Reforming Social Security

Option: Increase the Payroll Tax Rate

Employers and employees each currently pay a 6.2 percent tax to Social Security on earnings up to $110,100. Self-employed workers pay both the employer and employee share, for a total of 12.4 percent. One option to help close the Social Security funding gap would raise the payroll tax rate for all workers and employers. For instance, on a $50,000 annual salary, increasing the payroll tax rate to 6.45 percent would increase both the annual employee and employer contribution by $125 each. Changing it to 7.2 percent would increase the annual employee and employer contribution by $500 each. The rate increase could occur gradually or all at once. Increasing the payroll tax rate from 6.2 percent to 6.45 percent immediately is estimated to fill 22 percent of the funding gap. Increasing the payroll tax rate gradually over 20 years on employers and employees from 6.2 percent to 7.2 percent is estimated to fill 64 percent of the funding gap.

Argument for:

Virginia Reno
National Academy of Social Insurance

Argument against:

David John
The Heritage Foundation

Virginia Reno

Workers pay for Social Security's insurance protection through premiums (also called payroll taxes) that are deducted from their pay, and their employers pay a matching amount. Social Security does not need additional income now, but almost certainly will within the next 25 years. Policymakers should act soon to schedule an increase in the payroll tax rate to take effect in the future when more money will be needed. This fiscally responsible action would help balance Social Security's long-term finances and assure young workers that they can count on getting the benefits they are paying for. This kind of responsible stewardship is a long-standing feature of Social Security.

Policymakers could act now to schedule a gradual rate increase starting five years from now, when the economy is expected to be stronger. A gradual increase of 1/20th of 1 percent each year for 20 years, from 2017 through 2036, would eliminate nearly two-thirds of the program's projected 75-year shortfall. For an average worker, the additional payment would amount to about 50 cents more a week each year—"barely the cost of a pack of chewing gum," as one advocate of this policy has noted. If Congress combines this gradual rate increase with lifting the cap on earnings, we can afford to improve benefits for particularly needy and deserving individuals *and* balance Social Security's finances for 75 years and beyond.

Americans say they don't mind paying for Social Security, and they would rather pay more than see benefits cut. Across both party lines and age groups, large majorities of

Americans agree that it is important to preserve Social Security even if that means increasing working Americans' contributions to the program. In a recent NASI poll, those agreeing with this statement included 87 percent of Democrats, 75 percent of independents, and 67 percent of Republicans; and 79 percent of younger workers (age 18–34), 71 percent of the middle group (age 35–49), and 76 percent of workers age 50–64.

Scheduling a gradual increase in Social Security premiums—to match the increase in future benefits as baby boomers retire— simply makes good sense. Together with lifting the cap on earnings subject to Social Security taxes, this change would—

- Soundly finance Social Security's promised benefits for the next 75 years;
- Pay for some improvements to benefit adequacy; and
- Assure young workers that they can count on Social Security just as their parents and grandparents have done.

David John

Increasing Social Security's payroll tax rate is a bad idea. It would increase taxes for everyone, no matter what their income. Higher payroll taxes would cause increased unemployment. The number of jobs lost would depend on how high the payroll tax level gets and when. Economists have known for decades that if the cost of employees gets too great, employers have an incentive to replace them with machines or to move to a lower-tax location. Unfortunately, this does not hit all employees equally. Employers are most likely to replace younger workers and those with lower skill levels.

Even seemingly small increases in the percentage of wages that both the employer and employee must pay to Social Security would have an effect. Increasing payroll tax rates a tiny amount could cost jobs in companies that only earn a few cents for each dollar of sales and firms that are already losing money. In a highly competitive international economy, every dollar counts.

What is worse is the added uncertainty that such a move would cause. Payroll tax rates have remained the same since 1990. Once they start to change, employers will fear that additional increases will follow and factor this worry into their hiring decisions.

The amount of the increase needed to fix Social Security depends on when the increase is made. An increase now would just produce more surpluses for Congress to spend just as it spent the surpluses from 1983 through 2009. Most experts agree that if payroll taxes are increased when Social Security needs them to close its deficits, payroll tax rates would have to go up by a total of 50 percent in order to solve all of Social Security's financial problems. That would mean that instead of the employer and employee each paying an amount equal to 6.2 percent of income to Social Security, they would have to pay about 9 percent of income each. And both would still have to pay state, federal, and sometimes local income taxes also. What is worse, the self-employed and certain small business owners who pay both the employer and employee share would see their Social Security payroll taxes climb from 12.4 percent of income to about 18 percent of income.

In general, increasing taxes is a bad idea. For one thing, it reduces the amount that Americans have to spend on their own and their family's food, housing clothes, education, and so on. This is especially true in today's economy, where so many people live from paycheck to paycheck. What seems like a trivial amount to people in Washington may cause real problems to normal Americans.

Virginia Reno *is Vice President of Income Security Policy at the National Academy of Social Insurance.*

David John *is a Senior Research Fellow at The Heritage Foundation.*

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AARP Public Policy Institute,
601 E Street, NW, Washington, DC 20049
www.aarp.org/ppi.
202-434-3890, ppi@aarp.org
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NOTE: The estimated solvency effects in this Perspectives report are based on the intermediate assumptions in the *2011 Social Security Trustees Report*.

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