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INSIGHT

Social Security: Removing the Taxable Maximum and Long-Term Program Solvency

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Social Security payroll taxes are levied on covered earnings up to an annual maximum amount, referred to as the *taxable earnings base* (also called *contribution and benefit base* or *taxable maximum*). Raising or removing the taxable maximum is one potential policy change that would increase the revenue of the Social Security program and reduce the projected long-term deficit. In the past decade, the estimated percentage of the long-term funding shortfall that would be eliminated by raising or removing the taxable maximum has generally decreased.

Background

Social Security is facing a projected long-range funding shortfall. The Social Security Board of Trustees projects that the asset reserves held by the trust funds will begin to decline in 2021 and will be depleted in 2034 (under the intermediate assumptions in the 2021 Annual Report). Following depletion of trust fund reserves, ongoing tax revenues are projected to cover 78% of scheduled benefits.

One option to improve Social Security's finances is to increase the amount of covered earnings subject to the payroll tax. (Employers and employees each pay 6.2% of covered wages up to the taxable maximum, and self-employed workers pay the combined 12.4%.) In 2022, the taxable maximum is $147,000, indexed to the growth in average wages. This earnings level is both the contribution base (i.e., amount of covered earnings subject to the Social Security payroll tax) and the benefit base (i.e., amount of covered earnings used to determine benefits). Roughly 94% of covered workers have earnings below the taxable maximum, and about 83% of aggregate covered earnings is subject to Social Security payroll taxes.

Impact of Removing the Taxable Maximum on Program Solvency

Table 1 shows the expected impact of removing the contribution and benefit base on the projected Social Security funding shortfall, as estimated by the Social Security Administration's (SSA's) Office of the Chief Actuary (OCACT) over the period from 2005 to 2021. Under this option, all covered earnings would be subject to the Social Security payroll tax and would be counted in the benefit calculation.

In 2005, the Social Security trustees projected that the 75-year actuarial deficit for the trust funds equaled 1.92% of taxable payroll. The trustees pointed out that an immediate 1.92-percentage-point increase in the

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payroll tax rate (from 12.40% to 14.32%) would have been needed for the trust funds to remain solvent throughout the 75-year period (barring any other options such as benefit changes or a combination of options). In the same year, OCACT estimated that removing the contribution and benefit base starting in 2006 would have reduced the long-range actuarial deficit by 1.82% of taxable payroll, thus eliminating 95% of the long-range funding shortfall. From 2005 to 2021, the projected actuarial deficit became larger, and the percentage of the funding shortfall that would be eliminated under this option became smaller. In 2021, OCACT projected that the 75-year actuarial deficit equaled 3.54% of taxable payroll and that removing the contribution and benefit base starting in 2022 would eliminate 57% of the funding shortfall.

OCACT's projections show that the percentage of the funding shortfall eliminated by removing the contribution and benefit base has decreased over time. One reason is the increase in the projected 75-year actuarial deficit, which is mainly attributable to a change in valuation period and other factors (e.g., assumptions and methods). For example, the projected 75-year actuarial deficit increased by 0.43% of taxable payroll from 2019 to 2020, in part due to the inclusion of a large negative annual balance for 2094. With a relatively stable increase in tax revenues from removing the contribution and benefit base, the percentage of the funding shortfall eliminated under this option decreased from 65% to 55% based on OCACT's 2019 and 2020 projections.

Another reason is the decrease over time in "the ability to phase in changes"—where changes to Social Security taxes and benefits could be phased in over a longer period, affecting more people but to a lesser degree. The Social Security Board of Trustees and the Social Security Advisory Board (SSAB) have stated the need to address program solvency "sooner rather than later." The SSAB 2010 report noted that the possibilities for distributing this cost across generations would diminish as time passes. In the case of removing the contribution and benefit base, for example, OCACT projected that implementing the policy in 2006 would have kept the trust funds solvent for at least another 38 years (from 2041 to 2079), while implementing the policy in 2022 would delay the trust funds' depletion for 20 years (from 2034 to 2054, based on 2021 projections).

Table 1. Impact on the Projected Social Security Funding Shortfall of Removing the Cap on Contributions and Benefits

			Removing the Cap on Contributions and Benefits		
Year of Estimation	75-Year Projection Period	Present Law Long-Range Actuarial Balance (Percent of Taxable Payroll)	Change from Present Law Long-Range Actuarial Balance (Percent of Taxable Payroll)	Percentage of Shortfall Eliminated	Projected Year of Trust Funds Depletion
2005	2005-2079	-1.92%	1.82%	95%	Beyond projection period
2008	2008-2082	-1.70%	1.84%	108%	Beyond projection period
2009	2009-2083	-2.00%	1.89%	95%	Beyond projection period

2010	2010-2084	-1.92%	1.90%	99%	Beyond projection period
2011	2011-2085	-2.22%	1.91%	86%	2078
2012	2012-2086	-2.67%	1.92%	72%	—
2013	2013-2087	-2.72%	1.91%	70%	2063
2014	2014-2088	-2.88%	1.91%	66%	2060
2015	2015-2089	-2.68%	1.91%	71%	2066
2016	2016-2090	-2.66%	1.90%	72%	2067
2017	2017-2091	-2.83%	1.89%	67%	2062
2018	2018-2092	-2.84%	1.93%	68%	2063
2019	2019-2093	-2.78%	1.80%	65%	2064
2020	2020-2094	-3.21%	1.78%	55%	2057
2021	2021-2095	-3.54%	2.00%	57%	2054

Source: Estimates for each year are available at OCACT, "Estimates of Individual Changes Modifying Social Security," Option E2 in the estimation for 2005 and 2008, and Option E2.2 for 2009-2021.

Notes: Estimates are based on the intermediate assumptions in the trustees' report for each year. Direct links for specified years are provided above. SSA did not publish estimates for 2006 and 2007. Dashes are estimates currently not available.

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