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# Raising the Wage Cap No Painless Solution to Social Security's Fiscal Woes

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Raising someone else's taxes may seem like a painless solution when a government program starts running deficits. For instance, in 2017 Social Security will begin to spend more in benefits than it takes in from payroll taxes, and some interest groups believe that the ideal solution is to simply increase taxes on "wealthier" Americans.

Raising payroll taxes is the wrong solution to Social Security's long term financing problem, and it is not the way to achieve retirement security for Americans. The wiser approach is to view Social Security reform in the context of comprehensive retirement income reform. That means taking steps to strengthen retirement savings as well as Social Security and reviewing the tax treatment of retirement programs and savings plans as well as the structure of Social Security benefits.

**The Wage Cap.** A cap on taxable earnings has existed since the inception of the Social Security system in 1937. Currently, workers pay Social Security payroll taxes on only the first $97,500 of their annual income (as of January 1, 2007; in 2006, workers paid Social Security taxes on their first $94,200 in wages). This "wage cap" is indexed to the growth of real wages in the economy and increases every year. The wage cap serves to limits the amount of Social Security benefits that a well-off retiree will receive. Even though Bill Gates and Donald Trump earn millions of dollars a year, for the purpose of calculating Social Security benefits, they earned just $97,500 in 2007.

**The Economic Impact of Raising the Wage Cap.** Raising the amount of earnings subject to Social Security payroll taxes would do nothing to address the wider challenge of securing retirement for working Americans. Moreover, it would have real and damaging effects on working families and the U.S. economy. Some would dismiss the negative effects by noting that "only" about 6.5 percent of taxpayers would be affected, but a large proportion of those whose taxes would increase earn less than $125,000 annually. While these workers are not poor, neither are they wealthy. Subjecting all earnings to Social Security payroll taxes would:

- Reduce the annual take-home pay of 10.3 million workers by an average of $5,650 in the first year alone after the cap is removed. Most of these workers have incomes below $125,000.[1]
- Raise taxes on 4.0 million workers over the age of 50—just when they are trying to steer towards retirement.
- Raise taxes on 3 million small business owners.
- Greatly increase the top effective federal marginal tax rate.
- Weaken the U.S. economy by reducing the number of job opportunities and workers' personal savings. By fiscal year 2015, the number of job opportunities lost would exceed 965,000,

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and personal savings would decline by more than $55 billion, in real terms.[2]

- Not save Social Security. A 2003 Social Security Administration study showed that eliminating the Social Security wage cap would delay the program's deficits for only about six years.

Rather than focus on raising the wage cap, Congress should develop a comprehensive solution to Social Security's future deficits that examines all aspects of the program and places a strong emphasis on increasing personal savings across all income levels. This approach would be the first step towards placing all entitlement programs on a sound financial footing and protecting our children and grandchildren from having to deal with those program's massive deficits.

**Stifling Marginal Tax Rates .** If Social Security's wage cap were raised, many workers would immediately find that federal taxes consume over 43 cents of every additional dollar that they earn. While raising the wage cap is sold with the rhetorical point that "Those who have benefited from the growth in the economy should be asked to pay a little more to help secure Social Security," the fact is that it would mostly hurt the middle class.

By raising the wage cap to $140,000, a single worker earning $110,000 would see his or her marginal tax rate increase from approximately 31 percent to 43 percent, plus any state or local income tax.[3] A married couple in which the sole-earner makes $110,000 will see their marginal tax rate increase from 28 percent to 40 percent. If the other spouse also works and makes $40,000, the couple would face a marginal tax rate of 43 percent for both earners. For the highest income workers, the marginal tax rate would rise from 38.4 percent to about 53 percent—a level not seen since the 1970s.

**A Short Delay of Massive Deficits.** An October 2003 report from the Social Security Administration (SSA) examined the effects of not just raising the wage cap, but of eliminating it completely.[4] Under this radical approach, Bill Gates and Donald Trump would pay Social Security taxes on every dollar that they earn. They would also receive benefits on those earnings. The SSA study showed that that eliminating the payroll tax cap entirely would only delay the start of Social Security's annual deficits by six years. If completely eliminating the wage cap only delays Social Security's coming deficits by six years, just raising it would not solve a significant part of Social Security's financial problems.

**Who Would Pay More?** Raising the wage cap does not mainly affect the rich. For every taxpayer with an income of over $500,000 affected by raising the tax cap to $125,000, 24 taxpayers with lower incomes would pay higher taxes.[5] In 2004, the majority of taxpayers earning more than $90,000 had incomes between $90,000 and $150,000. Only a very small number of the 132 million tax returns filed in 2004 (0.33 percent of taxpayers) showed income between $500,000 and $1 million, and an even smaller number (0.18 percent) showed incomes over $1 million.

In addition, raising the wage cap does not target just executives or the wealthy. Increasing the wage cap above $97,500 would raise the taxes of 71,214 elementary and middle school teachers, 97,065 carpenters, 110,908 policemen and policewomen, 254,992 nurses, 208,562 post-secondary teachers, and 237,000 dentists.

1. Heritage calculations on raising the wage cap from $90,000 to $200,000, based on Census Bureau, Current Population Survey, March 2006.
2. Heritage Foundation calculations based on the Global Insight U.S. Macroeconomic model. The methodologies, assumptions, conclusions, and opinions in this paper are entirely the work of Heritage Foundation 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.
3. This assumes that the individual files use the standard deduction.
4. Chris Chaplain, Actuary, and Alice H. Wade, Deputy Chief Actuary, Social Security Administration, "Estimated Long-Range OASDI Financial Effects of Eliminating the OASDI Contribution and Benefit Base."
5. Numbers based on a Heritage Foundation analysis of 2004 federal income tax return data.

**Americans Want Congress to Fix Social Security.** A December 2006 poll showed that Americans want Congress to fix Social Security. The Rasmussen survey of 1000 likely voters showed that 57 percent felt that Social Security needed to be fixed, while only 30 percent wanted the program to be left alone. Other polls show that Americans want Congress to work on a bipartisan basis to address key issues such as entitlement reform.

**Conclusion.** Fixing Social Security will require bold leadership. Raising the Social Security wage cap would be damaging and does not reform the program. Some steps have to be considered to rein in the costs of the program, such as raising the retirement age, instituting lower promised benefits for younger workers, and modifying the cost-of-living adjustment formulas. But a comprehensive approach to fixing Social Security also requires a comprehensive overhaul of America's system of retirement financing, including personal savings and the tax treatment of retirement plans and programs.

Congress should not try to take the "easy" approach to dealing with Social Security. While raising Social Security's wage cap would provide more money to the program and delay the coming annual deficits for a few years, it would also hurt the economy and the millions of workers with incomes just about the wage cap. In addition, after such a tax increase, our children would still be left with a Social Security program that has promised more in benefits than it can afford to pay.

Instead, Congress should consider a comprehensive approach that recognizes America's changing demographics and creates a sustainable Social Security system that can afford to pay adequate benefits to those who need them the most. Most importantly, a comprehensive solution to Social Security should also enable workers of all income levels to build personal savings, part of which they could use to enhance their Social Security benefits or to leave a nest egg to their children. Such a reform would enable Social Security to provide workers with the same kind of retirement security that our parents and grandparents achieved.

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