2016 MAKING ISSUES COUNT

CHANGING SOCIAL SECURITY'S FINANCING

APPROXIMATELY 85 PERCENT of Social Security's funding currently stems from payroll taxes on earnings of most workers. Employees and employers each pay a tax of 6.2 percent of an employee's wages, (Federal Insurance Contributions Act [FICA] tax) while self-employed workers pay the entire 12.4 percent (Self-Employment Contributions Act [SECA] tax). The rest of the program's income comes from taxes on Social Security benefits and investment earnings of the trust fund.

Should the Payroll Tax Be Increased?

Payroll taxes are limited on annual earned income —called the taxable maximum, which was $118,500 in 2015—and do not apply to investment and other non-wage income. By way of an illustration, if Social Security were to be made solvent over the next 75 years by only changing payroll taxes rates, it would require an immediate increase of 2.62 percentage points. Few are suggesting this course of action because it would place a large burden on employers and workers, especially those earning less than the taxable minimum. Gradual, small increases in payroll taxes could increase Social Security's income while not placing too great of a burden on employees and employers.

Should the Limit on Taxable Earnings Be Raised?

Some experts support raising, or even eliminating, the taxable maximum limit as a way to increase Social Security revenues. Advocates cite a disproportionate tax burden on lower-income workers, who pay an equal or higher portion of their total income to Social Security than wealthier taxpayers. Many oppose increasing burdens on any taxpayers regardless of income and assert that ensuing revenue increase would be relatively small compared to other proposals.

When the taxable maximum structure was most recently changed in 1982, it was set to cover 90 percent of earnings. Proponents suggest that the ratio of taxable earnings to covered earnings should be restored to 90 percent. Opponents suggest that increases in the taxable maximum would simply result in behavior changes that negate the policy change.

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Should the Taxpayer Base Be Expanded?

Some federal, state, and city employees do not pay Social Security taxes because they are covered by a public retirement system. It has been argued that requiring these workers to pay into Social Security, and later collect benefits, could add revenues to the program and reduce the long-term deficit.

Should the Trust Funds Assets Be Invested Elsewhere?

Social Security's trust fund assets are invested almost entirely in non-marketable, special-issue U.S. government securities that represent loans to the U.S. Treasury's general fund. The bonds pay market rates of interest. Some have advocated that greater returns could be achieved, on average, in the stock markets. However, equity returns are highly variable, which could cause short- and long-range actuarial projections to fluctuate significantly from year to year. Additionally, the vast sums involved could have unintended effects on the stock markets.

Should General Revenues Be Raised?

Social insurance programs in many other countries receive some financing from general taxes, and that approach could help with Social Security's solvency challenge. Such an undertaking would require raising income taxes or raising revenues elsewhere, such as creating a national value-added tax. However, it has been argued that such proposals could compromise Social Security's basic principle of a self-supporting program that is financed by its participants.

Should Individual Accounts Be Created?

Some reform proposals would allow workers to accumulate contributions in individual accounts under Social Security as a source of retirement income. Supporters say workers could exert more control over their accounts, obtain better returns on their contributions, and reduce the burden to future generations. However, the establishment of individual accounts within Social Security would not by itself address the program's financial problems.

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