Reaffirming Social Security in an Era of Rising Inequality

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As Social Security reaches its 80th anniversary, America faces income and wealth disparities greater than at any time since the 1920s. Social Security was integral to overcoming the inequalities of that era, and with modest reforms it can again counteract rising income gaps.

Why Slow and Unequal Wage Growth Undermines Social Security

From 1947 through the late 1970s in the United States, a rising economic tide raised virtually all boats. The real wages of American workers nearly doubled – and incomes at the bottom and middle of the income spectrum increased *faster* than those at the top. Since the late 1970s, however, wage growth for the typical U.S. worker has stalled and all income growth has gone into the pockets of the top ten percent, the owners and high-level managers in the U.S. economy.

Growing wage inequalities undermine Social Security as well as most American workers:

- Because payroll taxes for Social Security are levied only on annual earnings up to the $118,500 "tax cap," not everyone pays equally. Only the bottom 94 percent of earners pay Social Security contributions on all of their earned income, while the highest earners pay no contributions on annual income above the cap. What is more, people who gain large amounts of income from investments pay no contributions for those earnings.

- Because of rising income inequality, revenues for Social Security are not keeping up with overall economic growth. Actuaries tell us that Social Security will face a funding gap in future decades – and at least one-third of that shortfall, and probably more, is attributable to growing inequality and limited Social Security contributions from top earners.

- Much of the income gained at the top has been converted into wealth, further feeding inequalities. In 2010, for example, millionaires got $258 billion of the $261 billion reported on tax returns as capital gains – all of it outside of the Social Security system.

How Social Security Could be Adapted

In an era of growing economic insecurity for many workers and families, Social Security is more important than ever. Benefits actually need to be expanded, not cut, in the future, to help workers and families who have been hard hit by decades of stagnant wages and uncertain jobs. Fortunately, there are straightforward steps that can be taken to adjust Social Security to the new economic realities – and improve its capacity to help most Americans in the future.

- **Eliminate Social Security's tax cap.** To remain solvent, Social Security must have a revenue stream that grows with the economy. If there had been no rise in inequality, the tax cap would have little effect. But now that virtually all income growth is "leaking" out of the system at the top, Congress should scrap the cap. In 1994, the payroll tax cap was eliminated for Medicare hospital insurance without any public outcry or economic harm.

- **Incorporate high-earners' income from investments.** To help Social Security's finances keep pace with economic growth and to push back against rising economic inequality, income that higher earners get from investments can be incorporated into the Social Security system and subjected to payroll contributions like any other earnings.

- **Restore the estate tax to its 2000 level and dedicate the revenues to Social Security.** From the late 1930s through the 1970s, the top federal estate tax rate was always 70 percent or above, with few assets exempted. But by 2000, the tax had been substantially weakened, exempting many family assets and lowering the rate of taxes due. Fewer than two of every 1,000 estates now owe any estate levies – which hardly makes sense given the enormous wealth accumulated at the top since 1980. To push back against rising inequalities rather than make them worse, Congress could restore the estate tax to something close to previous levels and earmark the revenues for Social Security. This approach also makes sense in historical terms, because Congress decided to allow the first generations of beneficiaries to receive far more in benefits than their contributions plus interest would have yielded. Today, Social Security's funding challenge can be divided into two parts: the need to pay for current and future benefits, and the need to pay off the legacy debt. Using estate tax revenues would be an elegant, shared way of gradually paying down the legacy debt – to a large extent from levies on riches accumulated by families that benefitted the most from the sacrifices the Greatest Generation made to turn post-World War II America into a global economic superpower.

Social Security Can Protect Middle-Class Retirement for the 21st Century

The numbers add up both to bolster and to expand Social Security's vital protections. Eliminating the annual tax cap would address two-thirds of the program's 75-year funding shortfall; and incorporating the investment income of high earners would close much of the remaining gap. In addition, restoring the estate tax to its 2000 level would generate more than enough revenue to increase benefits by $72/month, as already proposed by some in Congress. Social Security has been a foundation for the middle class for 80 years – efficient, reliable, always self-funded, and never contributing to national debt. Now that many employer retirement systems are dropping workers or underfunding pensions, Social Security must do more, not less.

Fortunately, the solutions at hand are just. Notably, scrapping the cap and including investment income would ***simply require America's top earners to contribute to Social Security on all of their income at the same rate as the typical U.S. worker.*** Social Security was designed to collect contributions from workers and, in return, ensure protections to them and their families. To safeguard this proven system's future, all we need to do is reinvent that same social contract.

Read more in Benjamin W. Veghte, "Social Inequality, Retirement Security, and the Future of Social Security," *Poverty and Public Policy* 7, no. 2 (forthcoming).