AMERICAN ENTERPRISE INSTITUTE

Statement before the United States Senate Budget Committee

Hearing on “Protecting Social Security for All: Making the Wealthy Pay Their Fair Share.”

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Wednesday, July 12, 2023

Years ago, when asked about eliminating the ceiling on wages subject to Social Security payroll taxes, a prominent conservative politician replied as followed:

> [T]here may be an argument for raising the income [threshold] some because of inflation and because a lot more people have moved into higher income brackets in the last five years. But … let's suppose you took it off altogether. You say, what do I care about some baseball player making $10 million a year, right? But if you think about it, what would happen is you would be putting people in a position of paying over the course of their lifetime 50, 60, 100 times more than they would ever draw out of the Social Security system. And you can say, well, they owe it to society. But these people also pay higher income taxes and the rates are still pretty progressive for people in very high rates.
>
> …[Y]ou would really have tremendously changed the whole Social Security system. You would have basically said, if you get to where you make $70,000 or more a year we're going to soak you and you're never going to get anything out of this compared to what you're putting in.[1]

That conservative, by today's standards at least, was President Bill Clinton, speaking in 1998.

And yet, the policy of, in President Clinton's words, "soaking the rich" where "you're never going to get anything out of this compared to what you're putting in" is now embraced by many Members of both the House and the Senate. While Social Security historically has addressed solvency issues through a combination of increases in the payroll tax rate and largely uniform reductions to benefits, the current policy trend is to address Social Security's $23 trillion funding shortfall entirely through tax increases imposed on higher-income Americans.

I will argue that this approach: first, is inconsistent with Social Security's history and philosophy; second, is out of step with how government pensions around the world are funded; third, leaves little on the table to address the federal government's massive long-term fiscal gap; and fourth, is unnecessary, given the already record-high levels of Social Security benefits and total retirement incomes and record-low rates of poverty in old age.

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[1] Clinton, B. (1998). *Response to questions; The Great Social Security Debate. April 7, 1998, Kansas City, Missouri.*

Balancing equity and adequacy. Since its inception in 1935, Social Security has balanced the two pillars of individual equity and social adequacy. Individual equity means that each American is provided a fair rate of return on the contributions they pay into Social Security. Adequacy tilts the benefit formula in favor of low earners to reduce poverty in old age or disability.

According to the Congressional Budget Office, an individual in the bottom fifth of lifetime earners receives a benefit equal to about 80 percent of their inflation-adjusted pre-retirement earnings.[2] A middle quintile earner receives benefits equal to about 50 percent of their average pre-retirement earnings, while someone in the top fifth of the income distribution receives a replacement rate of 32 percent.

From the beginning, Social Security was designed *not* to soak the rich. In 1934, President Roosevelt established the cabinet-level Committee on Economic Security, chaired by Secretary of Labor Francis Perkins. The Committee developed the framework of the Social Security Act, which was passed the following year.[3]

The Committee recommended that participating in the Social Security program be mandatory for any employee earning less than $3,000 per year, which translates to about $67,000 in inflation adjusted dollars or about $215,000 if we account for the growth of average wages.

But here is the important part: under the original framework for Social Security, anyone earning above that $3,000 amount would not be required to participate in Social Security. Thus, there would have been *no* redistribution from high earners to low and middle earners.

In practice, the Committee's recommendation to exempt higher earners from Social Security was impractical; for instance, an individual with multiple job could have exceeded the Committee's ineligibility threshold, but each of the employee's employers might be unaware of that fact. Thus, when Congress passed the Social Security Act in 1935, high earners contributed up to the $3,000 maximum salary threshold and received benefits calculated upon their

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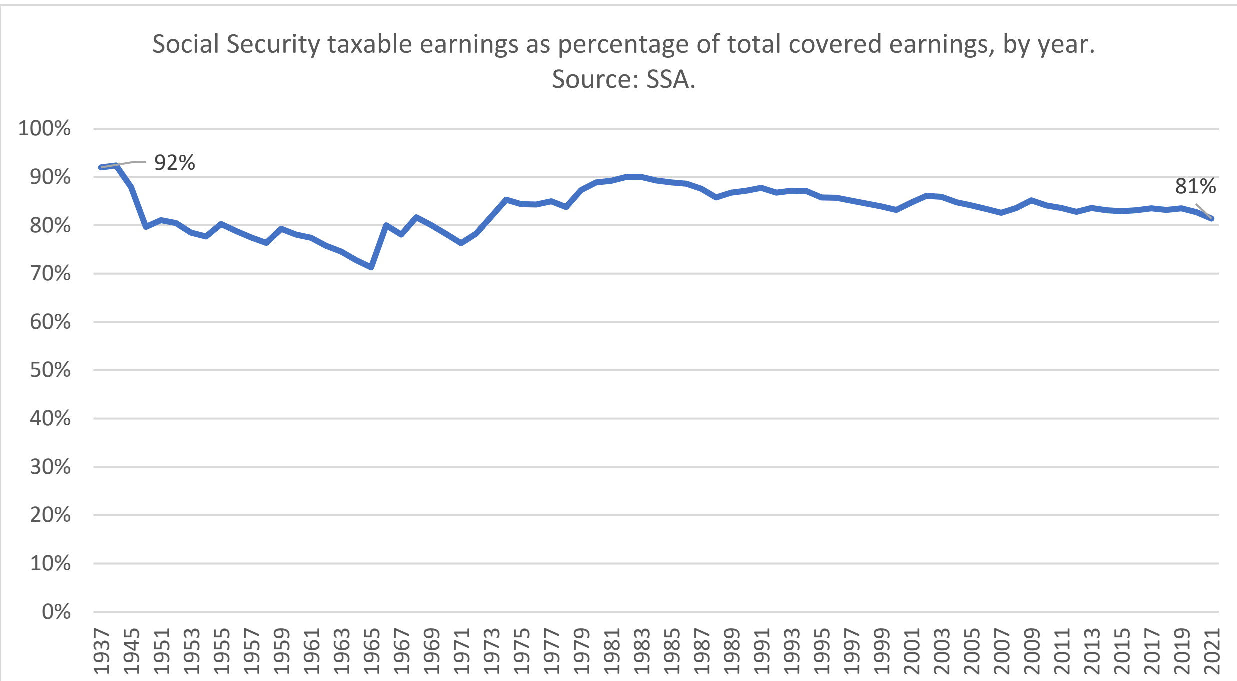
[2] Congressional Budget Office. (2021). *CBO's 2021 Long-Term Projections for Social Security: Additional Information.* . Retrieved from https://www.cbo.gov/publication/57342

[3] Committee on Economic Security. (1934). *Report of the Committee on Economic Security*. https://www.ssa.gov/history/reports/ces/ces5.html

earnings up to that threshold, but neither paid taxes nor received benefits based on earnings above that amount. That practice has continued through today.

The evolution of the maximum taxable salary. Since Social Security was enacted the maximum taxable salary has increased in nominal terms from $3,000 in 1935 to $160,200 for 2023. From 1937 to 2021, an average of 83 percent of total earnings have been subject to Social Security taxes. (See Figure 1.) The highest rate of coverage was 92 percent when Social Security taxes began in 1935, while the lowest coverage was 71 percent in 1965. In 2021, 81 percent of total earnings were taxed by Social Security.[4]

Figure 1.



Some have argued for increasing Social Security's maximum taxable salary to cover 90 percent of total earnings. Doing so would reduce Social Security's long-term funding shortfall by about one-quarter, but also would increase the effective marginal tax rate paid by employees in that salary range by approximately 12 percentage points. Employees would pay 6.2 percent more directly, while both the SSA and the CBO assume that employers would fund their additional 6.2 percent contribution by holding back on employee wages. While there are pros

[4] Source Social Security Administration. (2022). *Social Security Bulletin: Annual statistical supplement*. Social Security Administration.

and cons that policymakers must consider and balance, adjusting the payroll tax ceiling to cover the same share of earnings as it did at Social Security's inception is not out of step with the program's original design.

Proposals to increase Social Security revenues. However, that is not the design of current proposals to reform Social Security through tax increases. For instance, the Social Security 2100 Act, introduced in both the House and Senate, would create a "donut hole" between the current payroll tax ceiling of $160,200 and a new threshold of $400,000, above which the 12.4 percent payroll tax would be levied. The $400,000 threshold would not be indexed for inflation or wages while the $160,200 current law ceiling is increased each year along with wage growth. Over about 25 years the two dollar figures would converge, the donut hole would be closed, and all earnings would be taxed by Social Security.

The Social Security Expansion Act, which has ten Senate co-sponsors, goes further. It would immediately tax all earnings above $250,000 at the rate of 12.4 percent. Breaking with Social Security's history, additional benefits would not be paid in exchange for these higher taxes. The $250,000 threshold also would not be indexed for inflation or wage growth, meaning that within about 10 years the donut hole would be closed and all earnings would be taxed by Social Security.

Going further, the Social Security Expansion Act would apply a separate 12.4 percent tax on investment income for single filers with incomes above $200,000 and joint filers with incomes exceeding $250,000. The Act also would impose a 16.2 percent tax on investment income from S-corporations, with similar income thresholds.

The Social Security Expansion Act would raise sufficient revenues to make Social Security solvent under the Social Security Trustees' intermediate projections for the program, which is a standard benchmark for many reform proposals. However, the Social Security Expansion Act would fall short of achieving solvency when measured relative to the Congressional Budget Office's estimates, which project a long-term funding shortfall for Social Security that is roughly 50 percent larger than that projected by the Social Security Trustees.[5]

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[5] Congressional Budget Office. (2023). *CBO's 2023 Long-Term Projections for Social Security*. Retrieved from https://www.cbo.gov/publication/59184

The size of proposed tax increases. It is useful to gauge the size of the tax increases proposed in the Social Security Expansion Act, although the massive scope of the federal budget makes comparisons difficult. Over its first 10 years of operation, the Act would increase taxes paid into Social Security by about $5.7 trillion, making it nearly three times as large as the "Build Back Better" proposal from 2021.

Alternately, by the 10th year the Social Security Expansion Act would increase annual Social Security taxes by about 1.9 percent of gross domestic product, according to the SSA actuaries' analysis.[6] By contrast, the combined tax increases included in the Biden administration's 2023 budget would increase revenues dedicated to *all* federal programs by 1.1 percent, or slightly over half as much.

Based on a Tax Foundation analysis of the revenue effects of major legislation relative to the size of the economy, the Social Security Expansion Act would likely be the largest peacetime tax increase in U.S. history.[7]

Just as importantly, all of these additional revenues would be dedicated to a single program, Social Security, during a time when the nation faces a significant fiscal gap along with other needs that will require revenues, such as Medicare, health care in general, education, infrastructure, and more.

Geographical implications of Social Security tax increases. Members may also want to consider how eliminating the Social Security maximum taxable earnings threshold would affect Americans geographically. Based on SSA data, for each state I compiled the share of earnings that exceed the current law Social Security taxable maximum.[8] Ranked from first through tenth, the states with the greatest share earnings above the payroll tax ceiling include: Connecticut; California; Nevada; Massachusetts; New York; Ohio; the District of Columbia; Colorado; Illinois; and New Jersey. While detailed data on capital gains tax revenues by state appear not to be publicly available, one would imagine they are similarly concentrated.

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[6] See Office of the Chief Actuary. (2023). *Estimates of the Financial Effects on Social Security of Enacting the Social Security Expansion Act*. Social Security Administration

[7] Watson, G. (2021). *Placing the House Build Back Better Act Tax Increases in Historical Context*. https://taxfoundation.org/house-democrats-tax-increases-historical-context/

[8] Data drawn from Social Security Administration. (2022). *Social Security Bulletin: Annual statistical supplement*. Social Security Administration.

This ranking reads like a list of states that were heavily affected by the repeal of the State and Local Tax (SALT) deduction. Yet, while the Social Security Expansion Act's tax increases have a similar geographical impact to capping the SALT deduction, the two differ greatly in size. The SALT cap raises total federal tax revenues by about $90 billion per year. By contrast, in 2024, the Social Security Expansion Act would increase federal revenues by $265 billion, with greater increases in following years. Thus, one can imagine the impact on citizens of affected states as being approximately similar to the SALT cap multiplied by three.

International comparisons. There is much that the U.S. can learn from other developed countries, all of which are experiencing the fiscal burdens that an aging population places upon government pension systems.

In the context of considering what it means for "the rich to pay their fair share," it is worth noting that very few countries fund their government pension program with an uncapped tax on earnings. In fact, the U.S. current payroll tax ceiling of $160,200 is well *above* that of the typical developed country. For instance, in the United Kingdom, the National Insurance Tax that funds the state pension and a number of other programs is equal to 12 percent of wages up to around $64,000 in annual earnings, with a 2 percent continuing tax on earnings above that amount. In Canada, the 11.9 percent tax for the Canada Pension Plan applies only to about the first $49,000 in earnings.

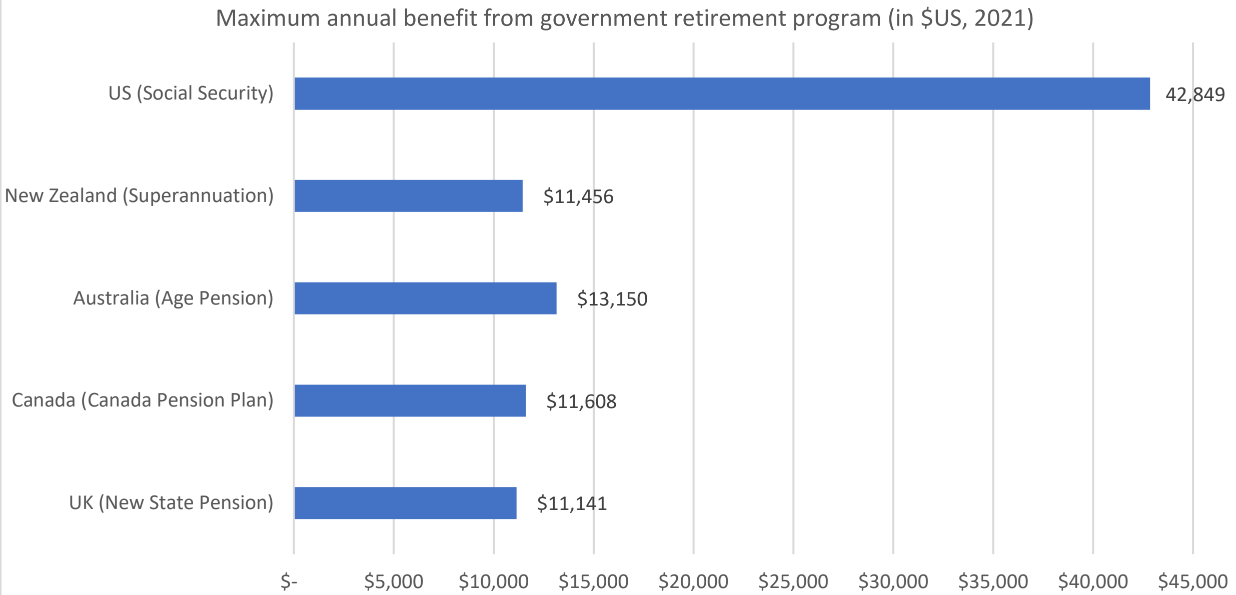
In Figure 2 below, I calculate what the U.S. Social Security payroll tax ceiling would be if it were set using the rules followed by a number of other developed countries. Specifically, I rely upon OECD data that express each country's maximum taxable salary as a multiple of the average salary in that country. I then apply those multiples to the average U.S. salary to produce the dollar figures shown in Figure 2. Only Japan would have a higher payroll tax ceiling than the U.S., exceeding the U.S. level by about four percent. But Belgium, Canada, France, Germany, Japan, Korea, Luxembourg, the Netherlands, Norway, Sweden and Switzerland all have payroll tax ceilings that are approximately half those of the U.S. Social Security program.

Figure 2.

One reason other countries have lower taxable maximums than the United States is that their pension benefits are not as generous as under Social Security. This is not to say that these countries do not provide adequate social protection against poverty in old age. In many cases, their benefits for low-income retirees are higher than under Social Security, which in fact has no true minimum benefit. However, the maximum benefits paid in other countries are often only a fraction of those paid by Social Security.

Figure 3 shows the maximum Social Security benefit for 2022 compared to the maximums paid in New Zealand, Australia, Canada and the United Kingdom, all countries with similar economic and governmental systems to the U.S. The maximum Social Security benefit is between three and four times higher than the maximums paid in these other countries.

Figure 3.



Drawn from governmental sources; adjusted for exchange rate differences as of July, 2022.

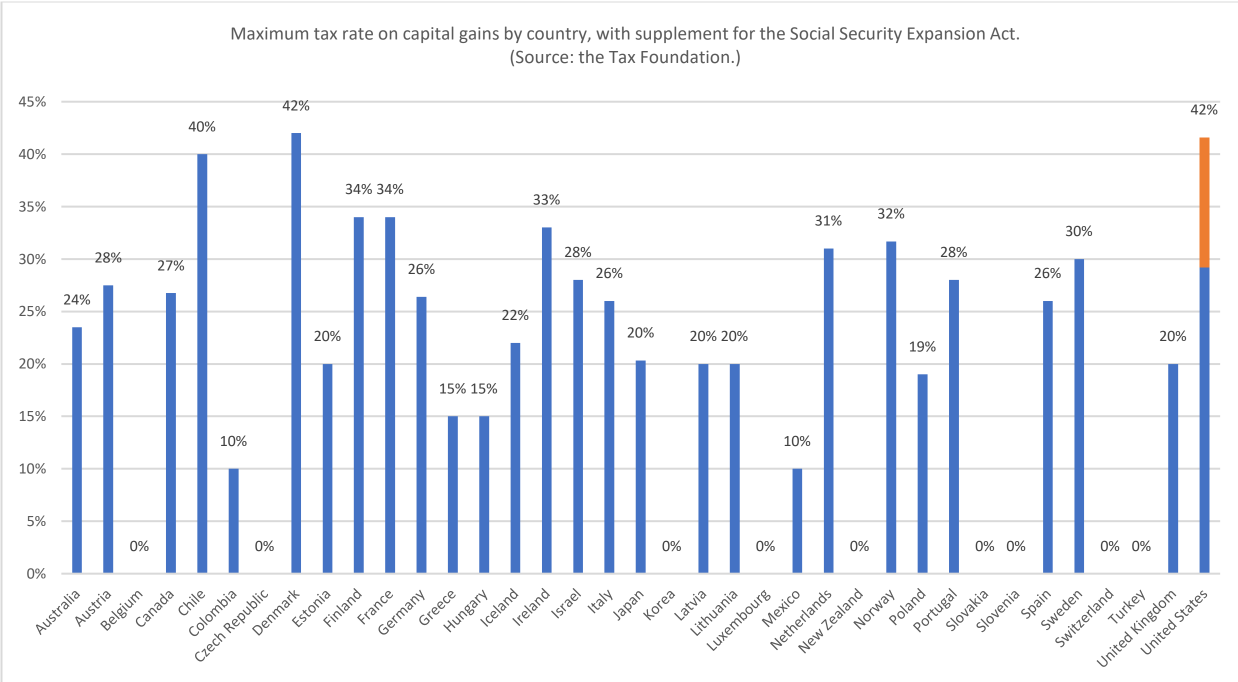
These other countries have concluded that the proper role for government in old-age income provision is to focus on preventing poverty, while the task of retirees' maintaining their pre-retirement standard of living should largely be left to personal savings. These countries do facilitate personal savings; for instance, in Australia every employee has access to a retirement plan at work and is required to participate; in the United Kingdom, every worker is automatically enrolled in a retirement account, though they have the option to withdraw. New Zealand has a similar auto-enrollment retirement plan. But none of these countries see fit to pay a single, high-income retiree over $40,000 annually in government benefits. They have rightly concluded that government has better things to do with its limited resources.

Increasing taxes on wages and investment income also could impact the United States' competitive position relative to other developed countries. According to OECD data for 2019, the top marginal tax rate in the U.S. was 48.4 percent. That figure includes federal income and payroll taxes and an assumed state income tax rate of 2.4 percent. This placed the U.S. slightly above the median among 35 developed countries. If we add the 12.4 percent combined payroll tax that the Social Security Expansion Act would impose on higher earners, the top marginal tax *effective* rate would increase to 60.8 percent[9], placing the United States top marginal tax rate among the top five of 35 OECD countries. Due to the concentration of high earnings in a small number of states where top state income tax rates may significantly exceed the 2.4 percent state income tax rate assumed by the OECD, the true top tax rate could be higher. For instance, the maximum state/local income tax for a resident of New York City is 14.8 percent, in California 13.3 percent, in New Jersey 10.8 percent, and Massachusetts 9.0 percent.

The United States also would face a less competitive situation with regard to investment taxes. Figure 4 shows maximum capital gains tax rates by country. The current maximum rate in the United States is 29.2 percent, a figure that includes the formal capital gains tax, the 3.8 percent Net Investment Income Tax (NIIT) for high-income earners, and the average capital gains tax imposed by states. If the Social Security Expansion Act's 12.2 percent additional tax were applied, the U.S. rate would increase to 42 percent, matching Denmark for the highest rate in the world.

Figure 4

[9] I again stress the effective tax rate, because in nominal terms the employee tax rate would increase by only 6.2 percent, the employee share of the Social Security payroll tax. However, it is the standard view of economists, as well as both the Social Security Administration and the Congressional Budget Office, that employers fund increased payroll tax obligations by holding back on employee wages. That is, a 6.2 percent increase in the employer payroll tax would result in a commensurate reduction in wages paid to affected employees. As a result, the net return to earning one dollar of additional wages would be reduced approximately as if the employee tax rate increased by 12.4 percentage points.



Is Social Security expansion even needed? Many believe that it is necessary to expand Social Security to protect Americans for destitution in old age. The data show, conclusively, that this is not the case. Social Security benefits are at record highs, and more Americans are saving more for retirement than ever before.

- Census Bureau research utilizing IRS data finds that retiree incomes are at record levels, whether measured for middle income retirees (the 50th percentile of the income distribution), working class retirees (the 25th percentile) or upper middle class retirees (the 75th percentile). The share of retirees with incomes below the federal poverty threshold has been dropping for decades.[10]
- Federal Reserve Survey of Consumer Finances data show that retirement savings have risen to record levels in every age, income, education and racial/ethnic group.[11]
- Total assets in private retirement plans in 2022 were roughly six times higher than the mid-1970s, when participation in traditional “defined benefit” pensions was at its peak.[12]

[10] Bee, A., & Mitchell, J. (2017). Do older Americans have more income than we think? Proceedings. Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association,
[11] See Biggs, A. (2020). *Changes to household retirement savings since 1989* (AEI Economic Perspectives, Issue.
[12] Source: Federal Reserve, Financial Accounts of the United States.

- Coverage by employer-sponsored retirement plans has increased to record levels. When traditional pensions were at their peak in the mid-1970s, only 39 percent of private sector workers had access to a retirement plan at work. By contrast, 2022 data from the Bureau of Labor Statistics National Compensation Survey show that 69 percent of private sector employees have access to a retirement plan. Expanded use of automatic enrollment could ensure that every worker who has a plan and needs to save is doing so.
- Contributions to private retirement plans are at record levels. Department of Labor data show that in 1975, when defined benefit pensions were at peak participation, total employee and employee contributions to retirement plans equaled 5.8 percent of employee wages. By 2020 contributions had risen to 8.8 percent of wages, a 51 percent relative increase.[13]
- Social Security benefits already are at record levels. The average new retiree in 2021 receive a monthly benefit that was 36 percent higher than a new retiree in 2000, even after accounting for inflation.[14] A two-earner couple, each with medium earnings and retiring at the normal retirement age in 2023, would receive an annual Social Security benefit exceeding $56,400.[15] This would take the couple to 3.2 times the federal poverty threshold before touching even a penny of their own savings.
- According to the OECD, the median U.S. senior has the highest disposable income in the world, giving the typical American senior an income 29 percent higher than Germany, 33 percent above France, and 48 percent higher than Sweden.[16] U.S. seniors report considerably higher retirement income security than do seniors in the European Union, according to a survey by the Dutch investment bank ING.[17]

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[13] See Department of Labor data at https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletin-historical-tables-and-graphs.xlsx, with private sector wage and salary data from the National Income and Product Accounts.
[14] Author's calculation from Social Security Administration. (2022). *Social Security Bulletin: Annual statistical supplement*. Social Security Administration.
[15] Social Security Trustees. (2023). *The 2023 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*. Washington, D.C.: Government Printing Office
[16] Source: OECD Income Distribution Database.
[17] ING. (2019). *International Survey Savings*.

Conclusion. In short, the idea of funding Social Security by imposing very high tax rates on high earners is inconsistent both with Social Security's founding ethos as well as the practice of similar programs around the world. Social Security expansion plans would require truly large tax increases, in part to facilitate higher benefits for middle and high-income retirees who already are doing well. Meanwhile, those revenues could not be used to address the long-term fiscal gap or to fund other governmental priorities.

Social Security *does* need reform, both to restore long-term solvency and to improve the safety net for low-income seniors. But there are ways to do so both effectively and affordably, leaving sufficient resources for other national priorities.[18] Countries such as Australia and New Zealand provide a true guarantee against poverty in old age, while facilitating private retirement savings on top of these amounts. Either approach provides better social insurance at lower cost than the U.S. Social Security program. Policymakers would benefit from expanding their horizons and thinking deeply about how to structure a Social Security program for the 21st century.

Our leaders need to start somewhere, to build trust and credibility with each other. Senators Cassidy, Kaine, Collins and Coons have recently introduced legislation that would provide Americans with better information on what they can expect to receive from Social Security and how their benefits are affected by when they chose to retire. A journey of a thousand miles begins with a single step, but we must begin the journey to a sustainable and effective Social Security program soon.

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[18] Biggs, A. G. (2022). Rethinking Social Security In The Face Of Economic Threats. In P. Ryan & A. Rachidi (Eds.), *American Renewal: A Conservative Plan to Strengthen the Social Contract and Save the Country's Finances* American Enterprise Institute

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