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Social Security Earnings Test: Recent and Proposed Changes

Geoffrey Kollmann
Education and Public Welfare Division

Summary

On September 26, 1998, the House of Representatives approved H.R. 4579, the Taxpayer Relief Act of 1998, which would have increased the "exempt amounts" under the Social Security earnings test — the amount of earnings Social Security recipients may earn before their benefits are reduced — for recipients between the "full retirement age" (currently age 65) and age 70. Their exempt amounts would have increased gradually by higher amounts than under current law beginning in 1999, reaching $39,750 in 2008. However, the Senate did not take up the bill, and the measure was not included in any legislation passed by the 105th Congress. This report will be updated periodically.

Background

With variations, the earnings test has been part of the Social Security program since its beginning. It reduces the benefits of recipients who earn income from work above a certain sum. The original rationale for the test was that, as a "social insurance" system, Social Security protects workers from certain risks, among them the loss of income due to their retirement, and therefore benefits should be withheld from workers who show by their substantial earnings that they have not in fact "retired."

In 1999, the law provides that recipients under age 65 may earn up to $9,600 a year in wages or self-employment income without having their benefits affected. Those aged 65-69 can earn up to $15,500 a year. For earnings above these amounts, recipients under age 65 lose $1 of benefits for each $2 of earnings, and those aged 65-69 lose $1 in benefits for each $3 of earnings. The test does not apply to recipients over age 69, or to the disabled.[1] The exempt amounts rise each year at the same rate as average wages in the

[1] However, in the disability program earnings above a certain amount indicate ability to engage in "substantial gainful activity" (SGA) and therefore disqualify a person from receiving benefits. For non-blind disabled recipients, that amount is set by regulation at $500 a month. Before enactment of P.L. 104-121, SGA for the blind was tied to the monthly earnings test (the annual exempt amount divided by 12) for those who have attained the full retirement age. P.L. 104-121 removed (continued...)

economy. Beginning in 2003, the full retirement age gradually will rise, reaching 66 in 2009 and 67 in 2027, and the minimum age for eligibility for the upper earnings test exempt amount will rise accordingly.

Recent Legislation

The earnings test has always been one of the most unpopular features of the Social Security program, and congressional proposals to liberalize or eliminate the earnings test have been perennial. In 1996, P.L. 104-121 included a measure to increase the earnings test limit, for those who have attained retirement age, over a period of 5 years, reaching $30,000 in 2002. On September 17, 1998, the House Committee on Ways and Means by a vote of 23-15 approved H.R. 4579, the Taxpayer Relief Act of 1998, among whose provisions was a measure that would have increased the earnings test exempt amount for recipients at or above the full retirement age according to the schedule to the right. After 2008, the exempt amount again would be indexed to wage growth. On September 26, 1998, H.R. 4579 was approved by the full House by a vote of 229-195. However, the Senate did not take up the bill, and the measure was not included in any legislation passed by the 105th Congress.

Year	Current Law	H.R. 4579
1998	$14,500	$14,500
1999	15,500	17,000
2000	17,000	18,500
2001	25,000	26,000
2002	*30,000	30,000
2003	*31,230	31,300
2004	*32,463	34,000
2005	*33,806	35,400
2006	*35,149	36,800
2007	*36,604	38,350
2008	*37,948	39,750

*Projected

The increase in the exempt amount was projected to increase Social Security outlays by $565 million over the next 5 years. To offset this cost, the bill provided that recomputations of benefits due to earnings after full retirement age would be deferred by one year. Under current law, a retired recipient's benefits are based on the average of a prescribed number of years of their highest earnings (35 years for those born after 1929). If recipients continue to work after they become entitled to benefits, their benefits may be increased if the new yearly earnings are greater than one of the years used in the initial computation of their benefits. Currently, these recomputations are effective beginning in the year after the year of such earnings. H.R. 4579 would have altered the law so that these recomputations would be effective beginning in the *second* year after the year of the earnings, effective for earnings after 1997. However, it exempted from this provision recipients who have years of "zero" earnings used in their previous computation of benefits. This provision would have reduced Social Security outlays by $570 million over the next 5 years.

Effect on Recipients. Based on data from the Social Security Administration, each year about 1.4 million recipients over age 65 receive recomputations of their benefits. Of these it is estimated that 516,000 would have been exempt from this provision because

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[1] (...continued)
the linkage between the SGA level of the blind to the exempt amount for individuals who have attained the full retirement age. Instead their SGA level continues as before (i.e., adjusted annually to reflect growth in average wages — it is $1,100 a month in 1999).

they have zero years used in the previous computation of their benefits. Of the remaining 920,000 who would have had the recomputation of their benefits delayed, 387,000 (42%) are 66-69 (and thus could benefit from the increase in the earnings limit), and 534,000 (58%) are over age 69 (and thus could not benefit from the increase in the earnings limit). It is estimated that initially about 580,000 recipients aged 65-69 would have been affected by the increase in the exempt amount. The following tables compare how a recipient would have fared in 1999 under current law and under H.R. 4579.

Age 65 in 1999: *Current Law*	
Earnings	$26,000
Exempt Amount	15,500
Difference	10,500
Reduction in benefit (1/3 of difference)	3,500

Age 65 in 1999: *H.R 4579*	
Earnings	$26,000
Exempt Amount	17,000
Difference	9,000
Reduction in benefit (1/3 of difference)	3,000

Arguments for raising the earnings limit. Opponents of the earnings test traditionally have maintained that it is unfair to senior citizens because it penalizes them for working. They argue that the combination of the reduction in benefits and income and payroll taxes impose very high effective marginal tax rates on working retirees. Proponents of raising the exempt amount say that doing so would ameliorate the severe disincentive the earnings test provides for retired beneficiaries who must work to supplement their benefits.

Arguments against raising the earnings limit. Opponents of H.R. 4579 did not specifically object to the earnings test measure during its markup. However, a similar measure passed in the 104th Congress was criticized for the method used to pay for raising the exempt amount, i.e., delaying recomputations of benefits for working retirees. Because both these provisions affect working retirees, the effects can be uneven, benefitting some and penalizing others. Also, as the two measures offset each other, critics say it is a case of robbing Peter to pay Paul.