BACKGROUNDER

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Social Security Expansion Act: $33.8 Trillion Tax Would Destroy Jobs, Slash Incomes, and Increase Workers' Dependence on the State

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KEY TAKEAWAYS

Without changes to fix the program, Social Security will be insolvent in a decade and benefits will be cut by 23 percent for all Social Security recipients.

Democrats' proposed Social Security Expansion Act is part of an economically illiterate, socialist agenda that would destroy American innovation, jobs, and incomes.

Policymakers should protect and improve Social Security's most important functions, modernize the program, and help all Americans to build personal wealth.

Americans need thoughtful proposals for Social Security reform. Absent changes to the program, Social Security will be insolvent in a decade and benefits will be cut by 23 percent for all Social Security recipients. With $20.4 trillion in unfunded obligations—the equivalent of $157,000 per household—maintaining the program without structural changes would be incredibly costly.

Anyone who puts forward a thoughtful Social Security reform proposal should be applauded for attempting to fix a popular, but broken, program. Policymakers who promise not to touch Social Security benefits and fail to put forward viable solutions to fix the shortfall are, by default, supporting current law, which will result in 23 percent, across-the-board, and permanent benefit cuts for more than 65 million Social Security recipients in 2033 and beyond.[1]

A new proposal from a group of Democratic lawmakers attempts to make Social Security solvent while adding to its liabilities and imposing $33.8 trillion in new taxes.[2] On paper, the proposal appears to make Social Security solvent over the next 75 years, but that is based on a narrow cost analysis that ignores the damaging effects the plan would have across the entire economy, reducing output, destroying jobs, and restricting income growth that could otherwise boost Social Security's revenues. As part of an economically illiterate, socialist agenda, these reverberating consequences would cause younger and future generations to be more dependent on government and less free to pursue their own goals.

Social Security Expansion Act: Big Benefit Increases, Super-Sized Tax Hikes

The Social Security Expansion Act—introduced by Senators Bernie Sanders (I–VT) and Elizabeth Warren (D–MA), along with Representatives Jan Schakowsky (D–IL) and Val Hoyle (D–OR)—includes four benefit expansions and three massive tax hikes.[3]

The Social Security Expansion Act's benefit expansions include:

1. A Large and Permanent Benefit Increase for all Social Security Recipients Beginning in 2024. The Social Security Expansion Act would apply a larger percentage factor to Social Security's first step of its benefit formula—raising the current 90 percent to 95 percent—and would also increase, by 22 percent, the amount of income to which that 95 percent factor applies. Based on the current benefit formula, that would translate into an extra $210 per month, or $2,520 per year, for nearly all Social Security recipients, including millionaires and billionaires.[4]

2. Application of a Narrow Inflation Measure that Results in Larger Cost-of-Living Adjustments (COLAs). Social Security recipients receive an annual COLA based on the consumer price index for urban wage and clerical workers (CPI-W). In 2023, Social Security recipients received an 8.7 percent benefit increase—an extra $1,750 per year for the average beneficiary.[5] Meanwhile, the average worker received only a 3.6 percent wage increase over the past year (and a 2.7 percent wage cut after accounting for inflation).[6]

The Social Security Expansion Act would replace the CPI-W with the consumer price index for the elderly (CPI-E). This change is estimated to increase annual COLAs by 0.2 percentage points per year. That difference is small initially but rises exponentially over time. By the 75th year, a 0.2 percentage point difference grows to a 15.8 percentage point difference. That means that a worker who retires 60 years from now and collects benefits for 15 years would receive an extra $53,000 in total benefits compared to the current inflation adjustment that already overstates inflation.[7]

Beginning in 2002, the Bureau of Labor Statistics (BLS) began calculating a new inflation measure—the chained CPI—that tracks what people are purchasing on a monthly basis, instead of only updating what people purchase every two years. According to the BLS, the chained CPI "is designed to be a closer approximation to a cost-of-living index than other CPI measures" because it accounts for how consumers' purchases respond to changes in prices.[8] Essentially, the chained CPI reflects the actual purchasing power experience of American households and thus should be used to adjust Social Security benefits and across other government programs. Presidents George W. Bush and Barack Obama both proposed using the chained CPI for Social Security adjustments and Congress recently adopted the chained CPI to adjust income-tax brackets. According to the Congressional Budget Office, applying the chained CPI would reduce Social Security's shortfalls by about $150 billion over the next 10 years while the CPI-E would increase Social Security shortfalls by about $150 billion.[9]

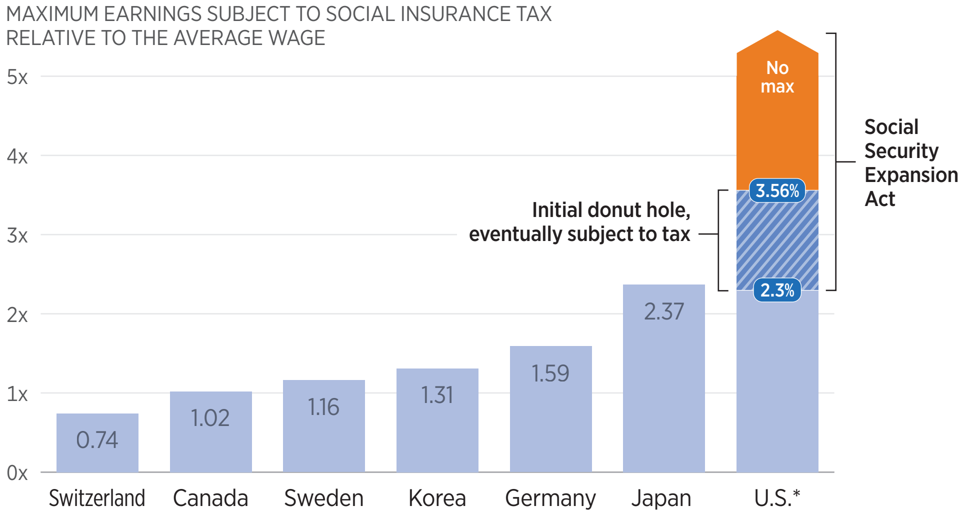
3. An Increase in the Special Minimum Benefit. For individuals who are newly eligible for benefits in 2024 and beyond, the Social Security Expansion Act would increase the special minimum benefit to 125 percent of the federal poverty level for individuals with 30 or more years of earnings. This would translate into a roughly 37 percent increase in the special minimum benefit. As of 2019, the Social Security Administration reported that only about 0.05 percent—one of every 2,000 beneficiaries—received the special minimum benefit. This significant increase would bring the special minimum benefit to just 10 percent below the current average benefit of all Social Security and Disability Insurance recipients and would, consequently, result in far more individuals receiving the minimum benefit.

This proposed increase would effectively eliminate the "earned benefit" component of Social Security for a significant number of workers who would no longer receive larger Social Security benefits as a result of earning higher incomes and working more than 30 years. This change would act as a tax that reduces lower-income workers' labor force participation.

4. Continuation of Children's Benefits Through Age 22, Instead of the Current Age 18. Beginning in 2024, the Social Security Expansion Act would extend benefits for children of disabled or deceased workers until age 22 if they are in high school, vocational school, or college. To the extent that current student financial aid packages consider students' household incomes, these additional benefits could be partly offset by reduced student aid.

CHART 1

Social Security Expansion Act Would Make U.S. Outlier with Unlimited Social Security Taxes



*The Social Security Expansion Act would initially create a "donut hole" of earnings not subject to the payroll tax cap (between $160,200 and $250,000). Because the current cap is indexed for inflation and the proposal's $250,000 level is not, all earnings would eventually be subject to the tax.
SOURCE: OECD, "Pensions at a Glance 2021," Table 3.4, p. 129, https://www.oecd-ilibrary.org/docserver/ca401ebd-en.pdf?expires=1676679614&id=id&accname=guest&checksum=838FCD82E12D94AC9979C1436021A157 (accessed February 17, 2023).

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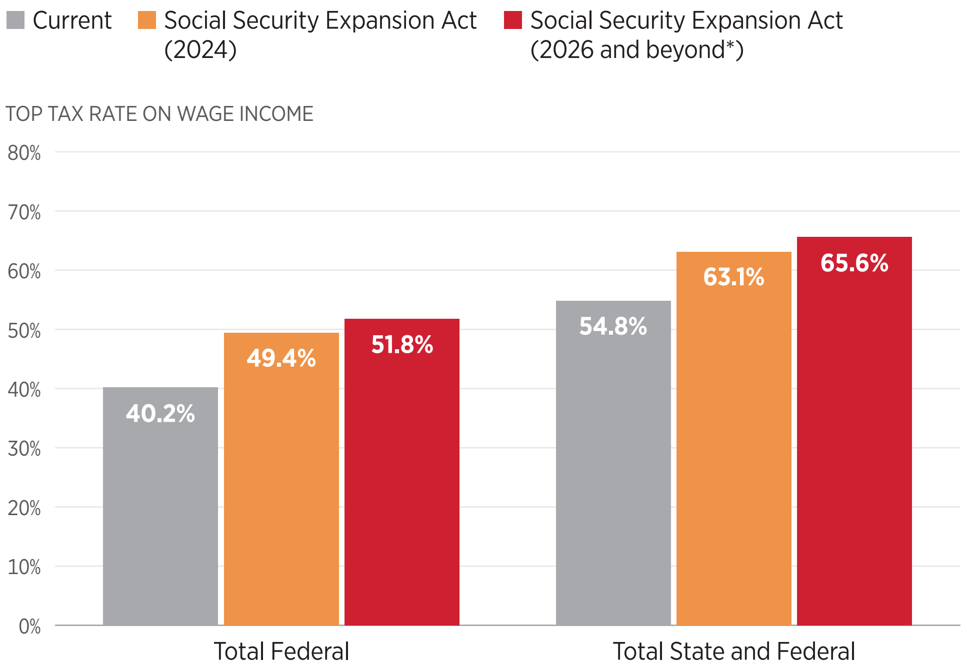
According to the Social Security Actuaries' analysis, these benefit increases would add $12.8 trillion in new costs over the next 75 years.[10]

To pay for all those benefit increases and cover the program's existing $20.4 trillion shortfall, the Social Security Expansion Act would impose three massive new taxes on workers, savers, and small business owners. Those three tax increases are:

1. Raising and Then Eliminating Social Security's Payroll Tax Cap. Currently, Social Security's 12.4 percent tax rate applies to the first $160,200 of workers earnings. The Social Security Expansion Act would add Social Security's 12.4 percent tax to all earnings above $250,000 without any increase in benefits for the newly taxed earnings. Initially, there would be a "donut hole" of earnings between the $160,200 cap and $250,000 threshold that would not be subject to the 12.4 percent tax, but because the cap will continue to rise with inflation and the $250,000 threshold remains constant, all earnings would be subject to the Social Security tax after about 15 years.

CHART 2

Top Tax Rates on Wage Income Rise Sharply Under Social Security Expansion Act



* Figures for 2026 and beyond assume the scheduled expiration of the Tax Cuts and Jobs Act.
NOTE: Figures factor in the employer portion of Social Security and Medicare taxes as wages that are not included in the taxable wage base. This equates to dividing the total tax rate by 1.0145 for wages subject only to the Medicare tax and by 1.0765 for wages subject to both the Social Security and Medicare taxes.
SOURCE: Author's calculations based on current law and the Social Security Expansion Act.

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Eliminating the payroll tax cap is counter to Social Security's original intent, which was to prevent poverty in old age, and not to serve as Americans' primary source of retirement income. When President Franklin Roosevelt's Committee on Economic Security designed the Social Security program, it proposed exempting people making over $3,000 annually—the equivalent of about $66,000 in 2023—from the Social Security system altogether because those workers were expected to be saving on their own. The House Ways and Means Committee decided to instead include most workers in the program, and to cap contributions at the first $3,000 of income. That $3,000 cap did not increase until 1950. In inflation-adjusted dollars, the current maximum of $166,200 is nearly 2.5 times Social Security's original taxable maximum and four times the program's 1950 maximum.

Raising and eliminating the payroll tax cap would also make the U.S. an anomaly among other industrialized countries that apply Social Security taxes to a significantly lower level of earnings.[11] Canada, for example, caps its Social Security tax at incomes at $66,600 per year, which is equal to the average wage.[12]

Finally, subjecting all earnings to payroll taxes and ignoring large amounts of taxes paid in benefit calculations would eliminate any illusion that Social Security acts like a pension where people get out of the program what they put in.

The Social Security Expansion Act would bring the top federal tax rate on wages to 49.4 percent in 2024 and 51.8 percent in 2026 and beyond.[13] Combined with state and local income taxes, the top rate on wages would become 63.1 percent in 2024 and 65.6 percent in 2026 and beyond.[14] High marginal tax rates on work will reduce the amount of work that is done by higher-income earners. That reduction in effort and output among high-income earners will reduce demand and investment, which will mean fewer jobs and lower incomes even for those not directly subject to higher tax rates. As history demonstrates, high marginal tax rates on the high earners does not lead to higher total tax revenues and, in fact, reduces the share of taxes paid by the highest earners.[15]

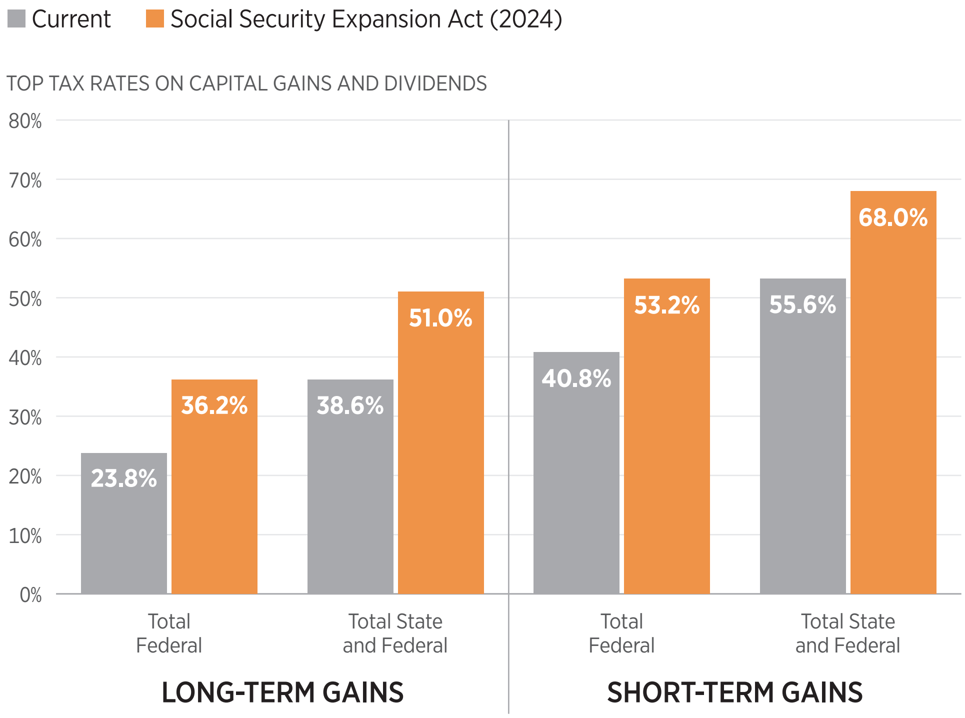
2. A New 12.4 Percent Investment Surtax. The Expansion Act would add a 12.4 percent surtax to investment income of individuals making over $200,000 and married couples making over $250,000. In addition to the current 3.8 percent Obamacare surtax and the top 20 percent marginal tax rate, this would raise the top rate on long-term dividends and capital gains from 23.8 percent to 36.2 percent, and the top federal rate on interest income and short-term capital gains from 40.8 percent to 53.2 percent. Combined with state and local capital gains tax rates, the top rate would reach 68 percent.[16] These rates do not include other various layers of potential wage and corporate tax rates that apply prior to capital gains realization.

Taxpayers are very responsive to investment income taxes, making them an inefficient and even destructive means of raising tax revenues.[17] The Penn Wharton Budget model estimated that increasing the 20 percent statutory tax rate on capital gains and dividends to 39.6 percent would *decrease* tax revenues by $33 billion over 10 years.[18]

3. A New 16.2 Percent Tax on Small Business Owners. Currently, S-corporations, limited partnerships, and other businesses that file taxes as "pass-through entities" (which pay taxes at the individual level and not at the corporate level) are subject to these Social Security, Medicare, and Obamacare taxes only on the salaries and certain compensation paid to

CHART 3

Top Tax Rates on Capital Gains and Dividends Rise Sharply Under Social Security Expansion Act



NOTE: Figures factor in the employer portion of Social Security and Medicare taxes as wages that are not included in the taxable wage base. This equates to dividing the total tax rate by 1.0145 for wages subject only to the Medicare tax and by 1.0765 for wages subject to both the Social Security and Medicare taxes.
SOURCE: Author's calculations based on current law and the Social Security Expansion Act.

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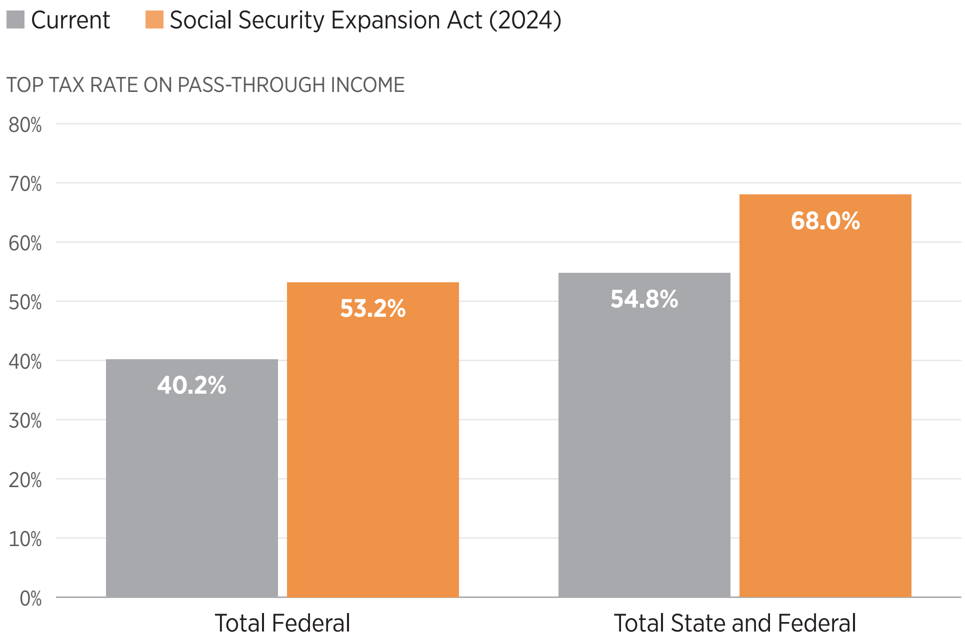
employees or owners (and only up to the current taxable max for Social Security), but not on owners' share of the active business income, which carries more inherent risk. The Social Security Expansion Act would impose a new, 16.2 percent "net investment income" surtax on all such entrepreneurial profits of these business owners above $200,000 for individuals and $250,000 for married couples. Of the new 16.2 percent tax, 12.4 percent would go to Social Security and the other 3.8 percent would go to general tax revenues.

This would mark an unprecedented tax increase on small businesses, stifling their growth prospects, handicapping their ability to stay afloat in downturns (such as the COVID-19 pandemic), and impeding innovation.

CHART 4

Social Security Expansion Act Hikes Taxes the Most on Small Businesses



NOTE: Figures factor in the employer portion of Social Security and Medicare taxes as wages that are not included in the taxable wage base. This equates to dividing the total tax rate by 1.0145 for wages subject only to the Medicare tax and by 1.0765 for wages subject to both the Social Security and Medicare taxes.
SOURCE: Author's calculations based on current law and the Social Security Expansion Act.

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Small businesses are the engine of America's growth and multi-trillion-dollar tax hikes on them would surely suppress innovation, entrepreneurship, jobs, incomes, and economic growth.

According to the Social Security Actuaries' limited analysis, these three tax hikes would increase Social Security's tax revenues by $33.8 trillion.[19]

Social Security Expansion Act's Widespread Economic Consequences

Senator Sanders stated that the Social Security Expansion Act will not raise "taxes by one penny on over 93 percent of American households that make less than $250,000."[20] That is not true. For starters, the bill's tax hikes apply to individuals making $200,000 or more, which includes many people making less than $250,000. Moreover, that claim refers to a snapshot in time and does not account for the proposal's unavoidable economic fallout.

According to the Social Security Trustees, only about 7 percent of people make over the taxable maximum in a given year, but "between 20 percent and 25 percent of individuals will earn above the tax max at some point during their working careers."[21] That only considers wage earners; factoring in all the small business owners (many of whom make less than $250,000 in wages) and savers and investors that would also be subject to higher taxes under the Social Security Expansion Act would increase the percentage of individuals who directly pay higher taxes.

Regardless of who pays higher taxes, the Social Security Expansion Act's massive tax hikes would ripple destructively across the entire economy, including all other government revenues. Taking into account how people would respond to these new tax increases, it is almost certain that the Social Security Expansion Act would fail to make the program solvent and would cause large declines in other government tax revenues.

At a bare minimum, employers who have to pay higher Social Security taxes for their workers will reduce those workers' wages by a near equivalent amount to the taxes, which will mean lower incomes subject to federal income, state and local income, Social Security, and Medicare taxes.[22] A study by Jeffrey Liebman and Emmanuel Saez that looked at workers' earnings responses to changes in payroll taxes estimated that this shift in taxable wages to account for higher taxes on employers would reduce static revenue estimates by 20 percent to 25 percent.[23] Although the Social Security Actuaries note that this change would cause employers to redistribute total compensation to accommodate for employers' higher employee tax costs, the analysis does not include the impact of employers reducing workers' wages on non–Social Security federal and state tax revenues. Based on the Social Security Actuaries' estimate that this provision would generate $15.7 trillion in new revenues, upwards of $3 trillion of that could be lost to lower state and local tax revenues.

Adding in the negative impacts from behavioral changes would further reduce the actual revenue gains. Liebman and Saez estimated that the likely behavioral impacts of eliminating the payroll tax cap (as the Social Security Expansion Act fully accomplishes after about 15 years) would result in revenues equal to less than half of the static revenue estimates and could be so large as to result in zero net new tax revenue.[24]

By reducing economic output, jobs, and incomes, the Social Security Expansion Act would limit Americans' ability to pursue what they desire and instead make them more reliant on the government. As rising federal deficits and debt increase the risks of a fiscal crisis, greater dependence on the government would make Americans more vulnerable to the consequences of a fiscal crisis, which could include significant cuts to government programs and even higher tax rates, or inflationary policies that make everyone poorer.

Social Security Expansion Act Is Only a Fraction of the Progressive Agenda

The Social Security Expansion Act's $33.8 trillion in tax hikes over the next 75 years would only cover a small portion of progressives' socialist agenda. Providing other things—like Medicare for all, free college, a universal basic income, and the "Green New Deal"—would cost roughly another $50 trillion to $90 trillion over just 10 years.

As Heritage Foundation analyst David Burton explained:

> Even using lower cost estimates, confiscating every dollar earned by every taxpayer with incomes of $200,000 or more would only pay for about half of the progressive agenda. And that figure is based on the false assumption that people would continue to work, save, and invest when subject to a 100 percent flat tax. The reality is that progressive promises can only be funded by increasing taxes on the middle class from three to 10 times their current level, or, for a limited time, by dramatic and unsustainable increases in federal borrowing.[25]

The Social Security Expansion Act is a big step toward Bernie Sanders's mathematically impossible and economically inconceivable socialist agenda. As history repeatedly demonstrates, socialist governments depress economic output and consign everyone but the ruling elite to drastically lower standards of living.[26]

The only reason that the Social Security Expansion Act's proposed tax hikes could appear to generate $33.8 trillion in new tax revenues is because there has been sufficient private-sector economic growth and activity in America's market-based democracy to generate enormous wealth and well-being that continues to grow from generation to generation. By proposing to bite the hand that feeds it, the Social Security Expansion Act would so drastically alter American entrepreneurship, work, and innovation that future policymakers would be grasping at straws to fund even a fraction of the size of government that exists today.

How to Preserve Social Security's Purpose and Strengthen Workers' and Retirees' Futures

Instead of making Social Security bigger, taxing small businesses, workers, and investors more, and making everyone more dependent on the government, policymakers should strengthen Social Security's solvency and efficacy by letting workers and retirees keep more of their own money and build wealth that they can control and pass on to their families.[27]

Policymakers should preserve Social Security's original intent by gradually shifting toward a universal benefit. That would mean slowly ratcheting up benefits for lower earners and reducing benefits for higher earners so that by the time workers just entering the labor force today retire, they will receive the same flat Social Security benefit (based on years of work instead of earnings) and it will keep more people out of poverty. Combining a universal benefit with other commonsense changes like using a more accurate inflation index and increasing Social Security eligibility age and indexing it to life expectancy would make Social Security solvent for the long run and allow a roughly 20 percent reduction in Social Security's tax rate to 10.1 percent. Compared to the 15.64 percent[28] and 17.3 percent[29] tax rates that the Social Security Trustees and Congressional Budget Office, respectively, estimate are necessary to maintain Social Security in its current form, that would mean thousands of dollars more in after-tax income every year for average households to save in accounts they own, that generate higher returns, and that can be passed on to their families.

Instead of expanding a flawed Social Security architecture, a targeted program would lead to a stronger economy. Researchers with the Penn Wharton Budget Model analyzed a proposal similar to the Heritage Foundation's that would do a better job of targeting Social Security benefits, as well as a proposal that would expand Social Security.[30] They found that a better-targeted program would result in an economy in 2043 that is 7.3 percent larger—the equivalent of $12,500 more in annual household income—compared to an expanded Social Security program.[31]

Another important piece to Americans' financial security and opportunities is the ability to build wealth over time. Social Security is not transferable, which unfairly penalizes millions of people who die before becoming eligible to collect benefits or who receive benefits for only a few years after paying taxes into the system for decades. Social Security's lack of ownership disproportionately harms lower-income and minority populations that have shorter life expectancies. One of five African American men dies between the ages of 45 and 64, after paying taxes to Social Security for decades, but receiving little or nothing to pass on to their families.[32]

In addition to commonsense changes to preserve Social Security's purpose and ensure its solvency, policymakers should incorporate a wealth-building option within Social Security. Workers should have the choice to put part of their Social Security taxes into an account that they own, that can generate large positive returns over time, and that can be passed on to their families. Research by Heritage Foundation analysts shows that if individuals were able to put their Social Security taxes into their own retirement accounts, workers at all income levels would have far more in retirement than Social Security will provide.[33] A middle-income man, for example, would have three times as much income in retirement from a personal account than from what Social Security will provide.[34] Under this option, anyone who wants to remain in the current Social Security system without a wealth-building account would be free to do so.

Conclusion

Social Security, as past generations and current retirees have experienced it, is simply not viable for current workers and future generations. The program's excessive growth imposes significant burdens on younger generations, and all but the very oldest Americans will be affected by Social Security's insolvency in just 10 years.

Americans need realistic options for reforming Social Security, and they need to have information (through dynamic economic analysis) about how those reform options will affect them, their families, and the economy. The reality is that Social Security cannot be saved simply by taxing the rich, as alluded to by President Biden and many liberal politicians. Democrats' Social Security 2100 Act: A Sacred Trust imposes 75 years of tax increases on high-income earners, provides only five years of benefit expansions, and still fails to make the program solvent.[35] And the Social Security Expansion Act's tax increases on individuals, families, and small businesses start at incomes of $200,000 and $250,000.

The Social Security Expansion Act's expanded benefits and enormous tax increases would exacerbate Social Security's strain on workers and families, making all but the oldest generations worse off. The $33.8 trillion in tax hikes on workers, savers, investors, and small business owners would distort positive activities and cause significant economic damage. And by taking more income away from people and promising them higher government benefits, the Social Security Expansion Act would make Americans more dependent on the government, less free to pursue their own goals, and more vulnerable to an increasingly likely fiscal crisis.

Instead of ballooning Social Security, policymakers should preserve the program and improve incomes and economic growth through a targeted structure that increases benefits for the lowest earners and allows workers the opportunity to build wealth that they own and can pass on to their families. Despite Social Security's enormous unfunded obligations and deleterious political rhetoric criticizing policymakers who dare to acknowledge the program's shortfalls, it *is* possible to make Social Security solvent, protect and increase benefits for those who need them most, and allow all workers and families the opportunity to have more income and more control of their own money throughout their lifetimes.

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Endnotes

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7. Author's calculations based on the average Old Age and Survivor's Insurance benefit of $1,745 per month in January 2023. To provide a 2023 present-value comparison, this average benefit level is applied forward by 60 years to 2083 and increased by the applicable differences in annual benefit levels based on a 2 percent and a 2.2 percent COLA. Social Security Administration, "Research, Statistics & Policy Analysis: Monthly Statistical Snapshot, February 2023," https://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/ (accessed February 17, 2023).
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13. The top rate in 2024 under the Social Security Expansion Act includes the 37 percent top income tax rate, the 2.9 percent Medicare tax, the 0.9 percent Obamacare surtax, and the 12.4 percent Social Security tax. The combined rate of 53.2 percent is divided by 1.0765 to incorporate the employer's (or self-employed) half of the Social Security and Medicare taxes (7.65 percent of 15.3 percent) that is not included in the taxable wage base. For 2026, the top rate includes the 39.6 percent top income tax rate, the 2.9 percent Medicare tax, the 0.9 percent Obamacare surtax, and the 12.4 percent Social Security tax. The 55.8 percent total divided by the 107.65 wage base equals a 51.8 percent top tax rate.
14. New York City has the top income tax rate on wages of 14.776 percent (including 10.9 percent state and 3.876 percent local). The combined total rate of 67.976 (37+12.4+2.9+0.9+14.776) is divided by 107.65 to account for the employer's share of Social Security and Medicare taxes not included in the tax base, resulting in a top combined wage tax rate of 63.1 percent. For 2026 and beyond, the sum of wage taxes rises to 70.576 percent, which is 65.6 percent after dividing by the 107.65 wage base.
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