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Obama's Social Security Fine Print

By Donald L. Luskin

Last week, Barack Obama revealed his plan to shore up Social Security's shaky finances by raising the income level on which the payroll tax is applied. Currently, incomes above $102,000 are exempt, with that threshold rising every year indexed to wage inflation. Mr. Obama would keep that limit in place, but then assess payroll taxes on incomes above $250,000, which his campaign claims would apply to only the richest 3% of Americans.

Mr. Obama angered liberals last year when he admitted that there was a "Social Security crisis." But at least Mr. Obama's base should be appeased now that his solution to the "crisis" is to soak the rich. One liberal columnist actually noted with glee the fact that this would take us back to top tax rates not seen since the 1970s.

According to the nonpartisan Tax Policy Center, Mr. Obama's new tax would siphon off 0.4% of gross domestic product annually. Combined with Mr. Obama's other tax-hike initiatives, "the total tax on labor would be close to 60 percent. In high-tax states like California and New York, the top rate would be even higher."

Would it help Social Security's financing problems? Mr. Obama has no idea. One of his senior economic advisers admitted to me that no one on the campaign has run any detailed models or performed any rigorous analysis. When one proposes an enormous tax increase, shouldn't there at least be a spreadsheet somewhere?

But the most alarming thing about Mr. Obama's proposal is that the $250,000 threshold, above which the payroll tax would be applied, refers to household income, not individual income. So it's quite deceptive when he claims that the $250,000 threshold will "ensure that lifting the payroll tax cap does not ensnare any middle class Americans."

Suppose your household consists of you and your spouse, each earning wages of $150,000 per year. Currently, you are each subject to the payroll tax up to $102,000 of wages, so together you are taxed on $204,000. Under the Obama plan, you'd be taxed again on another $50,000 of wages.

At the current payroll tax rate of 12.4% – 6.2% from wage-earners and 6.2% from their employers – your household would be looking at a tax hike of $6,200 per year. You probably didn't consider yourself rich before, and you certainly won't after paying that tax bill.

But that tax bill could be higher still. While the payroll tax has always been calculated just on wages from labor, Mr. Obama hasn't decided yet what forms of income will be included in the $250,000 threshold. It's an open question whether it might include interest on savings and capital gains income.

And neither has Mr. Obama said whether the rich – and, truth be told, the middle class – paying his new higher taxes will get correspondingly higher Social Security benefits when they retire. Throughout the history of the Social Security program, there has always been a connection between what you contribute in taxes and what you get back in benefits. If Mr. Obama uncaps the wages subject to tax, but doesn't uncap benefits, then he has severed the link between them. Social Security would stand revealed not as a work-related contributory retirement system, but simply as a tax-funded welfare and income-redistribution program.

And for all that, Mr. Obama's proposal won't help Social Security's long-run solvency problems.

According to the Social Security Administration actuaries, uncapping all wages subject to the payroll tax (not just those above $250,000) doesn't make much difference to the system's long-run solvency. If the increased payroll tax payments earn increased benefits, then only about one third of the system's 75-year shortfall is addressed. Even if there is no corresponding benefit increase, only about half the shortfall is addressed.

Remember, that inadequate result is what you get when all wages are subject to payroll taxes. Mr. Obama's plan – even with his household definition of $250,000 income – would collect far less than that. No wonder Mr. Obama's economic advisers aren't interested in doing any detailed analysis.

Worst of all, even the small contribution to Social Security solvency that Mr. Obama's plan might make is entirely illusory. In fact, the more taxes his plan collects, the worse Social Security's long-term situation gets. That's because all plans based on collecting taxes and saving them in the Social Security Trust Fund for future benefit payments rely on the U.S. government being able to redeem the Treasury bonds that trust fund holds.

There's only one place that the money to redeem those bonds can come from: taxes. So ironically, any tax dollars collected today will have to be collected all over again – plus interest. You like the idea of paying more taxes today for Mr. Obama's Social Security plan? Then just wait 20 years or so, because you'll get to pay more taxes all over again.

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