

Lifting the payroll tax cap, as Democrats want, may sound like a temptingly simple fix. But it's a trap.



POLITICAL ECONOMICS

Republicans' Pre-Emptive Social Security Surrender

The battle over Social Security reform will be among the most consequential economic fights Washington has had in several generations. So why are some Republicans already preparing to surrender?

The issue has taken on new urgency as it becomes clear a legal cliff edge will force reform by 2032 or else. By that date the so-called trust fund for the old-age portion of Social Security will be exhausted. By law, annual benefit payouts then immediately shrink to match annual payroll-tax revenues. That would mean a 22% reduction in Social Security checks in the first year. *Note*

As miserable as that would be for retirees, one can lose sight of all the other ways Social Security reform will be transformative for the economy, for good or ill. It's the country's largest entitlement program and the single largest line item in the federal budget. The decisions we make about Social Security's finances will determine whether and how we ever get a grip on our public finances in general, in a world of higher interest rates and \$40 trillion public debt. *Note*

Meanwhile, the structure of the program drives a set of crucial economic variables. How long, on average, do people stay in the workforce? Who invests privately to save for retirement, and how much? What tax burden do we place on work and job creation to fund which benefits for which retirees? *Note*

All these questions elude easy answers, although that won't stop lawmakers from trying. In the first instance, Democrats are reaching for tax increases. *Note*

The program is funded by a payroll tax of 12.4%, borne equally by employer and employee and applied to the first \$184,500 of taxable income. The theory is that if high-earning households pay the payroll tax on all their income, it removes a regressive element of the existing system and creates a fabulous new revenue stream. *Note*

Liberals have agitated for this change for years. More worrying is that they're starting to gather some Republican support. Republican Sen. Bernie Moreno of Ohio joined Democratic Sen. Elizabeth Warren of Massachusetts in writing an op-ed for another newspaper this summer arguing for the change. Rep. Tom Cole, an Oklahoma Republican and the Appropriations Committee chairman, recently offered a similar statement to the Washington Post.

It's a trap.

Democrats are kidding voters when they claim raising the payroll tax in this way would be sufficient to stabilize Social Security. Over the next 75 years, the combined old-age and disability systems expect a shortfall of \$29 trillion between the cost of extending today's benefit levels and the revenue to be raised by today's payroll tax rules. The Social Security Administration believes that eliminating the cap would close at best 67% of that gap. Other estimates, such as the Cato Institute's, plausibly put the figure nearer 50%—and perhaps as little as 30%.

This means that far from a one-and-done fix, monkeying with the payroll tax would have to be part of a broader discussion about taxation, eligibility and benefit levels. The question for Republicans then becomes: If they're going to need to fight about all the other stuff anyway, why give up so much leverage so early by agreeing to the tax hike?

Especially when the proposed fix would be so economically destructive. In terms of annual revenue as a share of gross domestic product, eliminating the payroll-tax cap would constitute the largest tax increase since 1982 and the second largest peacetime tax increase since at least 1940, according to the Tax Foundation.

Worse, this tax hike would be targeted at work, the one thing we need more of to generate economic growth and shore up public finances. The combined federal, state and local marginal tax rate on higher earners could soar to 60% in some states. Democrats assume such incentives cease mattering at higher income levels, despite ample historical evidence to the contrary. Republicans should know better than to take that bet.

This is why someone needs to realize that Social Security reform is an economic-policy debate first and a fiscal-number-adding-up exercise second. That "someone" probably will have to be the Republicans.

The fate to avoid is Europe's. Absent any serious reform impetus, politicians for generations have fixated solely on trying to pummel the fiscal numbers into some semblance of balance—never successfully. Along the way, they've achieved levels of taxation that suffocate economic growth without ever stabilizing the finances of their pension and other welfare programs. Britain's experience in recent years increasing its payroll tax to fund unreformed welfare programs has been particularly wretched, as heavier taxation on work has contributed to a job-creation slowdown and a youth-unemployment epidemic.

U.S. lawmakers may think they're debating an old-age program, but they're deciding something much bigger.

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