A Friendly Amendment to the Social Security 2100 Act

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MarketWatch Blog by Alicia H. Munnell

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It might be worth separating out the costs attributable to Social Security's missing trust fund.

The first bill out of the gate this year to solve the Social Security financing problem was the **Social Security 2100 Act**, proposed by Representative John Larson (D-CT), Chairman of the House Ways and Means Subcommittee on Social Security; Senator Richard Blumenthal (D-CT); and Senator Chris van Hollen (D-MD). This legislation retains – and even slightly enhances – benefits and substantially increases the income rate. Other legislative proposals have followed.

My view is that maintaining current benefits and increasing revenues to pay for them is the correct approach. The main argument is that people do not have much else to fall back on. The private retirement system covers only about half of workers at any moment in time and those lucky enough to have a 401(k) plan have **only modest balances**.

One response to this maintain-benefits position was that the Social Security 2100 Act involves a substantial increase in the payroll tax rate. Indeed, **the**

legislation would:

1. Raise the combined OASDI payroll tax of 12.4 by 0.1 percentage point per year until it reaches 14.8 percent in 2043.
2. Apply the payroll tax on earnings above $400,000 and on all earnings once the taxable maximum reaches $400,000, with a small offsetting benefit for these additional taxes.

While maintaining benefits does require a big increase in revenues, there is a compelling reason not to rely solely on the payroll tax. The reason is that a substantial portion of today's Social Security costs can be attributed to the program's missing trust fund.

The 1935 Social Security Act set up a plan that bore a much stronger resemblance to a private insurance plan than to the system we know today. The legislation called for the accumulation of a trust fund and stressed the principle of a fair return. The 1939 amendments, however, fundamentally changed the nature of the program. They tied benefits to average earnings over a minimum period of coverage, and thus broke the link between lifetime contributions and benefits. As a result, early cohorts received windfall returns on their contributions.

Virtually all observers agree that the decision to provide full benefits to early cohorts was a wise one. Many of these people had fought in World War I and had endured the economic devastation of the Great Depression. Poverty rates among older people were at unacceptably high levels. Moreover, the recession of 1937 followed rapidly after the introduction of the Social Security system, making the accumulation of a substantial surplus undesirable on fiscal policy grounds.

The benefits paid to the early retirees did not come for free, however. If earlier cohorts had received only the benefits that could have been financed by their contributions plus interest, trust fund assets would be much larger than they are today. The assets in that larger fund would earn interest and that interest would cover a substantial part of the cost of benefits for today's workers. Without it, payroll taxes must be substantially higher. Our estimate is that the required payroll tax rate under the current pay-as-you-go program is **3.7 percentage points higher** than it would be if we had a trust fund paying interest.

No rationale exists to put the burden of the missing trust fund fully on the back of current and future workers through higher payroll taxes. Instead that burden should be shared more broadly by financing the burden created by the missing trust fund through the income tax. Precisely how to accomplish this goal without losing the benefits of an earmarked tax would require deft drafting. But a discussion about the implications of the missing trust fund is one worth having.