

IRET Congressional Advisory

April 4, 2000 No. 103

EARNINGS TEST REFORM ONLY PART OF WHAT'S NEEDED

Congress is widely reported to have voted to repeal the Social Security earnings test for workers age 65 through 69, while leaving in place the even more onerous test for workers age 62 through 64. (Those over age 70 are not subject to the test.) In fact, Congress voted to repeal the test for workers **at or above the "normal retirement age"**. The normal retirement age is rising in stages to 66 and 67 (to age 66 at the rate of two months a year for people turning 62 between 2000 and 2005; to 67 for people reaching 62 between 2017 and 2022). Within a few years, people ages 65 and 66 will be subject to the earnings test again.

If Congress meant to spare people age 65 and above from the earnings test, it should have specified repeal as of age 65, not as of "normal retirement

age". The added benefit outlays would be small and would be largely offset by tax revenue as more people work. Static scoring, of course, doesn't take such offsets into account.

In fact, as the retirement age rises under old law, future 65 and 66 year-olds will face a stricter earnings test than their predecessors. Under current law, workers at or above the normal retirement age lose \$1 in benefits for every \$3 over a fairly high earnings threshold (\$17,000 in 2000), an implicit 33-1/3% add-on tax on wages. Beneficiaries age 62 up to the normal retirement age (currently, workers ages 62 through 64, soon to be 65, and eventually 66) lose \$1 in benefits for every \$2 in earnings over a lower threshold (\$10,800 in 2000), an implicit 50% add-on tax. Therefore, as normal retirement age rises, 65 and

66 year-olds will face the more restrictive version of the test now applied to younger retirees. The test will remain an enormous disincentive to work. It should be scrapped for workers below normal retirement age too.

Apologists for the earnings test claim that it doesn't discourage work because lost benefits are restored when the beneficiaries subsequently work less than the thresholds or reach the age at which the earnings test does not apply (age 70 now, normal retirement age under the bill). **But that is true only if the beneficiaries live long enough.** Lost benefits are restored over the beneficiaries' remaining

average expected lifetimes. Affected workers who

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don't live up to their life expectancies don't get back what they lost. That risk is a clear deterrent to working for many seniors.

A small bit of relief in current law for workers below normal retirement age was preserved when the Senate amended the House version of the earnings test repeal. Current law lets workers switch to the less severe earnings test at the start of the calendar year in which they reach normal retirement age, rather than in the month in which they reach it. For example, if a worker reached age 65 in July of 1999, all his 1999 wages, starting in January, would be subject to the more generous age 65 earnings limit and loss ratio rather than the age 64 rules.

Under the original House version of the repeal, future workers would have faced the more onerous less-than-normal-retirement-age test until the month in which they reached their (rising) normal

retirement age. Under the Senate amendment, their earnings earlier in that calendar year will still be allowed the less onerous earnings limit and loss ratio that is now applied to workers age 65 through 69. Consequently, the old "normal retirement age" tier of the test is not gone completely, just trimmed back to apply to a few months prior to normal retirement age for workers not born in January.

Social Security has become too complicated for Congress and the public to understand. It is a labyrinth, and most of the pathways are mined. It is time to replace the whole mess with a clean system of personal saving for retirement, one that would yield a decent return to savers and avoid the tax traps that wreck work and saving incentives under the current system.

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