

# A REPORT OF THE HERITAGE CENTER FOR DATA ANALYSIS

KEEP THE SOCIAL SECURITY WAGE CAP:  
NEARLY A MILLION JOBS HANG IN THE BALANCE

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The Social Security system is facing an immense financial crisis.<sup>1</sup> In 12 years, it will begin taking in less money than it needs to pay the benefits currently promised to program participants.<sup>2</sup>

As a result, starting in 2017, Congress will be forced either to raise taxes or to borrow substantial sums to maintain benefit payments from the Old-Age and Survivors Insurance (OASI) program. Annual deficits will exceed \$100 billion within about five years, \$200 billion after about 10 years,

and \$300 billion after about 15 years.<sup>3</sup> The 2004 Social Security Trustees Report estimates that the system's unfunded liabilities will total about \$3.7 trillion over the next 75 years.<sup>4</sup>

In light of these projections, some policymakers have called for increasing Social Security taxes, which means raising the OASI payroll tax rate, the maximum amount of wages subject to that tax, or both.<sup>5</sup> Some lawmakers have already proposed increasing the taxable wage cap,<sup>6</sup> while

1. Hereafter, the term "Social Security" is used to refer only to the Social Security Old-Age and Survivors Insurance program. These projections do not include and would not involve any change in the Disability Insurance program or the Health Insurance (Medicare) program. This report updates and expands D. Mark Wilson, "Removing Social Security's Tax Cap on Wages Would Do More Harm Than Good," Heritage Foundation *Center for Data Analysis Report* No. 01-07, October 17, 2001, at [www.heritage.org/Research/SocialSecurity/CDA01-07.cfm](http://www.heritage.org/Research/SocialSecurity/CDA01-07.cfm).
2. Heritage Foundation calculations based on data from Social Security Administration, "Single-Year Tables Consistent With 2004 OASDI Trustees Report," updated March 23, 2004, at [www.ssa.gov/OACT/TR/TR04/lrIndex.html](http://www.ssa.gov/OACT/TR/TR04/lrIndex.html) (February 24, 2005). Data from the 2005 annual report were released too late to be included in these calculations.
3. For more on this, see David C. John, "A Guide to the New 2005 Social Security Trustees' Report," Heritage Foundation *WebMemo* No. 702, March 24, 2005, at [www.heritage.org/Research/SocialSecurity/wm702.cfm](http://www.heritage.org/Research/SocialSecurity/wm702.cfm).
4. Social Security Administration, *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, March 23, 2004, pp. 7-15, at [www.ssa.gov/OACT/TR/TR04/tr04.pdf](http://www.ssa.gov/OACT/TR/TR04/tr04.pdf) (April 5, 2005). The Social Security Trustees use a 75-year "test period" in assuming how economic and policy changes affect the program's ability to pay benefits.
5. In 2004, the Social Security payroll tax was levied on the first \$87,900 of labor income. Any income earned over this amount is not subject to the 12.4 percent OASDI payroll tax. The tax cap amount is increased every year by the rate of growth in average wages.
6. For example, Senator Lindsey Graham (R-SC) has suggested raising the cap to as much as \$200,000. See Associated Press, "Graham Takes Lead on Social Security: South Carolina Republican Suggests Various Changes to System," CNN.com, February 12, 2005, at [www.cnn.com/2005/ALLPOLITICS/02/12/socialsecurity.broker.ap](http://www.cnn.com/2005/ALLPOLITICS/02/12/socialsecurity.broker.ap) (February 24, 2005; unavailable April 6, 2005). The American Association of Retired Persons (AARP) has called for raising the cap to \$140,000. William D. Novelli, "How America Can Afford to Grow Older: A Vision for the Future," speech at the National Press Club, Washington, D.C., February 2005, at [www.aarp.org/research/press-center/speeches/america\\_older.html](http://www.aarp.org/research/press-center/speeches/america_older.html) (April 11, 2005).

some policy analysts have advocated completely eliminating it.<sup>7</sup>

Heritage Foundation analysts used Social Security Administration (SSA) data and a leading econometric model of the U.S. economy to consider:

1. The feasibility of saving the OASI program by raising the taxable wage cap and
2. How raising the cap would likely affect the economy.

Specifically, they looked at the complete elimination of the taxable wage cap, which would subject all taxable income to the OASI payroll tax rate.<sup>8</sup>

Using SSA's own projections, Heritage analysts found that eliminating the cap would generate only enough revenue to delay the date of the system's insolvency by a few years. Under the current law, by 2041, the OASI program would receive only enough revenue to pay 74 cents on every dollar in promised benefits.<sup>9</sup>

Yet the cost of eliminating the cap would be substantial. It would result in the largest tax increase in the history of the United States,<sup>10</sup> subjecting millions of American families to a massive hike in their payroll taxes and further reducing the already dismal rate of return to Social Security.<sup>11</sup> It would also negatively affect America's economic

prospects, slowing U.S. output growth and eliminating hundreds of thousands of employment opportunities.

Specifically, eliminating the cap on taxable wages would:

- Result in the largest tax increase in U.S. history, raising \$607 billion (in nominal dollars) over five years and just over \$1.4 trillion over 10 years.<sup>12</sup>
- Fail to save Social Security from bankruptcy. Social Security would start paying out more in benefits than it collects in taxes in 2025, only eight years later than under the current system. (See Chart 1.)
- Increase the top effective federal marginal tax rate on labor income to over 50 percent, its highest level since the 1970s.
- Reduce the take-home pay of 9.8 million workers by an average of \$4,206 in the first year alone after the cap is removed.
- Weaken the U.S. economy by reducing the number of job opportunities and personal savings. By fiscal year (FY) 2015, the number of job opportunities lost would exceed 965,000, and personal savings (adjusted for inflation) would decline by more than \$55 billion.<sup>13</sup>

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7. See Nathan Newman, "Social Security Easy to Fix: Remove the Cap," October 20, 2003, at [www.nathannewman.org/log/archives/001278.shtml#001278](http://www.nathannewman.org/log/archives/001278.shtml#001278) (April 5, 2005).

8. The same number (and type) of workers would be affected by either an increase in or the outright elimination of the taxable wage cap. Only the magnitude of the tax increase and its impact on family budgets and the economy would differ.

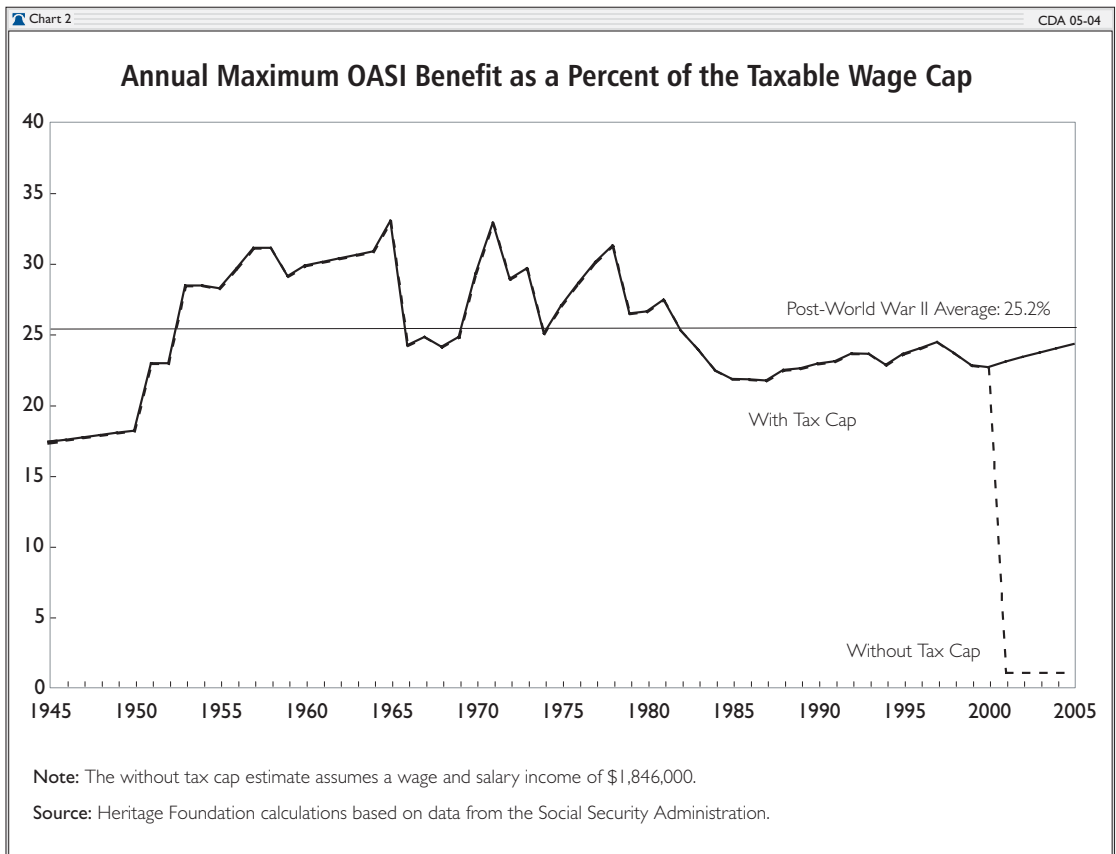
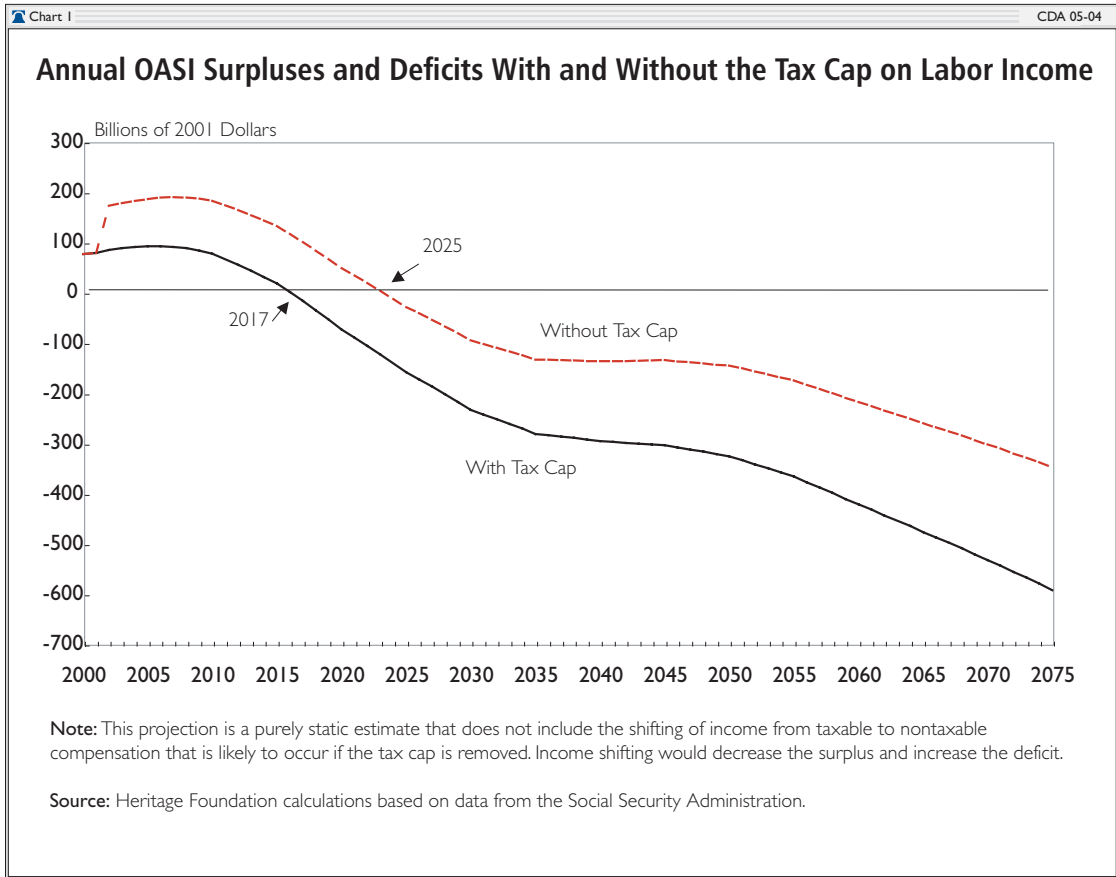
9. Social Security Administration, *The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, March 23, 2005, p. 8, at [www.socialsecurity.gov/OACT/TR/TR05/tr05.pdf](http://www.socialsecurity.gov/OACT/TR/TR05/tr05.pdf) (April 11, 2005).

10. Heritage Foundation calculation based on data from Social Security Administration, *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*. This projection is a purely static estimate that does not include the shifting of income from taxable to nontaxable compensation that is likely to occur if the tax cap is removed. Income shifting would decrease the amount of revenue available to pay benefits.

11. See William W. Beach and Gareth E. Davis, "Social Security's Rate of Return," Heritage Foundation *Center for Data Analysis Report* No. CDA98-01, January 15, 1998, at [www.heritage.org/Research/SocialSecurity/CDA98-01.cfm](http://www.heritage.org/Research/SocialSecurity/CDA98-01.cfm).

12. These revenue projections do not account for the negative effects of higher payroll taxes on economic growth and employment. They also do not account for any likely shifting of income from taxable wages and salaries to nontaxable fringe benefits like health insurance. As a result, the amounts of federal payroll taxes ultimately collected are likely to be less. (See the federal budget indicators in Appendix B, Table 1.)

13. Heritage Foundation calculation based on the Global Insight U.S. Macroeconomic model. (See Appendix A.) The methodologies, assumptions, conclusions, and opinions in this *CDA Report* are entirely the work of CDA analysts. They have not been endorsed by, and do not necessarily reflect the views of, the owners of the Global Insight model. Leading government agencies and *Fortune* 500 companies use the Global Insight model to provide decision makers with insights into the likely effects of important economic events and changes in public policy on hundreds of major economic indicators.



## THE CAP ON TAXABLE WAGES

The OASI program is currently funded by a payroll tax of 10.6 percent on labor income (wages, salaries, and self-employment income), with a cap on earnings subject to the OASI tax. In 2005, the maximum taxable amount (the cap) is \$90,000. This amount is indexed to the growth rate of the average wage.

Social Security benefits are calculated on the basis of a worker's earnings over his or her career. However, only the worker's earnings under the maximum taxable amount (and subject to the payroll tax) are used to compute those benefits.

A cap on taxable earnings has existed since the inception of the Social Security system in 1937. The maximum taxable amount reflects the original purpose of the OASI program: to provide workers with a "safety net" of retirement income.

Social Security was created as a pay-related retirement system, not as a welfare program that redistributes money from workers to those in need regardless of whether or not its recipients had paid into the system. The benefits that retirees received were linked to the taxes that they had paid when in the workforce. Social Security was intended to supplement rather than replace private sources of retirement income by providing only a basic, government-guaranteed source of income.

**Maximum Level of Benefits and Maximum Taxable Wages.** Within this context, Congress determined that it was appropriate to set an upper limit on the amount of income that Americans could receive from the Social Security program. A limit on benefits, combined with the principle that workers' benefits should relate to the amount of money that they paid into the system, made an upper limit on the taxes that workers would pay appropriate.

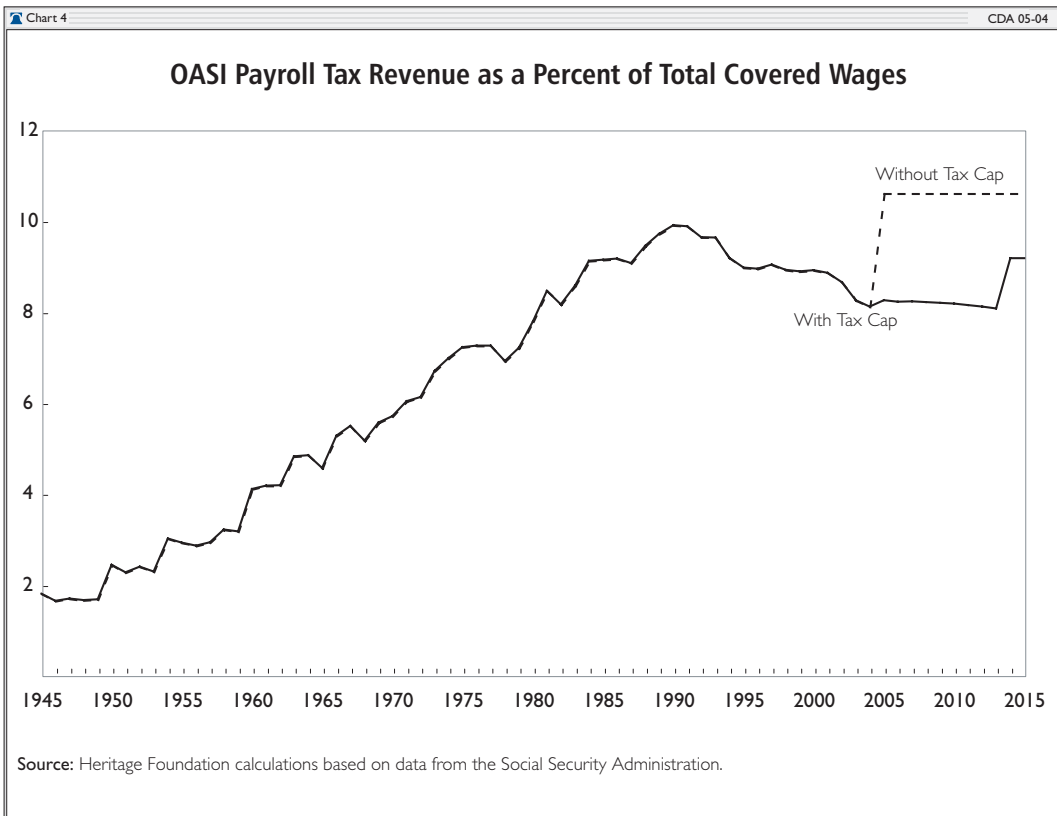
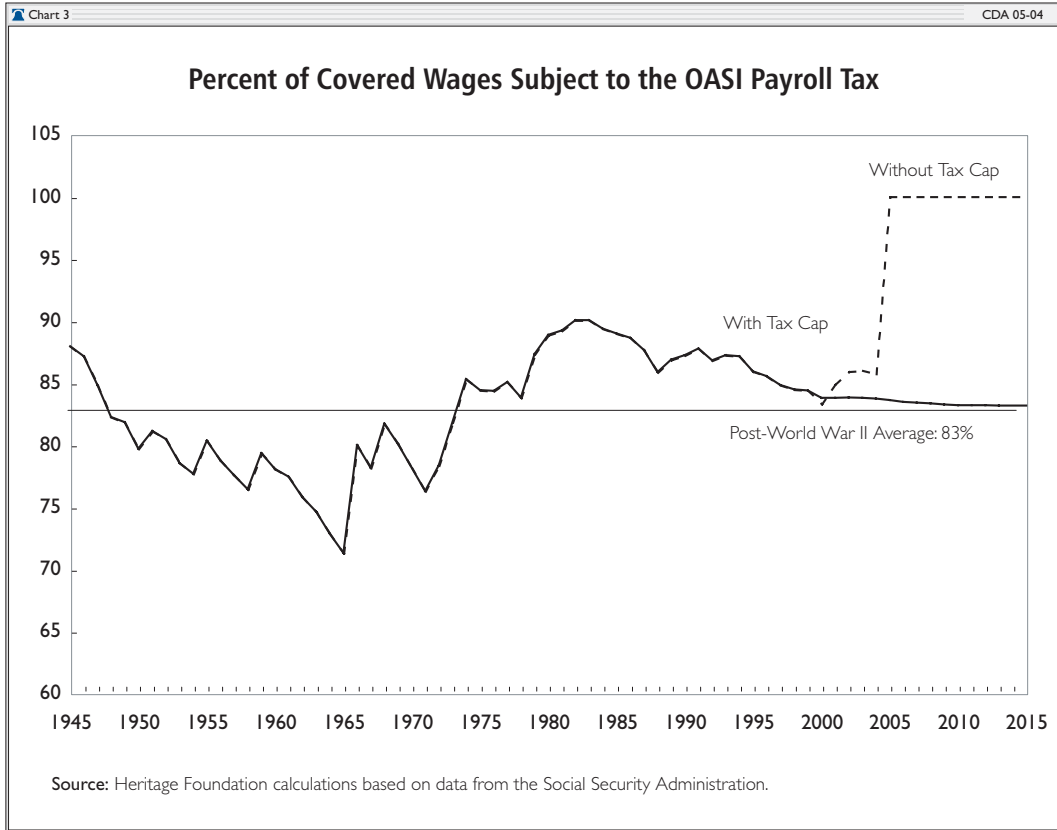
In 1939, Congress set the maximum Social Security benefit at \$494 per year (\$6,728 in 2004 dollars) and set the cap on taxable labor income at \$3,000 (\$40,856 in 2004 dollars).<sup>14</sup> In 2004, the maximum benefit payable to a single participant retiring at age 65 was \$21,900, while the maximum taxable amount of labor income subject to the payroll tax was \$87,900.<sup>15</sup> Since 1945, the maximum OASI benefit as a percent of maximum taxable earnings has ranged from 17.3 percent to 32.9 percent.<sup>16</sup> (See Chart 2.) In 2004, the maximum OASI benefit was about 25 percent of maximum taxable earnings, close to the post-World War II average of 25.3 percent.

If the tax cap is removed, the percentage will fall to less than 10 percent. For example, raising the cap on taxable wages to the mean income for families in the top 5 percent of the income distribution (\$280,312) in 2001<sup>17</sup> without increasing the maximum benefit would drop the maximum OASI benefit dramatically to about 8 percent of maximum taxable earnings.

Since 1939, Congress has raised the Social Security payroll tax rate 23 times and has raised the maximum taxable amount six times before 1972 and yearly since 1972, exposing an ever-higher percentage of workers' income to taxation. Contrary to assertions made by a number of commentators today, the proportion of covered earnings below the maximum taxable amount is not at a historic low. In fact, it is now above the average for the entire post-1945 period. (See Chart 3.)

**Proportion of Wages.** From 1945 to 1965, the proportion of wages subject to the Social Security payroll tax declined from 87.9 percent to 71.3 percent. From 1965 to 1983, this trend reversed as additional revenue was needed to pay for the Great Society's expansion of benefits, climbing to an all-time high of 90 percent after the 1983 payroll tax

14. Although the Social Security Act was passed in 1935, benefit payments were not supposed to begin until 1942. In 1939, Congress amended the act to provide benefits to the dependents of retired and deceased workers and begin paying benefits in 1940.
15. Heritage Foundation calculation based on a worker's earning the maximum taxable amount during each year of his or her working life.
16. Heritage Foundation calculation based on data from Social Security Administration, *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*.
17. U.S. Bureau of the Census, "Historical Income Tables—Families," revised July 8, 2004, Table F-3, at [www.census.gov/hhes/income/histinc/f03.html](http://www.census.gov/hhes/income/histinc/f03.html) (April 5, 2005).



increase. Since then, the percentage has slowly declined to 86 percent. This proportion is projected to fall slightly to 83 percent by 2014—close to the post–World War II average of 84.4 percent.<sup>18</sup>

**The Tax Rate.** Not only is the proportion of total payroll subject to Social Security taxes above historic levels, but the successive increases in the payroll tax rate mean that the proportion of total labor income consumed by OASI taxes is close to an all-time high. As Chart 4 shows, since 1945, the proportion of all covered wages (including those above the maximum taxable amount) consumed by OASI taxes has increased to 9.1 percent.

Removing the maximum cap on taxable payroll would increase this tax burden to 10.6 percent of all covered labor income, with an additional 1.8 percent taxed for Disability Insurance. This would boost payroll taxes as a share of all covered wages, salaries, and self-employment income to their highest level ever.

## THE BIGGEST TAX INCREASE IN U.S. HISTORY

As noted above, eliminating the Social Security taxable wage cap would result in the largest tax increase in U.S. history—amounting to over \$600 billion between FY 2006 and FY 2010 and over \$1.4 trillion from FY 2006 to FY 2015. That increase would dwarf the size of each of the two most recent tax increases (passed in 1993 and 1990), whether they are measured in nominal dollars or in inflation-adjusted dollars.<sup>19</sup> Even after that enormous tax increase, Social Security would still need to borrow to maintain benefits, with annual deficits exceeding \$100 billion by about 2031, only 10 years later than under the current system.<sup>20</sup>

Removing the cap on taxable wages would also result in a massive 12.4 percentage point hike in

the top marginal tax rate for millions of workers, increasing the top marginal rate on wage income to almost 50 percent, the highest rate since the 1970s. If Social Security’s tax cap were removed, many workers would immediately find that federal taxes consume over 42 cents of every additional dollar that they earn, with their employers paying another 7 cents.

An increase in the marginal tax rate on labor income would damage the economy by reducing the incentive to work. The fact that the Social Security tax increase would fall on wage, salary, and self-employment income would lead many workers—especially the self-employed and small-business owners—to find ways to avoid this tax, perhaps by taking employment income in the form of non-taxable “profits” or fringe benefits. This shift to non-cash income would shrink Social Security’s tax base, thus reducing potential revenue growth.

## WHO WOULD PAY ADDITIONAL OASI TAXES?

Heritage analysts, using data from the U.S. Bureau of the Census, estimate that eliminating the Social Security taxable wage cap would subject 9.8 million workers to a \$1.45 trillion tax increase from FY 2006 to FY 2015.<sup>21</sup> Almost 5.0 million of these workers are heads of families, and 3.3 million are spouses. Another 1.4 million single workers also would see their paychecks decline. On average, these 9.8 million workers would see their taxes increase by \$8,412 in the first year after the tax cap is removed.<sup>22</sup>

Of the 9.8 million workers who would be directly affected by tax increases:

- 7.8 million (80 percent) are men. Two-thirds (5 million) of these men are between the ages of 35 and 54. Another 1.9 million are over the age of 54 and nearing or eligible for retirement.

18. Heritage Foundation calculation based on Social Security Administration, *Annual Statistical Supplement to the Social Security Bulletin*, 2000, at [www.ssa.gov/policy/docs/statcomps/supplement/2000/supp00.pdf](http://www.ssa.gov/policy/docs/statcomps/supplement/2000/supp00.pdf) (April 5, 2005), and *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*.

19. The last three tax increases were passed in the Omnibus Reconciliation Act of 1993, the Omnibus Budget Reconciliation Act of 1990, and the Tax Equity and Fiscal Responsibility Act of 1982. Based on calculations provided by the Tax Foundation. The calculations are available upon request.

20. For more on this, see John, “A Guide to the New 2004 Social Security Trustees’ Report.”

21. All data in this section are drawn from Heritage Foundation tabulations of U.S. Bureau of the Census, Current Population Survey, March 2004.

22. This number includes the increase in Social Security taxes that employers would have to pay on behalf of workers.



- On average, these 9.8 million workers work 49 hours per week year-round.
- 7.8 million (80 percent) are married.
- 4.5 million (46 percent) are married with children.
- 7.3 million (74 percent) have college degrees; 1 million (10.6 percent) have only a high school education or less.
- Over 52 percent (5.1 million workers) live in eight states: California (1.6 million); New York (725,000); Texas (653,000); Illinois (420,000); New Jersey (509,000); Florida (508,000); Pennsylvania (436,000); and Virginia (330,000).
- Most (58 percent, or 5.7 million) live in the suburbs. Another 2.2 million, or 23 percent, live in central cities.
- Two-thirds (6.6 million) are private-sector wage and salary workers; 2.1 million (21.2 percent) are self-employed.
- Nearly 2 percent (225,336) are union members.
- Nearly 5 percent (491,000) are not U.S. citizens.
- Over 70 percent (7.1 million) are in executive, managerial, or professional specialty occupations, but not all are doctors, lawyers, or chief executive officers.
- Two-thirds (6.6 million) work in six major industries: manufacturing (1.5 million); finance, insurance, and real estate (1.3 million); other professional and business services (1.7 million); public administration (539,000); medical health care and social services (999,000); and retail trade (632,000).

These Americans work long and hard to provide for their families and save for their retirement years. The record size of the tax increase and its focused impact may induce many of the 604,000 workers ages 62 and above to retire early rather than pay additional taxes. Others may decide to shift some of their compensation from wages and salaries to benefits that are not subject to payroll

taxes. Still others may reduce spending and/or saving as their disposable income declines. The most likely effect of an increase in payroll taxes would be a combination of these three responses.

## THE EFFECTS ON RETIREMENT SAVINGS

Data from the U.S. Department of Labor show that families earning more than \$90,000 per year (many of the same families who would be affected by the tax increase) use a disproportionate share of their income to pay Social Security taxes and invest in pension funds.<sup>23</sup> This spending is done with discretionary income that is left over after purchasing necessities such as food and clothing. Eliminating the Social Security tax cap on labor income would reduce these families' discretionary income and likely lead to a decrease in private retirement savings.

An expectation of higher Social Security benefits in the future would amplify this effect by making these families even less inclined to set aside funds for their own retirement. In 2001–2002, these families devoted about \$1 of every \$10 in their budgets to Social Security and private pensions.<sup>24</sup> Significantly increasing federally mandated taxes for retirement would substantially decrease take-home pay and likely reduce the amount saved for retirement rather than the amount spent on food and shelter.

Increasing the OASI taxable wage cap is also likely to alter support for Social Security among high-wage workers. These high earners are currently projected to receive very low or even negative rates of return on their future OASI payroll taxes.<sup>25</sup> Any tax increase that targets these workers would drive their rate of return so low that they would likely stop perceiving Social Security as a retirement system and instead view it as just another welfare program that consumes 12.4 percent of their labor income with no benefit to themselves. Such a change in perception would likely reduce public support for Social Security.

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23. U.S. Department of Labor, Bureau of Labor Statistics, Consumer Expenditure Survey, "High Income Tables 2001–02," at [www.bls.gov/cex/2002/highincome/hincome.pdf](http://www.bls.gov/cex/2002/highincome/hincome.pdf) (February 24, 2005).
24. *Ibid.* The "Personal Insurance and Pensions" category includes Social Security taxes paid. Currently, Social Security taxes are calculated based on a fixed share of labor income up to a maximum threshold. Given that the wages of upper-income households are more likely to exceed this threshold and contain a higher proportion of non-labor income, including Social Security taxes in these figures is likely to result in underestimation of the differential between low-income and upper-income earners in the proportion of income that is devoted to retirement savings.
25. Beach and Davis, "Social Security's Rate of Return."

## ECONOMIC EFFECTS OF REMOVING THE CAP

Removing the Social Security taxable wage cap would increase payroll taxes for American workers and reduce job creation and economic growth. A slowdown in the expansion of real (inflation-adjusted) compensation would further squeeze family budgets, leading to a marked drop in the personal savings rate.

Heritage analysts used a leading econometric model of the U.S. economy to produce dynamic estimates of likely impacts of the proposed removal of the taxable wage cap.<sup>26</sup> The Heritage dynamic analysis shows that removing the taxable wage cap would:

- **Cut the rate of economic growth.** Higher OASI payroll taxes would decrease the rate of economic growth by 0.4 percentage points in FY 2005 and 0.2 percentage points in FY 2006. By the end of FY 2015, gross domestic product (adjusted for inflation) would be almost \$100 billion lower than the baseline forecast without the tax policy change.
- **Eliminate hundreds of thousands of jobs.** Nearly 1 million fewer Americans would be working by the end of FY 2015, compared with the baseline forecast. In addition, the unemployment rate would average about 0.3 percentage points higher from FY 2006 to FY 2015.
- **Reduce family income.** By the end of FY 2015, real disposable personal income for a family of four would fall by \$2,248. As a result, consumer spending would drop by over \$122 billion in aggregate, or by over \$1,500 for a family of four.
- **Reduce family savings.** By the end of FY 2015, a family of four would be able to save roughly \$685 less (adjusted for inflation) than under the baseline forecast. The already low savings rate would fall an average of more than 0.4 percentage points below baseline between 2006 and 2011, from 1.5 percent of disposable personal income to less than 1.1 percent.
- **Reduce investment.** On average, investment (adjusted for inflation) would decline by more than \$10 billion per year from FY 2006 to FY 2015. By the end of FY 2015, the real (inflation-adjusted) capital stock would be more than \$35 billion below the baseline forecast.<sup>27</sup>

Eliminating the Social Security taxable wage cap would not necessarily improve the federal government's fiscal outlook. Eliminating the wage cap would push the unified budget balance from a deficit of over \$400 billion in 2004 to a small surplus of \$13 billion in 2015.

However, the off-budget surplus and the on-budget surplus would move in opposite directions. The off-budget (mostly Social Security) surplus would rise by some \$1.3 trillion between 2006 and 2015, reflecting the increase in federal payroll taxes. Conversely, the on-budget deficit would increase by \$66 billion over the same period, reflecting the negative impact of slower economic growth on corporate and personal income tax collections.

## CONCLUSION

Congress has increased the Social Security payroll tax rate 23 times, an average of once every three years since the inception of the Social Security program in 1937,<sup>28</sup> yet the system continues to slide toward bankruptcy. Although the Tax Equity and Fiscal Responsibility Act of 1982 was intended to restore Social Security to permanent solvency, a mere 23 years later, the system is once again facing bankruptcy.

Eliminating the cap on the maximum taxable amount of labor income subject to Social Security taxes would result in the largest tax increase in U.S. history. It would raise taxes on millions of hard-working Americans and their families, reduce savings, slow economic growth, and eliminate employment opportunities. It would likely also have the unintended consequence of undermining one of the most vital activities that American families undertake: privately saving for retirement.

Despite the massive hike in the tax burden, eliminating the cap on taxable earnings would

26. For a description of the methodology used, see Appendix A.

27. For more detailed estimates, see Appendix B.

28. Social Security Administration, *Annual Statistical Supplement to the Social Security Bulletin*, 1997, p. 34. This does not include annual indexing of maximum taxable earnings.

not save the Social Security system. It would delay insolvency by only eight years, from 2017 to 2025.<sup>29</sup> Even after implementing this tax increase, Social Security would not have enough money to pay every dollar in promised benefits. Congress will need either to raise payroll tax rates again, to borrow more money, or to cut promised benefits.

In short, eliminating the Social Security maximum taxable wage cap will do little good and much economic harm.

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29. David C. John, "Raising the Social Security Payroll Tax Cap Does Not Fix Social Security," Heritage Foundation *WebMemo* No. 667, February 16, 2005, at [www.heritage.org/Research/SocialSecurity/wm667.cfm](http://www.heritage.org/Research/SocialSecurity/wm667.cfm).

## APPENDIX A

### METHODOLOGY

To analyze the economic effects of removing the taxable wage cap, Heritage Foundation economists used the February 7, 2005, version of the Global Insight baseline forecast and U.S. Macroeconomic Model.<sup>30</sup> That version of the baseline forecast does not embody strict current-law assumptions about changes in tax policy and government spending. For example, a current-law baseline forecast would assume the expiration in 2010 of the tax cuts enacted under the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 and the Jobs Growth and Tax Relief Reconciliation Act (JGTRRA) of 2003. The result would be a sharp increase in federal personal income taxes in 2011. A current-law baseline would also exclude any anticipated, future increases in federal defense and non-defense spending.

In contrast, the Global Insight baseline forecast incorporates anticipated supplemental funding for Iraq and Afghanistan. It also allows for a gradual increase in the effective federal social insurance tax rate on wages and salaries. However, that increase is the result of rising Medicare premiums, not higher payroll taxes on wages and salaries.

#### TWO STEPS

Heritage Foundation economists followed a two-step procedure in analyzing the economic and budgetary effects of raising the Social Security taxable wage cap.

*First*, preliminary estimates of the gains in payroll tax revenue stemming from the elimination of the Social Security payroll tax cap were estimated using published forecasts of total earnings from the Social Security Administration.<sup>31</sup> Those estimates are purely static. They do not account for the macroeconomic effects of a payroll tax increase, including changes in interest rates, inflation, personal income, employment, and

output, all of which can significantly affect federal tax revenue collections. Therefore, the static revenue estimates give only a partial analysis of the economic and budgetary effects of the policy change. For a more complete analysis, a dynamic model must be used.

*Second*, the static revenue gains were input into the most recent Global Insight U.S. Macroeconomic Model. The Global Insight model is a dynamic model frequently used by private-sector and government economists to estimate how changes in government spending and tax policy will affect the general economy. It contains a number of variables that can be used to simulate an increase in the Social Security payroll tax cap.

An increase in the payroll tax cap is introduced into the Global Insight model by:

- Increasing the effective federal social insurance tax rate on wages and salaries. That effective tax rate is increased to reflect the Heritage analysts' estimates of static revenue gains in federal payroll taxes.
- Adjusting several of the model's labor supply variables to capture the policy change's likely effects on labor force participation and the average number of hours worked per week. These adjustments are small. The labor supply elasticities applied are taken from a 1996 Congressional Budget Office memorandum.<sup>32</sup> The memorandum puts the total wage elasticity with respect to changes in after-tax wages between 0 and 0.3 for the population as a whole. The total wage elasticity, in turn, breaks down into a participation elasticity that falls between 0.1 and 0.2 and an average-hours elasticity that does not exceed 0.1. All labor supply elasticities are further weighted by the share of total income going to households earning roughly \$87,000 or more in 2003.

30. The methodologies, assumptions, conclusions, and opinions in this *CDA Report* are entirely the work of CDA analysts. They have not been endorsed by, and do not necessarily reflect the views of, the owners of the Global Insight model. Leading government agencies and *Fortune* 500 companies use the model to provide decision makers with insights into the likely effects of important economic events and changes in public policy on hundreds of major economic indicators.

31. Social Security Administration, *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*.

32. Frank S. Russek, "Labor Supply and Taxes," Congressional Budget Office memorandum, January 1996, p. 11.

- Assuming that the Federal Reserve Board reacts to this policy change as it has historically.

Heritage analysts used the March 2004 Current Population Survey to estimate the number and demographic characteristics of wage earners who

exceeded the payroll cap. If a worker reported earnings above the 2003 earnings cap of \$87,000, the study considered that worker to be affected by an increase in the payroll wage cap.

# APPENDIX B

Economic Indicators	Fiscal Year										Average 2005 - 2015		
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013		2014	2015
<b>Gross Domestic Product</b>	<b>In Billions of Inflation-Adjusted Dollars (Indexed to the 2000 Price Level)</b>												
Forecast	10,738.5	11,081.8	11,402.9	11,793.5	12,168.8	12,564.6	12,979.7	13,378.9	13,763.4	14,144.8	14,574.0	15,032.4	12,989.5
Baseline	10,738.5	11,123.5	11,473.3	11,844.1	12,217.9	12,615.9	13,036.1	13,444.3	13,837.8	14,230.9	14,666.7	15,129.1	13,056.3
Difference	0.0	-41.7	-70.4	-50.6	-49.1	-51.3	-56.4	-65.4	-74.4	-86.1	-92.7	-96.7	-66.8
<b>Real GDP Growth Rate</b>	<b>Percent Change from Preceding Year</b>												
Forecast	4.6	3.2	2.9	3.4	3.2	3.3	3.3	3.1	2.9	2.8	3.0	3.1	3.1
Baseline	4.6	3.6	3.1	3.2	3.2	3.3	3.3	3.1	2.9	2.8	3.1	3.2	3.2
Difference	0.0	-0.4	-0.2	0.2	0.0	0.0	0.0	-0.1	-0.1	-0.1	0.0	0.0	-0.1
<b>Total Employment</b>	<b>In Thousands of Jobs</b>												
Forecast	130,941	132,786	134,288	135,822	137,104	138,272	139,592	140,663	141,623	142,505	143,607	144,888	139,195.5
Baseline	130,941	133,123	135,095	136,599	137,767	138,919	140,269	141,402	142,428	143,389	144,548	145,855	139,944.9
Difference	0	-337	-807	-777	-663	-647	-677	-739	-805	-884	-941	-967	-749
<b>Unemployment Rate</b>	<b>Percent of Civilian Labor Force</b>												
Forecast	5.6	5.6	5.7	5.5	5.5	5.4	5.3	5.4	5.4	5.5	5.5	5.3	5.5
Baseline	5.6	5.3	5.2	5.2	5.2	5.1	5.1	5.1	5.2	5.2	5.2	5.0	5.2
Difference	0.0	0.3	0.5	0.3	0.3	0.2	0.2	0.3	0.2	0.3	0.3	0.3	0.3
<b>Disposable Personal Income</b>	<b>In Billions of Inflation-Adjusted Dollars (Indexed to the 2000 Price Level)</b>												
Forecast	7,922.1	8,100.9	8,297.6	8,561.8	8,836.1	9,112.7	9,413.7	9,696.3	9,972.7	10,246.5	10,566.1	10,909.9	9,428.6
Baseline	7,922.1	8,187.5	8,415.8	8,679.4	8,953.4	9,230.8	9,536.8	9,826.7	10,113.0	10,404.1	10,735.5	11,091.3	9,561.3
Difference	0.0	-86.6	-118.2	-117.6	-117.3	-118.1	-123.1	-130.4	-140.3	-157.6	-169.4	-181.4	-132.7
<b>Disposable Income per Capita</b>	<b>In Inflation-Adjusted Dollars (Indexed to the 2000 Price Level)</b>												
Forecast	26,999	27,357	27,769	28,399	29,054	29,704	30,421	31,066	31,680	32,274	33,001	33,790	30,410.5
Baseline	26,999	27,649	28,164	28,789	29,440	30,089	30,818	31,484	32,126	32,771	33,530	34,352	30,837.5
Difference	0	-292	-395	-390	-386	-385	-397	-418	-446	-497	-529	-562	-427
<b>Consumption Expenditures</b>	<b>In Billions of Inflation-Adjusted Dollars (Indexed to the 2000 Price Level)</b>												
Forecast	7,562.5	7,800.3	7,990.5	8,217.8	8,432.8	8,673.2	8,932.3	9,181.5	9,419.4	9,650.0	9,904.7	10,190.8	8,944.8
Baseline	7,562.5	7,839.7	8,059.4	8,284.9	8,502.8	8,746.5	9,010.8	9,267.8	9,513.4	9,755.3	10,019.0	10,313.1	9,028.4
Difference	0.0	-39.4	-68.9	-67.1	-70.0	-73.3	-78.5	-86.3	-94.0	-105.3	-114.3	-122.3	-83.6
<b>Personal Savings</b>	<b>In Billions of Inflation-Adjusted Dollars (Indexed to the 2000 Price Level)</b>												
Forecast	82.3	5.7	0.1	22.3	63.2	79.0	99.7	113.9	135.3	164.4	216.1	260.9	105.5
Baseline	82.3	50.8	44.8	68.7	106.8	120.4	141.8	156.0	179.5	214.2	268.0	316.2	151.6
Difference	0.0	-45.1	-44.7	-46.4	-43.6	-41.4	-42.1	-42.1	-44.2	-49.8	-51.9	-55.3	-46.1

**How Removing the Social Security Tax Cap Would Affect Selected Economic Indicators (Preliminary Results)**

Economic Indicators (cont.)	Fiscal Year										Average 2005 - 2015		
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013		2014	2015
<b>Personal Savings Rate</b>	<b>Percent of Disposable Personal Income</b>												
Forecast	1	0.1	0.0	0.3	0.7	0.9	1.1	1.2	1.4	1.6	2.0	2.4	1.1
Baseline	1	0.6	0.5	0.8	1.2	1.3	1.5	1.6	1.8	2.0	2.5	2.8	1.5
Difference	0.0	-0.5	-0.5	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	-0.5	-0.4	-0.4
<b>Investment</b>	<b>In Billions of Inflation-Adjusted Dollars (Indexed to the 2000 Price Level)</b>												
Forecast	1793.9	1,921.0	1,956.2	2,047.1	2,124.4	2,206.2	2,303.2	2,391.2	2,474.5	2,552.7	2,664.8	2,783.0	2,311.3
Baseline	1793.9	1,936.0	1,986.3	2,052.8	2,126.9	2,209.8	2,308.7	2,400.6	2,485.3	2,565.5	2,676.9	2,793.4	2,322.0
Difference	0.0	-15.0	-30.1	-5.7	-2.5	-3.6	-5.5	-9.4	-10.8	-12.8	-12.1	-10.4	-10.7
<b>Non-Residential Investment</b>	<b>In Billions of Inflation-Adjusted Dollars (Indexed to the 2000 Price Level)</b>												
Forecast	1,196.8	1,311.4	1,400.0	1,491.8	1,581.6	1,665.0	1,755.7	1,843.5	1,933.1	2,018.9	2,121.6	2,232.4	1,759.5
Baseline	1,196.8	1,317.1	1,418.4	1,500.1	1,582.8	1,666.6	1,759.1	1,849.3	1,939.8	2,026.6	2,128.9	2,238.1	1,766.1
Difference	0.0	-5.7	-18.4	-8.3	-1.2	-1.6	-3.4	-5.8	-6.7	-7.7	-7.3	-5.7	-6.5
<b>Residential Investment</b>	<b>In Billions of Inflation-Adjusted Dollars (Indexed to the 2000 Price Level)</b>												
Forecast	552.0	561.4	533.9	518.7	513.9	517.7	524.7	535.2	538.9	540.4	549.5	562.6	536.1
Baseline	552.0	564.3	538.9	521.9	516.3	518.9	526.1	537.4	541.5	543.4	552.8	566.3	538.9
Difference	0.0	-2.9	-5.0	-3.2	-2.4	-1.2	-1.4	-2.2	-2.6	-3.0	-3.3	-3.7	-2.8
<b>Effective Capital Stock</b>	<b>In Billions of Inflation-Adjusted Dollars (Indexed to the 2000 Price Level)</b>												
Forecast	12,074.6	12,579.7	13,100.6	13,626.9	14,174.9	14,730.9	15,307.0	15,887.5	16,482.8	17,085.9	17,706.6	18,356.5	15,367.2
Baseline	12,074.6	12,582.6	13,119.0	13,654.2	14,200.0	14,757.0	15,335.4	15,919.6	16,518.0	17,122.8	17,743.8	18,392.3	15,395.0
Difference	0.0	-2.9	-18.4	-27.3	-25.1	-26.1	-28.4	-32.1	-35.2	-36.9	-37.2	-35.8	-27.8
<b>Consumer Price Index</b>	<b>Percent Change from Preceding Year</b>												
Forecast	2.3	2.5	1.5	1.9	2.1	2.2	2.4	2.6	2.7	2.8	2.7	2.7	2.4
Baseline	2.3	2.5	1.5	1.9	2.1	2.2	2.4	2.5	2.7	2.7	2.7	2.7	2.3
Difference	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.0	0.0	0.0
<b>Treasury Bill, 3-Month</b>	<b>Annualized Percent</b>												
Forecast	1.094	2.6	3.2	3.6	4.1	4.4	4.9	5.0	5.0	4.9	4.9	4.9	4.3
Baseline	1.094	2.6	3.4	3.7	4.1	4.2	4.8	4.9	4.9	4.9	4.9	4.9	4.3
Difference	0.0	-0.1	-0.2	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
<b>Treasury Bond, 10-Year</b>	<b>Annualized Percent</b>												
Forecast	4.3	4.3	4.8	5.2	5.7	5.8	6.3	6.3	6.3	6.3	6.3	6.3	5.8
Baseline	4.3	4.4	5.0	5.3	5.7	5.9	6.4	6.4	6.4	6.4	6.4	6.4	5.9
Difference	0.0	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1

**How Removing the Social Security Tax Cap Would Affect Selected Economic Indicators (Preliminary Results)**

Federal Budget Indicators	Fiscal Year										Total 2005 - 2015		
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013		2014	2015
<b>Unified Federal Tax Revenue</b>													
Forecast	1,880.0	2,131.0	2,278.0	2,431.0	2,581.0	2,745.0	2,909.0	3,101.0	3,329.0	3,534.0	3,738.0	3,965.0	32,742.0
Baseline	1,880.0	2,069.0	2,205.0	2,346.0	2,491.0	2,653.0	2,813.0	3,002.0	3,225.0	3,419.0	3,619.0	3,838.0	31,680.0
Difference	0.0	62.0	73.0	85.0	90.0	92.0	96.0	99.0	104.0	115.0	119.0	127.0	1,062.0
<b>Change in Federal Tax Collections</b>													
Static Change to Tax Revenue	0.0	75.0	106.0	113.0	121.0	129.0	138.0	148.0	157.0	167.0	174.0	183.0	1,511.0
Dynamic Change to Tax Revenue	0.0	62.0	73.0	85.0	90.0	92.0	96.0	99.0	104.0	115.0	119.0	127.0	1,062.0
Revenue Feedback	0.0	-13.0	-33.0	-28.0	-31.0	-37.0	-42.0	-49.0	-53.0	-52.0	-55.0	-56.0	-449.0
Feedback Percent	-	-17.3%	-31.1%	-24.8%	-25.6%	-28.7%	-30.4%	-33.1%	-33.8%	-31.1%	-31.6%	-30.6%	-29.7%
<b>Unified Federal Spending</b>													
Forecast	2,292.0	2,422.0	2,513.0	2,635.0	2,771.0	2,905.0	3,045.0	3,192.0	3,352.0	3,535.0	3,735.0	3,952.0	34,057.0
Baseline	2,292.0	2,423.0	2,519.0	2,646.0	2,786.0	2,924.0	3,068.0	3,219.0	3,383.0	3,573.0	3,781.0	4,006.0	34,328.0
Difference	0.0	-1.0	-6.0	-11.0	-15.0	-19.0	-23.0	-27.0	-31.0	-38.0	-46.0	-54.0	-271.0
<b>Unified Federal Surplus/Deficit</b>													
Forecast	-412.0	-292.0	-235.0	-204.0	-190.0	-160.0	-136.0	-91.0	-22.0	-2.0	3.0	13.0	-1,024.0
Baseline	-412.0	-354.0	-314.0	-300.0	-295.0	-270.0	-255.0	-217.0	-159.0	-154.0	-163.0	-168.0	-2,295.0
Difference	0.0	62.0	79.0	96.0	105.0	110.0	119.0	126.0	137.0	152.0	166.0	181.0	1,271.0
<b>Federal On-Budget Surplus/Deficit</b>													
Forecast	-462.0	-426.0	-381.0	-340.0	-315.0	-285.0	-248.0	-187.0	-131.0	-92.0	-62.0	-31.0	-2,498.0
Baseline	-462.0	-417.0	-363.0	-331.0	-306.0	-273.0	-236.0	-175.0	-121.0	-90.0	-67.0	-44.0	-2,423.0
Difference	0.0	-9.0	-18.0	-9.0	-9.0	-12.0	-12.0	-12.0	-10.0	-2.0	5.0	13.0	-75.0
<b>Federal Off-Budget Surplus/Deficit</b>													
Forecast	500	134.0	146.0	136.0	125.0	125.0	112.0	96.0	109.0	90.0	65.0	44.0	1,182.0
Baseline	500	63.0	49.0	31.0	11.0	3.0	-19.0	-42.0	-38.0	-64.0	-96.0	-124.0	-226.0
Difference	0.0	71.0	97.0	105.0	114.0	122.0	131.0	138.0	147.0	154.0	161.0	168.0	1,408.0
<b>Privately Held Federal Debt</b>													
Forecast	4,210.0	4,528.0	4,776.0	4,986.0	5,180.0	5,350.0	5,497.0	5,606.0	5,654.0	5,663.0	5,663.0	5,660.0	5,323.9
Baseline	4,210.0	4,559.0	4,886.0	5,185.0	5,481.0	5,758.0	6,021.0	6,253.0	6,433.0	6,589.0	6,749.0	6,921.0	5,894.1
Difference	0.0	-31.0	-110.0	-199.0	-301.0	-408.0	-524.0	-647.0	-779.0	-926.0	-1,086.0	-1,261.0	-570.2
<b>Privately Held Federal Debt Share</b>													
Forecast	36.0	37.0	38.0	37.0	37.0	36.0	35.0	34.0	32.0	31.0	29.0	28.0	34.0
Baseline	36.0	37.0	38.0	39.0	39.0	39.0	38.0	38.0	37.0	36.0	35.0	34.0	37.3
Difference	0.0	0.0	0.0	-2.0	-2.0	-3.0	-3.0	-4.0	-5.0	-5.0	-6.0	-6.0	-3.3

Source: Heritage Foundation calculations using the Global Insight baseline forecast and U.S. Macroeconomic Model.