S. HRG. 104–72

SOCIAL SECURITY EARNINGS LIMIT AND TAXATION OF BENEFITS

HEARING

BEFORE THE

COMMITTEE ON FINANCE UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

MARCH 1, 1995

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

90–371—CC WASHINGTON : 1995

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-047388-8

COMMITTEE ON FINANCE

BOB PACKWOOD, Oregon, *Chairman*

BOB DOLE, Kansas
WILLIAM V. ROTH, JR., Delaware
JOHN H. CHAFEE, Rhode Island
CHARLES E. GRASSLEY, Iowa
ORRIN G. HATCH, Utah
ALAN K. SIMPSON, Wyoming
LARRY PRESSLER, South Dakota
ALFONSE M. D'AMATO, New York
FRANK H. MURKOWSKI, Alaska
DON NICKLES, Oklahoma

DANIEL PATRICK MOYNIHAN, New York
MAX BAUCUS, Montana
BILL BRADLEY, New Jersey
DAVID PRYOR, Arkansas
JOHN D. ROCKEFELLER IV, West Virginia
JOHN BREAUX, Louisiana
KENT CONRAD, North Dakota
BOB GRAHAM, Florida
CAROL MOSELEY-BRAUN, Illinois

LINDY L. PAULL, *Staff Director and Chief Counsel*
LAWRENCE O'DONNELL, JR., *Minority Staff Director*

CONTENTS

OPENING STATEMENTS

CONGRESSIONAL WITNESSES

PUBLIC WITNESSES

ALPHABETICAL LISTING AND APPENDIX MATERIAL SUBMITTED

Page

COMMUNICATIONS

SOCIAL SECURITY EARNINGS LIMIT AND TAXATION OF BENEFITS

WEDNESDAY, MARCH 1, 1995

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice at 9:35 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Bob Packwood (chairman of the committee) presiding.

Also present: Senators Chafee, Simpson, Nickles, Moynihan, Baucus, Rockefeller, Graham, and Moseley-Braun.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. We will come to order.

Today we are having hearings on the subject of Social Security, both the earnings limit and the 85 percent maximum tax that was imposed a number of years ago, the amount above 50 percent being put into the health insurance fund rather than the Social Security fund.

And we have as our first witness today Senator John McCain from Arizona, who has, I think more than anyone else, led the fight, especially on the earnings limit.

I will say this. I just commented to one of the newscasters outside, if you look at the Social Security trust fund report, there is no question that sooner or later the fund does run out of money. And all the bonds are gone.

And, for many of those who say let us put Social Security off budget, they may say that now, but I am not sure what their position would be if the Social Security fund were running negative, and we were having to put money into it to pay benefits. I am not sure they would still want it off budget at that stage or not, or whether they would then say well, perhaps we had better put it back in the unified budget to pay the benefits.

But that issue is not that far away. The Social Security trustees say 2029. That is a reduction from 2065 in just four or 5 years, as I recall, in their estimates. And I have predicted, and I am sure this will happen, as Medicare goes into the red, there will be an argument that we should simply transfer some of the trust fund bonds in the old age fund into the Medicare fund. So, in theory, Medicare would have bonds to redeem.

That argument is going to be made, which means that the year 2029 will move down closer to 2025, or 2020, or it depends how much money we transfer to put in to the Medicare fund. I am not advocating that. I just am willing to bet that, given a couple more years, that suggestion will be made.

Senator Moynihan?

Senator MOYNIHAN. Agreeing with you, I think what you meant was that we would transfer the payroll tax going into OASDI to HI.

The CHAIRMAN. Well, we might do that. Or initially we might just say that since Social Security holds $300 million worth of bonds, we will transfer $100 million of those bonds to the HI fund.

Senator MOYNIHAN. But then you will have to raise the bonds.

The CHAIRMAN. We will still have to redeem them. But in theory, therefore, the HI fund would have $100 million in bonds. But that, therefore, means that the retirement has $100 million in bonds.

Senator MOYNIHAN. The theory class.

Could I just take the opportunity, and a pleasant one, to thank our lead witness, Senator McCain, for having persuaded us to establish the Commission on the Social Security Notch Issue.

One of the unexpected events of Social Security in its mature years has been the emergence of national organizations designed to terrify people about the system, misrepresent it, and make money doing so. And they have done very well, the notch issue being one such.

The Commission reported, as it was scheduled to do, at the end of last year, as the Chairman knows. It was headed by Scotty Campbell and inevitably, properly, Robert J. Myers, former Chief Actuary, was a member.

I think it would be correct to say that this would be 60 years ago that Bob Myers arrived in Washington to work with Edwin Witte, on the Committee on Economic Security. Was it not Economic Security that produced the Social Security Act the following year. And he is still here, and an exemplar of all a public servant can be.

We think this was a marvelous report. It resolved the issue. I had hoped it might be received at the White House, but other things intervened, but let it be received by the Committee, if I may, Mr. Chairman.

Thank you very much.

[The information appears in the appendix.]

The CHAIRMAN. And Senator Baucus.

Senator BAUCUS. I have no statement, Mr. Chairman.

The CHAIRMAN. We have both Congressman Hastert and Senator McCain with us. And we will take Senator McCain first, and then Congressman Hastert.

STATEMENT OF HON. JOHN McCAIN, A U.S. SENATOR FROM ARIZONA

Senator MCCAIN. Thank you, Mr. Chairman. And I will try to be brief this morning because this issue is certainly well known to you, the Ranking Member, Senator Moynihan, and other Members of the Committee. It is certainly not a new issue.

I would also like to thank you for your support, and thank you for your willingness to hold this hearing.

I would like to acknowledge my friend, Denny Hastert, who has labored long and hard in the other body for a long time, and has certainly been a stalwart in this effort.

I would also like to echo the words of Senator Moynihan concerning Mr. Myers. There are very few benefits about being around here for a while, but I know that the Chairman remembers, as I do, the great Social Security crisis of 1983. When the system was going to go bankrupt, Mr. Myers stepped in at that time and was certainly the most credible voice in helping shape a very difficult compromise that saved the Social Security system into the next century.

And I would also like to thank my dear friend for many years, Martha McSteen, for being here today.

Mr. Chairman, very briefly, the two pieces of legislation I have introduced. One, of course, is total repeal of the earnings test. The second one is basically the same as was in the House, which causes the limit to rise from $11,000 to $20,000.

Mr. Chairman, I understand the problem with scoring. That is a very significant problem for you. I would be more than happy to discuss how we would make whatever compromises necessary to ease that burden. I would suggest that an equitable agreement might be a gradual lifting of the earnings test limit. I think $30,000, with a cost-of-living adjustment cranked into it.

Now I would point out, Mr. Chairman, that this is just an unfair situation. We all know that there is no reason why we should penalize people for working in their retirement years. This earnings test was a product of the Depression. It was a disincentive for people to work, which was what national policy was intended to be at the time. Now, clearly, that time has long past.

Unfortunately, every year there are more and more seniors who, for one reason or another, many times because of health care problems, are required to go out and work.

And, if I may, just quote, "It is not only $1 for every $3. We are talking about a shocking 55 to 65 percent tax bite, and sometimes even more." Federal tax 15 percent, FICA 7.65 percent, earnings test penalty 33 percent, State and local tax 5 percent. Obviously, this earning cap is punitive. Anybody struggling along at $11,000 a year should not have to face an effective marginal tax rate which exceeds 55 percent.

As an aside, Mr. Chairman, if we strictly interpreted the earnings test, we should impose that on all members of the Congress who are between the ages of 65 and 69, both on their salaries and their pensions. If we did, as we just passed, requiring Congress to live under the laws of the country. I do not think that we should do that, obviously. But I also believe that we should give that kind of relief to senior citizens.

Finally, two points, Mr. Chairman. One, it is costing the Social Security system $200 million a year for compliance with the earnings test. So right away you save $200 million a year. And I understand the scoring system, and I do not think that I am qualified, nor do I choose to enter the debate about dynamic versus static scoring. I will leave that to the superior wisdom of both the Chairman and the Ranking Member.

But I find it impossible to believe that, if someone is going to pay an effective tax rate of somewhere around 55 to 65 percent if they go to work, that is an enormous disincentive to working. And when that tax is reduced, clearly we are going to have more people in the work force, and they are going to be paying taxes. And I believe that the net overall will be a gain in revenues to the Federal Treasury, rather than a loss.

But I also understand the scoring system that is imposed on the Committee when we do these things.

Mr. Chairman, I just want to thank you. You have been involved in this issue for a long time. I appreciate your having the hearing this morning. I know we have more knowledgeable witnesses than I am on this issue. And I appreciate the opportunity to be here.

I would also mention that, in the President's booklet, which was called "Putting People First", and I quote, "Lift the Social Security earnings test limitation so that older Americans are able to help rebuild our economy and create a better future for all." I could not say it better than the President did during the campaign.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you Senator.

[The prepared statement of Senator McCain appears in the appendix.]

The CHAIRMAN. Congressman Hastert?

STATEMENT OF HON. J. DENNIS "DENNY" HASTERT, A U.S. REPRESENTATIVE FROM ILLINOIS

Congressman HASTERT. Thank you, Mr. Chairman.

Let me first congratulate you for your rise to Chairman of this Committee, and thank you for the opportunity to testify.

The CHAIRMAN. Thank you.

Senator MOYNIHAN. His return.

Congressman HASTERT. That is correct.

I am here to speak this morning on behalf of H.R. 8, the Senior Citizens Equity Act that we have in the House, which is part of the Contract with America.

Basically, the issue I would like to talk about is the same as my colleague, Senator McCain, who has certainly been a leader on this issue for a long long time. I appreciate his efforts as well.

The fact is that a senior who earns less than $1,000 a month, somebody who has worked by the sweat of his brow all his life, and has not been able to accumulate huge pensions or interest coming in from savings—which are set aside, because they are on earned incomes, and are not subject to the earnings test on Social Security—those people, who have to continue their jobs as machinists, or work at McDonald's, or work in a flower shop, are being penalized. Those folks who work by the sweat of their brow their whole life, and earn $6,000 or $7,000 or $8,000 in Social Security, depending on what their previous earnings were, they are earning less than $1,000 a month. And they get to the $11,000 cutoff and, all of a sudden, they are hit with a 56 percent marginal tax on anything earned over that. A 56 percent marginal tax, twice the amount that millionaires today are asked to pay. And those folks all of a sudden have a disincentive to work.

Who are these people? These people are grandmas and grandpas that want to live like everybody else. They may want to help their grandchildren go through college. They want to live in their own homes, but they cannot afford to pay the property taxes on them.

They want to live like everybody else, and maybe buy a car so that they can travel and do some things.

But they are prohibited from doing that because of the earnings test. It is prohibitive tax. It is a penalizing tax on seniors, those people who have raised their kids and have done the hard work in this country, and created the successes.

But, who else are they? They are people businesses want to hire because they have the work ethic. They have the ability to go out and put in an 8-hour day and give 8 hours of work. They are the people that service organizations and service industries many times use as teachers for young people coming into the programs, so that they too can learn the work ethic and how things get done, and how to treat and serve people.

I just think it is a real disservice to seniors in this country to have the earnings test.

I do not want to get into the dynamic scoring and the static scoring issue either. But we had some studies a couple of years ago. As you get around this place, those years go faster. I think it was probably 1991 and 1992. But, if we had raised the earnings test then, the studies show that there would be about $15.5 billion of increased economic activity, and a flow back to the Federal Government of $3.2 billion in taxable income.

Now all that does not go back into the Social Security trust fund, granted, but it is income that the Government would not have otherwise that would flow back.

And so I think, in a sense, we are cutting off our noses to spite our faces. Not only are we denying our seniors the ability to be productive, and forcing them into some subrosa economy, but we are also denying ourselves income, or revenue, that people want to pay. People want to be forthright about their earnings. But, because they are denied the ability to work and be productive, we are not getting this.

I have written testimony here. I am not going to read it. I would like to have it inserted in the record, if that is possible, and open up to any questions you might have.

[The prepared statement of Congressman Hastert appears in the appendix.]

The CHAIRMAN. Gentlemen, I have no questions of either one of you. As Senator McCain said when he first started, this is a subject that is well known. This is not a first blush at this.

I will ask Senator Moynihan if he may have any questions.

Senator MOYNIHAN. I much agree, Mr. Chairman, in thanking the witnesses.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. I share the wisdom of the Chairman and the Ranking Member.

The CHAIRMAN. Let us see if Senator Simpson does.

Senator SIMPSON. Mr. Chairman, Senator McCain and I have had rich discussions about this issue, and we are going to spare you all any further. Would you not say that, Jack?

Senator MCCAIN. Yes, sir. Yes indeed.

Senator SIMPSON. We do not concur.

Senator NICKLES. Mr. Chairman, let me just say that I am pleased that you are having this hearing. I compliment Senator McCain and Congressman Hastert or their statements.

I will tell you just a little different perspective from maybe most of the Members of this Committee. As an employer, I have hired a lot of people who had retired early.

We found big companies laying people off, or encouraging early retirement, enhanced bonuses and so on, to get people to retire early. So we had hired these individuals as salesmen and other things because they were not ready to retire. They did not want to retire, frankly.

And this earnings limit is really a disincentive for seniors that wish to continue working. The marginal tax rates are excessive. They are almost abusive. They are certainly a disincentive for people to work. A lot of those people want to work. A lot of those people need to work. When you find marginal rates that are in the astronomical ranges, the highest marginal rates of any taxpayers, I think it needs to be remedied. Hopefully, that will be one of the things that this Committee will do.

I appreciate both of our witnesses for their statements today.

The CHAIRMAN. I might just read a short letter, and this sums it up as well as anybody can do it. "Dear Senator Packwood: I really appreciate your effort in trying to solve a problem I find disturbing. I have been working at a Dairy Queen for many years, and I am still employed. I just entered the Social Security age group, and am very grateful for it, but find it troublesome having to count every hour I work so I can be productive all year long. I have voluntarily cut back my hours, but there are people who call in sick, or extra help is needed. I am in good health, and I really enjoy my job. I have never made very much money, but even going over the limit by perhaps a few hundred dollars, and then paying half of it back, does not make much sense. Thank you again, and I hope you will be able to raise the limit." It says it about as well as you can say it, I guess.

Senator MCCAIN. Mr. Chairman, could I just make one brief comment along the lines of what Senator Nickles was saying?

I have had meetings with people who run McDonald's. And I once had a meeting, believe it or not, with the head of Disney, Mr. Eisner. At the end of the meeting, he said, "By the way, I hope you will work on the earnings test because our best workers, our best people at Disney World, that interact best with the kids and the people that come to our facilities, are seniors.

So it is clear out there that the people who do the hiring, as Senator Nickles had to do, would like to take advantage of this labor pool as well.

Thank you, Mr. Chairman.

Senator MOYNIHAN. Mr. Chairman, could I make one comment?

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. I would be willing to make a slight defense of the Congress, which needs some defending these days. You suggested that if we lived by the rules, we would undertake this sort of loss of our earnings.

I joined the Navy 51 years ago. And I have a very considerable pension which, by my standards, would be more than enough to live on. And I do not get a penny of it. Now, if you could arrange for me to get the penny of it, get my pension, I would be perfectly willing to have an earnings test on my Senate salary. [Laughter.]

Senator MCCAIN. Thank you, Senator Moynihan, but first we would like to know what you did in the Navy.

Senator MOYNIHAN. Do you know what I got? I got a certificate of satisfactory service from James F. Forrestal. They were not very gushy.

Senator MCCAIN. We appreciate your service, Senator Moynihan, very much.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Mr. Chairman, as the sponsor and our good friend, Senator McCain, knows, I have been a supporter of lifting this earnings test. I think that, in a way, this issue is also going to be a test of the Congress in the balanced budget era.

I, for one, have been advocating that we should take Social Security out of the balanced budget amendment. And this issue raises one of the reasons why we should do so.

The fact is that there are now going to be some additional disincentives to adopting appropriate policy relative to Social Security, because there are going to be those who will recognize that, as we reduce the amount of surplus in the Social Security fund—and this action will have that effect—we will (a) make it more difficult to bring the budget into balance under the consolidated approach which the amendment will require, and (b) we will have less money that we can borrow at a majority vote, rather than a three-fifths vote, because there will be less money in the Social Security trust fund.

Now I say that in hopes that, in fact, we will adopt the proposal that is being proposed so that we can disabuse those, including myself, who have been concerned that the way in which we have integrated Social Security with the rest of the Federal Government will serve to the disadvantage of Social Security beneficiaries.

This will be a good first test, coming in what I hope will be the post-balanced-budget environment. I am hoping that because I hope the Senate will pass the balanced budget amendment today, or in the very near future.

As to whether we are still willing to do things that are clearly rational and benefit the recipients of Social Security, even though it will make it more difficult for us to achieve the objectives of the balanced budget.

Senator MOYNIHAN. Mr. Chairman, could I make a statement here?

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. I would like to ask my friend from Florida, in what sense do you think the receipts of the Social Security trust fund are not part of the finances of the Federal Government?

Senator GRAHAM. They are part of the finances of the Federal Government, but they should not be part of a balanced budget Constitutional amendment for two reasons, in my opinion.

One, because of the structure of the Social Security trust fund. Most trust funds are essentially holding vessels for funds that come in, and then go out in a relatively short period of time, on almost an annual basis—the highway trust fund being one example.

The Social Security trust fund, as you know better than anybody in this room, is structured to develop a large surplus, and then spend that surplus out in a short period of time.

Second is just the sheer scale of the Social Security trust fund. We are going to end up with the Social Security trust fund holding almost half of the national debt by the year 2018. And to try to integrate such an enormous battleship——

Senator MOYNIHAN. Could I ask, you do recognize that proposals on the floor would mean that the operating budget would be balanced. And then, for a period of about 15 years, there would be a continued surplus, accumulating to about $2 trillion, which I think most economists would probably would suggest would cost you a point of GDP every year. And it would be truly a depressant.

The CHAIRMAN. If it was genuinely independent.

Senator MOYNIHAN. Well, if you just had to have that much of a surplus every year, regardless of the business cycle, we would strap ourselves into a situation which would be inexplicable, probably is inexplicable, but I would like to ask Mr. Myers about that one.

Thank you, Mr. Chairman.

Senator SIMPSON. Mr. Chairman, if I might just add, I have no qualms about people working at the Dairy Queen, and the things Denny talks about, and John. That is not the issue. For me, the issue is affluence testing. And I want you to know where I am coming from.

We are going to have to address affluence testing. I am not going to call it means testing. It has to come. It has to come with regard to COLA's. It certainly has to come when we are going to try to figure out, if we take this back from 85 percent, suppose the 85 percent taxability, that is another matter, taking it back to 50, that money was to go into the health insurance trust fund.

So, will someone please tell us where we are going to get the money if we take it that way, and where we get the money to go to the trust fund. And we know that health insurance is going to go broke by the year 2001.

So I can see the impetus, and the need for people to work. But, when people write to me and say, "I love the joy of working." And I know that they are doing pretty well in life, there is a way to do that, and it is called volunteer. And somewhere we have forgotten that. We had a debate on that last year where we paid volunteers $19,000 a pop to volunteer.

So I hear carefully what you are saying about productivity and people wanting to work. And I would help that woman at the Dairy Queen, but I am not going to help the person who says it is fun to work, while they are doing very well in retirement, and we are paying for it.

Senator MCCAIN. Senator Simpson, could I just respond very quickly?

I do not want to confuse two issues here—one is the Social Security tax increase, and the other the earnings test. The earnings test limitation that we are hoping will come out of this Committee, and out of Congress, would apply to people up to about $30,000 a year. So your concern about affluence would be satisfied.

Second, I believe that if people have to go out and work, as many people do, they should not be subjected to a 55 to 65 percent tax.

And finally, again, on the issue of affluence, the earnings test does not apply to people who have pensions or millions of dollars in stocks, or some kind of steady stream income, because they are wealthy people. It only applies to people who go out and get a job and work.

And finally, I mentioned before you came in, if we really wanted to apply all the rules to Congress that we apply to the American people, all the members of Congress who are between age 65 and 69 should be paying $1 out of every $3 of their salary and/or their pension.

Senator MOYNIHAN. But will you let me collect my pension at the same time?

Senator MCCAIN. I would certainly want to make a special exception for everybody who served in the Navy, Senator Moynihan. [Laughter.]

So I hope my dear friend from Wyoming does not misunderstand what I am seeking here, and that is the low-income people, who right now are starting at around $10,000 a year, any income they earn above that is subject to a one-third tax, which costs us about $200 million a year for the Social Security system itself to make sure that everybody is in compliance.

I think we have had past testimony that it is one of the most difficult things for the Social Security people to do is to track all this earnings test.

But I thank my friend from Wyoming for his usual erudite and insightful comments.

Senator SIMPSON. Well, Mr. Chairman, I just want to conclude and say that I am anxious to look at this very carefully.

But when we are told continually that there is a terrible burden on seniors in the form of "taxes". And then we come up with income tax and Social Security benefits and payroll taxes, and the earnings limit and so on, as if there was a huge burden. And you name 55 percent. But we want to look at the things of tax rates of 15 to 39 percent. I am ready to probe around in it. And I just want to be certain that the benefits go truly to those, and not to those who should not have them. Because it is costing us money.

If the system is going to go broke in the year 1019, I would like to kind of see that it did not.

Thank you, sir.

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Thank you very much. I would like to welcome my colleague from Illinois, and from the State legislature as well, to the Committee this morning.

I do not know if this question has been asked already, but Senator McCain, you are a supporter of the balanced budget amendment. The question becomes, in spite of our interest in this legislation, how do you square this kind of revenue loss from the trust fund with support for balancing the budget and getting our fiscal house in order, and putting us on a glide path so that we do not go bankrupt by the year 2002?

Senator MCCAIN. Because there is not a doubt in my mind that there will be an increase in revenues as millions of Americans who right now, rather than face a 55 to 65 percent real tax on any earnings that they make, will go out and work and pay taxes, and increase revenues.

Before you came in, I had a little exchange with the Chairman about static and dynamic estimates of revenues. I know of no study—and there have been a number of them that Congressman Hastert mentioned—that do not show that there will be an increase in revenues. According to Congressman Hastert, there will be as much as a $15 billion increase in the economy of this country.

I, frankly, would not be nearly as enthusiastic about lifting the earnings test, although I would not lose enthusiasm.

And finally, Senator Moseley-Braun, it is fundamentally unfair to poor elderly men and women in this country. And so I have a zeal for balancing the budget. I do not have a zeal for continuing what is one of the most unfair practices ever inflicted on some of the poorest and least able to defend themselves Americans in this country.

Senator MOSELEY-BRAUN. I appreciate the interest in helping the workers.

Senator MCCAIN. I appreciate your appreciation. I have only been working on it for 12 years.

Senator MOSELEY-BRAUN. Well, the studies seem to indicate that this change would not significantly increase work effort among older Americans and, in fact, there is no empirical evidence of any increase in revenue.

Senator MCCAIN. We have lots of empirical evidence of it.

Senator MOSELEY-BRAUN. Could you provide it?

Senator MCCAIN. I will be glad to provide it for the record.

Congressman HASTERT. Senator, we know that 700,000 seniors would continue to work now instead of quite half way through their jobs. And they would be producers of revenue. We have not even begun to find out how many people would go out and get jobs, if they were not being penalized at a 56 percent marginal tax rate after they earned $11,000.

And, you know, the folks who are hit by this are not people who have had an easy life in the past. They are people that have not been able to accrue huge pensions or savings accounts. Because when they get pension money, or interest money, or rent money, or those types of income, that is not touched by the earnings test. It is only people that had to go out and sweat and work, and try to take care of their families to earn this money. Those are the ones who are penalized—earned income—that means you have to punch a time clock.

Senator MOSELEY-BRAUN. Representative Hastert, I think you understand that we all want to try to help those seniors who have worked hard, and who want to continue working, and who are struggling to make ends meet.

That is not my question, and I have no real interest in making things harder for people. But when you say that we know that 700,000 people would go back to work, on what do you base that?

Congressman HASTERT. It is based on the study that we did in 1991 and 1992.

Senator MOSELEY-BRAUN. Have you provided that study to the Committee?

Congressman HASTERT. Well, it has been provided to this Committee many times, but we will be glad to provide you with a copy of that study.

Senator MOSELEY-BRAUN. I would appreciate that.

Congressman HASTERT. The only problem is that it is a little bit dated, but the numbers still stand up.

Senator MOSELEY-BRAUN. All right. Well, I would like to see that.

Congressman HASTERT. We will be happy to provide you with one.

[The information appears on page 53 of the appendix.]

Senator MOSELEY-BRAUN. While the Social Security trust fund is currently running a surplus, without any policy changes—and this gets back to the balanced budget issue and the long-term funding issues—because I think, if we just focus on the short-term, we really impair our ability to do right by the next generation.

And we want to do right by the generation of Americans who have worked already, but we also want to do right by the next generation as well.

We know the fund will be insolvent by 2029. That is what the demographics, or the numbers show. According to the Social Security Administration, raising the earnings limit to $30,000 would cost an additional $6.6 billion over 5 years.

Are you contesting those numbers? Are you suggesting that those numbers are inaccurate?

Congressman HASTERT. I am saying, if I may, that is a static view. We believe that, if just 700,000 seniors continue to work, without any added, it will create about $15 billion of economic activity, with an accrual to the Federal Government of $3.2 billion. And we think that is significant.

However, in our Contract with America, which this is part of, we will pay for this on a static model. So the "loss" to the Federal Government will be made up.

Senator MOSELEY-BRAUN. Thank you, Mr. Chairman. Thank you, Representative Hastert.

The CHAIRMAN. Thank you.

Gentlemen, Senator, Congressman. Thank you very much for taking the time to be with us today.

Congressman HASTERT. Thank you.

Senator MCCAIN. Thank you very much.

The CHAIRMAN. Now if we can have Bruce Bartlett, Martha McSteen, Deroy Murdock and Robert Myers.

Senator Simpson, do you have an opening statement before this panel, or have you made your opening statement?

Senator SIMPSON. Mr. Chairman, if I could just take 5 minutes?

The CHAIRMAN. Absolutely. While they are sitting down, please go ahead.

OPENING STATEMENT OF HON. ALAN K. SIMPSON, A U.S. SENATOR FROM WYOMING

Senator SIMPSON. These are the two charts that came out of the Entitlements Commission's work. These charts are based on the Social Security trustees' information.

There is no mystery. Thirty-two of us on the 32-member Commission agreed that this is happening. Thirty of the 32 of us agreed with the full scope of the report.

Chart A shows you right here, according to the trustees, that Medicare will go broke. That is Chart A. It will be insolvent in the year 2001. Senator Moynihan mentioned a date yesterday of 2003. That may be the new information. I am not aware of that. But, in either event, it is not exactly cheerful news. So there it is, Chart A.

Chart B is in the year 2013. According to the trustees, Social Security benefit payments will be greater than supporting revenues. And in the year 2013 the split comes, and the trust fund is exhausted in the year 2029. And, according to the trustees, Social Security will be broke.

These are the trustees speaking. This is not the ghost of Ronald Reagan. This is not Jimmy Carter revisited. This is not something back in the Nixon administration or Bush, or Ford, or President Clinton. The doomsday date has been moved up 7 years from 2036 to 2029 in just 1 year. And this date assumes a perfect stewardship of the surplus in the interim. That is it, those are the figures.

According to the trustees, at this point the national payroll tax will have to be 30 percent in the year 2030 to fund Social Security and Medicare alone. It will have to be 30 percent.

You heard our colleague saying that there is a way to get where we are going, and that is raise payroll taxes. I think the American people will not stay still for that one.

And it seems unconscionable to me that anyone would want to voluntarily speed up these dates of doom. But that is exactly what these various provisions that we are discussing today will do.

And, as Chairman of the Social Security Subcommittee of this Finance Committee, I have the responsibility to avert the situations on those charts. And the proposal to cut the amount of Social Security benefits subject to tax would eliminate revenues that currently keep the Medicare system barely above water.

Even with these revenues, Medicare will go broke in 2001 or 2003. The earnings limit proposal directly takes money from the retirement and Medicare trust funds. Supporters of these proposals will argue vehemently that current tax policy does not discourage higher-income retirees from working during their retirement.

But during these coming months, whether we pass the balanced budget amendment or not, drastic spending cuts will be necessary to cut the deficit. We all know the figures. We all agree with the figures. We do not have the luxury to enact these proposals so that higher-income retirees who want to work, because they need the income perhaps, because they enjoy the spirit of work, will be encouraged to work.

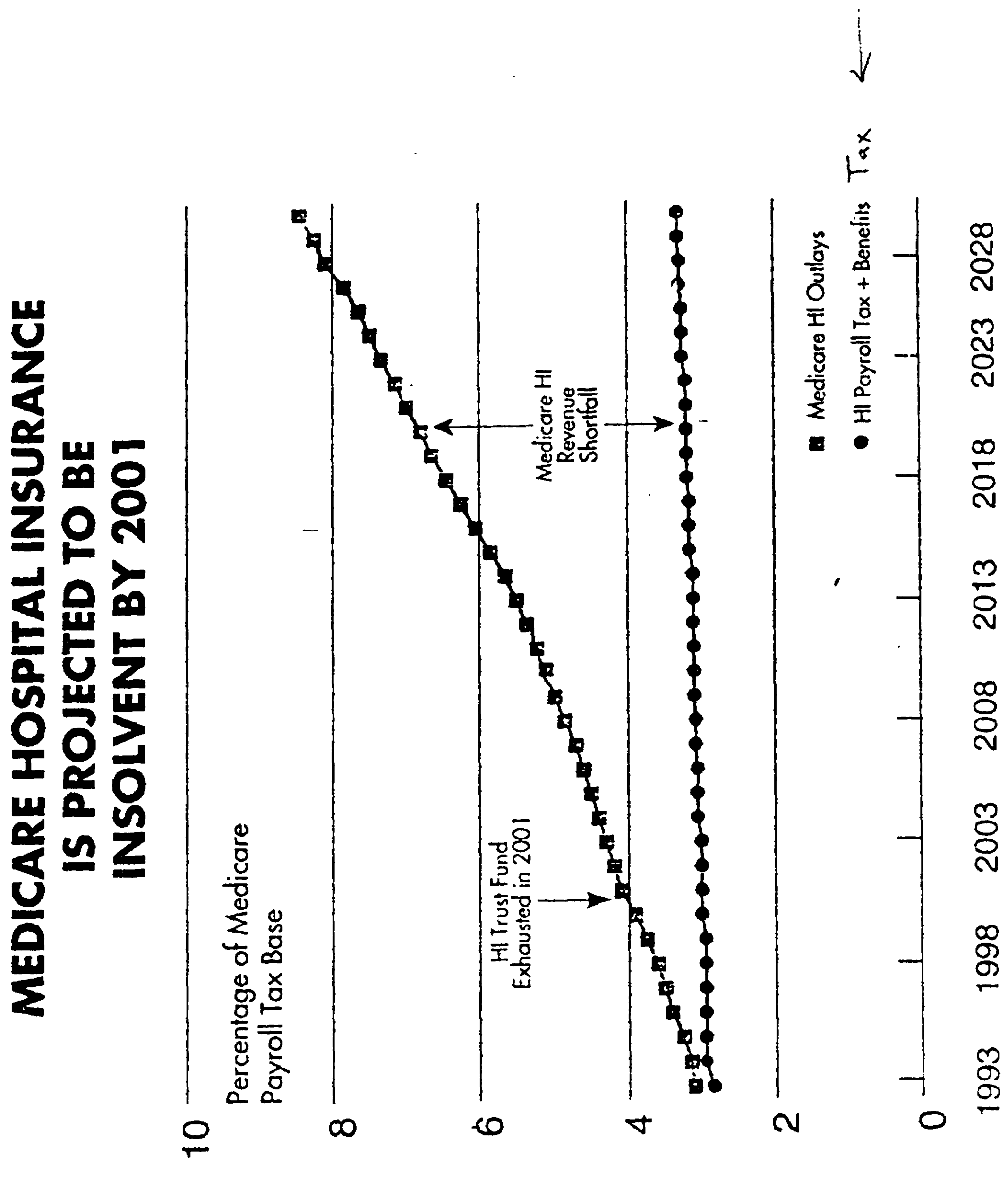
And, finally, Sandra, if you would just put the final one up there one more time so that we do not miss what is happening in our country, and not fool ourselves any longer. The line running through the middle is existing revenue. And in that year 2013, 2012, there will be only sufficient funds, without any increase in taxes, and having done perfect health care bill, there will be only sufficient funds to pay for Medicare, Medicaid, Social Security, Federal retirement and interest on the debt.

And then keep going on the line where we are raising no additional taxes, and you can see what is unfunded in the Federal Government. We would not be able to fund education, transportation, defense, WIC, Head Start, NEA, NEH, or any other discretionary program of the Federal Government.

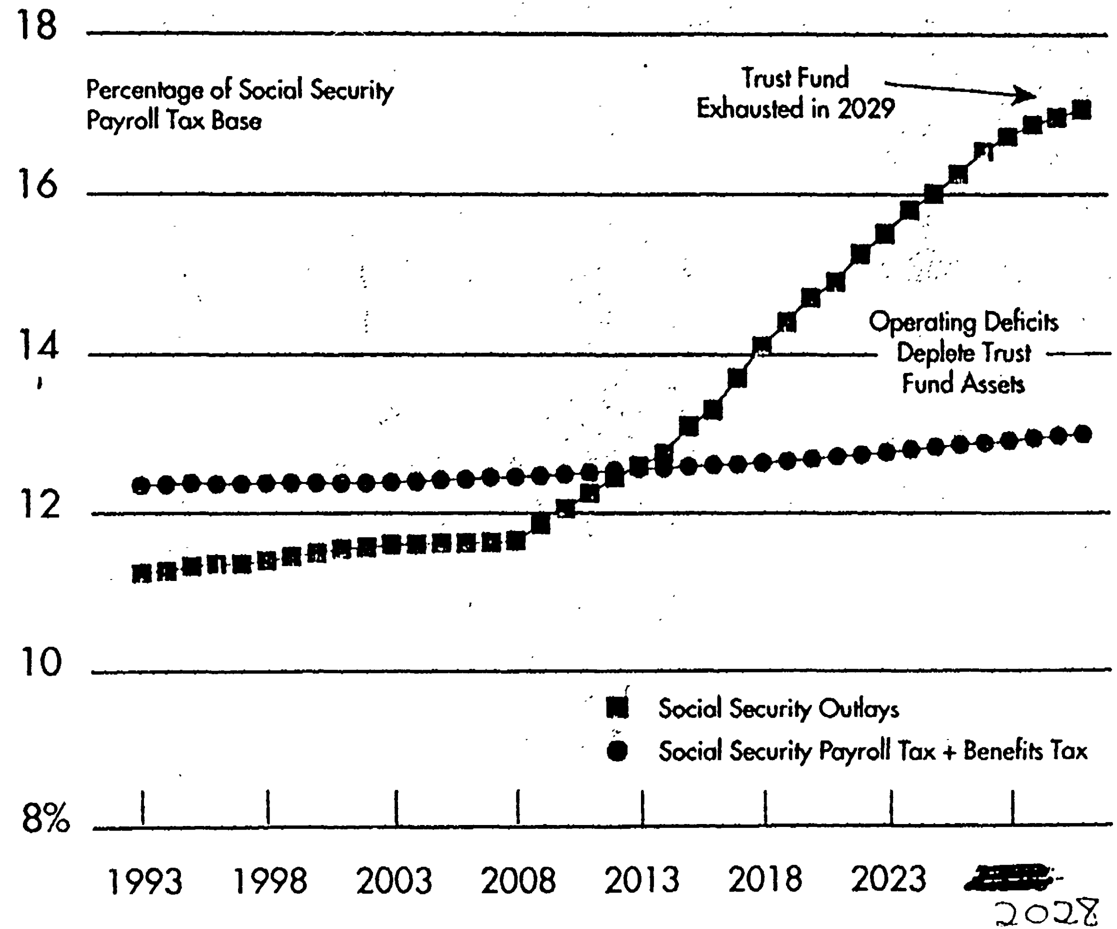
Those are the figures of the Bipartisan Commission on the Deficit and on Entitlements.

Mr. Chairman, that is all I wish to do. And I thank you for your courtesy.

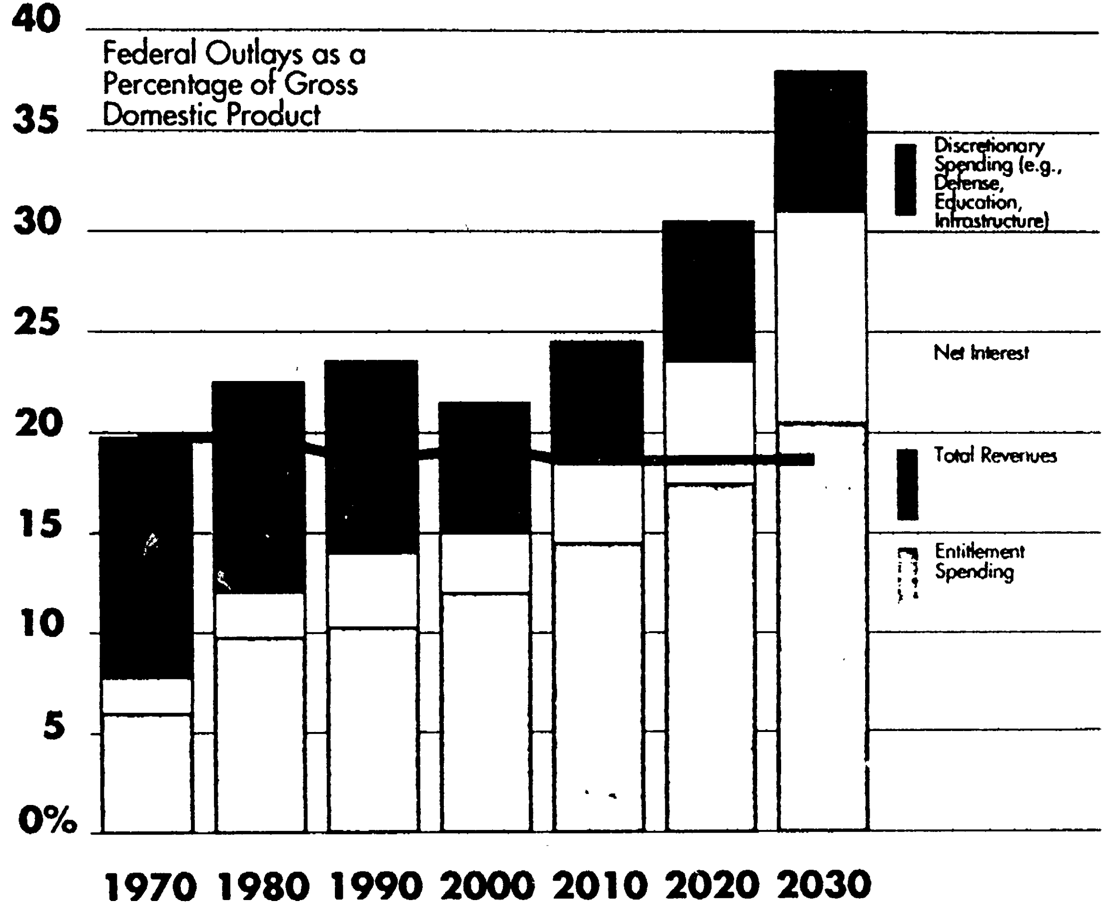
[The charts referred to follow:]



SOCIAL SECURITY TAX COLLECTIONS EXCEED CURRENT BENEFITS, BUT ARE NOT ENOUGH TO FUND FUTURE PROMISES



CURRENT TRENDS ARE NOT SUSTAINABLE



The CHAIRMAN. I thank you, Senator Simpson. You know I agree with you completely on your conclusions.

We will start today with Dr. Bartlett, the Senior Fellow for Policy Analysis in Dallas, Texas.

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

Mr. BARTLETT. Thank you, Mr. Chairman.

With your permission, I will simply submit my statement for the record, and make a few brief comments.

The CHAIRMAN. Without objection.

[The prepared statement of Mr. Bartlett appears in the appendix.]

Mr. BARTLETT. One point about the retirement test that I think is very important to make is how it relates to the Social Security system in general.

Whenever anybody makes any kind of proposal for cutting Social Security benefits, as we know, the argument is always made that we cannot do this because this is an earned benefit. This is a pension, and it would be unfair to make any cuts in benefits. Yet, clearly, we do make cuts in benefits, but only for people who work.

And this has been part of the Social Security system since 1935. There has always been an earnings test in which benefits were reduced in some way. This was expanded in 1954 and in 1972. As we know, the age was changed to 72, so that you could earn benefits above that amount and still work. And in 1981, this was changed to age 70.

Now, from an economic point of view, it seems to me that this has been going in the opposite direction we should want to go. All the studies that have been done on the labor supply response to eliminating the earnings test have looked at just eliminating it altogether. And, clearly, there are limits to the amount of additional work that somebody who is, say, age 68, earning a few extra dollars at the McDonalds or something, could do. Maybe he could work a few more hours a week if the earnings limit were raised, or maybe he would not.

But there is one very important place where I think you could get a very powerful labor supply response. And that is by delaying retirement. There is no law which says that you have to retire on your 65th birthday. If people were given an incentive to continue working in their regular jobs after age 65, I think you could get a very powerful response.

So, in other words, instead of coming down in terms of the age limit, we should be moving up. And this is especially the case, I think, for early retirement. As you know, for people age 62, 63, 64, the earnings limit is much lower. It is about $8,000, and you lose 50 percent instead of 33 percent, as you do above 65.

So the penalty is greatest for people who have the greatest capacity to expand their labor supply. So, it seems to me that we ought to be thinking in terms of not raising the cap for everybody, which benefits people, as Senator Simpson is concerned about, who would continue working anyway. Let us try to target any changes in the retirement test to people who are most likely and have the greatest capacity to substantially increase their labor supply.

I think that this basically applies to people who are very close to the retirement age, or who are coming right up to the point at which they could retire.

This also suggests a combination of, perhaps, some other changes that might be looked at, in terms of the overall package, such as changing the delayed retirement credit to make it more worthwhile for people to put off the date at which they begin to draw benefits.

As you know, you can voluntarily not begin drawing your benefits until a later date, and you get an increase in that benefit. But this benefit is not actuarially adjusted. You do not get as much as you should. Although the credit is being increased, it is being phased in very slowly.

And I think we also have to address Senator Simpson's concerns, and look seriously at speeding up the increase in the general retirement age. This would save enormous amounts of money, but way off into the future, unfortunately. You would not save any money for the next couple of decades, depending on how you decided to do it. But the present value of that change would be enormous.

And I think, if you look at this in combination of doing various other things, in terms of the retirement test, the delayed earnings credit, and the earnings test, I think you can do a lot to greatly increase the labor supply response to this change.

Now, I would like to just clarify one point that the Senator made about the 700,000 figure. That applies to the number of people who are currently working and who lose some of their Social Security benefits as a result of the earnings test. There are about 750,000 elderly workers out there right now who are losing some benefits. And so, presumably, these are the people who would be the most responsive to an increase in the earnings limit right now.

And we have done some estimates at NCPA about this. And we have found that an increase in the earnings limit of $1,000—just $1,000—would increase the labor force participation rate by about 60 to 70 thousand workers. So, it would be about a 10 percent increase.

And we believe that this would increase Federal taxes by about $563 million, and it would increase Social Security revenues by about $660 million. So it is almost a wash. But you cannot extrapolate from this and say, well, we are going to increase the threshold by about $20,000, so you just multiply these numbers by 20. It does not work that way because people tend to cluster around the cap, the limit. So it is relatively easy to increase your earnings a little bit, but more difficult to increase it a lot.

Increasing the threshold all the way up to $30,000, you would not get anything close to this kind of response, although I think it is something worth doing.

Thank you.

Senator MOYNIHAN. Interesting.

The CHAIRMAN. Do you have a question?

Senator MOYNIHAN. No. It is just interesting.

The CHAIRMAN. Ms. McSteen, it is good to have you with us again. You have been here on a number of occasions.

STATEMENT OF MARTHA McSTEEN, PRESIDENT, NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE, WASHINGTON, DC

Ms. McSTEEN. Thank you, Mr. Chairman.

Members of the National Committee welcome as a major step in the right direction the Senior Citizens Equity Act, sponsored by Senator McCain and Mr. Hastert, to raise the Social Security earnings limitation for persons who have reached age 65, and to gradually reduce from 85 percent to 50 percent the amount of benefits taxable.

Let us assume, for the sake of argument, that the economy of the 1930's and the post-World War II 1940's required extreme measures to get older workers out of the work force.

Those conditions do not exist today. Yet the earnings limitation stays in place, still encouraging older workers into retirement. The truth of the matter is, like younger workers, many seniors need to work. Increased costs of living, including high health care costs, force many retirees to supplement their savings and fixed incomes.

Social Security is often depicted as one element of a three-part retirement income package; savings and pensions are meant to provide the remaining two-thirds. It is shocking that, in this country, almost 50 percent of retired men and over 75 percent of retired women have no pensions to supplement Social Security. For them, additional earnings are not an option, they are often a necessity.

Other seniors remain in the work force, or re-enter the work force to meet extraordinary medical or nursing care expenses of an ill spouse.

And, as life spans increase, more and more retirees find themselves responsible for the care of an aged parent.

Independence has long been a hallmark of today's seniors. And to be able to maintain that independence in later years is highly significant. Many seniors do receive satisfaction from continuing to be productive and creative. Instead of a national policy to encourage the continuing use of talent, experience and energy, the nation discourages it.

Opponents of raising the earnings limit center their arguments on the advantage eliminating the earnings test would give to the wealthy, who do not need Social Security. But upper-income workers have paid into the system, and need is not supposed to be a criterion. High-income individuals have another decided advantage over those with lesser income and assets. Unearned income from savings and investments often provide a substantial supplement to Social Security. But, as you know, unearned income never affects a right to benefits. A question of equity does exist in these situations.

It is estimated by Social Security actuaries that eliminating the retirement test, and recomputations, would save $50 to $100 million a year in administrative expenses. The paperwork, not just for the Social Security Administration, but also for the beneficiary, are resource intensive administrative operations that could be eliminated, and are reduced with the lifting of the earnings limit.

And let me address the rollback of the tax on Social Security benefits. Under the proposal in the Senior Citizens Equity Act, the amount of benefits taxable will decline gradually from 85 percent to 50 percent. Support for the higher tax was built on a flawed assumption that most low- and middle-income beneficiaries would not be affected by the increased taxation of Social Security benefits.

Bracket creep has been eliminated for every taxpayer except Social Security beneficiaries. Individuals have paid tax on 50 percent of Social Security benefits with income above $25,000 since 1984, when benefits were first taxed. Over time, many moderate- and low-income retirees will see their income pushed over the thresholds for paying tax on benefits because the thresholds are not indexed.

In 1984, these thresholds were high enough so that only 10 percent of beneficiaries paid tax on benefits. By 1998, 26 percent of beneficiaries will pay tax on benefits, according to the Social Security Administration.

The increased tax is a heavier burden on middle-income seniors with income between $40,000 and $80,000 than it is on upper-income seniors, whose taxable Social Security benefits are capped at no more than 85 percent of Social Security benefits.

And some defend the increased tax as fair because they believe that Social Security is not progressive. Yet the benefit formula is already progressive. Taxing up to 85 percent of benefits is excessive, and discourages retirement savings.

Although frequently not acknowledged, the Social Security benefit formula favors low-income workers, at the expense of upper-income workers. Benefits for a low-wage earner are approximately 58 percent of average earnings, and only 24 percent for the maximum earner.

Support for taxing benefits also grows out of the belief that all beneficiaries receive huge windfalls that upper-income beneficiaries do not need. But those windfalls are really false because it now takes around 16 years to receive back the combined employer/employee payroll tax, plus interest.

We think you are moving in the right direction and, again, compliment this Committee for addressing these issues.

Thank you.

The CHAIRMAN. Thank you very much.

[The prepared statement of Ms. McSteen appears in the appendix.]

The CHAIRMAN. And Mr. Deroy Murdock, a co-founder and national board member of Third Millennium. Is this your first appearance before this Committee?

Mr. MURDOCK. Yes it is, sir.

The CHAIRMAN. Welcome. It is good to have you with us.

STATEMENT OF DEROY MURDOCK, CO-FOUNDER AND NATIONAL BOARD MEMBER, THIRD MILLENNIUM, NEW YORK, NY

Mr. MURDOCK. Thank you very much, Mr. Chairman and Members of the Committee.

My name is Deroy Murdock. I am a co-founder of Third Millennium, a nonpartisan, New York-based educational and advocacy organization launched by young Americans born after 1960. My organization is most grateful for the invitation to join you this morning.

Third Millennium wishes to add the voices of our members in all 50 States to those that have urged repeal of the existing Social Security earnings limit threshold. The earnings limit creates a significant penalty for seniors who either choose or have no choice but to remain in the labor force.

Reducing the Social Security benefits of seniors who earn any sum over $11,160 cruelly drops the boom on people struggling to get by in their sunset years.

Eliminating this provision will encourage them to continue working and paying tax revenues into the Treasury. In fact the National Center for Policy Analysis estimates that, while the Federal Government would pay $4.8 billion in additional benefits to these seniors, they in turn would pay $4.94 billion in additional taxes. Net Federal revenues, in other words, would grow by $140 million.

Second, Third Millennium believes that tax increases on Social Security benefits should be replaced with a strict affluence test on Social Security and other entitlements, based on the Concord Coalition Zero Deficit Plan.

In short, retirees with entitlement, interest, employment and private pension incomes below $40,000 would not have their benefits touched. Benefits would drop by multiples of 10 percent for every $10,000 above that $40,000 limit.

In other words, a couple with a total income of $55,000, including $10,000 in Social Security and $5,000 worth of Medicare insurance payments, would see a 10 percent drop in their Social Security benefits, plus a 20 percent reduction in their Medicare payments.

The affluence test would reduce their retirement benefits from $15,000 to $13,000. The Concord Coalition estimates that this prudent, yet realistic, approach to America's mushrooming entitlement problem would save $68 billion in the year 2000 alone.

We also would urge Congress to stop the inefficient practice of taxing Social Security and other entitlement payments. It makes no sense to pay recipients money, and then turn around and tax it back later. Why not just write smaller checks in the first place?

Now, in all candor, Mr. Chairman, I must point out that this entire discussion of the Senior Citizens Fairness Act is akin to watering the rose bushes as the whole house goes up in flames. Hard working Americans of all ages continue to pump money into a Social Security system that treats their hard-earned cash as kindling for a bonfire.

Of the $376 billion in revenues wheeled through the front door of the Social Security system last year, $320 billion kept rolling right through the back door, directly into the hands of today's retirees. The remaining $56 billion, the so-called Social Security trust fund, disappeared through a side exit. It was loaned to the U.S. Treasury to mop up an equal amount of red ink that funded everything from fighter jets to refreshments on Air Force One. The Treasury replaced these greenbacks with special issue Treasury notes or, in plain English, IOU's.

I think the American public, or at least those my age, now realize that their money is not safeguarded or invested in gold bars, real estate or preferred shares of General Electric.

This crisis of confidence in Social Security was brought to light in a bipartisan survey Third Millennium commissioned. It was conducted by GOP researcher Dr. Frank Luntz and Democratic consultant Mark Siegel.

Last fall we asked 500 Americans between the ages of 18 and 34 for their views on Social Security. Only 9 percent expect the system to provide them the income they need for their retirements. A mere 28 percent expect Social Security even to exist when they retire. Meanwhile, 46 percent say that they believe in UFO's.

In other words, Mr. Chairman, people my age believe that, in our lifetimes, we are more likely to see a flying saucer than a Social Security check.

Our poll also found overwhelming support for what we believe is the ultimate answer to the Social Security conundrum. Eighty-two percent of young Americans want to be given the freedom to invest all or part of their Social Security payments in private retirement accounts that they would own, control, and even pass along to their children and grandchildren. We also discovered a plurality of senior citizens endorse this concept.

The tremendous boost in savings and capital formation that a privatized Social Security system would institutionalize would keep interest rates low and provide tens of billions of dollars to the economy that could be used for new plant and equipment, research and development, and worthwhile investment projects.

Economists agree that Chile's private social security system is one of the chief reasons that particular Latin American country is booming today. That is why Argentina, Bolivia, Columbia, Peru and other Latin countries are adopting the Chilean model, and thriving as a consequence. If such bold reforms can flourish in the emerging markets, there is no reason why they would not succeed in the United States.

Senator Bob Kerrey and former Senator John Danforth took a small step in the right direction when they suggested last year that people be freed to devote a portion of their FICA payments each month to an account that would be in their hands, rather than those of legislators and civil servants in Washington.

Last month, Senate Majority Leader Robert Dole, an esteemed Member of this Committee, declared, "I . . . believe that we cannot keep Social Security off the table forever." Senator Dole is right on target. For people in my generation, Social Security is already on the table. The questions are: will legislators carve off the fat, so that needy baby boomers will get the portions they expect? And, will people my age be excused from the table to nourish ourselves elsewhere?

To return to an earlier metaphor, while my generation is willing to make the sacrifices necessary to douse the flames engulfing our national house, it will take the concerted effort of all Americans to clean up the damage and rebuild.

With Social Security now on a rendezvous with bankruptcy as early as 2014, the time to start reconstructing, or even replacing this system is not in the next Congress, or next year, but today.

This year, Social Security will turn 60. For 60 years, Social Security has worked hard, and soon it hardly will be working.

We suggest that today mark the beginning of a candid and sincere national dialogue on how to move beyond Social Security to a system of private retirement accounts.

We further propose that, by the year 2000, when Social Security turns 65, we give it the retirement party it so richly deserves.

Getting from here to there will not be easy. But there is a large and growing constituency demanding fundamental progress in this area.

Mr. Chairman, and Members of this Committee, the power to change is in your hands. Please lead us so we can move forward, together.

Thank you very much.

Thank you, Mr. Murdock. And we will conclude with Robert Myers. And I would wager that he has appeared more often before this Committee than Mr. Murdock is years old.

Mr. Myers?

[The prepared statement of Mr. Murdock appears in the appendix.]

STATEMENT OF ROBERT J. MYERS, FORMER CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION, SILVER SPRING, MD

Mr. MYERS. Thank you, Mr. Chairman.

I think that your actuarial estimate is right on. I have had the great privilege and pleasure of appearing before this Committee many many, times since the first time, which I think was in 1950.

Before discussing the two changes that are proposed, I would like to deal with two matters that affect the adoption of these changes.

First is the relationship between Social Security and the general budget deficit. I am constrained to say that I think there is considerable hoax, even fraud, involved in the way this relationship is considered and presented by many people.

For example, consider the fiscal year 1994. The budget deficit under the unified budget approach was stated to be $203 billion. The real budget deficit in fiscal year 1994 was $292 billion, which was the increase in the national debt.

Similarly, what this seems to mean is that, under the unified budget deficit, all surplus of the Social Security system—in other words, the excess of income over outgo—is counted as general taxes that go into the general fund of the Treasury, and not into an earmarked trust fund.

This implies—and I think quite wrongly—that the bonds in the trust funds are worthless, and the interest on them that is paid is meaningless. This is not the case. The bonds in the trust funds are just as valid as the bonds that you or I might hold.

In the same way, too, there is a bit of hoax in that the interest on these bonds is not counted when we talk about the horrendous amount of interest on the public debt. The interest is around $200 billion a year, according to he budgeteers. But, actually, the interest on the national debt, counting what is paid to the trust funds, is closer to $300 billion. So the public does not see what a horrendous picture it is. It is horrendous enough the way that it is presented, but it is even worse in actuality.

I believe that changes in Social Security should be made for program reasons, not for budget reasons. If the program is going to have problems, as everybody agrees that it will sometime 30 or 40 years from now, changes should be made. They should be made now. The program should continue to be self-supporting. The changes can be either in benefit cuts, or in tax increases, or a combination.

I would assert that the two changes considered would affect neither the national debt, nor the real budget deficit. For instance, under the change in the retirement earnings test, the trust funds would be reduced slightly, some $5 billion over the next 5 years. This does not mean that the national debt would be changed one penny. What it means is that $5 billion of the national debt would no longer be held in the trust funds. It would be held by the public.

The other matter I want to discuss is two legislative procedural rules about any changes in Social Security. The first is that any changes over the long run must be self-financed in one way or another. I think that is a good rule, and I think that the Congress has always followed it.

The other rule, which I do not think is desirable, is the 5-year rule, that any changes have to be financed within those 5 years.

In a long-range program, that requirement of 5 years is not needed. The result can be penny-wise and pound-foolish. One current example is that more money should be spent on the administrative expenses for the disability benefits program. If this were done, I think that many cases of disability would be removed from the rolls. But the budgeteers say, "oh no, we cannot spend more money. That will affect the budget this year or next year." However, over the long run, it would actually save money.

Another example is in connection with the retirement earnings test. If more money were paid now, there is also a savings over the long run because, if people take their benefits today, they will not get the delayed-retirement credits later. So, any social insurance program of a long-range nature should not be constricted by a 5-year rule.

There is one very good way to avoid the 5-year rule. If the Congress were to pass legislation today saying that the retirement earnings test would be changed 5 years from now, the 5-year rule would not apply. If this had been done in 1990, we would be in a different situation today.

As to the proposed change in the retirement earnings test, in theory, I strongly believe that there should be such a test, under the principle that retirement pensions should not be paid to people who are not retired.

However, in practice, the way that the test works out, there is a great work disincentive because of the small net cash flow in the year. However, I should point out that it is not as bad as many people think because there is a return to them later. If people do not get paid benefits today, they get delayed retirement credits later.

Another thing that people do not realize is that 15 years from now, the retirement earnings test for people over the normal retirement age, now 65, will, in effect, be eliminated, because the delayed retirement credits will be 8 percent per year, which is the actuarial equivalent.

The test should be eliminated then, and it would have no cost effect whatsoever. If people are wise, though, they would not take the benefits at age 65. They would delay them and get the delayed retirement credit at 8 percent a year, and it is a better retirement income picture to have more retirement income rather than to have benefits and work income at the same time, and then smaller benefits for life.

Finally, as to the income taxation of benefits, I strongly believe that they should be taxable, just like any other retirement income. However, I believe that the present 85 percent factor, such that 85 percent of the benefits are taxable, is too high. This is what is done for private pensions, and it is slightly inequitable because it puts the taxation up front. People who die early have really paid too much.

Under the basis which I would propose, about 80 percent should be taxable currently, and this percentage should decrease to maybe 72 percent over the years, as people have paid in more and more at the higher tax rates currently applicable.

I also believe that the money from the income tax on benefits, at least on that above the 50 percent basis, should not go to the Medicare Hospital Insurance Trust Fund. There is no logic to that at all. It should stay in the General Treasury, as the House bill had provided. And then it would really help to balance the budget, whereas, now, it does not balance the budget at all. It just makes the Hospital Insurance program have more money and more investments, and the public has less investments in government bonds, and the national debt is still the same.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Myers appears in the appendix.]

The CHAIRMAN. But we put it into the health insurance fund because it was running out of money, and it was purely an expedient thing to do.

Mr. MYERS. That is correct. It is like this fellow who robbed banks because that is where the money was.

The CHAIRMAN. That is exactly right.

As you heard me say earlier, I will bet that at some stage we will transfer $100 billion worth of bonds from the old age fund to the HI fund, and say now the HI fund is solvent.

Mr. MYERS. I certainly would hope not.

The CHAIRMAN. I would hope not, too.

Mr. MYERS. But your fear is a possibility.

The CHAIRMAN. Mr. Bartlett, I was intrigued. We go through these estimates all the time. And, of course, according to Joint Tax and CBO estimates, the earnings limit repeal loses money.

You have got a model that says it does not lose money, or I think you do. Tell me how you got there.

Mr. BARTLETT. Well, it is based on a model that I think the Committee is somewhat familiar with. It was done by Gary and Aldonna Robbins.

The CHAIRMAN. Who?

Mr. BARTLETT. Gary and Aldonna Robbins, who are consultants to the National Center for Policy Analysis. They did a complete study on this subject, which I can submit for the record, if you want.

Basically, they looked at increases in labor supply, increases in capital income, and tried to figure out how much additional taxes you would get.

The CHAIRMAN. What were those people's names again?

Mr. BARTLETT. Robbins, Gary and Aldonna Robbins.

The CHAIRMAN. All right. Thank you.

Mr. BARTLETT. And you would really have to talk to them about the details of how they do it.

But, as I said, I think that one has to be very careful about extrapolating from these kinds of estimates because there are limits. And I think we need to be looking at the places where we are going to get the most bang for the buck, and how we can do a total package of tax and benefit changes that would be most likely to encourage additional work effort.

The CHAIRMAN. Let me ask you, are they the same ones who have done this study on capital gains?

Mr. BARTLETT. Yes.

The CHAIRMAN. That has been absolutely blown out of the water by everybody that has ever looked at it. They presume more savings than there are conceivable savings in the country.

Mr. BARTLETT. What their model does is, they assume that the after-tax rate of return to capital is roughly constant at about 3.3 percent. So any reduction in the after-tax rate of return reduces the capital stock to the point at which you again have a 3.3 percent rate of return.

Similarly, if the rate of return, the after-tax rate, is cut, then the capital stock will expand to the point at which you are again back to 3.3 percent.

The CHAIRMAN. I know what their theory is. And I am familiar with static versus behavior versus dynamic. I have never seen a study as far out as their study, by the most far-out economist. It strains credulity.

Mr. BARTLETT. It depends on how you look at it. Professor Dale Jorgenson from Harvard recently was quoted in the Washington Post saying that, if a flat rate tax, like Congressman Armey's proposal, took effect, you would get an immediate $2 trillion increase in the nation's capital stock.

Now this is a revaluation, keep in mind. It is like a bond. If the interest rate goes down, the price of the bond immediately goes up. And, if interest rates go up, the price of the bond immediately falls. The capital stock, the valuation, the economic value of that capital stock will change immediately. You do not have to have additional saving or investment for the value of an existing capital asset, such as a machine, to have more value. So that is part of what is going on here. It is a revaluation effect of the capital stock.

But, I did not do these estimates. It was done on behalf of the organization I represent.

The CHAIRMAN. Do you support a flat tax?

Mr. BARTLETT. Absolutely. I believe that the Armey-Hall-Rabushka plan is really the ideal of where we ought to be.

The CHAIRMAN. You have seen the estimates from the Joint Tax Committee, now headed by a Republican, on the loss on the Armey flat tax.

Mr. BARTLETT. That is being redone. I think there were some errors that they have admitted to.

The CHAIRMAN. Initially, the Washington Post reported in error. Treasury had made an error. Treasury said it lost $240 billion a year. And the Washington Post reported that. It turns out Treasury had made a mistake—and, unfortunately, Joint Committee roughly confirms it. It is not $240 billion, it is only $180 billion a year loss.

Mr. BARTLETT. Well, I would point out that Congressman Armey wanted his proposal to be a tax cut. And he deliberately did not set the rate at a revenue-neutral rate.

The CHAIRMAN. He thinks it should be set at a revenue-neutral rate?

Mr. BARTLETT. Yes. I argued with him personally about this.

The CHAIRMAN. Now, if he had a flat tax——

Mr. BARTLETT. It would be about 19 percent, I think.

The CHAIRMAN [continuing]. And still have a modest deduction for the poor of $15,000 and $30,000, or something like that.

Mr. BARTLETT. Right.

The CHAIRMAN. But then you would have to include Social Security as part of the income base, all of Social Security.

Mr. BARTLETT. No. I believe that——

The CHAIRMAN. Eighty-five percent of it, as you would a private pension.

Mr. BARTLETT. I would be treated as any other pension. That is right.

The CHAIRMAN. Which would mean that you put roughly 85 percent of it into the base?

On normal private pensions, you would contribute about 15 percent.

So long as you understand what you mean. You are going to put in the interest on municipal bonds, capital gains, all income, fringe benefits taxed from dollar zero, no charitable deductions, no home mortgage deductions, and you can do it for around 18 percent.

Mr. BARTLETT. Yes. Of course, the really important revenues are on the business side. Corporations would no longer be allowed to deduct any interest. And that is where you pick up most of the revenue that pays for the lower rates.

The CHAIRMAN. Mr. Murdock, tell me a little bit about your organization. I am not familiar with it.

Mr. MURDOCK. Third Millennium was launched in July of 1993 by a group of young Americans born after 1960. We got together a group of people from the left, the middle and the right of the political spectrum to see if there was anything we had in common.

And, to our pleasant surprise, we found that we did have a lot in common, and that was primarily a concern about this country's long-term economic future, and a desire to get politicians and the entire political process to focus on the long-term impact of public policy.

Unfortunately, many people in the political sphere seem to focus on the next election. So, long-term thinking right now is November, 1996. And, unfortunately, as Senator Simpson so eloquently pointed out, there are big problems after 1996. We are trying to get people to focus on that, and what we can do today to try to avoid some of the calamities that lie just around the corner.

The CHAIRMAN. I am intrigued with the flying saucer remark.

Senator Moynihan.

Senator MOYNIHAN. Yes. Why do we not start right there. You find, Mr Murdock, in the Commission's survey, that 46 percent of a sample of young Americans 18 to 34 believe in UFO's. Did you ask how many believe in a flat earth?

Mr. MURDOCK. We did not ask about that. I would think it would be a lower figure. I would hope so.

Senator MOYNIHAN. All right. Flat tax?

Mr. MURDOCK. We did not ask about a flat tax either.

Senator MOYNIHAN. I see. Well, we would like to know more about that. I do not mind them not expecting Social Security, but believing in UFO's suggests that we have got an awful lot of dopes out there. But I will not get into that.

I would say two things, Mr. Chairman, and then ask a question. First, it is important, I think, to note as Ms. McSteen did, that we have now reached the point where you get back from Social Security just about what you put in. Is that right, Mr. Myers?

Mr. MYERS. Yes; that is correct.

Senator MOYNIHAN. And it is a little sooner than you expected. Is that right?

Mr. MYERS. Yes.

Senator MOYNIHAN. But it is now a retirement system. It is actuarially balanced. That early bias in favor of early entrance is gone.

I am interested in the dynamics of this retirement pattern. What strikes me—and no one has ever explained it to me—is that 55 percent of Social Security retirees retire at 62. And two-thirds retire before they are 65.

I do not know what that argues. It could argue that they are well enough off, and tired of working, or want to go Arizona, or whatever.

Those who continue on, I am pretty sure, are disproportionately professional people, such as Mr. Myers. They like whatever they are doing, lawyering or teaching, or what not.

Does anybody have any advice for me on that? Could I just ask Bob Myers? You are the one who should know. Americans are retiring very early. And finally, we now have that personal earnings and benefit estimate statement after 14 years.

And they give an example of a worker who is making about the median wage, nothing high. At age 62 he retires at $815, at age 70 $1,500.

The CHAIRMAN. Say that again.

Senator MOYNIHAN. At age 62, you get $815 a month, at age 70, $1,500.

The CHAIRMAN. Almost double.

Senator MOYNIHAN. Yes. Stick around a while, and you will get a lot more. But they retire earlier.

Do you have any ideas on this. Does anybody know? Mr. Murdock? Mr. Bartlett? Mr. Myers?

Mr. BARTLETT. Well, I would just venture a guess that perhaps people are so insecure about making sure that the benefits are really going to be there, that they just want to grab them as quickly as possible.

Senator MOYNIHAN. Oh my gosh! People in Texas really do not trust us up here. [Laughter.]

And you know, they are entitled to four. They could have eight Senators. Lloyd Bentsen used to say, "They just cannot agree on who would get the Alamo."

Bob, do you have any feeling on this?

Mr. MYERS. I think you cannot say that there is any one typical case. It is mixture of people. There are people, as you say, who do professional work, doctors, lawyers, actuaries and others, who would like to go on working at their high-paid jobs. They really do not need the benefits. And, in fact, if there were no retirement test after age 65, they would be foolish to take the benefits because they would be paying income tax on the benefits, as well as on their earnings.

But then, at the other extreme, there are many relatively low-income people who go on working, as has been said, at fast food chains and things like that. So I think that the picture of people working beyond age 65 is a very varied one.

Senator MOYNIHAN. Do you think we ought to have more data before we make a decision about these things? The Social Security Administration could get us the data could they not?

Mr. MYERS. Yes.

Senator MOYNIHAN. I would just like to say that, Mr. Chairman.

Ms. McSteen?

Ms. MCSTEEN. Yes. I would like to say that many corporations, and the Government too, are providing early out packages, and I think that has moved a lot of people into the retirement arena.

One of the greatest plights, I think, of that mass movement is that those individuals have a very difficult time getting health insurance coverage. And it becomes a major problem for them.

Senator MOYNIHAN. Do you mean between 62 and Medicare?

Ms. MCSTEEN. You are right. Yes.

Senator MOYNIHAN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

I have a factual question I would like to ask if anyone has some information on.

We know that there has been a fairly significant decline in the number of working Americans who have health insurance provided at the point of their employment. The estimates are that, by early in the next century, less than half of working Americans will have such health insurance.

Has there been a similar decline in the number of Americans who are receiving pension and retirement benefits at their place of employment?

Mr. MYERS. There has been some decline, but most of the change has been from what are called defined benefit plans, where a certain benefit is promised, such as in your Congressional retirement system, that is based on salary and length of service, to so-called defined contribution plans, which are like a savings bank that accumulates. And you are never certain under the latter plans what it is going to buy until you retire. And, even then, you cannot always convert it to an annuity. So it has a much less stable nature, it is much less certain as to what the benefit will be.

And there has been this shift from the one type of plan to the other for various reasons, including regulation, and also that the employer then knows what the cost is, because the risk is borne not by the employer, who is no longer promising defined benefits. The risk is borne by the participant, who is not certain just how much this big pile of money that he or she is accumulating will actually be, or how much it will buy when he or she retires.

Mr. MURDOCK. I would add, Senator, that I do not have any hard data for you on that phenomenon. But one thing we have seen in this country over the last decade or so is a tremendous increase in self-employment.

Some people decide to become their own bosses. Other people are put into that situation because of corporate downsizing. I imagine, as people run their own companies, you are seeing exactly the sort of phenomenon you described.

Senator GRAHAM. Well, Ms. McSteen talked about the fact that there have been three pillars to economic security, of which Social Security was one. If one or two of the other pillars is either declining, becoming less relevant because fewer people are working for an employer, or shifting into a less stable source, what does that say about Social Security?

Is Social Security going to have a relatively more prominent role, as the other two pillars become less secure?

Ms. MCSTEEN. Well, Social Security, of course, was always intended to be the base, the floor, on which to build for the future. And I think the problem is that many people really do not build on that system, and do not save sufficiently.

But certainly, as one of the three legs of the stool begins to collapse or diminish, then we do need to turn to something that is predictable. And the Social Security system is the way to go. We have a lot to do to shore it up, perhaps. But we have done that through the years; it can be done.

And this Committee has recommended in the past legislation that would clearly support Social Security far into the future, both with truth in budgeting and Senator Moynihan's pay-as-you-go system. There are many opportunities for us to address the system for beyond the turn of the century. And it is an inter-generational program. Many young people do not realize that Social Security really provides survivor and disability benefits for themselves and their families. About 38 of the beneficiaries are not retirees. And yet, we do not focus on that very often.

Mr. BARTLETT. Senator, I think the leg of the stool that is most endangered is not the private pension part, but the private saving part.

As we all know, and this Committee has discussed many times, the personal savings rate in this country has been declining. And this is a very serious problem that needs to be addressed, both for macroeconomic reasons, as well as for retirement reasons.

Senator GRAHAM. So what we are really saying is that all three pillars are under assault, for a variety of reasons?

The specific issue of the level of earnings which should be offset against Social Security, you were discussing the clustering phenomenon, and what would happen if you raised it by $1,000, and then beyond. Do you have a suggestion of what would be the most appropriate balance, in terms of maximizing the ability of older Americans who wish to work to be able to do so undeterred, which also maximizing Federal income, or minimizing Federal loss of revenue as a result of that?

Mr. BARTLETT. I think it is pretty clear that a small increase in the threshold would probably make money for the Government.

I do not know what the revenue maximizing threshold would be. The proposal in the Republican Contract, as you know, is to raise the threshold to $30,000. That may be higher than whatever the revenue maximizing rate would be. Obviously, it is going to change over time. It is very difficult to estimate.

Senator GRAHAM. You mean, in the final analysis, we are going to have to put a specific number into this proposal? I wonder if you might supplement your testimony today with some further analysis based on your model of what you think that number ought to be in order to achieve this combination of objectives.

Mr. BARTLETT. Well, the study that was referred to earlier by Gary and Aldonna Robbins was done in 1990. It suggested that raising the threshold from—at that time, I believe, it was $10,352—to $17,000 maximized the net revenue to the Government, and it declined thereafter. Completely eliminating the threshold altogether did lose money, but not very much.

So that suggests that a 60 percent or so increase in the threshold might be optimum, from that point of view.

Senator GRAHAM. Thank you.

The CHAIRMAN. Senator Simpson.

Senator SIMPSON. Mr. Chairman, I think Senator Nickles has another pressing obligation. I would yield my time to him, if I could come back.

The CHAIRMAN. That is fine. Senator Nickles.

Senator NICKLES. Mr. Chairman, thank you. I appreciate Senator Simpson's cooperation.

I have heard some very interesting things. I will make a couple of comments. I was interested in Senator Moynihan's pay-go proposal because I am concerned about what is going to happen in the year 2013.

I heard Mr. Murdock questioned the younger generation, asking whether or not that money is going to be there. I hear Mr. Myers talk as if the trust fund is there, and we can cash out the trust fund as if the money is invested in the bank.

Mr. Murdock said there is no trust fund there. I do not want to put words in your mouth but, basically, it was an IOU.

Mr. MURDOCK. IOU's—stacks and stacks of IOU's.

Senator NICKLES. I concur with Mr. Murdock. I know, Mr. Myers, that you are the actuary. Correct me if I am wrong, but by the year 2013, we theoretically have a trust fund, but basically a Government IOU. But the way we have paid off T bills in the past, we have always borrowed more T bills.

And so, by the year 2013, even though, theoretically, we are going to have a trust fund that is going to have hundreds of billions of dollars in it, the way we are going to make payments in the year 2014 is that we are going to borrow money to pay that.

We are going to be issuing T bills because every T bill we have paid off, we have paid it off by issuing more T bills. I am afraid that is exactly what is going to be happening. I think Mr. Murdock is right on target.

Mr. MYERS. Senator, if I might say, that same argument would apply to paying off the bonds that are maturing that private people hold.

I agree that, unfortunately, we have a terrible budget situation. We should get more nearly a balanced budget through some means or other, which I cannot say just how to do.

But the fact is that any Government bond that matures is paid off now by borrowing, and issuing new issues. And this is just as valid for the investments held by the trust fund as the investments held by you and I. They are all IOU's, but what is wrong with an IOU?

Senator NICKLES. Well, I just wanted to clarify that because some of us are concerned about the IOU's. We are concerned about a misgiving that there is that enormous wealth. People will be able to cash in the gold bars, cash in their G.E. stock, or cash in something to pay this.

I want to make a couple of other comments, Mr. Chairman, and Senator Moynihan. I would like a copy of that paper that you referred to recently, Pat. I think that would be helpful to me—the one that had the $800 and the $1,500.

Mr. Chairman, a lot of people say that we cannot cut Social Security. The administration says that disability applications have experienced a 10.5 percent average annual growth since 1990. An additional 710,000 disability beneficiaries have joined the rolls since 1994. I think we are going to have to do something on disability.

And, Ms. McSteen, what did you say the percentage was of Social Security beneficiaries who were on disability?

Ms. MCSTEEN. Thirty-eight percent of the beneficiaries are either survivors or disabled and dependents.

Senator Nickles. I appreciate that fact.

And one other comment, which goes back to the Chairman's comment about what is the normal taxation of benefits in the private sector? It is 85 percent? And that may be the average. But, in the private sector, you are taxed on all income above what you have already contributed and paid taxes on. I do not know, would it be that difficult, Mr. Myers, for us to do the same thing in Social Security, in other words, allow everybody to recoup the dollars which they have contributed and already paid taxes on, and tax 100 per cent of the benefit above that? Would that be that difficult, to know that demarcation line? Social Security, I think, already has it.

Mr. MYERS. This could be done. I think that the reason it was not done in the 1983 amendments, or in the subsequent changes, is the difficulty that many people just would not understand it. It is very complicated, and the 85 percent factor was put in as the most that anybody would pay on. For others, in essence, it would be a bargain. Some of them should be, as you say, paying on 100 percent by now.

Senator NICKLES. One of the reasons that I mentioned that, I think it would be very educational if people knew when they have received all their own money back, or all their contributions back.

I think there is a real misconception. I am one of the younger Members here, and I started paying Social Security when we were paying 3 percent on $4,800. And, as a matter of fact, everybody until——

Senator MOYNIHAN. Nineteen fifty-nine.

Senator NICKLES. 1959 was in that category. I think that a lot of people have assumed that they have been paying hundreds and hundreds of dollars since the 1940's and 1950's. And that is not the case. So I think it would be educational if people knew exactly when they had received back every dollar that they had contributed.

Mr. BARTLETT. Senator, the last time I checked, the average recipient got back all that he put in, including the employer's contribution, including earnings, in 18 months.

Senator MOYNIHAN. Oh no, sir. We have different estimates.

Senator NICKLES. I think that is an older figure.

Senator SIMPSON. It is about 6 years now.

Senator NICKLES. It depends upon whether or not you give credit for interest.

Senator MOYNIHAN. We have just been told 16 years.

Senator SIMPSON. Yes, but he mentioned both employer and employee contributions.

Ms. MCSTEEN. Yes.

Senator SIMPSON. If you just take the employee contribution, it is at least half of that.

Senator MOYNIHAN. Well, let us find out when the CRS has a study. Geoffrey Kollmann, "How Long Does It Take New Retirees To Recover the Value of Their Social Security Taxes?"

Senator NICKLES. That would be great.

Mr. Chairman, thank you very much. I want to thank my colleague from Wyoming for accommodating my schedule, as well.

The CHAIRMAN. Senator Simpson.

Senator SIMPSON. Well, this is fascinating to me. And it is thanks to Senator Moynihan that we are going to begin to look at this little sheet of paper. Because 9 million of those are going out now to people over 60. And that is going to be a wake up call deluxe. We will not hear from a lot of them again, because they are going to be embarrassed.

My own is the most remarkable one. Here I was practicing law in Cody, Wyoming. The most productive years of my life started with the start of my law practice in 1958, until I came to the U.S. Senate in 1978. And I never paid over $1,000 a year in Social Security.

The actuary right here knows. There was a limit. You did not pay above that. So I did not pay over $1,000 a year. And, if I were to retire at 62, I would receive $900 and some bucks. At 65, I would receive $1,100 and some bucks. And, at 70, it would be up to $1,500 and some bucks.

And that was for everybody. That was for rich guys. I was not rich, but I was making over $20,000 a year. And so there it is. And we have to listen to this continual babble about, I put in it from the beginning, and I want it all back. Well, take a look at your figures, and I would like to enter them into the record. This is the number of years to recover taxes, plus interest, for workers retiring at age 65. It is from CRS, and it is all here—minimum earner, average earner, maximum earner, illustrations combined, and so on. So pick your area.

But, in 1960, you got it all back in about 18 months, 2 years. And then, finally, it was 3 years, 4 years. And, remember, there were 16 people paying into the system, or 13 when I was a freshman at the University of Wyoming. Now there are 3.3 paying into the system. In 20 years, there will be 2 people paying in, and one taking out.

It cannot work, and we all know it. And we sit here and listen to groups just ask for more, more, more. Plus long-term health care for everyone in the U.S., regardless of their net worth or income. Fight the country to its knees.

[The material referred to by Senator Simpson, follows:]

TABLE 1.—NUMBER OF YEARS TO RECOVER TAXES PLUS INTEREST FOR WORKERS RETIRING AT AGE 65 *

	Minimum earner	Average earner	Maximum earner
Illustration 1:			
Years to recover employee's OASI taxes			
Year of retirement:			
1940	**	0.1	0.2
1960	0.5	0.8	1.0
1980	1.5	2.0	2.1
1995	5.8	8.1	10.7
2005	8.3	11.7	15.6
2015	9.0	13.0	18.7
2025	8.5	12.8	20.9
Illustration 2:			
Years to recover combined employee-employer OASI taxes			
Year of retirement:			
1940	**	0.2	0.4
1960	1.0	1.6	2.0
1980	3.0	3.9	4.4
1995	12.9	18.8	25.8
2005	18.6	27.7	40.1
2015	20.4	31.5	52.0
2025	19.1	30.9	62.1
Illustration 3:			
Years to recover retirement portion of employee's OASI taxes			
Year of retirement:			
1940	**	0.1	0.2
1960	0.4	0.6	0.7
1980	1.1	1.4	1.6
1995	4.2	5.8	7.2
2005	6.1	8.5	11.2
2015	6.6	9.5	13.4
2025	6.4	9.6	15.2
Illustration 4:			
Years to recover retirement portion of combined employee-employer OASI taxes			
Year of retirement:			
1940	**	0.2	0.4
1960	0.7	1.1	1.4
1980	2.2	2.8	3.1
1995	9.1	13.1	17.6
2005	13.2	19.0	26.4
2015	14.5	21.5	32.9
2025	14.0	21.8	38.8

* Under the alternative II assumptions and taking into account benefit increases and continued accrual of interest after retirement but not the taxation of benefits. The retiree is assumed to attain age 65 and retire in January of the designated year.

** Less than 0.1 years.

Senator SIMPSON. So those are some very disturbing things. But I have heard Mr. Murdock testify before the Entitlements Commission. You are impressive in every way.

Mr. MURDOCK. Thank you.

Senator SIMPSON. It is very pleasing to me to know that people born after 1960 are in this game. My only hope and prayer for you is that you will go and round up 33 million members at $8 bucks a year dues like the AARP, and you may be able to influence things here. You may. But you will need to scratch up 33 million members.

Mr. MURDOCK. Our work is cut out for us.

Senator SIMPSON. Yes it is, indeed.

But you are ready for it. Your loins are girded. [Laughter.]

Now, Mr. Myers, I always appreciate what you share with us.

The figures, the $300 billion in interest out there that we are paying on the national debt. We will vote on a $5 trillion national debt within the next few weeks or months.

A $5 trillion national debt, and still these groups come before us to go into the wretched exercise. I wonder where these groups were when we reallocated, or actually transfused, the taxpayer's bucks from the retirement fund of the disability fund. Did anybody say anything about that around the land?

Because we are always stealing, we in the Congress have stolen the money from the trust fund. We have robbed it. When you go to the town meetings, you hear about stealing from the Social Security trust fund. I say, no, we did not take a penny.

Senator MOYNIHAN. That was a letter from Martha McSteen. It was.

Ms. MCSTEEN. I do not know about that.

Senator SIMPSON. Anyway, we did not steal anything from anybody. Because all the surplus has to be invested in securities of the United States. We all know it. It is a travesty. And then, when we saw this disability fund going bankrupt, the people involved reallocated and transferred the precious bucks from the retirement fund to the disability fund. And how many billions was that? Billions and billions of bucks. We never heard a word from any of these groups, not a word, not a peep.

Well, next time it will be the health insurance fund that will go broke. And we will "transfer" bucks within that system and, I guess, never hear a peep from anybody on that either. Meanwhile, we will be accused of robbing and stealing.

And every other fund that goes broke, we will reallocate until we have reallocated these young people out of their inheritance, and out of everything that the rest of us always tried to provide for our young people throughout our history.

I hope we can pay close attention to the disability issue. There is a situation there. Mr. Myers, let me ask you again, on that disability information, you said that we would do better if we had more people involved in following up on that. Tell me that again, so that we all hear what is happening to that.

Mr. MYERS. Yes, Senator. First, as to the matter of the distribution of the money between the retirement fund and the disability fund, none of the money was taken out of the retirement fund from the past. It is just that the future money going in was allocated more to the disability fund and less to the retirement fund.

So it did have that effect, of course, that the retirement fund is not as large as it would otherwise have been.

In law, there is a provision that states there should be continuing disability reviews. People who are getting disability benefits should be checked on every once in a while to see that they are still under a disability, that they are not working and not able to work, and so forth. Because of a lack of administrative funds, the Social Security Administration has done very little of that, even though they are supposed to do it every couple of years.

I agree with you on this. The General Accounting Office has put out a report which states that, if a little more money was spent on administration, there would be a much greater savings in benefits by removing people from the rolls who are not really disabled. So it is the old case of being penny-wise, not having enough administrative expenses, and pound-foolish, losing a lot of money on benefits that should not be paid under the law.

Senator SIMPSON. I thank the Chair. Thank you very much.

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman. This is such an interesting hearing, and I want to thank you for having it. I want to particularly congratulate Mr. Murdock. I am impressed also, for the same reasons that Senator Simpson raised. It is just wonderful to see young people getting involved with the substantive issues of our time.

But I want to get to Mr. Myers. I want to talk about disability for a minute because I have gotten any number of complaints from people at home who are concerned that drug addicts and alcoholics get more money under SSI disability for their support than do people who are dependent upon public aid because they have children and cannot work.

As you know, with all of the debate going on about welfare reform and the like, this is a real point of contention and a sticky wicket, in that folks who are poor, if you will, because of circumstances beyond their control, are treated less well than people who receive assistance because of a drug addiction or alcoholism. And folks just resent that.

If I heard you correctly, your response was that we could clear out a lot of those cases with greater administrative support for Social Security, in terms of the way they review those cases.

And yet, it has been my experience over time that the use of the representative payees, which is where a lot of the money goes for administration under disability, does not get to the core issue of what do you do about getting folks who are drug addicts and alcoholics off of disability, so that the program is preserved and stabilized for people who are poor, again for circumstances beyond their control, and for people who are disabled and actually need the money.

So, I guess my question is, with regard to the administration, are you aware of any studies, or have there actually been investigations, that by beefing up the administration, as opposed to taking a good look at actually fixing the system itself, as opposed to administering what we have got right now, would be the most appropriate and efficient response to these kinds of issues within SSI disability?

Mr. MYERS. Senator, first of all, let us make it clear that the money for SSI does not come out of the Social Security trust funds. That is paid out of the general fund of the Treasury.

Senator MOSELEY-BRAUN. But you were raising the disability issue, so I wanted to talk about that first, and then get to the Social Security issue later.

Mr. MYERS. I think that both courses of action are desirable. The provisions should be such that people who are not rehabilitated, and not making efforts to be rehabilitated, should not get SSI.

As I am sure you are aware, in the Independent Agency bill that was enacted last year, this was tightened up. But both things should be done. The law should be such that these abuses would not be permitted. And, also, the administration should be such that the law is carried out in the way that it is written, and the way that it was intended.

Senator MOSELEY-BRAUN. Well, again, I guess the reason I raise that with you is because we went through a period in the 1970's in which the law was overzealously carried out. And a lot of people who should have been entitled to disability were not entitled. And there was a lot of litigation, and there had to be changes at that end as well.

I suppose your answer that we ought to do both, in terms of taking a look at the law on the one hand, and beefing up the administration of what we have on the other, makes sense to me. It is just that what I was hearing you say earlier was that beefing up and hiring some more bureaucrats would solve some of the problems with disability. And I just could not imagine that to be true.

Mr. MYERS. No. I did not mean that that was a complete solution. But that is a partial solution that should be done. And, certainly the provisions of the law should be written so as to be equitable and fair.

As you recognize, disability is a very difficult thing to determine. The administration should not swing too far one way or the other. As to some of the actions that took place in the early 1980's, people were taken off the rolls who should not have been.

Senator MOSELEY-BRAUN. That is right.

Mr. MYERS. But, on the other hand, the administration should not be too lax, and let people on the rolls who really are not disabled. It is a difficult program to administer.

Senator MOSELEY-BRAUN. Well, under our current rules, though, alcoholism and drug addiction are considered disabilities. And that is a problem I think we will have to look at.

Thank you very much, Mr. Myers.

I would like to ask Mr. Murdock a question. In your statement, you made the point that, "82 percent of young Americans want to be given the freedom to invest all or part of Social Security payments in private retirement accounts." And you call this the ultimate answer to the Social Security conundrum.

First, I would ask where you got the number 82 percent of young Americans, what your sample was? But I am not going to challenge your data.

Mr. MURDOCK. Would you like me to answer that question?

Senator MOSELEY-BRAUN. Yes, please.

Mr. MURDOCK. Sure. This survey was conducted September of last year by a bipartisan group, Dr. Frank Luntz, of Luntz Research, and a Democratic consultant by the name of Mark Siegel.

This was a random phone survey of 500 young Americans 18 to 34. We also interviewed 500 people over 65. We found that, while 35 percent of senior thought that the idea of private retirement accounts was not a good idea, 41 percent thought it was a good idea. So, a plurality of senior citizens think this is a good idea as well.

Mr. MYERS. Senator, might I come in on that, because I have looked into this matter very extensively over the years. I went to Chile, at the request of the Chilean government, twice to look at their plan, how it is working, and so forth.

Individual retirement accounts are a great idea, if they are built on top of a base of Social Security. The difficulty with individual retirement accounts is that those who are wealthy, and have a high income, will do fine. They think that it is a great idea, as the respondents in this survey said. But they do not realize that, for the lower-income people, the amount accumulated will not be very large, so that there will have to be supplementary public assistance. This then brings on all the problems of public assistance, including all the intrusion into people's private lives, the possibility of fraud and abuse, and so forth.

The Chilean system is not well understood in this country. It involves not only these individual retirement accounts, but also huge amounts from general revenues. They happen to have general revenues available, and we do not. The Chilean system, as I told the Chileans, was fine for the particular problem that they have, but it was not necessarily transferrable to other countries, and particularly not to the U.S.

Our system is working quite well and, according to the saying, "if it ain't broke, don't fix it."

Mr. MURDOCK. May I respond to that.

Senator MOSELEY-BRAUN. Well, my time has actually run out, Mr. Murdock.

The CHAIRMAN. Go ahead.

Senator MOSELEY-BRAUN. The question I wanted to raise with you has to do with the whole issue of, (1) what happens when lower-income people, and (2) for everybody, low-income and high-income alike, the whole solvency issue. There is a huge problem with unfunded pension liabilities out there in the private sector.

And, if Barrens can go belly-up after 400 years, since 1787, if a venerable institution like that can go belly-up, who is to say that one of these private pension systems might not, at some point, go belly-up. And you would wind up with a situation where people who have invested their retirement security, will not have anything to fall back on, will not have the security, if you will, of the safety net that Social Security has always provided, the full faith of the United States Government backing up a system of retirement security.

You do not get that on the private side of the equation. Given the level of unfunded pension liabilities out there, I think that is something that folks are talking about. I support IRA's and private pension plans and the like. But, at the same time, using that as an exclusive answer, I think poses almost as many questions as it answers.

Mr. MURDOCK. I am also concerned about the problem of unfunded pension liabilities in private companies. This is something which has been brought up in the auto industry, for example, and there have been some accounting reforms that companies now are employing to declare their pension liabilities on their books.

But again, I think that is yet another argument for private retirement accounts, so that if I am working for IBM the first 10 years of my career, and then I go to work for General Motors, I can take that money with me. And IBM does not have to worry about perhaps having a bad investment, or having people in their accounting department who might be 28 years old, run off with the money, and hop on a yacht, as this gentleman did in Singapore.

I would really like to see a situation, and people in Third Millennium want to see the situation, where we control these assets, we invest them ourselves, and we neither have to rely on the U.S. Government, nor on large private employers.

Senator MOSELEY-BRAUN. Yes, but what if you make a mistake? Inevitably, there are winners and losers when you are talking about investing money. What is you make a mistake? There you are, 74 years old, you cannot work, the company just declared that it is belly-up and your pension just went with it. You are not eligible for Social Security at this point because you did not put a dime in it. Where are you going to go?

Senator MOYNIHAN. You just made a great argument for grandchildren. [Laughter.]

Mr. MURDOCK. That is a good point.

There are winners and losers in Government as well. And I think, with Social Security, we see a situation where there are winners and losers.

Without means testing, which is the situation we are in today, there are people who are quite affluent, quite wealthy, who are collecting Social Security. And there are people my age who are working in minimum wage jobs in order to subsidize their retirements.

So you do have winners and losers in the public sector, as it is now.

Specifically, to your concern about a pension fund going belly-up, or something like that, I think it would be perfectly appropriate to have U.S. Government agencies provide supervision to make sure that these companies invest in investments that are not overly risky or——

The CHAIRMAN. We did. We supervised the S&L's.

Mr. MURDOCK. Not very well, obviously.

The CHAIRMAN. Correct, but it was Government supervision.

Mr. MURDOCK. Not terribly well.

The CHAIRMAN. So do not place too much faith in Government supervision of these pension funds that Senator Moseley-Braun is talking about.

Mr. MURDOCK. I would also say that we would have a much better situation if the Government merely said that, if there is a tremendous disaster like you described, we would provide a guaranteed minimum pension, as Chile does, to those people where there is a problem versus the situation now where——

Senator MOSELEY-BRAUN. But that is what we have got.

Mr. MURDOCK [continuing]. We provide for everybody, not people who are running into economic problems. There are people who are very wealthy who are collecting pensions now, not just the people who are running into financial problems.

Senator MOSELEY-BRAUN. Yes, but the guaranteed system you are talking about, that is what we have got. It has got problems but, bottom line, you know that the good old US of A is going to be there for you, in most cases. Now, there are some people who fall outside of Social Security, but right now that is what we have got.

And, if you say let us ditch that, and let all the bright young people who can work on Wall Street and go and have private plans, that is great while you are still a bright young person, but what if you get to the point where you are 74 and the plan goes belly-up? You are in trouble.

Mr. MURDOCK. I am talking about a model along the lines of Federal Deposit Insurance for banks. The Government does not go in and give every person money when the person retires or closes a bank account.

However, if there is a disaster, the Government has stepped in and aided those people where there is a financial calamity.

Now, in the retirement area, we could have a situation where we say to people, invest your own retirement assets. We do not expect there to be problems. If there is a pension fund that goes bust, we will guarantee people's retirement incomes in those cases. And those people who have healthy pension funds will benefit from the healthy pension funds.

It is a very different argument to say that Government will take care of those people where there is an emergency or calamity, versus Social Security, where we take care of everybody.

When Ross Perot retires, he will get Social Security, and I will be subsidizing the next ranch he buys. I think that is unjust, and an injustice that desperately needs to be corrected.

Senator MOSELEY-BRAUN. Thank you.

The CHAIRMAN. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

I guess I am just to ruminate here until my time runs out, and then I may have a question.

I remain a little perplexed. Senator Simpson and I had an engagement yesterday on the subject of Medicare. And it is interesting because Medicare and Social Security do interact. They have effects on each other, and the totality of what happens affects seniors enormously.

Let me just say a couple of things. We were discussing yesterday, on the Medicare side of things, that it is going up at 10 percent a year. It was felt, I think, according to the discussion, that Medicare could not control itself, did not know what it was doing, and the rest of it.

I want to make a point or two on that. One, Medicare, like any other health index, is made up the following things. Medicare, and what happens to the cost of it is the number of people who become eligible for it each year, which is rapidly advancing. That number is growing more rapidly all the time.

It is also a factor that the cost of health care, a kind of medical inflation index, is rising, and at this point the government has not decided to try and contain health care costs. We did not have comprehensive health care reform. So the cost of health care is something that we have decided we do not want to attend ourselves to.

And, also, it is the number of incidents of health care that any Medicare individual has. So, it is growth in population, plus the cost of health care, then the number of incidents of medical engagement. And then, on that you have the rising cost.

Now Medicare, it needs to be pointed out to people who think otherwise, is not an inefficient program. In fact, there is no corporation in the United States of America which comes anywhere close to being as efficient as Medicare is. I believe its overhead and administrative costs are 2 percent, which is absolutely extraordinary. This includes all the bureaucrats and everything else, all the telephone calls, everything that goes on, 2 percent. That is not bad.

Now you get to the Social Security problem, and I am perplexed, Mr. Chairman, a little bit by the GOP Contract, in which they would in effect repeal the 1993 tax increase for the seniors earning over $34,000 single or $44,000 couple. That is $15.5 billion a year over 5 years. And then a dramatic liberalization of the Social Security earnings income limit, which would cost about $7.6 billion, presumably, over the same period of time. And then the complete repeal, which Senator McCain talked about this morning, would cost about $27 billion, almost $28 billion, over 5 years.

And I am trying to figure out is, how one does that. You are looking at Medicare, which is increasing, and you then look at the idea of these revenue reductions which, at the least, come to $15.5 billion. And then I get a little bit skeptical. How do we merge these two things? What do we really need to focus on, in terms of the long-term solvency of Medicare, the long-term solvency of Social Security.

If we are talking balanced budget amendment or, if that does not pass, then we are talking about trying to balance the budget, as the cost of Medicare is going up. It is going to be very hard to control Medicare costs until we control the cost of health care because, in the year 2000, which is only 5 years away, the cost of health care is going to be 24 percent of the Federal budget. A lot of that, of course, will be Medicaid and Medicare.

Now, in the meantime, Social Security has kept 38 percent of the people of America off poverty. And, in my State, West Virginia, in an average nursing home, 75 percent of the patients are paid for by Medicaid. So these matter cannot be considered lightly.

So I guess I would just express substantial concern that we seem to be trying to liberalize on the one hand, and then worrying about the future of the trust fund on the other hand. And I think that is a very substantial worry.

Senator Moynihan, and others on the Greenspan Commission in 1983, made major contributions to stabilizing the trust fund. But I will admit that I am worried, I am concerned, because we have conflicting views. Some want to liberalize, some want to cut back. And, when you are dealing with something like Social Security, and you are dealing with something like Medicare, which I think is tremendously misunderstood by most Americans, and they say, well, put people in HMO's. Well, you put people in HMO's and it actually costs Medicare more money. It costs more money to put them in HMO's because the people who go into HMO's are healthy and do not need what HMO's have to offer.

So I am just probably in one of the least cogent expositions that the Finance Committee has seen in the last 10 years to simply express a series of concerns and worries, Mr. Chairman.

I thank you for your indulgence.

The CHAIRMAN. Senator Moynihan, go ahead and ask. I am trying to figure out something.

Senator MOYNIHAN. I have no further questions. I want to thank the panel. You have been very helpful.

I wonder if Mr. Murdock could send us that UFO study?

Mr. MURDOCK. I would be more than happy to do that.

Senator MOYNIHAN. Thank you.

[The article appears in the appendix with Mr. Murdock's prepared statement.]

Senator SIMPSON. Mr. Chairman, I would like to ask another question, if I may. Is there one more round? Am I out of order here?

Senator MOYNIHAN. You are in order.

Senator SIMPSON. Thank you, Mr. Assistant Chairman. [Laughter.]

Senator MOYNIHAN. Chairman Emeritus?

Senator SIMPSON. Let me ask Martha McSteen and Max, they are both here, and they are both very good at their work. I want to ask you about notch babies. Have you given up juicing up your membership about notch babies?

Ms. MCSTEEN. Senator, you know that the National Committee has supported this through the years, because of its membership's interest in the notch situation. We certainly have indicated to you, and to others, that with the Notch Commission report when it was issued, we would accept that report.

That does not say that our members are not still vitally interested in the issue because they perceive it, as some of the issues we have talked about today, as really unfair.

They do see the Social Security trust funds as being healthy. And, actually, they feel that the intent of Congress was not to have a drop in the notch, as did occur because, rather than the 10-year phase-in, it was 5 years.

This has been a very difficult issue for me, and for the Committee. But I am saying to you, even though we do not do anything about it, there are a lot of people in this country who are notch babies, who feel an unfairness.

Senator SIMPSON. Would your group then, Martha, send them a copy of the final report on the Social Security notch issue of the Commission, and put their heaving bosoms to rest. Because there is nothing we can do legislatively—nothing. And, in fact, it shows why Senator Moynihan and Company had to do what they did because these people were receiving 66 percent of the replacement rate instead of 43.

And so that is what we did. These people have not diddled. And I want to know if you are going to continue to mail material out to your membership in any way, other than maybe to ask them how they feel about the issue. Are you going to gin up you troops on the notch baby issue continually?

Ms. McSTEEN. No.

Senator SIMPSON. Thank you.

Martha, that was the most extraordinary answer I have ever had. That is enough. I would not go an inch further. But let me ask you another thing.

You stated that, according to the SSA, seniors who do work have about twice the total income of seniors who do not work. Now that is an interesting statement.

Current law there is a huge disincentive to work, when these statistics prove that, if seniors do work they earn double, compared to those who do not work. Now, does that not chop the argument that, under current law, there is some disincentive to work?

Ms. McSTEEN. Well, I think, under the current law, there is a disincentive to work because you have to pay back if you make more than the earnings limit, as you know.

It is a difficult issue, and I do not think we know it all.

Senator SIMPSON. All right. I think we need to do more.

Ms. McSTEEN. We do not know what is going to happen. Maybe there will not be very many people going back into the labor market. Certainly, the administrative costs in Social Security are tremendous in trying to control the misunderstandings and the overpayments.

Senator SIMPSON. I just think if we are going to show figures, that seniors who work make twice the income of seniors who do not work, there is something there cutting against the fact that there is some present disincentive. How is there a disincentive? If you work, you make double what the guys who do not work.

Ms. McSTEEN. It is only in reference to the suspension of benefits.

Senator SIMPSON. And, finally, I just want to share my own situation. Again, I did not bring my little chart, but Senator Moynihan had his. I have just computed now what I will receive under Social Security. You were asking what people receive back.

Remember, here is how it works. If you retired in 1960, and a minimum earner, you got all yours back in half a year. If you were an average earner, you got it all back. This is your employee OASI taxes. In 1995, a minimum earner will get it back in 5.8 years. The average earner will get it back in 8.1 years, and the maximum earner 10.7 years, with life expectancies, of course, increasing all the time.

But, in my own situation, and calling attention to what you say, you keep saying that upper-income workers have paid for their Social Security benefits. That is like a cry from the cliffs of the National Committee. I hope that you would send them the form, that your members would receive the form showing, like my own, that in my first job at the age of 15, and then the Army, and college, where I did not even earn enough to pay. And, in 20 years of practicing law, I never paid in over a thousand bucks. And at 65, I will have paid in 48 thousand bucks over the whole history of my Social Security. And this was maximum. I was paying the maximum self-employed. I will have paid in 48 thousand bucks, and at 65 I will get a check, and the total annual payment to me will be about 14 thousand bucks.

And so, I will get it all back, every penny of it, plus interest, in between 4 and 5 years. And my mother lived to be 94, and my father lived to be 95. I cannot wait. [Laughter.]

Thank you.

Senator MOYNIHAN. But what I want to know is why are you not a Democrat?

Senator SIMPSON. There are many who think I am, in certain areas.

The CHAIRMAN. Either Mr. Myers or Ms. McSteen, let me pose this question.

The argument about our Social Security trust fund, and we get this in part from your mailings, there is this tremendous surplus. We are taking and robbing from Social Security to pay for defense and what not now. I am not going to get into that argument.

I want to talk about Medicare. This year, we will pay out more money in Medicare Part A than we take in. We have been subsidizing Part B for years at three-quarters of its cost. And the HI fund has had Government bonds. Between now and 2001, we will redeem those bonds. In 2001, the bonds are gone, there is no more money. Now we are bankrupt, in the normal sense of the word.

The argument cannot be made that we are robbing the Medicare fund to pay for defense or something else.

Assuming that Social Security wants to be off budget—there are those who are saying put it off budget—what do we then do about Medicare?

You are now off budget. You have asked to be off budget. Do we say, all right, Medicare recipients, you are now going to be limited in benefits to the income we have coming in. I would appreciate your comments.

Ms. MCSTEEN. Go ahead.

Mr. MYERS. Mr. Chairman, I think that the real answer to that problem is that something must be done to the hospital insurance portion of Medicare long before this occurs.

The CHAIRMAN. It is only 5 years away.

Mr. MYERS. Yes. And it should be done now. And it should be, possibly like in 1983, partly on the income side, higher payroll taxes, and partly by reducing benefits, make people pay more, such as a small amount for every day that they are in the hospital. But something has to be done about that situation because, as you well put it, if it was just the HI trust fund, they would like that to be off budget.

The CHAIRMAN. They would like that to be on budget I think, and have it funded out of the general fund when we run out of money for redeeming the bonds.

Mr. MYERS. Yes. And it is going to be a problem redeeming those bonds because the fact is that, on the other side, the Social Security trust funds are buying the bonds.

But one point I might mention is that, if this ever happened, if this scenario took place—I do not think it will, because I am sure Congress will take some responsible action—when the trust fund reached zero, the system would not just collapse. What would happen is that the hospitals would be paid increasingly later. Instead of the bill being paid when due, it would first be 3 days late, then 5 days late, and so forth. It is the same thing with Social Security.

If the scenario comes true that, in 2029, the trust funds run out of money, the system does not stop. Rather, what happens is that people, instead of getting benefits for the first following month on the 3rd of the next month, will get them maybe on the 5th, and then the next month on the 7th. Of course, there would be sort of a revolt among the beneficiaries if this happened, but the system does not go bankrupt like a store and close its doors. There would be all these delays, which, of course, would be untenable.

The CHAIRMAN. No, it does not, but it may come to Mr. Murdock's generational battle. This comes early. We are talking about Medicare now, which is going to come in the next 5 years, and we are either going to raise the taxes, or we are somehow going to, if not restrict the benefits, ask the beneficiaries to pay more. I am not sure Ms. McSteen's group will be wild about the beneficiaries paying more.

Mr. MYERS. I think that, on the Social Security side, changes should be made now, even though it is 30 or more years off before the fund balance is estimated to be exhausted. As to changes, I like the approach of some on the income side and some on the benefit side. I believe that we should raise the retirement age, and have a little higher tax rate some years later. But I am strongly opposed to any means testing of the benefits. Income taxing, yes. But not means testing, because I think that will discourage people from saving, which is the opposite of what the advocates want. Many people would say, look, they are taking some of my Social Security away now. When I get to be retirement age, they will take it all way. Why should I save, and have my Social Security benefits reduced?

Also, there will be much fraud and abuse. People will transfer their assets, or hide their assets and income. Means testing benefits is just a bad thing all around.

The CHAIRMAN. Ms. McSteen, what should we do about the Medicare fund?

Ms. MCSTEEN. Well, let me say first of all that the Medicare system has really served its population very well. That is not to say there are not a lot of problems with it, both in fraud and abuse, and the high cost. But I do not think we should single out just Medicare. It is not just Medicare that is creating the problem. It is health care costs escalating all across the population.

And the administration led an effort last year to try to improve our health care system. We still have to address the health care system overall. I am not trying to avoid answering, but I certainly think we have to look at how the system is used.

Many people use the system—I am not talking about Medicare—i.e., going to the emergency room, for example, for a toothache or their child has fallen and hurt themselves because it is more convenient.

So we just simply have to face up to the fact that health care costs us when we use the system, and we have to make choices.

The CHAIRMAN. I understand. But I want to ask you one more. I remember Dr. Reischauer sitting at the center of this table and saying, if we adopt this plan, it will save us 1 percent of our gross national product, but will reduce it a full 1 percent on medical costs. And David Durenberger said, well, what do you mean by that?

Well, he said, it will reduce it from 20½ percent to 19½ percent of our gross national product. At which time, Senator Durenberger said, well, it is 14 percent now.

And this, he said, was if the plan worked perfectly, if all the cost containments worked perfectly, if everything went as planned, our medical costs still skyrocketed.

Maybe that would have meant, if the plan worked perfectly, that Medicare went bankrupt in 2002 or 2003, instead of 2001. Maybe we would have contained the costs enough to pick up a couple of years.

The financing of it still runs out, plus or minus a year or two, from 2001. All I am asking is what should we do? Fine, we adopt health care, we save all the costs we can. It does not solve our financing problem on Medicare. What should we do?

Dr. Myers says we have either got to go to copayments or deductibles, or something, or increase taxes, or a combination of something. But this is not 25 years away, it is 5 years away. What do we do?

Ms. MCSTEEN. Well, I think we are all perplexed by what we would do, not only with Medicare, but also with Social Security.

And, fortunately, we have the Social Security Advisory Council now meeting. Certainly we can look at the investment policies we now have, and try to make a determination as to whether a portion of those trust funds can be invested in the infrastructure. We can certainly look at increasing the retirement age, although I would say that there are certain jobs in the marketplace where you would be required to work until 72, such as coal mining.

But there are certainly things, if you make a concerted effort, as in 1983, to bring the system up. I think we can do the same thing with Medicare, if you are going to focus just on Medicare. But I think there are things that can be done in the health care arena without a major cost of trying to cover everything, but to try to make health insurance affordable for all Americans, for example, to address the issue of malpractice and tort reform. Those are the kinds of things that we have to address. But there is no easy solution, or we would have already addressed it.

The CHAIRMAN. President Clinton has all of that in his bill. He had universal coverage. He had malpractice reform, as I recall. Do not hold me to that, I cannot remember. He had cost containment. He had everything in it. And, if it worked perfectly, our health costs would still skyrocket. And Medicare would still have been out of money, with or without his health plan.

All I am asking is, given that, what should we do. And I am not talking about 20 years. I mean this year, next year. What should we do?

Ms. MCSTEEN. Well, I wish I had the answer. Certainly we are all coping with it, trying to come up with it, trying to come up with an answer. It is a serious issue, and we have to approach it in a reasonable manner, whether we give more in tax or larger copays, the numbers have to be crunched out.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Thank you, Mr. Chairman. I have very much enjoyed the hearing.

The CHAIRMAN. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

The CHAIRMAN. We are adjourned. Thank you very much.

[Whereupon, at 11:51 a.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED

PREPARED STATEMENT OF BRUCE BARTLETT

The nation's elderly pay higher tax rates than any other Americans because as much as 85 percent of their Social Security benefits are subject to taxation. They can even be taxed on tax-exempt income through the device of the Social Security benefits tax. In addition, they face special penalties on earnings if they work to replace the income lost to high taxes. The situation is such that the marginal tax rate for some elderly people can exceed 100 percent.

I will address the Social Security benefits tax first because it affects the largest number of retired persons.

Social Security benefits were entirely free of taxes until 1983, when Congress voted to tax 50 percent of benefits above a certain income level. Congress, at the recommendation of President Clinton, raised this to 85 percent in 1993. The Clinton administration called it an "entitlement spending reduction," but it was in fact a tax increase on the investment income and wages of elderly Americans. The Social Security Administration estimates that approximately 3 million families paid higher income taxes in 1994 as a result of the expanded Social Security benefits tax. The average tax increase was about $1,000, or 7.6 percent of the Social Security benefits of the elderly and disabled affected by the change.

The real impact of the tax is far greater. Because of the Social Security benefits tax, the savings and retirement plans of the vast majority of young people are much less valuable.

How the Tax Works. Just calculating the Social Security benefits tax is enormously complex. Beneficiaries must first add up all their non-Social Security income—wages, investment income—even any tax-exempt interest (such as from municipal bonds). Then they add to this sum 50 percent of any Social Security benefits they received. If the total is greater than $25,000 for a single person or $32,000 for a couple, one-half of the excess amount is included in taxable income.

Before the 1993 law, additional federal income taxes were paid on up to 50 percent of benefits. Under the Clinton tax increase, 50 percent of benefits are taxed until taxable income reaches $34,000 for singles and $44,000 for couples. At that point, 85 percent of benefits become taxable up to the point at which 85 percent of total benefits are included in taxable income. The whole process is every bit as confusing as this description makes it sound.

Higher Tax Rates for Non-Social Security Income. Despite its name, the Social Security benefits tax is not really a tax on benefits. It is a tax on other income. No tax is paid unless a taxpayer's income reaches a certain level. Beyond that point, the tax rises as income rises. Since 85 cents of benefits is taxed for each additional $1 of income, when elderly taxpayers earn $1 they pay taxes on $1.85. The effective tax rate on their income is 85 percent higher than it otherwise would be.

Taxing Savings. About 60 percent of the income of elderly taxpayers comes from investments (including pensions). For most younger people, the tax rate on investment income is 15 percent or 28 percent. For the elderly, the Social Security benefits tax raises the rate on income from savings by as much as 85 percent.

- Elderly taxpayers in the 15 percent income tax bracket pay an effective rate of 27.8 percent (15% x 1.85).
- Elderly taxpayers in the 28 percent tax bracket pay an effective rate of 51.8 percent (28% x 1.85).

Taxing Wages. Perhaps the most insidious effect of this policy is to severely penalize moderate-income elderly persons who must continue to work after age 65. This is especially so in light of the fact that Social Security benefits are already reduced (actually, taxed) by the limit on earnings. The earnings penalty reduces Social Security benefits by $1 for every $3 of wage income earned above $11,280 per year for workers age 65 to 69—a 33 percent marginal tax rate- and by $2 for every $1 of income earned above $8,160 per year for those age 62 to 64—a 50 percent marginal tax rate.

To see how this affects an elderly wage earner, let's consider a single male worker between age 65 and 70 whose earned income plus one-half of his Social Security benefits puts him at $25,000. If he earns one additional dollar he will lose 33 cents worth of benefits, and he will pay 15 cents in federal income taxes and 7.65 cents in FICA payroll taxes. One-half of his previously tax-free Social Security benefits are now taxable; after considering the loss of benefits due to the earnings penalty, the Social Security benefits tax results in a marginal rate of 5 percent on the additional dollar. Put all this together, and this worker in the 15 percent income tax bracket has to pay a marginal tax rate of more than 60 percent on that additional dollar he earns above $25,000 per year. Thus, we have a wage earner taking home 40 cents of each additional dollar of earned income.

Workers in the 28 percent marginal income tax bracket face even higher marginal tax rates. In addition, at least 15 states tax Social Security benefits. And workers who are self-employed face an additional 7.65 percent in FICA taxes. We have calculated that it is at least theoretically possible for a self-employed elderly worker living in Montana to face a marginal tax rate of 130 percent.

Hidden Effects. Because of the way income tax returns are organized and because of the complexity of the tax system, many elderly taxpayers do not realize that the Social Security benefits tax actually taxes other income. Many also are unaware of how far-reaching it is. The Social Security benefits tax reaches capital gains income, tax-exempt income and Social Security COLA increases. And because many states accept the federal definition of taxable income, it increases some state and local income tax rates by 50 percent.

- Capital gains income is subject to the 52 percent top rate for Social Security recipients versus 28 percent for others.
- Tax-exempt income of the elderly can be taxed at a rate of 24 percent versus a zero rate for younger taxpayers.
- Social Security cost-of-living adjustment (COLA) increases are taxed at a rate as high as 12 percent.

Why the Social Security Benefits Tax Also Taxes the Young. Congress created a special tax status for employer-provided pensions, IRAs, 401(k)s, Keoghs and SEP (Simplified Employee Pension) plans to encourage retirement savings. The law allows people to avoid taxes now and defer them until their retirement years on the theory that most income will be taxed at lower rates after they retire. That is no longer true for many young workers.

- The average U.S. worker is in the 15 percent income tax bracket today.
- Because of economic growth and because of the Social Security benefits tax, many of these workers will see their retirement income taxed at a rate of 52 percent.

Taxing 85 percent of Social Security benefits is not merely taxing the elderly. The provision has decreased the after tax value of most American workers' pension plans.

Hurting Those With Middle Incomes. The incentive effects of the increase in taxes on Social Security benefits fall primarily on those with middle incomes. According to the Social Security Administration, 42 percent of those paying increased taxes on their Social Security benefits in 1994 earned more than $78,034. However, higher marginal tax rates on non-Social Security income begin to affect taxpayers with incomes as low as $25,000.

Those with no income other than Social Security or only modest additional income are unaffected by the benefits tax. And those with very high incomes already pay taxes on 85 percent of their total Social Security benefits. Only those in the middle face the sharply higher marginal tax rates.

The 1993 increase in the Social Security benefits tax increases federal revenue by less than $5 billion per year. But the ultimate economic cost is huge, since the tax creates a powerful disincentive for many elderly Americans to work, save or invest. By the year 2000, the Social Security benefits tax will cause an $84.4 billion reduction annually in gross national product and federal revenue will be $10 billion lower than it otherwise would be.

Those who favor taxing Social Security benefits say that the beneficiaries paid for only a small portion of their benefits through payroll taxes. Even if this argument is accepted, why should Social Security beneficiaries not be taxed at the same marginal tax rate as all other taxpayers? One way to do this would be to have a portion of Social Security benefits included in the ordinary income of elderly beneficiaries—

taxable at ordinary income tax rates. This would leave the elderly facing the same marginal tax rates as younger taxpayers. Exemptions could be raised to prevent undue hardship for the low-income elderly without increasing marginal tax rates.

The other area that cries out for legislative correction is the earnings penalty on elderly workers. As mentioned before, the retirement earnings penalty reduces Social Security benefits:

- By $1 for every $2 earned above $8,160 by those ages 62 through 64.
- By $1 for every $3 earned above $11,280 by those ages 65 through 69.

There are 42 million-plus Americans age 60 and over. They represent a vast store of human capital, rich in talent and ability. Yet this valuable resource is increasingly wasted.

- In 1930, before Social Security, 54 percent of men age 65 and over were in the labor force.
- Today the labor force participation rate of men age 65 and over is about 16 percent.

A big reason for the change is government policy. If elderly workers under the age of 70 want to improve their standard of living or continue using their work experience and skills, the government takes the bulk of their additional wages through the earnings penalty. Faced with the earnings penalty in addition to other taxes, many elderly workers simply drop out of the system.

Effects on Elderly Workers. About 1.9 million retired workers ages 65 to 69 who are eligible for Social Security benefits have earnings. An extraordinarily large number of them earn up to (or near) the earnings limit and then quit working. Specifically:

- About 400,000 elderly workers earn annual wages within 10 percent of the earnings limit.
- These workers apparently earn all they can without being subject to the retirement earnings penalty.

No doubt many others pass up full-time or part-time work because of the earnings penalty. And no doubt still others work in the underground economy, receiving unreported cash or some other form of payment.

Why Have an Earnings Limit? The retirement earnings limit has been part of Social Security since its inception. The original reason given for it was that Social Security should replace lost earnings. Benefits, it was believed, should not go to people who continued to work. This policy was consistent with the Depression-era view that Social Security should encourage older workers to leave the workforce, making more jobs available for the young.

Times have changed. The United States now faces a shortage of workers, not a glut. The continuing labor force participation of older Americans, who possess valuable skills acquired over 30 or 40 years, is increasingly important to the health of the U. S. economy.

Washington has been reluctant to change the Social Security earnings penalty, partly because of a fear that the change would cost the Treasury billions in lost federal revenues. An econometric analysis by NCPA Senior Fellows Aldona Robbins and Gary Robbins showed that fear to be unfounded. The analysis found that increasing the earnings limit, or eliminating it altogether, would result in the federal government's receiving more in new work-related tax revenues than it would lose in increased Social Security benefit payments.

Effects of Increasing the Earnings Limit. The Social Security benefits of some 750,000 elderly workers are partially withheld because their wage income exceeds the earnings limit. If each of these workers were allowed to earn an additional $1,000 without penalty, benefit payments would rise by about $37 million. However:

- The workforce would increase by the equivalent of 60,000 to 70,000 full-time jobs.
- The federal government would receive an additional $563 million in taxes on increased earnings and another $134 million in taxes because of an increase in capital income.
- On balance, the total increase in new revenue ($697 million) would exceed the total increase in new Social Security spending ($37 million) by $660 million.

Raising the earnings limit by $1,000, then, would result in a net increase in federal revenues and a reduction in the federal deficit.

Effects of Abolishing the Earnings Limit. Eliminating the earnings limit altogether for retired workers between the ages of 65 and 69 would increase labor and capital income, thereby increasing federal tax revenues. It would also increase the amount of Social Security benefits paid, thereby increasing federal spending.

- The number of elderly workers with some wage income would rise from 1.9 million to 2.6 million—an increase of 38 percent.

- The additional work effort would increase the wage income of all elderly workers by $10.3 billion.
- The federal government would be obligated to pay an additional $4.8 billion in Social Security benefits, but would collect $4.94 billion in additional taxes, for a net increase in federal revenue of $140 million.

In summary, taxing 85 percent of Social Security benefits and exacting an earnings penalty on Social Security beneficiaries are both bad policies. It would behoove the Congress to at least roll back to 50 percent the portion of benefits subject to income tax and to raise or even eliminate altogether the earnings penalty—the first in the interest of fairness, the second because of the psychic and economic benefits that would ensue.

Prepared Statement of Senator Charles E. Grassley

Mr. Chairman, I want to thank you for holding this hearing on these issues. I have supported for a long time now relaxation of the Social Security retirement earnings test. And I offered an amendment in this committee in 1993 to strike the increase in the percentage of Social Security benefits subject to the personal income tax.

I find it hard to believe that many more older people would not contribute through paid work were they not faced with such steep marginal tax rates. So, bringing their marginal tax rates more into line with those facing other workers is certainly something I support.

Thank you.

Prepared Statement of Congressman J. Dennis Hastert

Mr. Chairman, let me first congratulate you on your rise to the Chair of this Committee and thank you for the opportunity to testify before you today.

I am here this morning to speak on behalf of H.R. 8, the Senior Citizen Equity Act of 1995, and similar legislation in the Senate. This legislation, included in the House of Representatives "Contract with America," enables seniors to remain independent and self-sufficient. For far too long, we have penalized our working senior citizens unfairly, forcing them to pay taxes at rates higher than those assessed on millionaires. But then, on top of that, two years ago, Congress voted to force thousands of seniors to pay increased taxes on their Social Security benefits to help pay for other government programs. In addition, we have left seniors without incentives to pay for long-term care insurance, and public housing officials are uncertain about what constitutes a senior housing community. It's time that we address these inequities and problems. The Senior Citizen's Equity Act accomplishes that goal.

Each provision of our bill is critically important, but let me begin by focusing on lifting the Social Security Earnings Test—an effort I've undertaken every year since coming to the Congress.

Specifically, Title I of the Senior Equity Act gradually increases the amount of income seniors can earn before the government reduces their Social Security benefits.

As I'm sure you would agree, Mr. Chairman, the idea that we currently severely penalize hard-working seniors who make less than a thousand dollars a month is unconscionable.

Under our proposed legislation, seniors of retirement age would be able to earn approximately $4,000 more each year for the next five years, raising the earnings cap to $30,000 by the year 2000. Compare that for just a moment with the increase that occurred under current law. In 1994, a 65 year old working senior could only earn $11,160 before being penalized. In 1995, this same senior can now earn $11,280, a difference of a mere $120. *Seniors need relief and they need it now.*

This proposal is helping those that need it the most. Seniors who are independently wealthy, or have stashed away money for their retirement years, are able to receive that income and also receive their Social Security benefits. But those who have not been able to save and invest over the years, and must continue to work, are severely penalized for doing so. We are, in effect, punishing them for not being rich.

We are also punishing society as we strip the most experienced and knowledgeable sector of the work force from full time service. As we work to prepare our economy to meet the challenges of the new global marketplace, we need the years of experience and expertise that our senior citizens have accumulated. I have been told numerous tunes by businesses that some of their most valuable employees quit half-way through the year because they have reached the earnings limit. These are the real life stories that affect seniors and businesses.

Title II of the Senior Citizen Equity Act specifically repeals the Social Security tax increase that was part of President Clinton's '93 budget. Our bill phases out the tax increase over a five year period. Next year, the tax increase is reduced from 85 percent to 75 percent, with additional reductions in 1997, '98 and '99. In calendar year 2000 the tax on Social Security benefits would return to the 50 percent level.

Back in 1993, I went before the House Rules Committee seeking to offer an amendment to strip this tax on seniors out of President Clinton's budget. The tax costs Illinois seniors $183 million per year, and seniors in the 14th district of Illinois $7.4 million. We should not be taking this money out of the pockets of seniors. Of course, I was not allowed to offer the amendment back in 1993.

Mister Chairman, it is my belief that Congress broke faith with the American people in increasing the tax on Social Security benefits in 1993. The Social Security program was established as a "trust" for the American people, a safety net that would assist them in their later years of life. Those who have paid into the system have done so with the faith that government would do nothing to jeopardize their benefits. Yet, that is exactly what we did in increasing taxes on those benefits by $25 billion. The 1993 action by Congress imposed exorbitantly high income tax rates on senior citizens simply because their earned and unearned (in some cases, supposedly non-taxable) income added to half their Social Security benefits equalled as little as $34,000 a year. It also set a dangerous precedent, Mister Chairman. For the first time, monies within the Social Security Trust Fund were diverted for a purpose unrelated to Social Security.

Mister Chairman, some have argued that we can't adopt this legislation because it will increase the deficit. But Americans know that the Federal budget deficit is not the result of them paying too little in taxes. Rather, it is the result of the government spending too much.

We in the new House majority are committed to adopting this legislation, along with the rest of the "Contract with America," and will do so without increasing Federal outlays. Discussions among members of the House leadership and the Ways and Means Committee have begun to address those questions, and I am awaiting word on the results of their efforts. One thing is clear—*the bill will be paid for with spending reductions prior to passage.*

I am hopeful that the new majorities in both the House and Senate will move to raise earnings limit and adopt the other provisions of this legislation as soon as possible. As recently as last November, H.R. 300, the "Older Americans Freedom to Work Act," a bill that completely repealed the Social Security earnings limit, had 225 cosponsors. Under the previous House leadership, though, while that was enough to pass the measure on the floor, no vote was ever allowed. I am glad to see that will no longer be the case.

Mr. Chairman, I commend this legislation to the attention of this Committee and urge its speedy adoption. I'm sure we can all agree that government should work on behalf of the people, not unfairly force the people to work on behalf of their government.

Prepared Statement of Senator John McCain

Mr. Chairman, I would like to thank you and the Finance Committee for holding today's hearing on two critical issues facing senior citizens, the Social Security Earnings Test and the increase in taxation on Social Security benefits. I am honored to be testifying today on behalf of our nation's senior citizens about the important issue of repealing or at least raising the Social Security Earnings Test for older Americans between the ages of 65 and 69 and repealing the increase in taxes on Social Security benefits. I am pleased to be testifying about these important issues along with my good friend Martha McSteen, the President of the National Committee to Preserve Social Security and Medicare. Ms. McSteen and the Committee to Preserve Social Security and Medicare have been diligent in their fight to repeal the overburdensome Social Security Earnings Test as well as working to eliminate the unfair increase in taxes on Social Security benefits.

As you know, the Social Security Earnings Test legislation was created during the depression era when senior citizens were being discouraged from working. This may have been appropriate then when 50 percent of Americans were out of work, but it is certainly not appropriate today. It is not appropriate today when seniors are struggling to get ahead and survive on a limited income. Many of these seniors are working to survive and make it day to day.

Another financial obstacle seniors are facing is the increase in taxation on Social Security benefits contained in President Clinton's 1993 budget package. This measure has one of the biggest impacts on the middle income seniors. High taxes affect their abilities to work additional hours, sell assets and realize other types of income. My good friend and colleague, Senator Jon Kyl has persevered in his battle to repeal the 85 percent increase in taxes on senior citizens. He has introduced S. 50, the Tax Increase on Social Security Benefits, repeal in effort to rectify this matter for our nation's seniors. I applaud him for his dedication to the needs and concerns of the elderly.

Most people are amazed to find that older Americans are actually penalized by the Social Security Earnings Test for their productivity. For every $3 earned by a retiree over the $11,160 limit, they lose $1 in Social Security benefits. Due to this cap on earnings, our senior citizens, many of whom are existing on low incomes, are effectively burdened with a 33.3 percent tax. Combined with Federal, State and other Social Security taxes, it will amount to a shocking 55-65 percent tax bite, and sometimes even more—Federal tax—15 percent, FICA—7.65 percent, earnings test penalty—33.3 percent, State and local tax—5 percent. Obviously, this earnings cap is a tremendous disincentive to work. No one who is struggling along at $11,000 a year wants to face an effective marginal tax rate which exceeds 55 percent.

This is unquestionably an issue of fairness. No American should be discouraged from working. Unfortunately, as a result of the earnings test, Americans over the age of 65 are being punished for attempting to be productive. The earnings test doesn't take into account an individual's desire or ability to contribute to society. It arbitrarily mandates that a person retire at age 65 or face losing benefits.

Perhaps most importantly, the earnings cap is a serious threat to the welfare of low-income senior citizens. Once the earnings cap has been met, a person with a job providing just $5 an hour would find the after tax value of that wage dropping to only $2.20. A person with no private pension or liquid investments—which, by the way, are not counted as "earnings"—from his or her working years may need to work in order to meet the most basic expenses, such as shelter and food. Health care costs, rising at an astronomical rate, are another expense many elderly Americans have trouble meeting.

There is also a myth that repeal of the earnings test would only benefit the rich. Nothing could be further from the truth. The highest effective marginal rates are imposed on the middle income elderly who must work to supplement their income. Plus these middle income seniors are precisely the group that was hit hardest by the 85 percent tax increase included in President Clinton's Budget Reconciliation Act of 1993. This tax increase hits hardest those seniors who were frugal during their working lives in order to save toward their retirement since the tax affects both their Social Security and their savings. The 85 percent increase has hit a group of seniors who are far from rich with a triple-whammy and is a further disincentive to these seniors who could further contribute to our economic growth by working.

The most disturbing consequence of the President's tax increase on Social Security is that is continues to punish those seniors who still need to work in order to make ends meet. They are hit with both the tax on their benefits and the Social Security Earnings Test penalty.

It is certainly true that our nation's seniors—as a group—are better off today that they were when Social Security was created in 1935. It is also true that many other groups in our society are suffering from declining standards of living. Deficit reduction and economic growth are paramount concerns for this nation. But increasing the taxation of Social Security benefits is neither an appropriate nor effective way to achieve these goals.

Finally, it is simply outrageous to continue two separate policies that both keep people out of the work force who are experienced and want to work. We have been warned to expect a labor shortage. Why should we discourage our senior citizens from meeting that challenge? As the U.S. Chamber of Commerce, which strongly supports this legislation, has pointed out, "retraining older workers already is a priority in labor intensive industries, and will become even more critical as we approach the year 2000."

We have a massive Federal deficit. Studies have found that repealing the earnings test could net $140 million in extra Federal revenue. Furthermore, the earnings test is costing us $15 billion a year in reduced production. Taxes on that lost production would go a long way toward reducing the budget deficit. Nor, as it continues to become tougher to compete globally, can America afford to pursue any policy that adversely affects production or effectively prevents our citizens from working.

Repeal would also save the taxpayer over $200 million a year in reduced compliance costs. According to the Social Security Administration, the earnings test is the largest administrative burden. Sixty percent of all overpayment and 45 percent of benefit underpayment are attributable to the earnings test.

A number of our nation's prominent senior organizations are lining up in favor of repealing both of these measures. Among these groups are the National Committee to Preserve Social Security and Medicare and the Seniors Coalition.

I can say, in closing, that America cannot afford to continue to pursue two separate policies that adversely effect production and are unfairly burdensome to one particular segment of society. Our nation would be better served if we eliminate the burdensome earnings test and the grossly unfair tax increase and provide freedom, opportunity and fairness for our nation's senior citizens.

Attachment.

PAYING PEOPLE NOT TO WORK:

THE ECONOMIC COST OF THE SOCIAL SECURITY

RETIREMENT EARNINGS LIMIT

(Updated September 1990)

By:

Aldona Robbins and Gary Robbins

With an Introduction by Congressman Dennis Hastert

Cosponsored by:

Institute for Policy Innovation
250 S. Stemmons, Suite 306
Lewisville, Texas 75057
(214) 219-0811

IPI Policy Report No. 101

National Center for Policy Analysis
7701 N. Stemmons, Suite 800
Dallas, Texas 75247
(214) 951-0306

NCPA Policy Report No 142

INTRODUCTION BY: CONGRESSMAN DENNIS HASTERT

Since coming to Congress, I've been concerned about a dilemma facing many Americans age 62 to 69. They want to continue working after they reach retirement age, but to do so would mean a loss of a significant portion of Social Security benefits they were told they had already earned. Their problem is a result of the ***Social Security retirement earnings test*** — a law that unfairly discriminates against working Americans age 65 to 69 by reducing their Social Security benefits by 33 cents for every dollar earned above $9,360 and against those 62 to 64 by reducing their benefits by 50 cents for every dollar earned above $6,840.

I commend the Institute for Policy Innovation and the National Center for Policy Analysis for this thorough examination of the economic and revenue effects of liberalizing or eliminating the social security retirement earnings test. Seldom is there a policy change that promises so much yet remains unchanged because of an unfounded fear that it will increase the deficit. As this report shows, the earnings limit could be doubled, tripled, or even quadrupled, and the federal government would receive considerably more in new work-related tax revenues than it would lose in increased Social Security payments.

Some claim that the retirement earnings test is not really a tax. In fact, the very purpose of the test (which dates back to Social Security's origins) was to encourage older Americans to leave the workforce. Times have changed since the mid-1930s, and whatever it is called today, the practical effect of the earnings test is to discourage work effort by depriving elderly workers of a significant part of each additional dollar earned.

This tax doesn't just affect wealthy Social Security recipients. In fact, the earnings test hurts those who need extra income to supplement their Social Security benefits considerably more than wealthier Americans who have the option of not working if they choose.

In addition to unfairly discriminating against elderly workers, the American economy is also hurt by the retirement earnings test. At a time when we are all concerned about economic growth, it seems foolish not to exploit the collective work experience and skills of millions of elderly workers who desperately want or need to continue working. Eliminating the test would mean that at least 700,000 elderly retirees would enter the labor market and, as a result, our annual output of goods and services would increase by at least $15.4 billion.

The Social Security Administration tells us that at most only 170,000 older workers would be affected by liberalizing the earnings test. This number is unbelievably low. I've been contacted by thousands of my own constituents, and have talked with colleagues who have been overwhelmed by their constituents complaining about the unfairness of the earnings test.

For a host of reasons — fairness, economic growth considerations, and the positive effect it would have on the deficit — it makes sense to reevaluate the retirement earnings test. Hopefully, as more is learned about its ill-effects, Congress will end economic discrimination against elderly workers.

EXECUTIVE SUMMARY

Our nation's senior citizens represent a rich pool of talent and ability that is largely untapped. This vast resource of valuable human capital has the potential to add billions of dollars to our annual output of goods and services; provide new, earnings-related tax revenues for federal, state, and local governments; and strengthen the competitive position of the U.S. economy in the international marketplace.

One reason why so many of the elderly have abandoned the workplace is that the federal government has imposed extraordinarily high marginal tax rates on wages they earn.

- For middle-income elderly workers, federal taxes take at least 75 cents out of each additional dollar of wage income.

- In some cases, the marginal tax rate reaches 102 percent, and elderly workers lose $1.02 for each $1 of earnings.

Of the various taxes on the wage income of the elderly, the most draconian is the Social Security retirement earnings penalty. Because of this tax, elderly workers currently lose 50 cents in Social Security benefits for each $1 of earnings -- a marginal tax rate of 50 percent. Yet this tax is self-defeating. It raises no additional net revenue for the federal government and imposes a large cost on the U.S. economy. Based on a conservative estimate,

- If the retirement earnings penalty were eliminated, at least 700,000 elderly retirees would enter the labor market.

- As a result, our annual output of goods and services would increase by at least $15.4 billion.

- Government revenue would increase by $4.9 billion, more than offsetting the additional Social Security benefits that would be paid.

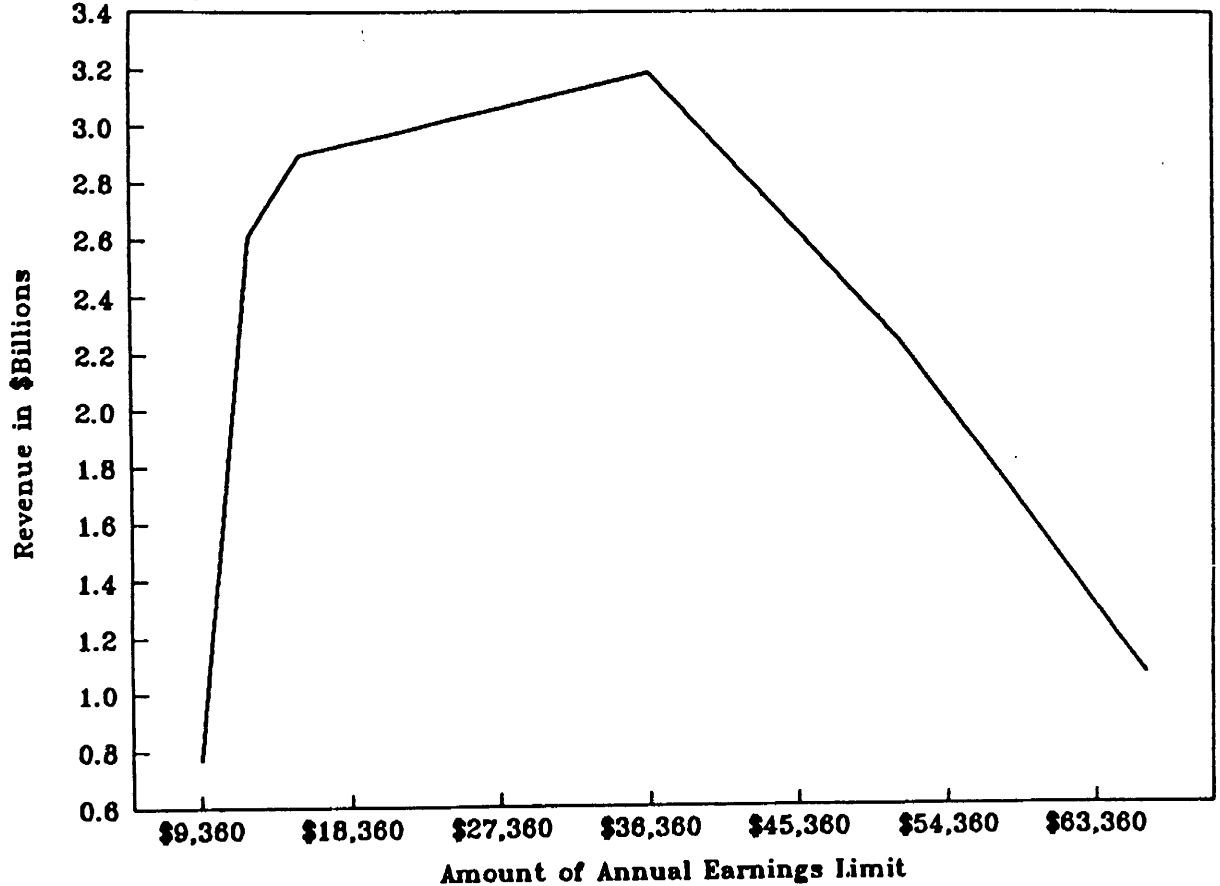
One argument against the complete elimination of the retirement earnings penalty is that it would obligate the federal government to pay Social Security benefits to high-income elderly individuals who are willing to continue working whether or not they receive the benefits. For these workers, elimination of the earnings penalty would cause the federal government to lose funds (in the form of Social Security benefit payments) and get nothing in return. Yet if the only objective were to reduce the federal deficit, Congress is passing up the opportunity for a free lunch.

- In 1990, elderly workers will be allowed to earn as much as $9,360 (the earnings limit) without loss of Social Security benefits.

- If this earnings limit were doubled, tripled, or even quadrupled, the federal government would receive considerably more in new work-related tax revenues than it would lose in increased Social Security benefit payments.

- If the earnings limit were increased to $39,360 the federal deficit could be reduced by $3.2 billion.

INCREASE IN NET FEDERAL REVENUE
FROM RAISING THE RETIREMENT EARNINGS LIMIT
(Net Taxes Minus Social Security Payments)



PREFACE:

CONTROVERSY OVER RETIREMENT EARNINGS TEST CONTINUES

Today, a year after this report was first issued, controversy continues to rage over the effects of liberalizing or eliminating the Social Security retirement earnings test. The key issue — would the federal deficit be higher or lower — depends upon the extent to which the earnings test discourages work effort by Social Security recipients.

On this question, there are two different schools of thought. One side sees the retirement earnings test as having little or no effect on the work effort of elderly Americans. Removing the test would be an unwarranted windfall for those who have some or all of their Social Security benefits withheld. Such a move would, by their estimates, cost the federal government (more specifically the Social Security trust fund) $4 to $5 billion annually in higher benefit payments.

The other side believes that eliminating the retirement earnings test would significantly increase labor participation of elderly workers. They believe the earnings test results in older workers cutting back on the number of hours they work, selecting jobs they might not if there were no test, or dropping out of the labor market altogether. Moreover, removing the test would increase payroll and income tax revenue that would partially or completely offset higher Social Security benefit payments.

The Social Security Administration (SSA) does not appear to be swayed by these arguments. To buttress their contention that, at most, 170,000 older Americans would increase their work effort and earnings, SSA points to research describing the work behavior of older workers. Unfortunately, this research cannot provide answers to what would happen if the retirement earnings test were liberalized or eliminated, largely because it focuses on unrelated issues.

First, the retirement decision models assume planning conditions remain constant over time, an assumption completely unjustified by empirical observation. Further, planning models that include only annual income to explain labor supply behavior are also flawed. The results are biased because annual income is an inaccurate measure of a person's true budget. Important components not taken into account are leisure time and wealth.

Studies which use gross (or pretax) wage rates are also biased because they use an inappropriate measure of work incentives facing the elderly. In effect, these studies ask how labor responds to taxes by constructing a test which ignores taxes. Not surprisingly, the test concludes that taxes don't matter, a result dismissed by common sense.

This study relies on increasing evidence that people supply labor in response to their aftertax wages. The labor supply elasticities of so-called secondary workers like the elderly are much higher than those of primary workers such as prime-age married men. Since the elderly are more sensitive to changes in aftertax wages, liberalizing or eliminating the earnings test would bring more of them into the workforce.

The findings of this study have not changed over the year, although the positive economic and revenue effects resulting from repeal or liberalization seem even more compelling in today's slow growth environment. The elderly represent an experienced, productive resource. Allowing them to work without penalty would help the economy and help increase federal revenues.

September 1990

PAYING PEOPLE NOT TO WORK:

THE ECONOMIC COST OF THE SOCIAL SECURITY

RETIREMENT EARNINGS LIMIT

The retirement earnings limit has been part of Social Security since its inception. This provision allows elderly retirees to earn only a small amount of wage and salary income and still receive full Social Security benefits. At the same time, the earnings limit imposes a very high tax on retirees who choose to work and earn additional income.

- Elderly workers are currently losing 50 cents in Social Security benefits for every dollar in wages above the earnings limit -- reflecting a marginal tax rate of 50 percent.

- In 1990, this marginal tax rate will decrease from 50 percent to 33 percent, and elderly workers will lose 33 cents in benefits for each extra dollar of wages.

The original reason given for the retirement earnings limit was that Social Security should replace lost earnings. Benefits, it was believed, should not go to people who continued to work. This policy was consistent with the Depression-era view that Social Security should encourage older workers to leave the work force, making more jobs available for younger workers.

Times have changed, however. Current fears are that the United States is facing a shortage of workers, not a glut. The continuing labor force participation of older Americans, who possess valuable skills acquired over 30 or 40 years, will be increasingly important to the health of the U.S. economy in future years.

In response to these economic realities, Congress is considering proposals to liberalize the Social Security retirement earnings limit:

- Senator William Armstrong (R-CO) has proposed an amendment that would begin to phase out the earnings limit for retirees between the ages of 65 and 69 by raising the limit an additional $3,000 per year in 1990, 1991, and 1992.

- The House Ways and Means Committee has voted to increase the 1990 earnings limit for retired workers between the ages of 65 and 69 from $9,360 to $9,720 and to increase the 1991 limit from $9,840 to $10,440.

Reducing or eliminating the earnings limit raises budgetary concerns. The Social Security Administration estimates that in 1990 approximately $4.8 billion will be withheld from beneficiaries between the ages of 65 and 69 because of the earnings limit. From a static view of the world, it would seem that there would be a corresponding increase in federal budget deficit of $4.8 billion.

Because the earnings limit imposes extremely high marginal tax rates on income from work, however, elimination of the limit will induce retired workers to enter the labor force and to increase their earnings. This increased work effort will lead to higher federal income and payroll tax revenues that will more than offset the increased payout of Social Security benefits.

TABLE I

PENALTIES FOR ELDERLY WORKERS[1]

Year	Social Security Earnings Limit: Ages 65 to 69	Social Security Earnings Limit: Ages 62 to 64	Loss of Benefits for Excess Earnings
1989	$8,880	$6,480	$1 for every $2 of wages
1990	$9,360[2]	$6,840[2]	$1 for every $3 of wages

[1]Social Security beneficiaries age 70 and over are not subject to the earnings limit.

[2]These are estimates for 1990. The earnings limit is indexed and rises with the growth of average wages.

THE RETIREMENT EARNINGS LIMIT AND MARGINAL TAX RATES

Elderly workers between the ages of 65 and 69 face higher marginal tax rates on labor income than any other group of American workers.[1] In addition to the federal income tax, the federal payroll tax (FICA), and the retirement earnings limit, two new taxes adopted during the last six years have dramatically increased marginal tax rates for the elderly. The first is the Social Security benefit tax, enacted as part of the 1983 Social Security reform legislation. The second is the Medicare surtax, enacted as part of the Catastrophic Coverage Act of 1988.

The Social Security Benefit Tax. Under current law, one-half of Social Security benefits potentially are subject to the income tax. In 1986, for example, at least 20 percent of the elderly had to pay taxes on an average of $3,373 of Social Security benefits, and the percentage of the elderly paying the tax will rise continuously in future years.[2] As the law is structured, however, one-half of Social Security benefits are not automatically included in the ordinary income of the taxpayer. Instead, the tax applies only if one-half of Social Security income plus all non-Social Security income (including income from tax-exempt bonds) exceeds $25,000 for an individual or $32,000 for a couple. For taxpayers who exceed these amounts, 50 cents of Social Security benefits is taxed for each dollar of additional income.

One way to think about the Social Security benefit tax is to see it as a tax on income, rather than as a tax on Social Security benefits -- since the tax increases only as income increases. For individuals who exceed the income limits described above,

- Taxpayers who earn an additional $1 of income are forced to pay taxes on $1.50.[3]
- This means that taxpayers in the 15 percent income tax bracket automatically face an income tax rate of 22.5 percent.
- Individuals in the 28 percent income tax bracket automatically face an income tax rate of 42 percent.

The Medicare Surtax. As pointed out in a previous NCPA report, genuine catastrophic insurance for the elderly is rather inexpensive, provided it does not include nursing home care. For example, genuine catastrophic coverage could be provided for as little as $60 per year per Medicare beneficiary, or through small increases in the Medicare deductibles and copayments.[4] In

---

[1]For a discussion of the special taxes on the elderly, see John C. Goodman and A. James Meigs, "The Elderly: People the Supply-Side Revolution Forgot," NCPA Policy Report No. 135, February 1989. See also Stephen Entin, The Social Security Retirement Earnings Test (Washington, DC: Institute for Research on the Economics of Taxation, 1989).

[2]The percentage of elderly paying the tax will continue to rise because the income thresholds, beyond which Social Security benefits become taxable, are not indexed. See Aldona Robbins, *The ABC's of Social Security* (Washington, DC: Institute for Research on the Economics of Taxation, 1988), p. 16.

[3]Assumes that additional income does not result in a loss of Social Security benefits. If taxpayers are at or above the earnings limit, they pay taxes on $1.38 for each $1 of earnings.

[4]John C. Goodman and Gerald Musgrave, "Health Care for the Elderly: The Nightmare in our Future," NCPA Policy Report No.130, October 1987, pp. 29-30. See also Peter J. Ferrara and Edmund F. Haislmaier, "The Catastrophic Health Tax on America's Elderly," *Issue Bulletin*, No. 132, Heritage Foundation, July 21, 1987.

the hands of politicians, however, catastrophic health insurance quickly developed into a Christmas package of costly benefits, even without including coverage for nursing home care.[5] Because Congress needed additional tax revenues to fund this program, the elderly now pay a Medicare surtax equal to 15 percent of income taxes. This surtax will increase in future years, reaching 28 percent of income taxes in 1993.

For taxpayers in the 15 percent income tax bracket, the surtax equals 2.25 percent (15% X 15%) of income. For taxpayers in the 28 percent income tax bracket, the surtax equals 4.20 percent (15% X 28%) of income. Remember, however, that taxpayers who are subject to the Social Security benefit tax face income tax rates as much as 50 percent higher than the rates faced by other taxpayers. As a result:

- For elderly taxpayers earning little more than the minimum wage, the Medicare surtax can be as high as 6.3 percent of each additional dollar of income.

- In 1993, when the surtax reaches 28 percent of income taxes, elderly taxpayers will face a Medicare surtax as high as 11.76 percent of each additional dollar of income.[6]

Total Marginal Tax Rates for the Elderly. Retired people receiving Social Security benefits face higher marginal tax rates on income from labor today than have ever been imposed on middle-income American workers. As Table II shows,

- Elderly workers earning only $8,880 are facing a marginal tax rate this year of at least 58 percent -- even if they earn too little to pay income taxes.

- For those elderly workers who barely have enough income to pay federal income taxes, the marginal tax rate is at least 75 percent.

Elderly workers with incomes just high enough to be subject to the Social Security benefit tax face the highest tax rates of all. The income of these workers will be reduced by at least 80 cents for each additional dollar of wages. Moreover,

- For those elderly workers who earn $8,880 in wages and are also in the 28 percent income tax bracket, marginal tax rates are 102 percent.

- Federal policy forces these elderly workers to pay to work -- each additional dollar they earn will decrease their total income.

It is important to note that marginal tax rates in excess of 100 percent are not imposed on the wealthiest of elderly taxpayers. Indeed, for very high-income earners, the marginal tax rate is 28 percent. The highest marginal tax rates are imposed on middle-income elderly. For those with non-Social Security incomes of $25,000 to $40,000, tax rates are higher than they have ever been for any group of U.S. taxpayers.

---

[5]For a critique of catastrophic health care legislation, see Aldona Robbins and Gary Robbins, "Facts About Catastrophic Coverage," *Economic Report*, No. 41, Institute for Research on the Economics of Taxation, May 23, 1988.

[6]Assumes the 1993 cap on the Medicare surtax will be increased sufficiently to apply to couples in the 28 percent income tax bracket.

90-371 - 95 - 3

TABLE II

MARGINAL TAX RATES OF ELDERLY WORKERS EARNING $8,880[1] ($9,360 In 1990)

Income Too Low to Pay Federal Income Taxes[2]

	1989	1990
FICA Tax	7.51%	7.65%
Earnings Penalty	50.00%	33.00%
Total	57.50%	40.64%

Income High Enough to Pay Income Taxes, But Too Low to Pay the Social Security Benefit Tax[3]

15 Percent Bracket	1989	1990
Federal Income Tax	15.00%	15.00%
FICA Tax	7.51%	7.65%
Medicare Surtax	2.25%	3.75%
Earnings Penalty	50.00%	33.00%
Total	74.76%	59.40%

28 Percent Bracket	1989	1990
Federal Income Tax	28.00%	28.00%
FICA Tax	7.51%	7.65%
Medicare Surtax	4.20%	7.00%
Earnings Penalty	50.00%	33.00%
Total	89.71%	75.65%

Elderly workers will get some relief in 1990, when the retirement earnings penalty is reduced from a 50 percent to a 33 percent tax on earnings. Yet this gain will be partially offset by a rising Medicare surtax. Elderly workers who pay income taxes in 1990 will face a marginal tax rate of at least 60 percent, and the highest marginal tax rate imposed on middle-income elderly workers will be 90 percent.

Income High Enough to Pay the Social Security Benefit Tax[4]

15 Percent Bracket	1989	1990
Federal Income Tax	15.00%	15.00%
FICA Tax	7.51%	7.65%
Social Security Benefit Tax	5.63%	6.26%
Medicare Surtax	3.09%	5.32%
Earnings Penalty	50.00%	33.00%
Total	81.23%	67.23%

28 Percent Bracket	1989	1990
Federal Income Tax	28.00%	28.00%
FICA Tax	7.51%	7.65%
Social Security Benefit Tax	10.50%	11.69%
Medicare Surtax	5.78%	9.92%
Earnings Penalty	50.00%	33.00%
Total	101.79%	90.26%

[1]Refers to workers age 65 to 69.

[2]In 1989, taxable earnings are less than $10,800 for a couple. Most single individuals earning the earnings limit are subject to the income tax.

[3]Total income from all sources (including Social Security benefits) less than $25,000 for an individual and $32,000 for a couple.

[4]Assumes taxpayers pay tax on some of their Social Security benefits but remain under the maximum of one-half of benefits taxed. Taxpayers also pay less than the maximum Medicare surtax of $800 in 1989 and $900 in 1990.

Delayed Retirement Credit. Workers who delay receiving Social Security benefits past normal retirement age are rewarded with an increase in their future benefits. A retired worker reaching age 65 in 1990 will receive an additional 3.5 percent in benefits per year for delaying Social Security benefits past age 65. For each month that benefits are withheld due to the earnings test, the retired worker receives a pro-rated share of the delayed retirement credit.[7] At age 70, the worker receives full benefits plus the delayed retirement credit, regardless of earnings.

This increase in lifetime Social Security benefits, however, falls far short of offsetting the tax imposed by the earnings penalty. For example, a retired worker reaching age 65 in 1990 can expect to collect benefits until age 81. Table III shows the present value of increased Social Security benefits due to the delayed retirement credit and the additional taxes on earnings (federal income taxes + payroll taxes + withheld benefits) for a worker who earns enough to have Social Security benefits withheld. As the table shows,[8]

- Elderly workers who earn enough to have 20 percent of their benefits withheld can expect to pay six times more in additional taxes than the additional benefits they will receive because of the delayed retirement credit.
- For elderly workers who have 100 percent of their benefits withheld, the additional taxes paid are twice the additional benefit they will receive because of the delayed retirement credit.

[7]A retired worker may receive credit for Social Security benefits delayed for up to five years. The maximum credit for someone reaching age 65 in 1990 is 17.5 percent. The delayed credit is also prorated. In the case of a 3.5 percent annual credit, the retired worker would receive 0.29 percent for each month that benefits were withheld.

[8]In order to equalize the streams of benefits and taxes, there would have to be a negative internal rate of return. Specifically, the internal rates of return are as follows:

Internal Rate of Return to Equalize Present Values:

	20% Withheld	100% Withheld
Without FICA tax	-7.5 %	-7.7 %
7.65% FICA tax	-10.6 %	-12.7 %
15.3% FICA tax	-12.9 %	-15.8 %

TABLE III

EFFECTS OF THE DELAYED RETIREMENT CREDIT[1]

Present Value	20% of Benefits Withheld Because of Earnings	100% of Benefits Withheld Because of Earnings
Additional Social Security Benefits at Age 70	$ 3,038	$15,191
Additional Taxes Paid While Working	$18,692	$31,060

[1]Elderly workers age 65 to 69.

EFFECTS OF THE EARNINGS LIMIT ON THE LABOR SUPPLY

America's most underutilized resource is the productive capacity of our elderly population. The 40 million men and women age 60 and over represent a vast store of human capital, rich in talent and ability. They have more than one billion years of cumulative experience in business, accounting, engineering, finance; and virtually every other productive endeavor. Yet this valuable resource is, increasingly, wasted.

- In 1930, before Social Security, 54 percent of men age 65 and over were in the labor force.[9]
- Today the labor force participation rate of men age 65 and over is about 16 percent.[10]

The withdrawal of the elderly from the labor force is predicted to get worse.[11] It is occurring as the Department of Labor is warning us about future labor shortages.[12] It is also

---

[9]Aldona Robbins, *The ABC's of Social Security* (Washington, DC: Institute for Research on the Economics of Taxation, 1988), p. 4.

[10]U.S. Bureau of the Census, *Statistical Abstract of the United States*: 1989 (109th edition) Washington, DC, 1989, p 376.

[11]*Older Worker Task Force: Key Policy Issues*, U.S. Department of Labor, 1989, p. 2.

[12]*Labor Market Shortages*, U.S. Department of Labor, 1989.

occurring as entry into the labor market is becoming increasingly easy for senior citizens, and may involve little more than establishing a telephone link between a computer in the home to one at the office.[13]

Some retirees do continue to work after age 65. About 26 percent of retired workers between the ages of 65 and 69 who are eligible for Social Security benefits report some earnings.[14] Of those working, 65 percent earn less than the retirement earnings limit.

Graph 1 illustrates the earnings distribution in 1990 for the 1.9 million retired workers between the ages of 65 and 69 who will be eligible for Social Security benefits and who will have earnings.[15] As the graph illustrates, there are an extraordinarily large number of elderly retirees who earn up to (or near) the earnings limit and then quit working. Specifically,

- About 400,000 elderly workers earn annual wages within 10 percent of the earnings limit.
- These workers are apparently attempting to earn all they can without being subject to the retirement earnings penalty.

There are undoubtedly many others who pass up the opportunity for full-time or part-time work because a substantial part of their earnings would be subject to the earnings penalty.

In 1990, the maximum Social Security benefit for a worker retiring at age 65 will be $11,712.[16] This individual will have to earn $43,041 before all Social Security benefits are withheld.[17] Beyond that point, the earnings limit has no effect since there are no Social Security benefits left to tax. For a retiree receiving the average Social Security benefit of about $8,000, Social Security benefits will be completely withheld at an income level of $33,360.[18] As Graph 1 illustrates, within the range of $31,908 to $43,041 the number of wage earners begins to rise -- reflecting the fact that the retirement earnings penalty at this point no longer influences the decision about how much to earn.

In the absence of the earnings limit, there would not be the sharp drop in the number of retired workers earning between $9,360 and $43,041. Rather, the market would exhibit a

[13]Joanne H. Pratt, "Legal Barriers to Home-Based Work," NCPA Policy Report No. 129, September 1987.

[14]Based upon Social Security Administration data from the 1983 Continuous Work History Survey (CWHS) of Social Security beneficiaries.

[15]Figures are derived from the 1983 CWHS by adjusting the class intervals for the growth in average wages. Number of retired workers are from projections made by the Social Security Administration, Office of the Actuary.

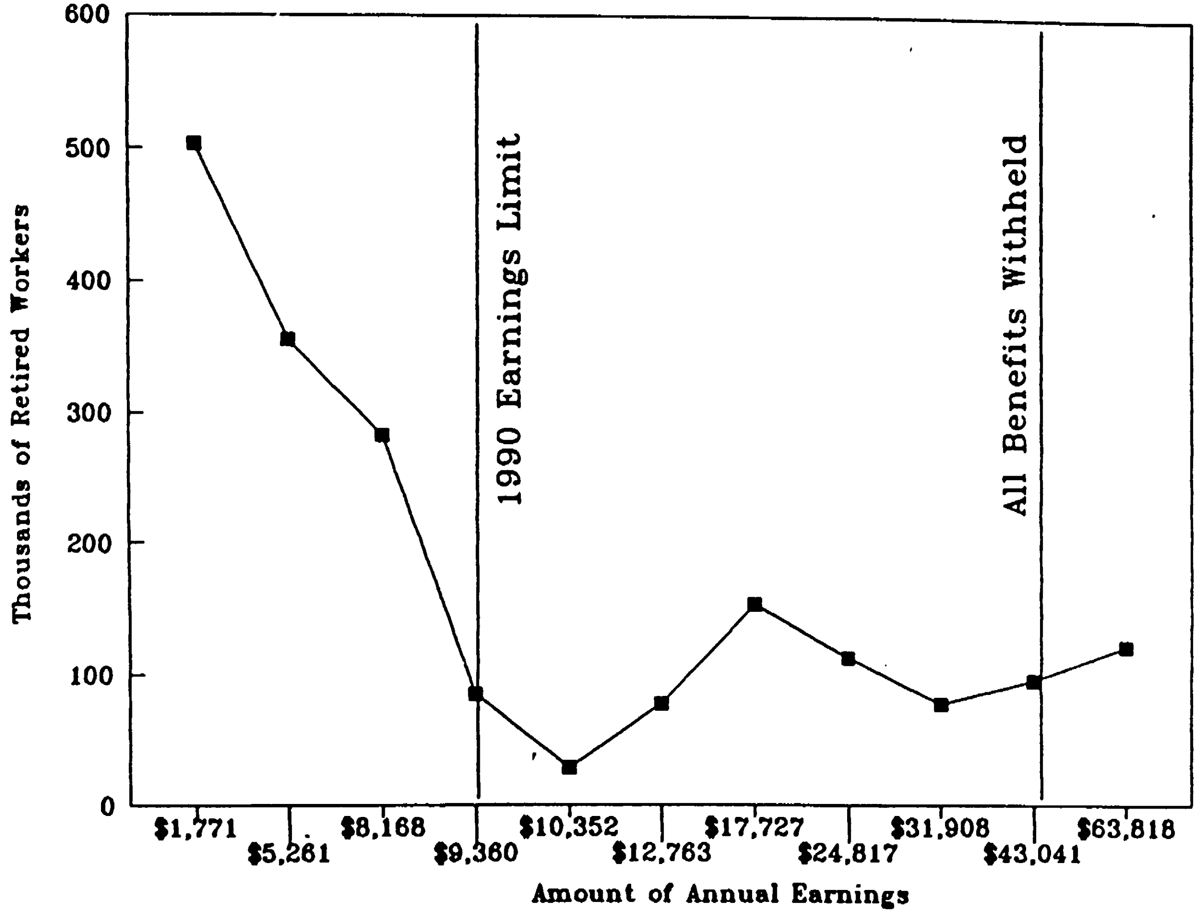
[16]Board of Trustees of the Federal Old-Age Survivors Insurance and Disability Insurance Trust Funds, *1989 Annual Report of the Board of Trustees of the Federal Old-Age Survivors Insurance and Disability Insurance Trust Funds*, Washington, DC, April 24, 1989, Table F6, p. 138.

[17]Calculated as ($11,712 X 3) + $9,360.

[18]Calculated as ($8,000 x 3) + $9,360.

Graph 1

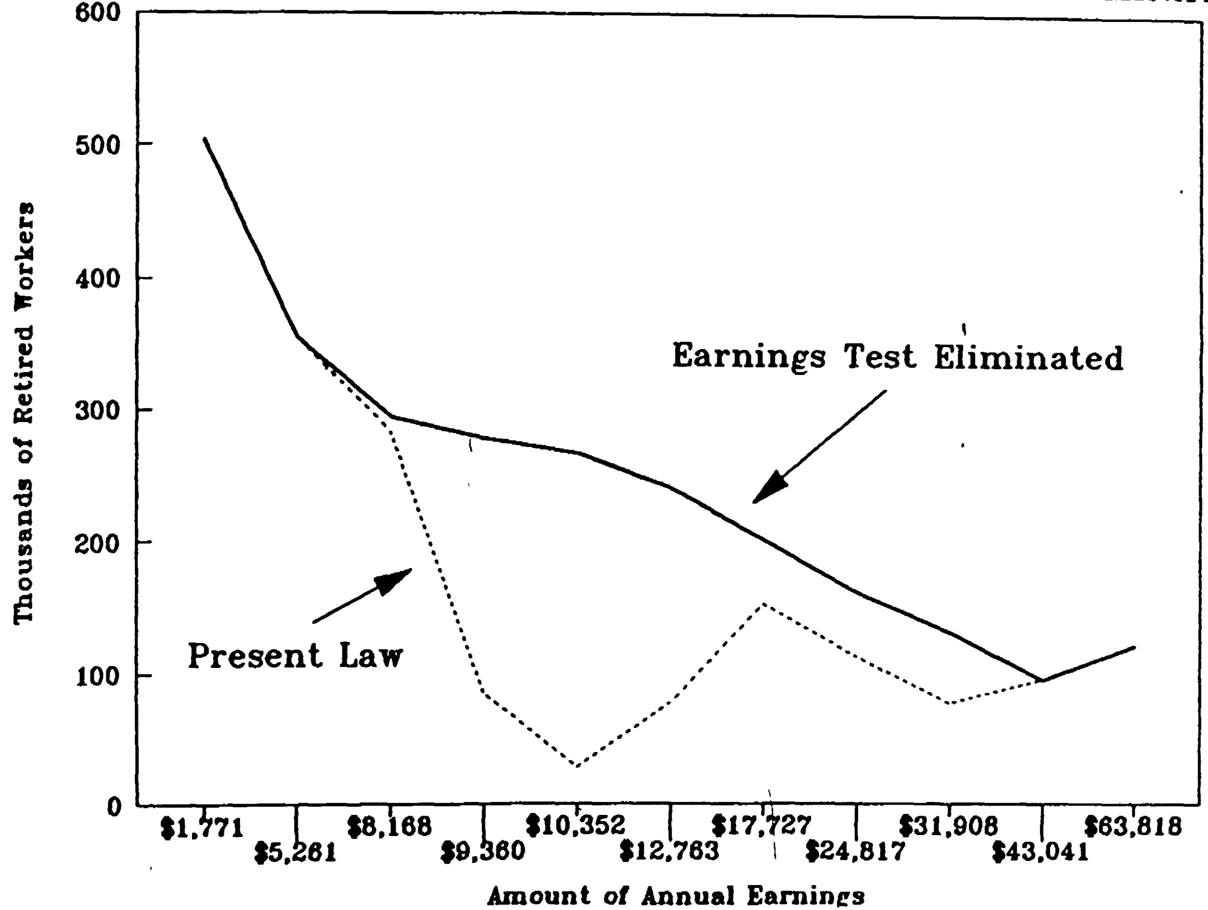
DISTRIBUTION OF RETIRED WORKERS AGES 65 TO 69 WITH EARNINGS *



* About 26% of retired workers have earnings

Graph 2

EARNINGS DISTRIBUTION FOR RETIRED WORKERS AGES 65 TO 69
UNDER PRESENT LAW AND IF EARNINGS TEST WERE ELIMINATED



smoother decline (as illustrated in Graph 2) with more elderly workers earning higher annual earnings.[19] Specifically:

- Without a Social Security earnings limit, the number of elderly workers with some wage income would rise from 1.9 million to 2.6 million -- an increase of 38 percent.

- The additional work effort would increase the wage income of all elderly workers by $10.3 billion.[20]

THE EFFECT OF ELIMINATING THE EARNINGS LIMIT ON THE FEDERAL DEFICIT

Eliminating the earnings limit for retired workers between the ages of 65 and 69 would increase labor and capital income, thereby increasing federal tax revenues. It would also increase the amount of Social Security benefits paid, thereby increasing federal spending. If the increase in taxes paid exactly offsets the higher Social Security benefits, there will be no net effect on the federal budget deficit. If the increase in revenues is greater than the increase in benefit payments, the deficit will decrease, and if it is less than the benefit increase, the deficit will increase.

Taxes on the increased earnings include both federal income taxes and the Social Security payroll tax, which will be 15.3 percent in 1990.[21] In Appendix B we estimate the increase in taxes on earnings using two different marginal tax rates. The first provides a lower-bound estimate because it assumes a 15 percent federal income tax rate for all the earnings classes. The second provides the more likely impact because it uses the average marginal federal income tax rate for each income class.[22]

Raising the Earnings Limit by $1,000. In 1990, there will be approximately 750,000 elderly workers whose Social Security benefits are partially withheld because their wage income exceeds the 1990 earnings limit of $9,360. If each of them were allowed to earn an additional $1,000 without penalty, the Social Security Administration would have to increase Social Security benefit payments by about $37 million.[23] Yet as Table IV shows, this increase in government spending would be more than offset by an increase in federal revenue. According to the best estimate,

---

[19]We estimated a logarithmic function based upon the change in earnings between $1,771 and every other earnings class.

[20]Aftertax earnings would increase by 122 percent. This would imply a labor supply elasticity of 0.31 (0.38/1.22) for workers between the ages of 65 to 69, which is quite plausible. Labor supply elasticities for the U.S. labor force as a whole range from 0.1 to 0.45, and it is generally believed that the labor supply elasticity for elderly workers is much higher than for younger workers. It is important to note that income from capital would also increase. Historically, for every $1 increase in labor income, capital income goes up by 50 cents.

[21]The employer and employee each pay 7.65 percent.

[22]The Appendix lists the average marginal tax rate by adjusted gross income and average wage. The marginal rates used in the calculations do not include the new Medicare surtax.

[23]At this point 640,000 would still have benefits partially or wholly withheld.

- If the retirement earnings limit were increased by $1,000, the federal government would receive an additional $563 million in taxes on the increased earnings of elderly workers.

- The government would receive an additional $134 million in taxes because of an increase in capital income.[24]

- On balance, the total increase in new revenue ($697 million) would exceed the total increase in new Social Security spending ($37 million) by $660 million.

Raising the earnings limit by $1,000, then, would result in a *net increase* in federal revenues and a *reduction* in the federal deficit.

Raising the Earnings Limit by $3,000. Table IV also shows the effects of raising the earnings limit by $3,000 in 1990. As noted above, this proposal has been made in the Senate by Senator William Armstrong (R-CO). The Armstrong Amendment would cost the federal government $110 million in additional Social Security benefit payments in 1990. However, this Amendment would also generate $1.5 billion in additional federal revenue, thus producing a net decrease in the federal deficit of $1.4 billion.

Maximizing Net Federal Revenue. As the earnings limit is increased, net federal revenue also increases, reaches a maximum, then declines. Thus, if the only goal were to reduce the federal deficit, Congress could achieve significant deficit reduction by simply increasing the earnings limit to the point at which net federal revenue is at a maximum. According to the best estimate, a net federal revenue of $3.2 billion would be available if the 1990 earnings limit were increased to $39,360.

Abolishing the Earnings Limit. If the earnings limit were completely abolished, the federal government would still receive more in new tax revenues than it would pay out in increased Social Security benefits, according to our best estimate. Tables V-A and V-B show the increase in net federal revenue by the earnings class of wage earners, and Table VI shows the net results.

- If the earnings limit were abolished, the federal government would be obligated to pay an additional $4.8 billion in Social Security benefits.[25]

- The government would collect $4.1 billion in additional taxes on a $10.3 billion increase in income from wages.

- The government would collect $0.8 billion in additional taxes on a $5.1 billion increase in capital income.

- The result would be a $140 million net increase in federal revenue.

---

[24]In general, we cannot experience an increase in income from labor without also experiencing an increase in income from capital. For example, if new elderly workers begin working in a previously empty office building, the building owners will receive a new rental income. If the workers use computers, there will be new income to the owners of computers. For the economy as a whole, about 50 cents in capital income is associated with each $1 of labor income. The average marginal tax rate on corporate capital is 47 percent (including dividend taxes) and the average marginal rate on noncorporate capital is 25 percent. Corporate capital constitutes roughly two-thirds of the U.S. capital stock. We have assumed a 15 percent marginal tax rate on capital, however, because tax depreciation offsets about 62 cents out of every dollar of gross capital income.

[25]The Office of the Actuary estimates that eliminating the earnings limit would increase OASDI benefit payments by $3.5 billion in fiscal year 1990 and by $5.3 billion in fiscal year 1991. This translates into $4.8 billion on a calendar-year basis. Included are 80,000 new claimants that the Office estimates would file for benefits solely as a result of eliminating the earnings test.

TABLE IV

EFFECT ON THE FEDERAL DEFICIT OF RAISING THE EARNINGS LIMIT[1]

(In $ Millions)

Best Estimate

Raising the Earnings Limit From:	To:	Increase in Social Security Benefits	Increase in Revenue from Taxes on Wages	Increase in Revenue from Taxes on Capital	Deficit Reduction
$9,360 →	$10,360	$37	$563	$134	$660
$9,360 →	$12,360	$110	$1,184	$284	$1,358

Lower-Bound Estimate

Raising the Earnings Limit From:	To:	Increase in Social Security Benefits	Increase in Revenue from Taxes on Wages	Increase in Revenue from Taxes on Capital	Deficit Reduction
$9,360 →	$10,360	$37	$449	$134	$539
$9,360 →	$12,360	$110	$927	$284	$1,101

[1] For elderly workers ages 65 to 69.

TABLE V-A

INCREASE IN NET FEDERAL REVENUE FROM ABOLISHING THE RETIREMENT EARNINGS LIMIT: BEST ESTIMATE

Income Intervals	Increase in Net Federal Revenue[1] ($ Millions)	Cumulative Total ($ Millions)
$9,360 → $12,360	$771[2]	$771[2]
$12,360 → $15,360	1,845	2,616
$15,360 → $18,360	284	2,900
$18,360 → $21,360	42	2,942
$21,360 → $24,360	42	2,984
$24,360 → $27,360	42	3,026
$27,360 → $30,360	42	3,067
$30,360 → $33,360	42	3,109
$33,360 → $36,360	42	3,151
$36,360 → $39,360	42	3,192
$39,360 → $42,360	-188	3,005
$42,360 → $45,360	-188	2,817
$45,360 → $48,360	-188	2,629
$48,360 → $51,360	-188	2,441
$51,360 → $54,360	-188	2,253
$54,360 → $57,360	-237	2,016
$57,360 → $60,360	-237	1,779
$60,360 → $63,360	-237	1,543
$63,360 → $66,360	-237	1,306
$66,360 → $69,360	-201	1,069
$69,360 +	-929	140

[1]Additional work-related taxes minus additional Social Security benefit payments.

[2]Note this number is somewhat higher than number shown in Table IV for an increase in the earnings limit of $3,000. That is because completely abolishing the earnings limit will have an even greater effect on this income class.

Source: Appendix B

TABLE V-B

INCREASE IN NET FEDERAL REVENUE FROM ABOLISHING THE RETIREMENT EARNINGS LIMIT: LOWER-BOUND ESTIMATE

Income Intervals	Increase in Net Federal Revenue[1] ($ Millions)	Cumulative Total ($ Millions)
$9,360 → $12,360	$628[2]	$628[2]
$12,360 → $15,360	1,492	2,120
$15,360 → $18,360	182	2,303
$18,360 → $21,360	-21	2,282
$21,360 → $24,360	-21	2,261
$24,360 → $27,360	-21	2,240
$27,360 → $30,360	-21	2,220
$30,360 → $33,360	-21	2,199
$33,360 → $36,360	-21	2,178
$36,360 → $39,360	-21	2,157
$39,360 → $42,360	-188	1,969
$42,360 → $45,360	-188	1,781
$45,360 → $48,360	-188	1,593
$48,360 → $51,360	-188	1,406
$51,360 → $54,360	-188	1,218
$54,360 → $57,360	-237	981
$57,360 → $60,360	-237	744
$60,360 → $63,360	-237	507
$63,360 → $66,360	-237	271
$66,360 → $69,360	-201	34
$69,360 +	-930	-896

[1]Additional work-related taxes minus additional Social Security benefit payments.

[2]Note this number is somewhat higher than number shown in Table IV for an increase in the earnings limit of $3,000. That is because completely abolishing the earnings limit will have an even greater effect on this income class.

Source: Appendix B

TABLE VI

SUMMARY OF ECONOMIC AND REVENUE EFFECTS FROM ELIMINATING THE EARNINGS LIMIT IN 1990
(Amounts in $ Millions)

Addition to:	Lower-Bound Estimate[1]	Best Estimate[2]
Earnings	$10,256	$10,256
Taxes on Earnings	3,107	4,143
Capital Income	5,128	5,128
Taxes on Capital[3]	769	769
Social Security Benefits Paid	4,773	4,773
Net Effect On		
Social Security Trust Fund	-$3,203	-$3,203
Rest of Federal Budget	+ 2,308	+ 3,343
Total Budget Effect	- $896	+ $140

[1] Assumes 15 percent marginal income tax rate.

[2] Assumes average marginal tax rate calculated in Appendix A.

[3] Assumes 15 percent tax rate.

CONCLUSION

Eliminating the earnings limit for retired workers between ages 65 and 69 makes good economic sense. The substantial reduction in marginal tax rates on wages will lead to an increase in labor effort that yields additional income and payroll tax revenues to offset the increase in Social Security benefit payments. Short of abolishing the earnings test, virtually any increase in the earnings limit would lead to an increase in federal revenue that would more than offset the increase in Social Security benefit payments.

- In 1990, elderly workers will be allowed to earn as much as $9,360 without loss of Social Security benefits.
- If this earnings limit were doubled, tripled, or even quadrupled, the federal government would receive considerably more in new work-related tax revenues than it would lose in increased Social Security benefit payments.
- If the earnings limit were increased to $39,360 the federal deficit could be reduced by $3.2 billion.

Several proposals before Congress also would increase revenue for the federal government. Specifically,

- The Armstrong amendment to increase the earnings limit by $3,000 in 1990 would raise about $1.4 billion in revenue.
- The House Ways and Means proposal to raise the earnings limit to $10,440 by 1991 would raise about $0.7 billion in net federal revenue.

NOTE: Nothing written here should be construed as necessarily reflecting the views of the National Center for Policy Analysis or the views of the Institute for Policy Innovation or as an attempt to aid or hinder the passage of any bill before Congress.

APPENDIX A

COMPUTATION OF AVERAGE MARGINAL TAX RATES FOR ELDERLY TAXPAYERS

Our tax model is based upon 1985 Internal Revenue Service tax return data for taxpayers age 65 and over.[1] This model computes the average marginal tax rates that elderly taxpayers will pay under present law or any other tax regime. Elderly taxpayers are classified as (1) married couples, filing jointly, both age 65 or over; (2) married couples, filing jointly, one age 65 or over; (3) married couples, filing separately; (4) head of households; and (5) single individuals.

Assumptions regarding the growth in the number of taxpayers and income sources are needed to project future income and tax liability. We use the following assumptions:

1. The number of returns grow at roughly 4 percent a year from 1985 to 1989, based on recent experience, and at 3 percent thereafter.

2. Income sources, other than Social Security benefits, grow at the actual rate of per capita income growth from 1985 to 1988; at the per capita income rate assumed in the 1990 Budget from 1989 to 1993; and at 4.35 percent a year, the 1993 rate, thereafter.

3. Social Security benefits are assumed to grow at the actual rate of average retired worker benefits from 1985 to 1988; at the rate of average retired worker benefits in the 1989 Trustees Report from 1989 to 1993; and at 4.56 percent a year, the 1993 rate, thereafter.

4. The tax parameters, such as the brackets, personal exemption, and standard deductions, are actual law from 1985 to 1989; grow at the Consumer Price Index assumed in the 1990 budget from 1990 to 1993; and at 3 percent a year, the 1993 rate, thereafter.

Table A-1 shows the federal marginal tax rate on wages and salaries of elderly taxpayers in 1990 by adjusted growth income (AGI). This tax rate is a weighted average of the marginal tax rates of all taxpayers by AGI class with wage income. The weights are income amounts, and the marginal rate represents the federal income tax consequences if the taxpayer earned an additional dollar of wage income. In 1990, elderly taxpayers who earn an additional dollar of wages will, on average, owe 25 cents in federal income taxes (26 cents if the Medicare surtax is included). These marginal rates *do not* include the Social Security payroll tax rate or the Social Security earnings limit.

---

[1] Internal Revenue Service, *Statistics of Income--1985, Individual Income Tax Returns*, U.S. Government Printing Office, Washington, DC, 1988.

TABLE A-1

FEDERAL MARGINAL INCOME TAX RATES ON WAGES & SALARIES OF ELDERLY TAXPAYERS IN 1990

Adjusted Gross Income			Wages	Marginal Tax Rate on Wages: Without Surtax	With Surtax
$0	to	$6,611	$3,799	0.12%	0.12%
$6,611	to	$10,578	4,646	8.70%	9.07%
$10,578	to	$19,834	6,613	14.79%	17.94%
$19,834	to	$23,801	8,930	17.33%	21.16%
$23,801	to	$26,446	9,976	23.47%	28.54%
$26,446	to	$33,057	12,121	23.52%	27.76%
$33,057	to	$39,668	16,701	23.56%	26.51%
$39,668	to	$52,891	18,941	28.03%	29.32%
$52,891	to	$66,114	22,837	29.44%	29.44%
$66,114	to	$99,171	27,028	30.00%	30.00%
$99,171	to	$264,456	43,982	32.41%	32.41%
$264,456	and	over	153,147	28.00%	28.00%
All taxpayers			$4,688	24.74%	26.22%

APPENDIX B

THE IMPACT OF RAISING THE EARNINGS LIMIT ON NET FEDERAL REVENUE

Our estimate of the distribution of earnings for elderly workers between the ages of 65 and 69 is based on Social Security Administration data from the 1983 Continuous Work History Survey (CWHS) of Social Security beneficiaries. The estimate was derived from the 1983 CWHS by adjusting the class intervals for the growth in average wages. The number of retired workers in 1990 is based on projections made by the Social Security Administration, Office of the Actuary.

To obtain a distribution of earnings for the elderly in the absence of a retirement earnings limit, we estimated a logarithmic function based on the change in earnings between $1,771 and every other earnings class. Based on this estimate, we project an overall increase in aftertax earnings of 122 percent and an increase in the number of elderly workers of 38 percent. This implies a labor supply elasticity of 0.31 (0.38/1.22) for elderly workers. Note that this estimate is conservative. Labor supply elasticities for the U.S. labor force as a whole range from 0.1 to 0.45, and it is generally believed that the labor supply elasticity is much higher for elderly than for younger workers.[1]

When elderly workers increase their earnings, the federal government receives additional revenue because of taxes on those earnings. Our estimates of this increase are depicted in Table B-1. The first estimate assumes that all elderly workers pay a 15 percent income tax rate and a 15.3 percent FICA tax rate, for a combined marginal tax rate of 30.3 percent. Since these rates are well below the actual marginal tax rate faced by most elderly workers, this estimating technique establishes a lower boundary on the likely outcomes of increasing the earnings limit.

The second estimate uses the marginal tax rates in Table A-I (excluding the new Medicare surtax) combined with a FICA tax rate of 15.3 percent. This produces the "best estimate" of the increase in federal revenues that would occur if the earnings limit is increased. But since this estimate ignores the Medicare surtax, it is still conservative.

To obtain the net impact on federal revenues from increasing the earnings limit, it is necessary to make two adjustments to the numbers in Table B-1. First, in addition to the increase in income from labor there will also be an increase in capital income as a result of the increased work effort of elderly workers. On the average, the U.S. economy produces 50 cents in capital income for every $1 in labor income.[2] Second, as a result of increasing the earnings limit, the

---

[1]For example, in his analysis of the effects of the Reagan tax cuts, Robert Haveman (University of Wisconsin) estimates that the elderly are 2-1/2 times as sensitive to tax rates as male, adult workers under age 62. See Robert Haveman, "How Much Have the Reagan Administration's Tax and Spending Policies Increased Work Efforts?" in Charles R. Hulten and Isabel V. Sawhill, eds., *The Legacy of Reaganomics: Prospects for Long-Term Growth*, (Washington, D.C.: The Urban Institute Press, 1984), p. 114. See also, David R. Henderson, "Analyzing the Reagan Record," NCPA Policy Report No. 114, October, 1984, pp. 9-12.

[2]The average marginal tax rate on corporate capital is 47 percent (including dividend taxes) and the average marginal rate on noncorporate capital is 25 percent. Corporate capital constitutes roughly two-thirds of the U.S. capital stock.

federal government will have to pay more in Social Security benefits. If the earnings limit were completely abolished, we estimate that the federal government would have to pay about $4.8 billion in additional Social Security benefit payments.[3]

Tables B-II and B-III show the net impact of raising the earnings limit, using the two different estimating techniques described above. The net impact on federal revenue is the additional revenue due to taxes on increased wage income plus the additional revenue due to taxes on increased capital income minus the increase in Social Security benefit payments.

Tables V-A and V-B in the text represent interpolations based on Tables B-II and B-III.

We have assumed a 15 percent marginal tax rate on capital; however, because tax depreciation offsets about 62 cents out of every dollar of gross capital income.

[3]The Office of the Actuary estimates that eliminating the earnings test would increase OASDI benefit payments by $3.5 billion in fiscal year 1990 and by $5.3 billion in fiscal year 1991. This translates into $4.8 billion on a calendar year basis. Included are 80,000 new claimants that the Office estimates would file for benefits solely as a result of eliminating the earnings test.

Table B-1

RAISING THE EARNINGS LIMIT:

TAXES ON THE INCREASED EARNINGS OF RETIRED WORKERS, 1990

(Revenues in $ Millions)

	Lower-Bound Estimate		Best Estimate	
Earnings in $1990	Marginal Tax Rate[1]	Added Revenues	Marginal Tax Rate[2]	Added Revenues
$ 8,880	30.30%	$ 28.5	32.63%	$ 30.7
$ 9,360	30.30%	549.2	38.77%	702.7
$10,352	30.30%	747.8	38.77%	956.8
$12,763	30.30%	635.3	38.82%	813.9
$17,727	30.30%	262.1	43.30%	374.6
$24,817	30.30%	368.6	43.30%	526.7
$31,908	30.30%	515.9	43.30%	737.3
$43,041	30.30%	0.0	43.30%	0.0
$63,818	30.30%	0.0	43.30%	0.0
TOTAL		$3,107.4		$4,142.8

[1]Assumes 15 percent income tax bracket and 15.3 percent total payroll tax.

[2]Based on calculations in Table A-1.

Table B-II

TOTAL EFFECTS OF RAISING THE EARNINGS LIMIT:

BEST ESTIMATE[1]

Earnings Limit in 1990	Additional Social Security Benefits Paid	Additional Tax Revenue ($ Millions)[3]	Net Impact On Federal Revenue ($ Millions)
$ 9,360	0	$ 38	$ 38
$10,352	0	877	877
$12,763	$ 37	2,013	1,981
$17,727	125	2,984	2,864
$24,817	553	3,423	2,875
$31,908	1,133	4,041	2,913
$43,041	1,719	4,906	3,192
$63,818	2,658	4,906	2,253
Unlimited[2]	4,773	4,906	140

[1]Entries are cumulative totals.

[2]Includes $693 million in Social Security benefits paid to new claimants.

[3]Includes taxes on labor income (shown in Table B-I) plus taxes on income from capital.

TABLE B-III

TOTAL EFFECTS OF RAISING THE EARNINGS LIMIT:

LOWER-BOUND ESTIMATE[1]

($ Millions)

Earnings Limit in 1990	Additional Social Security Benefits Paid ($ Millions)	Additional Tax Revenues ($ Millions)[3]	Net Impact On Federal Revenue ($ Millions)
$ 9,360	0	$ 36	$ 36
$10,352	0	721	721
$12,763	$ 37	1,653	1,616
$17,727	125	2,466	2,321
$24,817	553	2,773	2,220
$31,908	1,133	3,232	2,099
$43,041	1,719	3,876	2,157
$63,818	2,658	3,876	1,218
Unlimited[2]	4,773	3,876	-896

[1]Entries are cumulative totals.

[2]Includes $693 million in Social Security benefits paid to new claimants.

[3]Includes taxes on labor income (shown in Table B-I) plus taxes on income from capital.

ABOUT THE AUTHORS

Aldona Robbins, Vice President of Fiscal Associates and Senior Fellow of the NCPA, has extensive experience with public and private retirement programs. As senior economist in the Office of Economic Policy, U. S. Department of the Treasury from 1979 to 1985, Dr. Robbins performed staff work for the Secretary in his capacity as Managing Trustee of the Social Security trust fund. Her research efforts have resulted in a model to project Social Security benefits and tax revenue. Recent publications include *The ABCs of Social Security; Institute for Research on the Economics of Taxation (IRET) Economic Reports* entitled "Effects of the 1988 and 1990 Social Security Tax Increases" and "Facts about Catastrophic Coverage" (both with Gary Robbins); *IRET Economic Policy Bulletins* entitled "Social Security Build-Up or Shake-Down?" and "Catastrophic Health Insurance is Bad Medicine" (with Dr. William Hurwitz); "The Economic Status of the Aged: Implications for Energy Policy" (with Paul Craig Roberts) in *Proceedings of A Symposium on Energy Costs and the Elderly: The Next Twenty Years* sponsored by the U.S. Department of Health and Human Services; and articles on "End IRA Deductions, but Make Withdrawals Tax-Free" (with Gary Robbins) and "At the Heart of Medicare's Woes" (with Paul Craig Roberts) in the *Wall Street Journal.* Her master's degree and doctorate in economics are from the University of Pittsburgh.

Gary Robbins is President of Fiscal Associates and Senior Fellow of the NCPA. Mr. Robbins has developed a general equilibrium model of the U. S. economy that specifically incorporates the effects of taxes and government spending. Before joining the private sector, he was Chief of the Applied Econometrics Staff at the U. S. Treasury Department from 1982 to 1985, Assistant to the Under Secretary for Tax and Economic Affairs from 1981 to 1982, and Assistant to the Director of the Office of Tax Analysis from 1976 to 1981. Recent publications include an article entitled "Encouraging Private Provision for Long-Term Care" (with Aldona Robbins) in *Compensation and Benefits Management;* an *IRET Economic Policy Bulletin* entitled "Mandating Health Insurance" (with Aldona Robbins and John Goodman); an *IRET Op-Ed* entitled "Tax Catastrophes of Medicare Legislation" (with Aldona Robbins and Norman Ture); and two papers prepared for the Congressional Task Force on Long-Term Health Care Policies entitled "Promoting Long-Term Care Insurance through Existing Retirement Programs" and "Tax Policies to Promote Long-Term Care" (both with Aldona Robbins). Articles entitled, "Why the Tax-Reform Numbers Don't Add Up" (with David Brazell); "End IRA Deduction, but Make Withdrawals Tax-Free" (with Aldona Robbins); and "Tax Reform Aims at Very Industries Up for Protection" (with Paul Craig Roberts) have appeared in the *Wall Street Journal.* He earned his master's degree in economics from Southern Methodist University.

INSTITUTE FOR POLICY INNOVATION

IPI ISSUE BRIEF — No.101-3
Social Security Retirement Earnings Penalty

October 8, 1991

THE SOCIAL SECURITY STEEPLECHASE

By Aldona and Gary Robbins

The retirement earnings limit resembles a steeplechase. A steeplechase places hurdles, water hazards, and other obstacles in the path of rider and horse. Those receiving Social Security benefits who also would like to earn money from work face similar obstacles because of the retirement earnings test.

The retirement earnings limit has been part of Social Security since its inception. This provision currently takes back 33 cents in Social Security benefits for every dollar a worker between 65 and 69 earns in wages and salaries over specified limits. Beneficiaries between the ages of 62 and 64 lose 50 cents in benefits for every dollar earned over the limit. In 1991, the earnings limit for Social Security beneficiaries between 65 and 69 is $9,720, while the limit for beneficiaries between 62 and 64 is $7,080. Beneficiaries over 69 may earn any amount without penalty.

The original argument for a retirement earnings limit was that Social Security was supposed to replace lost earnings. Benefits, the argument went, should not go to people who continue to work after age 65. It was also consistent with the Depression-era view that Social Security was supposed to encourage older workers to leave the labor force to make room for younger workers.

That was nearly sixty years ago. Current fears are that the United States is facing a long-term shortage of workers, not a glut. The continuing labor force presence of older Americans, who possess valuable skills acquired over 30 or 40 years, will be increasingly important to the health of the U.S. economy. In response to these economic realities, Congress is considering proposals to increase the retirement earnings limit or eliminate it altogether.

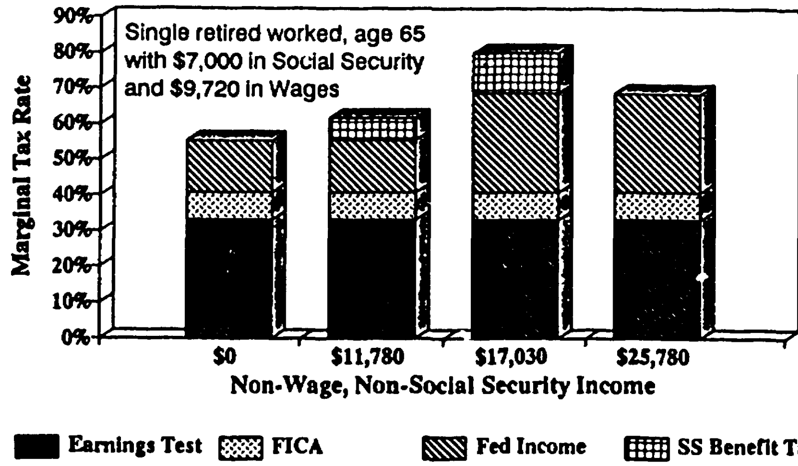
The Height of the Hurdle

A Social Security beneficiary who wants to work faces a high hurdle at the earnings limit — $9,720 in 1991 for someone 65 to 69. The hurdle consists of very high marginal tax rates on additional income from working. These tax rates begin at a minimum of 40.65 percent for a worker between 65 and 69 and can reach over 80 percent, depending upon how much the worker receives in Social Security benefits and other income.

Graph 1 shows the marginal tax rates on the next dollar of earnings for a *single* person age 65 with $9,720 in earnings, $7,000 in benefits, and various levels of other income.

Graph 1

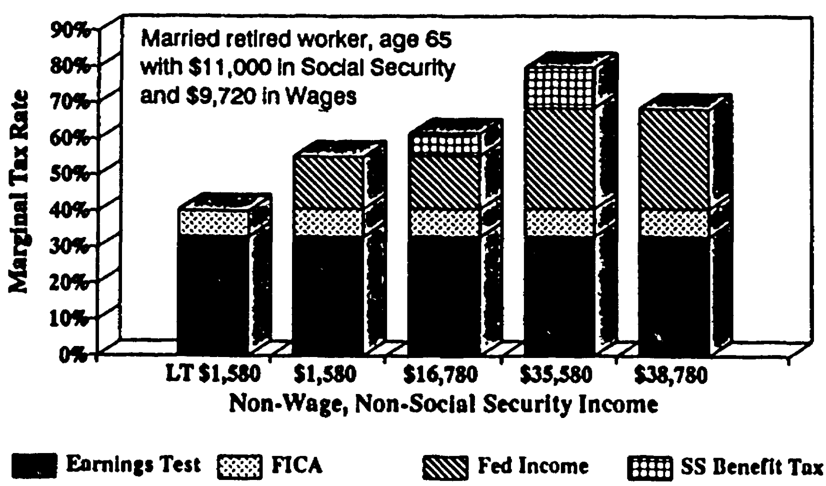
"HEIGHT OF THE HURDLE"
Tax Rate on the Next Dollar of Wages



Graph 2 illustrates the marginal tax rates on the next dollar of earnings for a *married* person age 65 with $9,720 in earnings, $11,000 in Social Security benefits and other levels of income.

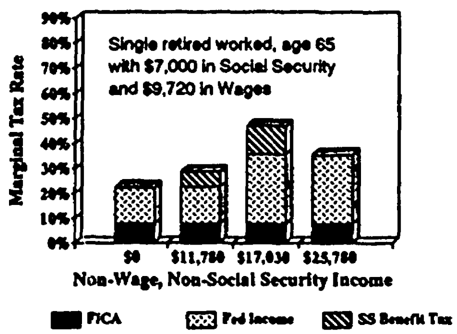
Graph 2

"HEIGHT OF THE HURDLE"
Tax Rate on the Next Dollar of Wages

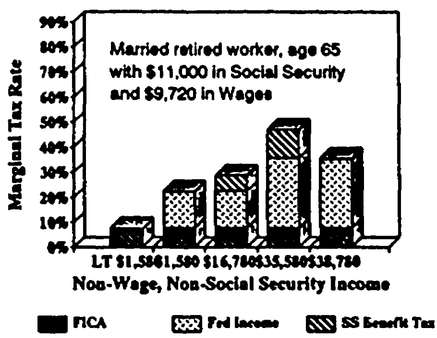


Graphs 3 and 4 show what these marginal tax rates would look like if there were no earnings test.

Graph 3
"NO EARNINGS TEST"
Tax Rate on the Next Dollar of Wages



Graph 4
"NO EARNINGS TEST"
Tax Rate on the Next Dollar of Wages



Currently, the ***minimum*** marginal federal tax rate for someone at the earnings limit who pays no income tax is 40.65 percent — the 33 percent retirement earnings tax plus the 7.65 percent Social Security payroll tax.[1] For someone in the 15 percent federal income tax bracket and just at the earnings ceiling, the marginal tax rate is 55.65 percent. Specifically,

- the 33 percent loss of Social Security benefits for every dollar earned over the earnings limit, plus[2]
- the 15 percent federal income tax rate, plus
- the 7.65 percent FICA tax rate.

The minimum marginal rate for someone in the 28 percent bracket is 68.65 percent.

The tax rates can go even higher due to the taxation of Social Security benefits as income. At the point where benefits become taxable, taxpayers must add $0.50 in Social Security benefits to adjusted gross income (AGI) for every additional dollar of income. This process continues until the maximum one-half of Social Security benefits are included in AGI. On income other than earnings, the tax on Social Security benefits adds another 50 percen' of the marginal income tax rate up to the point where the taxpayer pays taxes on one-half his benefits. Thus, someone in the 15 percent bracket faces an additional 7.5 percent tax rate and someone in the 28 percent bracket faces an additional 14 percent tax rate.

The earnings limit complicates matters. For each dollar in earnings above $9,720, the taxpayer loses 33 cents in Social Security benefits. For taxpayers in the 15 percent bracket, taxing benefits adds another 6.26 percent. For taxpayers in the 28 percent bracket, taxing benefits adds 11.67 percent. Marginal federal tax rates for these workers thus exceed 80 percent.

State and local income tax rates make the marginal tax rate on earnings above the earnings limit even higher. For someone in a state with a 4 percent income tax rate, the marginal tax rates on earnings would range from 44.65 percent to 84.32 percent.

Length of the Hazard

A steeplechase rider that negotiates the first hurdle is not home. On the other side lies another obstacle. The same is true for the Social Security beneficiary at the earnings limit. In this case the hazard is the range of income over which the high tax rates apply. The length of the "hazard" depends upon the amount received in Social Security benefits.

The earnings test, which significantly contributes to the high marginal rates, ends only when the beneficiary has no more Social Security benefits to lose. For someone between 65 and 69, the range of income over which the high marginal tax rates apply is ***three times*** the amount of Social Security benefits. For someone between 62 and 64, it is ***twice*** the Social Security benefit amount.

Graph 5 illustrates the "hazard" for a married retired worker, age 65, with $11,000 in benefits and no other income. If that individual decides to work, the marginal tax rate on the next dollar of wages will be:

- 7.65 percent, the FICA payroll tax rate, for wages up to $9,720;
- 40.65 percent, the FICA tax plus the earnings test penalty, for wages between $9,720 and $11,300;
- 55.65 percent, the FICA tax, the earnings test penalty, and a 15 percent federal income tax, for wages between $11,300 and $26,500;
- 61.91 percent, the FICA tax, the earnings test penalty, the 15 percent federal income tax, and the tax on Social Security benefits, for wages between $26,500 and $42,719; and
- 80.32 percent, the FICA tax, the earnings test penalty, the 28 percent federal income tax, and the tax on Social Security benefits, for wages at $42,720.

A Regressive Tax

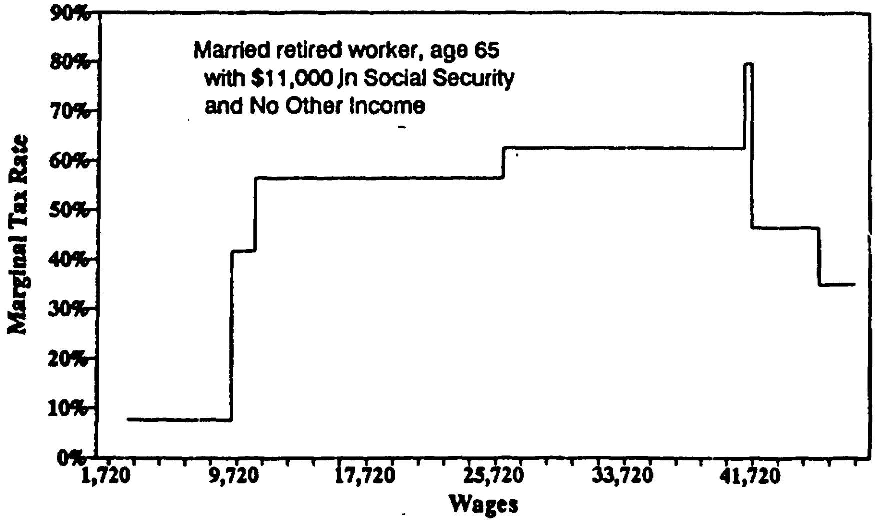
For this individual, the earnings test taxes away all of his Social Security benefits at $42,720 in wages.[3] After that point, the tax rate on the next dollar of wages drops to 47.32 percent (80.32 percent minus 33 percent). At $46,941, the individual is including the maximum one-half Social Security benefits in adjusted gross income and the Social Security benefit tax ends. After $46,941, the marginal tax rate on income falls to 35.65 percent (28 percent for federal income tax and 7.65 percent for the FICA payroll tax).[4]

The Earnings Test Is Controversial

Controversy over what would happen if the Social Security earnings limit were increased or eliminated remains. The chief argument in Washington against its elimination is that it would increase expenditures. But this spending increase would be partially or entirely offset by new revenues collected from the working elderly. Reducing their tax rates would tend to increase their willingness to work.

Graph 5

"LENGTH OF THE HAZARD"
Tax Rate on the Next Dollar of Wages



If the lower tax rates had no effect on the work effort of the elderly, removing it would simply be a boon to those workers who currently have some or all of their Social Security benefits withheld. As such, it would cost the federal government on the order of $4 to $5 billion in higher annual benefit payments.

But reducing their marginal tax rates might elicit a significant increase in the work effort of older Americans. The earnings limit causes older workers to cut back the number of hours they work, to select jobs they might not take if there were no limit, or to drop out of the labor market altogether. Eliminating or substantially liberalizing the earnings limit would encourage greater work effort, which in turn would result in increased payroll and income tax revenue that would partially or completely offset the higher Social Security benefit payments.

Misleading Studies

The Social Security Administration (SSA) believes that, at most, some 170,000 older workers might increase their earnings. SSA points to studies on the labor supply of older workers.[5] Some of the studies are irrelevant: They address the question of how a worker decides to retire, how elderly workers respond to changes in gross wage rates, and what relationships describe hours worked across different levels of income at a point in time rather than the response of workers to changing conditions. Whatever the method, the conclusion drawn is that, at most, only those people with wages roughly 10 percent on either side of the earnings limit — $8,700 to $10,700 in 1991 — would be affected. Thus, they mistakenly conclude, removal of the limit would have no effect on the behavior of those earning lower wages, higher wages, or those not working at all.

There is increasing evidence that people supply labor in response to their *aftertax* wages. Estimates on labor supply elasticities for the U.S. economy range from 0.2 to 0.4. For example, an elasticity of 0.2 means that a 10 percent increase (or decrease) in the aftertax wage rate would bring forth a 2 percent increase (or decrease) in labor supply. The labor supply elasticities of so-called secondary workers, such as teenagers or the elderly, are much higher than those of primary workers, such as prime-age married men. The elderly would be expected to be more responsive to changes in the aftertax wage as they tend to have greater flexibility to accept or reject employment than other groups in the labor force.

Paying People Not to Work

Marginal wage tax rates between 40 and 80 percent are a clear disincentive to work. Some Social Security beneficiaries do continue to work after age 65. About 26 percent of retired workers between 65 and 69 who are eligible for Social Security benefits report some earnings. Of those working, 65 percent earn less than the retirement earnings limit.

In the absence of the earnings limit, the earnings distribution of retired workers between 65 and 69 would be different. Specifically, there would not be the sharp drop in the number with earnings above the earnings test. Furthermore, the entire shape of the earnings curve would change as workers readjusted hours and non-workers re-entered the labor market.

If people 65 to 69 respond to changes in their aftertax earnings the same way workers economy-wide do, elimination of the earnings limit would result in about 760,000 more "jobs."[6] (Economy-wide a 10 percent increase in aftertax wages results in a 3 percent increase in employment.) "Job" is used here to mean the average hours worked by people in the affected groups. Although insufficient data prevent us from splitting the increase in employment between new entrants and increased work hours, this increase in work effort could occur in three ways:

- An additional 760,000 people would be working. This would require that the labor force participation rate of retired workers between the ages of 65 and 69 increase from 26 percent to 37 percent.
- Those already employed could increase their work hours. For example, four people working one-quarter time who increased their hours to half-time would constitute one "new" job.
- Or, most likely, there would be some combination of new entrants and increased hours from those already employed.

Increased Work Effort and the Economy

The increase in work effort would mean more income for both capital and labor. This higher income, in turn, would mean increased income and payroll tax revenues for government. If the labor force response of people between the ages of 65 and 69 is the same as workers economy-wide, the increased federal revenues from the additional work effort would completely offset the higher Social Security benefit payments from elimination of the earnings test.

Other studies have found that older people are actually ***more responsive*** to changes in their wage rates than prime-age workers who support families and who make up the bulk of the labor market.[7] If that is the case, the federal government would come out ahead.

Changing the Earnings Test

There are currently a number of proposals to reduce the earnings penalty. One bill, proposed by Representative Dennis Hastert (R-IL) and 244 House co-sponsors, would eliminate the test altogether. Senate Finance Committee Chairman Lloyd Bentsen (D-TX) has proposed to raise the earnings limit to $25,200, more than doubling what it is expected to be under present law. Another bill proposed by House Ways and Means Committee Chairman Dan Rostenkowski (D-IL) and Social Security subcommittee Chairman Andrew Jacobs (D-IN) would raise the earnings limit to $16,200 in 1996, or $3,860 above present law.[8]

Last year's budget agreement, the Omnibus Budget Reconciliation Act (1990), could reduce positive economic effects from liberalizing the earnings test. OBRA mandates strict technical procedures and estimations methods that essentially ignore behavioral adjustments caused by policy changes. Furthermore, OBRA's pay-as-you-go requirement means that any new spending program or tax cut must be offset with spending reductions or tax increases elsewhere. The earnings test is being "scored" as a spending increase due to higher Social Security benefit payments.[9]

To offset the "costs" of raising the limit, the Bentsen and Rostenkowski-Jacobs bills would raise the amount of earnings subject to the Social Security payroll tax by $3,000 over present law. Doing so, however, would raise the marginal tax on labor economy-wide. The resulting increase in the cost of labor could mean between 75,000 and 100,000 fewer jobs, considerably dampening the positive impact of raising the earnings limit.[10]

Conclusion

The earnings limitation is an anachronism. It should be repealed, or at least substantially raised, because:

- It is an exorbitant tax: It increases marginal tax rates on the earnings of seniors by 33 to 50 percent.
- It is a regressive tax: The earnings limit penalizes lower and middle income elderly workers more than those receiving higher incomes.
- The savings in reduced Social Security benefits are more than outweighed by labor market distortions; and
- Future demographic trends, labor force pressures, and longer life expectancies dictate that we encourage, not discourage, experienced workers to remain active in the labor market.

Note: Nothing written here should be construed as necessarily reflecting the views of the Institute for Policy Innovation or as an attempt to aid or hinder the passage of any bill before Congress.

ENDNOTES

1. In 1991, only married taxpayers could fall into this category because the $9,720 in earnings brings the single person over the $6,400 in standard deductions and exemptions.

2. The Social Security Administration claims that the delayed retirement credit offsets some of the benefits reclaimed by the earnings test. Workers who delay receiving social security benefits past normal retirement age are rewarded with an increase in their future benefits. For each month that benefits are withheld due to the earnings test, the retired worker receives a pro-rated share of the credit. The delayed retirement credit, which is currently 3.5 percent a year, is scheduled to rise to 8 percent a year by 2005. This increase in lifetime social security benefits, however, falls far short of offsetting the tax imposed by the earnings penalty.

3. The point at which the earnings test phases out for someone between ages 65 and 69 is the earnings limit plus three times the Social Security benefit amount. In this case, $9,720 plus $33,000. For someone between the ages of 62 and 64 with $11,000 in benefits, the earnings tax phases out at the earnings limit plus two times the benefit amount. In this case it would be $7,080 plus $22,000, or $29,080. Although the earnings penalty is higher, the range over which it applies is shorter.

4. At higher income levels marginal rates go back up again.

5. Michael V. Leonesio, "The Effects of the Social Security Retirement 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.

6. These results are based upon the study, "Paying People Not To Work: The Economic Cost of the Social Security Retirement Earnings Limit," by Aldona and Gary Robbins for The Institute for Policy Innovation and the National Center for Policy Analysis, Dallas, TX, September 1989.

7. Robert Haveman, "How Much Have the Reagan Administration Tax and Spending Policies Increased Work Efforts?" in Charles R. Hulten and Isabel V. Sawhill, eds., *The Legacy of Reaganomics: Prospects for Long-term Growth* (Washington, DC: The Urban Institute Press, 1984), p. 114. See also David R. Henderson, "Analyzing the Reagan Record," National Center for Policy Analysis, Policy Report No. 114, October 1984, pp. 9-12.

8. The earnings limit for persons 65 through 69 under present law is estimated to be $12,360 in 1996. The Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, *1991 Annual Report of The Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Washington, DC, May 1991, Table D3, p. 136.

9. Social security is off-budget for purposes of deficit calculations under the budget agreement. Technically, the earnings limit could be exempted from the pay-as-you-go requirements.

10. This estimate is based upon those contained in Aldona and Gary Robbins, "Reducing Social Security Taxes: Sound Policy for Today and Tomorrow?" IPI Policy Report No. 110, March 1991.

PREPARED STATEMENT OF MARTHA MCSTEEN

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. I am pleased to appear before the Finance Committee to express the National Committee's support both for substantially increasing the earnings limitation for persons who have reached age 65 and for repealing the 1993 increase in the taxation of Social Security benefits.

Under the proposals in the Senior Citizens' Equity Act sponsored by Sen. John McCain, R-Ariz., by the year 2000 the Social Security earnings limitation would be increased to $30,000 and the amount of benefits taxable will decline gradually from 85 percent to 50 percent. 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 exacts a high price which would be substantially reduced by increasing the earnings limitation to $30,000. The National Committee also estimates that beneficiaries affected by the increased tax will save an average of $158 in 1996 increasing to $662 in the year 2000.

Increasing the Earnings Limitation

Members of the National Committee to Preserve Social Security and Medicare welcome as a major step in the right direction the proposal to raise the Social Security earnings limitation to $30,000 by 2000 for persons who have reached age 65. The National Committee also supports complete repeal of the earnings limitation for those 65 and over.

Many National Committee members need or want to work, but they also deserve to receive their retirement benefits. Today it is difficult to understand why benefits are still tied to an earnings limitation. It is really viewed as a relic of the depression years. National Committee members do not believe that members of the 104th Congress would sanction such a provision if they were starting new.

Yet, in the past, concern over the short-term cost and the continued use of Social Security trust funds to offset general budget deficits has kept Congress from relieving workers of the financial penalties of the earnings limitation. Likewise it has prevented the Social Security Administration from eliminating its administrative burden. Mr. Chairman, you have indicated by your past sponsorship of Truth in Budgeting Legislation that you agree that Social Security should not be part of the unified budget. Social Security has the reserves to cover the short-term cost.

The National Committee agrees with the need to pay for this change over the long-term. Fortunately, the long-term cost to repeal the earnings limit is a negligible 0.03 percent of payroll and somewhat smaller if the earnings limit is increased rather than repealed. By 2008, scheduled increases in the delayed retirement credit will fully offset any savings from the earnings limit. Also alternative investments could increase revenue sufficiently to cover the cost. Each 0.5 percentage point increase in the assumed real interest rate increases the long-range actuarial balance by about 0.3 percent of taxable payroll.[1] Chambers Associates prepared a research monograph on Social Security investment options for the National Committee last summer and we hope that the Advisory Council on Social Security will consider this option.

Financing the increase in the earnings limit, however, is a minor issue relative to the larger problem of long-term solvency. The Advisory Council on Social Security will be making recommendations about long-term financing later this year. The National Committee believes changes

[1] 1994 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, p. 137.

such as an increase in the retirement age in the context of restoring long-term solvency should be considered.

Let me review some considerations involved in creating the Social Security system. A major goal in 1935 was to move older workers out of the work force to open up jobs for younger, unemployed workers. Even in 1935, the concept that there was a one-for-one tradeoff between entrants into and departures from the work force represented a misreading of the dynamics of the economy. Nevertheless the availability of Social Security benefits made retirement feasible for workers unable or unwilling to continue working and the earnings limitation encouraged into retirement those who might otherwise have chosen to remain in the work force. Workers wisely responded to the double-edged disincentive.

Assuming for the sake of argument that the economy of the 1930s and the post-World War II 1940s required extreme measures to get older workers out of the work force, those conditions do not exist today. Yet the earnings limitation is still in place, and still encourages older workers to retire because it financially penalizes many of those who do not retire.

Under existing circumstances, it is hard to imagine why any senior would continue working after reaching retirement age. The truth of the matter is that, like younger workers, many need the money. Increased costs of living, including high health care costs, force many retirees to supplement their savings and fixed income.

Social Security is often depicted as one element of a three-part retirement-income package. Savings and pensions are meant to provide the remaining two-thirds. A fact difficult to accept is that almost 50 percent of retired men and over 75 percent of retired women have no pensions to supplement Social Security. For those who do have pensions, lack of cost-of-living adjustments after retirement mean a continuing decline in the purchasing power of those pensions.

Savings can be equally elusive. Investments are not always successful and for those who chose bank or savings accounts to avoid the risk of a loss of principal, the decline in interest rates has meant far less income than anticipated at retirement. Some have seen life savings wiped out by medical expenses not covered by Medicare or incurred before becoming eligible for Medicare. Younger spouses of retired workers, particularly those with preexisting conditions, for example, can find themselves without health insurance protection and unable to buy a policy.

Other seniors remain in the work force or reenter the work force to meet extraordinary medical or nursing care expenses of an ill spouse. And, as life spans increase, more and more retirees find themselves responsible for the care of an aged parent.

Statistics compiled by the Social Security Administration from the Census Bureau Current Population Survey demonstrate that seniors who work have approximately twice the median total income of seniors who do not work (see chart 1) and are one-fifth less likely to live in poverty (see chart 2).

Independence has long been a hallmark of today's seniors. To be able to maintain that independence in later years is very important. However, not all seniors work because they need the money. Many seniors enjoy their work and the associations that come with work. They receive satisfaction from continuing to be productive and creative. Instead of a national policy to encourage the continuing use of talent and energy, this nation discourages it by placing a limitation on earnings.

Research by the Commonwealth Fund's Americans over 55 at Work Program identified 1.6 million Americans between the ages of 65 through 69 who were ready and able to work. Interestingly, the largest group of seniors 55 or older who pronounced themselves ready and able to work were in the 65 through 69 age group. This is the group who are not only discouraged from trying to supplement retirement income, but who are also penalized with a lifetime loss in Social Security benefits.

Whether the senior works out of the need for extra income or the pleasure of working or both, the combination of FICA payroll taxes, income tax and the loss of Social Security if earnings exceed the limitation exacts a high price.

Opponents of raising the earnings limit argue that eliminating the earnings limitation would give to the wealthy who "don't need Social Security." Need is not supposed to be a criterion. Upper income workers have paid for their benefits. This attitude is nothing more than means testing in disguise.

High income individuals have another decided advantage over those with lesser income and assets. Unearned income from savings and investments often provide a substantial supplement to Social Security. But unearned income never affects a right to benefits. A question of equity exists in these situations.

Over the years, Congress has increased the earnings limits and reduced the penalty. This has been a big help to many seniors. Yet the current limit of $11,160 a year for those age 65-69 is anything but generous, especially in metropolitan areas like New York, Chicago or Los Angeles where the cost of living is high. And it is hardly a princely sum in many other communities.

Many seniors learned the hard way about the earnings limitation. A National Committee member from Texas learned his lessen well in the first year of retirement when his earnings exceeded the limit. He had to ask that all benefits be ceased until he was out of debt. But to make up for the loss of Social Security income, he needed to increase his earnings over those intended. Again, he went over the limit and lost three more checks the following year. In June of 1995, he will reach age 70. Until then he will continue to keep his earnings right at the limit. He writes

> For a salary equal to the earnings limitation, I agreed to work from 8:00 a.m. to noon. Now I work from 6:30 a.m. to noon, but my pay is the same. . . . I would like all of them (Members of Congress) to get $900 in Social Security and be limited in what they can earn over that. . . . We need to raise the cap to $20,000 now. Taxes, insurance and utilities have been raised. All we want to do is live like human beings.

It is estimated by Social Security actuaries that eliminating the retirement test and recomputations would save $50 to $100 million a year in administrative expenses. If the earnings limitation was eliminated, 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 and the new benefit 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. Each year of work generates endless paperwork both for the Social Security Administration and for the beneficiary. These are resource intensive administrative operations.

Although the administrative costs would not totally be eliminated if the earnings limitation was raised to $30,000, any simplification of the process and reduction in the number of violations would be cost effective.

Repeal the 1993 Increase in the Tax on Social Security Benefits

The 1993 budget bill increased the amount of Social Security benefits subject to tax from 50 percent to 85 percent for individual beneficiaries with income above $34,000 or for couples with income above $44,000. The Administration consistently claimed that the 1993 budget package would only increase taxes for the upper one percent of Americans and, while that was true for younger American taxpayers, it was not true for senior taxpayers.

The increased taxation affected about 13 percent of Social Security beneficiaries in 1994 and it is estimated that it will affect about 17 percent in 1998—unless it is repealed. Therefore, National Committee members strongly endorse the proposal to repeal the tax increase. There are four reasons why the proposal to repeal the increased tax on Social Security benefits makes sound public policy.

First, under the proposal in the Senior Citizens' Equity Act sponsored by Mr. McCain, the amount of benefits taxable will decline gradually from 85 percent to 50 percent. The National Committee estimates (see Table 1) that affected beneficiaries will save an average of $158 in 1996 increasing to $662 in the year 2000.

Table 1. Impact of Repeal of 85 Percent Taxation of Benefits on Social Security Beneficiaries (S. 30)

Year	Percent of Benefits Taxed	Revenue Reduction	Number of Beneficiaries Affected	Average Tax Savings for Beneficiaries Affected
1996	75%	$0.9 billion	5.7 million	$158
1997	65%	$2.2 billion	6.2 million	$355
1998	60%	$3.1 billion	6.7 million	$463
1999	55%	$4.1 billion	7.2 million	$569
2000	50%	$5.1 billion	7.7 million	$662

Source: SSA. National Committee estimated number of beneficiaries affected in 1997, 1998 and 1999 and average tax savings. Revenue estimates and average tax savings are for fiscal years.

Second, no Social Security benefits were taxed during Social Security's first 44 years and up to 50 percent have been taxed only for the last ten years. The National Committee is concerned that the increase in the taxation of Social Security benefits could undermine future public support for Social Security.

Bracket Creep

Third, support for the higher tax is built on the flawed assumptions that most low and middle income beneficiaries will not be affected by the increased taxation of Social Security benefits. "Bracket creep" has been eliminated for every taxpayer except Social Security beneficiaries. Individuals have paid tax on 50 percent of Social Security benefits with income above $25,000 ($32,000 for a couple) since 1984 when benefits were first taxed. Over time, many moderate and low income retirees will see their income pushed over the thresholds for paying tax on benefits because the thresholds are not indexed. In 1984, these thresholds were high enough so that only ten percent of beneficiaries paid tax on benefits. By 1998, 26 percent of beneficiaries will pay tax on benefits according to the Social Security Administration. While the income thresholds for paying tax on 85 percent of benefits are higher, they are also not indexed. As a result, most middle income and even some low income beneficiaries will be affected over time.

Because the threshold for married couples is only 29 percent higher than for individuals, married couples are more likely to pay tax on 85 percent of benefits than individuals, especially if one of the married persons is still in the work force.

Further, the increased tax is a heavier burden on middle income seniors with income between $40,000 and $80,000 than it is on upper income seniors whose taxable Social Security benefits are capped at no more than 85 percent of Social Security benefits.

Excessive Progressivity

Fourth, some defend the increased tax as fair, because they believe that Social Security is not progressive. Yet the benefit formula already is very progressive. Taxing up to 85 percent of benefits is excessive and discourages retirement savings.

Although frequently not acknowledged, the Social Security benefit formula favors low income workers at the expense of upper income workers. Benefits for a low earner are approximately 58 percent of average earnings, 43 percent for an average earner and only 24 percent for the maximum earner. If a maximum earner with a monthly benefit of $1,195 in 1995 would receive 43 percent of average earnings, his or her benefit would be $946 a month higher. The low earner would lose $133 a month if he received only 43 percent of average earnings. The $946, which the maximum earner loses, is in effect a "tax" to provide $133 more in benefits for a lower income workers.

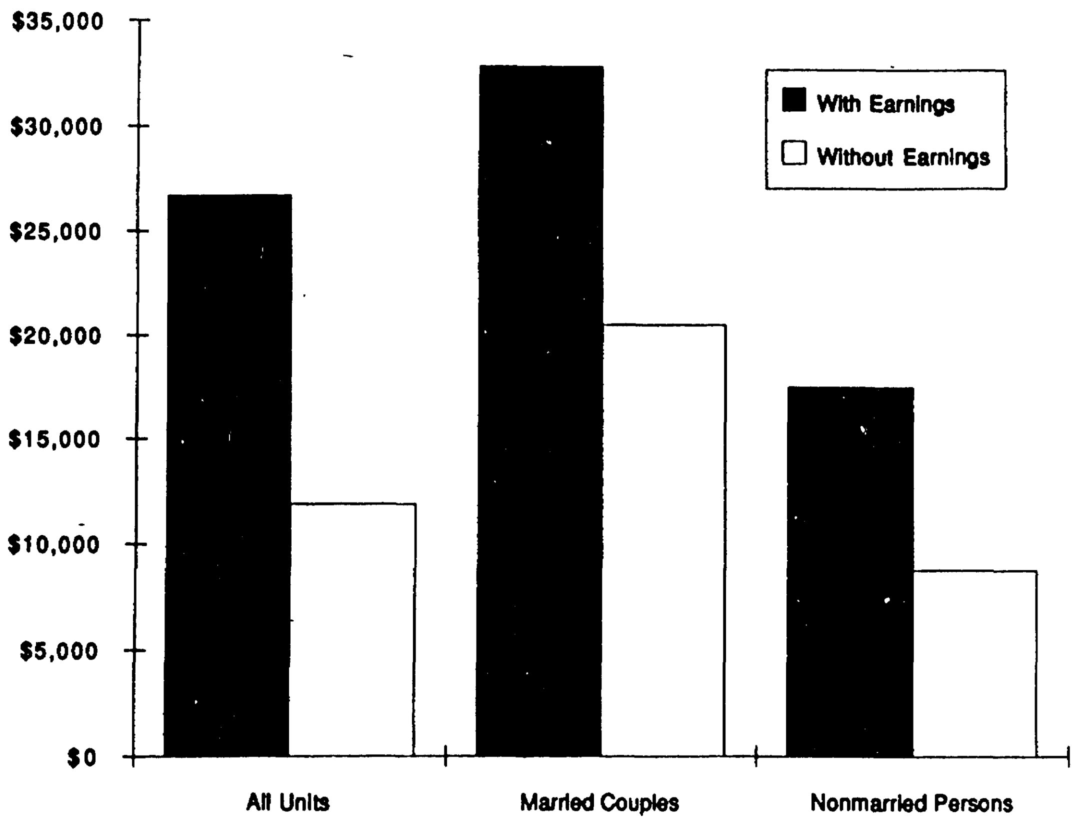
Support for taxing benefits grows out of the belief that all beneficiaries receive huge windfalls, windfalls that upper income beneficiaries don't need. But the so-called windfalls that earlier generations received under Social Security, typical of all pay-as-you-go pension plans in the early years, are no longer true for Social Security benefits today. For the average earner who retired at age 65 in 1994, taking into account COLAs and continued accrual of interest, it takes 16 years to receive back the combined employer-employee OASI payroll taxes plus interest. It takes a maximum earner 22 years. With the average male life expectancy at age 65 of 15 years, the average earner

breaks even and the high earner subsidizes the low earner.[2] Factoring in the reduction in benefits due to the taxation of benefits could add three or more years to the number of years it takes to receive back contributions.

Conclusion

Thank you Mr. Chairman for holding this hearing. Retirees of today and tomorrow look forward to the passage of the Senior Citizens' Equity Act.

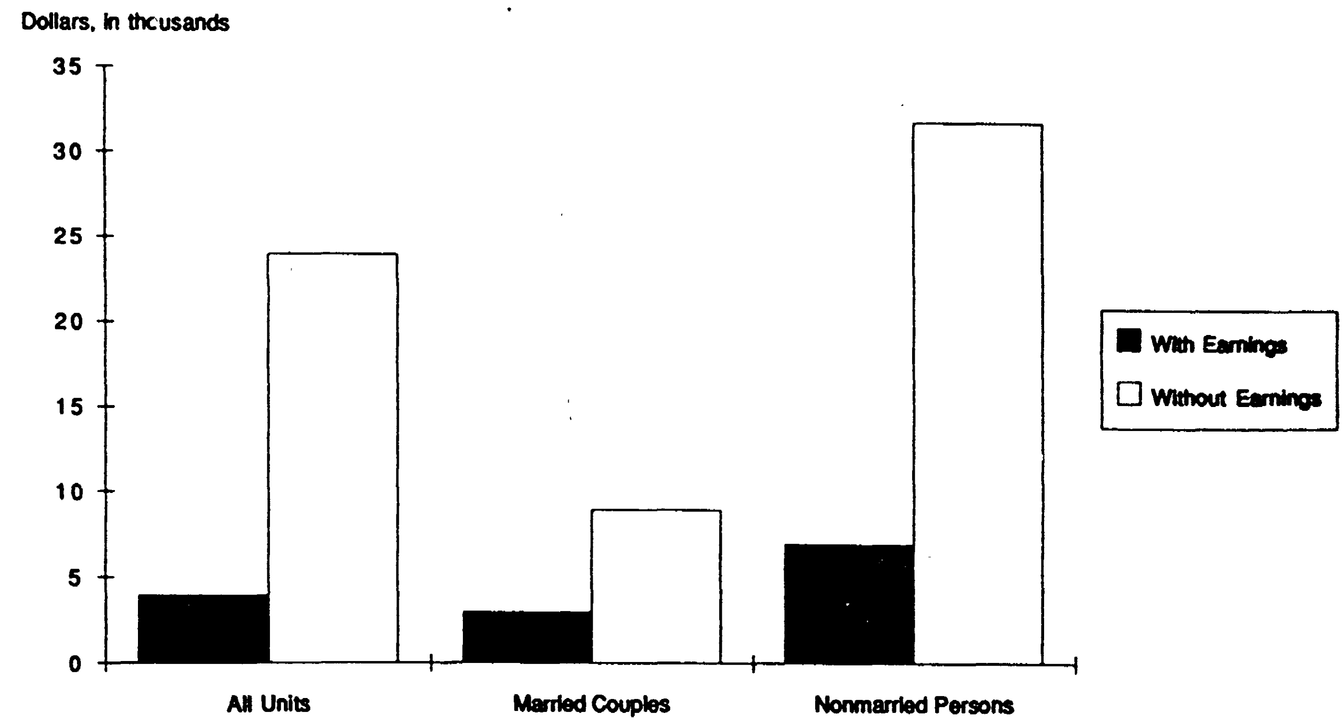
Chart 1, Median Total Money Income, Aged Units 65 and Older, 1992



Source: *Income of the Population 55 and Older, 1992*, Social Security Administration, May 1994

[2] Geoffrey Kollman, "How Long Does It Take New Retirees to Recover the Value of Their Social Security Taxes?" Congressional Research Service (94-5 EPW), updated January 3, 1994, p. 9, illustration 10.

Chart 2, Percent of Aged Units 65 and Older Below Poverty Line, 1992



Source, *Income of the Population 55 and Older, 1992*, Social Security Administration, May 1994 millennium

THIRD MILLENNIUM, 817 Broadway, New York, NY 10003 Ph: 212 979.2001 E-Mail: thirdmil@reach.com

Senate Finance Committee Testimony of Deroy Murdock
Co-Founder & Board Member of
Third Millennium: Advocates For The Future
March 1, 1995

My name is Deroy Murdock. I am a co-founder and national board member of Third Millennium, a non-partisan New York-based educational and advocacy organization launched by young Americans born after 1960. My organization is grateful for the invitation to join you this morning, and I personally am honored to have the opportunity to address this august panel.

On the matters at hand today, Third Millennium wishes to add the voices of our members in all 50 states to those that have urged repeal of the existing Social Security Earnings Limit Threshold. The earnings limit creates a significant disincentive for seniors who either choose or have no choice but to remain in the labor force. Reducing the Social Security benefits of seniors who earn any sum over $11,160 cruelly drops the boom on people struggling to get by in their sunset years.

Eliminating this provision will encourage them to continue working and paying tax revenues into the Treasury. In fact, the National Center for Policy Analysis estimates that while the Federal government would pay $4.8 billion in additional benefits to these seniors, they, in turn, would pay $4.94 billion in additional taxes. Net Federal revenues would *grow* by $140 million.

Second, Third Millennium believes the tax increase on Social Security benefits should be replaced with a strict means test on Social Security and other entitlements based on the Concord Coalition's Zero Deficit Plan. In short, retirees with entitlement, interest, employment and private pension incomes below $40,000 would not have their benefits touched. Benefits would drop by multiples of 10 percent for every $10,000 above that $40,000 limit.

In other words, a couple with a total income of $55,000 including $10,000 in Social Security and $5,000 worth of Medicare insurance payments would see a 10 percent drop in their Social Security benefits plus a 20 percent reduction in their Medicare payments. The means test would reduce their entitlement benefits from $15,000 to $13,000. The Concord Coalition estimates that this prudent yet realistic approach to America's mushrooming entitlement problem would save $68 billion in the year 2000 alone.

We also would urge Congress to stop the inefficient practice of taxing Social Security and other entitlement payments. It makes no sense to pay recipients money, then turn around and tax it back later. Why not just write smaller checks instead? While today's approach excites accountants and tax attorneys, it would be far more efficient to avoid this give-with-one-hand-and-snatch-with-the-other method and simply reduce payments by a predetermined amount.

Now, in all candor, Mr. Chairman, I must point out that this entire discussion on the Senior Citizens Fairness Act is akin to watering the rose bushes as the whole house goes up in flames. Hard-working Americans of all ages continue to pump money into a Social Security system that treats their hard-earned cash as kindling for a bonfire.

Of the $376 billion in revenues wheeled through the front door of the Social Security system last year, $320 billion kept rolling right through the back door, directly into the hands of today's retirees. The remaining $56 billion—the so-called Social Security Trust Fund—disappeared through a side exit. It was loaned to the U.S. Treasury to mop up an equal amount of red ink that funded everything from fighter jets to refreshments on Air Force One. The Treasury replaced these greenbacks with Special Issue Treasury Notes or, in plain English, IOUs.

I think the American public, or at least people my age, now realize that their money is *not* safeguarded and invested in gold bars, real estate or preferred shares of General Electric. The crisis of confidence in Social Security was brought to light in a bipartisan survey Third Millennium commissioned. It was conducted by GOP researcher Dr. Frank Luntz and Democratic consultant Mark Siegel.

Last fall, we asked 500 Americans between the ages of 18 and 34 for their views on Social Security. Only nine percent expect the system to provide them the income they need for their retirement. A mere 28 percent expect Social Security even to exist when they retire. Meanwhile, 46 percent say they believe in UFOs. In other words, Mr. Chairman, people my age believe that in our lifetime, we are more likely to see a flying saucer than a Social Security check.

Our poll also found overwhelming support for what we believe is the ultimate answer to the Social Security conundrum. Eighty-two percent of young Americans want to be given the freedom to invest all or part of their Social Security payments in private retirement accounts that they would own, control and even pass along to their children and grandchildren. We also discovered a plurality of senior citizens endorse this concept. The tremendous boost in savings and capital formation that a privatized Social Security system would institutionalize would keep interest rates low and provide tens of billions of dollars to the economy that could be used for new plant and equipment, research and development and worthwhile investment projects.

Economists agree that Chile's private Social Security system is one of the chief reasons that Latin American country is booming today. That's why Argentina, Bolivia, Colombia, Peru and other Latin countries are adopting the Chilean model and thriving as a consequence. If such bold reforms can flourish in the emerging markets, there's no reason why they wouldn't succeed in the United States. Senator Bob Kerrey (D—NE) and former Senator John Danforth (R—MO) took a small step in the right direction when they suggested last year that people be freed to devote a portion of their FICA payments each month to an account that would be in their hands rather than those of legislators and civil servants in Washington.

Last month, Senate Majority Leader Robert Dole, an esteemed member of this Committee, declared, "I...believe that we can't keep Social Security off the table forever." Senator Dole is right on target. For people in my generation, Social Security already is on the table. The questions are: will legislators carve off the fat so that needy Baby Boomers will get the portions they expect? And, will people my age be excused from the table to nourish themselves elsewhere?

And to return to an earlier metaphor, while my generation is willing to make the sacrifices necessary to douse the flames engulfing our national house, it will take the concerted effort of all Americans to clean up the damage and rebuild. With Social Security now on a rendezvous with bankruptcy as early as 2014, the time to start reconstructing or even replacing this system is not in the next Congress or next year, but today.

This year, Social Security turns 60. For 60 years, Social Security has worked hard, and soon it hardly will be working. We suggest that today mark the beginning of a candid and sincere national dialogue on how to move beyond Social Security to a system of private retirement accounts. We further propose that by the year 2000, when Social Security turns 65, we give it the retirement party it so richly deserves. Getting from here to there won't be easy, but there is a large and growing constituency demanding fundamental progress in this area.

Mr. Chairman and members of this Committee, the power to change is in your hands. Please lead us so we can move forward, together.

Thank you very much.

The Washington Post

TUESDAY, SEPTEMBER 27, 1994

Poll Finds Young Americans Doubt Social Security Future

By Jennifer Dixon
Associated Press

Young Americans find it easier to believe in UFOs than in the likelihood that Social Security will be around when they retire, says a group that surveyed the nation's "Generation X."

The survey, released yesterday, tells a "chilling tale of young people convinced that the social contract between the generations has been dissolved," said the sponsoring group, Third Millennium.

The name refers to the period following the year 2000, when people in the age group sometimes called Generation X will be moving into positions of authority.

Just over one-fourth of those surveyed between the ages of 18 and 34 believe Social Security will still exist when they retire, compared with 46 percent who think there are UFOs.

Only 9 percent of the young people think Social Security will have the money to pay their retirement benefits.

"Despite their faith in UFOs, young people know that the solution to the Social Security funding crisis—and the national debt crisis—will not fall from the sky," said Richard Thau, Third Millennium executive director.

Indeed, a new draft report by the Congressional Budget Office concludes that "no easy fixes to the funding problems of the Social Security system exist."

Right now, the Social Security trust funds take in more than they spend. This year alone, CBO estimates that Social Security will collect about $58 billion more than it will pay in benefits.

See SOCIAL SECURITY, C6, Col. 4

UFOs Top Safety Net In Survey

SOCIAL SECURITY, From C1

But during the retirement years of the baby boomers, the generation of people born between 1946 and 1964, annual benefits will exceed receipts and the trust funds will be exhausted by 2029, unless changes are made.

The congressional budget experts, in their draft study, conclude that improving the investment returns of Social Security's trust funds or investing to improve overall economic growth will not solve the funding problem.

Third Millennium, based in New York, was founded in July 1993 as an advocacy and education group to raise awareness about long-term problems facing America and offer solutions to those problems, Thau said.

Its poll found that one-third of senior citizens think they are getting less than they deserve from Social Security, although their benefits have outstripped their contributions.

According to the poll, just over half of the youth surveyed supported paying benefits based on need and making benefits 100 percent taxable for wealthy recipients.

The poll was conducted in early September and had a margin of error of plus or minus 4.4 percentage points. Surveyed were 500 Generation Xers and 500 senior citizens.

STATEMENT BY ROBERT J. MYERS PRESENTED TO THE COMMITTEE ON FINANCE, U.S. SENATE, MARCH 1, 1995, WITH REGARD TO THE SOCIAL SECURITY EARNINGS LIMIT AND THE INCOME TAXATION OF BENEFITS

Mr. Chairman and Members of the Committee: My name is Robert J. Myers. I served in various actuarial capacities with the Social Security Administration and its predecessor agencies during 1934-70, being Chief Actuary for the last 23 of those years. In 1981-82, I was Deputy Commissioner of Social Security, and in 1982-83, I was Executive Director of the National Commission on Social Security Reform. In 1994, I was a member of the Commission on the Social Security "Notch" Issue, being an appointee of the Senate.

Purpose and History of Retirement Earnings Test

The retirement earnings test under the Old-Age, Survivors, and Disability Insurance program has, over the years, attempted to draw a line between a person being retired and being employed. In the original Act, this provision was on an "all or none" basis; benefits were to be withheld if the person engaged in "regular employment" (not defined in the law). This concept was changed in the 1939 Act (before monthly benefits first became payable) so as to establish covered wages of $15 per month as the point at which the person would not be considered retired, and therefore no benefits would be payable.

Over the years, the earnings test has been changed so as to phase in more smoothly and equitably for persons who have moderate earnings. At present, there is an annual exempt amount -- currently, $11,280 for persons aged 65-69 and $8,160 for younger persons -- such that persons with earnings equal to or less than this receive full benefits, whereas those with higher earnings who are under age 65 have their benefits reduced by $1 for every $2 of excess earnings, on a $1-for-$3 basis. While for those aged 65-69, the reduction is on a $1-for-$3 basis.

Originally, the earnings tests applied at all ages. The 1950 Act provided that it should not be applicable after attainment of age 75. Such limiting age was reduced to 72, effective for 1955, and then to 70, effective for 1983. In all logic, there is no reason to have a limiting age beyond which the test does not apply. This basis of a limiting age was adopted solely because of political pressures arising from individuals who argued that, otherwise, they would never get any return on their contributions because they would work all their lifetime.

Individuals who have benefits withheld because of excess earnings are compensated therefor, as to OASDI benefits, through two means. First, the additional earnings result in a recomputation that may increase subsequent benefit amounts -- but this will not always occur, depending upon the current level of earnings as contrasted with that in previous years. Second, future benefits are increased by the Delayed-Retirement Credit (DRC), which is at the rate of 3% per year for those who attain age 65 in 1982-89 (1% for those attaining age 65 earlier), but increases gradually for persons reaching age 65 later. Thus, for persons who attain age 65 in 1994-95, the DRC is at the rate of 4-1/2%; for 1996-97 attainments, it is 5%. In the long run, the DRC will be at the rate of 8% per year -- for those attaining the Normal Retirement Age in 2009 (when it will be age 66) and thereafter.

It is important to note that, when the DRC is 8%, it will then be approximately the actuarial equivalent. By this is meant that, insofar as the OASDI program is concerned, the long-range cost effect of persons delaying retirement and then receiving larger benefits due to the DRCs will be approximately the same as though benefits were payable automatically at the Normal Retirement Age, regardless of subsequent earnings. It may also be noted that this actuarial equivalency is present for those who now retire before the Normal Retirement AGe (currently, age 65). Specifically, at present, if an individual retires at age 62, the benefit is 80% of that available at age 65. Thus, if retirement were deferred for 3 years, the benefit would be 25% higher relatively, or about 8% per year of delay.

Over the years, the earnings test has been perhaps the most controversial feature of the OASDI program insofar as the general public was concerned. Many people view it as being unfair because they believe it to be a significant deterrent to continued employment -- which, as I will discuss later, is frequently actually the case. Still other persons believe the earnings test to be unfair because they believe that "they have bought and paid for the benefits to be payable at age 65" -- but this is not a correct conclusion, because the "insurance" provided was against retirement, not against attainment of age 65.

In defense of the earnings test, the basic argument is that it is not appropriate to pay retirement benefits to people who are not retired, because they are still in the paid labor market. Employers having private pension plans do not continue individuals in employment beyond the normal retirement age and pay them both salary and pension. Especially, it is argued that program costs should not be incurred in paying benefits to persons beyond the Normal Retirement Age who are earning high salaries -- often as much or more than they ever did in the past.

Effect of Legislative Restrictions on Benefit Liberalizations

Before discussing how the retirement earnings test should be liberalized, I would like to describe certain current legislative restrictions that artificially and illogically hinder such action. There is the requirement that any increases in outgo in the next five years resulting therefrom must be offset by reductions in other outgo under the program and/or by increases in program income. Two faults occur in connection with this requirement.

First, in a long-range social insurance program that is self-financing -- as Social Security has been for over half a century -- the only important matter is the long-run effect of the proposed change. If the increased cost of a proposal is negligible when measured over the 75-year valuation period, the short-run, 5-year cost is irrelevant, and it should not be considered in relation to the general-budget deficit. In fact, the operations of the self-supporting Social Security system should not be considered at all with regard to our horrendous general-budget deficit, which it did not cause at all at any time. Either reducing or increasing Social Security's outgo has no effect whatsoever on the National Debt, but rather on the proportion owned by the general public as against the proportion owned by the trust funds.

Second, the 5-year restriction would prevent a desirable proposal that would significantly strengthen the long-range financial status of the Social Security program, but would have small excesses of outgo over income in the next five years. This seems to be a matter of being pound-wise, but penny-foolish!

My Views as to Desirable Changes in Retirement Earnings Test

I believe strongly, in theory, in the principle of the retirement test. However, up to this time, despite great effort to have the test operate so as to phase in equitably for persons between full employment and full retirement, it produces significant disincentives for employment for a large number of persons.

Quite obviously, persons with relatively low earnings -- below the annual exempt amount - have no work disincentives on account of the test. However, those with higher earnings -- up to perhaps $40,000, or about twice the nationwide average earnings -- have very considerable disincentives. Additional work by them beyond the annual exempt amount results not only in a loss of some benefits, but also the payment of higher federal and state income taxes -- and Social Security and Medicare taxes as well. As a result, the net gain from additional work will be relatively small. For more specific details on the subject, may I refer to my paper, "Income of Social Security Beneficiaries as Affected by Earnings Test and Income Taxes on Benefits" in The Journal of Risk and Insurance, June 1985.

As a partial offset to the small incentive to work under such circumstances, there is the favorable financial effect over the long run that larger benefits will eventually be payable when retirement occurs (or at age 70, if earlier). However, although this is a very real offsetting feature, many people so affected do not understand its effect, but rather they only look at current net income and not also -- as should properly be done -- at the present value of the additional future benefits.

I am convinced that the best solution to the problems caused by the earnings test is to eliminate it for all persons at or above the Normal Retirement Age and, at the same time, to raise the DRC to 8% for all future non-payment of benefits for persons at or above the Normal Retirement Age. Further, the DRC should be made applicable at ages 70 and over, for those who wish to defer benefit receipt until they cease employment. I might point out that I made this recommendation in a hearing before this subcommittee on May 23, 1990.

Simultaneously, a continuing educational campaign should be mounted to inform individuals about the advantages of deferring claim for benefits until they actually retire after the Normal Retirement Age, so that they receive the substantial increases from the DRCs. Such procedure results in much better benefit design -- namely, having only earnings while working, and then having a larger benefit while retired, versus a very high income while working (earnings, plus "normal" benefits), but sharply reduced income while retired ("normal" benefits only). Furthermore, such levelling of income over the years after Normal Retirement Age might produce lower income taxes over all.

These changes would increase the cost of the program somewhat. Such increased cost due to the larger DRCs will ultimately be present anyhow under present law. If we can afford it then, we can afford it now! Actually, increasing the DRCs at once would reduce costs somewhat in the short run because individuals would be more likely to defer retirement, and thus receipt of benefits.

Change in Retirement Earnings Test in the Senior Citizens' Equity Act

The Republican Contract with America contains the Senior Citizens' Equity Act. One portion of this bill would raise the annual exempt amount of earnings under the retirement earnings test for persons at and above the Normal Retirement Age (currently, age 65) and below age 70 to $15,000 for 1996, $19,000 for 1997, $23,000 for 1998, $27,000 for 1999, and $30,000 for 2000, with automatic adjustment thereafter based on increases in nationwide average wages. The $30,000 figure for 2000 compares with an estimated figure of $13,680 that would result under the automatic-adjustment provisions in present law (based on the intermediate-cost estimate).

This change would go a long way toward solving the problem of work disincentives for lower-earning and middle-earning workers, as discussed previously. At the same time, high-earning workers would not be able to receive benefits currently, although they would instead have the partially compensating effect of the Delayed-Retirement Credits. And, in fact, after about 15 years from now, the effect of such credits would, from an actuarial viewpoint, approximately compensate for the loss of benefits due to substantial employment.

Some relatively small additional cost to the Social Security program would result if this change were made, but such cost would almost entirely be restricted to the next 15 years. Much of the higher cost in the next 5 years would be offset later, because the additional benefits paid immediately would mean that fewer Delayed-Retirement Credits would be earned, and so lower benefits would be payable over the long run as compared with present law. Thus, as I have indicated previously, it is illogical to apply the 5-year restriction on increased outgo, rather than looking solely at the long-range effect.

Some persons have proposed that part of the cost of liberalizing the earnings test should be met by eliminating recomputations of benefits to take into account earnings received after initial entitlement to retirement benefits. I strongly oppose such a change. First, I believe that potential OASDI benefit rights should be available on all earnings credits for which contributions have been paid. Second, it is unfair to place persons in the position that they must decide when it is most (or least) advantageous to file claim (and the District Offices of SSA cannot, and will not, advise them on such matters). Instead, the long-standing principle should be continued that individuals are never adversely affected by early claims filing.

In summary, I strongly support the proposal in the Senior Citizens' Equity Act that would significantly increase the annual earnings limit in the retirement earnings test for persons above the Normal Retirement Age and under age 70. This would most certainly create a much more equitable situation as to work incentives and receipt of Social Security benefits for low-earning and middle-earning workers aged 65 and over. The increased cost involved is extremely small -- even negligible -- when measured over the long run, taking into account all factors, especially the effect of the Delayed-Retirement Credits.

History of Income Taxation of Social Security Benefits

In the early 1940s, the Bureau of Internal Revenue issued a ruling that OASI Benefits were not subject to income tax. This was done largely on the ground that they were considered as gratuities from the government (based, probably, on the fact that the benefits and the taxes which finance them in large part are in different titles of the Social Security Act).

From time to time, proposals have been made that the benefits should be included in taxable income, just as are private pensions in contributory plans. The basis usually advocated was that 50% of the benefits should be so included -- on the simplistic, and erroneous, grounds that the employee taxes (which are made out of after-tax income) "purchase" half of the benefits. This would be more generous treatment than that provided in a defined-contribution plan with equal employer and employee contributions, under which less than 50% of the pension comes from employee contributions (as a result of the interest earnings on the employer-employee contributions), and so more than 50% of the pension must be included in taxable income.

Even though a portion of OASDI benefits is included in taxable income for income-tax purposes, a substantial proportion of the beneficiaries would not pay any income tax. Many have little or no other income, and the effect of personal exemptions and deductions will very often result in no income-tax liability.

Several times in the years preceding the 1983 Act, the Congress passed unanimously (or close thereto) nonbinding resolutions to the effect that never, never would OASDI benefits be made subject to income tax. Nonetheless, because sources of additional resources were needed to solve the financing crisis in 1983, the legislation of that year included such a provision, with the proceeds of the income taxation of benefits being returned to the OASDI Trust Funds.

Some who favored this income-tax procedure as to the treatment of OASDI benefits did so on the grounds that it was good tax policy. They, however, questioned the return of the additional taxes resulting to the OASDI Trust Funds, which they viewed as general-revenue financing, the first injected into the program on a continuing basis. Such procedure of returning the taxes to the pension fund is not followed for private pension plans, so such persons saw no reason why it should be done for OASDI -- other than on the weak grounds that the trust funds "need the money."

The procedure for the income taxation of Social Security benefits adopted in the 1983 Amendments was to include in adjusted gross the smaller of (1) 50% of the benefits for the year or (2) 50% of the excess of the sum of (a) "preliminary" adjusted gross income, (b) tax-exempt interest, and (c) 50% of the benefits for the year, over the statutory thresholds ($25,000 for single persons and $32,000 for married couples filing joint returns). Quite consistently and logically, the 50% factor for Social Security benefits is used throughout.

In the early 1990s, because of the problems with the General Budget, proposals were made to make more of the benefits be subject to income tax. The goal was to have the benefits be taxable in the same general manner as private pensions. However, for administrative simplicity (as well as for the fact that all necessary data were not readily available to the beneficiaries), the proposals frequently were that 85% of the benefits --rather than the original 50% -- should be taxable.

Why Social Security Benefits Should Be Adequately Taxed

I believe that, in theory, Social Security benefits should be properly subject to income tax. This should apply to the benefit exclusive of the part which may be said to arise from the individual's Social Security contributions, which came out of after-tax income. In practice, some approximations or transitional arrangements may be necessary in order to achieve administrative simplicity and ease of application.

I do not view such income taxation as a needs or means test, or as a reduction in benefits, but rather such taxation is merely good, equitable tax policy. Persons with low and moderate incomes will not be adversely affected by including the proper portion of Social Security benefits in their income for income-tax purposes, because they will not pay any income taxes anyhow -- as a result of personal exemptions and the standard deduction.

Some view the taxation of OASDI benefits as introducing a means or income test into the program. Others view it as a reduction in benefits for higher-income persons, and thus as the introduction of more social adequacy at the expense of less individual equity. Still others view the current procedure as good tax policy accompanied by poor Social Security policy, as a result of introducing general revenues into the long-range financing of the OASDI program.

How Social Security Benefits Should Properly be Subject to Income Tax

Assuming that Social Security benefits should be subject to income tax, other than the portion arising from the individual's post-tax contributions, there are several ways in which this income taxation can be done.

One method would be to follow exactly the same procedure as is used in connection with contributory private pensions. I reject this because it is too complicated, even if it were done on a rough approximate basis. I also reject this procedure because it is not done in an actuarially equitable manner, but rather it has been geared to the needs of the federal government, so as to bring in as much money as quickly as possible, rather than being equitably averaged out over the individual's lifetime.

I believe that the proper basis of income taxation of Social Security benefits is to consider the portion thereof which is "actuarially purchased" by the individual's past contributions (without regard to interest or to indexing so as to reflect wage inflation over the years). In other words, I would follow the basis used in the money's-worth computations that Bruce D. Schobel and I did in a paper that was the subject of a hearing before this Committee on 3/11/93. The procedure to be followed is to tax no higher portion of the Social Security benefit than the proportion of the benefit which was not "actuarially purchased" by the individual's total contributions in the past for the case of a person who currently attains age 65 and has had maximum taxable earnings as an employee ever since age 21.

On this basis, rough justice would prevail at the present time if 80% of the benefit were to be taxed. This basis could be continued for the next 5 years, and then the proportion should be decreased to 78% in 1998-2007, 76% for the following 10 years, 74% for the next 10 years, and ultimately 72% (after 2027). Such a schedule should be written into the law and, of course, should be modified from time to time as the contribution rates are changed from those in present law.

The underlying basis for the percentage factors which I recommend is described in my paper "Is the 85-percent Factor for Taxing Social Security Benefits Perpetually Correct?" from Tax Notes, March 15, 1993.
I might mention that the 85% basis was correct about 5 years ago, but -- as mentioned previously -- this rate declines slowly over time.

It seems inappropriate to consider past contributions either accumulated with interest, or else indexed to reflect changes in earnings levels, for the purpose of determining the "purchased" benefit for income-tax purposes. My belief is based on the fact that no income taxes were levied in the past on such increments to the nominal contributions.

What Should Be Done with Proceeds of Increased Income Taxation of Social Security Benefits?

A very important matter is what should be done with the proceeds of the increased income taxation of Social Security benefits. This is not often discussed. As is well known, these income taxes under the present provision are returned from the General Fund of the Treasury to the OASDI Trust Funds. Although this is not at all logical -- because the income taxes on private pensions do not revert to such plans -- it was intentionally done as one of the measures to solve the financing crisis of the OASDI program in 1983. Accordingly, I would recommend continuing this procedure for the portion of the income taxes based on the 50% rate, but any additional income taxes should not go to the Hospital Insurance Trust Fund (as at present), but rather should remain in the General Fund and thus assist in really diminishing our horrendous budget deficit.

It is most important to note that receipts from the income taxes on benefits under the present provisions do not reduce the federal budget deficit by a single penny! On the other hand, I believe that the additional income taxes on benefits should be treated just the same as other income taxes and be applied against federal general expenditures, and thus reduce the federal budget deficit.

The new, additional income taxes on Social Security benefits under OBRA of 1993 are diverted from the General Fund to the Hospital Insurance Trust Fund. This is presumably done because that trust fund needs more financing over the long run. For the reasons given previously, I oppose any such diversion because these income taxes, like any others, should be used for general purposes. The financing problems of the HI Trust Fund should be solved directly and openly.

Conclusions as to Income Taxation of Social Security Benefits

I do not believe that the 85% maximum rate on the amount of Social Security benefits which can be taxable should be reduced to 50%, or in other words reverting to the basis established by the 1983 Amendments. Instead, I recommend that such maximum rate should be decreased to 80% for the next 3 years, with scheduled decreases of 1% every 2 years thereafter, to 72% eventually. On this basis, benefits would be taxable in a manner which is equitable to all beneficiaries, with none being over-taxed and most receiving favorable treatment.

Finally, as to how the changes in the taxation of benefits and in the retirement earnings test could be made without increasing the federal budget deficit, I believe, as indicated previously, that such deficit is not really affected in any way thereby. In fact, if the proceeds from the reduced amount above the 50% rate which I recommend were left in the General Fund, instead of going to the Hospital Insurance Trust Fund, the budget deficit would be reduced in reality.

PREPARED STATEMENT OF SENATOR WILLIAM V. ROTH, JR.

Thank you, Mr. Chairman. I commend you for holding today's hearing on the Social Security earnings limitation, and the 85% tax on social security benefits.

I firmly believe that the earnings limitation is a work disincentive that makes little sense in this day and age. I do not think that seniors should be penalized for continuing to work whether it is to remain active or to make ends meet. This restriction in the Social Security system is a burden to Social Security recipients; for many, an economic load that is difficult to bear.

I have been a long-time proponent of increased savings incentives in the tax law. The 85% tax on social security benefits was one of the biggest "disincentives" in the law for savings. The massage that was sent by the President's tax increase on seniors was, "don't save for your retirement, because you'll be punished if you do. You are better off under the Clinton Administration if you spend all your money today, and forget about tomorrow!" What kind of plan for saving and investment was this?

Last year, too many seemed to be pre-occupied with raising taxes to pay for more government programs, without considering the impact these disincentives have on Americans.

Finally, I would like to point out a major flaw in the Administration's theory that the 85% tax on benefits will treat social security pensions more like private and public pensions. I strongly disagree. In fact, the 85 percent inclusion ratio is not fair, it results in the double taxation of seniors of today and tomorrow, and it is not based on the current law rules for other pension plans. Future generations are now locked in to paying taxes on 85% of their benefits, resulting in massive double taxation, because they are paying very high payroll taxes now. I might add, the new rules are exceedingly complex.

I am glad that the Chairman called the hearing today to explore these issues, and I will work to repeal the earnings limitation, and repeal the unfair tax burden on America's seniors caused by the 85% tax on benefits—which is why I have co-sponsored S. 50, a bill to repeal the 85% tax.

Thank you.

COMMUNICATIONS

PREPARED STATEMENT OF THE AIR FORCE SERGEANTS ASSOCIATION

(BY JAMES D. STATON, CHIEF MASTER SERGEANT, USAF (RET.))

Mr. Chairman and distinguished committee members, on behalf of the 160,000 members of the Air Force Sergeants Association (AFSA), I appreciate having this opportunity to express our views on an issue being closely watched by older enlisted veterans and their families, and all senior Americans. AFSA represents the millions of active, retired and veteran enlisted members (and families) of the Air Force, Air Force Reserve and Air National Guard.

Over the years, this association has worked with Congress to eliminate the Social Security Earnings Test or significantly increase the earnings threshold ceiling. Most recently, we welcomed the support of Senator John McCain (R-AZ) and Representative J. Dennis Hastert (R-IL), who clearly reflect the views of our senior citizens. We, too, were frustrated last year by overwhelming congressional support (with strong bipartisan co-sponsorship) stifled by inaction within congressional committees. Clearly, the time has come for action.

I am here to express, on behalf of our members, our strong endorsement of the effort to eliminate the Social Security Earnings Test or raise its earnings threshold. The current proposal would permit seniors of retirement age to earn approximately $4,000 more each year for the next five years, raising the earnings cap to $30,000 by the year 2000. Under current law, a working senior aged 62 to 64 who earns over $8,160 loses 50 cents in benefits for every dollar above the threshold. Seniors between 65 and 69 can earn only $11,280 before being penalized, and have their benefits reduced by $1 for every $3 earned. This extremely unfair tax clearly must be changed.

I would submit that there are several national problems with the current system that require immediate attention. It puts our senior former-enlisted citizens at risk. It blatantly tells our senior citizens, once again, that this nation does not need their input into our working economy. It serves as a disincentive for senior Americans to remain active and productive. It taxes those who can afford it least at rates experienced nowhere else in our society. Finally, it permits the wealthy non-working seniors to collect their full Social Security benefit with no penalty. In short, it reneges on the reciprocal contract our nation has with its citizens to treat them fairly if they work to ensure its economic and social vitality.

Enlisted veterans and retirees will most certainly be affected by this program. During their careers, they are called upon, by and large, to work very difficult jobs at pay levels far below those experienced in the civilian sector. Savings and preparation for the future are usually deferred in light of the low wages.

These patriots are called upon to sacrifice all, if necessary to protect our nation. Many do. And yet, those few who invest a third of their lives to serving our nation, and reach retirement, enter the job market at a disadvantage because of their middle age. Make no mistake: Enlisted retirement must be supplemented with a second job to exist in our society. As these veterans reach Social Security age and enter their most physically vulnerable years, they must often continue to work.

The first message they receive as they enter this age group is that their contribution is no longer needed or wanted by a nation that once depended on them for its defense. They can continue to work, but it will cost them: Once again, our nation sends the message too pervasive in many government programs: You will benefit more if you fail to produce; if you work, you will be penalized.

Thus, these veterans are forced to examine the resources that will help them manage their final years. A military annuity check and Social Security will have to completely underwrite the cost of their lives, homes, health care—in short, their well-being.

Unfortunately, this disincentive to work, created by the Social Security Earnings Test, can be gladly embraced only by those who are wealthy. Usually, enlisted veterans don't have the luxury of choice. They must work, and they again face a greater-than-normal burden.

Clearly, no other group in our society is as highly taxed as those who are penalized under the current earnings test. The administration itself estimates that nearly a million beneficiaries currently lose some or all of their benefits because of the test that applies at age 65. With the one-dollar penalty for every three earned, those in that age group face the equivalent of a marginal tax rate of 33 percent. When the returned benefits are combined with payroll taxes, federal income taxes, state taxes, and a possible tax on up to 85 percent of benefits, marginal tax rates are extraordinarily high. Once again, the disincentive to work is enormous. In fact, in some cases, the combined effect of the earnings limit and the various taxes can result in an equivalent marginal tax rate in excess of 100 percent.

Finally, the current earnings test tells senior citizens that those who least need the economic assistance of Social Security assistance will receive the full benefit without penalty. Only those who are already at jeopardy face the test. Because the earnings test applies only to wage income, those who can afford to live off of dividend and investment income face no reduction in benefits whatsoever. This clearly tells our enlisted seniors that because of their reduced career wages, they will pay still another price for their sacrifice.

Funding and deficit-impact arguments for increasing the earnings threshold or eliminating the earnings test enti: ly have, to this point, been circular. Viewpoints have generally depended on the position of the presenter. The Social Security Administration focuses on short- and long-term costs; it minimizes the positive economic impact on the increased productivity through greater employment of our senior citizens. Others contend that the increased tax income and overall productivity of our seniors will more than compensate for any impact on the deficit. Rather than enter into this argument, we call for this committee to get the facts from bipartisan experts. We charge you to include in your deliberations the need to treat those who enter their late years of citizenship fairly.

While the current proposal will not eliminate the inequities cited here, raising the earnings limit, without penalty, to $30,000 over the next five years is clearly a step in the right direction. It is an effort that has often been proposed but unfairly sidestepped by our congressional leadership for too long. AFSA wholeheartedly endorses your effort.

In closing, Mr. Chairman, the Air Force Sergeants Association does not underestimate the difficulty of the task before you. You are being closely watched by our senior citizens as this committee decides how to make the right decisions for those it represents. We applaud your effort and wish this committee well. As always, AFSA stands ready to assist in any way we can to do the right thing for the senior enlisted members we represent.

Statement of the American Council of the Blind (ACB)

This is testimony for the record by the American Council of the Blind (ACB) in the hearing of March 1, 1995 about the Senior Citizens' Equity Act of 1995 before the Honorable Bob Packwood, Chairman, Committee on Finance, United States Senate.

The American Council of the Blind is a national membership organization established to promote the independence and well-being of individuals who are blind and visually impaired. By providing numerous programs and services, ACB enables blind and visually impaired people to live and work independently, contribute significantly to their communities, and advocate for themselves.

We are greatly concerned about a proposed amendment (sec. 101(b)) in the Senior Citizens' Equity Act which would have far reaching and detrimental effects on people who are blind and who are employed or who may find employment while in receipt of Social Security Disability Insurance (SSDI) benefits. That amendment would destroy the linkage between the basic earnings limit for retirees age 65-69 which is by law used to determine if a blind person is performing Substantial Gainful Activities (SGA). The linkage has been in effect since 1977 and has been helpful to people who are blind in their continuing efforts to be productive members of society. Blind beneficiaries want very much to work and contribute to society, but those who are able to earn enough to approach the SGA level are fearful of losing their SSDI benefits and Medicare coverage. Those fears are serious work disincentives.

The proposed legislation to increase the earnings limitations for retirees would provide those older workers an incentive to remain productively employed. The current earnings limit has been shown to punish senior citizens who must work out of economic necessity, by penalizing them with a loss of benefits if they have earnings above the limit. It is the same for people who are blind, except the penalities are even more punitive since the blind person loses his or her total benefit for the month if the earnings exceed the SGA limitation for that month. If the blind person continued to exceed the earnings limitation he or she would lose benefits and Medicare coverage, and have difficulty in regaining social security benefits.

Retention of the linkage between the SGA level for people who are blind and retirees would have little effect on the numbers of people who are on the SSDI rolls and those who may become eligible in the future. Currently, the number of people who are blind and under the age of 65 in receipt of social security benefits is approximately 109 thousand, based on Social Security Administration estimates. The number includes disabled widows/widowers and disabled adult children.

An increase in the earnings limit for people who are blind would not affect those already on the rolls except to encourage them in their efforts to improve their earnings to the extent possible. An increase in earnings would result in increased social security and medicare taxes, as well as income taxes if the earnings are high enough. As for additional beneficiaries who may become eligible for SSDI, the numbers might increase slightly year by year as the limitations are lifted. It is noted however that the CBO (June 19, 1991) estimated that approximately only 69,000 might be added to the SSDI rolls if the earnings limit for people who are blind was totally removed.

In addition to the above figures, data developed by the Inspector General (IG) of the Department of Health and Human Services more clearly define the possible effects of relaxing the earnings limitations. In September 1993, the IG reported on a study of the Work Experiences of Blind and Non-Blind disabled SSDI Beneficiaries. The IG used 1990 SSA data and found that only 1.6 percent (1,100) of blind beneficiaries had earnings between $6,000 and $9,360 per year, page 6 of the IG report. It was found that only 11.3 percent of blind beneficiaries had some earnings in 1990. If the linkage with the earnings for retirees is retained, based on the above data there would be no additional cost for those already on the rolls. Based on the above, retaining the linkage between those who are blind and the retirees would have little, if any effect, on the numbers of people who are blind and who file for SSDI benefits in the future.

Inasmuch as the definition of disability because of blindness established by law is very strict and specific, the Congress recognized in 1977 that the definition of SGA for people who are blind could best be established by setting a dollar amount for earnings, and that linking such amount to the earnings limitations for the retirees was the most equitable and efficient way of doing so. Should Congress overturn the Congressional actions of 1977 and break that linkage, it would not be helpful to the program at large and would discourage the efforts of those who attempt to remain in the labor market.

Glenn M. Plunkett, Program Associate, American Council of the Blind, 1155 15th St., N.W. S-720, Washington, D.C. 20005, tel. 202-467-5081 fax 5085

Statement of the National Farmers Union

(BY LELAND SWENSON, PRESIDENT)

Mr. Chairman, and members of the committee, I am pleased to represent the 253,000 farm and ranch family members of National Farmers Union in responding to your request for written statements for the printed record of your hearing on proposals to raise the Social Security earnings limit and to repeal the 1993 increase in the taxable portion of Social Security benefits.

The National Farmers Union believes older Americans provide knowledge, experience and skills which make them a valuable national resource. Our organization historically has supported programs which benefit senior citizens.

However, National Farmers Union's membership does not believe the current proposal to raise the Social Security earnings limit to $30,000 by the year 2000 is in the best interests of our nation and its senior citizens, particularly when there is no defined plan to pay the projected $7 billion in increased costs over the next five years.

The Congressional Budget Office (CBO) agrees and has found no data to support arguments that raising the earnings limit will result in large-scale re-entry of individuals into the workforce. CBO's findings result from the fact that no significant behavior changes occurred in the 1970's when the earnings test was liberalized.

CBO further presents data showing that more than 50 percent of new Social Security beneficiaries elect Social Security as soon as they are eligible at age 62, even though amounts are reduced.

The present earnings test exists because Social Security was designed to help replace the income lost by workers when they *genuinely retire.* Because weakening the test broadens the entitlement and would cost the federal government $7 billion over five years it simply does not make sense to take such an action during a time when other *critical* programs for the elderly, children and the truly needy are being slashed or eliminated in the rush to reduce the federal deficit and balance the budget!

Data shows that the neediest beneficiaries would not be helped by this proposal. However, one-third of the $7 billion in increased Social Security costs which would result instead would go to increase benefits to households with incomes of more than $70,000, according to the Social Security Administration. More than half would go to households with incomes of more than $50,000.

As the number of elderly in our population increases due to the aging of baby boomers and improved medical technology, it becomes ever more important to assure the future financial integrity of Social Security.

Delegates to our most recent national convention adopted the following policy statement in this regard:

> "The current Social Security tax rate could be reduced if it were made applicable to all earnings, as is the case with the Medicare tax rate, which in 1993 was applicable to $135,000 in earnings. . . . We urge continued support for strengthening and protecting the Social Security program."

Concerning the increase in the taxable portion of Social Security benefits, National Farmers Union believes this rate could be reduced if it were made applicable to all earnings, as is the case with the Medicare tax rate. We would support such a proposal.

Thank you for the opportunity to express the views of our organization on these important issues.

Statement of the Retired Officers Association

(BY COL. CHRISTOPHER J. GIAIMO, USAF (RET.))

Dear Mr. Chairman: On behalf of The Retired Officers Association, an association comprised of over 400,000 active duty, retired, reserve and guard personnel and their dependents, we wish to express our appreciation for the opportunity to present this statement in support of The Senior Citizens' Equity Act, a bill which proposes to raise the Social Security earnings limit to $30,000 by the year 2000. We support this legislation as a critical first step in redressing the current, unfair, seniors only tax.

Mr. Chairman, The Retired Officers Association (TROA) has worked diligently for the past several years to remedy what we consider to be a grave injustice—a form of discrimination, if you will—being perpetrated against our nation's senior citizens for over fifty years. This injustice comes in the form of the Social Security earnings test. At every turn we have supported efforts to either repeal or amend this egregious law—from whatever source or political party, for we truly believe it to be a non-partisan issue.

We applauded President Clinton's campaign document, *Putting America First,* wherein he pledged to "lift the Social Security earning limitation so that older Americans are able to rebuild our economy and create a better future for all." We stood shoulder to shoulder with 'Senator John McCain in 1991 when he successfully introduced a Social Security earnings test repeal amendment to the Older Americans Act. Likewise, we decried the House of Representative's refusal to act on this measure; a measure which was passed by a voice vote in the Senate. Lastly, we urged our membership to strongly support Senator McCain, Representative Dennis Hastert and their co-sponsoring colleagues in their 1993 efforts to, once again, achieve repeal of this law or, at the very least, incrementally increase the base amount of "excludable" income in some meaningful way. Had we been successful Mr. Chairman, there would be no need for this testimony today.

Members of the committee, the goals and opinions of The Retired Officers Association with respect to the Social Security earnings test have not changed over the years. We continue to maintain that the law is one of the most egregious, inequitable and anachronistic burdens of modern day America. We continue to aver that this law is bad economic policy, bad social policy and bad labor policy.

With your permission, we would like to highlight for the committee our rationale for these views:

- The law unequivocally "targets" senior citizens who wish to continue to work and contribute to America, specifically, those between the ages of 62 and 69 who are eligible to receive social security benefits. We say unequivocally because the Social Security earnings test applies to no other segment of working Americans.
- The tax penalty (and make no mistake about it, it is indeed a tax penalty) is extremely onerous on working seniors, costing those between the ages of 62 and 65, fifty cents in benefits for every one dollar they earn above $11,280 and, for those between the ages of 65 and 70, one dollar in benefits for every three dollars they earn above the limit. Coupled with the recently enacted tax increase on social security benefits for individuals with incomes in excess of $25,000 and couples with incomes in excess of $32,000, the tax penalties imposed by the Social Security earnings test makes working seniors the most highly taxed Americans in our society.
- We believe that the rationale which supported passage of this law some fifty years ago is archaic and out of step with current economic realities and needs to be carefully re-examined. At one time, it was a commonly accepted economic tenet that it was preferable to encourage older workers to leave the work force, have their lost earnings replaced by social security benefits, and have their jobs taken over by those younger workers who were under-employed or unemployed. This tenet is no longer true. Today, America is facing a shortage of skilled labor, a shortage that can be filled by allowing older Americans who have honed their skills over a 30 or 40 year span, to participate in the work force without fear of losing a large portion of their Social Security benefits. America needs to re-examine it's perspective on this issue, to study how American society has changed in the last fifty years and how the Social Security program should and must interface with those employment practices that will carry us well into the 21st century.
- Mr. Chairman and members of the committee, we would like to briefly discuss what we consider to be perhaps the most egregious facet of this law and that is the impact that it has had on the morale of our nation's older citizens. No one, regardless of age, wants to be shunted aside; no one wants to be forced into doing something they don't want to do, especially if they are happy doing it and feel productive. Furthermore, Americans have always believed that as long as a person was willing and able to do a job, then that person should have the freedom to do it to the best of their ability. We know all too well the effects that forced retirement has on people. Higher health care and social service costs are just two that come to mind. People, who were never sick a day in their lives because they were gainfully and productively employed, suddenly become the victims of real or perceived illnesses. Programs (federal, state and local) that provide a variety of services to senior citizens have become fiscally strapped, due in no small measure to a law that forces the beneficiaries of these programs into not working.

Despite what supporters of this law say about the law not denying anyone their constitutional right to work, the practical impact is just the opposite. A reading of the legislative history behind this law amply demonstrates that it's stated purpose was to convince or "force" people not to work, to quit as it were, to make room for younger workers. While it may have been politically expedient and necessary to do so fifty years ago, it is not so today nor should it be.

Finally, we believe Congress has, to a certain extent, been mislead as to the real fiscal impact outright repeal or the incremental raising of the Social Security earnings test base amount would have on our budget deficit. In the past, opponents have postulated that such actions would require an increased expenditure of Social Security funds to pay higher benefits to Social Security eligible recipients, with the result being the eventual bankruptcy of the Social Security trust fund and the addition of yet another huge increase to the federal budget deficit. We do not agree with this position. In an independent study conducted by The Institute for Policy Innovation, it was demonstrated that if the retirement earnings penalty were eliminated, at least 700,000 older workers would re-enter the labor market and that, as a result, our annual output of goods and services would increase by at least $15.4 billion and our government revenues (moneys received by the government through taxes) would increase by some $4.9 billion, more than offsetting the additional Social Security benefits that would be paid. As you can see, there is not a uniformity of opinion on this issue. We would, therefore, as a second critical step, urge the committee to consider the feasibility of having an independent non-governmental agency conduct a thorough analysis of this so-called "threat" and ascertain exactly what the real effects on the budget, Social Security trust fund, etc., would be if a total repeal of the Social Security earnings test were enacted. We also suggest that this study include data on how much revenue would be generated by senior citizens if they were allowed to work freely without fear of loss of social security benefits. If this independent study corroborates the work done by The Institute for Policy Innovation, we strongly recommend you take the final step to repeal the earnings limit entirely.

Mr. Chairman, members of the committee, we thank you for the opportunity to express our views on the issue of the Social Security earnings test. As mentioned earlier, we have been in this battle a long time. On many occasions, we have joined with other like-minded organizations representing the interests of senior citizens in concerted efforts to get the earnings test law repealed or amended. Up to now we have failed in our efforts. Today this committee has a chance to start the ball rolling on crafting a remedy for this long-standing injustice and we applaud you for this effort. In that regard, we urge the committee to carefully examine all aspects of this issue: to commission an independent study of the fiscal impact repealing or amending this law would have on our budget deficit, to listen to those who will explain to you how our country is in need of skilled workers in an increasingly competitive international environment, to listen to those who tell you that they would rather be working than on the federal dole. Then, perhaps, armed with accurate data and a fresh outlook on this issue, you may accomplish meaningful change.

Mr. Chairman, The Non Commissioned Officers Association representing over 160,000 enlisted personnel, active and retired, from all seven uniformed services and their survivors and dependents join with us in presenting this statement.

O

90-371 - 95 (128)