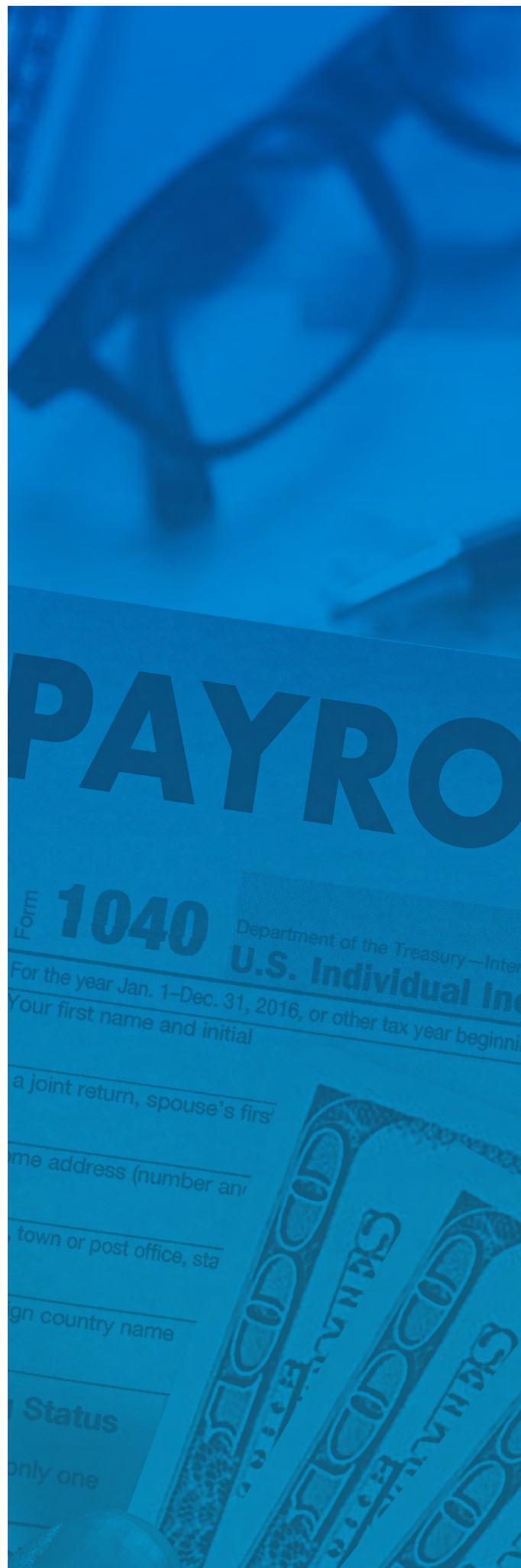March 2023

Payroll Tax Revenues Down $400 to $900 Billion Due to Lower Wages and Less Growth

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Introduction

Joe Biden has pledged many times that he will not cut Social Security and Medicare benefits—and has even accused Republicans of a secret plan to cut these programs for seniors. But the real risk to the financial security of Americans in retirement comes from Biden's anti-growth welfare, regulatory, tax, and employment policies that will reduce GDP, growth, work, and wages. Real wages have fallen during his administration while real returns on many investments turned negative. The Committee to Unleash Prosperity recently released a report measuring the financial losses in retirement savings plans, finding a loss of $4 trillion since President Biden's inauguration (Moore and Antoni 2022).

Promised Social Security and Medicare benefits are also put in harm's way by low- or negative-growth economic policies. Today's benefits are paid for out of today's worker wages and tomorrow's benefits (and thereafter) are paid out of future wage growth. Quite literally, the programs give the elderly a share of the earnings of the nation's workers.

The more people that work, and the more that each worker earns, the more payroll tax revenue that is available to fund Social Security and Medicare. Wage stagnation and wage declines are the enemy of the two programs' finances.

The combination of health insurance expansions, economic regulation (including policies related to welfare programs and labor markets), energy or climate regulation, education policy, and business taxation reduced growth and thus revenues into the trust funds. In addition to these failures to grow incomes and payroll tax revenues sufficiently ahead of inflation, Democrats' support for pandemic school closures have already set back student learning, which will translate into substantially less future earnings of today's young people. This is another hit to Medicare and Social Security payroll tax bases.

Because Social Security and Medicare operate on a "pay as you go" basis, benefits will be severely squeezed in the years to come as Congress struggles to figure out how to make up for this worsening structural deficit. Even before that happens, less national labor income translates to lower Social Security benefits, lasting the rest of their lives, for every worker reaching retirement age.

I estimate that these policies will ultimately reduce Medicare and Social Security tax revenue by at least $400 billion and perhaps up to $900 billion depending on how long these anti-growth policies last.

The Social Security and Medicare Programs

Social Security and Medicare are essentially pay-as-you-go systems, meaning that today's benefits are largely financed with today's payroll tax revenues. The programs deviated slightly from pure pay-as-you go when the baby boom was in its prime working years, which built up a "trust fund" that allows for a period when benefits exceed payroll tax revenues until the trust fund balance reaches zero. Both programs now spend more than they bring in, meaning other revenues or borrowing covers the shortfall.

The more inflation-adjusted revenue coming in, the more inflation-adjusted benefits that the systems can support. Quite literally, the programs give the elderly a share of the real earnings of the nation's workers. In the short run, the less that workers earn, the sooner that the trust funds run out and Congress would seriously consider benefit cuts of one kind or another. Even before that point, lower real wages at the national level reduce the Social Security benefits new retirees receive for the rest of their lives because those benefits are linked to the National Average Wage Index. In the long run, low real wages mean less Social Security benefits because they are also (imperfectly) linked to the retiree's earnings history.

The Biden Agenda and the Labor Market

For the purposes of understanding its effects on national incomes, the Biden policy agenda can be considered in five primary parts: health insurance expansions, economic regulation (including policies related to welfare programs and labor markets), energy or climate regulation, education policy, and business taxation. I expect the first two policy types to primarily affect the number of workers rather than real wages because the health insurance expansions and economic regulations are redistributive.[1] The latter three policy types affect the labor market primarily by affecting real wages.

In an October 2020 study, Fitzgerald, Hassett, Kallen, and I estimated that the Biden agenda would reduce labor income by 8.5 percent, or 5.0 percent without its business-tax elements. Since then, President Biden has largely implemented the anticipated insurance expansions, especially through the 2022 Inflation Reduction Act. Both economic and energy/climate regulation have proceeded vigorously. The 2020 study did not consider education policy. Biden's aspirations for taxing business income through the corporate and personal income taxes are still largely unattained although we do not expect him to renew the 2017 tax cuts.

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1   By discouraging work and hiring, health insurance expansions and economic regulations will also discourage individ-uals and business from investing in human capital, which will eventually reduce real wages. On the other hand, the health insurance expansions may increase average real wages among those who work by disproportionately discourag-ing work among low- and middle-income workers.

With some benefit of hindsight as to policy implementation, a good estimate of the combined effect of Biden's insurance, regulatory, and tax policies is to reduce labor income by 5 - 6.5 percent, with an additional reduction due to education policy, as discussed further below. Not surprisingly, the labor market is falling short. Real employee compensation per adult, which reflects the fraction of adults working, the number of hours they work, and the inflation-adjusted cash and fringe benefits they receive per hour of work, is 3.3 percent below the pre-pandemic trend. The employment-population ratio is still 1.3 percent below its pre-pandemic level.[2] The lower employment and lower real wages are some of the first dividends of this policy agenda.

Of course, the pandemic resulted in an economic depression that would temporarily leave the economy somewhat below previous trends. But even if the Biden economy had attained 2.0 percent annualized growth per adult from the first quarter of 2021—a tepid growth rate for a normal recovery—real compensation per adult would be 2.5 percent above where it is now.[3] These results are shown in the chart below.

Real Employee Compensation is Falling Short

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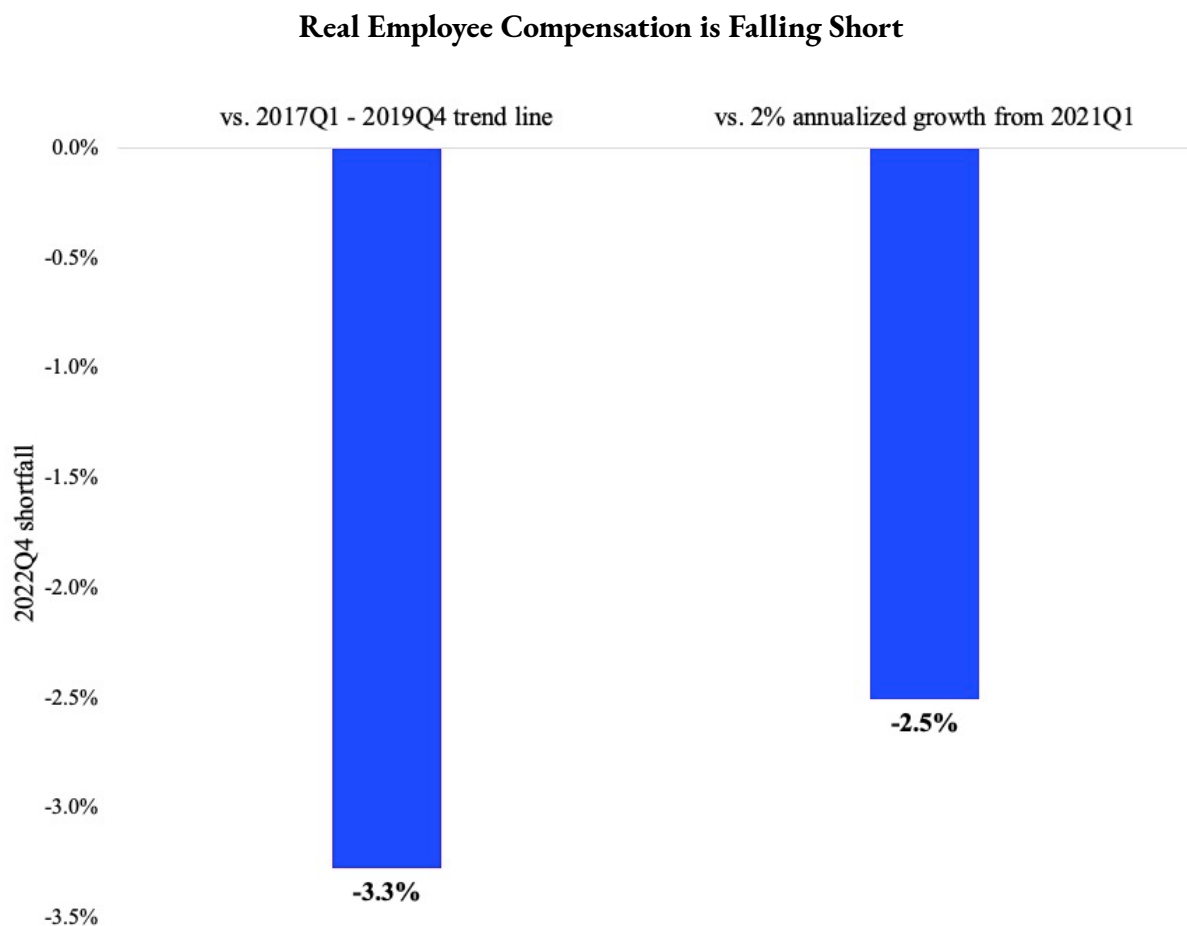
2   The employment population ratio is even further below its pre-pandemic upward trend. The widely cited unemployment rate is low, but that statistic does not reflect the extraordinary number of early retirements and other people who are out of the labor force.

3   I am using the quarterly FRED series through 2022-Q4: EMRATIO, COE, CPIAUCSL, and CNP16OV.

Near Term Effects: Insurance, Regulation, and Tax Policy

The full effect of policy on the labor market is not immediate, especially as regards productivity. For the same reason, the effect of ending Biden's policy will not be immediate. Therefore, I assume that four years of the insurance, regulation, and tax agenda will reduce four years of labor income by 5.0-6.5 percent, although those four years are not necessarily 2021-24. Eight years of the agenda would affect labor income for double the number of years. With much of the Medicare taxes collected as a flat rate on all payroll, and Social Security taxes a flat rate on the payroll below the cap (currently $160,200), each percent reduction in labor income is expected to reduce Medicare and Social Security tax collects by essentially the same percent.

In fiscal year 2022, the U.S. Treasury reported Medicare and Social Security tax revenue of $1.5 trillion. Of this, 5 - 6.5 percent is $296 billion to $385 billion over four years and $592 billion to $770 billion over eight years. The results are reported in Table 1.

Table 1. Medicare and Social Security Tax Losses due to Democrats' Degrowth Agenda

	Billions of dollars
Remote learning (present value)	118
Federal policies (Biden): Regulation and health-insurance subsidies	
Biden 4 years	296 - 385
Biden 8 years	592 - 770
Sum	
Biden 4 years	414 - 503
Biden 8 years	710 - 888

Long Term Effects: Remote Learning

Private schools quickly returned to meeting in-person, as it was widely understood that it was essential for learning. Teachers' unions together with President Biden's Centers for Disease Control and Prevention vigorously resisted returning in-person.[4] As a result, about half of the in-person days of public K-12 school were lost nationwide during the 2020-21 school year. Assuming that remote learning was half-effective and that each year of schooling increases earnings by 9.1 percent (Hanushek and Woessmann 2020), the remote learning policies reduce the earnings of the 50.8 million by an average of 2.275 percent (2.275 = 0.5*0.5*9.1) *for their entire working lives.*

Pandemic era public-school students will be part of the future workforce. But each year's workforce will also include workers who were not in public school during the 2020-21 year. Based on the number of students in public school and the total number of people aged 18-65, I assume that the pandemic era public-school students would have been 25 percent of the workforce until they turn age 65. This suggests that remote learning policies reduce labor income nationally by 0.56 percent during the working years of the 2020-21 students. For context, 0.56 percent of current Medicare and Social Security tax revenue would be $10 billion per year.

Many of these years are in the distant future. I discount future national earnings at a 4.5 percent annual rate, which reflects the time value of money as well as trend productivity and population growth. With these assumptions, I estimate that remote learning policies reduce Medicare and Social Security tax revenue by $118 billion in present value.

Conclusion

The ability of the Social Security and Medicare programs to pay promised benefits in future years depends on future growth of the economy and the future growth of real wages. For the next 10 years the Congressional Budget Office predicts a real growth rate of roughly 1.6 percent annually. Some of this is due to the aging of the baby boomers, but some is due to energy, climate change, welfare, tax and regulation policy that reduce growth now and in the future. The post-pandemic recovery has already been slower than expected and the financial health of Social Security worse than it would have been with a vigorous recovery.

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4   This report does not attempt to allocate responsibility for continued remote learning between the Biden Administration, state and local Democratic officials, and Democratic special interests such as teachers' unions.

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