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Brobdingnagian Tax Rates Under the Social Security Earnings Test

by Steve Charnovitz

▶ **The reduction in Social Security benefits experienced by beneficiaries who work raises their implicit marginal tax rate—sometimes to more than ten million percent.** *These extraordinarily high rates occur only in what is called, ironically, the "grace" year.* ◀

Under the U.S. Social Security program, monthly payments may be reduced for beneficiaries who continue working or return to work. This reduction in benefits —known as the *earnings test* or the *retirement test*—raises the implicit marginal tax rate. Numerous studies have demonstrated that older workers can be subjected to high marginal rates as a result of the earnings test in combination with federal income and payroll taxes. For example, Oestreich, Toole and Galbraith found rates as high as 96%.[1] Entin found rates (including state income taxes) as high as 105%.[2] Although the existence of such high rates is well documented, what is less well known is that the marginal rate can, in some cases, go much higher than 100%. Indeed, it can exceed 10,000,000%! Such brobdingnagian tax rates occur only in what is called, ironically, the "grace" year.

The *grace year* is normally the first calendar year that a person receives Social Security benefits.[3] The earnings test operates differently in the grace year than in subsequent years.

Generally, the earnings test works this way. A beneficiary of ages 62-64 may earn up to $7,080 (the annual "exempt amount") in 1991 without any penalty. If he or she makes above $7,080, then any additional earnings are subject to a 50% "tax"—that is, his or her benefits are reduced one dollar for every two dollars of such earnings.[4] A beneficiary of ages 65-69 may earn up to $9,720 in 1991 without penalty. If he or she makes above $9,720, then any additional earnings are subject to a 33⅓% tax—that is, his or her benefits are reduced one dollar for every three dollars of such earnings. There is no earnings penalty for workers over age 69.

In the grace year, however, an additional rule applies. Benefits are not reduced for any month in which the retiree earns one-twelfth or less of the annual exempt amount.[5] For instance, a person who applies for Social Security in 1991 at age 65 can earn up to $810 a month ($9,720 ÷ 12) without incurring any penalty. While the monthly "test" was meant to lead to benign results, this exemption can have a sharply punitive impact on ben-

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TABLE I

Monthly Earnings Test for Mr. Washington

Month	Benefit Entitle-ment	Earnings	Charge-able Excess Earnings	Reduction in Benefit	Monthly Payment
June	$1,022	$ 0	$4,496.11	$ 0.00	$1,022.00
July	1,022	811	4,766.44	1,022.00	0.00
August	1,022	811	4,014.78	1,022.00	0.00
September	1,022	811	3,263.11	1,022.00	0.00
October	1,022	811	2,511.44	1,022.00	0.00
November	1,022	811	1,759.78	1,022.00	0.00
December	1,022	811	1,008.11	1,008.11	13.89

TABLE II

The Difference a Dollar Can Make

Month	Benefit Entitlement	Earnings	Monthly Payment
June	$1,022	$ 0	$1,022.00
July	1,022	810	1,022.00
August	1,022	811	0.00
September	1,022	811	0.00
October	1,022	811	0.00
November	1,022	811	0.00
December	1,022	811	0.00

eficiaries who earn slightly above $810 a month and have sufficiently high preretirement earnings in the grace year.[6] This predicament is best demonstrated by example.

OPERATION OF THE MONTHLY TEST

Take the case of Mr. Washington, who works in a job paying $55,700 a year.[7] On June 1, 1991, Washington turns 65, leaves his job and applies for Social Security. His preretirement income for five months is $23,208. Assuming that Washington has been a high income employee for his entire career, he qualifies for the maximum Social Security benefit of $1,022 per month, which he begins drawing in the month of June.[8] After one month at home, Washington gets bored and takes a part-time job with a local charity paying about $200 a week.

As Table I shows, Washington gets his full benefit of $1,022 for June. Although Washington has $4,496 of "excess earnings" (one-third of the difference between $23,208 and $9,720), these are not charged against him because (by not working in June) he passes the monthly test.[9] In July, however, Washington earns $811.[10] Since this exceeds the monthly exempt amount, he is liable for the full balance of his excess earnings—now $4,766.[11] The most that can be charged against him for July is 100% of his benefit, or $1,022. So Washington loses it all.[12] In August through November, Washington continues to lose all of his benefits as his excess earnings get used up each month. In December, after earning $811, Washington's remaining excess earnings are $1,008.11. So that is what the government reclaims for December. Therefore, his December benefit will be $13.89.[13]

What is Washington's marginal tax rate? Because of the way the monthly test operates in the grace year, there is no single marginal rate for the year. Instead, one must determine the marginal rate for each month. For June, the marginal rate is zero. For December, the marginal rate is the same 33⅓% one normally associates with the earnings test for 65 year olds. For example, if Washington earned $812 in December, his benefit for December would fall from $13.89 to $13.56. In the other five months (July-November), three different methods could be used to calculate his tax rate.[14]

If Washington earned $810 in July instead of $811, his marginal rate for that month would be zero (see Table II). Since Washington earns $811, his tax rate could be calculated by amortizing his additional tax liability over his entire monthly income. Using this method, Washington's "average" marginal rate is 126% ($1,022 ÷ $811).

But that is not a true marginal rate. It does not tell us the extra tax from earning the last (and pivotal) dollar of income. By going from $810 to $811 in income, Washington does not lose 33¢. He loses $1,022.[15] With respect to that dollar of income, Washington's marginal tax rate is 102,200% ($1,022 ÷ $1).

A third way to calculate the marginal rate is to look for the worst possible case—that is, the smallest increment of income that can cost an entire month of benefits. If Washington earned $810.99 in July, he would receive his full $1,022 monthly benefit. But by earning the additional penny, he loses the full $1,022. Viewed in this way, Washington's marginal tax rate (on the penny) is an astonishing 10,200,000%.[16] And that is *before* income taxes!

Exceedingly high marginal rates can occur in any tax structure where rates are a discontinu-

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ous function of income. Sometimes called "cliffs," "notches," "spikes" or "humps," these phenomena result from disqualifications or stepped phase-outs.[17] For instance, Coven has shown that the phase-out of the dependent care credit leads to the possibility of an effective marginal tax rate of 4,800%.[18] The phase-out of the personal exemption under the Omnibus Budget Reconciliation Act of 1990 causes tax rates to spike over 100,000%.[19] Nevertheless, the 10,000,000% rate generated by the earnings test appears to be the highest in existence.

INEQUITIES IN THE GRACE YEAR

To judge whether the high rate imposed on Washington is fair, one can look at how current law would treat other hypothetical beneficiaries in slightly varying circumstances.

Consider the case of Ms. Adams, who is identical to Washington except that she turns 65 on February 1. Adams stops working and begins drawing Social Security on that date and later joins Washington in July in taking the same part-time job. Under the earnings test rules, Adams will receive her full $1,022 benefit for 11 months because her annual earnings are less than $9,720.[20] Despite the fact that Washington and Adams have the same postretirement income, Washington gets far lower benefits than Adams for July through December because the later one retires in the grace year, the more likely the earnings test will penalize postretirement income.

Consider the case of Ms. Jefferson, who is similar to Washington except that she earns a much lower (preretirement) salary. Jefferson leaves her job when Washington does and joins him in July at the same part-time employment. So long as Jefferson's preretirement salary does not exceed an annual level of $11,649, she will not lose a penny of benefits due to her postretirement earnings. Washington gets far lower benefits than Jefferson because the higher one's preretirement salary, the more likely the earnings test will penalize postretirement income.

Consider the case of Ms. Madison, who is identical to Washington except that she earns only $810 rather than $811 a month. At the end of the year, Madison's annual earned income will be $6 less than Washington's. But Madison's Social Security benefits will be $6,118 greater.[21] She will get her full $1,022 monthly benefit for seven months. Madison's preretirement income could even be higher than Washington's—and thus her total annual income could be higher—and she would still receive full benefits. Alternatively, if Madison earns $820 in December, her annual income would again be higher than Washington's, yet she would lose only one month of benefits while Washington loses nearly six full months. Washington gets far lower benefits than Madison because the distribution of postretirement income per month can be more determinative than the total amount of income per year.

Consider the case of Dr. Monroe, who is identical to Washington except that she has a much better understanding of the grace year rules. Monroe applies for Social Security benefits on January 2 effective for that month. Like Washington, Monroe continues to work until June 1 when she becomes 65. Monroe has the same annual earnings as Washington—$23,208 for January through May, nothing for June and $4,866 for July through December.[22] Thus, both claimants have "excess earnings" for the year of $6,118.[23] But unlike Washington, Monroe gets to charge off most of her earnings test penalty to the first five months of the year. So while Washington receives only $13.98 for July through December, Monroe receives $4,983.89.[24] Washington gets far lower benefits than Monroe because the later one retires (i.e., commences entitlement to Social Security) in the grace year, the fewer months are available for charging off excess earnings.[25]

In addition to causing incongruous results in the grace year, the earnings test also leads to first and subsequent year recipients being treated inconsistently. After the grace year, an additional dollar of income from earnings can never cost a retiree (ages 65-69) more than 33¢. Consider the case of Mr. Jackson, who began Social Security in 1990 at the maximum benefit and took a part-time position at $811 a month. In 1991 Jackson can work all 12 months and lose only $4 in benefits (33¢ per month) for the year. Although Washington and Jackson have very similar preretire-

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ment earnings and earn the same postretirement monthly wage, Washington would receive much lower Social Security benefits than Jackson for the last six months of 1991.

The above examples use 65 year olds to demonstrate the inequities of the earnings test because the impact on 62-64 year olds is more complicated. On the one hand, the earnings test for the 62-64 age group is more restrictive because of the lower annual exempt amount ($7,080) and the higher penalty rate (50%). For example, if Washington were a year younger when he retires in June 1991, he would lose all benefits (except for June) at an annual preretirement earned income level as low as $33,163.[26] On the other hand, the earnings test is much less onerous because any months lost (wholly or partially) trigger higher benefits beginning at age 65.[27] Specifically, for each month Washington loses benefits due to the earnings test before he turns 65, his reduction for early retirement will be permanently decreased by one month. Thus, an exact marginal rate calculation would also have to factor in the present value of this future benefit increase.[28]

An examination of these cases shows that slight distinctions can make a big difference in determining Social Security benefits. It is certainly debatable whether these distinctions are justifiable. Should Washington receive far lower Social Security benefits than Adams, Jefferson, Madison, Monroe and Jackson? Should the results of the earnings test hinge on factors like the amount of preretirement income, one's retirement date or whether one earns a penny too much? If not, how could the test be reformed?

WHY THE INEQUITIES OCCUR

The predicament of beneficiaries like Washington can occur whenever both pre- and postretirement earnings are sufficiently large. The punishingly high marginal rates are caused by the interaction of two features of Social Security that occur only in the grace year: (1) an annual earnings test that is retrospective and (2) the monthly exemption.

Normally the annual test measures earnings received by a Social Security recipient after retirement. But in the grace year, the earnings test counts not only postretirement earnings but also preretirement earnings.[29] This retrospective, or look back, provision may lead to an immediate large benefit reduction because a new retiree may begin Social Security with a liability of excess earnings. When that happens, a 33⅓% penalty on preretirement earnings above the exemption is added to the 33⅓% penalty on postretirement earnings.

The extent of preretirement earnings that are "tested" depends upon one's retirement date. Thus, five months will be counted for Washington, while only one month will be counted for Adams. The rationale for treating Washington and Adams differently is that a tax year is the proper period for measurement. Assuming for the sake of argument that this is reasonable, it raises the issue of why the testing of preretirement income should stop at just one tax year since this same logic could be extended to require testing of previous years of preretirement income.

The high marginal rate occurs because of the operation of the annual test in conjunction with the monthly exemption. The monthly exemption causes a cliff because there is no gradual phaseout. A month is either exempt or not exempt.[30] Of course, the monthly test alone does not increase anyone's benefit loss. It can only help a beneficiary. If there were no monthly test in the grace year, a beneficiary could lose even more money than at present. But there would be no cliff effect.

In summary, because preretirement earnings are counted in the initial year, the monthly test is provided to offer grace. It does that. What is questionable is whether it offers enough grace.

ORIGINS OF THE GRACE YEAR CLIFF

The high marginal tax rate caused by the earnings test in the initial year is not a recent anomaly. On the contrary, the cliff is a vestige of the original Social Security Act of 1935.[31] Although the earnings test has been reformed 16 times since then, the possibility of losing an entire month's benefit by earning a penny too much has always existed. What has changed, however, are the circumstances that could lead to such a draconian penalty. The various modifications of the earnings test have continually narrowed these circumstances. Originally, the cliff applied to every beneficiary every month. Now it applies only in the grace year to beneficiaries below the age of 70 who continue to work and exceed the limits of both the annual and monthly tests.

There has always been a monthly exemption from the earnings test in the initial year. Indeed, in 1940, the first year in which benefits were paid, the monthly exemption constituted the entire earn-

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ings test and applied in the initial and all subsequent years.[32] Under the test, beneficiaries lost their entire monthly benefit if they earned wages of $15 or more in such a month.[33]

Over the past 40 years, the earnings test has been repeatedly liberalized. In 1950 the earnings test was abolished for beneficiaries over age 74.[34] In 1955 an annual test was added to the monthly exemption,[35] to permit beneficiaries to work seasonally.[36] Also that year, the earnings test was abolished for beneficiaries over age 71.[37] In 1961 the penalty rate was lowered from 100% to 50% in certain circumstances.[38] In 1973 the 100% rate was completely replaced with a 50% rate.[39] In 1978 the monthly exemption was abolished except for the initial year.[40] The purpose of this change was to prevent certain seasonal workers (e.g., teachers) from receiving full benefits during their months off. According to the House committee report, the monthly test was retained in the grace year so that new beneficiaries who retired "after earning a substantial amount in the year of retirement would get benefits for the months in that year in which the beneficiary actually was retired."[41] In 1983 the earnings test was abolished for beneficiaries over age 69.[42] In 1990 the penalty rate was lowered to 33⅓% for 65-69 year olds.[43]

By contrast, testing preretirement earnings was not part of the original design for Social Security. The earnings test did not begin counting preretirement earnings for employees until 1955 when the annual test was instituted.[44] This new test applied to all income from earnings in a taxable year which, in the first year of eligibility, normally included preretirement income.[45]

Applying the earnings test to preretirement income, it can be argued, violates the original intent of the test. The purpose of Social Security is to replace a portion of the earnings lost from retiring. The function of the earnings test, therefore, is to gauge whether a beneficiary truly is "retired."[46] But in the grace year, the earnings test goes beyond its function of measuring the degree of retirement. By counting preretirement income, the earnings test misuses information not relevant to determining whether a beneficiary has actually "retired."

NUMBER OF AFFECTED BENEFICIARIES

It is one thing to demonstrate the possibility of multimillion percent marginal tax rates, but another to show that real beneficiaries are being hit by them. Unfortunately, there are no data available on how many recipients are in this predicament or on the extent to which such benefit loss can be attributed to preretirement earnings.

Nevertheless, one can get some idea of the size of the potentially affected population. Of the approximately 1.4 million individuals ages 62-69 who began their entitlement to Social Security during 1989, more than 249,000 (or 17%) lost some benefits as a result of the earnings test. Of that 249,000, about 81% lost more than one-half of their benefits, and 47% lost them all.[47] In addition, there are about 1.2 million working elderly who have not filed for benefits because of the earnings test.[48] Thus, there could be numerous individuals in situations similar to the case of Washington.

OPTIONS FOR REFORM

There are several options for dealing with the problem of super high marginal tax rates.[49] First, better program information would assist individuals in avoiding any problem. Despite the fact that this penalty is more than 50 years old, its existence is not well understood. Since the grace year rules are very complicated, new retirees may not fully comprehend them until they see the impact of the earnings test on their own benefits. Yet learning from experience is not very useful in this circumstance because the grace year is a once-in-a-lifetime event.

Although the Social Security Administration provides brochures and fact sheets about the earnings test, these brochures do not clearly explain the interaction of the annual and monthly tests.[50] These brochures could be rewritten to give new retirees an explicit warning of what will happen if they earn more than the monthly exempt amount. The brochures could also explain the advantages and disadvantages of applying for benefits early in one's grace year (as Monroe shrewdly does).

Second, the annual test in the initial year could be revised to cease counting preretirement earnings.[51] (This change was included in a Social Security bill passed by the U.S. House of Representatives in 1979 but was not encompassed in the final 1980 legislation.)[52] In the absence of data on the number of affected recipients, there are no cost estimates for such a reform. Nor are there any data on the income level of the group involved.

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A third solution would be to apply a cap on any earnings test reduction based on the ratio of postretirement to total annual earnings. For example, if postretirement earnings were 40% of total annual earnings in the grace year, then no monthly benefit would be reduced more than 40%. A strong argument against this option, however, is that it would add yet another layer of complexity to an already too complicated program. At present, there are at least 90 different ways to compute an initial benefit—and that is before any reductions for factors like the earnings test.

The best reason for eliminating the possibility of a 10,000,000% marginal tax rate is to enhance program equity. The traditional efficiency argument—that high marginal rates are work disincentives—may not be very important here since many of the affected beneficiaries probably learn about their benefit loss long after it could influence their behavior.[53] By the time a new beneficiary gets his or her first check, reports postretirement earnings and learns of any benefit reductions, the grace year may well be over.[54]

In 1988, then-Commissioner of Social Security Dorcas Hardy told a House Ways and Means Subcommittee what she thought of the earnings test:

> I am not quite sure who had the bright idea of calling the retirement earnings provision a test, because the only thing that it appears to test is the mettle of the beneficiaries who try to live with it, and also the patience of the Social Security Administration employees who try to administer it.[55]

Whether or not one agrees with that unfavorable assessment, it seems a safe bet that the earnings test will continue to be reformed, but never quite perfected. ◀

Endnotes

1. Nathan Oestreich, Howard Toole and Oliver Galbraith, "Restoring the Incentive for the Elderly to Work," *Tax Notes,* 22 October 1990, 470.
2. "Social Security Retirement Test," Hearing before the Subcommittee on Social Security of the Committee on Ways and Means, U.S. House of Representatives, Serial 102-98, May 1991, p. 146.
3. The grace year is defined in 20 CFR 404.435(c), which is based on 42 U.S.C. 403(f).
4. While the reduction of Social Security benefits is not really a "tax," it can be treated as the functional equivalent of taxation for the purpose of marginal rate analysis. See John R. Gist and Janemarie Mulvey, "Marginal Tax Rates and Older Taxpayers," *Tax Notes,* 5 November 1990, 683.
5. This applies to earnings as an employee. There are different rules for earnings from self-employment.
6. As used in this article, the terms *preretirement* and *postretirement* refer to the act of applying for and becoming entitled to a Social Security pension. Thus, *retirement* will not mean the act of leaving the labor force or resigning a particular job, since many retirees continue to work.
7. This salary was selected because it illustrates the operation of the earnings test in a minimally confusing manner. Any preretirement salary over $19,000 could cause Washington to lose an entire month's benefits.
8. This is the maximum benefit for a person who attains age 65 in 1991 and did not have a period of disability.
9. The Social Security Administration rounds down "excess earnings" to the lower dollar, but that is not done in these tables.
10. It seems unlikely that a person would have wages of just one dollar above the monthly exempt amount for six consecutive months. But this example is used for purposes of clarity. If Washington earned $5,000 in July, he would still lose his entire monthly benefit at the 811th dollar.
11. The calculation for July is $4,496.11 + ($811 ÷ 3) = $4,766.44. For August, the calculation is $4,766.44 − ($811 ÷ 3) − $1,022 = $4,014.78. (See Table I.)
12. See *Overbey v. Heckler,* 569 F. Supp. 698 (1983).
13. The Social Security Administration rounds down benefits to the lower dollar (after deducting for Medicare Part B), but that is not done in these examples.
14. It should also be noted that postretirement income may increase one's future monthly benefit amount if the new earnings are higher than the lowest year (adjusted for inflation) in one's earnings history. This annual recomputation is done for all recipients. See *Social Security Handbook* (Washington, DC: Social Security Administration, 1988), Section 720.
15. While Washington loses $1,022 in July, he makes up $13.89 of it in December. If Washington earned only $810 in July, he would receive no benefit in December. (See Table II.)
16. Actually, the rate could be even higher for a family unit. The earnings penalty applies not only to the worker but also to any auxiliary beneficiaries (such as a spouse or child) whose entitlement is based on the worker's earnings record. See *Social Security Handbook, supra* note 14, Section 1804(A). The rate could also be lower. The example here is based on the maximum benefit of $1,022. Using the benefit for the average earner retiring in 1991 at age 65, the tax rate would be 7,500,000%.
17. Normally, a marginal rate applies to *each* additional increment of income within a specified range. When a tax spike occurs, however, the high marginal rate applies only to one particular increment. For additional increments within the range, the marginal rate is usually zero. For example, consider Washington's situation in July. For the first $810 of income, the marginal rate is zero. For the 811th dollar, the marginal rate is 102,200%. But for the 812th dollar, the marginal rate falls back to zero. By contrast, in December Washington's marginal rate on the 811th dollar is 100,811%. (See Table I.) For the 812th dollar, the marginal rate falls to 33%. After the 850th dollar, the marginal rate falls back to zero.
18. Glen E. Coven, "Congress as Indian-Giver: 'Phasing-Out' Tax Allowances Under the Internal Revenue Code of 1986," *Virginia Tax Review,* Winter 1987, 518.
19. For example, in 1991 a married taxpayer with $150,000.49 in income could lose $43 of exemptions (2% of $2,150) by earning one penny more. The federal tax liability would rise by $13.33 per exemption (31% of $43). For a family of four, taxes would increase by $53.32. That would imply a marginal income tax rate (on the penny) of 533,200%. This spike can occur 50 times.
20. Her annual earnings are $9,508 (i.e., $\frac{1}{12}$ × $55,700 + 6 × $811).
21. ($1,022 × 6) − $13.89 = $6,118.11.
22. $811 × 6 = $4,866.

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23. ⅓ × ($23,208 + $4,866 − $9,720) = $6,118.

24. Monroe loses all her benefits for January-May, which is $4,970. (Monroe's monthly benefit is $994 because she retires five months before turning 65.) Therefore, $1,148.11 ($6,118.11 − $4,970) must be charged against July-December. Since she receives $6,132 for those six months ($1,022 × 6), she gets to keep $4,983.89 ($6,132 − $1,148.11). (Monroe's monthly benefit is increased to $1,022 at age 65 to make up for the months lost due to the earnings test.)

25. Until recently, individuals could backdate their retirement claim for up to six months when they applied for Social Security. (See *Social Security Handbook, supra* note 14, Section 1513.) For example, this could have allowed Washington to obtain the same result in June that Monroe obtained by filing in January. As a result of the Social Security amendments of 1990, however, beneficiaries may no longer request a retroactive retirement date in order to charge off excess earnings. (See P.L. 101-508, Title V, Subtitle B, Section 5116, codified at 42 U.S.C. 402(j)(4).) Although this law will allow well-informed participants (like Monroe) to game the system, the Social Security Administration will no longer be able to assist poorly informed individuals (like Washington) to maximize their benefits. For an extensive discussion, see Robert J. Myers, "When to Apply for Social Security Benefits," *Social Security News,* William M. Mercer, Incorporated, Spring 1991.

26. The calculations are based on an age 64 benefit of $967 per month. Total earnings in the year amount to $18,684 (7/12 × $33,163 + 6 × $811), which is $11,604 in excess of the exempt amount of $7,080. Thus, the benefit loss of $5,802 (50% of $11,604) is equal to the total potential benefits for July-December (6 × $967).

27. This adjustment starts in the month that he turns 65. See *Social Security Handbook, supra* note 14, Section 727.

28. There is a different adjustment for recipients of ages 65-69 who lose any month of benefits due to the earnings test, called the delayed retirement credit (DRC). This credit increases future benefits, but not enough to make up for what is lost from the earnings test. By the year 2009, however, the DRC should provide such actuarial equivalence. See *Social Security Handbook, supra* note 14, Section 719. In the example of Washington, the DRC will increase his benefits for 1992 and after by 1.46%. (Based on the 3.5% annual factor for those attaining age 65 in 1991-1992, the calculation is: 5/12 × 3.5% = 1.46%. Five out of 12 months of benefits are lost.)

29. See 20 CFR 404.428(a), which is based on 42 U.S.C. 403(f)(3).

30. The cliff effect could theoretically occur each month of the grace year, up to 12 times.

31. P.L. 271 (1935), Section 202(d). The law stated that whenever an individual "received wages with respect to regular employment after he attained the age of sixty-five, the old-age benefit payable to such individual shall be reduced, for each calendar month in any part of which such regular employment occurred, by an amount equal to one month's benefit."

32. P.L. 329 (1939), Title II, Section 203(d), effective in 1940.

33. The $15 level can be put in perspective by considering that in 1940 the average wage for production and nonsupervisory workers in manufacturing (the only benchmark available) was $108 per month and the average benefit was $23 per month. See U.S. Bureau of Labor Statistics, Bulletin No. 2370, Volume I, March 1991, 64; and Social Security Administration, "Annual Statistical Supplement to the Social Security Bulletin," 1990, Table 5.C2.

34. P.L. 734 (1950), Title I, Section 103(a), effective in 1950.

35. P.L. 761 (1954), Title I, Section 103(d), effective in 1955.

36. U.S. House of Representatives, House Report No. 1698, 83rd Congress, 2nd Session, May 1954, p. 21.

37. P.L. 761 (1954), Title I, Section 103(a), effective in 1955.

38. P.L. 86-778, Title II, Section 211, effective in 1961.

39. P.L. 92-603, Title I, Section 105(a)(3), effective in 1973.

40. P.L. 95-216, Title III, Section 303, effective in 1978.

41. U.S. House of Representatives, House Report No. 95-702(I), October 1977, p. 50.

42. P.L. 95-216, Section 302, as amended by P.L. 97-35, Section 2204, effective in 1983. Codified at 42 U.S.C. 403(f)(1).

43. P.L. 98-21, Title III, Section 374(a), effective in 1990. Codified at 42 U.S.C. 403(f)(3).

44. For the self-employed, the earnings test began counting preretirement earnings in the initial year in 1951—at the time that self-employment was first covered. See P.L. 734 (1950), Title I, Section 103(e).

45. P.L. 761 (1954), Title I, Section 103(d)(2).

46. The ambiguity of the term *retired* is symptomatic of the changing workforce patterns that make the earnings test problematic. Instead of a fine line between employment and retirement status, there is, more accurately, a continuum between full-time employment and full-time retirement.

47. Social Security Administration, "Annual Statistical Supplement to the Social Security Bulletin," 1990, Table 6.B1. Many of these beneficiaries may be full-time employees who apply for Social Security under the erroneous impression that they need to do so in order to receive Medicare coverage.

48. "Proposals to Liberalize the Social Security Retirement Test and to Repeal Certain Social Security Benefits," Hearing before the Subcommittee on Social Security of the Committee on Ways and Means, U.S. House of Representatives, Serial 101-18, May 1989, p. 52.

49. One approach not discussed is to abolish the earnings test. In the long run, this option may be inevitable since the increasing DRC will make the earnings test nearly superfluous for retirees who are at and above the normal retirement age (up to age 70) after the year 2008.

50. See "Retirement," SSA Publication No. 05-10035, January 1990, 14-15, and "The Retirement Earnings Test," Fact Sheet No. 3, SSA Publication No. 05-10069, January 1990. The fact sheet states: "A special rule allows people who retire during a year to receive benefits for the rest of the year no matter what they earned before retiring. You can be paid for any month your wages do not exceed the monthly exempt amount and you do not perform substantial services in self-employment."

51. The annual exempt amount could be prorated to correspond to the number of months of retirement in the initial year (similar to what is done now for a short taxable year). See *Social Security Handbook, supra* note 14, Section 1809.

52. See *Congressional Record,* 19 December 1979, 36968. The provision as enacted is in P.L. 96-473, Section 4, and codified at 42 U.S.C. 403(f)(1).

53. For a review of the literature on work disincentives, see Michael V. Leonesio, "Effects of the Social Security Earnings Test on the Labor-Market Activity of Older Americans: A Review of the Evidence," *Social Security Bulletin,* May 1990, 2-21.

54. Beneficiaries who learn they have been hit by the high grace year penalty may withdraw their application for benefits if it is not too late. See *Social Security Law and Practice* 2, §28:59.

55. "Social Security Retirement Test," Hearing before the Subcommittee on Social Security of the Committee on Ways and Means, U.S. House of Representatives, Serial 100-91, September 1988, p. 84.

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