Let’s Raise Social Security Taxes Now

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MarketWatch Blog by Alicia H. Munnell

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Acting soon allows baby boomers to share the burden and reduces the size of the changes

The most recent report from the Social Security trustees was virtually unchanged from last year and showed a 75-year deficit equal to 2.72 percent of taxable payrolls. That figure means that if payroll taxes were raised immediately by 2.72 percentage points – 1.36 percentage points each for the employee and the employer – the government would be able to pay the current package of benefits for everyone who reaches retirement age at least through 2088. Alternatively, benefits would have to be cut by 16.5 percent – or by 19.8 percent if the reductions were limited only to new beneficiaries.

We need to eliminate Social Security’s deficit, and we need to do so soon for two reasons. First, the sooner we make changes the smaller they need to be. If nothing were done until the trust funds were depleted in 2033, the payroll tax would have to be increased by 4.1 percentage points at that point, with the increase rising to 5.1 percentage points by 2087. Alternatively, benefits would have to be cut to match scheduled taxes, which would require a 23-percent cut in 2033 rising to 28 percent in 2087.

Second, the sooner we make changes the fairer it will be to young workers, who are already scheduled to contribute more than they will get back in benefits. If the change were made this year, the second half of the baby boom (who are mainly in their 50s today) would contribute to solving the problem; if we wait, the entire baby boom gets off scot free by retiring before any changes are made. They escape entirely from helping to solve a problem that has been evident during their entire working life.

How should we eliminate the deficit? Policymakers have spent decades putting together alternative packages of tax increases and benefit cuts. All the options are known. But in this current environment, the likelihood of agreeing on a complicated combination of cuts and tax increases seems unlikely. So let's just go ahead and raise the tax rate by 1 percentage point each on employees and employers and raise the taxable earnings base to about $215,000 so that it covers about 90 percent of earnings. That should do the trick for the next 75 years.

Is it feasible to raise the payroll tax by 1 percentage point on the employer and employee? Interestingly, many did not even notice when Congress cut the employee portion of the payroll tax by two percentage points in 2011 and 2012 and then restored the cut in 2013. From the perspective of the individual, who will see only half of the required increase (the other half is paid – if not borne – by the employer), the tax increase required to eliminate the 75-year deficit is less than the 2013 restoration of the employee rate.

Is it sensible policy to raise taxes and forget about benefit cuts? I would say "yes." We live in a world where 401(k)/IRA balances for the typical household approaching retirement are only $120,000, so people are going to need every penny they can get from Social Security.

If the private sector pension system matures into something that provides meaningful retirement income, we can make cuts in Social Security benefits down the road when we need to revisit the program's solvency. Solvency will remain an issue because any package of reforms that restores balance only for the next 75 years will show a deficit in the following year, as the 75-year projection period moves forward and picks up a year with a large negative balance. Therefore, any change we make in the next year or so should realistically be seen as a down-payment on a permanent solution. So let's get on with it.