Social Security's Earnings Test Is too Complicated – and It Discourages Work

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But eliminating it would probably do more harm than good.

The most powerful lever to ensure retirement security is **working longer**.

People who delay claiming their Social Security benefit until age 70 will generally **have enough retirement income** to maintain their preretirement standard of living. The goal of policy makers should be to eliminate impediments to working and increase incentives to stay in the workforce.

On the positive side, increasing the earned-income tax credit for workers without dependent children would raise the after-tax wage and encourage work. In terms of eliminating impediments, some argue for eliminating the Social Security earnings test. The problem is that eliminating the earnings test would likely do more harm than good.

Social Security's retirement earnings test is complicated and often misunderstood. Individuals who claim retirement benefits before they reach the Full Retirement Age and continue working have some or all of their monthly Social Security benefits withheld. In 2019, the withholding rate is 50 cents for each dollar earned above $17,640 (for a person reaching the Full

Retirement Age after 2019). For example, a beneficiary earning $40,000 would have $11,180 in benefits withheld (($40,000 – $17,640) x .5 = $11,180).

What most people do not understand is that any benefits withheld under the earnings test are effectively credited back to them with interest once they reach the Full Retirement Age, resulting in a permanent increase in their monthly benefits.

Because people don't understand that any withholdings are credited back, they view the earnings test as a tax and may work less. In response, economists and policy makers who want to encourage work at older ages often suggest reforming or eliminating the earnings test.

However, studies show that changing the earnings test impacts not only labor-force participation and earnings, but also claiming patterns. That is, people may delay claiming to avoid running afoul of the earnings test. To the extent that the elimination of the earnings test encourages people to sign up for benefits earlier, workers and their surviving spouse will end up with lower monthly amounts for life.

The effect of the earnings test on behavior is a well-studied area, and the results are **nicely summarized in a 2013 paper**. The earnings test was liberalized three times between 1970 and 1990, and the studies generally show that earnings by beneficiaries increased by about 15% and that the labor-force participation rate rose by about 3 percentage points as a result of the liberalizations.

In 2000, the earnings test was eliminated for those over the Full Retirement Age. Studies found that benefit claims increased 2-5 percentage points for individuals ages 65 to 69 following the repeal. Since only about 10% of individuals in that age group had not claimed benefits, the response suggests a 20% to 50% increase in claiming among non-beneficiaries. Taking the average of those estimates suggests that the 35% of individuals ages 62 to 66 who have not yet claimed benefits will claim one year earlier. This change means that many survivors, whose benefit depends on when the worker claims, would end up with lower benefits late in life. Thus, the benefits of eliminating the earnings test are reduced complexity and some increase in work incentives, but the risk is increased poverty among the very old as workers claim their benefits earlier. This last consideration helps explain why policy makers retained the earnings test for younger beneficiaries when they eliminated it for beneficiaries above the Full Retirement Age in 2000.