

“Scrap the Cap,” really?

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MarketWatch Blog by Alicia H. Munnell



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Eliminating Social Security's taxable wage cap is the wrong solution to the program's financing shortfall

I fancy that I stay abreast of what's happening in the Social Security policy arena, so I was taken aback during a trip to Washington to learn that a whole movement has developed to eliminate the bulk of Social Security's 75-year deficit by scrapping the cap – that is, eliminating the cap used for tax and benefit calculations (\$113,700 in 2013). Estimates from the Social Security actuaries indicate that this change alone – if no benefits were provided in exchange for the higher taxes – would close about 90 percent of the 75-year gap. This proposal even has its own rap video “We’re Movin’ In” in which a hilarious older couple warns their son that he should pull out the couch and get more towels if Social Security does not scrap the cap.

But I am skeptical about the widespread support and don't like the idea of removing the cap entirely. The documentation for the support comes from a new survey released by the National Academy of Social Insurance (NASI) – ***Strengthening Social Security: What Do Americans Want?*** (For the record, I was one of the founders of the organization in the early 1980s and its first president.) The interviewer not only asked participants their opinions about

particular changes, but also asked them to choose a preferred package of changes, much as lawmakers might do. The most favored package, which would more than solve the 75-year financing shortfall, consists of four components: 1) gradually eliminating the cap; 2) gradually raising the payroll tax rates for employees and employers from 6.2 percent of earnings to 7.2 percent; 3) increasing the COLA to more accurately reflect the inflation actually experienced by seniors; and 4) raising the minimum benefit.

I checked to see how scrapping the cap got to the top of the list. The option was described to participants as follows:

“Another proposal would completely eliminate the taxable earnings cap, which is currently set at \$110,100 per year. Gradually eliminating the cap over 10 years would mean that the top 5% of earners would pay Social Security taxes on all their earnings throughout the year, just like everyone else. In return they would receive somewhat higher benefits when they retire. This change would close 71% percent of Social Security’s financing gap.”

(Note that the NASI proposal would erase a smaller share of the funding gap than the earlier estimate because it would give higher earners some additional benefits for their additional contributions.)

The description of the option is misleading in two respects – the definition of fairness and the implication that it has no downside. The description defines fairness in terms of the portion of the year over which people pay taxes. In my view, the relevant metric is the ratio of benefits to contributions. If the cap were scrapped, high-earners would receive much less in benefits than they pay in taxes.

Having a very large imbalance between contributions and benefits for high-earners brings us to the downside of scrapping the cap. Social Security is successful because it is a broad-based social insurance system where everyone contributes and everyone receives valuable benefits. Scrapping the cap would mean that for the first time a select group would get a really bad deal on their contributions. This select group is powerful and has disproportionate influence in the political process. They may well push to withdraw from the system, setting in motion a series of changes that could fundamentally alter the nature of Social Security from social insurance to welfare.

I am totally sympathetic with the desire to increase the progressivity of the federal tax system. The wealthy can and should pay more. But this change should be made through the personal income tax, which comprehensively measures a person's ability to pay. Increasing the progressivity of the tax structure through Social Security risks undermining political support for the backbone of the nation's retirement system.

We should not scrap the cap, no matter how amusing the rap video!