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Cutting Payroll Taxes is an Ineffective Way to Counter the Economic Damage of the Coronavirus

The coronavirus outbreak poses an extremely serious threat to the U.S. economy. Markets already are showing an extreme lack of confidence in the administration's ability to respond to the public health crisis, with markets dropping 20 percent since their recent peak.[1] Consumer spending, which has been the primary driver of recent U.S. economic growth, likely will fall precipitously as Americans limit their exposure to the virus by curtailing shopping, eating out and other everyday activities. A downward spiral of less spending, lower profits, fewer jobs and less spending threatens to the throw the economy into recession.

The most effective way to safeguard the economy would have been to mount an effective public health response to the coronavirus outbreak weeks ago. However, with the number of confirmed coronavirus cases expanding exponentially, the public health response must now be accompanied by actions to stimulate the economy to make up for the expected steep drop in consumer demand. As that aid package is developed, a key question is how to get the biggest bang for the buck—the biggest, fastest, most equitable boost to provide support for the economy as we deal with the outbreak.

The White House has proposed a temporary cut in the payroll taxes that fund Social Security and Medicare. However, the proposal has been roundly criticized by economists of both parties who argue that there are much more effective ways to provide economic stimulus.

Too little money goes to those most likely to spend it

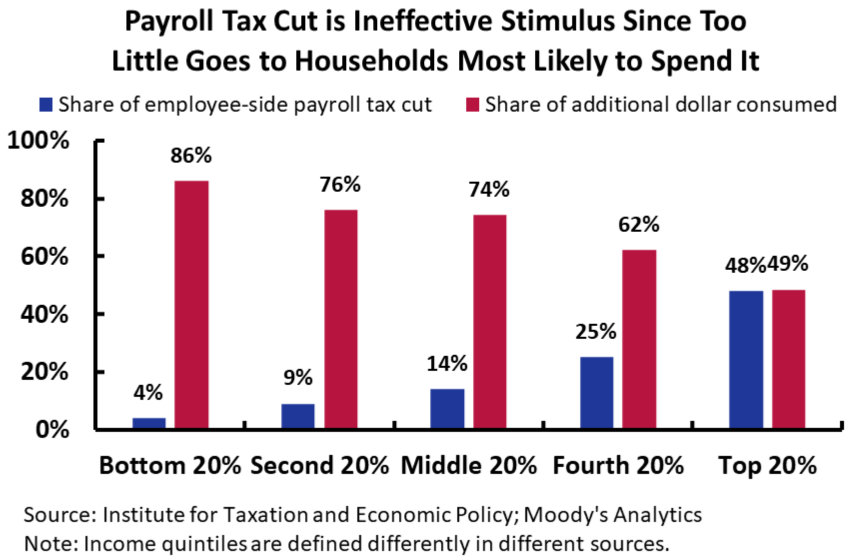
A payroll tax cut is poorly designed to boost demand since it provides relatively few benefits to low-income households. These are the households most likely to spend an additional dollar, boosting consumption and keeping the economy afloat. Estimates show that low-income households will spend most of an additional dollar of income while high-income households will only spend about half of it.[2] Well-designed stimulus should, therefore, prioritize payments to low-income households. Even cutting payroll taxes for just employees (as opposed to employers) fails to pass this test since it delivers less than 5 percent of its benefits to the bottom fifth. Nearly half of the benefits would flow to the top fifth, the group most likely to save it.[3]

Payroll tax cuts are too slow to take effect

In addition to targeting tax savings to workers less likely to spend them, a payroll tax cut delivers little immediate stimulus. Workers pay payroll taxes throughout the year with each paycheck, so the effect of a tax cut will dribble out over time instead of immediately softening the blow of coronavirus. The White House has publicly floated a payroll tax holiday where the total tax is eliminated for a period. This is the fastest possible way to deliver a payroll tax cut to workers, but even that works slowly: the most a full-time minimum-wage worker can save from eliminating her share of the payroll tax is less than $100 each month.

Corporations get a large tax cut

The above numbers may dramatically understate the regressiveness—and thus overstate the effectiveness—of the payroll tax cut the White House may propose. That is because the administration is apparently considering cutting payroll taxes paid by employers as well as employees.



With a temporary cut, employers could simply pocket the savings as nothing would require them to pass along savings to employees as is generally assumed in long-term analysis of payroll taxes. For example, Amazon—which already paid no federal corporate taxes in 2018 despite $11 billion of profits—could easily save over $1 billion payroll taxes on an annual basis from their complete elimination.[4] A large portion of the payroll tax cut would, therefore, accrue to business owners—including the owners of the largest, wealthiest corporations—instead of employees. Policymakers seeking to help small businesses struggling with liquidity should pursue other, targeted policies such as loans to small businesses that do not provide windfalls to giant corporations for whom liquidity is not a problem.[5]

Those who need it the most get nothing

A payroll tax cut leaves out anyone who is not working, including those who lost their job because of coronavirus. This is especially cruel because these workers will both miss out on their normal pay and the boost in their paychecks that lower payroll taxes provide. By contrast, other proposals such as one advocated by former Council of Economic Advisers chair Jason Furman, would provide immediate and direct payments to individuals, working or not, that they could spend immediately. It would offer faster and larger stimulus while ensuring those most affected by the virus's economic impact are not left out.[6]

Payroll tax cuts could Threaten Social Security and Medicare

Payroll taxes fund Social Security and Medicare—critical programs facing long-term funding shortfalls that their opponents have used to justify proposing cuts. Presumably, the payroll tax cut would follow the example of previous payroll tax cuts whereby other tax revenue would be tapped to make up for the additional shortfall for both programs. Yet reversing a large payroll tax cut may be politically difficult, as it could be framed as a substantial middle-class "tax increase." This drain on federal revenue could give politicians who have long sought to cut Social Security and Medicare an opportunity to pursue cuts.

Leading economists from both parties oppose a payroll tax cut

The strength of these arguments has led economists with Democratic and Republican backgrounds to oppose a payroll tax cut as fiscal stimulus. Among these economists are:

- Jason Furman, former Chair of the Council of Economic Advisers under President Obama, called the payroll tax cut under Obama, when Republicans controlled the House of Representatives, the best they could do but “far from optimal then and would be even further from optimal now."[7]
- Gene Sperling, Director of the National Economic Council under President Obama, called the 2011-2012 payroll tax cut “positive because this $240 billion in additional stimulus was [the] best we could get w/GOP House resistance - NOT because it was the best or most fair design.”[8]
- Michael Strain, Director of Economic Studies at The American Enterprise Institute, recently outlined eight different reasons why a payroll tax cut is not optimal.[9]

Additional reading

Chye-Ching Huang, "Far Better Ways Than Payroll Tax Cut to Contain Virus’s Economic Damage," Center on Budget and Policy Priorities, March 10, 2020, https://www.cbpp.org/blog/far-better-ways-than-payroll-tax-cut-to-contain-viruss-economic-damage

Jason Furman, "The Case for a Big Coronavirus Stimulus," The Wall Street Journal, March 5, 2020, https://www.wsj.com/articles/the-case-for-a-big-coronavirus-stimulus-11583448500

Steve Wamhoff, "Trump’s Proposed Payroll Tax Cut Is Not the Right Answer," March 10, 2020, https://itep.org/trumps-proposed-payroll-tax-cut-is-not-the-right-answer/

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[1] Taylor Telford and Thomas Heath, "Dow slumps after coronavirus declared pandemic," *The Washington Post*, March 11, 2020, https://tinyurl.com/yx47779r

[2] Table 5, Mark Zandi et al, "The Macroeconomic Consequences of Mr. Trump's Economic Policies," Moody's Analytics, June 2016, https://tinyurl.com/hboz3qw

[3] Steve Wamhoff, "Impact of 2 Percentage Point Cut in Social Security Payroll Tax in 2020," March 10, 2020, https://tinyurl.com/uyx3gwc

[4] Institute for Taxation and Economic Policy, "Amazon in Its Prime: Doubles Profits, Pays $0 in Federal Income Taxes," February 13, 2019, https://tinyurl.com/yyf6d98d ;
Amazon has over 400,000 employees in the U.S. It reported in 2018 that its median compensation—which is based on salary, bonus, and stock options—was $35,000. The payroll tax savings would likely be considerably more since Amazon’s average compensation is likely higher than its median compensation.

[5] Chye-Ching Huang, Payroll Tax Holiday a Poor Stimulus Idea,” Center on Budget and Policy Priorities, January 27, 2009, https://tinyurl.com/rdwda3s

[6] Jason Furman, "The Case for a Big Coronavirus Stimulus," The Wall Street Journal, March 5, 2020, https://tinyurl.com/t9dmcoh

[7] https://twitter.com/jasonfurman/status/1237156477531385856

[8] https://twitter.com/genebsperling/status/1237429020142096384

[9] Michael Strain, "Don’t Cut the Payroll Tax. Just Send People Money," Bloomberg News, March 11, 2020, https://tinyurl.com/v27xt8h