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Trump's Payroll Tax Proposal Doesn't Go Far Enough

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A payroll tax cut proposal is a good idea that is workable, pays for itself, and can help ordinary Americans at all levels.

It's no secret Washington is a mess. Polarization over the latest Covid-19 relief bill negotiations have reached new heights of irrationality, with each side of the aisle claiming the other is sabotaging America's effort to get back to some semblance of normal. Typical of the disfunction is the reflexive howls of protest over President Trump's memorandum "deferring" payroll taxes for workers earning less than $104,000 a year .

Originally proposed by Mr. Trump in March before the virus decimated the economy and threw millions out of work, he pushed for it again in the latest economic relief package. When talks over a relief bill stalled, the president issued his memorandum to Secretary of the Treasury Secretary Mnuchin. And was met with the same reaction by Congress and the media: DOA. "The first shot in a class and generational war," read the headline over a column by Washington Post financial columnist Allan Sloan. "The hydroxychloroquine of economic policy," tweeted New York Times columnist Paul Krugman. "Unworkable, weak and narrow policy announcements to slash the unemployment benefits that millions desperately need and endanger seniors' Social Security and Medicare," announced House Speaker Nancy Pelosi (D-CA) and Senate Democratic Leader Chuck Schumer (D-NY).

The fact that Mr. Trump has had a payroll tax holiday on his wish list of tax reform long before the current crisis means it carries the predictable baggage. Like many, we don't necessarily agree with a number of the president's current policies. But to give credit where it's due, a payroll tax cut proposal is a good idea that is workable, pays for itself, and can help ordinary Americans at all levels. The problem with the president's version is its limitation in scope, covering just a few months, which opens it up for apocalyptic criticism that he's trying to "dismantle" and "gut" Social Security.

One of the primary arguments against the tax break is that it only helps the still-employed, not the unemployed scrambling to pay for rent and necessities. While technically valid, the argument is shortsighted. Because the major beneficiaries of this tax holiday are lower-income wage earners who have a higher propensity to consume, this helps overall economic growth almost immediately.

The payroll tax withholding rate, now 6.2 percent on the first $137,700 of an employee's gross income (employers cover another 6.2 percent), could be reduced to 0 percent for the first two years. The rate could then rise to 2 percent in years three and four, and 4 percent in years five and six, before returning to the current rate in year seven. This would increase disposable income for existing workers, which would spur further consumption that would encourage more hiring. Under such a program, an average worker (about 40 years old) earning an average wage ($53,756 in 2019) would receive $15,767 in increased disposable income over the next six years, free to spend on whatever.

On the other side of the equation, employers would also receive the benefit of the same tax holiday. By driving down the after-tax cost of labor, businesses would receive an immediate incentive to hire and retain workers. The big winner for the employer side of the payroll tax holiday would be small- and medium-sized businesses that often employ lower wage workers.

Cue the perennial scare tactic that cutting the payroll tax will make Social Security insolvent and shove grandma onto the street. If anything, the opposite is true if paired with an extension of an employee's retirement date. For those who participate, they would receive a higher net paycheck now in exchange for delaying retirement, an especially appealing tradeoff for younger workers a long way from retirement.

For instance, each year the full retirement age (currently 67 years) could be increased by half a year until reaching 78 years or retirement, whichever comes first. Using data from the Social Security Administration, this reform could eliminate $14.1 trillion of federal debt over the next 60 years if only two-thirds of American workers participate. Additionally, roughly 36 million new entrants to the workforce over the next 15 years could produce additional savings of $4 trillion. This reduction in federal debt frees up massive new resources for Congress to use on additional federal stimulus programs.

Then there is the argument that a payroll tax holiday is regressive, benefiting the wealthy more than low- and middle-income earners. We would argue it's the other way around, that payroll taxes are regressive, but a payroll tax cut is progressive. All taxpayers pay the 6.2 percent payroll tax. But this has a bigger impact on the total disposable income of lower-wage workers, exactly the type who need the assistance now, are most likely to spend the money, and will see the largest relative increase in their paychecks.

Rather than limiting new stimulus to programs designed solely to prop up consumption, a payroll tax holiday would unleash the power of free markets to escape the morass of government subsidies.

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