That is really the gross cost. Some offsets will occur. Somewhere on the order of 25 percent will come back in, and that will come back in through added payroll tax income.

Mr. COLLINS. It has a positive effect on the payroll tax.

Mr. APFEL. A positive effect on the payroll tax. There are three——

Mr. COLLINS. I have one quick hypothetical question for you. That is a big word for me. Supposing—and that is a good Southern word for "suppose." Supposing there was no need to borrow the Social Security FICA tax cash flow by the general fund—in other words, all of the public debt was retired and there is no need to continue to build debt, because when we do build debt, we have a tendency to spend it. What interest-bearing account would you suggest those funds be deposited in?

Mr. APFEL. You are now projecting out 10 and 15 years?

Mr. COLLINS. Yes.

Mr. APFEL. Well, ultimately——

Mr. COLLINS. Now, I didn't say stock market or mutual funds. What interest-bearing account——

Mr. APFEL. But, Mr. Collins, I would. It seems to me that in the long term we need to be investing part of these surpluses in not only government securities but also in the equity market.

If we look at State and local pensions systems—and Social Security is not a perfect analogy to State and local pensions, but it does have many of the same similarities. State and local pensions now invest about 60 to 70 percent of their assets in equities to ensure a higher rate of return. But higher rate of return means that taxes don't have to be raised or benefits cut to provide for those obligations.

I think this is an area that we should look at. I think there is quite a bit of resistance to such a proposal right now in the Congress that I have heard, a very significant——

Mr. COLLINS. Yes, I understand that, and we don't want to get into that debate because—and I think it should be looked at, too. But what interest-bearing account? Very similar to what Galveston does in Texas. They put theirs in interest-bearing accounts. What interest-bearing account would you——

Mr. APFEL. Interest-bearing bonds and government securities, as well as in the market itself. I think all of them are legitimate options and we should be doing all of them in the long term.

If I could just finish up on the question that you asked a minute ago, Mr. Collins, about the gross cost and the fact that there are offsets to the overall cost, about 25 percent, that is due to three things, really: Higher payroll taxes because people will be working more; somewhat higher taxation of benefits; and, three, lower Medicare costs. This is something that many people are unaware of, but if people are working more, they have third-party insurance that will be paying some of those health care costs that are now being paid for by Medicare. So there is potentially—there will be a positive impact on Medicare as well as some positive income to the system from payroll taxes.

Mr. COLLINS. Thank you, Mr. Chairman.

Chairman SHAW. If I could just follow up on just a couple of things here that you unearthed, which really is going beyond the scope of this hearing, but I think it is necessary to be sure that the record is clear.

As we pay off the publicly owned debt, the debt that is out there that people are holding, a lot of it is foreign owned, but we are paying that down. But that is counterbalanced within the Social Security trust fund is that for every dollar that goes out of the surplus, it is replaced with a Treasury bill, which is debt. It is debt by the government to the Social Security Administration or debt by the government to itself, but it certainly represents a liability in that it stands for the resolve that the Congress and the administration have to future generations. But when that starts going down, we obviously have to go to the taxpayer or the general fund in order to get the money to pay that off. There is no arguing in that arena.

When we start talking about privatization of the Social Security system, and you made remarks that you weren't for privatization, but you are for investment in the private sector. Now we can say, as far as the investment is concerned, that it is privatized, but as far as who controls it, it is government controlled. But I think that that's a dangerous road to go down. I would hope that, whereas equities are important, they should be invested outside of the Social Security system.

The Social Security system should be left totally alone. It is presently invested in the government securities, and it should continue to go that way. Any investment in the private sector should be outside of the Social Security system, but used at a later date to come and help out. I think this is of concern to us.

I think that every poll that I have seen says that they do not want, that the American people do not want the Social Security Administration playing the stock market. I agree with the American people on that. And I would be very much opposed to any privatization of the Social Security system, whether it be through the privatization of investment or whether it would be the taxes, FICA taxes, going outside for investment in the private sector. It is not necessary, and it should not happen, and we should not privatize the Social Security system at all.

If you would like to comment on that.

Mr. APFEL. Well, Mr. Shaw, this whole issue is one that we have yet to get to consensus on. I think that is fair to say.

From my perspective, I believe that as the Social Security system develops larger surpluses in the future, that a very legitimate option is to diversify the portfolio. I don't think that the consensus has emerged on that yet. But if we look at State and local pensions, which used to be invested very low in equities, they are now quite high in equities, to help increase rates of return and also to increase—to obviate tax increases and to obviate benefit cuts for State and local pensioners.

I think that this is an issue that needs a whole lot more debate and will continue to be debated. But I must tell you, where I sit on this issue, I think that it is the right thing to do in the long term. I think that the potential of a consensus on this this year is unlikely on the issue of equity investments, either individually or collectively. But I do believe it is the right thing in the long term for the system, and that debate will continue, sir.

Chairman SHAW. We understand each other.

Thank you. Thank you, Commissioner.

Mr. APFEL. Thank you.

Chairman SHAW. We now have our next panel, and we are actually going a lot slower than I had anticipated. We have Jane Baumgarten, who is a member of the board of directors of the American Association of Retired Persons, North Bend, Oregon; we have Tom Woods, who is the president of T.E. Woods Construction in Kansas City, Missouri. He is chairman of the board of trustees of the National Association of Home Builders; Jim Martin, president of The 60 Plus Association, down in Arlington, Virginia; we have Colonel Henry A. Hough, who is a member of The 60 Plus Association, in Arlington, Virginia; Martha McSteen, who is the president of the National Committee to Preserve Social Security and Medicare; and Zed Wondemu of Zed's Ethiopian Cuisine in Georgetown and the National Restaurant Association.

Welcome. We have all of your full testimony, which will become a part of the permanent record, and we would welcome you to proceed as you see fit, and please feel free to summarize.

Ms. Baumgarten.

STATEMENT OF JANE BAUMGARTEN, MEMBER, BOARD OF DIRECTORS, AMERICAN ASSOCIATION OF RETIRED PERSONS

Ms. BAUMGARTEN. Thank you, Mr. Chairman. I am Jane Baumgarten, a member of AARP's board of directors. The Association appreciates the opportunity to present our views regarding the Social Security earnings limit.

AARP supports increasing, as well as eliminating, the earnings limit for beneficiaries ages 65 through 69. This would enable many beneficiaries to work and supplement their Social Security, just as other recipients do with pensions and unearned income. With a change, beneficiaries will be able to earn more without penalty. AARP is pleased to have worked on a bipartisan basis with this Committee and other Members of Congress to increase the earnings limit for beneficiaries ages 65 through 69.

We support the legislation enacted in 1996 that phases in an increase. It provided needed relief, while maintaining the integrity of the Social Security trust funds. Given the increased longevity and improved health of many older people, as well as the changing definition of retirement, it is time once again to look at the earnings limit for those who work past age 65.

The economy today is different than it was when Social Security began. With labor shortages looming on the horizon, we ought not to discourage older works from remaining in the labor force. At a time when the law prohibits age discrimination in the work force, we should not be sending mixed signals to older workers.

Raising or eliminating the earnings limit would mean less frustration and inconvenience for beneficiaries and the Social Security Administration. SSA spends between $100- and $150 million annually monitoring excess earnings and updating workers' wage records. Over 60 percent of the agency's overpayment errors result from the earnings limit. As we hear from our members, working beneficiaries ages 65 through 69 are perplexed by the earnings limit and feel punished for their work initiative.

Misunderstandings result not only in overpayments that have to be recouped, but also in underpayments because beneficiaries overestimate their earnings in the report. They file annually with SSA. Even a temporary loss in income can have immediate economic consequences for those who work out of necessity.

Despite the fact that many older persons need extra income and are willing to work, some oppose increasing or repealing the earnings test for those who work past age 65. They argue that the change would be costly to the Social Security trust funds. While there are short-term costs, the Social Security actuaries estimate that the long-term cost to the trust funds is negligible.

Others suggest that any change would be benefit higher income individuals. Many middle-income beneficiaries also work to supplement their Social Security in order to meet current expenses or to set something aside for the future. If they are willing to work, they ought to be able to earn more than the current law allows, particularly if they do not have much in addition to Social Security.

Of course, higher income working beneficiaries will also benefit from the change, but they will pay higher income taxes, more payroll taxes, as well as additional income taxes on up to 85 percent of their Social Security.

AARP firmly believes that now is the time to change the earnings limit. It is good labor, it is good social, and it is good economic policy. We need to find ways to better tap the valuable and still underutilized skills of our older workers. One of the best ways to do this is by removing the penalty that discourages workers, ages 65 through 69, from working and contributing to the economy.

The Association is pleased that Congress and the administration are revisiting the Social Security earnings limit. AARP looks forward to working with this Committee and other interested policy makers on a bipartisan basis to let older workers know their contributions to our economy are needed and are appreciated.

And I thank you very much for this opportunity, gentlemen.

[The prepared statement follows:]

Statement of Jane Baumgarten, Member, Board of Directors, American Association of Retired Persons

AARP appreciates this opportunity to present its views on the Social Security earnings limit or "retirement test." The Association has long supported increasing the earnings limit and has been pleased to have worked with this committee and other Members of Congress to allow beneficiaries ages 65 through 69 to earn more without losing any earned Social Security benefits. AARP supported the legislation enacted in 1996 that phases in an increase in the earnings limit. That change will enable beneficiaries ages 65 to 69 to earn up to $30,000 in 2002 before their Social Security is reduced. The legislation not only helps older Americans who work in order to supplement their Social Security, but it also maintains the financial integrity of the Social Security trust funds.

The earnings limit discourages older people from remaining in the work force and contributing to the country's economic growth. 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 critical that we find ways to better tap the valuable and still underutilized skills of older workers. It is equally important that we enable more beneficiaries to supplement their income without a penalty, just as many do with employer provided pensions and other *non-wage* income.

I. The Earnings Limit in Practice

The earnings limit reduces the Social Security benefits of working beneficiaries up to age 70 whose earnings exceed an annually adjusted threshold. The retirement test is different for beneficiaries under age 65 than for those ages 65 through 69, and no longer applies when a beneficiary reaches age 70. In 2000, beneficiaries ages 62 through 64 lose $1 in benefits for every $2 in earnings above $10,080. Those ages 65 through 69 lose $1 in benefits for every $3 in earnings above the $17,000 limit in 2000. The earnings limit not only restricts the amount a beneficiary can earn from employment without losing any Social Security retirement benefits, but it also can affect spousal and dependent benefits.

Although Social Security has always had a retirement test, it has been modified over time by narrowing its applicability. For example, the age at which the test no longer applies was reduced to 75 in 1950, then to 72 in 1954, and in 1977 was lowered to age 70. The test was changed from measuring only monthly wages to one that measures monthly and yearly earnings. In 1960, the penalty for earnings above the 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 average annual wages. The 1983 Social Security Amendments further eased the penalty for those ages 65 through 69 to a $1 benefit reduction for every $3 of excess earnings. In 1996, an increase was enacted that gradually raises the earnings threshold for beneficiaries ages 65 through 69 to $30,000 in 2002.

AARP believes we should continue to modify the retirement test to accommodate the aging of our population, evolving retirement patterns, and the needs of our labor market and our economy.

II. Reasons for Change

Members of Congress and the Administration have proposed additional improvements in the earnings limit. Changes currently being considered include increasing or repealing the threshold for working beneficiaries ages 65 through 69 as well as adjusting the limit for those ages 62 through 64. Interest in additional improvements reflects a legitimate concern about the effect of current law on working beneficiaries, the administrative burdens imposed on the Social Security Administration

(SSA), and the overall economic and societal benefits of encouraging older Americans to continue working.

AARP supports further liberalization, including repeal, of the earnings limit for those beneficiaries who continue working beyond the Normal Retirement Age. We recognize that there is a short-term cost to the trust funds and urge that the impact be minimized. However, the long-term financial impact on the program is negligible.

A. Effect on Beneficiaries

Most Social Security beneficiaries are not in the paid labor force and will not be affected by changing the earnings limit. Last year, Social Security Commissioner Apfel testified that during 1999, nearly 1.1 million beneficiaries had some or all of their benefits withheld because of work at or after age 62. (Statement before the Senate Democratic Task Force on Social Security, September 13, 1999) About 690,000 beneficiaries ages 65 through 69 lost some or all of their benefits because of excess earnings. In addition, 103,000 dependent and spousal beneficiaries were affected. Among beneficiaries ages 62–64, about 221,000 lost some or all of their Social Security because they worked, and 38,000 dependent and spousal beneficiaries were also affected.

In addition to those who lose benefits, many others who deliberately hold their earnings *below* the threshold in order to preserve their full benefit and maximize their retirement income are adversely affected by the earnings limit. Many in this group rely heavily on Social Security and are likely to have less in savings and/or pension income. For those who are capable and have the desire to earn more than the current earnings limit, the additional income from raising the limit can make a difference. Continued or increased employment may be the only option many working beneficiaries have 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 a penalty on earnings because nonworking beneficiaries with the same or even larger incomes generated from other sources, such as pensions or capital gains, do not have to forego any benefits. They feel punished for their work initiative. The argument that Social Security was designed as a partial replacement for income lost due to retirement, and that the earnings limit is designed to measure whether a worker is retired, often does not resonate with beneficiaries who need income today and must work to augment their Social Security.

B. Administrative Problems

The retirement test creates administrative problems for the Social Security Administration. It spends $100 -$150 million annually to monitor excess earnings and update workers' wage records. The agency estimates that sixty-eight percent of its overpayments are due to the earnings limit. Changing the limit would ease Social Security's administrative burdens.

A substantially higher or repealed earnings limit also would mean less frustration and inconvenience for working beneficiaries. Misunderstanding about the earnings limit creates financial and emotional hardships when overpayments are recouped, especially from beneficiaries who depend on their earnings to supplement their Social Security. Beneficiaries who overestimate earnings will have more benefits withheld than necessary. These lost benefits may be restored, but a temporary reduction in income could have immediate economic consequences. In addition, some beneficiaries forfeit a month of benefits for failing to file a report of estimated earnings in a timely manner. They may be unaware of this annual filing requirement, especially if they return to the labor force some time after having filed for benefits. (Generally, beneficiaries receive information about filing an annual earnings estimate when they apply for Social Security.)

C. Effect on the Economy

While Social Security is intended as a partial replacement for income lost due to retirement, disability, or death of the worker, the definition of retirement has evolved to accommodate changing work patterns, labor shortages, and increased longevity. Some older individuals choose to gradually ease out of the work force rather than drop out entirely, and many continue working full-time or part-time because they need additional income. As our society continues to age and the pool of knowledgeable and willing workers lags behind demand, older workers will be needed in the work force more than ever.

If older Americans can earn more without penalty, there could be a greater incentive for them to work. Working beneficiaries will have additional money to contribute to the economy and will pay additional tax dollars into the federal treasury.

Moreover, employed older people tend to remain healthy longer, suggesting the prospects for lower costs for the Medicare program.

D. Additional Costs

Working beneficiaries ages 65–69 who exceed the limit resent having to return 33 ⅓ cents of their benefits to the government for each dollar earned. When the returned benefits are combined with payroll taxes, federal income taxes, state taxes, and income taxes on up to 85 percent of benefits, the cost of working can be quite high and acts as a strong disincentive to work. Those ages 65 through 69 who lose some of their benefits will receive a delayed retirement credit (DRC) that partially compensates for lost benefits. They are not made whole, however, because the current 6 percent DRC is not actuarially equivalent to the lost income. (The credit is being increased to the actuarially fair level of 8 percent by the year 2008, on a phased-in basis.)

III. Concerns About Changing the Earnings Limit

While many policymakers and analysts recognize the value in changing the earnings limit for those who work past the Normal Retirement Age, some concerns remain. The most widely mentioned are the impact on the trust funds and the economic status of those who would benefit from the change.

A. The Cost Concern

Some oppose changing current law because it creates a modest cost to the trust funds over the short term. While this is true, SSA actuaries estimate that the long-term cost to the trust funds is negligible since the value of the total benefits paid to the individual over a lifetime does not change significantly. This results from the fact that those whose post–65 earnings cause a benefit loss will receive a delayed retirement credit, which currently does not fully compensate for the lost Social Security. With further liberalization (or elimination), the individual can earn more and receive a benefit now instead of getting a larger benefit later that includes a DRC. Once the DRC reaches 8 percent, the trust funds pay the individual roughly the same amount of lifetime total benefits; it is simply that the payout schedule differs.

The Congressional Budget Office (CBO) suggests that the overall costs associated with raising the limit may be overstated because the revenue generated by additional work is often disregarded. (SSA estimates the additional revenue would offset between 10 and 15 percent of the cost of repeal.) While the revenue gained from increased work force participation may be difficult to project because of uncertainties about the number of retirees who will increase their work effort and their earnings level, it is clear that some additional federal revenues will be collected. The primary revenue sources are the income tax, the payroll tax, and increased taxation of Social Security benefits.

B. Benefit Distribution Concern

Raising the earnings limit will have little impact on low and moderate income older Americans since many of them do not work or have earnings below current law thresholds. Middle income working beneficiaries, however, may be trying to cope with a smaller income, modest assets, and the prospect of increased longevity. Should we penalize beneficiaries who work to supplement their Social Security while other beneficiaries with the same or even higher incomes from pensions and non-wage income do not have a benefit reduction? What other options do these working beneficiaries have to increase their income and prepare for a time when ill health and/or advanced age may force them out of the work force?

Some oppose further improvements because they believe that only those with higher incomes would benefit. If the earnings limit is changed, *many* older Americans will benefit, including those with higher incomes. Higher income beneficiaries, however, will pay additional income and payroll taxes, as well as higher income taxes on their Social Security benefits. In any event, *all* beneficiaries age 70 and over regardless of earnings receive their full Social Security benefit without penalty.

IV. Changing the Earnings Limit for Beneficiaries Age 62 Through 64

There is widespread agreement on raising, if not eliminating, the earnings test for those ages 65 through 69, but there is no consensus about what changes should be made for the age 62–64 group.

Supporters of liberalization (or elimination) note that beneficiaries ages 62 through 64 may continue working or increase their work effort and thus continue to contribute to our economy. Some policy analysts observe that the earnings test for the younger group is a greater deterrent than many realize. They believe that if older workers withdraw from the labor force at age 62 because of the earnings test, they would be less inclined to enter the workforce at age 65 even if, at that age, there are no earnings restrictions.

Those who oppose eliminating the test for beneficiaries ages 62 through 64 cite the added short-term costs to the trust funds and the potential impact on the long-term economic well-being of those who would start collecting Social Security at 62 instead of waiting. The adverse impact will be greatest for the survivors of poor and modest income older beneficiaries who have less income from other sources to augment their Social Security. Workers who currently file for benefits at age 62 experience a twenty percent actuarial reduction because they begin receiving benefits before the Normal Retirement Age. As the age for collecting full benefits moves to age 67, future beneficiaries who collect benefits at 62 will face a thirty percent reduction. The effect of these substantially reduced benefits will not be apparent immediately while earnings supplement the Social Security benefit. The impact of a permanently reduced benefit, however, could be more pronounced later in life as older beneficiaries, particularly their survivors, become more reliant on Social Security income. Older beneficiaries have a greater chance of being poor, of having consumed their other assets, and of not being able to supplement their Social Security.

Opponents of repeal argue that if the earnings test remains in place, more people will continue to work and not collect benefits. As a result, upon retirement they and their survivors will receive a larger benefit.

AARP believes that because of the added trade-offs, further evaluation of the impact of any change for the age 62–64 group is necessary. While we should remove disincentives to continued work where possible, we must also ensure the long-term adequacy of Social Security benefits.

V. Conclusion

AARP is pleased that Congress and the Administration are revisiting the earnings limit. We strongly support removing penalties that discourage workers ages 65 through 69 from remaining in the workforce and contributing to the economy. This is good public policy. We look forward to working with this committee on a bipartisan basis to achieve this goal.

Chairman SHAW. Thank you.
Mr. Woods.

STATEMENT OF TOM WOODS, CHAIRMAN OF THE BOARD, HOME BUILDERS INSTITUTE, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. WOODS. Good morning, Mr. Chairman, and Members of the Committee. I am Tom Woods, and I am a small business owner and a homebuilder from Kansas City, Missouri. And I come to you today not only representing my 25 years of experience as a small business owner, but also representing the perspective of the 200,000 business members of the National Association of Home Builders and their 8 million employees. I also serve as the chairman of the board of the Home Builders Institute, which is the educational arm of the National Association of Home Builders.

Mr. Chairman, before I get into my testimony and all of the facts and the figures that are so important to this complicated issue, I would like to share a very brief anecdote with you. It put a very human face on the Social Security earnings test issue for me. This is not part of my formal written testimony that I submit to the record, but I feel it is important.

Just before I flew here, I took the time to stop at a coffee shop that is frequented by a lot of the men that I have known over the years who have worked for and with me building homes, and I asked them, as a group, flat out: If you could come back to work, even part time, or come back to work to help me teach the young people that are now on our job sites, the young men and women, would you? Every single one of them said they wished they could, but they couldn't afford to.

Mr. Chairman, they may be older, but they are fit, and they are strong, and they know things, with 30 or 40 years' of experience, that the young people have yet to even imagine or learn. They have the experience to know, but they cannot afford to come back to work because of the Social Security earnings test. Mr. Chairman, these people are hardly millionaires, and they want to know since when in America does it cost you to want to work hard?

Today, Mr. Chairman, my colleagues in the home building industry are experiencing a severe shortage of skilled workers. It is not a short-term phenomenon. For the last 3 years, it has been the number one issue among NAHB members in our quarterly surveys. It has become even more important than things like dealing with permit process or material costs and the like. And with most young people looking for their future in the high-tech industry, we do not expect the trend to go away any time soon.

To put the problem in perspective, last year, there were 1.7 million permits issued for the construction of new homes. I employ about 300 workers on each house, either through my own crews or contractors or subcontractors. The math is staggering. The need for skilled workers is great. And this is especially so in an industry accounting for 4.7 percent of the gross domestic product.

The Labor Department tells us that we need 240,000 new workers each year, that they must be recruited and trained every year to meet America's building needs. And, Mr. Chairman, it is just not happening. We are experiencing shortages across the Nation in every occupation in the home building industry.

The National Association of Home Builders, through the Home Builders Institute, is training thousands of young adults every year in the construction trades, but we don't come close to making up for those lost through retirement. And the people we are losing are the men and women with the best knowledge base, the ones who would make the very best teachers because of their years of experience.

Mr. Chairman, the Social Security earnings test robs our Nation of the contributions that our vibrant, healthy seniors want to contribute and continue making. It robs them of the ability to be part of our strong, growing economy. And perhaps worst of all, the Social Security earnings limit robs them of what researchers tell us American seniors need most: physical activity, a purpose in life, and the socialization that goes along with working and teaching and sharing knowledge on a day-to-day basis.

Let me just conclude with this: The Social Security earnings limit was created when our economy wasn't stable enough to support both young workers and older workers, and we weren't living as long, and we weren't as healthy in our later years as we are now. It made sense then, but times have changed. Instead of helping solve a problem, it is creating one. That is the shortages that I talked about, the work force that we are not able to sustain. It is robbing our younger workers of the incredible knowledge base older workers have and want to share.

Please let me go back to Kansas City, go back to the coffee shop, go back and tell these men who want to come back to work that I won't break their budget.

Thank you very much for your time, and I look forward to working with you.

[The prepared statement follows:]

Statement of Tom Woods, Chairman of the Board, Home Builders Institute, National Association of Home Builders

Good morning, Mr. Chairman and members of the Ways and Means Subcommittee on Social Security. My name is Tom Woods, and I am a small business owner and home builder from Kansas City, Missouri. I am here today to talk to you about how the Social Security earnings test deprives the home building industry of many of its best and most experienced workers. And also to tell you that the Social Security earnings test robs our vibrant and healthy senior citizens of the opportunity to contribute to the economic vitality of this country and share their expertise and positive work ethic with younger workers.

I am not only representing my personal experiences of more than 25 years in the home building business, but also the perspective of the 200,000 business members of the National Association of Home Builders (NAHB) and their more than 8 million employees.

I have a strong commitment to the issue of worker development and retention. I currently chair the Association's Task Force on Labor Shortages and concurrently serve as Chair of the Board of Trustees of the Home Builders Institute (HBI), an organization solely dedicated to educating and training workers for the home building industry. And I am pleased to say that I am accompanied today by Frank Riggs, the recently appointed President of the Home Builders Institute and your former colleague from Northern California.

Today the home building industry is experiencing a severe shortage of skilled workers. This shortage of workers is so severe that for the past three years labor availability has ranked as the number one industry issue across the country in NAHB quarterly surveys of twenty critical issues. For the home building industry, labor availability is proving to be more important than all of the more traditional issues that one might associate with construction, such as cost and supply of materials, development costs, and the entire development and permitting process.

And far from being a temporary situation, a strong economy and changing demographics, coupled with occupational trends, suggest that this shortage of skilled workers in the home building industry will continue well into the future. To give you a perspective on this, please consider the following:

- Last year there were 1.71 million permits issued to build new homes. To give you an example of what this means in terms of numbers of workers, I estimate that for each of the homes I build I employ about 300 workers, either directly or through sub-contracts. If you multiply that by even 1 million new homes, it is easy to see how significant a skilled workforce is to this important industry that represents more than 4.7% of the Gross Domestic Product.
- In terms of demographics, aging Baby Boomers in the construction industry are already beginning to retire, and in part because of the Baby Bust of the 1970s, there is a much smaller pool from which to draw new workers. Currently, the United States Department of Labor estimates that some 240,000 new workers must be recruited and trained each year to meet the nation's building needs, and it is just not happening. Today we are experiencing a shortage of skilled workers in virtually every occupation in the home building industry.
- And we find that we are also challenged in our recruitment efforts by the draw of competing occupations, particularly new technology jobs that are such an attraction for younger workers.

While NAHB, through HBI and its state and local affiliates, trains thousands of young adults each year in the construction trades, these efforts do not compensate for the loss that the industry suffers each year in retirements.

From our industry's standpoint, the current Social Security earnings limit deprives the industry of an important segment of its knowledge base—craft skills workers with years of experience who face a very real financial disincentive if they want to continue working beyond retirement age. And with those retirements, we also lose the best teachers that we have to transfer craft skills to younger generations, the high quality workmanship that goes along with many years of experience, and a work ethic that sets standards for high productivity.

The Social Security earnings test allows recipients under age 65 to earn up to $10,080 a year in wages or self-employment income without having their benefits affected. After this "earnings limit," retired workers lose $1 in benefits for every $2 in earnings. If retired workers are between ages 65 and 69, they can only earn up to $17,000 a year before losing $1 in benefits for every $3 in earnings. For most workers, including those whom I use to build my homes in Kansas City, this substantial reduction in benefits is entirely too much to justify working beyond the earnings limit.

As you know, the earnings test has been part of the Social Security program since its inception. And early on, when the American economy was not stable enough to sustain great numbers of both older and younger workers, and when we were not living longer, healthier lives as we are now, it made sense. But now that America has the opposite problem of insufficient numbers of workers, and many, many vital senior citizens who very much want to work, its sole function is to force, and keep, our older citizens out of the workforce.

From our perspective, this is unfair, as Social Security is a retirement benefit that is earned through a lifetime of contributions, and as such should not be taken away because an individual continues to work beyond the traditional retirement age. And what about retired individuals who must continue to work in order to survive?

Social Security benefits are oftentimes meager and, alone, do not provide for the quality of life that hard-working Americans deserve in their golden years. And for some older individuals, continuing to work is an absolute necessity, as they have no other source of income to cover basic necessities and pay their bills. Continuing to maintain the Social Security earnings limit unduly hurts poorer retired workers. The limit should be eliminated to encourage their participation in the workforce.

A recent study published by the Institute for Policy Innovation (IPI) estimates that someone between 65 and 69, paying no income tax but earning over the limit, could face a marginal tax rate of forty-one percent. "For people who also pay federal income tax, the marginal tax rate on wages can be well over 80 percent. . .such high, punitive tax rates on working individuals may help explain why only 16.5 percent of men age 65 and over are in the workforce today, compared to 47 percent fifty years ago."

For our nation's home builders, retention of skilled workers plays an important role in meeting our workforce needs. Because the skills of decades ago are no longer taught in current education and training programs, home builders especially recognize the need to keep and utilize the unique talents of retirees. And study after study confirms the importance of physical activity, having a purpose in life, and the opportunity for socialization, to the continued health and mental vitality of senior citizens.

Mr. Chairman, NAHB believes that it is time to retire the Social Security earnings test. We thank you for giving us the opportunity to share our views with you, and we commend you for your efforts to encourage older Americans to stay in the workforce longer and remain productive members of society. We look forward to working with you, and members on both sides of the aisle, to lift the Social Security earnings limit and help diminish the labor shortage problem confronting the home home building industry today.

Chairman SHAW. Thank you, Mr. Woods. And you can bring that message back to the coffee shop.

Mr. Martin.

STATEMENT OF JAMES L. MARTIN, PRESIDENT, 60 PLUS ASSOCIATION, ARLINGTON, VIRGINIA

Mr. MARTIN. Thank you, Mr. Chairman. The 60 Plus Association is a nonpartisan seniors group that honors Members of Congress in both parties who are senior friendly, and we look forward to honoring everybody on this panel that is going to vote for repeal of this particular bill.

Having worked on Capitol Hill 35 years ago as chief of staff to the late Senator Ed Gurney of Florida, I have seen a lot of taxes come, but I haven't seen very many go. But if today's headline is accurate in this paper, with the President of the United States, no less, endorsing today's efforts, then here is a tax whose time to go has come.

The earnings limitation was imposed, as was said before, during Depression times, 25-percent unemployment, to free up jobs for younger workers. But the Chairman himself was widely quoted today as saying, "While it may have made sense then, it sure doesn't make much sense today."

And Congressman Sam Johnson, who is chief sponsor of this bill, this former Marine looks at him in awe, he was quoted this morning, after having fought in two World Wars, he also fought for the freedom to work.

We shouldn't penalize those who not only want to work, but need to work to supplement their Social Security, and that includes my favorite senior citizen, my mom, my sainted mom, who still works part time down in Florida. The 60 Plus Association strongly endorses repeal of this tax. It is a major step toward fulfilling our slogan, "Tax Fairness for Seniors."

On behalf of the 60 Plus chairman, former Congressman Roger Zion, who served on this body well in the sixties and seventies, it is my pleasure to introduce our coworker at 60 Plus, Colonel Hank Huff, who has a personal story to tell about this particular tax.

Thank you.

[The prepared statement follows:]

Statement of James L. Martin, President, 60 Plus Association, Arlington, Virgnia

Mr. Chairman, Members of the Subcommittee,

I'm Jim Martin, President of the 60 Plus Association, an eight-year national nonpartisan seniors' advocacy organization of over half a million members.

Having worked on Capitol Hill more than 35 years ago as press secretary and administrative assistant to the late Senator Edward J. Gurney of Florida, I'm well aware of the long hours and hard work that go into these hearings.

Our slogan at the 60 Plus Association is "tax fairness for seniors."

There are many unfair taxes on seniors, notably the federal estate or death tax. We are dealing with another unfair tax today, the earnings limitation imposed on senior citizens between the ages of 65 and 69.

This earnings limitation was imposed at a different time in a different era to meet very different conditions.

It was imposed in the early days of the Social Security Act. At that time, seniors were fortunate to live to 65 years of age. There was concern that those who lived 65 and beyond and wanted to work or had to work would take jobs away from others. Therefore, a penalty was imposed.

Today is a much different situation. More seniors are living not only to 65, but many into their 70s, 80s, 90s and beyond.

We also are living in prosperous times where there is a shortage of workers, rather than of jobs.

We should be encouraging seniors to continue work. It helps them. It helps the economy.

We should reward those who want to work, not penalize them. This should be the case whether they choose to work or to spend full-time in leisure and other pursuits.

The 60 Plus Association commends this Subcommittee, its Chairman and its Members, for holding hearings on repeal of this tax. Removing it will be a major step toward tax fairness for seniors.

I'd now like to turn to my co-worker at the 60 Plus Association, Hank Hough, who has his own story to tell regarding this tax and its personal effect.

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60 Plus is a seven-year-old non-profit, nonpartisan group with a less government, less taxes approach to seniors' issues. 60 Plus is supported by voluntary donations from its 500,000 citizen lobbyists to print and mail millions of letters, petitions and voting indexes. 60 Plus publishes

Continued

Chairman SHAW. Thank you.
Colonel.

STATEMENT OF RETIRED LIEUTENANT COLONEL HENRY A. HOUGH, EXECUTIVE VICE PRESIDENT, 60 PLUS ASSOCIATION, ARLINGTON, VIRGINIA

Lt. Colonel HOUGH. Mr. Chairman, Committee members. My name is Henry A. Hough. I am 72 years old and am executive vice president of The 60 Plus Association and work for Jim Martin. I retired from the Army as a Lieutenant Colonel in July 1974 and have worked full time as a civilian since then in a variety of careers.

From 1974 to 1977, I worked for Amtrak here in Washington. And for the next 17 years, I was involved in Air Defense Command Control and Communications projects in Saudi Arabia, working for full time for Litton, Boeing and Westinghouse.

I certainly don't claim to be a tax expert. However, I am something of an expert on the negative personal impact of this egregious legislation. As a result, I paid back $11,452 over the 3 years that I worked when I was 67, 68 and 69; $3,245 in 1995; $4,621 in 1996; and $3,586 in 1997. Understandably, this is an emotional issue with me. Even though my loss is unrecoverable, I am highly pleased by the Committee's efforts, headed by Chairman Shaw, to eliminate this tax to correct a gross injustice to older Americans, 65 through 69, who want to work or, in some cases, may have to work.

Furthermore, I submit to the Committee not only is the law wrong, but the administration of it by the Social Security Administration is all fouled up. While I certainly don't fault the Social Security employees who are doing their best under the circumstances, repaying the Social Security earnings limit has been a bureaucratic nightmare. The details are in my prepared statement. But it suffices to say that the notices were delayed for as long as a year and a quarter. It is difficult to develop a viable personal budget when you don't know when the other shoe will drop.

The economic and employment picture has changed drastically since the earnings limit was established, as has been pointed out here today. Today, there is a tight labor market with firms having to go abroad to get qualified workers, particularly in professions and highly technical areas. That says something about our educational system, but that is another matter. Older workers have the experience, qualifications, work ethic and good judgment to fulfill these labor shortages, provided there are economic incentives for them to do so.

I am not advocating, by any means, that all of us older workers should rush into the labor market. It should be an individual choice. Many seniors have hobbies, family and other interests which favor full retirement, precluding working. Others may want

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a newsletter, SENIOR VOICE, and a SCORECARD, bestowing a GUARDIAN OF SENIORS' RIGHTS award on lawmakers in both parties who vote "pro-senior." 60 Plus has been called "an increasingly influential lobbying group for the elderly."

to work part time. But those of us seniors who want to or have to work full time, should have an unfettered choice to do so. As Senator Dole asks, why retire? And look at Chairman Greenspan and, I might add, certain Members of Congress who pursue active careers as bona fide seniors.

There are favorable psychological factors to having an opportunity to work. For one thing, work contributes to seniors' self-esteem. Instead of older people being regarded as a burden on society, they can make a positive contribution to the economy and society and feel good about themselves. Another factor is the changing demographics, with seniors representing an increasing percentage of the U.S. population, based on greater numbers entering the retirement age pool, or baby boomers, and increased life expectancy.

The real issue is are seniors going to be a burden or an asset to society? If you work, you pay taxes and contribute to economic growth. If you don't work, you don't pay taxes. Also, the more older workers contribute to the economy, the less strain on the rapidly emerging problems of the Social Security system.

And, finally, I believe there is widespread support amongst all seniors to remove this egregious inequity.

Thank you very much.

[The prepared statement follows:]

Statement of Retired Lieutenant Colonel Henry A. Hough, Executive Vice President, 60 Plus Association, Arlington, Virginia

My name is Henry A. Hough and I am 72 years old. I am Executive Vice President of the 60 Plus Association located in Arlington, Virginia. This matter of the earnings limit on older Americans in the 65–69 age group has been a major issue of the 60 Plus Association.

I retired from the US Army as a lieutenant colonel, July 1, 1974, and have worked full time as a civilian since then in a variety of careers. From 1974 to 1977 I worked for Amtrak here in Washington with extensive traveling around the USA. For the next 17 years, 1977 to 1994, I was involved in various Air Defense Command, Control and Communications projects in Saudi Arabia working for Litton, Boeing and Westinghouse, working full time, both in Saudi Arabia and in the United States.

When I returned from Saudi Arabia in 1994, I decided to start yet another career as a political activist; rather than just talking about what's wrong with the country, try to do something about it. At the age of 67, I started working for 60 Plus in April 1995.

I certainly don't claim to be a tax expert which I most emphatically am not. However, I am something of an expert on the negative personal impact of this egregious legislation, the Social Security Earnings Limit, which has resulted in a loss of $11,452 to me for working when I was 67, 68 and 69, broken down as follows:

1995	$3,245.00	(Support Data Enclosed)
1996	4,621.00	(Support Data Enclosed)
1997	3,586.00	(Support Data Enclosed)
Grand Total	$11,352.00	

Understandably, this is an emotional issue with me. Even though my loss is unrecoverable, I am highly pleased by the committee's efforts, headed by Chairman Shaw, to eliminate this tax to correct a gross injustice to older Americans, 65 through 69, who want to, or in some cases, may have to work.

Furthermore, I submit to the committee not only is the law wrong, but the administration of it by the Social Security Administration is all fouled up. While I certainly don't fault the Social Security employees who are doing their job as best they can under the circumstances, repaying the Social Security Earnings Limit has been a bureaucratic nightmare. I knew about the law and starting before April 15, 1996, for tax year 1995, I started inquiring about the procedures for repayment and got no response after repeated inquiries. I explained I was trying to do the right thing,. Finally, I got the notice for tax year 1995 dated October 31,1996, followed by a penalty assessment of $1150.00 dated February 18, 1997. I received the payment notice for tax year 1996 dated July 31, 1997 in a fairly timely manner. However, I did not receive the notice for tax year 1997 until March 21, 1999. It's difficult to develop a viable personal budget when you don't know when the other shoe will drop.

The economic and employment picture has changed drastically since the EarningsLimit was established in 1935. Today, there is a tight labor market with firms having to go abroad to get qualified workers, particularly in professions and highly technical areas, that says something about our educational system, which is another matter. Older workers have the experience, qualifications, work ethic and good judgment to fulfill these labor shortages providing there are economic incentives for them to do so. The progressive increases of the earnings limit starting in 1996 up to the current $17,000 were a step in the right direction, but, as my experience indicates it certainly is a disincentive. You may ask, why am I working? Well, for one thing I started working at 60 Plus closer to the threshold age of 70 after which there are, of course, no limits on earnings. For a person continuing to work after 65, that five year gap to 70 can really be a whopper, much larger than the loss I experienced. Another reason I'm still working is a sense of fulfillment, but even here there are limits to economic obstacles like the Earnings Limit.

I am not advocating, by any means, that all of us older workers should rush into the labor market. It should be an individual choice. Many seniors may have hobbies, family and other interests which favor full retirement, precluding working. Others may want to work part time. But those of us seniors who want to, or have to, work full time should have an unfettered choice to do so. As Senator Dole asks, why retire? And look at Chairman Greenspan and, I might add, certain members of Congress who pursue active careers as bonafide seniors. There are favorable psychological factors to having an opportunity to work. For one thing, work contributes to seniors' self esteem. Instead of older people being regarded as a burden on society, they can make a positive contribution to the economy and society and feel good about themselves.

Another factor showing the impracticability of the Earnings Limit is the changing demographics with seniors representing an increasing percentage of the U.S. population, based on greater numbers entering the retirement age pool (baby boomers) and increased life expectancy. The real issue is: "Are seniors going to be a burden or an asset to society?" If you work, you pay taxes and contribute to economic growth. If you don't work you don't pay taxes. As I said, I'm not a tax expert, but I'm willing to bet that a study would show that the projected revenue gains from more seniors working would more than offset revenues from paying back under current legislation. Also, the more older workers contribute to the economy, the less strain on the rapidly emerging problems of the Social Security system.

And finally, I believe there is widespread support amongst all seniors to remove this egregious inequity. Whether or not they are working, they recognize the inequity of this terrible legislation which I believe, they overwhelmingly want repealed. Even if they are not working, they know somebody who has been adversely affected by it.

Thank you very much.

Chairman SHAW. Thank you, Colonel.

Ms. McSteen.

STATEMENT OF MARTHA A. McSTEEN, PRESIDENT, NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

Ms. MCSTEEN. Thank you, Mr. Chairman. I am Martha McSteen, president of the National Committee to Preserve Social Security and Medicare, a grassroots education and advocacy organization representing millions of senior Americans. The members and supporters of the National Committee strongly support enactment of H.R. 5.

Many National Committee members need to remain in the work force because of such factors as increased cost of living and expensive prescription drug bills. Others work because they receive satisfaction from continuing to be productive and creative. And increasingly, "retirees" must help support an 80- or 90-year-old parent.

As we all know, the intent of the original legislation was to preclude workers from returning to a crowded work force. Today, unemployment is at a 30-year low, and our Nation faces an acute labor shortage. It is, indeed, time to retire the Social Security earnings limitation.

I commend you for your actions in 1996 and urge you to now take the final step and eliminate the earnings test. About one in three people between the ages of 65 and 69 and eligible for retired worker benefits is employed at some point during the year. In 1999, about 800,000 beneficiaries in this age group lost some or all of their benefits because of the earnings limitation. The Social Security Administration withheld about $3.9 billion in benefits from these beneficiaries in 1999. These statistics do not factor in the number of individuals dissuaded from applying for benefits because they realized the earnings limit would consume most or all of their earned benefits. The impact of the earnings limitation may explain why, despite improved health among seniors, only 16.5 percent of men 65 and over are in the work force today. That is compared to about 47 percent 50 years ago.

Maintaining independence in retirement is important to today's seniors. Not all seniors work because they need the money. Many receive satisfaction from continuing to be productive and creative. Instead of a national policy to encourage the continuing use of the talent, energy and wisdom America's seniors bring to the workplace, the earnings limitation serves as an active disincentive to work. Others who do work find ways of avoiding paying Social Security taxes so their benefits will be protected. At the same time, the trust funds lose those rightful contributions.

Opponents of eliminating the earnings limit, argue that such policy would primarily benefit the wealthy who, "Don't need Social Security." However, Social Security is not a needs-based program. Upper-income workers have earned their benefits. They are also more likely than low- or middle-income workers to have substantial unearned income from savings and investments. Since unearned income is not subject to the earnings limitation, the question of equity exists. Whether or not the senior works out of necessity or for enjoyment, the combination of FICA payroll taxes, income tax and loss of Social Security benefit if the earnings exceed the limitation exact a high price.

Over the years, the main obstacle to eliminating the earnings limitation has been the cost. True, there would be a short-run budgetary cost. Removing the earning test for those at the full benefit age and above would raise Social Security expenditures by about $21 billion over the first 9 years. However, since elimination of the earnings test reduces the subsequent benefit increases that would have occurred through the actuarial adjustments, the cost of repeal declines as the years pass. Over the long run, we are told there is very little, if any, actuarial impact.

In addition to being one of the least-popular features of Social Security, the earnings limitation is also one of the most widely misunderstood and confusing. Reductions in current benefits are offset by an increase in future benefits, the so-called delayed retirement credit. Although the actuarial adjustments are fair, on average, for the population as a whole, they are not always accurate for specific population groups. Even if delayed retirement credit balances out over the long run, it does not help those seniors who are working because they need all of their benefits and earned income for immediate needs.

Finally, I would note that administering the test is a resource-intensive administrative operation. Repeal of the test would mean that claims representatives would no longer have to calculate benefit withholding based on the earning estimates under our overpayments. 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.

Let us acknowledge that the earnings test is an outdated relic from the Depression era. Given today's booming economy and record low unemployment, it makes sense to encourage seniors to continue to use their wisdom, skills and work ethic to benefit American business rather than penalize them for working.

Mr. Chairman and Members of the Subcommittee, I commend you for holding these hearings on this important issue and urge you to continue to work to eliminate the Social Security earnings limitation.

Thank you very much.

[The prepared statement follows:]

Statement of Martha A. McSteen, President, National Committee to Preserve Social Security and Medicare

Thank you Mr. Chairman for giving me the opportunity to come before the Subcommittee and talk about the need to repeal the Social Security earnings limitation for those individuals who have reached the normal retirement age. Thank you, too, for your ongoing interest in issues affecting our nation's seniors.

I am Martha McSteen, President of the National Committee to Preserve Social Security and Medicare, a grassroots, education and advocacy organization representing millions of seniors Americans. The about five million members and supporters of the National Committee strongly support enactment of H.R. 5.

Many National Committee members need to remain in the work force, because of such factors as increased costs of living and expensive prescription drug bills. Others work because they receive satisfaction from continuing to be productive and creative. Whatever the reason they chose to continue paid employment, America's seniors also deserve to receive their full retirement benefits earned through a lifetime of contributions. Seniors cannot see why they should lose part or all of their benefits for continuing to work or the rationale behind penalizing retirees at 68 or 69 but not at 70.

The Social Security earnings limitation dates back to the establishment of Social Security. In 1935, the Committee on Economic Security appointed by President Franklin D. Roosevelt recommended that no benefits be paid before a person had "retired from gainful employment." Initially, the Social Security Act provided that benefits would not be paid for any month in which the individual had received "wages with respect to regular employment."

The intent of this limitation was to preclude workers from returning to the workforce. This was deemed necessary because of the high unemployment rate our nation was experiencing at the time. Today, though, our situation is very different. Unemployment is at a 30 year low and our nation faces an acute labor shortage. It is indeed time to retire the Social Security earnings limitation.

In 1996 Congress enacted legislation (P.L. 104–121) to allow a faster increase in the earnings limit for retired workers between ages 65 to 69. In 2000, senior citizens aged 65 to 69 lose $1 in benefits for every $3 they earn over $17,000 annually. By 2002 those seniors will be able to earn up to $30,000 annually without penalty. I commend you all for your actions in 1996, and urge you to now take the final step and eliminate the earnings test.

About one in three people between the ages of 65 and 69, and eligible for retired worker benefits, is employed at some point during the year. In 1999, about 800,000 beneficiaries in this age group lost some or all of their benefits because of the earnings limitation and the Social Security Administration withheld about $3.9 billion in benefits from these recipients. Of course, these statistics do not factor in the number of individuals dissuaded from applying for benefits because they realized the earnings limit would consume most or all of their earned benefits.

The impact of the earnings limitation may explain why, despite improved health among seniors, only 16.5 percent of men age 65 and over are in the workforce today compared to 47 percent 50 years ago.

Social Security benefits are often described as being one leg of a three-legged stool. The other legs are made up of private savings and pensions. It is important to note that fewer than half of all seniors have their Social Security benefits supplemented by a pension. For those who do have pension income, lack of cost-of-living adjustments after retirement results in a continuing decline in their purchasing power.

Savings can be equally elusive. Even those seniors who have accumulated respectable nest eggs, can see them quickly eroded by the high costs of nursing home care, exorbitant prescription drug costs, or other major medical expenses not covered by Medicare. And, as life spans increase, more and more retirees find themselves responsible for the care of an aged parent.

Maintaining independence in retirement is important to today's seniors. Not all seniors work because they need the money. Many receive satisfaction from continuing to be productive and creative. Instead of a national policy to encourage the continuing use of the talent and energy and wisdom America's seniors bring to the workplace, the earnings limitation serves as an active disincentive to work.

Opponents of eliminating the earnings limit argue that such policy would primarily benefit the wealthy who "don't need Social Security." However, Social Security is not a needs based program. Upper income workers have earned their benefits. They are also more likely than low or middle-income workers to have substantial unearned income from savings and investments. Since unearned income is not subject to the earnings limitation, a question of equity exists.

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 exact a high price.

Over the years, the main obstacle to eliminating the earnings limitation has been the cost. It is true that there would be short-run budgetary costs. Removing the earnings test for those at the full benefit age and above would raise Social Security expenditures by about $21 billion over the first nine years. However, since elimination of the earnings test reduces the subsequent benefit increases that would have occurred through the actuarial adjustments, the costs of repeal required declines as the years pass. Over the long run, there is very little actuarial impact.

In addition to being one of the least popular features of Social Security, the earnings limitation is also one of the most widely misunderstood and confusing. Reductions in current benefits are offset by an increase in future benefits (the delayed retirement credit).

However, although the actuarial adjustments are fair on average for the population as a whole, they are not always accurate for specific population groups. For example, cohorts with shorter-than-average life expectancies generally do not recover all of their lost benefits. Because of differences in life expectancies, the earnings test works to the disadvantage of lower-income beneficiaries in particular. Also, even if the delayed retirement credit balances out over the long run, it does not help those seniors who are working because they need ALL of their benefits and earned income for immediate needs.

Finally, I would note that administering the test is a resource intensive administrative operation. Repeal of the test would mean that claims representatives would no longer have to calculate benefit withholding based on earnings estimates, under or overpayments at the end of the year based on actual earnings or the new benefit amount 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.

Mr. Chairman and Members of the Subcommittee, I commend you for holding hearings on this important issue, and I urge you to continue your work to eliminate the Social Security earnings limitation for those seniors who have achieved the normal retirement age.

The earnings test is an outdated relic from the depression era. Given today's booming economy and record low unemployment, it makes sense to encourage seniors to continue to use their wisdom, skills and work ethic to benefit American business rather than penalize them for working.

Chairman SHAW. Thank you. Ms. Wondemu?

STATEMENT OF ZED WONDEMU, OWNER, ZED'S ETHIOPIAN CUISINE, GEORGETOWN, WASHINGTON, D.C., ON BEHALF OF NATIONAL RESTAURANT ASSOCIATION

Ms. WONDEMU. Mr. Chairman and Members of the Subcommittee, thank you for the chance to testify on the impact of the Social Security earnings test. My name is Zed Wondemu and I own and run Zed's Ethiopian Cuisine in Georgetown.

This issue has long been a frustration of mine and it is my sincere hope that you, as lawmakers, will eliminate the earnings test and allow more older Americans to work without fear of losing their benefits.

I know that when people think of restaurant employees they think of younger adults. But as the nation's largest private sector employer, the food service industry also employs tens of thousands of individuals between the ages of 65 and 70.

Although I am testifying today on behalf of the National Restaurant Association, I am here to tell my own story. As a small business person, I see firsthand how the Social Security earnings test changes the choices people make. My restaurant, which offers excellent cuisine with quality service, employs only ten individuals. Clearly, I rely on the quality of employees, not the quantity, to uphold my restaurant's reputation.

I take great pride in the fact that, for several years running, my restaurant has been recognized by Washingtonian Magazine as one of Washington's 100 very best restaurants.

In addition to my restaurant, I also own a small apartment building, with just seven units. Given the size of the building I do not need, and cannot afford, a management company. To help out with the upkeep of the building, I wanted to hire an older gentleman who lives in one of the apartments. Prior to his retiring, the tenant was a maintenance worker for a company in this area. At the age of 69, he is in excellent health. In fact, I would say he is still very strong and vibrant for any age. However, because of his concern over losing his Social Security benefits if he works too many hours, I am unable to hire him to be an on-site manager.

I do not understand the need to continue this limitation. There may have been a reason in the past, but times are different. We are in a changing society. I do not need to tell you how the population is changing. I know the point has been overemphasized here today, but I hope the baby-boom generation will change the way this culture thinks about its senior citizens.

This is not the time to prevent people from working. You can figure out there is a big labor shortage today by just taking a quick drive around this town. Everyone is looking for help. In my business, we place a premium on the type of help that older employees offer, dependability, experience, a certain knowledge of the world, a work ethic, and a cultural history.

In a small restaurant, the ability to employ quality workers is critical. To me, the highest quality employees are the more "seasoned" individuals, the ones who do not need all the training, the ones who provide a chance for us to learn from them.

Coming to this country at the age of 15 to go to school, it is obvious that I have lost some of the real tradition and habits of cooking from the ancient nation of Ethiopia. Now, my adopted country's free enterprise system allows me to transport this fine cuisine to this beautiful country of ours. In doing so, I constantly depend on the older generation's advice and consultation to preserve the true cooking and tradition. I believe there is much to be learned from the older generation. But policies such as the earnings test send a strange message to our senior citizens about how much they "should" work.

As the number of older Americans grows, this country will need to tap into this resource. For this reason, I hope this Congress is successful in eliminating the Social Security earnings test so we can truly take advantage of the experience and the skills that older Americans contribute to this country's economic future.

Again, thank you for the chance to address this distinguished Subcommittee and, most of all, for listening to those of us on the frontlines of this issue.

Thank you.

[The prepared statement follows:]

Statement of Zed Wondemu, Owner, Zed's Ethiopian Cuisine, Georgetown, Washington, D.C., on behalf of National Restaurant Association

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Again, thank for the opportunity to address this distinguished subcommittee, and most of all, for listening to those of us on the frontlines of this issue.

Chairman SHAW. Thank you, and thank all of the witnesses. Mr. Johnson?

Mr. JOHNSON. Thank you, Mr. Chairman.

Tom, I was in the construction business and I know, like the restaurateurs, that they lean on some of the more experienced elderly to teach them the profession. I think you do that in the building business, too. Is it not true that some of your, especially plumbers, electricians, and even carpenters, learn the trade from the older guys and you need them around to help you out? Is that true or false?

Mr. WOODS. That is very true. You know, across the country, in HBI, the group that I work with, the education arm, and I am a homebuilder, the very best programs that we have are the programs where we have people with years and years of experience and understanding, and we have them involved.

Numerous people on this panel have said, our older citizens today are in better health. Some of the reasons they are in better health is they have stayed active, they have worked hard. To take that away, you know I gave an example and unfortunately today this man would have probably been here with me, but he is having both knees replaced this morning in Kansas City. And he is doing that, quite frankly, because of his activity level. He is in excellent health. He retired, I would guess a year ago, maybe a little more.

He still comes by the job site to check on the kids, as he says. He was one of those at that coffee shop and he was one of those that I asked would you come back? And his comment to me was in a minute. So I think there is a real need for that.

Mr. JOHNSON. Thank you so much for your answer. I do not have any further questions, Mr. Chairman.

Chairman SHAW. Just to add to that, I think it's improvment to consider not only the questions of the skills, but the work ethics. I used to work as a forester with a lumber company down in the woods. And I will tell you, when you go down to Alabama, down in the swamp, in August and you see an old man, you say I have got to keep up with this guy.

There is really a lot to learn, not only from the technical skills, but also the work ethic.

Mr. WOODS. It is an amazing thing, if I might say, we talk about the fact that sometimes the generations do not have all that much in common. But if you really look at that, there is an interesting thought. I have heard it said the reason that grandparents and grandchildren get along so well is they have a common enemy.

And I think that sometimes works in the industry, too, because I think sometimes I see it with the youngest, most spirited sometimes, they really build a kinship to some of the older, well experienced, and when you look back, they might just see a reflection there, I think.

Chairman SHAW. Thank you. Do any other members have further questions? Mr. Hulshof?

Mr. HULSHOF. Mr. Chairman, just briefly, to follow up with you, Mr. Woods, it is always great to have another resident from the Show-me State. Welcome to Washington.

As I understand your testimony, in following up on what Mr. Johnson said, it is not just that older workers would be retained to help train younger workers, but they are there swinging hammers and climbing ladders and doing the manual labor, just like the younger guys. Is that a fair statement?

Mr. WOODS. I think it is a fair statement. I am not trying to indicate to you that that is everybody, but I will tell you there are individuals there who I will put up against the best of them. They may not be as physically quick as maybe they once were, or whatever, but wisdom will make up an awful lot for that. They are certainly not to be sold short.

And I certainly do not want to be in the position, nor do I think you want to be in that position, to tell someone who has the ability and has the desire to be involved at that level, that they cannot do it. And I think a couple of these people said it best.

In some cases, they simply have to do it, whatever those circumstances may be. It may be taking care of a parent. It may be because of other medical experiences or circumstances we do not know. And I just think it should not be our decision to put any more obstacles in their way than some of them may have experienced already.

Mr. HULSHOF. What is the real impact? I do not know what the number would be, but let us say that an older worker recognizes the earnings limit and then maybe works up to that and says I am going to leave the job site? I am not sure what the number of people would be who fall in that category, but how does that affect maybe a construction site that you are the supervisor on and somebody is no longer there? What is the real-life impact of some decision like that, Mr. Woods?

Mr. WOODS. Well, any time you build a team, and that is what home building, that is what construction is, it is a team effort. As Mr. Johnson said, it takes the plumbers, the electricians, and carpenters. And as you get to where you work within that team and you build together, you become very dependent on each other. And any time you take one person out of that mix, no matter what their job, and no matter what level, you have to rebuild that team.

While I would not call any of these people rich, by any stretch of the imagination, the gentleman that was here earlier from Chicago, a lot of these guys will make $35,000 or $40,000 a year, or easily could. But I certainly do not think they are rich. But if you take them out when they have reached that $17,000 limit, it means that we have lost them for half the year, and they are just very, very hard to replace.

I see the young people in many of our programs, and when I speak to this I am speaking of HBI, who works with a lot of disadvantaged youth. In some cases, these older people are the only real role models they have ever been introduced to. And when you take that out of the situation, you have got another problem to overcome.

So I do not know that you can put a number on to it. But in some cases, it is devastating.

The other thing it does, it creates the situation where the employer, whether it is myself or the plumber or whatever, in many cases simply cannot hire that young person because we do not have the personnel to put him with to be able to supervise or to teach him. And so from that line, in many cases, it simply means that it is a house that does not get built, a dream that does not get fulfilled.

Mr. HULSHOF. Thanks, Mr. Woods.

A final comment, Ms. McSteen, or really not a question but a comment. I really do appreciate your statement and position, very succinctly and powerfully put, that eliminating the earnings penalty for seniors who have reached full retirement age would not primarily benefit the wealthy. We often hear, when we try to take limits off and remove disincentives, that we cannot do it, and you can follow along with the mantra, because it would only benefit the wealthy.

It appears that, at least on this issue, and I know Mr. Weller was inquiring of the Commissioner about the 1993 tax increase from 50 percent to 85 percent, maybe there is hope for the future that we can even roll that back.

But I do appreciate your statement that this is not a needs-based program. This is a retirement system people have worked for and played by the rules, and they are entitled to these benefits. I appreciate your statement.

Thank you, Mr. Chairman.

Chairman SHAW. Thank you. Mr. Matsui?

Mr. MATSUI. Thank you. Mr. Chairman, I just want to thank the panel. The lack of asking a question does not indicate at all disinterest. We just agree with you so much. So we want to thank you all for your testimony with you today. Thank you.

Chairman SHAW. Mr. Portman?

Mr. PORTMAN. Thank you, Mr. Chairman.

I would like to start by saying, as a father of young kids, I am the common enemy. They get along well with their grandparents. They also get along well with their great-grandmother. And increasingly we have family situations where, because of longevity, you are going to have great-grandparents out there who are part of this conspiracy against us parents.

I am just delighted that we are here today. Sam Johnson deserves a lot of credit, and others here, for getting us to this point. This is really exciting for me.

I have a dear friend who is a nurse care giver. She took care of my grandfather before his death at 97 a couple of years ago, and she is in her late sixties. She wants to work and she is able to work, and she is someone who can give a lot to our society, and particularly to our elderly right now. Yet her effective tax rate, as I have helped her figure out, is about 80 percent.

Because when you add up all these taxes, including what is about a 33 percent marginal tax rate on work because of the earnings limit, it is just not worth it for her to work. Everybody is advising her just do not work. She wants to work and she has a lot to give.

So I have just been delighted over the last 24 hours even to see people come together on this issue from both sides of the aisle, and to finally begin to talk about putting this into place. Over the long-term, as I understand, it is not going to have an impact on the solvency of Social Security because of the delayed credits in any case.

The one issue I get some feedback on back home, that I want to have somebody address if they would, and Ms. McSteen I know you talked about this, and AARP, Ms. Baumgarten, you have addressed this as well. Some people have said gee, the earnings limit really is not unfair because there is a delayed increase in benefits over time to those people like my friend, the care giver.

Can you address why it is indeed unfair to my friend the care giver, and other older Americans out there who want to work, even though over the younger term theoretically, using the actuarial data, they would get an increased benefit or get the same benefit?

Ms. MCSTEEN. In the case you mentioned, I would think that the urgency is for the moment, that she needs to be able to work now, and she does not need to be worried about the future. So she will gain in the long run by continuing to work and to contribute and be able to draw her Social Security. It is the right thing.

Mr. PORTMAN. Ms. Baumgarten?

Ms. BAUMGARTEN. The fact that the money is taken out now, up front, when they are working because they need it hurts. Looking at something down the road just does not register. A lot of them are working because they need the extra money. And if you need the extra money, you need it now, not in an actuarial equivalency down the road.

Mr. PORTMAN. I appreciate the response and I agree with that. I think this is about behavior and it is about what people will do when faced with again, what I have calculated from my friend, about an 80 percent marginal tax rate.

It also is a risk. In other words, the actuaries can come in and say gee, over time, on average you are going to end up getting a delayed credit for this. But, unfortunately, not everybody is going to live that long. So for individuals, it is a risk to delay the benefit, rather than getting the benefit of the Social Security you have worked all your life for while you need it. And at the same time, again contributing to our work force, contributing to society.

We have got about a 3 percent unemployment rate in my area. I think nationally it is about 4 percent. These are wonderful workers to have out in the work force, the mentoring you talked about, just adding that maturity to the work force and letting people do what they want to do, and to give so much back. Ms. McSteen?

Ms. MCSTEEN. There is one additional thing that we really have not talked that much about this morning. That is we must recognize that there are many individuals who may, in fact, die early. That is something that, particularly minorities, are faced with because of their early death rate overall. And the delayed retirement credit may make up for lost benefits over time for some people, but not for all.

Mr. PORTMAN. Thank you, that is an excellent point.

Mr. Chairman, again I commend you for having this hearing, and I yield back the time.

Chairman SHAW. Thank you, and I want to thank this panel for putting a very human face on the task that is before us. I think that, from the last line of questions by Mr. Portman, the question that comes to my mind is who in the world said that it is up to the Congress to decide when someone gets the benefits that they have earned? That is just flat wrong.

We are going to put the record straight. We are going to put the law straight. We are going to deal with everybody fairly on this. I am delighted to see the wonderful bipartisanship that we have here. In dealing with this wonderful part of our population, it is wonderful to know that we can leave our partisan hats at home and work together.

Thank you very much.

We now have our final panel, Leora Friedberg, Ph.D., Assistant Professor of Economics at the University of California, San Diego, and the National Bureau of Economic Research in Cambridge, Massachusetts; Bruce Bartlett, who is a Senior Fellow at the National Center for Political Analysis; Robert Greenstein, who is the Executive Director of the Center on Budget and Policy Priorities; and Aldona Robbins, Ph.D., Senior Research Fellow, Institute for Policy Innovation, Lewisville, Texas.

Dr. Friedberg? As the previous panels, we have the full text of your statements that will be made a part of the permanent record. You may proceed.

STATEMENT OF LEORA FRIEDBERG, PH.D. ASSISTANT PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA, SAN DIEGO, AND FACULTY RESEARCH FELLOW, NATIONAL BUREAU OF ECONOMIC RESEARCH, CAMBRIDGE, MASSACHUSETTS

Ms. FRIEDBERG. My name is Leora Friedberg. I am an economist and, as you said, a professor at the University of California, San Diego. This summer I am moving to the University of Virginia.

I have been invited here to summarize my research findings. In my research I have analyzed how beneficiaries have changed their hours of work in response to past changes in the earnings test. And then I used this past evidence to develop predictions if the earnings test were changed or removed today.

These predictions directly pertain to a particular subset of beneficiaries, men aged 65 to 69, already working a fair amount. For technical reasons, this is the group for which I can make the most precise predictions. This is also the group losing the most benefits to the earnings test. But I will be happy to discuss later what might happen with other groups.

In my research I use large data files collected by the Bureau of Labor Statistics in which people reported their earnings and hours of work during the previous year. Many workers in those surveys responded noticeably to past changes in the earnings test.

For example, in 1983 the earnings test was eliminated for people age 70 and 71. In the data, we can see the cluster of workers with earnings just below the earnings limit, and we can see them smooth out their earnings after the earnings test was eliminated for this age group. So we can conclude that they had been changing their work hours because of the earnings test beforehand.

In 1978, the earnings limit was raised from $3,000 to $4,000 for people aged 65 to 71. You see this cluster of workers move their earnings just up to the new earnings limit after that change.

Based on these past responses, I have developed predictions if the earnings test is changed today. These predictions focus on the hours of work among people who are already working, and there are three important subgroups to consider. The first group is low earners, people who keep their earnings just at or below the earnings limit. We have heard many examples of that today.

This group is reacting most visibly to the earnings test and will be the most responsive to a change. Compared to their actual hours of work in 1995, they would be predicted to work 50 percent more, on average as a group, if the earnings test is eliminated.

The second group to consider are medium earners, people who are working a little more initially, losing some but not all of their benefits to the earnings test. In theory, we do not know if this group would work more or less when the earnings test is eliminated. They might work more because this effective marginal tax rate from the earnings test declines or they might work less because they have extra income. The evidence from past changes is that this group would work 18 percent more on average.

The third group are high earners, people working so much that they lose all of their benefits now. This group would not work more because now they would be getting extra income and they would face no actual change in their effective tax rate. Responses in the past suggest that they would work 4 percent less on average because of this extra income.

There is an important caveat for this group in particular. It consists mostly of full-time workers who may have less flexibility to change their work hours, compared to the part-time workers who are already showing a flexible response to the earnings test. So these high earners may not be able to change their work hours just a little. They may not change their hours at all. So the prediction for this group is somewhat less certain.

The same consideration is important with regards to retirement. I have not addressed the question of whether the earnings test causes some people to retire completely and thus whether eliminating the earnings test will lead them to postpone retirement. If jobs are not perfectly flexible and people cannot find part-time work that lets them keep their earnings just below the limit and avoid the earnings test, then it might cause some people to retire.

It is difficult to analyze this because it depends on these constraints on work hours. Indirect evidence supports the notion that jobs are not perfectly flexible, that people cannot control their hours precisely, and therefore we might expect that eliminating the earnings test would cause some people to delay retirement. But I do not have direct evidence about this.

So to sum up, my past research suggests that among men age 65 to 69 who are earning at least up to the earnings limit, they would be predicted overall to work 5 percent more. The low earners would work 50 percent more. Medium earners would work 18 percent more, and the high earners would work 4 percent less.

So that is what the evidence suggests from past changes in the earnings test. I will be happy to answer questions about other groups and how they might respond to the earnings test or how they might respond to raising the earnings limit in the next couple of years. Thank you.

[The prepared statement follows:]

Statement of Leora Friedberg, Ph.D., Assistant Professor of Economics, University of California, San Diego, and Faculty Research Fellow, National Bureau of Economic Research

Summary

The Social Security earnings test produces some of the highest tax rates in the economy. A beneficiary aged 62–64 loses $1 in benefits for every $2 earnings above an earnings limit of $10,800 this year, in effect a 50% marginal tax rate. A beneficiary aged 65–69 faces a 33% marginal tax rate for earnings above $17,000. The tighter rules for younger beneficiaries will apply for longer as the normal retirement age is gradually raised from 65 to 67, beginning this year. Many beneficiaries appear unresponsive to the additional provision that lost current benefits are returned as a small percentage increase in benefits forever after they retire. If beneficiaries are unaware of this provision, even as many economists and journalists reporting on Social Security have been then we have a perverse policy that distorts people's choices as if they were taxed yet raises virtually no revenue.

I have been invited here to summarize my research findings. In my research I have analyzed how beneficiaries changed their hours of work in response to past changes in the earnings test. I use this past evidence to develop predictions if the earnings test were removed today. These predictions directly pertain to a particular subset of beneficiaries—men aged 65–69 who are already working a fair amount. For technical reasons, this is the group for which I can make the most precise predictions. This is also the group losing the most benefits to the earnings test.

In my research I use large data files collected by the Bureau of Labor Statistics in which people report their earnings and hours of work during the previous year. Many workers in these surveys responded noticeably to past changes in the earnings test.

- For example, in 1983 the earnings test was eliminated for people aged 70–71. Before that, many of them kept their earnings just at the earnings limit. Afterwards, their earnings smoothed out, so we can concluded that they had been changing their work hours because of the earnings test.
- In 1978, the earnings limit was raised from $3000 to $4000 for people aged 65–71. In the data, we can see the cluster of workers with earnings just below the earnings limit move their earnings up to the new higher limit.

Based on these past responses, I have developed predictions if the earnings test is changed today. These predictions focus on the hours of work *among people who are already working*. There are three important subgroups to consider.

- *Low earners*, people who keep their earnings just at or below the earnings limit. This group is reacting most visibly to the earnings test and will be the most responsive to a change; compared to their actual hours of work in 1995, they would be predicted to work 50% more on average, if the earnings test is eliminated.
- *Medium earners*, people working a little more initially, losing some but not all of their benefits to the earnings test. In theory we do not know if this group would work more or less when the earnings test is eliminated—they might work more because the marginal tax rate declines, or they might work less because they have extra income. The evidence from past changes is that this group would work 18% more on average.
- *High earners*, people working so much that they lose all of their benefits. This group will not work more, because they get extra income but face no actual change

in their marginal tax rate. Responses in the past suggest that they would work 4% *less* on average. An important caveat for this group: it consists mostly of full-time workers who may have less flexibility to change their work hours, compared to the part-time workers who are already showing a flexible response to the earnings test. The high earners may not be able to reduce their work hours a little, so their work hours may not change at all, and the prediction for this group is less certain.

This is also an important consideration for retirement. I have not addressed the question of whether the earnings test causes some people to retire completely, and thus whether eliminating the earnings test will lead them to postpone retirement. If jobs are not perfectly flexible, and people cannot find part-time work that lets them keep their earnings below the limit and avoid the earnings test, then it depends on the structure of jobs, not just on their observable work hours. Indirect evidence supports the notion that jobs are not perfectly flexible, so we might expect that eliminating the earnings test would cause some people to delay retirement. But, I have not found direct evidence of this.

To sum up, all of the men aged 65–69 who were earning at least up to the earnings limit in 1995 would be predicted to work 5% more, in total. The lower earners would work 50% more, the medium earners would work 18% more, and the high earners would work 4% less.

The same type of analysis yields predictions about the how people would respond to the gradual increase to a $30,000 earnings limit for people aged 65–69, legislated in 1996. In comparison, people will not increase their work hours as much or will reduce their work hours more. The low earners would work 34% more, not 50% more. The middle earners would work 7% more, not 18% more. The high earners would work 10% less, not 5% less. The differences arise because the tax rate is not eliminated, but gets pushed up into higher earners.

While the short-run costs of relaxing or eliminating the earnings test will be substantial, the long-run costs approach zero, since future benefits will not be raised as they are today to make up for current benefits lost to the earnings test.

Now I will briefly discuss what we might expect with other groups if the earnings test is changed.

- *Working women* respond to the earnings test similarly to men, suggesting a similar change in work hours if the earnings test is eliminated. A significantly smaller proportion of women work at these ages, however.
- *People aged 62–64*, and eventually aged 65–66 as well, face much more restrictive earnings test rules, almost unchanged since the early 1970s. How do younger workers respond to the earnings test? Some also hold their earnings down, just below the limit, but more continue to work full-time. Therefore, more workers in this age range may reduce their hours, relative to the number who increase their hours. However, of this age group in particular, the "retirement effect" of the earnings test, which I discussed earlier, could be substantial. In other words, people in this age range may choose to postpone retirement if the earnings test is eliminated.

I will be happy to answer questions about my research on the expected response of workers aged 65–69 to changing the earnings test, and about the potential response of other groups, for example younger workers who continue to face more restrictive earnings test rules.

Background

Introduction. When Social Security was established during the Great Depression, one motive was to encourage older workers to leave the labor force and make way for younger workers. Thus, the system was designed not simply to give benefits to older workers, but also to condition benefits on retirement.

In the decades since, the typical retirement age of older workers has plummeted. The proportion of men aged 65 and over working or looking for work fell from 46% in 1950 to 17% last year. With life expectancy continuing to rise, the work force shrinking, and savings rates at an all-time low, the increasing length of retirement has come to be viewed as unsustainable.

To ease the penalty against working, the earning test was gradually liberalized beginning in the 1950s, principally for people aged 65 and over. In 2000, a beneficiary aged 65–69 earning more than a limit of $17,000 loses $1 in benefits for every $3 in additional earnings—which functions as a 33% tax on wages. March 1996 legislation will raise this exempt amount to $30,000 by 2002, the tighter earnings test rules for people aged 62–64 will be extended to ages 65 and 66 as the normal retirement age gradually rises.

Moreover, beneficiaries do not appear to respond to the provision that they will be compensated later, in the form of a small percentage increase in benefits forever after they retire. If beneficiaries are indeed unaware of this provision, as suggested by some evidence, then the earnings test has the perverse effect of distorting people's choices as if they were taxed, yet raising virtually no revenue.

Some researchers have concluded that gradual liberalization of the earnings test rules means that the earnings test no longer leads people to retire and has little effect on their hours of work. Two major problems arise with past studies. No one has analyzed data from after the 1970s, so previous results may be outdated. Also, not major changes in the earnings test rules occurred during the period studied in earlier research.

My strategy is to investigate several recent changes in the earnings test rules. It is easy to understand how people are influenced by the earnings test by observing how they respond when it is altered; otherwise it can be more difficult, since work decisions are shaped by many factors which we cannot observe and which change over time. The data I use show a strong response among workers to past changes in the earnings test, suggesting similar reactions if the earnings test were eliminated today. While the short-run costs of relaxing the earnings test would be substantial, the long-run costs are close to zero, since future benefits will not be raised as they are today to make up for current benefits lost to the earnings test.

The impact of the earnings test on hours of work. In my research, I studied the response of workers to the earnings test by analyzing data on how much people work, and earn, and how their behavior changed when the earnings test rules changed.[1,2] Three important changes have occurred in the last twenty-five years. In 1978, the earnings limit was raised from $3,000 to $4,000 for workers aged 65–71, while it did not change for workers aged 62–64. In 1983, the earnings test was eliminated for workers aged 70–71, while it remained in place for workers aged 62–69. Lastly, in 1990 the earnings test tax rate was lowered from 50% to 33% for workers aged 65–69, but not for workers aged 62–64. The structure of each of these rule changes, affecting people of some ages and not other similar ages, is extremely useful. It allows us to control for other potential shifts in work hours by comparing earnings and hours of the affected and the unaffected age groups over the period when the rules changed.

The earnings data show that a significant proportion of workers respond to the earnings test and that they shifted their earnings when the rules changed. Figure 1 begins by showing earnings distributions *relative to the earnings limit* before and after the limit was raised for 65–71 year olds in 1978. The graphs compare the earnings of affected 67–69 year old men and of unaffected 63–64 year old men. Figure 1–A shows, before 1978, the number of older and younger workers with earnings in each $1000 interval above and below the earnings limit, as a proportion of the total number of people in the age group.

Figure 1–A demonstrates a strong response to earnings test before any change in the rules. Many people in both age groups were clustered just at or below the limit—over 20% of 67–69 year old workers have earnings within $1000 below the limit, along the almost 10% of 63–64 year old workers. Roughly the same number of people appeared in each increment for several intervals, followed by a big drop from the interval just below to just above the limit.

After 1978, the clustered 67–69 year olds moved up to the new earnings limit. First, Figure 1–B shows earnings of both age group in relation to the *unchanged* earnings limit of the younger group. The 63–64 year olds keep their earnings at the same point, but the 67–69 year olds clearly shifted their earnings higher. Figure 1–C shows them clustered at their new higher limit. These changes were large and statistically significant.

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[1] In 1989 the Social Security Administration estimated that almost one million retired-worker beneficiaries lost some or all of their benefits to the earnings test, accounting for over one-third of people aged 65–69. In addition, about a couple hundred thousand beneficiaries kept their earnings just at or below the earnings limit. See Leonesio (1990) and Bondar (1993).

[2] The analysis is based on large data files collected by the Bureau of Labor Statistics in its Current Population Survey (CPS). People surveyed in the March CPS report their earnings and hours of work during the previous year. The data and methods are described in detail in Friedberg (2000).

[3] Figures 2–A and 2–B actually show 71–72 year olds, since they were 70–71 when the reported earnings were earned.

FIGURE 1-A, 1975-77

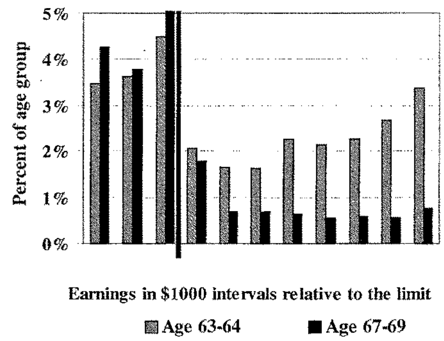


FIGURE 1-B, 1979-81

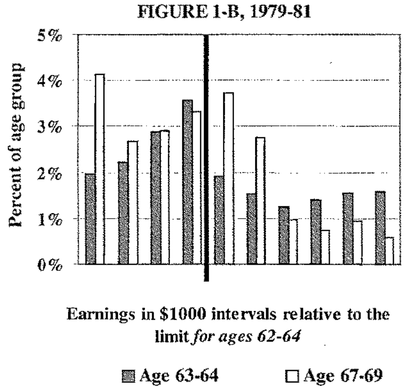


FIGURE 1-C, 1979-81

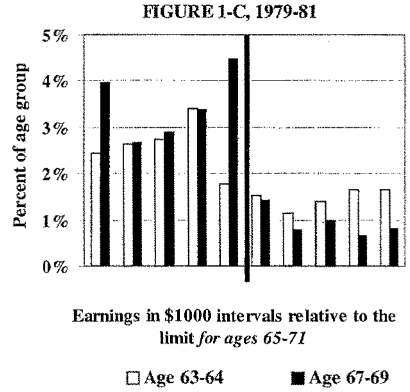


Figure 2 makes the same comparisons around the earnings limit before and after 1983, when the earnings test was eliminated for 70–71 year olds. Figures 2–A illustrates earnings patterns before 1983 of the affected age group.[3] They are juxtaposed with 73–75 year olds who do not face the earnings test and whose earnings decline smoothly over the same range. Figure 2–B shows the same comparisons after 1983. Now, the earnings of the affected 71–72 year olds decline smoothly over the range of the earnings limit, resembling the older group.

There was no noticeable reaction to the 1990 reduction in the earnings test tax rate. This is not inconsistent with the other strong reactions, however, because the 1990 change was smaller. The tax rate declined 17 percentage points from 50% to 33%, rather than falling to zero as it effectively did earlier. Predictions based on those earlier response suggest a small, ambiguous change in earnings when the tax rate declines.

[3] Figures 2–A and 2–B actually show 71–72 year olds, since they were 70–71 when the reported earnings were earned.

FIGURE 2-A, 1980-81

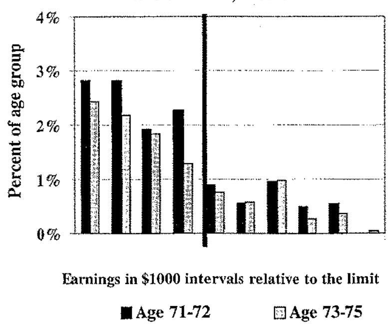
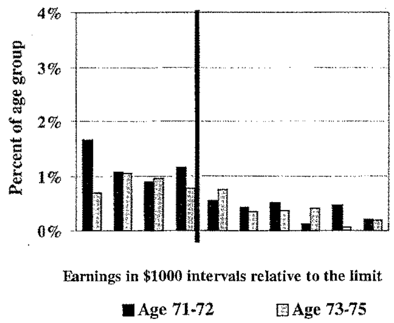


FIGURE 2-B, 1984-86



The data above show one particular reaction to the earnings test, among people keeping their earnings just at the earnings limit. Others working more and losing some or all their benefits to the earnings test will also react, but that reaction is more ambiguous and is thus difficult to observe above. The reasons are as follows.

The earnings test alters the incentive to work in two different ways. It changes the net wage and also the total income of beneficiaries, depending on how much a beneficiary works. Although intuition suggests the earnings test causes beneficiaries to work less, this is not unambiguously true. Facing a higher marginal tax rate will cause people to work less, but reducing income may cause people to work more. Similarly, eliminating the earnings test will not lead all beneficiaries to work more. There are three different subgroups we have to consider, depending on how much someone is working when the earnings test is in place.

- The first group is the one discussed above, consisting of people who hold their earnings just at or below the earnings limit. They will unambiguously work more when the earnings limit is raised, the earnings test tax rate lowered, or the earnings test eliminated.
- The second group consists of people earning somewhat more than the limit and losing some but not all their benefits. In theory, we cannot unambiguously predict whether they will work more or less if the earnings test is relaxed or eliminated. They may work more because their marginal tax rate falls or less because they have extra income. My research shows that on average people in this group will work more.
- The third group consists of people earning considerable more than the limit and losing all their benefits. Their marginal tax rate will not change when the earnings test is eliminated, but their income will rise. This will induce them to work less, if they can adjust their hours of work.

What about the increase in benefits later on? Just as people are rewarded with higher benefits in the future if they delay claiming benefits today, beneficiaries also receive an increase in all future benefits for current benefits lost to the earnings test. Someone under age 65 gets a 6⅔% increase in future benefits for each year's worth of benefits foregone. Someone aged 65–69 gets an adjustment that is gradually approaching 8%. These credits establish a tradeoff, actuarially fair for a person with average life expectancy, between a year's worth of benefits at present and a percentage increase in all future benefits.

However, there is no evidence that the credits are taken into account with regards to the earnings test. In all likelihood, many fewer people would respond to the earnings test and restrict their earnings, as we observe them doing in Figures 1 and 2.[4] Furthermore, descriptions of the earnings test in the popular press generally fail to mention the adjustment. When both *Money* (Simon 1996) and the *Los Angeles Times* (Kristof 1997) have described how the earnings test works, neither mentioned that higher future benefits compensate for lost benefits today. The perverse result is that people respond to the earnings test as if it were a tax, yet it raises virtually no revenue over the long-run.

The predicted impact of eliminating the earnings test. I used the information implicit in the response of workers to past changes in the earnings test to develop pre-

[4] We would still expect a reaction among people with less than average life expectancy and people who are more impatient than average. Other evidence shows that more people claim benefits at age 62 then either of these factors predict, however, suggesting that people either do not know or do not care about the future adjustments.

dictions about changes today, such as eliminating the earnings test or raising the earnings limit to $30,000.

Low earners, who keep their earnings just at or below the earnings limit are reacting most visibly to the earnings test and will be the most responsive to a change. Compared to their actual hours of work in 1995, they would be predicted to work 50% more on average, if the earnings test is eliminated. In comparison, medium earners would be predicted to work 18% more on average. As discussed earlier, they may work either more or less in theory because their marginal tax rate falls but their income rises. Thus, the evidence from past changes suggests that the tax rate effect dominates. Lastly, high earners would be predicted to work 4% less on average, because they have more income and their marginal tax rate does not change. In total, men aged 65–69 who were earning at least up to the earnings limit in 1995 would be predicted to work 5% more.

At this point, it is important to mention a caveat affecting high earners the most. These predictions have assumed that everyone can adjust their work hours flexible. However, while those at the earnings limit do appear to have a lot of control over their hours, other who work full-time and earn more may have less flexibility. Thus, it is somewhat less likely that the group of high earners will actually change their hours, even though they are predicted to, compared to the low earners. This issue will also determine whether the earnings test affects retirement, as I discuss later.

It is interesting to compare the predications of work hours if the earnings test is eliminated to the predictions when the earnings limit is raised to $30,000. Because this change is not as dramatic, people will not increase their work hours as much or will reduce their work hours more. The low earners would be predicted to work 34% more and the middle earners 7% more, while the high earners would be predicted to work 10% less. The differences arise because the tax rate gets pushed up onto higher earners. Raising the earnings limit removes the burden of the earnings test for many low earners but makes it bind more strongly for higher earners.

One argument made against changing the earnings test is the fiscal cost. However, while the initial costs is relatively high, the long-run cost is declining towards zero, because benefits will not be lost today to the earnings test and thus future benefits will not be raised.[5] As these adjustments are approximately actuarially fair on average, the fiscal cost of eliminating the earnings test today will be virtually canceled out within a number of years.

Another possible argument against relaxing the earnings test is that it would primarily benefit high income beneficiaries. It is true that total income would rise more for higher earners, but the data show that most of the distortions to behavior are observed among low and medium earners. Their work hours would rise the most if the earnings test were lifted.

Other potential effects. My research pertains directly to men aged 65–69 who are already working. Several other groups may be affected as well. I cannot offer as precise conclusions in their regard, but I will discuss some important considerations.

- It is essential to consider whether the earnings test induces people to retire. If jobs are perfectly flexible, then someone who wants to work but not lose benefits can limit their hours to keep their earnings below the limit. In the case, the earnings test will not cause anyone to retire completely. However, if jobs are not perfectly flexible, or if a part-time job involves a substantial cut in the hourly wage, then it may not be feasible to earn less than the limit, and retirement may be preferred to facing the earnings test. It is difficult to analyze the potential magnitude of such effects which depend on unobserved conditions of jobs, rather than on their observable work hours. Indirect evidence supports the notion that jobs are not perfectly flexible, so we might expect that eliminating the earnings test would cause some people to delay retirement.
- While my research focused on men, older women react similarly to the earnings test. Thus, we can expect a similar change in work hours if the earnings test is eliminated. A significantly smaller proportion of women work at these ages, though, so a small number will be affected.
- People aged 62–64, and eventually 65–66 as well, face much more restrictive earnings test rules, almost unchanged since the early 1970s. How do these younger workers respond? The data show that some hold their earnings just below the limit, as do older workers, while a greater proportion continue to work full-time. Therefore, more workers at these ages might reduce their hours, relative to older workers,

[5] Leonesio (1993) reported Social Security Administration forecasts that eliminating the earnings test for ages 65–69 would raise payouts by $4.3 billion in the first year. Income, payroll and benefits taxes due to higher earnings would offset 14.8% of the cost. That forecast was based on a very small predicted change in work hours. My research results suggest a larger offset through taxes paid as people work more.

if the earnings test is eliminated. However, it is among this group that the “retirement effect” of the earnings test is crucial. If the earnings test causes some 62–64 year olds to retire, eliminating it would have an extra punch because they are likely to continue working longer than 65–69 year olds.

Conclusions. The earnings test has been the subject of a great deal of popular attention, but less academic interest in recent years. I have used a new empirical strategy, analyzing the reactions to past changes in the earnings test rules, to arrive at several conclusions.

The data reveal a significant number of workers clustered just at the earnings limit. The clustering demonstrates that the earnings test leads some beneficiaries to hold down their hours of work. The clustering moved when the earnings limit moved and disappeared when the earnings test was eliminated for some ages. Thus, beneficiaries react promptly and flexibly to changes in the earnings test.

The past reactions indicate how people might respond if the earnings test is changed today. According to my estimates, men aged 65–69 who were earning at least up to the earnings limit in 1995 would be predicted to work 5% more, in total. Low earners, just at or below the earnings limit, would work 50% more, medium earners would work 18% more, and high earners would work 4% less. In comparison, people would be predicted to increase their work hours less or reduce them more when the earnings limit is raised to $30,000. These differences arise because the tax rate is not eliminated, but gets pushed up onto higher earners. Lastly, it is important to recognize that the long-run cost of eliminating the eliminating the earnings test is virtually zero.

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Chairman SHAW. Thank you.

Mr. Bartlett.

STATEMENT OF BRUCE BARTLETT, SENIOR FELLOW, NATIONAL CENTER FOR POLICY ANALYSIS

Mr. BARTLETT. Thank you, Mr. Chairman.

The Social Security earnings test is among the most unfair and counterproductive policies ever imposed by the Federal Government. On the one hand, we are continually told that workers have a right to Social Security whenever there is a proposal to modify cost of living adjustments. But on the other hand, we take away benefits from many seniors simply because they have chosen to work past the normal retirement age. And historically, it has been those most vocal about Social Security rights who have resisted most strenuously any elimination of the earnings test.

This is a massive injustice, in my opinion. If people have, in fact, earned their Social Security benefits, then they are entitled to them. No one takes away anyone’s private pension or annuity if that person continues to work after they have become entitled to benefits. This disparate treatment makes a mockery of the notion that Social Security is an earned benefit that people are entitled to by virtue of long years of work. It makes Social Security equivalent to a welfare program where benefits are rightly withdrawn from people who no longer need them.

A further element of unfairness results from the fact that the earnings test applies only to wage income. One can receive millions of dollars a year in interest, dividends and capital gains without losing a penny of Social Security benefits.

The earnings test was originally imposed for a reason that now makes no economic sense. Its purpose was to get workers out of the labor force during the Great Depression in order to open up jobs for younger workers. Today however, one of the biggest problems facing the country is not a lack of jobs, but a lack of workers. The earnings test is not only depriving American businesses of labor they desperately need, but is keeping out of the labor force some of our best educated and most experienced workers.

The withholding of benefits acts like an additional tax on earnings. In the case of retirees between the ages of 65 and 69 it is a 33 percent tax rate, and for those between the ages of 62 and 64 it is an even worse 50 percent tax rate. And these implicit tax rates come on top of explicit taxes such as Federal, State, and local taxes, including taxes on Social Security benefits for some people.

These high effective tax rates have a major impact on the employment status of older workers. They are a major reason why in 1999 only 16.9 percent of men over age 65 were in the labor force, either by working or seeking work. 50 years ago, 47 percent of such men were still in the labor force. At the turn of the century the figure was better than 60 percent.

It is my view that the earnings test should be scrapped in its entirety. Either people have earned their benefits or they have not, and singling out those who continue to work after retirement age is a violation of that principle. The only possible justification for keeping the earnings test is budgetary. Obviously, elimination of the test would lead to payment of benefits that are now not paid, increasing Federal outlays for Social Security.

However, I believe this cost is often grossly overestimated because it does not take into account the impact of the delayed retirement credit. The delayed retirement credit raises benefits for retirees when they put off drawing Social Security benefits, even though they are eligible for them. For workers turning 65 this year, they will receive a 6-percent increase in their Social Security benefits for each year they delay drawing benefits. Thus, if their work history entitled them to $1,000 per month in benefits at age 65, but they did not begin drawing benefits until age 66, they would get $1,060 per month.

In future years, the gain will increase. That is because the delayed retirement credit will rise to 8 percent in the year 2008. This means that someone waiting until age 70 before drawing benefits would get 40 percent more than if they started at age 65. After age 70 there is no further increase in benefits and also no earnings test. At that point, the Social Security actuaries estimate that the lifetime benefits people receive from Social Security will be about the same in the aggregate regardless of whether they retire at age 65 or age 70.

The delayed retirement credit is extremely important in calculating the long term budgetary impact of eliminating the earnings test. That is because those people who now lose benefits because of the earnings test are receiving higher future benefits. Because the DRC is supposed to cause lifetime benefits to be the same regardless of when people begin to draw benefits, the long term cost of eliminating the earnings test should in theory be zero. Higher benefits paid out in the short run to people who would otherwise lose benefits because of the earnings test will be offset by lower future benefits because they will no longer claim the delayed retirement credit.

In conclusion, I believe that all arguments against abolishing the earnings test are spurious. In fact, my suspicion is that the true barrier to doing so is simply class envy. Those who would benefit most in the short run from abolition of the earnings test are relatively high income earners. But in the longer run, especially given the rise in life expectancy, I would expect to see many more moderate income workers stay in the labor force if the earnings test were repealed.

Mr. Chairman, this is not a partisan issue President Clinton proposed eliminating the earnings test in his State of the Union address in 1999 and has reiterated his desire to do so as recently as yesterday. I urge the Committee to support him.

[The prepared statement follows:]

Statement of Bruce Bartlett, Senior Fellow, National Center for Policy Analysis

Mr. Chairman, the Social Security earnings test is among the most unfair and counterproductive policies ever imposed by the Federal Government. On the one hand, we are continually told that workers have a "right" to Social Security whenever there is a proposal to modify cost of living adjustments. But on the other hand, we take away benefits from many seniors simply because they have chosen to work past the normal retirement age. And historically it has been those most vocal about Social Security rights who have resisted most strenuously any elimination of the earnings test.[1]

This is a massive injustice. If people have in fact earned their Social Security benefits, then they are entitled to them. No one takes away someone's private pension or annuity if that person continues to work after they have become entitled to benefits. This disparate treatment makes a mockery of the notion that Social Security is an earned benefit that people are entitled to by virtue of long years of work. It makes Social Security equivalent to a welfare program where benefits are rightly withdrawn from people who no longer need them.

A further element of unfairness results from the fact that the earnings test applies only to wage income. One can receive millions of dollars per year in interest, dividends and capital gains without losing a penny of Social Security benefits. But someone who has invested in human capital rather than financial capital is punished when he or she seeks a return on that investment by continuing to work.

The earnings test was originally imposed for a reason that now makes no economic sense. Its purpose was to get workers out of the labor force during the Great Depression in order to open up jobs for younger workers.[2] Today, however, one of the biggest problems facing the country is not a lack of jobs, but a lack of workers. The earnings test is not only depriving American businesses of labor they desperately need, but is keeping out of the labor force some of our best educated and most experienced workers.[3] As a nation we cannot afford to keep doing this.

Keeping older workers out of the labor force is also harmful to them. When they are forced into idleness by retirement, it often impacts negatively on their health

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[1] For example, the *Washington Post* routinely decries any modification of the earnings test while strenuously defending a worker's right to benefits. See its editorials on March 15, 1996; December 3, 1995; January 17, 1995; January 17, 1991; December 2, 1989; and April 19, 1989.

[2] Marshall R. Colberg, *The Social Security Retirement Test: Right or Wrong?* (Washington: American Enterprise Institute, 1978), p. 2; C. Eugene Steuerle and Jon M. Bakija, *Retooling Social Security for the 21st Century* (Washington: Urban Institute Press, 1994), p. 226.

[3] See "Brain Drain," *Business Week* (September 20, 1999), pp. 112–126.

and self-esteem.[4] And the notion that older workers are not healthy enough to continue working is simply no longer valid. Rising life expectancy and improved medicine mean that today's average 65 year old is probably in better physical shape than a 40 year old worker was before World War II.[5] Of course, no retiree should be forced to work if they prefer leisure, but actively penalizing those who want to work and are able to work is harmful both to them and the economy.

According to the Social Security Administration, 3.5 million people between the ages of 62 and 69 have some earned income, about 37 percent of all retirees under the age of 70.[6] In 1995, 743,000 workers aged 65 to 70 had their Social Security benefits reduced because their earnings exceeded the allowed amount, 8.5 percent of all retired worker beneficiaries. Twenty-nine percent of those losing benefits received no Social Security benefits at all that year. The total amount of benefits lost was $4.3 billion and the median benefits lost per recipient was $3,596.[7]

It should be noted that the earnings test also creates a kind of marriage penalty, because earnings by the primary Social Security recipient above the threshold can also reduce the benefits of auxiliary recipients. In 1995, secondary recipients losing benefits were primarily female. Only 2,000 males receiving secondary benefits lost benefits, while 62,000 females did.

Inclusion of secondary beneficiaries raises the number of those losing benefits in 1995 to 806,000. And because 154,000 other family members—nonworking spouses and children—are also affected by the reduction in benefits, the total number of people harmed by the earnings test rises to 960,000. But even this number understates the impact of the earnings test, because about 152,000 additional workers did not apply for benefits because their earnings were above the threshold.[8]

The withholding of benefits acts like an additional tax on earnings. In the case of retirees between the ages of 65 and 69 it is a 33 percent tax rate, and for those between the ages of 62 and 64 it is a 50 percent tax rate.[9] And these implicit tax rates come on top of explicit taxes such as federal and state income taxes, including taxes on Social Security benefits for those whose incomes are high enough. Of course, older workers also continue to pay Social Security taxes as well.[10]

These high effective tax rates have a major impact on the employment status of older workers. They are a major reason why in 1999 only 16.9 percent of men over age 65 were in the labor force, either by working or seeking work.[11] Fifty years ago, 47 percent of such men were still in the labor force. At the turn of the century the

[4] See Committee for Economic Development, *New Opportunities for Older Workers* (1999), available at www.ced.org/pdf/OLDER.PDF.

[5] Eugene Steuerle, Christopher Spiro, and Richard W. Johnson, "Can Americans Work Longer?" *Straight Talk on Social Security and Retirement Policy* No. 5 (Washington: Urban Institute, 15 August 1999), available at www.urban.org/retirement/st/Straight5.pdf. A recent government report also suggests that estimates of rising life expectancy in the future may be understated. See Social Security Advisory Board, *The 1999 Technical Panel on Assumptions and Methods*, available at www.ssab.gov/reports.html.

[6] House Ways & Means Committee, *1998 Green Book* (Washington: U.S. Government Printing Office, 1998), p. 33.

[7] Bertram Kestenbaum, Michael Shakleford, and Chris Champlain, "Effect on Benefits of Earnings at Ages 65 or Older, 1995," *Social Security Bulletin*, vol. 62, no. 1 (1999), pp. 4–9. For data on earlier years, see Joseph Bondar, "Beneficiaries Affected by the Annual Earnings Test, 1989," *Social Security Bulletin*, vol. 56, no. 1 (Spring 1993), pp. 20–28.

[8] Kestenbaum, Shakleford and Chaplain, op. cit.

[9] Policymakers often overlook the more punitive earnings test for those taking early retirement. See Eugene Steuerle and Christopher Spiro, "Are Policymakers Overlooking a Second Earnings Test?" *Straight Talk on Social Security and Retirement Policy* No. 9 (Washington: Urban Institute, 15 October 1999), available at www.urban.org/retirement/st/Straight9.pdf. The authors note that under current law, this more punitive earnings test will apply to more people as the normal retirement age is raised to 67. This will make workers between the ages of 65 and 66 subject to the high de facto tax rates that now apply only to those aged 62 to 64.

[10] One study found that the marginal tax bite, both explicit and implicit, can reach more than 100 percent in some cases. See John Goodman, "Raising the Earnings Limit," National Center for Policy Analysis *Brief Analysis* No. 149 (January 31, 1995), available at www.ncpa.org/ba/ba149.html. Another study put the top rate at 96 percent just at the federal level. See Nathan Oestreich, Howard Toole, and Oliver Galbraith, "Restoring the Incentive for the Elderly to Work," *Tax Notes*, vol. 49, no. 4 (October 22, 1990), pp. 469–471. And the incidence of high de facto marginal tax rates is not limited to just a few of the elderly. One study found that 30 percent of the single elderly and 12 percent of married elderly faced marginal tax rates exceeding 60 percent. John R. Gist and Janemarie Mulvey, "Marginal Tax Rates and Older Workers," *Tax Notes*, vol. 49, no. 6 (November 5, 1990), pp. 679–694.

[11] Bureau of Labor Statistics data available at http://stats.bls.gov.

figure was better than 60 percent.[12] This sharp decline is all the more remarkable given the significant rise in life expectancy over this period.[13]

It is my view that the earnings test should be scrapped in its entirety. Either people have earned their benefits or they haven't, and singling out those who continue to work after retirement age is a violation of that principle. The only possible justification for keeping the earnings test is budgetary.[14] Obviously, elimination of the test would lead to the payment of benefits that are now not paid, increasing federal outlays for Social Security. However, I believe this cost is often grossly overestimated because estimates do not take into account the impact of the delayed retirement credit (DRC).

The DRC raises benefits for retirees when they put off drawing Social Security benefits, even though they are eligible for them. Workers turning 65 this year will receive a 6 percent increase in their Social Security benefits for each year they delay drawing benefits. Thus, if their work history entitled them to $1,000 per month in benefits at age 65, but they did not begin drawing benefits until age 66, they would get $1,060 per month.[15]

The idea of the credit is to encourage workers to stay in the labor force and not retire the minute they become eligible for benefits. But many workers are under the mistaken belief that any benefits they fail to draw simply are lost. Hence, many workers are retiring too soon for their own good. A recent study from the National Bureau of Economic Research says that most workers would be better off by delaying their first Social Security benefit check by up to 3 years.[16]

In future years, the gain will increase. That is because the delayed retirement credit will rise to 8 percent in the year 2008 (for workers born in 1943).[17] This means that someone waiting until age 70 before drawing benefits would get 40 percent more than if they started at age 65. (After age 70 there is no further increase in benefits and also no earnings test.[18]) At that point, the Social Security actuaries estimate that the lifetime benefits people receive from Social Security will be about the same in the aggregate regardless of whether they retire at age 65 or age 70.

The DRC is extremely important in calculating the long term budgetary impact of eliminating the earnings test. That is because those people who now lose benefits because of the earnings test are receiving higher future benefits. They also receive higher benefits because earnings past age 65 can cause their benefits to be recomputed. That is because Social Security uses a 35-year earnings history to calculate benefits. If post–65 annual earnings are greater than the lowest of these years, they can lead to higher benefits.

Because the DRC is supposed to cause lifetime benefits to be the same regardless of when people begin to draw benefits, the long term cost of eliminating the earnings test should in theory be zero. Higher benefits paid out in the short-run to people who would otherwise lose benefits because of the earnings test will be offset by lower future benefits because they will no longer claim the DRC. This fact is admitted even by those who oppose elimination of the earnings test.[19]

Another problem is that estimates of the net cost of eliminating the earnings test sometimes look only at increased payroll taxes that will result from expanded labor

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[12] Bureau of the Census, *Historical Statistics of the United States: Colonial Times to 1970* (Washington: U.S. Government Printing Office, 1975), part 1, p. 132. See also Roger L. Ransom and Richard Sutch, "The Labor of Older Americans: Retirement of Men On and Off the Job, 1870–1937," *Journal of Economic History*, vol. 46, no. 1 (March 1986), pp. 1–30.

[13] It is worth noting that when Social Security was first established, age 65 was greater than the male life expectancy at birth. See *Historical Statistics*, pt. 1, p. 56.

[14] Historically, this has been the greatest political barrier to elimination of the earnings test despite broad bipartisan support for doing so. See Helen Dewar, "Senate Blocks Rise in Social Security Earning Limit," *Washington Post* (November 3, 1995); Kitty Dumas, "Budget-Buster Hot Potato: The Earnings Test," *Congressional Quarterly* (January 11, 1992), pp. 52–55; Julie Kosterlitz, "Working for a Price," *National Journal* (February 6, 1988), pp. 318–321.

[15] Actually, the DRC is calculated on a monthly basis, meaning that those who lose benefits because of the earnings test get some of it back.

[16] Courtney Coile et. al., "Delays in Claiming Social Security Benefits," National Bureau of Economic Research Working Paper No. 7318 (August 1999), available at www.nber.org/papers/w7318.

[17] The DRC was only 3 percent until 1989. Thus any studies based on this lower figure will grossly overestimate the budgetary cost of eliminating the earnings test, compared with a 6 percent or 8 percent rate.

[18] Note that in 2008, when the DRC is fully phased-in, the age at which one may receive full benefits will be 66, and will continue rising to age 67 thereafter. This suggests a need to change the age at which the DRC is capped from 70 to age 72, or else future workers will not get as much value from the DRC as current workers do.

[19] Jonathan Gruber and Peter Orszag, "What To Do About the Social Security Earnings Test?" *Issue in Brief* No. 1 (Boston: Center for Retirement Research, Boston College, July 1999), available at www.bc.edu/bc—org/aup/csom/executive/crr/issuebriefs/ issuebrief1.pdf.

supply, as those now forced out of the labor market by the test remain in it or reenter.[20] These estimates tend to overlook higher income tax revenues and reduced outlays for Medicare due to older workers having employer-provided health benefits. One study that did take all of the relevant factors into account found that after about 8 years, the net increase in federal outlays is just $1 billion per year.[21]

In conclusion, I believe that all arguments against abolishing the earnings limit are spurious. In fact, my suspicion is that the true barrier to doing so is simply class envy. Those who would benefit most in the short run from abolition of the earnings test are relatively high income earners. But in the longer run, especially given the rise in life expectancy, I would expect to see many more moderate income workers stay in the labor force if the earnings test were repealed.[22]

Mr. Chairman, this is not a partisan issue. President Clinton proposed eliminating the earnings test in his State of the Union Address in 1999, and has reiterated his desire to do so again this year.[23] I urge the Committee to support him.

Chairman SHAW. Thank you, Mr. Bartlett.

Mr. Greenstein.

STATEMENT OF ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES

Mr. GREENSTEIN. Thank you, Mr. Chairman.

As you have heard today, there is a case for eliminating the earnings test applied to people who have reached the normal retirement age, as H.R. 5 does.

My one reservation is, as you know, long term solvency legislation is controversial, eliminating the earnings test is popular. My preference would be to do it as part of long term solvency legislation to make it easier pass. My concern is that without this, getting that agreement on long term solvency legislation is even a little harder.

[20] Recent estimates of how much the labor supply would rise from elimination of the earnings test suggest that the magnitude could be fairly large. See Leora Friedberg, "The Labor Supply Effects of the Social Security Earnings Test," National Bureau of Economic Research Working Paper No. 7200 (June 1999); idem, "The Social Security Earnings Test and Labor Supply of Older Men," in James M. Poterba, ed., *Tax Policy and the Economy*, vol. 12 (Cambridge: MIT Press, 1998), pp. 121–150. Earlier studies generally found much lower labor responses. See Marjorie Honig and Cordelia Reimers, "Is It Worth Eliminating the Retirement Test?" *American Economic Review*, vol. 79, no. 2 (May 1989), pp. 103–107; Michael V. Leonesio, "The Effects of the Social Security Earnings Test on the Labor-Market Activity of Older Americans: A Review of the Evidence," *Social Security Bulletin*, vol. 53, no. 5 (May 1990), pp. 2–21; Michael D. Packard, "The Earnings Test and the Short-Run Work Response to Its Elimination," *Social Security Bulletin*, vol. 53, no. 9 (September 1990), pp. 3–16. Two early studies that did find a high labor response to reduction of the earnings penalty are Michael J. Boskin, "Social Security and Retirement Decisions," *Economic Inquiry*, vol. 15, no. 1 (January 1977), pp. 1–25; and Anthony J. Pellechio, "The Social Security Earnings Test, Labor Supply Distortions, and Foregone Payroll Tax Revenue," National Bureau of Economic Research Working Paper No. 272 (August 1978).

[21] Gary Robbins and Aldona Robbins, "Retiring the Social Security Earnings Test," Institute for Policy Innovation *Issue Brief* (May 6, 1999), available at www.ipi.org. Another study found that the main long-run cost from eliminating the earnings test came from the recomputation of benefits. See Alan L. Gustman and Thomas L. Steinmeier, "Changing the Social Security Rules for Work After 65," *Industrial & Labor Relations Review*, vol. 44, no. 4 (July 1991), pp. 733–745. My guess is that most seniors would happily give up any recomputation of benefits for work after age 65 in return for abolition of the earnings test.

[22] Press reports indicate that many Baby Boomers don't wish to ever retire. See "So Who Wants to Retire?" *Business Week* (November 8, 1999), p. 8; Gene Epstein, "A Big New Wrinkle," *Barron's* (September 6, 1999), pp. 27–29; John Authers, "Boomers Want to Work For Ever," *Financial Times* (October 30, 1998).

[23] The President said, "we should eliminate the limits on what seniors on Social Security can earn." *Congressional Record* (January 19, 1999), p. H259. His latest comment came in an interview with reporters on February 1, 2000. He said, "I think that something that costs money in the short run, but makes you money in the long run is lifting the earnings limits. And we plainly ought to do that." Accessed at www.nytimes.com/yr/mo/ day/news/financial/clinton-text.html on February 2, 2000.

Having said that, I recognize that a decision seems to have been made to move forward this year with it, so I will proceed to discuss the earnings test questions themselves.

There are various ways to change the earnings test, some wise and some unsound. Fortunately, you have before you, I think, a very sound way to change the earnings test in H.R. 5 so that if you do more forward this year, I think passing H.R. 5 is the way to do it.

Before going a little further into why, I would like to make two observations. One is I tend to think we really should not talk about the earnings test as imposing a tax on the earnings because, as Congressman Portman just mentioned, if you lose benefits due to the earnings test, you get them back after you cease having the earnings test apply through higher monthly benefit for the rest of your life and, on average, you fully get back what you lost in the earnings test.

This means the earnings test is not really a tax on lifetime benefits, which is the very reason why you can eliminate it without worsening Social Security solvency. If it really were a big tax on lifetime benefits, then eliminating it would increase benefits and worsen solvency. But eliminating it does not worsen solvency, it means more benefits now instead of benefits later.

The second observation I want to make is that we should think very differently about the separate test that applies to those who begin receiving Social Security benefits early. For them eliminating that test, which H.R. 5 wisely does not do, would significantly increase poverty among the very old. People who begin to draw benefits at 62, as you know, receive a 20 percent lower monthly benefit for the rest of their lives, and that affects their widows, as well.

If we eliminated the test as it applies to the early benefit receivers, many more people would likely begin to claim benefits at 62, with the result that more beneficiaries and ultimately more widows would be receiving the lower benefits when they were very old. As Commissioner Apfel stated here this morning, that could increase the number of elderly poor by up to 700,000 people.

So what are the policy conclusions that I would draw? First, the research suggests that among those who have reached the normal retirement age, eliminating the earnings test may cause a modest increase in work effort. The Social Security actuaries report that eliminating that earnings test would have no effect on solvency. Eliminating the earnings test for people who have reached the normal retirement age therefore seems a sensible step and that is what H.R. 5 does.

The separate test that applies to early retirees is a different story. There is no evidence in the research literature that eliminating it would cause a significant increase in work effort. But eliminating it would cause a significant increase in poverty among the very old, especially among widows in their eighties and nineties.

In addition, the Social Security actuaries report that eliminating the earnings test for early retirees would move the date of insolvency forward from 2034 to 2033 and modestly reduce the trust fund's assets.

Eliminating the test for early retirees would have one other adverse effect. It would encourage increased claiming of benefits at age 62. Mr. Chairman, as we move forward into the difficult demographic decades ahead, when the population will age and Americans will live longer, encouraging more people to start claiming at 62 is one of the last things we should be doing.

In conclusion, if Congress does decide to move forward this year with earnings test legislation outside of larger solvency legislation, then H.R. 5 would be the way to go.

Thank you.

[The prepared statement follows:]

Statement of Robert Greenstein, Executive Director, Center on Budget and Policy Priorities

I appreciate the opportunity to testify before the Subcommittee today. I am Robert Greenstein, executive director of the Center on Budget and Policy Priorities here in Washington, D.C. The Center is a nonprofit policy institute that works on an array of public policy issues, with a particular interest in matters of fiscal policy and policy impacts on low-and moderate-income families. The Center receives no federal grants or contracts.

THE EARNINGS TEST AND SOCIAL SECURITY REFORM

I approach the topic of today's hearing with some ambivalence. On the one hand, as explained below, there is a case for eliminating the Social Security earnings test as it is applied to individuals who have reached the age at which full Social Security benefits are paid (sometimes known as the "normal retirement age"). On the other hand, the best course would be to deal with the earnings test as part of broader Social Security reform legislation, rather than to move legislation eliminating this test separate from—and ahead of—a broader reform package that restores long-term solvency.

Restoring long-term solvency to Social Security will necessarily entail some reductions in benefits or increases in payroll taxes unless policymakers pour in so much money from the rest of the budget for a number of decades as to make any hard choices unnecessary, a course of action that would likely cause serious fiscal problems a few decades from now. This point holds true for both privatization and non-privatization approaches to restoring long-term Social Security solvency.

Eventually, we will have to make some tough choices. Doing so will not be easy politically. Having elimination of the earnings test as part of such a long-term solvency package would make the package more politically palatable. By contrast, separate action now to eliminate the earnings test, outside of a long-term solvency package, would likely make such a package somewhat less attractive and still harder to pass. It also is difficult to argue that changes in the earnings test should be made on their own but that other changes for which the evidence may be more compelling—such as changes in the Social Security widows' benefit to reduce the high rates of poverty that old widows face—must wait for long-term solvency legislation.

I recognize, however, that Congress may wish to proceed nonetheless to address the earnings test this year. Accordingly, the main body of this testimony addresses various issues related to the earnings test and to potential legislation to eliminate it.

SHOULD THE EARNINGS TEST BE ELIMINATED?

I believe the answer to this question depends on *how* the earnings test is eliminated. Done in a sound way, elimination of the earnings test is likely to represent a positive, if modest, improvement. Done in an unsound manner, eliminating the earnings test would likely turn out to be a net negative, causing a significant increase in poverty among elderly widows.

Fortunately, the Ways and Means Committee has before it a piece of legislation that eliminates the earnings test in an appropriate manner. This is H.R. 5, introduced by Rep. Sam Johnson. If the Subcommittee resolves to move forward this year with earnings test legislation, H.R. 5 would be the bill to pass.

MISUNDERSTANDINGS ABOUT THE EARNINGS TEST

The earnings test is one of the most misunderstood aspects of Social Security. There are three common sources of misunderstanding about the earnings test:

1. Although many refer to the Social Security earnings test, there are, in fact, two earnings tests, not one. Separate tests apply for individuals who have reached the normal retirement age and for individuals who begin to draw benefits early (i.e., before the normal retirement age, most commonly at 62). As discussed below, the two earnings tests raise very different issues. Decisions need to be made separately about what to do regarding each of the earnings tests.

2. The earnings tests do not impose a tax on earnings. To be sure, a beneficiary's earnings do cause his or her Social Security benefits to be reduced. But on average, the Social Security benefits that are reduced while a beneficiary is working *are restored after the beneficiary stops working or reaches age 70*, whichever occurs first. Once the earnings test ceases to apply to a beneficiary, the monthly Social Security benefit the beneficiary receives for the rest of his or her life is increased above the level the beneficiary would have received if he or she had not been subject to the earnings test. *For a beneficiary with average life expectancy, the extra benefits received after the earnings test ceases to apply will about exactly equal the benefits lost due to the earnings test.*[1] The Social Security benefit structure is purposely designed to produce this result. (Technically, this result will be achieved for the earnings test above the normal retirement age starting in 2005, when legislation Congress passed to achieve this result is phased in fully. Today, the subsequent benefit increases compensate for most, but not all, of the benefits that a beneficiary with average life expectancy loses as a result of the earnings test.)

The fact that the earnings test is not a tax on lifetime benefits—and does not reduce benefits on average—is the reason why eliminating it has no effect on long-term Social Security solvency. If the earnings test truly were a tax on benefits, eliminating it would increase total Social Security benefits paid and hence worsen Social Security's long-term financial picture.

3. Elimination of the separate test that applies to those who begin receiving Social Security benefits early (i.e., before the normal retirement age) would significantly increase poverty among the very old. People who begin to draw Social Security benefits at age 62 now receive about a 20 percent lower monthly benefit for the rest of their lives than the benefit they would receive if they began drawing benefits at the normal retirement age. This actuarial reduction affects the benefits their widows later receive, as well. If the earnings test for early benefit receipt is eliminated, more people will begin claiming benefits at age 62, with the result that more beneficiaries—and ultimately more widows—will be receiving reduced monthly benefits while they are very old. Those who are very old often no longer have other income sources and may have largely exhausted their assets; many such individuals must live largely or entirely on their monthly Social Security check.

There is little question that early claiming of Social Security benefits at age 62 increases poverty. Economists Jonathan Gruber of M.I.T. and Peter Orszag of the University of California at Berkeley recently looked at the average Social Security benefits of very old widows. They found the average benefits of widows whose spouses had begun claiming Social Security benefits before 65 were below the poverty line, while the average benefits of widows whose spouses waited until the normal retirement age to collect benefits were nearly $2,000 above the poverty line. They also found that a significant portion of this difference in average benefits was due to the decision regarding whether to begin receiving benefits early or to wait until the normal retirement age.[2] Some preliminary work indicates that eliminating the earnings test for people who draw benefits early would increase the number of elderly poor people by some hundreds of thousands.

RESEARCH ON THE EFFECT OF THE EARNINGS TEST ON WORK EFFORT

Economists Gruber and Orszag also recently completed a review of the research literature on the effect of the earnings test on decisions about whether to work. They reported that most of the academic literature "suggests that, contrary to popular impression, the test has little effect" on the degree to which seniors work. They noted, however, that one recent study suggests the earnings test does have a more significant effect on the work decisions of individuals who have passed the normal

[1] Those with above average life expectancies are somewhat over-compensated; the application of the earnings test actually increases their lifetime benefits. Those with below-average life expectancies are somewhat under-compensated.

[2] Jonathan Gruber and Peter Orszag, "What to do about the Social Security Earnings Test?," Center for Retirement Research, July 1999.

retirement age, although they cautioned that this study has methodological limitations. Their overall conclusion is that, based on the available research, "The earnings test has some, but a relatively modest, effect on overall work activity" for those above the normal retirement age.[3] Their review found no evidence in the research literature of any significant effect on work activity of the earnings test that applies to early retirees.

POLICY IMPLICATIONS

The research suggests that among those who have reached the normal retirement age, eliminating the earnings test may cause a modest increase in work effort. The Social Security actuaries report that eliminating this earnings test would have no effect on long-term Social Security solvency. Eliminating this earnings test therefore seems a sensible policy step. That is what H.R. 5 does.

The separate test that applies to early retirees is a different story. There is no evidence that eliminating it would cause an increase in work effort. But eliminating this test would cause a significant increase in poverty among the very old, especially among widows in their 80s and 90s. In addition, the Social Security actuaries have reported that eliminating the earnings test for early retirees would move the date of Social Security insolvency forward from 2034 to 2033 and modestly reduce the trust fund's projected assets.

Eliminating the test for early retirees also would have one other adverse effect—it would encourage increased claiming of Social Security benefits at age 62. As we move toward the difficult demographic decades that lie ahead, when the U.S. population will be aging and Americans will be living longer, encouraging more people to start claiming Social Security at age 62 is one of the last things we should be doing.

CONCLUSION

Elimination of the earnings test is not so pressing a national need that it must be accomplished immediately. The more pressing need is fashioning Social Security solvency legislation. Solvency legislation inevitably will entail tough choices. Fashioning and enacting such legislation will be easier if earnings test elimination can be packaged with it. For this reason, the most prudent course is to wait.

If, however, Congress is intent on moving forward this year, it should adopt H.R. 5, which eliminates the earnings test for those reaching the normal retirement age. It would be most unwise also to scrap the earnings test that applies to early retirees, a step that H.R. 5 wisely does not take.

Chairman SHAW. Thank you.

Dr. Robbins.

STATEMENT OF ALDONA ROBBINS, PH.D., VICE PRESIDENT, FISCAL ASSOCIATES, AND SENIOR RESEARCH FELLOW, INSTITUTE FOR POLICY INNOVATION, ARLINGTON, VIRGINIA

Ms. ROBBINS. Thank you, Mr. Chairman and Members of the Committee.

As we have heard today, the Social Security retirement earnings test can lead to very high tax rates on wage income. Its elimination would be one of the best ways to improve work incentives.

The earnings test itself is a 33 percent marginal tax on the next dollar of wages over the limit. Payroll taxes tack on another 7.65 percent which makes the marginal tax rate at least 41 percent. And then depending on the retirees Federal income tax bracket and

[3] Gruber and Orszag, *op. cit*. Gruber and Orszag observe that one study (by Robbins and Robbins) concludes that the earnings test for beneficiaries who have reached the normal retirement age has very large effects on work effort. Gruber and Orszag note, however, that this study has been sharply criticized by Social Security experts, most notably in a critique published by the Office of Research and Statistics of the Social Security Administration, for a series of errors that make its results unreliable.

whether he or she must include Social Security benefits in adjusted gross income, the marginal tax rate on wages can reach over 80 percent. In the face of such high punitive tax rates, retirees may well decide to work fewer hours or not bother working at all.

There are at least two reasons that the earnings test should be eliminated all together. The first has to do with fairness and the second with economic common sense. The matter of fairness has to do with the delayed retirement credit. As we have heard today, retired workers who lose benefits for a month or more because of the earnings test will have them boosted later, thanks to the delayed retirement credit. Because men at age 70 have a life expectancy of roughly 12 years, for women it is about 16, the present value of benefits withheld between the normal retirement age and 69 due to the earnings test will be about the same as the higher benefits paid out after age 70 due to the delayed retirement credit.

So that is why the Social Security actuaries estimate that the long run cost of eliminating the earnings test is next to nothing. But while the government breaks even, individual retired workers may not. Because benefits withheld today are given back after age 70, the earnings test is essentially a forced loan from retired workers to the Federal Government at the government borrowing rate. But on average retirees fare worse because the market interest rate they face to replace benefits withheld is higher.

And of course, the actuarial calculations are based on life expectancies which mean that only half of the people will survive long enough to even break even. In other words, roughly half of those who lose benefits to the earnings test will never receive sufficient benefits from the delayed retirement credit.

Doing away with the earnings test also makes good economic sense. Stock and bond markets hold their collective breaths the first Friday of every month as they wait for the Bureau of Labor statistics report on job creation and unemployment. Last January the economy added an unexpectedly large 387,000 new jobs and the unemployment rate dipped to 4 percent, which is just a tick off a 30 year low.

With a population that is growing by less than 1 percent a year, there are continuing worries about tight labor markets. Congress is presently addressing this issue by looking at raising immigration limits for skilled workers in technology. But there is a skilled labor pool at home just waiting to be tapped.

Only one in three people between the ages of 65 and 69 who are eligible for retired worker benefits work sometime during the year. And about two-thirds of those who do work keep their earnings under the limit. Doing away with the earnings test would make more labor resources available.

The change that Congress enacted in 1996 in raising the earnings limit has already had a positive effect. Labor force participation rates of men ages 65 to 69 have increased by 8 percent and the rates of women have increased by 6 percent. Completely removing the penalty against work should encourage even more seniors to reenter the labor market.

Many jobs go begging in this tight labor market. Increasing numbers of older workers will find it much easier to get jobs, jobs that will otherwise go unfilled. But the revenue losses computed under normal budget scoring rules assume that these new workers would not lead to more jobs or output overall. In fact, on average each additional dollar of labor compensation earned by these workers would lead to about $1.50 more in gross domestic product.

In other words, while the combination of the earnings test and the delayed retirement credit may net the government a few pennies at best, it probably costs society $1.50 and this seems like a poor trade.

Thank you.

[The prepared statement follows:]

Statement of Aldona Robbins, Ph.D., Vice President of Fiscal Associates, and Senior Research Fellow, Institute for Policy Innovation, Arlington, Virginia

Mr. Chairman and members of the Committee, I am Aldona Robbins, Vice President of Fiscal Associates and Senior Research Fellow at the Institute for Policy Innovation (IPI). Thank you for the invitation to appear at this hearing on "Improving Social Security Work Incentives." [1]

Social Security's retirement earnings test can lead to very high marginal tax rates on wage income. Its elimination would be one of the best ways to improve work incentives.

Between the normal retirement age through age 69, workers who earn too much lose $1 in benefits for every $3 in wages and salaries over the earnings limit.[2] In other words, the earnings test itself is a 33.3 percent marginal tax on the next dollar of wages over the limit. Payroll taxes tack on another 7.65 percent raising the marginal rate on wages to at least 41 percent. Depending on the retiree's federal income tax bracket and whether he or she must include some Social Security benefits in adjusted gross income, the marginal tax rate on wages can reach over 80 percent.

In the face of such high, punitive tax rates retirees may well decide to work fewer hours or not bother working at all. The earnings test may help explain why only 16.5 percent of men age 65 and over are in the labor force today compared to 47 percent fifty years ago.

Recently, older workers have gotten some relief from these punitive marginal rates. The "Senior Citizens" Right To Work Act of 1996 temporarily allowed a faster increase in the earnings limit for retired workers between 65 and 69. This year the earnings limit is $17,000 versus $13,200 under old law. By 2002, retirees will be able earn up to $30,000 without penalty. After that, the earnings limit will go up more slowly, rising with average wages.

While this temporary relief is laudable, there are at least two reasons that the earnings test should be eliminated altogether. The first has to do with fairness and the second with economic common sense.

Why do I say that doing away with the retirement earnings test is a matter of fairness? Retired workers who lose benefits for a month or more because of the earnings test have them boosted later thanks to the delayed retirement credit. The credit increases the benefit amount to which a retired worker is entitled by a fixed percentage for every year he or she postpones retirement past the normal retirement age. Starting in 1986, the delayed retirement credit has been increased by half a percent every other year from its original 3 percent until it reaches its final value of 8 percent for everyone born in 1943 and after. For example, a retired worker born in 1945 who will lose a year's worth of benefits because of the earnings test will receive an 8 percent increase in his or her Social Security benefit at age 70. (A retired worker who will have two year's worth of benefits withheld will receive a 16 percent increase and so forth.)

Because men at age 70 have a life expectancy of a little over 12 years (women about 16 years), the present value of benefits withheld between normal retirement age and 69 due to the earnings test will be about the same as the higher benefits paid out after age 70 due to the delayed retirement credit. That is why the Social

[1] Much of the material in this statement is adapted from Aldona and Gary Robbins, Retiring the Social Security Earnings Test, The Institute for Policy Innovation, Issue Brief, May 6, 1999. Copies are available on IPI's website—www.ipi.org.

[2] Currently normal retirement age is 65. However, starting with people born in 1938 (and who turn 62 this year), the retirement age will gradually be raised to 67 for people born in 1960 and after.

Security actuaries estimate the long-run costs of eliminating the earnings test as next to nothing. In other words, the combination of the earnings test and the delayed retirement credit means the government breaks even.

But retired workers may not. Because benefits withheld today are given back after age 70, the earnings test is a forced loan from retired workers to the federal government at the government borrowing rate. On average, retirees make out worse because the interest rate they face to replace benefits withheld today is higher. Of course, the actuarial calculations are based on life expectancies, which mean that only half the people will survive long enough to break even. In other words, roughly half those who lose benefits due to the earnings test will never receive sufficient benefits from the delayed retirement credit.

The other reason to do away with the earnings test is that it makes good economic sense. Stock and bond markets hold their collective breaths the first Friday of every month waiting for the Bureau of Labor Statistics report on job creation and the unemployment rate. Last January the economy added an unexpectedly large 387,000 new jobs and the unemployment rate dipped to 4 percent, just a tick off a 30-year low. With a population that is growing by less than one percent a year, there are continuing worries about tight labor markets. Congress is presently addressing this issue by looking at raising immigration limits for skilled workers in technology.

But there is a skilled labor pool at home just waiting to be tapped. Only one in three people between the ages of 65 and 69 who are eligible for retired worker benefits work sometime during the year. About two-thirds of those who do work keep their earnings under the limit. Doing away with the earnings test would make more labor resources available. The change Congress enacted in 1996 has already had a positive effect. Labor force participation rates of men ages 65 to 69 have increased by 8 percent and those of women by 6 percent.[3] Completely removing Social Security's penalty against work should encourage even more seniors to reenter the labor market.

Many jobs go begging in this tight labor market. Increasing numbers of older workers will find it much easier to get jobs "B jobs that will otherwise go unfilled. But, the revenue losses computed under normal budget scoring rules assume that these new workers would not lead to more jobs or output overall. In fact, on average, each additional dollar of labor compensation earned by these new workers would lead to $1.50 more gross domestic product. In other words, while the combination of the earnings test and the delayed retirement credit nets the government a few pennies at best, it probably costs society a dollar and a half. This seems a poor trade.

With a low price tag, burgeoning federal budget surpluses and the economy's need for talented workers, now is the time to finish the job and repeal the earnings test.

Chairman SHAW. Thank you.

Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. I appreciate the testimony and all the thought that has gone into it.

My first question is for Dr. Friedberg. I just wanted to ask you why you think your research is indicating more behavioral shifts than other research? I know there is some other research that indicated the labor supply would not be affected much by the earnings limit being appealed, and yet you indicate that it would. I wonder if you can talk about maybe some of the assumptions you use, as compared to some other research in this area.

Ms. FRIEDBERG. That is a good question. The reason that I did some new research on the earnings test was that most of the previous research was based on data from the seventies. So it is not a question that I brought new assumptions to my research. I was using more recent data, so that the old conclusion might be somewhat outdated.

[3] BLS data show that the labor force participation rate of men averaged 26.3 percent between 1990 and 1996 versus 28.3 percent from 1997 through 1999. The averages for women are 17.1 percent versus 18.1 percent, respectively.

And also, during the seventies there were no changes in the earnings test, so we had no easy way to see exactly how people were responding. I used data following people through later changes that showed a strong response.

Mr. PORTMAN. So you have been able to actually look at behavior changes as a result of actual changes in law, raising the earnings limit in particular, and extrapolated from that as to what the impact might be if there were a repeal of the limit, particularly for those ages 65 and older.

Ms. FRIEDBERG. That is correct.

Mr. PORTMAN. Your research has shown that there would indeed be more folks who would be working, as compared to now, in that age group?

Ms. FRIEDBERG. That is precisely right. For example, in 1983 the earnings test was eliminated for 70 and 71 year olds, much as the proposal today focuses on a slightly younger group. And you see an increase in work hours, so those are the conclusions I got.

Mr. PORTMAN. Thank you for your research work.

Bob Greenstein, we have a lot to talk about on Social Security generally. I agree with you, it would be great if we had comprehensive Social Security reform, and this would be a nice way to compliment some other Social Security reform measures that would be necessary to increase the solvency. As you know, there are proposals out there. Archer-Shaw is one I think is very innovative, to look at that.

But the reality is, unless you feel otherwise, I think we would agree it is not going to happen this year. Major Social Security reform will probably have to wait until the new Congress and the next president, and I guess that is why I feel so strongly that we need to go ahead and clean up what is currently in the system which is counterproductive, and this would be one of them.

I would only encourage you to think broadly, too, about retirement security. I know we have differed sometimes on the pension reforms, but I really think we are missing a huge opportunity, not just to focus on Social Security, a government program, but to focus on the need for all Americans to have retirement security through private savings. Particularly in the pension area, where only half of America's workers have any kind of pension at all now. So you have 70 to 75 million workers with no defined benefit plan, 401(k) or any other pension.

I would look forward to working with you on that in the future and perhaps we need to have a discussion at another time about some of the behavior changes that Dr. Friedberg talked about as it relates to retirement security generally, that if you let people save more for their own retirement and give people incentives who own small businesses to offer plans, you are going to see a lot of those lower and middle income workers get real security through their private savings.

My question to you is, with regard to early retirement and your concern that if you allow the earnings limit to be eliminated for people who are 62 to 65 you are going to have poverty rates which will increase for older people, particularly women. One could take that to the next step which would be that early retirement, in general, is a bad idea.

If you believe that this will be counterproductive because it will encourage more people to retire at 62, not having an earnings limit at 62, as compared to the current situation, then would you also not believe that we should do other things to discourage people from retiring at age 62? Or even change that option all together so that retirement becomes, with life expectancy increasing, 65 and not 62?

Mr. GREENSTEIN. I think the particular concern with regard to the earnings test as it goes down to age 62 is encouraging not so much retirement as drawing benefits, encouraging people to start drawing benefits at age 62, to a larger degree, which then automatically triggers the actuarial reduction that lasts the rest of their life.

And of course, as the normal retirement age moves up over the next 20 years from 65 to 67, the actuarial reduction at age 62 becomes deeper. I really do have concerns even about the current numbers of people who draw at 62, and I certainly would not want there to be more of them.

Now you are absolutely right, a question that leads to is should the early eligibility age, now age 62, be raised a bit? I actually think, when you look across the research, the effects on more work effort of eliminating the earnings test above the normal retirement age, the research seems to indicate there are effects, but they are pretty modest.

If you wanted to get the biggest effect on increased work effort, increasing that early eligibility age above 62 probably would be the thing that would get you that biggest effect. But it would be enormously controversial and it would raise issues of people who really cannot keep working beyond age 62 but are not sufficiently disabled to quality for disability benefits.

For that reason, as you know, the standard view among most liberals in Washington is to say that age cannot move beyond 62, that early eligibility age. I actually think it is worth looking at as part of comprehensive Social Security reform. If we moved it up a little bit beyond 62 people would not get a 30 percent actuarial reduction at age 62, as they will when the full age goes to 67.

But if we did that we would need some mechanisms to take care of those people who really cannot keep working beyond 62, who are not quite disabled enough to meet the disability definition. Maybe there is something we could do to modestly revise the disability definition, just starting at 62. But I do think it is an area to look at and something that is worth considering as part of larger Social Security solvency legislation.

Mr. PORTMAN. I appreciate your candid response and I just would make the point, as you did, that the legislation before us today, Sam Johnson's bill, does not deal with the 62 to 65 earnings limit, and therefore I know that you are supportive of the legislation. But I know that on the other side of the Capitol there is interest in total elimination of the penalty, which would include early retirement. And I know that this will be an issue that we will be addressing over the next few weeks as we work through the process.

Mr. GREENSTEIN. Could I add one more point? I know this is not something members of either party talk about publicly, but privately there is some view that some year, some way, some how, we may have to look at some of the issues on retirement ages in Social Security. I would just urge you to think about the fact that if you eliminate the early earnings test, then we go to who knows, 70 or 80 percent, some huge percentage of Social Security beneficiaries starting to claim at 62.

Mr. PORTMAN. Let us be clear, so people who are watching this would know, do not about 60 percent of retirees now retire at age 62?

Mr. GREENSTEIN. That is correct. So we are talking about, if you can start at 62, there is no reduction whatsoever for the earnings you have, maybe some people will understand, what I think most do not, all of the actuarial consequences.

If the 60 percent goes significantly higher, politically that will make it even more difficult in the future to ever move that age 62, should it be deemed wise to do so.

See the point I am getting at? I think, in some ways, if you do that you actually foreclose politically some options you might want to think about when you get to long term solvency.

Mr. PORTMAN. Thank you for your testimony.

Mr. BARTLETT. Mr. Portman, would it be all right if I made a comment here?

Mr. PORTMAN. With the indulgence of the Chair, he has the time.

Chairman SHAW. Mr. Bartlett, go ahead.

Mr. BARTLETT. Thank you. With regard to this question of early retirement, I think it is extremely important that the Committee take into account the fact that with the increase in the retirement age to 66 and then to 67, more and more retirees are going to be affected by the more punitive earnings test that applies to early retirees. It will then, in the future, affect those who are 65, 66, and 67 who now have the lower test.

And so I think it would be a good idea to make it symmetrical so that you move up the age at early retirement, although I recognize the political problems there.

The other problem is that the delayed retirement credit now is capped at age 70. You do not get any further increase, and so you are also squeezing that period of time in which the delayed retirement credit would apply. So you might need to raise that 70 age up to 72, so that people would be able to get the same benefit in the future when the retirement age rises as they get today from the delayed retirement credit.

Mr. PORTMAN. Good point.

Chairman SHAW. Mr. Matsui?

Mr. MATSUI. I want to thank the panel, but let me follow up very briefly, Mr. Chairman. I know that we need to move quickly on this.

What percentage of the 60 percent that retire at 62, Bob, are women and men?

Mr. GREENSTEIN. I do not have those figures with me. I would have to go back to my office.

Mr. MATSUI. Does anyone have that figure?

Ms. ROBBINS. My recollection is that it is about even. Women might be a slightly bigger percentage.

Mr. MATSUI. I would imagine the reason that the poverty rate for single women on Social Security is 18 percent is that they have low earnings throughout their lifetime. And that is a principal cause. Is that right, Bob?

Mr. GREENSTEIN. That is a large part of it. It is actually aggravated by early claiming of benefits. There was a very interesting piece of research done last year by economists John Gruber and Peter Orszag. They looked at very old widows and they looked at their Social Security benefits. What was interesting was they found that for very old widows whose spouses had begun to claim benefits early, when those widows were in very old age, their average Social Security benefit was below the poverty line.

When they looked at very old widows, same age group, whose spouses had not begun to draw Social Security benefits before the normal retirement age, their average Social Security benefit was about $2,000 above the poverty line.

Now part of the difference was because one group had a higher earnings profile than the other. But they found that a significant factor in this difference was simply the actuarial reduction for claiming benefits early.

I feel like I am repeating myself here but the point I am trying to make is we should not be encouraging more people to claim benefits early. We should be concerned, as the full benefit age goes from 65 to 67 and the early age stays at 62, the 30-percent reduction people are going to get at age 62 is a real whopper and we are going to see effects on widow poverty and old age there. It is one of the things, when we do Social Security reform, I think both parties have indicated that there is a concern on the widow poverty issue. It is something we really need to pay attention to.

Mr. MATSUI. Did the study point out whether they were mainly low income women who were retiring at 62 or was there any distinction between income groups?

Mr. GREENSTEIN. If I remember correctly, the group where the spouse drew benefits early on average had a lower earnings profile than the group where the spouse did not begin to draw benefits until the normal retirement age. Or that even despite that the difference in when they drew benefits itself aggravated the poverty of the poor group.

Chairman SHAW. Just to follow up, those that least could afford it were taking the early retirement.

Mr. GREENSTEIN. Yes, they might also have been those who had the least job opportunities at that period, as well.

Chairman SHAW. That is true.

Mr. MATSUI. Dr. Robbins?

Ms. ROBBINS. I was just going to make an observation that it is inevitable that the longer one lives, if you are depending on Social Security, that relative to the rest of society you are going to end up losing ground because once you receive a benefit level, that is going to be increased only with the cost of living. And what is happening around you is the benefits of economic growth.

So part of it is simply because the widows are living longer lives and if it is their husbands who made the decision to retire early, women are outliving men by three to 5 years, as well.

Mr. MATSUI. I appreciate your testimony. In 1983 when we revised Social Security and increased that age from 65 to 67, I do not believe that we discussed any of this at all. I regret it. I supported it, but I regret it now.

Thank you very much for your testimony.

Chairman SHAW. Mr. Johnson?

Mr. JOHNSON. Thank you, Mr. Chairman.

Dr. Robbins, you described the earnings penalty as a forced loan from retired workers. Do you want to explain that a little bit?

Ms. ROBBINS. Simply that what is happening is the government faces a government borrowing rate but you are telling retirees we are going to take this money from you today and we are going to give it back to you later. In the calculations, if you use the government borrowing rate, in terms of present value, the benefits withheld today versus the delayed retirement credit, it works out to be about the same.

The problem is individuals generally, if they go to borrow, cannot get the government borrowing rate. They have to borrow at something higher.

Mr. JOHNSON. They do not pay interest do they? When they pay you back, they do not pay interest do they?

Thank you very much.

Chairman SHAW. I would like to thank this entire panel. It has been very helpful and very enlightening.

Mr. Greenstein, I too would have liked this to be a part of a larger package with general reform of the Social Security system to be sure that it is going to be out there and be strong for our kids and our grandkids. However, when it became increasingly clear that we were not going to have general Social Security reform this year because of some of the late announcements from the White House, it did not seem at all reasonable to hold back the seniors that are being unnecessarily punished with this unjust penalty.

So at that point the determination was made to go ahead and move this part of the bill. I am very pleased to see that the President has stepped out in front at a very early time, just yesterday at a news conference, that he indicated that he would sign this bill as long as it was in the general form of H.R. 5. I can assure him, unless some disaster happens over in the Senate, that it will be. We are going to pass this tomorrow—about four o'clock we are going to start our markup. I would anticipate the markup is going to go very, very quickly.

Mr. Matsui and I have been discussing this and we are in general agreement that we need a clean bill, we do not want it cluttered. And I would hope that all the members would support a closed rule going to the House, and we can bring it up as early as March 2nd, and that is our intention. From some of the early comments we are getting from the Senate, I think they will work on it rather quickly and we can get it to the President's desk.

In any event, the effective date of the bill that is before us is January 1, 2000 which means that it will retroactively, in a very positive way, affect those that are presently working and having to endure this penalty.

Thank you very much, and this hearing is concluded.

[Whereupon, at 4 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

AMERICAN BAR ASSOCIATION
CHICAGO, IL 60611
February 28, 2000

The Honorable E. Clay Shaw, Jr.
Chairman
Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing to you regarding the hearings your Subcommittee held February 15, 2000 relating to the Social Security Earnings test.

The ABA supports the elimination or the substantial liberalization of the retirement earnings test in Social Security. The retirement earnings test coupled with other taxes imposes a very large marginal tax rate on certain elderly Americans. We believe that such a high tax rate discourages work effort by these elderly workers, many of whom have the very skills America needs to continue to be competitive in the coming years.

Different individuals and groups have conflicting views as to how many elderly individuals aged 65 and over would either return to work or continue to work depending on whether the test were repealed or liberalized. We cannot say with certainty what the results would be. However, we believe that if even a modest number of individuals in this group is encouraged to continue working, the effect on the economy can only be positive. The addition of skilled and experienced employees will enhance the competitiveness of the American economy and supplement the tax revenues derived from employment.

Moreover, any projected revenue loss from changing the test will be offset, in whole or in part, by income taxes on the earnings of workers who are motivated to remain in the workforce, including income taxes on earnings past age 70 of workers who are not encouraged by this earnings penalty to retire at 65.

From the standpoint of tax policy, we believe that the current restrictions result in a most regressive tax. The changing patterns of compensation and employment have outdated and thwarted the original effects and objectives of the law.

The ABA understands the importance to the individual of being given the option to continue to work in one's field of interest. A marginal tax rate as high as this one creates a substantial barrier to continued employment.

We would appreciate it if you would include this letter in the record of the your Subcommittee's hearing on the Social Security Earnings Test.

Sincerely,

EDWARD E. KALLGREN
Chair, Senior Lawyers Division

cc: Robert D. Evans, Director, Governmental Affairs Office
Joseph E. Ross, Chair, Committee on Legislation and Administrative Regulations, ABA
Senior Lawyers Division

STATEMENT OF AMERICAN FARM BUREAU FEDERATION

The American Farm Bureau Federation supports the abolishment of the Social Security retirement earnings test.

The retirement earnings test is an original feature of Social Security. Under the provision this year, working seniors ages 65–69 with earnings above $17,000 lose $1 of benefits for every $3 they earn over the limit. For those under age 65, benefits are reduced by $1 for every $2 dollars above a $10,080 threshold. In addition, Social Security benefits become subject to taxation once the limitation has been exceeded.

The retirement earning test was created during the 1930s to keep older workers out of the labor force so that jobs would be available for younger workers. Today's situation is much different than it was during the depression. Unemployment is low and there are fewer younger workers. People are living longer and should be encouraged to work longer, not discouraged by an obsolete retirement earnings test.

The threshold creates special problems for farmers and ranchers who do not normally pick a retirement date and stop farming. Farms and ranches are businesses that must undergo an orderly transition to the next generation of agricultural producers. The retirement earning test wrongly imposes a penalty on senior partners as they phase-out of agricultural operations.

Farm Bureau urges Congress to eliminate the Social Security retirement earnings test.

Statement of Andrew F. Quinlan, Executive Director, Capitol Watch

"EARNINGS TEST REFORM: A SMALL STEP IN THE RIGHT DIRECTION"

Capitol Hill and the White House have been arguing over the best way to "save" Social Security. Unfortunately, the result has been gridlock; largely because there is no way of reconciling the differences between those who want to modernize the program with personal retirement accounts and those who think the problem can be solved by adding more IOUs to the Trust Fund.

This does not mean, however, that nothing good can happen. The President, for instance, recently endorsed a Republican-led effort to get rid of the Social Security "earnings test," a Depression-era law that penalizes working seniors by deducting money from their Social Security checks for every dollar they earn over a certain amount. This modest and long-overdue reform would, in effect, dramatically reduce marginal tax rates on working seniors and eliminate a barrier to continued employment for America's seniors.

For instance, workers between the ages of 62 and 64 can earn up to $10,080, with no reduction in their Social Security benefits. However, for every $2 they earn over the $10,080 threshold, they lose $1 in Social Security benefits. The threshold is increased to $17,000 for those between 65 and 69. They lose "only" $1 for every $3 earned over the limit.

In effect, the earnings test imposes the equivalent of a very steep marginal tax rate. Recall the essential insight of supply-side economics: high tax rates reduce productive behavior by lowering incentives to work, save, invest, and take risks. More specifically, people work to increase their disposable income, and policies that result in less disposable income will discourage employment. This in a nutshell is what the earnings test does. As mentioned before, seniors between age 62 and age 64 lose 50 cents in Social Security benefits for every dollar that they earn over the limit while seniors between age 65 and age 69 lose more than 33 cents of benefits for every dollar of "excess" earnings. This means that the benefit of working—more disposable income—is sliced by a huge percentage. And to add insult to injury, the worker must also pay a host of taxes on their income.

Let's take a 64 year-old Social Security recipient who works to balance the family budget and has annual earnings of $15,080. Since his earnings are $5,000 over the limit he must forgo $2,500 in Social Security benefits. A 65 year-old worker will not be penalized quite as heavily, but will still lose $1,667 in benefits if he or she has $5,000 of earnings above the limit. Moreover, once federal and state income taxes, payroll taxes, and other levies are added to the equation, elderly workers are facing an effective marginal tax rate that is far in excess of the confiscatory rates facing professional sports stars and Wall Street hotshots. It is not hard to understand why this person would decide to stop working before he passes the earnings limit.

At first glance, this type of law seems preposterous. What would motivate politicians to enact super-high tax rates on senior citizens who are trying to earn extra income to make ends meet? It turns out that the earnings limit on Social Security benefits was part of the original Social Security program. During the debate of the 1930's, Congress wanted to entice seniors out of the workforce and free up scarce jobs for younger workers.

With the benefit of hindsight, we now know that the Great Depression was not caused by too many seniors in the workforce, but rather by misguided monetary policy, high tax rates, trade protectionism, and other government policy mistakes. Nonetheless, one can understand how panicky politicians at the time adopted a zero-sum mentality. Today, there is no excuse for this kind of thinking. Jobs are plentiful and individuals are living and working longer than ever before. Older workers have valuable years of experience and can be productive well into their retirement years.

The earning test creates a whole range of individual tragedies by effectively forcing seniors out of the workforce. But the earnings test is also bad news for the overall U.S. economy. In a 1997 report entitled Earnings Limit Penalizes Working Seniors, the National Center for Policy Analysis argued that abolishing the earnings limit would increase federal tax revenues because of additional economic output.

NCPA also estimated that the elderly work force would increase by 38 percent, that wage income for the elderly would increase, and that the additional taxes paid by the elderly would more than offset the Social Security benefits paid to these workers.

Some progress has been made. This Committee as well as Congressional Leaders and the President have agreed to repeal the earnings test on seniors who have reached the normal retirement age. The only shortcoming is that the legislation leaves in place the penalty on Social Security recipients who have not reached retirement age. The earnings test should not exist at all. Congress and the American people should seize this rare opportunity and extend a good idea to its logical conclusion.

RICHARD J. SALMON, P.E.
JACKSONVILLE, FL 32258
February 26, 2000

Honorable E. Clay Shaw, Jr.,
Congressman (R–FL), Chairman
Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

RE: Hearing on Improving Social Security Work Incentives

I commend and urge the Subcommittee on Social Security to stay the course charted for support of and enaction of H.R. 5 by the 106th Congress.

My reason for this statement is personal. I am 66 years and five months of age and have worked full time since completing my formal education in 1956. My employer has asked me to continue working as a structural engineer and manager of a small office in North Florida. My employer feels that my experience in industry and in consulting engineering and my influence on young entry level and junior engineering staff is of significant continuing benefit to our firm and its objectives.

Last year, calendar 1999, my gross wages were $73,400.00. This amount is our gross household income. My Federal Income Tax withheld was $10,066.00. My Social Security Tax Withheld was $4,501.00. The figures cited are from my 1999 W–2 Wage and Tax Statement. I am married. My wife stopped working in May of 1997.

I accepted a re-assignment with my company from New England to North Florida, which gave me an opportunity to continue working. We purchased a modest home with a 30 year mortgage. Our combined retirement savings are less than our mortgage principal balance. Our one automobile is five years old.

I consider the current retirement earnings test to be highly punitive. My eligibility for Social Security Benefits between the ages of 65 through 70 were recently estimated to be approximately $85,200.00 total over the five year period. By virtue of the fact that I am working and paying taxes, under the current regulations (the retirement earnings test) I am forfeiting that entire amount of income by continuing to work and continuing to make a contribution to our nations economic well-being.

The after tax residue of those *earned* benefits would allow me to better provide for our retirement years, perhaps pay down our mortgage somewhat to a manageable retirement years expense.

Respectfully Submitted,

RICHARD J. SALMON, P.E.

Andrew F. Quinlan is the Executive Director of CapitolWatch a national, nonprofit, nonpartisan taxpayer advocacy organization with 250,000 supporters. Visit CapitolWatch's Web site at *www.CapitolWatch.org for more information.*