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Global CIO Outlook
Give Trump His Payroll Tax Cut. It's Good for America

The right payroll tax holiday would free up funds for Congress to increase stimulus.

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Last month, I penned an op-ed that advocated for a voluntary payroll tax holiday which would dramatically enhance federal finances to support additional fiscal stimulus. Structured correctly, this plan could play a pivotal role in boosting disposable income, incentivizing employers to hire workers, and making Social Security more sustainable while freeing up trillions of dollars to pay for extended unemployment benefits and other programs that Congress views as essential.

My proposal is sensible, effective, and economically sound. But the payroll tax cut idea has also attracted vocal opposition, including from Congress.

While our tired and beleaguered nation is reeling from the economic downturn, the House and Senate are at an impasse over the size and scope of the next fiscal package. Certain members of Congress point to an irresponsible increase in the federal deficit. This position is reasonable, as evidenced by Fitch Ratings announcing that it downgraded its rating outlook for the United States to negative as a result of growing deficits.

President Trump is in favor of a payroll tax cut. Congress, which needs the President to support a fiscal package, should give the President this political win. Political pragmatism would be good for America. The voluntary tax holiday focuses on returning America to work while enhancing the financial stability and economic growth of the nation and offering workers greater freedom and flexibility in retirement planning.

Critics have weighed in against the payroll tax cut, saying it only helps the still-employed, offers nothing to employers, doesn't help retirees, and speeds up the exhaustion date of the Social Security trust funds. Others have called it a regressive policy, claiming a payroll tax cut would be of greater value to higher-paid workers.

With my proposal, every one of these arguments is wrong.

A payroll tax holiday does more than help the still-employed:

Aiding those who are working puts more money in the pockets of consumers, in turn lifting aggregate demand. 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.

The payroll tax withholding rate—currently 6.2 percent on the first $137,700 of gross income—could be reduced to 0 percent for the first two years, delivering a much-needed income boost for workers who opt in. 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 and ignite a virtuous cycle that would encourage even more hiring. Under such a program, an average worker (40 years old) earning an average wage ($53,756 in 2019) would receive $15,767 in increased disposable income over the next six years.

Employers would benefit by getting a matching holiday for employees who opt in:

As a supply-side incentive to increase hiring, the employer would also receive the benefit of the same holiday that would mirror the savings of the employee. 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 generally employ lower wage workers. These companies are struggling to remain in business and have not received the same boost as larger companies that have been major beneficiaries of programs included in the CARES Act and Federal Reserve policies. The combination of increased consumption and lower costs could help ignite new job gains coincident with a rapid drawdown in unemployment. Employer payroll tax relief would also relieve pressure on small businesses with lower-paid workers and help limit failures and bankruptcies that would threaten the structural potential of the economy.

Cutting payroll taxes will extend the life of the Social Security trust funds if it is paired with an extension of the worker's retirement date:

This temporary payroll tax holiday could be offset by raising the retirement age for those who choose to participate. For those seeking more current income, a higher net paycheck now would be available in exchange for delaying retirement. This could be particularly attractive for younger workers whose expected retirement date is still decades away.

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 $4.0 trillion. This reduction in federal debt frees up massive new resources for Congress to use on additional federal stimulus programs.

A payroll tax holiday is progressive, not regressive:

Payroll taxes are regressive, but a payroll tax cut is progressive. All taxpayers pay the 6.2 percent payroll tax, but for lower-wage workers this has a bigger impact on their total disposable income. These workers, precisely those who need this assistance right now, are most likely to consume the increased income, and will see the largest relative increases in take-home pay.

A payroll tax holiday will help get America back to work while providing an opportunity for entitlement reform that will shore up Social Security for future generations while strengthening the financial position of the United States. Clearly this proposal gives the President what he wants, and more room for Congress to provide fiscal stimulus. The message is clear: Congress needs to give the President what he wants in order to give America the programs and resources it needs to help the economy recover.

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