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SHIPMAN: Reshaping Social Security and our society

Payroll tax holiday could transform the program into welfare

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Social Security has fundamentally changed. This is because the historical, almost sacrosanct, linkage between Social Security taxes and benefits has been severed. President Obama was able to achieve this feat with only marginal objection from supporters of the traditional system or from those who have advocated reforming Social Security to a saving-and-investment structure. This is a rather remarkable political coup in that these two factions have fought each other every step of the way on almost any suggested change to the system. But not this time, for the president framed the change mainly as a jobs program. Where this delinking ultimately leads is unknown. But there is no question that Social Security is headed in a very different direction.

It all started March 18, 2010, with the enactment of the Hiring Incentives to Restore Employment (HIRE) Act. Under this law, employers who hired new workers from Feb. 4 to Dec. 31, 2010, qualified for up to a 6.2 percent payroll-tax deduction for each new worker, essentially exempting the employer from the Social Security tax. The tax deduction had no effect on the new employee's Social Security retirement benefits, effectively delinking the two. According to Douglas H. Shulman, the Internal Revenue Service commissioner at the time of the bill's enactment, "These tax breaks offer a much-needed boost to employers willing to expand their payrolls, and businesses and nonprofits should keep these benefits in mind as they plan for the year ahead." A reduction in the payroll tax was packaged as a jobs program.

The delinking morphed into a bigger role in 2011 when Congress legislated a temporary tax holiday, allowing all workers to pay just 4.2 percent instead of the previous 6.2 percent employee tax for the full year. The holiday was promoted as a way of putting more money in the hands of workers to increase aggregate demand and as another jobs program. As Sen. Kent Conrad, North Dakota Democrat, put it, "I strongly support a payroll tax holiday because [the] Congressional Budget Office has told us it is the second-most-powerful thing we can do after extending unemployment insurance to help with job creation." As with HIRE, Social Security benefits were not reduced - a further delinking.

Toward the end of last year, both Republicans and Democrats wanted to expand the holiday, but for different reasons. The Democrats thought it unfair for the average wage earner to be hit with a $1,000 tax increase if the holiday ended, while the Republicans went along because raising taxes is anathema to their economic philosophy.

The tax cut lasts only through February but likely will be extended for the full year as both parties want. Mr.

Obama summed up this bipartisan prospect quite well. "How can we not get that done? Has this place become so dysfunctional that even when people agree to things, we can't do it? It doesn't make any sense."

But there never was a tax cut under HIRE in 2011 or 2012. The Republicans were duped. Although part of the payroll tax was cut, Social Security benefits were not. Therefore, other taxes go up by the amount that payroll taxes go down. This is so even though initially, Treasury issued bonds to the Social Security trust funds in lieu of the lower payroll-tax collections. Without a like reduction in spending, the bonds will have to be redeemed through higher taxes. There was no net tax cut, just a change from the regressive payroll tax to more likely the progressive income tax, thus shifting the burden to higher-income workers, an often-stated Obama objective. Think "millionaires and billionaires."

It may be difficult to stop this train because both parties, for different reasons, want it to keep chugging along. This may embolden them to extend or lower the payroll tax further, exacerbating the delinking. If this happens, the government could then argue that workers are only entitled to lower Social Security benefits because they're provided by the now lower payroll tax. Another outcome may be means-testing benefits, thus morphing Social Security into a welfare program. A third may be to finance Social Security benefits largely or entirely through the income tax, resulting in a significant redistribution of wealth.

It is way too early to tell the ultimate endgame. But President Franklin D. Roosevelt's comment in 1941 was prescient. "We put those payroll contributions there so as to give the contributors a legal, moral and political right to collect their pensions and their unemployment benefits. With those taxes in there, no damn politician can ever scrap my Social Security program." Without them, maybe they can.

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