
Why the Social Security Tax Cap Shouldn't Be Raised

BY DAVID R. HENDERSON

In recent months Senator Lindsey Graham, a Republican from South Carolina, has suggested making all earned income up to \$200,000 subject to the Social Security (FICA) tax. The current maximum on which Americans pay the tax is \$90,000. This maximum rises every year based on a government estimate of real wage growth in the recent past. Distressingly, President George W. Bush has refused to rule out such a tax increase. Pundit George Will, in a recent column that was favorable to the proposal, asserted that Graham's suggested tax hike "hardly blurs the distinction between conservatism and Bolshevism." Yet Will's own reasoning belies his assertion.

Marx's famous dictum was "From each according to his ability to each according to his need." And how does Will justify this tax increase? This increased tax, he writes, "would be paid mostly by Republicans—but also by the people most able to put substantial sums into the personal accounts that might become politically feasible only by raising the cap." In other words, the tax is justified, in Will's eyes, by ability to pay, which is the essence of communism.

Yet there is a strong economic, and a strong moral, case against the tax increase. First, the economics. Increasing the amount of taxed income would massively raise marginal tax rates for many of the most productive people. The marginal tax rate is the rate on the last dollar of income; non-economists typically call it their tax bracket. The marginal rate on those whose incomes are between \$90,000 and \$200,000 would increase by 6.2 percentage points for employees and by a whopping 12.4 percentage points for the self-employed. (Part of the 6.2 points paid by the employer would be borne by the employee. The actual split in the real burden of the

tax between employer and employee depends not at all on who nominally pays the tax; it depends entirely on the relative elasticities of supply and demand. But that's a longer story.)

Most people with earned income between \$90,000 and \$200,000 face a marginal tax rate of 31 to 40.5 percent. They are in a 25-to-33 percent federal income tax bracket. Their state tax bracket is probably about 6 to 9 percent. Of course, many high-income people itemize their deductions and thus can deduct their state taxes in arriving at their taxable income. So adjusted for the deductibility of state taxes on their federal tax form, the marginal state tax rate relevant to them is 4.5 to 6 percent. They also pay a 1.45 percent Medicare tax (2.9 percent for the self-employed) on all earnings. Thus raising the cap would increase the marginal rates of high-income employees by 15 to 20 percent. Raising the cap for the self-employed would increase their marginal rates by a whopping 31 to 40 percent.

A salaried worker making \$200,000 a year would pay \$6,820 more in taxes every year, while a self-employed worker would pay \$13,640 more. This would be the biggest tax increase on high-income people since President Clinton's and for many people would be a *bigger* tax increase than that. A rise in marginal rates would discourage work. The person previously in the 40.5 percent bracket would keep only 53.3 cents of an additional dollar earned, down from 59.5 cents before the tax increase. People would also find ways of being paid other than by

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taxable income, such as by receiving a company car. The employee considering a move to a less-desirable location for more pay, if he was just slightly inclined to make the move before the tax increase, might well say no.


It's not just the economics that makes the tax increase a bad idea. The tax increase is also morally wrong. Consider the fact that high-income people already get a lousy deal from Social Security. Of course, almost everyone gets a lousy deal: that's the nature of a Ponzi scheme, legal or illegal, for the latecomers, and today we're all latecomers. But high-income people get an even worse deal because the formula for Social Security benefits is heavily weighted in favor of low-income people. This is offset somewhat by higher-income people's longer life spans, but the net effect is still that high-income people, per dollar of taxes, do worse than low-income people. Presumably, benefits for higher-income taxpayers would not rise in line with taxes. Otherwise, why raise the tax in the first place? The purpose of the tax is to generate more revenue to solve the long-term funding problem. It would solve none of this problem if the government raised Social Security benefits dollar for dollar.

Furthermore, even if the government planned to raise Social Security benefits to help high-income people, that's little comfort. Many people are happy to save their own money for retirement. Currently, a few million Americans can look forward every year to reaching the existing threshold and knowing that the feds will keep their FICA hands off any additional income. We should be free to save that money or spend it as we wish.

How did we get in this situation where a President committed to tax cuts is considering a huge tax increase? The answer illustrates the old saw "Be careful what you wish for." Bush started with privatization as his goal. He wanted to figure out how to fund the budget hole left by letting people save in private accounts some of what would otherwise be taken in Social Security taxes. And then he noticed a juicy target: those who can well afford to pay the tax increase.

Wrong Goal

Some analysts have commented that Bush erred by having privatization as his goal rather than solving Social Security's long-term funding problem. Well, they're half right. Privatization is the wrong goal: at best, it's a means. But solving the long-term funding problem is the wrong goal too, because it takes as given that Social Security should be funded long-term. In other words, it accepts a program that is a form of perpetual intergenerational abuse. Each retired generation gets to tax the younger working generation, and when that generation comes of age it does the same, and so on. This intergenerational abuse must stop.

Bush would not have gone wrong if instead of asking, "How can I privatize?" he had asked, "How can I alter Social Security to reduce the size, intrusiveness, and injustice of this horrible government program?" Instead, he is poised to make Social Security more intrusive. What a tragedy it would be if a president who claims to believe in the "Ownership Society" ended up further violating our rights to our own income. 

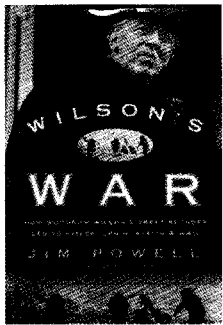
Book Reviews

Wilson's War: How Woodrow Wilson's Great Blunder Led to Hitler, Lenin, Stalin and World War II

by Jim Powell

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Reviewed by Richard M. Ebeling



It is difficult for many of us to understand the almost euphoric enthusiasm with which millions of Europeans marched off to war in the summer of 1914. For almost a century the people of Europe had, in general, lived through an amazing time in which living standards for practically everyone reached heights never before known in history. Governments, however imperfectly, had been tamed by constitutions, the rule of law, growing respect for individual liberty, and protection for private property and free enterprise.

Europe had not experienced a prolonged and massively destructive war since the defeat of Napoleon one hundred years earlier. To be sure, there had been some wars and civil wars, especially in central and eastern Europe during the nineteenth century. But they were relatively short and, compared to what were experienced in the twentieth century, rather limited in their destruction of life and property. “Rules of warfare” recognized the rights of neutrals and noncombatants in Europe, though not in the colonial areas of Asia and Africa.

But in the last decades of the nineteenth century, beneath the appearance of a classical-liberal utopia of freedom, peace, and prosperity, new ideological forces had been winning the hearts and minds of a growing number of people. These forces were socialism, nationalism, and imperialism—in a word, philosophical, political, and economic collectivism.

The air was filled with calls to arms in the name of national greatness and glory, talk of a higher social good more important than the “mere” interests of individuals, and the notion that peoples discovered their “destinies”

not in peaceful industry, but on battlefields amid the thrust of bayonets.

Four years after the war began, by the autumn of 1918, more than 20 million Frenchmen, Englishmen, Germans, Austrians, Hungarians, Italians, Russians, Greeks, Turks, Armenians, Serbs, Poles, Romanians, Bulgarians, and many others were dead. European industry and agriculture were ruined, and a good part of the accumulated wealth of a century had been consumed.

Jim Powell, in his book *Wilson's War*, tells the story of how this came about, what the consequences were, and the role Woodrow Wilson played in making this entire catastrophe worse than it might have been.

While not ignoring Imperial German militarism, aggressiveness, and bellicosity in the decades before World War I, Powell emphasizes the various nationalist ambitions and secret alliances among all the major belligerents that kept the war from being simply “Germany’s fault.” Battlefield incompetence by generals and political arrogance and stubbornness by national leaders on both sides dragged the war on and on in the face of mounting casualties and growing economic hardship unknown in living memory.

At first, Powell explains, Wilson—a vain and often vengeful man—claimed the role of impartial arbiter to bring the war to a negotiated conclusion. But soon both he and his circle of cabinet members and advisers decided that victory should belong to Great Britain and France. Finally, after winning reelection in 1916 on the slogan “He kept us out of war,” Wilson had Congress declare war on Germany in April 1917, although neither Germany nor any of its allies had attacked or threatened the United States. At the peace conference that followed the November 1918 armistice, Wilson’s idealistic rhetoric was drowned out by the imperial and territorial ambitions of the British and French that left Germany and the former Austro-Hungarian and Russian Empires in a shambles.

Powell persuasively suggests that if America had stayed out of the war the belligerents, exhausted and with no hope of a clear battlefield victory, might have accepted the need to end the conflict without any winner. Had that happened, there might well have been no Bolshevik revolution in Russia and therefore no deadly 75-year “experiment” in Soviet communism under