Not Taxing Social Security: Implications and Lack of Good Pay-For's

John T.H. Wong

Agenda

1. The fundamental problem of retirement spending.
2. How is social security taxed.
3. The impact of not taxing social security:
   - Fiscal.
   - Distributional.
4. How does "taxing payroll taxes instead" work as a pay-for proposal
5. The issues of taxing payroll taxes:
   - Fiscal.
   - Distributional.
   - Intuitiveness.

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Takeaways

1. Not taxing social security is fiscally bad.
2. Paying for it is distributionally bad.

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  - **Tax revenue: 4.1% per year.**
  - Medicaid: 3.9% per year.
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- Any spending targeted at old age runs into the issue of runaway growth: this is the Fundamental Problem of Retirement Spending.

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     - Alleviates the Fundamental Problem of Retirement Spending.
  2. Not taxing social security is equivalent setting both of those rates to zero.

Not taxing social security: fiscal impact

The following estimates from a simulation of the US economy with PolicyEngine, which:

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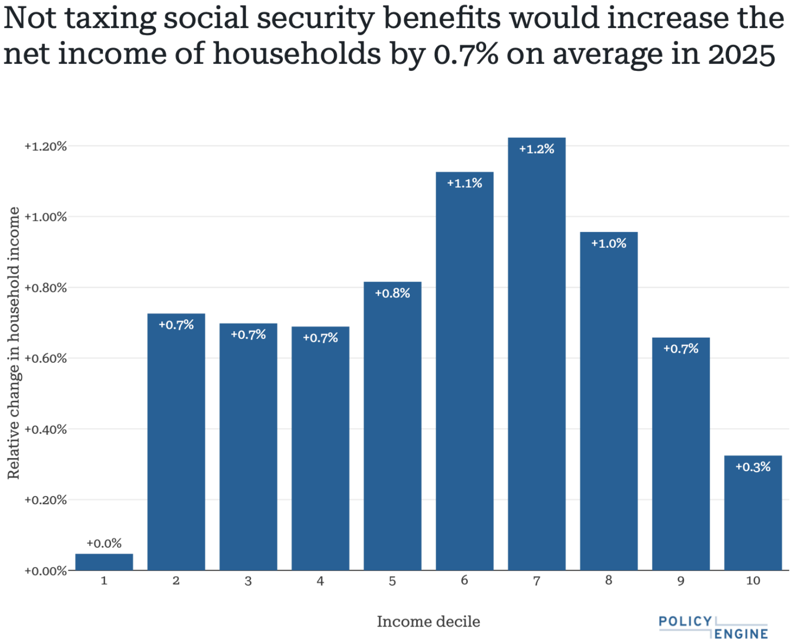
Savings ($bn)	-88	-108	-114	-119	-127

	2030	2031	2032	2033	2034	Ten year
Savings ($bn)	-130	-136	-142	-148	-155	-1267

The policy costs roughly $1.3 trillion over ten years.

Not taxing social security: distributional impact by income



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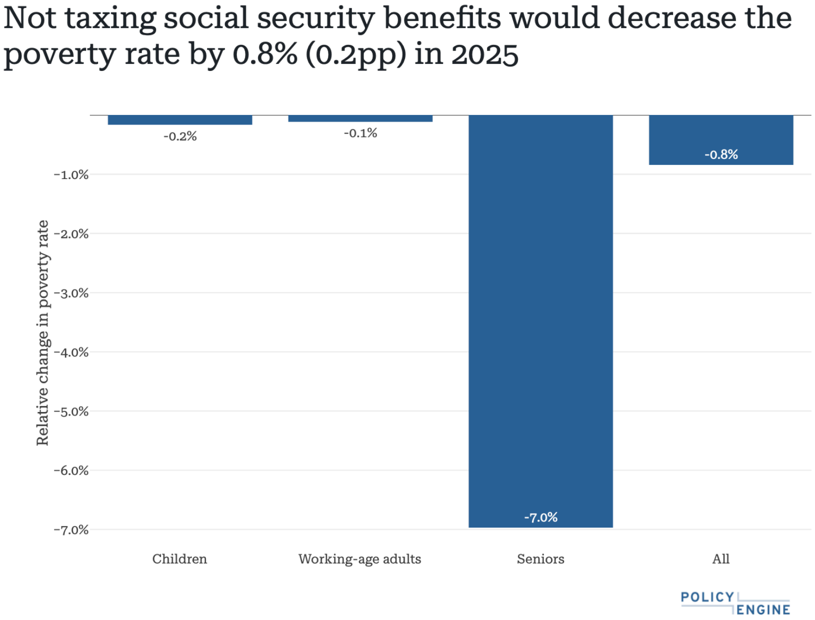

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  2. Tax only employer's *Medicare* payroll contributions as employee's additional income; set only the additional share of benefits subject to tax, to 0% (recall that it's currently at 35%, and that revenue goes to the Medicare fund).

Fiscal impact

Option 1 does lead to a surplus

	2025	2026	2027	2028	2029	
Savings ($bn)	52	60	63	68	72	
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Option 2 does not add up at all

	2025	2026	2027	2028	2029	
Savings ($bn)	-4	-8	-8	-8	-8	
	2030	2031	2032	2033	2034	Ten year
Savings ($bn)	-8	-8	-8	-9	-9	-77

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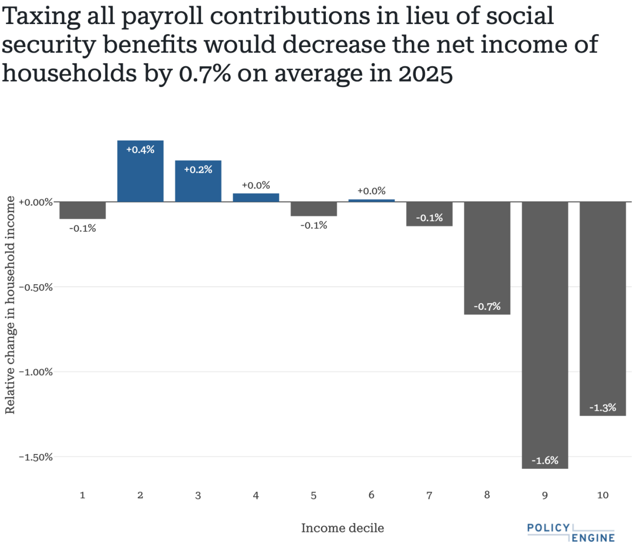

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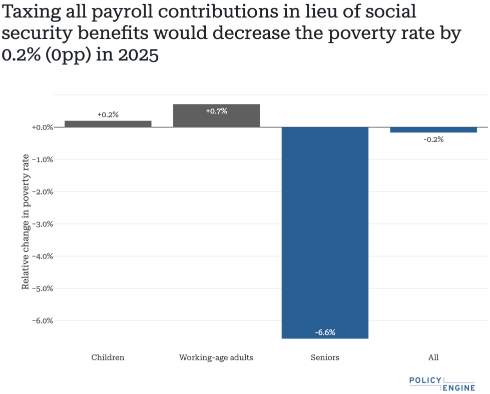

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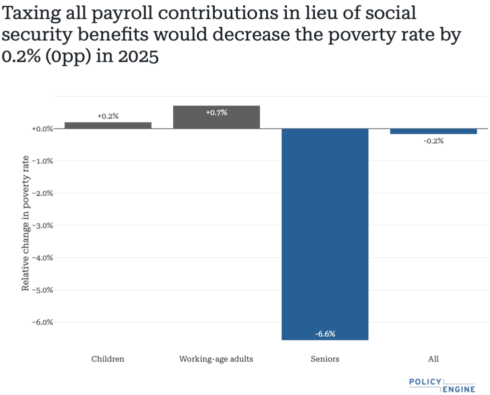

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- Note that taxing payroll contributions is identical to a flat tax, so this distributional pattern will be common to most revenue proposals.

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  - In fact, the government has taken money out of the trust funds to finance general expenditures before, so the payroll contributions aren’t really stored the same way like a retirement fund.
- So I expect taxing payroll contributions will be very unintuitive to taxpayers, to say the least, if not very unpopular.

Thank you!