
REMAPPING DEBATE

Asking "Why" and "Why Not"

FDR to Congress: don't mess with the payroll tax

Original Reporting | By Mike Alberti | Economy, Taxes

Dec. 3, 2011 (updated Dec. 6) — In 1941, six years after the passage of the Social Security Act, President Franklin Roosevelt was asked about the logic of funding Social Security with a dedicated payroll tax.

“We put those pay roll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions and their unemployment benefits,” President Roosevelt reportedly said. “With those taxes in there, no damn politician can ever scrap my social security program.”

“We put those pay roll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions and their unemployment benefits,” he [reportedly responded](#). “With those taxes in there, no damn politician can ever scrap my social security program.”

In the current fight on Capitol Hill over whether to extend and expand last year's payroll tax cut, some advocates for Social Security are recalling Roosevelt's message.

“The genius of Social Security is that it's separated from other funds,” said Nancy Altman, the co-director of Social Security Works, an advocacy organization, and the author of *The Battle for Social Security*. “When this comes up again next year, Republicans could be saying, ‘Let's make the tax cut permanent and reduce benefits to pay for it.’”

Senate Democrats introduced a bill last week to extend and expand last year's payroll tax cut and to pay for it with a 3.25 percent surtax on incomes over \$1 million. Republicans quickly countered with their own, smaller bill, to be paid for primarily with a 10 percent cut in the federal workforce. The Senate rejected both proposals last Thursday.

Senate Democrats proposed a new, less-expensive bill on Monday, and Republicans are expected to introduce their own second version today. Most observers expect some form of an extension to be enacted before the current tax cut expires on Dec. 31.

It is widely agreed that an extension would provide some needed stimulus to the ailing economy, although a [Citizens for Tax Justice report](#) points out that the Democrats' payroll tax proposal is “less targeted to working class people (and therefore less effective as economic stimulus) than the Making Work Pay Credit that expired at the end of 2010.”

It is also expected that the loss of revenue to the Social Security trust fund from lowered payroll taxes will be compensated for by money from the general fund, as it was this year. But Social Security advocates and some Members of Congress have raised concerns that by utilizing the payroll tax as the means by which to stimulate the economy, lawmakers may be providing opponents of Social Security with a long-awaited opening to undermine the program. Once a tax cut is passed, they note, it becomes very difficult to allow it to lapse.

On the Senate floor on Thursday, Sen. Joe Manchin (D-W.Va.), expressed concerns about the prospect of the tax cut becoming permanent. “[I]f we extend the cuts this year — what about the next year and the year after that?” he said. “When does it stop? When do we have the political will to finally say that we better start paying again for Social Security?”

“Social Security was thought of as untouchable”

Despite warnings from some Republicans, Social Security is not in any danger of going broke. In fact, it has a current account surplus of \$2.6 trillion. The Social Security Board of Trustees has estimated that, as it currently stands, the program will be able to pay out full benefits for the next 25 years. After that point, the fund is projected to have enough money in it to pay a substantial portion, though not all, of the benefits it owes. To fully fund current benefit levels over the long-term, some changes would need to be made to increase revenues, such as lifting the cap on the wages on which payroll taxes are paid. If that cap — currently set at about \$106,000 — were removed, analysts agree that the long-term shortfall would become a surplus.

None of the proposals currently being debated on Capitol Hill would have a direct impact on the program’s funding. The danger, according to advocates, is that by eroding the inviolability of the payroll tax revenues that had traditionally only been used to fund Social Security, lawmakers will set the stage for larger changes that could undermine the program.

According to Max Richtman, the president of the National Committee to Preserve Social Security and Medicare, Republicans have long made it clear that they would like to see benefit levels reduced, and would jump at any opening to change the program. Republican Presidential candidate Rick Perry, the Governor of Texas, has repeatedly called for ending the program, calling it a “Ponzi scheme.” House Budget Chairman Paul Ryan (R-Wisc.) released a plan last year that would

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raise the retirement age over time and effectively reduce benefits for all earners by [thousands of dollars](#) a year. “Republicans have had designs on it for years,” Richtman said.

Indeed, in this year’s fight over the payroll tax cut, some Republicans have said that they would not support it because it falls short of a complete restructuring of the program. Rep. James Lankford, (R-Okla.), told The New York Times, “If this is going to be the long-term rate, let’s set it and resolve long-term issues of Social Security.”

“For a long time, Social Security was thought of as untouchable,” Richtman said. “It would be political suicide to change it. Now, it’s very common to talk about raising the retirement age or cutting benefits.”

Altman agreed and added that by taking away part of the revenues that were dedicated to the program, it becomes more vulnerable in the future. “We’ve already changed the formula,” she said. “That makes it much easier to change again.”

Looking ahead to the maneuvering of 2012

Max Richtman, president of the National Committee to Preserve Social Security and Medicare, worries that, a year from now, when the tax cut is set to expire, Republicans could deploy the “tax increase” argument that Democrats are currently using to make permanent what is supposed to be a temporary tax cut.

To understand the risk, Richtman said, it’s important to look ahead to next year, when the extended payroll tax cut would likely be set to expire again. He and several other experts said that, once a tax cut is put in place, it becomes very difficult to restore rates to their earlier level. Those seeking to do so are persistently attacked as supporting tax *increases*.

Joseph J. Thorndike, the director of the Tax History project at Tax Analyst, which publishes tax information, added that temporary tax cuts or tax holidays are seldom temporary in today’s Washington. “We have, of course, an unpleasant tax record of applying temporary taxes that then just stick around,” he said, referring in particular to the Bush tax cuts of 2001 and 2003, which remain in place today. “These temporary tax cuts are like vampires — they never die.”

Even when the payroll tax cut was first enacted in 2010, some members of Congress were worried about the prospect that it could become semi-permanent. “Once something like this goes into place, a year from now, when it expires, it’ll be portrayed as a tax increase,” Sen. Bob Corker (R-Tenn.) said in Dec. 2010.

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How much would the proposals cost?

The payroll tax was first reduced in December of last year as part of a larger package that included an extension of unemployment benefits and of the Bush tax cuts that had been scheduled to expire. The payroll tax on employees was reduced to 4.2 percent from 6.2 percent at a cost of nearly \$112 billion. The revenues lost to the Social Security trust fund were replaced with money from the general fund. No offset was put in place, meaning that the tax cut essentially constituted deficit spending.

President Obama included an extension and expansion of the payroll tax cut as a part of the [American Jobs Act](#), a proposal replicated in a [Senate bill](#) introduced by Senate Majority Leader Harry Reid on Nov. 28. The proposed bill, which garnered 51 votes in the Senate on Thursday but fell short of the 60 votes needed to overcome a filibuster, would have cut payroll taxes on employees by a further 1.1 percent, to 3.1 percent, and cut payroll taxes on employers to 2.1 percent on the first \$5 million that a company pays in wages.

The price tag of the initial Democratic proposal would have been \$265 billion in 2012. That would have amounted to about 10 percent of the Social Security trust fund's current [\\$2.6 trillion surplus](#). The revenues that would have been lost to the trust fund would have been replaced from the general fund, but this time Democrats proposed to pay for that lost revenue with a 3.25 percent surtax on incomes over \$1 million.

Most Republicans have balked at the millionaires' tax, and they introduced their own bill last week that would have extended last year's tax cuts without expanding them, at a cost of about \$120 billion. They would have offset that revenue loss by freezing the pay of federal employees through 2015 and reducing the federal workforce by 10 percent. The Congressional Budget Office estimated that the Republican proposal would have decreased the deficit by \$111 billion.

After both bills failed to garner the necessary 60 votes in the Senate on Thursday, Democrats introduced a new bill on Monday that would not extend the tax cut to employers, and would lower the proposed surtax on incomes of over \$1 million to 1.9 percent. The estimated cost is \$185 billion. The surtax would expire after 10 years. Republicans have continued to express distaste for the millionaires' tax and are expected to introduce their own, modified bill today, which may include a provision to extend unemployment benefits.

Though all of the proposals so far under consideration would replace the revenue lost from the Social Security trust fund with general fund revenues, economists estimate that if the 2010 payroll tax rates were made permanent and the revenue were not replaced, Social Security's long-term shortfall would be doubled.

And now, President Obama, lawmakers from both parties, and many members of [the press](#) are, indeed, calling the return to normal rates a “tax increase.”

Richtman worries that, a year from now, when the tax cut is set to expire, Republicans could deploy the “tax increase” argument that Democrats are currently using to make permanent what is supposed to be a temporary tax cut.

“If that happens,” Richtman said, “the next logical step is for Republicans to demand that we reduce benefits to put them in line with [reduced] revenues.”

Altman agreed, and added that Republicans could argue that Social Security is increasing the deficit, because some of its funding had begun to come from the general fund dollars that were replacing lost payroll tax revenues. (While neither of the current proposals would add to the deficit because each provides an offset either in the form of additional taxes or reductions in the federal workforce, future payroll tax rate reductions will not necessarily come with such financing.)

Added impetus for tampering with Social Security will come from what many advocates and economists see as the likelihood of another extension of the payroll tax cut in 2012 in the face of a still-hurting economy.

It had always been the case that “Social Security does not add a penny to the deficit because it’s completely self-financing,” Altman said. “All of a sudden, it’s not anymore.” She anticipated Republicans taking up the argument that Social Security was “putting pressure on the entire federal budget.”

“It’s important to remember that this is what Republicans have wanted for a long time,” Altman said. “They want smaller government at all costs, and the way they do it is by continuously lowering taxes. This fits right into the ‘starve the beast’ strategy.”

Howard Gleckman, a resident fellow at the Urban Institute and the author of *Caring for Our Parents: Inspiring Stories of Families Seeking New Solutions to America’s Most Urgent Health Care Crisis*, said that public perception could be a compounding factor, especially since the Democrats’ proposal would cost \$265 billion, approximately 10 percent of the current trust fund surplus.

“There is already widespread concern that the trust fund is broke, which certainly overstates the case. But when you take \$265 billion out [of funds normally dedicated to Security Security], you’re not doing much to improve its credibility.”

Andrew Fieldhouse, federal budget policy analyst at the Economic Policy Institute, said that spending measures are more effective than tax changes. Indeed, he said, almost *any* measure that spent money would provide more of a boost than measures that work through the tax code.

Effectiveness and alternatives

While some lawmakers have questioned the effectiveness of the payroll tax cut in stimulating the economy, most economists agree that the payroll tax cut does create some demand in that it puts money into the hands of many people who are likely to spend it. The Center on Budget and Policy Priorities (CBPP) [has found](#) that the average family would receive \$934 in 2012.

In July of this year, 60 house Democrats signed a letter to President Obama opposing the use of a payroll tax cut for economic stimulus, saying, “Making it easier for enemies of Social Security to attack the program will surely outweigh any short term political or economic benefit or a deal that includes extending the current payroll tax cut or expanding it to include employers.”

And yet many economists point out that there are more stimulative measures that could be taken. The Congressional Budget Office has [repeatedly found](#) that extending unemployment benefits would offer more bang for the buck, because the unemployed are more likely to spend the money than those who have an income and might save it.

Citizens for Tax Justice [found](#) that a revival of the Making Work Pay Tax Credit (a program targeted to working class families that was replaced by the 2010 payroll tax cut) would provide just as much assistance to the poorest fifth of taxpayers as the Democrats’ new payroll tax proposal, but would be much more equitably distributed: Making Work Pay would yield the richest fifth of taxpayers \$70 billion less than the payroll tax measure.

Low-income workers are most likely to spend any extra money they receive and boost the economy. But Making Work Pay did not pack the political punch that a payroll tax cut did because many workers did not realize they were receiving it, said Gleckman.

The CBPP argued in 2009 that the Making Work Pay Tax Credit provided more stimulus than the payroll tax cut extension. Now that the payroll tax cut has been implemented, however, Chuck

Marr, the director of federal tax policy at the CBPP, said that it would be a mistake to return to higher rates. “In an ideal world, we would be doing this through the income tax, which would be more progressive, better-targeted, and there would be no concerns about Social Security,” he said. “But this is far from an ideal world.”

Andrew Fieldhouse, federal budget policy analyst at the Economic Policy Institute, said that spending measures are more effective than tax changes. Indeed, he said, almost *any* measure that spent money would provide more of a boost than measures that work through the tax code. “We’re only talking about this because Republicans generally support tax cuts,” he said. “If we were really talking about the best way to stimulate the economy, we would be talking about infrastructure spending and public works projects.”

Fieldhouse said that spending on infrastructure not only puts Americans back to work directly, it is also the only form of stimulus that leaves you with a tangible asset. “Infrastructure spending pays for itself in a way that tax breaks don’t because even when the money is spent, you still have a bridge or a road or a school, and that lays the groundwork for long-term growth.”

Most Democrats give in

In July of this year, 60 house Democrats signed [a letter](#) to President Obama opposing the use of a payroll tax cut for economic stimulus, saying, “Making it easier for enemies of Social Security to attack the program will surely outweigh any short term political or economic benefit or a deal that includes extending the current payroll tax cut or expanding it to include employers.”

Despite the abundance of more effective alternatives and the fears about eroding the credibility of the Social Security system, however, all but three Democrats in the Senate voted for the Democratic plan, and most Democrats in the House are planning to vote for an extension, as well.

Rep. Ted Deutch (D-Fla.), one of the three Members of Congress who organized the letter to President Obama, said that while he still has concerns that extending the payroll tax cut could make Social Security more vulnerable, the payroll tax cut is better than nothing.

“We’re at a moment when there aren’t a lot of options. This is the one option we have, and I’m going to take the President at his word that the trust fund will be replenished” he said.

According to Gleckman, the Democrats have designed their bill to draw distinctions with the Republicans for political gain. “They can say, ‘Republicans voted to raise taxes on the middle class and against raising taxes on the rich,’ he said. “That’s a strategy that will probably work in the short-term, but Democrats are playing a dangerous game. If this leads to a discussion about reducing Social Security benefits, then they could pay a serious price in terms of the long-term consequences” because they may be perceived as having set the stage for broader changes to the program.

Altman said that by proposing the payroll tax cut extension, Democrats have essentially started playing on the Republicans field, because they have adopted the Republicans’ tax-cut mentality and abandoned the struggle to implement more effective and progressive measures.

“The Democrats are failing to appreciate the legacy of Social Security and what this means to the Democratic Party,” she said. “We absolutely need to be drawing a line in the sand.”

A 2010 analysis by the Senate Committee on Aging showed that if the cap on payroll taxes were lifted while the cap on benefits were maintained, the 75-year shortfall would turn into a 75-year surplus of nearly \$81 billion.

Ira Cohen, a spokesperson for Rep. Danny Davis (D-Ill.), who signed the letter to President Obama, said that Rep. Davis had concerns at the time about whether Republicans might try to exploit the tax cut to change Social Security, but that he had given up on trying to predict what the Republicans were going to do.

“It doesn’t make any difference whether we extend them or not,” he said. “The Republicans are still going to do anything they can to protect the interests of the wealthy, even if that means cutting Social Security. We might as well give the middle class some relief while we can.”

Protecting Social Security next year?

Despite his support for the existing payroll tax cut and the current Democratic proposal, Rep. Deutch said that he is concerned about what the debate over the payroll tax cut will look like next year, especially if Republicans gain power in Congress or take the White House. “That’s why I’m determined to have the discussion about protecting Social Security in the long-run before then,” he said.

“The Democrats are failing to appreciate the legacy of Social Security and what this means to the Democratic Party,” said Nancy Altman, co-director of Social Security Works. “We absolutely need to be drawing a line in the sand.”

Earlier this year, he introduced [a bill](#) called the “Preserving Our Promise to Seniors Act,” which would eliminate the program’s long-term shortfall by phasing out the payroll tax cap on high earners. Many Americans are not aware that there is a cap, he said, which means that any there is no payroll tax on any wages over \$106,800. A 2010 analysis by the Senate Committee on Aging showed that if the cap on payroll taxes were lifted while the cap on benefits were maintained, the 75-year shortfall would turn into a 75-year surplus of nearly \$81 billion.

“If we’re going to set aside our worries about Social Security to provide middle class families with some relief, I hope that this becomes an opportunity next year to have a broader discussion about strengthening Social Security that could lead to a more broad-based, equitable system,” Rep. Deutch said.

“I hope that silver lining materializes,” Altman said, “because I think Roosevelt would pretty worried right now.”

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