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BACKGROUNDER

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Executive Order to Defer Social Security Taxes Unlikely to Affect Program Sustainability—But Social Security Reform Desperately Required, Payroll Tax Cut Possible

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KEY TAKEAWAYS

Despite enormous structural problems that far predated COVID-19, it is possible to make Social Security solvent and put Americans on a stronger financial footing.

While the executive order on payroll tax deferral will not affect Social Security, deficit-financed payroll tax cuts are not an effective way to boost this economy.

Making Social Security more targeted will secure the program's viability, reduce payroll taxes, increase personal wealth, and restore confidence in the U.S. economy.

President Donald Trump's executive order allowing a deferral of workers' Social Security payroll taxes between September 2020 and December 2020, to be paid in the future, will have only a tiny, if any, impact on Social Security's finances. Even if the next Administration and Congress were to convert the deferral into a payroll tax holiday by forgiving deferred taxes, policymakers would almost certainly hold Social Security harmless by using general revenues to replace lost Social Security taxes, as they have in similar instances in the past.

Financing a payroll tax holiday with general revenues could add as much as $149 billion to the U.S. debt, however. Now is a time to focus on the coronavirus pandemic and on getting Americans back to work safely. Boosting the incomes of individuals who still have jobs, and who are likely to save much of that income, is not an effective use of future taxpayers' dollars.

The economic consequences of COVID-19 have exacerbated Social Security's shortfalls, while also drawing the program's flaws to light as Social Security's significant tax burden makes it harder for individuals to accumulate savings. While deficit-financed payroll tax cuts would not be an effective way to boost the economy, it is possible to reduce payroll taxes over the long run while also making Social Security solvent. A smaller, more targeted Social Security program would restore confidence in the U.S. economy and give Americans more control over their finances today and in the future.

What the Executive Order on Payroll Tax Deferrals Allows

On August 8, 2020, President Trump issued a series of Executive Orders aimed at addressing the economic consequences of the COVID-19 pandemic. One order[1] directs the Secretary of the Treasury "to defer the withholding, deposit, and payment" of the employee portion (6.2 percent) of the 12.4 percent Social Security payroll tax between September 1, 2020, and December 31, 2020.[2] The Administration later clarified that the order was optional for employers, so it is yet unknown how many employers will defer their employees' payroll taxes and whether they will give their workers' a choice.

For someone making $60,000 a year, this provision would allow $1,240 in payroll taxes that would otherwise be withheld and credited to the Social Security trust funds to be included in that worker's paychecks between September 1 and December 31. Those deferred taxes will be due during the period of January 1, 2021, and April 30, 2021, and it appears that businesses that choose to defer employees' taxes will be responsible for later collecting and submitting those taxes to the IRS.[3]

Tax Deferral Will Not Significantly Affect Social Security's Sustainability

Many Americans—older ones, in particular—are concerned about the effects of a payroll tax deferral on Social Security's viability. They can rest assured, the deferral will have only a tiny impact, if any, on Social Security's finances. I estimate that, if all employers and all self-employed individuals opt to defer eligible employees' payroll taxes (an unlikely occurrence representing the upper bound), the Social Security trust funds could experience up to $131 billion in deferred tax revenues.[4] In order to keep making benefit payments, the Treasury Department will have to substitute deferred revenues by cashing in on an equal amount of Social Security's trust fund IOUs earlier than planned.[5] The lost revenues would later be replaced once deferred payments come due. That temporary shift would cause Social Security's trust fund to accumulate an estimated $778 million less in interest payments.[6] Social Security currently sends out about $90 billion in benefits each month, so a potential $778 million loss would shorten Social Security's solvency by about six hours.[7]

Since trust fund interest payments are essentially the government paying itself interest—a transfer of general revenues into the trust funds—interest lost by the trust funds would be interest saved by general revenues, resulting in zero deficit impact and a very slight hastening of Social Security's insolvency.

Potential Payroll Tax Holiday Also Unlikely to Affect Social Security's Sustainability

The Administration does not have the authority to grant a payroll tax holiday, but President Trump stated his intentions to convert the deferral into a "payroll tax holiday" if he is re-elected. In a press briefing on August 12, President Trump stated: "When I win the election I am going to completely and totally forgive all deferred payroll taxes, without in any way, shape, or form hurting Social Security."[8]

President Trump went on to explain: "That money is going to come from the general fund. We're not going to touch Social Security. I said from day one that we are going to protect Social Security."[9]

This transfer of revenues from the general fund to Social Security is what Congress did in 2011 and 2012. Following a two-year two percentage point reduction in the payroll tax, Congress provided $217 billion in general fund transfers to the Social Security trust funds to replace their lost revenues.[10]

But, Payroll Tax Holiday Would Almost Certainly Drive Up U.S. Debt

Assuming that a payroll tax holiday would be accompanied by replacement of those lost payroll tax revenues with general revenues, this would increase the U.S. publicly held debt. The potential cost of a payroll tax holiday depends on how many employers opt into deferring the payroll tax and whether workers who do not have their payroll taxes deferred will receive cash payments equal to the taxes that could have been deferred. For example, if a worker's employer did not defer his taxes, but he was eligible to defer $1,500 in taxes, would policymakers authorize payments—$1,500 in this case—to workers who "missed out" on the deferral-turned-holiday?

Assuming the maximum cost—with all eligible workers receiving the maximum deferral forgiveness or equivalent subsequent payment—I estimate that a four-month payroll tax holiday from September through December 2020 would cost up to $131 billion in lost revenues.[11] Including 10-year interest costs, a four-month payroll tax holiday for workers making less than $104,000 could cost up to $149 billion.[12] Since not all employers and individuals will defer taxes, the actual cost of a payroll tax deferral-turned-holiday would be lower unless policymakers also provided direct payments to those who did not defer taxes.

Social Security Has Long Been Insolvent, COVID-19 Exacerbates Its Future

Social Security was on track to become insolvent long before COVID-19. In fact, a mere five years after the major 1983 Social Security reforms that were supposed to keep the program solvent through at least 2058, the program's trustees projected that it would instead become insolvent 10 years sooner, in 2048. Since then, Social Security's finances have further deteriorated. The 2020 Social Security trustees' report projects that the program will become insolvent and able to pay only 79 percent of scheduled benefits beginning in 2035.[13] That does not include the effects of COVID-19.

The Great Recession had the effect of quickening the anticipated date of Social Security's trust fund exhaustion by nine years.[14] While is it unlikely that the COVID-19 recession will have as large of an effect on Social Security's finances, it will hurt Social Security's sustainability. According to initial estimates from the Social Security trustees, the Bipartisan Policy Center, the Penn Wharton Budget Model,[15] the Congressional Budget Office, and the Committee for a Responsible Budget, the COVID-19 recession is expected to hasten Social Security's insolvency by one to six years (to between 2029 and 2034), or potentially longer if the recession lasts longer than anticipated.[16]

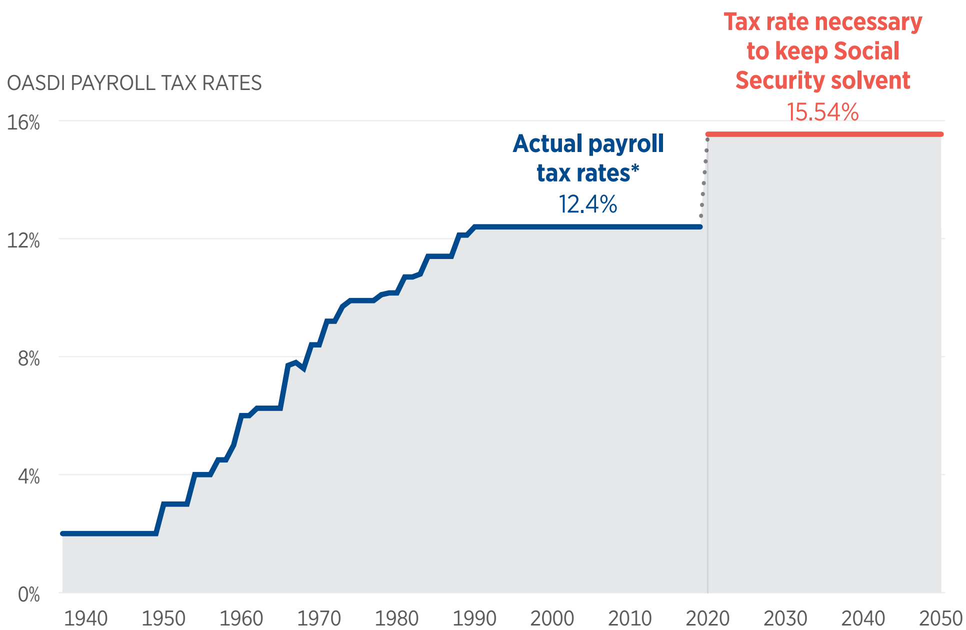
COVID-19 Focused a Spotlight on Social Security's Flaws

Despite its financial consequences, COVID-19 has not altered Social Security's fundamental flaws, but rather drawn them to the light. Many Americans lack the savings that could have helped them to better weather the pandemic. At least in part, that is because Social Security consumes so much of workers' paychecks that it can be hard to save for a rainy day, and even more difficult to save and pay for major life events like buying a

CHART 1

Rising Social Security Taxes and Costs

Despite promises from lawmakers that payroll taxes for Social Security would never exceed 6 percent, they have risen to 12.4 percent today. And even this isn't enough to fund Social Security—keeping the program solvent would require an immediate tax hike to 15.5 percent for 2020 and beyond.



SOURCE: Social Security Administration, *The 2020 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, April 22, 2020, https://www.ssa.gov/oact/tr/2020/tr2020.pdf (accessed August 26, 2020).

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home and the big costs involved with raising children, such as childcare and education. By locking up workers' money until a specified date, Social Security can also unfairly restrict the lifetime incomes of workers who die early and prevent them from passing their money on to their families. (This disproportionately affects lower-income and minority workers who tend to have lower life expectancies.)

These downfalls were not envisioned by Social Security's founders, but they are a consequence of Social Security expanding far beyond its original intent. When Social Security first began, it took just 2 percent of workers' paychecks, and promised to never take more than 6 percent. Today, it takes 12.4 percent—and even that is far short of the 15.5 percent needed to pay scheduled benefits. Consequently, Americans have grown disturbingly dependent on an insolvent government program for their retirement, while having smaller after-tax paychecks and less control over their finances and life decisions.

One of the biggest advantages of Social Security is that it is supposed to provide guaranteed benefits; but what was once considered a sure thing is increasingly uncertain. In fact, for anyone under the age of 47, the only guarantee is that Social Security *cannot* provide its scheduled benefits. Even people already retired and receiving Social Security could have their benefits cut within 10 years to 15 years. Not surprisingly, more than 80 percent of Generation X and Millennials are concerned that Social Security will not be there for them when they retire.[17]

And yet, Social Security is limiting workers' ability to make up for potential lost Social Security benefits because workers are forced to put 12.4 percent of their paychecks into a program that strips them of the opportunity to earn a positive rate of return over time. Since 2010, every dollar that workers contribute in payroll taxes has gone straight out the door to pay retirees' benefits. This is unfair to current workers and unhelpful to the American economy because shifting incomes from younger to older generations displaces savings, reduces productivity and output, and results in smaller incomes for younger and future workers. According to Heritage Foundation analysts, this lack of investment opportunity on Social Security taxes will strip $4,320 worth of retirement income per year from someone who makes about $20,000, while extracting $47,712 per year of potential retirement income from someone who makes about $60,000 per year.[18]

How to Preserve Social Security, Target Benefits, Increase Incomes, and Promote Wealth

Policymakers face straightforward choices on how to address Social Security's looming insolvency. They can make Social Security bigger by raising taxes and increasing benefits, or they can make it smaller by better targeting benefits and reducing everyone's taxes.

An example of the bigger solution is the Social Security 2100 Act,[19] which would make the program solvent by gradually raising Social Security's tax from 12.4 percent to 14.8 percent, while also increasing benefits for everyone. Under the Social Security 2100 Act, someone who earned $1,000,000 per year while working would, in retirement, receive an extra $1,028 per month from Social Security while someone who earns $30,000 per year would get an extra $28 per month.[20]

TABLE 1

Personal Savings Would Generate Higher Retirement Incomes for All Income Levels

MONTHLY PAYMENTS FOR INDIVIDUALS BORN IN FLORIDA IN 1995

MALES	Social Security	Personal Savings Annuity
0.5 Times Mean Earner	$1,551	$3,093
Mean Earner	$2,209	$6,185
Max Earner*	$2,683	$11,264
FEMALES	**Social Security**	**Personal Savings Annuity**
0.5 Times Mean Earner	$902	$1,262
Mean Earner	$1,393	$2,524
Max Earner*	$2,683	$10,132

* Max earner refers to a worker who makes at least the taxable maximum to which Social Security benefits apply ($128,400 in 2018).

NOTE: Florida earnings levels are representative of national averages. All figures are in 2017 dollars. Personal Savings Annuity represents what individuals are projected to be able to purchase if they were able to put their Social Security taxes into personal savings accounts and purchase inflation-adjusted annuities at the time they would otherwise claim Social Security benefits.

SOURCE: Kevin Dayaratna, PhD, Rachel Greszler, and Patrick Tyrrell, "Is Social Security Worth Its Cost?" Heritage Foundation *Backgrounder* No. 3324, July 10, 2018, Tables 11 and 12, https://www.heritage.org/sites/default/files/2018-07/BG3324_0.pdf.

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In contrast, Heritage Foundation analysts have a proposal to make Social Security smaller and better targeted to those in need. This proposal would gradually shift the program to provide a flat benefit by reducing benefits for middle-income and upper-income earners and increasing them for lower-income earners. Coupled with increasing and indexing Social Security's eligibility age to life expectancy, using a more accurate measure of inflation, and modernizing the spousal benefit, Heritage analysts estimate that these reforms would fully solve Social Security's shortfalls and even allow policymakers to reduce Social Security's payroll tax to 10.1 percent.[21] This would translate into higher incomes, greater ability for households to balance their finances throughout their lifetimes, and a probable increase in savings and investment that would spur increased productivity and higher incomes.

TABLE 2

Recommended Reforms to Improve Social Security's Retirement Program

Based on the 2018 Social Security Trustees report, the following recommended reforms to OASI would collectively save $681 billion over a 10–year period and cover 126 percent of the program's 75–year shortfall, as calculated by a dynamic model. Figures listed below represent the savings for each reform as a stand-alone proposal.

Proposal	Years 1–10 Savings (in bllions)	% Reduction in 75-Year Actuarial Deficit ("Shortfall")
Increase retirement age and index to life expectancy	$32	29.0%
Shift towards a flat, anti-poverty benefit	$645	84.0%
Modernize the spousal benefit	$2	3.0%
Use the chained CPI	$12	11.0%

SOURCE: Author's calculations based on data in the 2018 Social Security Trustees Report and using the Heritage Foundation Social Security Model.

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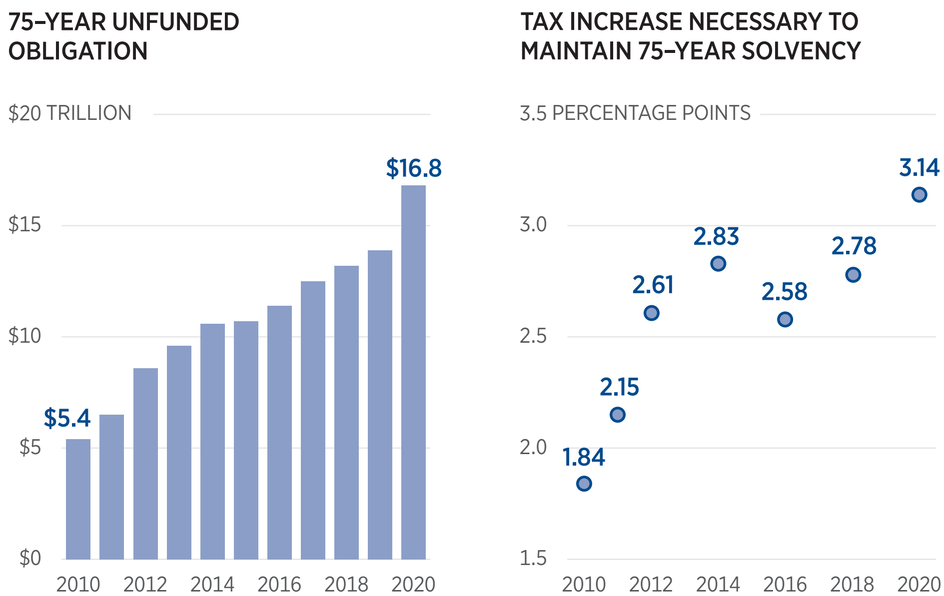
Analyses from the Penn Wharton Budget Model show that a smaller Social Security program would have positive impacts across the economy, leading to a 5.3 percent increase in gross domestic product (GDP) in 2049.[22] In contrast, the model projected that a larger Social Security program as envisioned under the Social Security 2100 Act would have an increasingly negative effect on the economy, reducing GDP by 2.0 percent in 2049.[23] As former Social Security Principal Deputy Commissioner Andrew Biggs explains: "The logic is straightforward: When taxes go up people work less; when Social Security benefits go up, people save less. If people work less and save less, the economy grows more slowly."[24]

Social Security is in desperate need of reform, and each year that Congress fails to address the program's shortfalls exacerbates Social Security's deficits and the magnitude of necessary reforms. Between 2019 and 2020 alone—and not accounting for any effects of COVID-19—Social Security's 75-year shortfall increased by $2.9 trillion to $16.8 trillion—a 21 percent increase in just a single year.[25] Between 2010 and 2020, Social Security's 75-year shortfall more than tripled, from $5.4 trillion to $16.8 trillion, and

CHART 2

Each Year that Policymakers Kick the Can Down the Road, Social Security's Shortfall Increases

Social Security's shortfall has expanded more than three-fold since 2010. At $16.8 trillion, its 75–year unfunded obligation would require a tax increase of 3.14 percentage points to remain solvent. Without reform, that tax increase will continue to rise.



NOTE: The 75–year unfunded obligation represents the amount of money needed to prevent the combined Social Security trust funds (OASDI) from declining to zero over the next 75 years. This figure does not include obligations accrued to workers that might not be payable in the 76th year or beyond.
SOURCE: Social Security Administration, "Reports from the Board of Trustees," 2010–2020, https://www.ssa.gov/oact/tr/ (accessed September 1, 2020).

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the amount by which payroll taxes would have to increase to ensure 75 years of solvency is now 70 percent higher than in 2010. Today, a 3.14 percentage point increase (to 15.54 percent) would be necessary, while a 1.84 percentage point increase (to 14.24 percent) would have been enough in 2010.[26] One can expect even greater shortfalls in the Social Security trustees' 2021 report.

Social Security, as current retirees and past generations have experienced it, is simply not possible for current workers and future generations. The program's enormous unfunded obligations mean that younger generations will have to bear part of the burden of the program's previous excesses. How much they will bear, however, will directly align with Social Security's size and scope—a bigger program will take more in taxes and limit households' control over their lifetime finances, while a smaller program will reduce taxes and give households more options to make lifetime choices that align with their unique circumstances and goals. Moreover, by shifting part of workers' tax dollars away from Social Security's pay-as-you-go structure to one that allows individuals to earn a positive rate of return over time (a return that reflects actual productivity growth from investments as opposed to extracted income from younger workers), all Americans could benefit from productivity and income gains. It is also likely that such a shift—particularly if accompanied by an option for workers to put part of their payroll taxes into personal accounts—would reduce income inequality and wealth inequality in the U.S.

Conclusion

The recent Executive Order allowing a deferral of workers' Social Security payroll taxes between September and December 2020 could reduce Social Security's interest revenues by $778 million—the equivalent of about six hours' worth of Social Security's expenses. Congress could decide to replace this lost interest with general revenues.

If the next Congress turns the payroll tax deferral into a payroll tax holiday, it is still highly likely that policymakers would hold Social Security harmless through a general revenue transfer. Such a move would, however, increase the federal debt by up to $149 billion over the next 10 years.

At $26 trillion-and-rising, the national debt already amounts to about $207,000 *per household*. Considering that personal disposable incomes actually increased by $1.5 trillion[27] and personal savings surged to $4.7 trillion[28] in the second quarter of 2020 (meaning many people already received an income boost and are saving, instead of spending, it), temporarily reducing taxes for the 147 million[29] Americans who still have jobs would not be an effective use of future taxpayers' dollars.

Social Security was on the path to insolvency long before COVID-19. Although the pandemic has exacerbated Social Security's shortfalls, it has not altered the program's fundamental flaws. Deficit-financed payroll tax cuts would not be an effective way to boost the economy, but reforming Social Security to make it smaller, better targeted, and viable for the long run would restore confidence in the U.S. economy and put Americans on a more sound financial footing for the future. Despite enormous unfunded liabilities, it is actually possible to make Social Security solvent, increase benefits for lower-income workers, and return more income and greater control to individuals. Doing so should be a priority for the next Administration and the 117th Congress.

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Endnotes

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2. Under the Coronavirus Aid, Relief and Economic Security (CARES) Act, which was signed into law on March 27, 2020, employers can defer their 6.2 percent portion of the Social Security FICA tax from March 27, 2020, through December 31, 2020, with 50 percent of the deferred taxes due December 31, 2021, and the other 50 percent due on December 31, 2022.
3. Internal Revenue Service, "Relief with Respect to Employment Tax Deadlines Applicable to Employers Affected by the Ongoing Coronavirus (COVID-19) Disease 2019 Pandemic: Part III Administrative, Procedural, and Miscellaneous," Notice 2020-65, https://www.irs.gov/pub/irs-drop/n-20-65.pdf?source=email (accessed August 31, 2020).
4. Author's calculations based on monthly Treasury Department statements containing Old-Age and Survivors Insurance (OASI) and Social Security Disability Insurance (SSDI) payroll tax revenues in U.S. Department of the Treasury, Monthly Treasury Statement, January 2019 through June 2020, Table 4. Receipts of the U.S. Federal Government, https://www.fiscal.treasury.gov/reports-statements/mts/previous.html (accessed August 17, 2020). Calculations based on total 2019 payroll tax revenues in the OASI and DI trust funds, and available data through June 2020. Actual combined OASDI payroll taxes revenues in 2020 exceeded the same revenues in 2019 by $23.6 billion (4.6 percent) from January through June. These estimates assume that payroll taxes for 2020 will be the same as in 2019 (a total of $930 billion). This is a somewhat simplistic assumption, based on the fact that payroll tax revenues actually increased through the first six months of the year, but could likely be lower over the coming months due to lower employment than in 2019. Holding payroll tax revenues steady between 2019 and 2020 results in a projected 5.5 percent decline in Social Security revenues over the second half of 2020 as compared to the first half of the year (for a total of $407 billion in revenues from July through December 2020). To estimate monthly payroll tax revenues for July through December 2020, I applied the same percentage of monthly revenues from 2019 to 2020. For example, July 2019 revenues equaled 16.0 percent of July through December 2019 revenues, so I assumed the same 16 percent for July 2020. This results in an estimated $275 billion in payroll taxes due between September and December 2020, half of which ($137.5 billion) is the employee portion that is eligible for deferral. I then estimated that 5 percent of revenues collected over those months will come from individuals making more than $104,000 per year, and thus not eligible for the deferral. This is based on the fact that about 6 percent of workers earn above Social Security's taxable maximum of $137,700 for 2020 (meaning a larger percentage make more than the $104,000 eligibility threshold), but some of these workers will already have stopped paying OASDI taxes in 2020 and thus their contributions are already excluded from estimated totals. This leaves up to $130.6 billion eligible for a payroll tax deferral.
5. Although the federal government keeps separate track of Social Security tax contributions so as to create notional trust funds (of which there are technically two separate trust funds, for Social Security's OASI and for its DI programs), this is merely an accounting exercise as there are no actual dollars in the Social Security trust funds. In reality, Social Security taxes go straight from workers' paychecks to current retirees' benefits and any excess is used to fund other government spending. When the government uses Social Security taxes for non–Social Security spending, it credits the Social Security trust funds with IOUs in the form of special-issue Treasury bonds. Since 2010, Social Security has been running cash-flow deficits, collecting less in tax revenues than it pays out in benefits. That means that Social Security is already adding to the federal deficit by cashing in on its trust fund IOUs, which requires trading Social Security's special-interest Treasury bonds for new, publicly held debt.
6. This applies the August 17, 2020, rate of 1.43 percent on 30-year U.S. Treasuries to my estimate of up to $130.6 billion in deferred payroll taxes, which I estimate would be deferred and thus financed for an average of five months with repayment due no later than April 30, 2021. Treasury rates available at U.S. Department of the Treasury, "Resource Center," https://www.treasury.gov/resource-center/data-chart-center/interest-rates/pages/textview.aspx?data=yield (accessed August 27, 2020). A 30-year rate is applied based on the historically low rates and expediency of locking in low long-term rates.
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12. This applies the August 17, 2020, rate of 1.43 percent on 30-year U.S. Treasuries to my estimate of up to $130.6 billion in deferred payroll taxes, for annual interest costs of $1.868 billion, and 10-year costs of $18.68 billion, bringing the total cost to $149.3 billion. If the interest payments were financed by adding more debt at the same 1.43 percent rate, the total cost would rise to $150.6 billion. Treasury rates at U.S. Department of the Treasury, "Resource Center." A 30-year rate is applied based on the historically low rates and expediency of locking in low long-term rates.
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14. Prior to the Great Recession, in 2008, the Social Security trustees projected a combined OASDI trust fund insolvency date of 2041, which continued to move forward in time over subsequent reports, reaching an estimated insolvency date of 2033 in the 2012 report. The trustees' most recent report for 2020 projects an insolvency date of 2035, excluding the effects of COVID-19.
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