Backgrounder

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Payroll Tax Holiday: Adding to Growing Social Security Deficits

John L. Ligon

Abstract: *The Hiring Incentives to Restore Employment (HIRE) Act could be considered an excellent piece of legislation—if, that is, the goal of the legislation was to ensure massive Social Security deficits without creating a single new job. Yet another attempt by the federal government to coerce companies into hiring more workers, the HIRE Act also signals two fundamental and likely permanent shifts to the Social Security system: a move away from a system where benefits are paid for entirely by worker contributions to a system where benefits are paid by a transfer from general revenue; and backdoor increases in taxes as a consequence of partial or full general fund financing. Rather than hobbling America's economic recovery with an ineffective payroll tax holiday like the HIRE Act, Congress should encourage productive and sustainable job creation—policies capable of generating real growth in the U.S. economy.*

Little more than a payroll tax holiday for employers, the Hiring Incentives to Restore Employment (HIRE) Act is yet another attempt by the federal government to coerce companies into hiring more workers.

The total cost of the payroll tax holiday plan in the HIRE Act would contribute to the massive and growing Social Security deficits and would likely create no new jobs on net. Additionally, this proposal signals two fundamental and likely permanent shifts to the Social Security system:

1. A move away from a system where benefits are paid for entirely by worker contributions to a sys-

Talking Points

- Using the HIRE Act to stimulate employment growth could result in a net decline in employment of 25,000 to 69,000 jobs.
- The total cost of the payroll tax holiday plan would far exceed the proposed $13 billion loss and would contribute to growing deficits within Social Security.
- The program will reduce revenue to the Federal Social Security OASDI Trust Fund—"a loss replenished" by funds from the federal general revenue account.
- This financing arrangement marks a fundamental shift in the nature of the Social Security program—opening the way to a backdoor tax increase.
- Federal legislation should—at a minimum—reconsider any federal stimulus legislation that will add to ongoing deficits in Social Security.

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214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

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tem where benefits are paid by a transfer from general revenue; and

2. Backdoor increases in taxes as a consequence of partial or full general fund financing.

Instead of pursuing ineffective measures such as payroll tax holidays, federal legislation should focus on:

- Permanently extending the 2001 and 2003 tax cuts;
- Repealing mandates and regulations that add to the high cost of running a business;
- Reducing crippling taxes—including those taxes applied to earnings from abroad—and mandates faced by businesses; and
- Rethinking any federal "stimulus" legislation that will further increase deficits in the Social Security system—especially if the financing involves deficit spending from general revenues.

The Payroll Tax Holiday

Section 101 of the HIRE Act outlines a temporary suspension on the employer share of the Social Security Old-Age, Survivors, and Disability Insurance (OASDI) Trust Fund payroll tax for any qualified employer hiring a qualified individual during a period of eligibility. Under this proposal, qualified employers would include only non-public-sector organizations—"post-secondary educational institutions,"[1] however, would also be considered qualified.

Moreover, the HIRE Act refers to a qualified individual as any individual who has been unemployed at least 60 days prior to being hired by a qualified employer during the period of eligibility. The tax holiday would apply to the employer share of the Social Security OASDI Trust Fund payroll tax—generally 6.2 percent of total payroll[2]—and the period of eligibility would be from February 3, 2010, to December 31, 2010.[3]

Impact of the Payroll Tax Holiday on Employers

Although the legislation attempts to prevent businesses from out-maneuvering the program, exactly how firms would respond to such a change in the employer share of the payroll tax system is uncertain. The payroll tax holiday would reduce the cost of labor for participating companies. However, such a reduction would be temporary and have little impact.[4] Essentially, a qualified employer hiring a worker earning $10,000 in annual wages would receive a wage subsidy roughly equal to $52 per month; this amount would equal roughly $264 per month for a worker earning $51,000 in annual wages.[5]

As a result of the significant drop in demand for goods and services,[6] firms are not hiring new workers—and in many cases are even laying off current employees.[7] In the absence of real demand for these firms' products, it is reasonable to assume that most

1. "IN GENERAL—The Term 'qualified employer' means any employer other than the United States, any State, or any political subdivision thereof, or any instrumentality of the foregoing"; (B) "TREATMENT OF EMPLOYEES OF POST-SECONDARY EDUCATIONAL INSTITUTIONS—Notwithstanding subparagraph (A), the term 'qualified employer' includes any employer which is a public institution of higher education (as defined in section 101(b) of the Higher Education Act of 1965)." U.S. Senate, Committee on Finance, "Hiring Incentives to Restore Employment Act," draft bill, February 11, 2010, Sec. 101(a)(d)(2)(A), at *http://www.finance.senate.gov/sitepages/leg/LEG%202010/021010%20HIREACT%20draft.pdf* (February 16, 2010).
2. The Social Security Old-Age, Survivors, and Disability Insurance (OASDI) Trust Fund tax rate for employees and employers, each, is 6.20 percent. The tax rate for self-employed persons is 12.40 percent. See Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, 2008 *Annual Report*, p. 4, at *http://www.socialsecurity.gov/OACT/TR/TR08/tr08.pdf* (February 16, 2010).
3. The start date may be different. For the exact details of this payroll tax holiday structure, see U.S. Senate, Committee on Finance, "Hiring Incentives to Restore Employment Act," draft bill, Sec. 101(a)(d)(3)(A)—(D).
4. The HIRE Act outlines a business credit for retention of certain newly hired individuals in 2010, which in sum, would amount to a $1,000 tax credit (applied against 2011 tax returns) for retaining any new employee for a 12-month period. U.S. Senate, Committee on Finance, "Hiring Incentives to Restore Employment Act," Section 102.
5. This calculation uses the employer share of the OASDI Trust Fund tax rate as it is applied to the payroll at 6.2 percent.

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employers, given a tax holiday, would likely not suddenly begin acquiring additional labor when they face the possibility of continued depressed demand for their products. It is equally unlikely that an employer operating in an industry or region where the economy is facing the weakest demand would suddenly embark on a permanent hiring splurge. Using the payroll tax holiday of the HIRE Act to stimulate employment growth could actually result in a net decline in employment of 25,000 to 69,000 jobs.[8]

Financing with Transfer from General Revenues

Section 101 of the HIRE Act would be financed with general revenue funds. Specifically, those funds otherwise used from the Treasury—amounting to lost revenue in the federal Social Security OASDI Trust Fund—would be replenished with equal amounts from the federal general revenue account.[9] Using such a transfer of funds as a financing mechanism for this part of the HIRE Act is yet another example of a shift in Social Security from a paid benefit financed from the worker's own contributions (including those of the employer paid in his or her behalf) into a benefit paid for from general revenues.

Adding to Social Security Deficits

The Social Security system is effectively drained of real money and, in 2009, the program ran a deficit of $4.3 billion.[10] These deficits are expected to continue for the next few years before moving back into a small surplus. However, by 2016, these deficits will reappear permanently, and by 2020, Social Security is projected to run $68.5 billion in annual deficits.[11] From then on, deficits will grow into the $300 billion level. Thus, the immediate loss of program revenue will continue to damage the Social Security OASDI Trust Fund both now and in the future.

The immediate loss of $13 billion generated from this legislation, however, is a gross underestimate of the total cost. First, 2010 estimates of net total contributions of payroll tax income are $635.8 billion.[12] This means that suspending the employer share of this figure could reach (at the extreme) a face value loss in revenue of roughly $26 billion in net income per month from the employer share of the OASDI payroll tax.

Second, the total cost of this type of financing plan is more than just the loss in revenue; it also must take into account the lost interest on the immediate revenue loss. The HIRE Act does state that there will be a transfer of money from general revenues to the Social Security OASDI Trust Fund to offset the income loss. However, this only signals yet again that the Social Security trust funds are nothing more than an accounting device—not actual monies that will enable the payment of future benefits.[13] Indeed, the trust funds are nothing more

6. Congressional Budget Office, "Options for Responding to Short-Term Economic Weakness," January 2008, p. 7, at *http://www.cbo.gov/ftpdocs/89xx/doc8916/01-15-Econ_Stimulus.pdf* (February 10, 2010).
7. *Ibid.*
8. The Heritage Foundation estimate assumes the following: (1) the total cost of the payroll tax holiday is the future value of $13 billion at 15 years of accumulation for the lower estimate and 25 years of accumulation for the higher estimate; (2) a constant interest rate of 5.096 percent equal to the current effective Social Security OASDI Trust Fund interest rate; (3) the payroll tax holiday will contribute to 165,000 jobs created among qualified employers during the period of eligibility; and (4) the ratio of total gross domestic product (GDP) for 2010 to total employment at $106,000 per job.
9. U.S. Senate, Committee on Finance, "Hiring Incentives to Restore Employment Act," Sec. 101(c).
10. David C. John, "Social Security's Deficits Reinforce the Need to Reform Spending," Heritage Foundation *WebMemo* No. 2727, December 2009, at *http://www.heritage.org/Research/SocialSecurity/wm2727.cfm.*
11. David C. John, "Social Security's Unexpected Deficits Show Urgent Need for Reform," Heritage Foundation *WebMemo* No. 2632, September 29, 2009, at http://www.heritage.org/Research/SocialSecurity/wm2632.cfm.
12. See Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, 2008 *Annual Report*, p. 35
13. David C. John, "Misleading the Public: How the Social Security Trust Fund Really Works," Heritage Foundation *Executive Memorandum* No. 940, September 2, 2004, at *http://www.heritage.org/research/socialsecurity/em940.cfm.*

than a call on future tax revenue, and the accounting shenanigans contained in the HIRE Act reinforce the urgent need to fix Social Security once and for all.[14]

Permanently Transforming Social Security

Relying on general revenues as a partial financing mechanism for this program signals a fundamental change to the nature of the Social Security program. This general revenue financing treatment starts the shift of Social Security from a paid benefit financed from the worker's own contributions—including those of the employer paid on his behalf—into a *de facto* welfare program.

In addition, this move toward a partial general revenue financing arrangement of Social Security opens the way to a backdoor tax increase. After all, shifting Social Security from benefits based on contributions to benefits financed from general revenues will make it far easier to transfer from general revenues to finance Social Security OASDI Trust Fund deficits.

Helping Businesses Grow with Better Solutions

Federal legislators should reconsider passing a "jobs stimulus" plan that will:

- Create a net decline in employment;
- Fail to provide incentives for productive and permanent employment; and
- Contribute significantly to the ongoing deficits in the Social Security system—especially if the financing involves deficit spending from general revenues.

The persistent message of potential energy regulation and taxes, employer mandates and taxes relating to health care reform legislation, and the immense uncertainty surrounding the pending expiration of the 2001 and 2003 tax cuts are stymieing businesses' ability to plan and expand.

Therefore, to help stimulate real growth in the U.S. economy—and to encourage productive and sustainable job creation—federal legislation should:

- Permanently extend the 2001 and 2003 tax cuts;
- Repeal mandates and regulations that add to the high cost of running a business;
- Reduce crippling taxes—including those taxes imposed on earnings from abroad— and mandates faced by businesses; and
- Reconsider any federal "stimulus" legislation that will add to ongoing deficits in the Social Security system—especially if the financing involves deficit spending from general revenues.

These steps, rather than payroll tax "holidays," will spark the economic recovery America needs.

—John L. Ligon is a Policy Analyst at The Heritage Foundation in the Center for Data Analysis. The author thanks David C. John, a Senior Research Fellow in Retirement Security and Financial Institutions in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation, for his contributions.

14. David C. John, "Automatic IRA Builds Retirement Security," Heritage Foundation *WebMemo* No. 2798, February 5, 2010, at *http://www.heritage.org/Research/Economy/wm2798.cfm.*