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expectancy, I would expect to see many more moderate income workers stay in the labor force if the earnings test were repealed.[22]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.