

CBO TESTIMONY

Statement of
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before the
Subcommittee on Social Security
Committee on Ways and Means
U.S. House of Representatives

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The "earnings test"--that is, the reduction of the benefits of Social Security recipients whose earnings exceed specified limits--has been the focus of much debate in recent years. More than a dozen bills have been introduced in the 102d Congress that would relax or eliminate the test.

In response to a request from this Subcommittee, the Congressional Budget Office (CBO) has examined the economic well-being of the people who would be affected by eliminating the earnings test for people aged 65 through 69. This statement summarizes that analysis and addresses four topics:

- o How the earnings test works;
- o CBO's analysis of the characteristics of people who would benefit from eliminating the test;
- o The impact on work effort of changing the test; and
- o The effects on federal outlays of eliminating or liberalizing the test.

HOW THE EARNINGS TEST WORKS

In 1991, Social Security beneficiaries aged 65 through 69 can earn up to \$9,720 annually without having payments withheld; benefits for this group are lowered by \$1 for each \$3 of earnings over this limit. Social Security beneficiaries under age 65 face an earnings limit of \$7,080; their benefits are lowered by \$1 for each \$2 of earnings over the lower limit. Beneficiaries are no longer subject to the earnings test once they reach age 70.

Two additional factors affect the operation of the earnings test. First, newly eligible beneficiaries are subject to a monthly earnings test: benefits are withheld if their monthly earnings exceed one-twelfth of their annual earnings limits. Second, people whose benefits are partially or completely withheld are compensated through a delayed retirement credit (DRC). The DRC increases future benefits (at a rate of 3.5 percent a year for people who turned 65 in 1990 and 1991) for each month in which benefits were reduced. At its current level, the DRC is not considered actuarially fair because the expected lifetime value of benefits is reduced for those whose benefits are withheld. The DRC is, however, scheduled to rise gradually to 8 percent a year for beneficiaries turning 62 in 2005 or later, for whom it is projected to be actuarially fair.

The analysis that follows is based on earnings and income data for 1989, when the benefit reduction rate for people aged 65 through 69 was 50 percent, not the 33 percent under current law. Had the new rules applied in 1989, they would have affected the magnitude of the benefit reduction, but not who had their benefits reduced. For example, a Social Security beneficiary who earned \$12,000 more than the earnings limit would have had up to \$6,000 in benefits withheld under the old rules, but would have had up to \$4,000 withheld had the new rules been in place then. In addition, the DRC was 3 percent a year in 1989, not the 3.5 percent under current law. The reduction in the expected lifetime value of benefits for workers with earnings above the limit was thus larger in 1989 than it is now.

One should also keep in mind that the total number of people the earnings test affects is probably larger than the number with earnings above the limit. For example, some beneficiaries probably have chosen to work less to hold their earnings below the limit and thereby avoid having benefits withheld. Also, some beneficiaries may have failed to report earned income for fear of losing benefits.

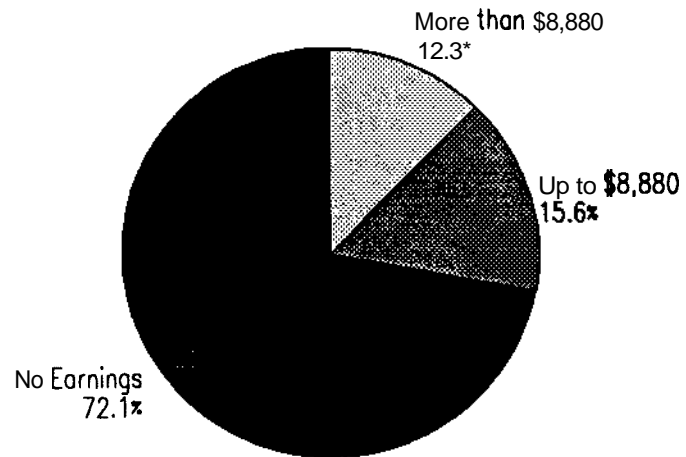
PEOPLE WHO WOULD GAIN FROM ELIMINATING THE EARNINGS TEST

Relatively few people aged 65 through 69 would gain if the earnings test were eliminated. Of the 10 million people in this group in calendar year 1989--the most recent year for which data on family incomes are available--only 12 percent had earnings more than the \$8,880 limit then in place (see Figure 1). Another 16 percent had earnings less than the limit, and 72 percent had no earnings in that year. These findings are based on data from the March 1990 Current Population Survey (CPS) for all retirees; a parallel analysis that excludes about 600,000 people who appear to have been covered by the monthly test can be found in the Appendix tables.

Elderly people living with their spouses represent just over 70 percent of those who would gain from eliminating the earnings test. This proportion is about the same as in the population aged 65 through 69 as a whole. Another 10 percent of those who would gain are other elderly men, and about 20 percent are other elderly women.

The people who would gain from eliminating the earnings test are generally better off economically than the population aged 65 through 69 as a whole. CBO's analysis measures economic well-being in two ways: using both family cash income and the ratio of family cash income to the

FIGURE 1. DISTRIBUTION OF PEOPLE AGED 65 THROUGH 69, BY THEIR OWN EARNINGS, 1989



SOURCE: Congressional Budget Office tabulations of data from the March 1990 Current Population Survey.

appropriate poverty threshold. In each case, income includes earnings, Social Security benefits, pensions, and interest and dividends of every family member.

About 31 percent of all people aged 65 through 69 had family incomes below \$15,000, but the fraction varied widely with the level of earnings (see Table 1). Only about 2 percent of the people who earned over \$8,880--and therefore would gain from eliminating the earnings test--had family incomes below \$15,000 in 1989. In comparison, 37 percent of people with no earnings and 29 percent of people with earnings up to the limit had family incomes below \$15,000.

Families with the same level of income are not necessarily equally well-off because the presence of additional family members requires additional income to achieve the same standard of living. One method of adjusting for differences in family size is to express family cash income as a multiple of the official federal poverty thresholds. In 1989, these thresholds were \$5,947 for an elderly person living alone, and \$7,501 for an elderly couple with no other family members in the household. Thus, for example, a family income of \$24,000 would be about four times the poverty threshold for an elderly person living alone, but just over three times the poverty threshold for an elderly couple.

TABLE 1. DISTRIBUTION OF PEOPLE AGED 65 THROUGH 69, BY FAMILY INCOME, THEIR OWN EARNINGS, AND MARITAL STATUS, 1989 (In percent)

Earnings	Number in Group (Thousands)	Family Income					Total
		Less Than \$15,000	\$15,000- 24,999	\$25,000- 31,999	\$32,000- 49,999	\$50,000 or More	
All People Aged 65 Through 69							
All Categories	10,130	31.3	23.5	12.1	16.8	16.4	100.0
No Earnings	7,300	36.7	24.4	12.1	14.5	12.3	100.0
Up to \$8,880	1,580	29.3	28.0	12.7	17.4	12.6	100.0
Over \$8,880	1,240	2.4	12.5	10.9	29.4	44.9	100.0
People Living with Their Spouses							
All Categories	6,780	21.4	25.8	13.6	19.1	20.2	100.0
No Earnings	4,880	26.5	28.0	14.0	17.0	14.6	100.0
Up to \$8,880	1,010	15.1	32.6	14.7	21.4	16.3	100.0
Over \$8,880	890	0.5	6.5	10.0	27.8	55.3	100.0
All Other Men ^{a/}							
All Categories	980	44.3	20.3	9.2	15.9	10.3	100.0
No Earnings	710	51.1	19.2	8.9	11.6	9.3	100.0
Up to \$8,880	150	40.8	24.8	11.2	17.6	5.7	100.0
Over \$8,880	120	7.5	21.7	8.6	40.3	21.9	100.0
All Other Women ^{a/}							
All Categories	2,370	54.5	18.0	8.9	10.5	8.0	100.0
No Earnings	1,710	60.0	16.3	8.1	8.5	7.1	100.0
Up to \$8,880	420	59.1	18.3	8.6	7.8	6.2	100.0
Over \$8,880	240	7.1	30.2	15.1	30.0	17.7	100.0

SOURCE: Congressional Budget Office tabulations of data from the March 1990 Current Population Survey.

NOTES: Details may not add to totals because of rounding.

In this table, the group of people aged 65 through 69 includes some who are not subject to the annual earnings test because they retired during the year. Recent retirees are excluded from the results shown in Table A-1.

a. All other men (and women) includes people who are widowed, divorced, never married, or who live apart from their spouse.

Even after taking family size into account, the data indicate that the benefits of eliminating the earnings test would go primarily to families that are better off economically. As shown in Table 2, only 1 percent of people with earnings above the retirement test limit had family incomes less than twice their poverty thresholds. This result is not that surprising, considering that the earnings limit in 1989 (\$8,880) exceeded the official poverty thresholds for both elderly individuals and elderly couples. In contrast, just over 10 percent of people with no earnings had family incomes under their poverty thresholds and another 27 percent had incomes between one and two times the threshold.

Previous analyses by CBO indicate that raising the earnings limit-but not eliminating it **entirely--would** also focus gains on beneficiaries who are better off economically. In general, the larger the change, the higher the proportion of the **gains--in** terms of the number of people **affected--that**would go to those with high family incomes.

THE IMPACT ON WORK EFFORT OF CHANGING THE EARNINGS TEST

Proponents of eliminating or liberalizing the earnings test argue that it contributes to high effective marginal income tax rates on Social Security

TABLE 2. DISTRIBUTION OF PEOPLE AGED 65 THROUGH 69, BY FAMILY INCOME RELATIVE TO THE POVERTY THRESHOLD, THEIR OWN EARNINGS, AND MARITAL STATUS, 1989 (In percent)

Earnings	Number in Group (Thousands)	Ratio of Family Income to Poverty Threshold					Total
		Less Than 1.00	1.00 to 1.99	2.00 to 2.99	3.00 to 3.99	4.00 or More	
All People Aged 65 Through 69							
All Categories	10,130	8.2	23.3	20.4	15.1	33.0	100.0
No Earnings	7,300	10.3	27.1	21.5	14.8	26.3	100.0
Up to \$8,880	1,580	4.6	23.4	24.9	17.9	29.2	100.0
Over \$8,880	1,240	0.0	1.1	8.3	13.5	77.1	100.0
People Living with Their Spouses							
All Categories	6,780	4.5	19.5	21.1	17.1	37.9	100.0
No Earnings	4,880	5.6	23.6	23.2	17.3	30.4	100.0
Up to \$8,880	1,010	3.0	16.2	25.4	20.1	35.4	100.0
Over \$8,880	890	0.0	0.9	4.4	12.7	82.0	100.0
All Other Men ^{a/}							
All Categories	980	11.7	29.0	19.6	12.5	27.1	100.0
No Earnings	710	14.6	34.8	19.0	11.1	20.5	100.0
Up to \$8,880	150	7.1	23.4	24.9	19.2	25.4	100.0
Over \$8,880	120	0.0	1.4	16.5	12.9	69.3	100.0
All Other Women ^{a/}							
All Categories	2,370	17.3	32.0	19.0	10.4	21.3	100.0
No Earnings	1,710	22.0	34.0	17.9	9.1	16.9	100.0
Up to \$8,880	420	7.8	40.8	23.7	12.1	15.6	100.0
Over \$8,880	240	0.0	1.6	18.9	16.6	62.9	100.0

SOURCE: Congressional Budget Office tabulations of data from the March 1990 Current Population Survey.

NOTES: Details may not add to totals because of rounding.

In this table, the group of people aged 65 through 69 includes some who are not subject to the annual earnings test because they retired during the year. Recent retirees are excluded from the results shown in Table A-2.

a. All other men (and women) includes people who are widowed, **divorced**, never married, or who live apart from their spouse.

recipients and thereby discourages work effort. They argue that reducing these rates would induce a significant number of older workers to delay their retirements or to reenter the labor force and that hours worked would increase, on average, for those who are already employed.

Eliminating the earnings test would increase work effort among some people aged 65 through 69, but the overall impact would be small. This conclusion is based on three considerations. First, the earnings test is only one of many factors that determine work effort. Among the other factors likely to influence a worker's decision to retire are the level of Social Security and private pension benefits that would be received, the employment of a spouse, the availability of suitable work, and the health of the worker.

Second, the empirical research that is available provides little support for the notion that older workers would increase their work effort significantly, as discussed in a recent survey by **Leonesio**. A widely cited study by Vroman, for example, found no evidence that liberalizing the earnings test in the 1970s precipitated large-scale reentry into the labor force. Based on data for workers aged 62 through 69, Honig and Reimers estimated that workers whose earnings are already above the limit might increase their hours by as much as 20 percent if the test were eliminated, but noted that such workers account for a very small share of this age group. In addition, workers whose

earnings are high enough that they lose all of their Social Security benefits under the current earnings test might reduce their work effort in response to the increase in their total incomes from eliminating the test.

Finally, it is noteworthy that more than half of all workers begin collecting benefits as soon as they become eligible at age 62, even though they will receive reduced benefits throughout their retirement. A sizable number of older workers clearly prefer retirement to continued employment, even though the 25 percent higher benefits they could obtain by delaying retirement until age 65 would compensate them for receiving three fewer years of benefits.

THE EFFECT ON FEDERAL OUTLAYS OF CHANGING THE EARNINGS TEST

Federal outlays for Social Security would increase if the earnings test for people aged 65 through 69 were relaxed or eliminated. One option would be to raise the earnings limit by \$3,000 a year for five years--to \$12,720 in 1992, reaching \$24,720 in 1996. This option would increase outlays by about \$6.0 billion over the 1992 through 1996 period (see Table 3). Another option would be to raise the 1992 limit to \$25,000, and retain the current indexing rules thereafter. This option would increase outlays by more than \$12 billion

TABLE 3. INCREASE IN SOCIAL SECURITY OUTLAYS OF OPTIONS FOR CHANGING THE EARNINGS TEST FOR PEOPLE AGED 65 THROUGH 69, 1992 THROUGH 1996
(By fiscal year, in billions of dollars)

Option	1992	1993	1994	1995	1996	Total 1992-1996
Increase Limit by \$3,000 per Year For Five Years <u>a/</u>	0.5	0.9	1.2	1.6	1.9	6.0
Increase 1992 Earnings Limit to \$25,000 <u>b/</u>	1.7	2.6	2.7	2.7	2.8	12.5
Eliminate the Earnings Test	3.9	5.9	6.0	6.1	6.2	28.1

SOURCE: Congressional Budget Office estimates.

NOTES: The estimates assume that each option would be put into effect on January 1, 1992. They also incorporate the effects of additional applications for Social Security benefits.

Details may not add to totals because of rounding.

- a. This option would replace current indexing rules.
- b. Current indexing rules would apply in 1993 and beyond.

during the same period. Over the five-year period, elimination of the earnings test entirely would cost \$28.1 billion. (These estimates include additional payments to workers who would apply for benefits as a result of the change in the earnings test.)

These estimates do not include the revenue effects of options to change the earnings test. Higher revenues would result from the taxation of Social Security benefits and any increases in federal income taxes and payroll taxes attributable to increased work effort. When revenue effects have been ~~considered--as~~ they are in the Social Security Administration's (SSA's) ~~estimates--they~~ offset only a small portion of the cost. Estimates by **SSA**, for example, indicate that the combined effect **would** offset only about 10 percent to 15 percent of the costs of eliminating the earnings test.

Finally, the budgetary savings shown in Table 3 do not include savings in administrative costs. These savings would, however, be quite small, especially in the first year. The SSA calculates that the savings in administrative costs would offset only 1 percent of additional benefit payments over five years if the earnings test were eliminated for people aged 65 through 69. Administrative savings would be larger, however, if the test were eliminated for all age groups.

APPENDIX TABLES

TABLE A-1. DISTRIBUTION OF PEOPLE AGED 65 THROUGH 69 (EXCLUDING RECENT RETIREES), BY FAMILY INCOME, THEIR OWN EARNINGS, AND MARITAL STATUS, 1989 (In percent)

Earnings	Number in Group (Thousands)	Family Income					Total
		Less Than \$15,000	\$15,000- 24,999	\$25,000- 31,999	\$32,000- 49,999	\$50,000 or More	
All People Aged 65 Through 69							
All Categories	9,510	32.0	233	120	165	16.2	100.0
No Earnings	7,290	36.7	24.4	12.1	14.5	12.3	100.0
Up to \$8,880	1,090	30.8	27.3	11.7	17.5	12.8	100.0
Over \$8,880	1,130	2.5	12.6	11.2	28.8	44.9	100.0
People Living with Their Spouses							
All Categories	6,360	22.0	25.6	13.4	18.9	20.0	100.0
No Earnings	4,880	26.5	28.0	14.0	17.0	14.6	100.0
Up to \$8,880	670	15.4	31.6	13.4	21.8	17.8	100.0
Over \$8,880	810	0.4	6.3	10.2	28.2	54.9	100.0
All Other Men <u>a/</u>							
All Categories	920	44.9	20.5	9.2	15.2	10.2	100.0
No Earnings	710	50.9	19.2	8.9	11.6	9.4	100.0
Up to \$8,880	100	42.8	26.3	11.0	17.9	1.9	100.0
Over \$8,880	110	8.0	23.3	9.2	36.5	23.0	100.0
All Other Women <u>a/</u>							
All Categories	2,230	55.0	17.9	8.9	10.2	8.0	100.0
No Earnings	1,710	60.0	16.3	8.1	8.5	7.1	100.0
Up to \$8,880	310	60.1	18.1	8.3	7.9	5.6	100.0
Over \$8,880	210	7.3	30.9	16.2	27.0	18.5	100.0

SOURCE: Congressional Budget Office tabulations of data from the March 1990 Current Population Survey.

NOTES: Details may not add to totals because of rounding.

In this table, the group of people aged 65 through 69 excludes those who appear to have retired in 1989 and who would therefore be subject to the monthly earnings test.

a. All other men (and women) includes people who are widowed, divorced, never married, or who live apart from their spouse.

TABLE A-2. DISTRIBUTION OF PEOPLE **AGED** 65 THROUGH 69 (EXCLUDING RECENT RETIREES), BY FAMILY INCOME RELATIVE TO THE POVERTY THRESHOLD, THEIR OWN EARNINGS, AND **MARITAL** STATUS, 1989
(In percent)

Earnings	Number in Group (Thousands)	Ratio of Family Income to Poverty Threshold					Total
		Less Than 1.00	1.00 to 1.99	2.00 to 2.99	3.00 to 3.99	4.00 or More	
All People Aged 65 Through 69							
All Categories	9,510	8.5	23.7	20.4	14.9	32.6	100.0
No Earnings	7,290	10.3	27.1	21.6	14.7	26.3	100.0
Up to \$8,880	1,090	5.1	24.4	24.5	17.3	28.7	100.0
Over \$8,880	1,130	0.0	1.0	8.5	13.5	77.0	100.0
People Living with Their Spouses							
All Categories	6,360	4.6	19.9	20.9	16.9	37.7	100.0
No Earnings	4,880	5.6	23.6	23.2	17.2	30.4	100.0
Up to \$8,880	670	2.9	16.4	24.3	19.3	37.1	100.0
Over \$8,880	810	0.0	0.7	4.3	12.7	82.3	100.0
All Other Men <u>a/</u>							
All Categories	920	12.1	29.5	20.3	12.1	26.0	100.0
No Earnings	710	14.6	34.7	19.0	11.1	20.6	100.0
Up to \$8,880	100	7.3	23.7	31.8	17.6	19.5	100.0
Over \$8,880	110	0.0	1.5	17.7	13.8	67.1	100.0
All Other Women <u>a/</u>							
All Categories	2,230	18.2	32.0	18.7	10.3	20.7	100.0
No Earnings	1,710	22.0	34.0	17.9	9.1	16.9	100.0
Up to \$8,880	310	9.3	41.8	22.7	12.8	13.4	100.0
Over \$8,880	210	0.0	1.9	20.0	16.3	61.9	100.0

SOURCE: Congressional Budget Office tabulations of data from the March 1990 Current Population Survey.

NOTES: Details may not add to totals because of rounding.

In this table, the group of people aged 65 through 69 excludes those who appear to have retired in 1989 and who would therefore be subject to the monthly earnings test.

- a. All other men (and women) includes people who are widowed, divorced, never married, or who live apart from their spouse.