Issue Brief

west virginia Center on Budget & Policy

www.wvpolicy.org

September 9, 2011

Extending the Payroll Tax Cut

Sean O'Leary

Thursday night, President Obama unveiled his jobs bill, a package of tax cuts and spending designed to jump-start the stalling economy. The plan features an extension of the temporary payroll tax cut originally passed last December, which is due to expire at the end of this year. That measure provided much-needed support for the economy this past year, and failure to extend the payroll tax cut in a struggling economy would increase the risk of another recession.

The tax cut reduced the employee share of the Social Security payroll tax. The original reduction is estimated to have raised workers' take home pay by $120 billion in 2011, providing a tax cut of $934 to the average worker.[1] Under the president's new proposal, the tax cut would be expanded, providing a $1,500 tax cut to the average family, cutting payroll taxes in half.[2] If the tax cut is not extended, workers would see reductions in their paychecks starting January 1, 2012, with the economy likely still in a weakened state.

Allowing Expiration Would Hurt the Economy

According to the Congressional Budget Office, the increase in take home pay provided by the payroll tax cut increased household spending. This increase in household spending rippled through the economy, boosting production and employment.[3] Despite this boost, the national economy is still weak, and the recovery has slowed. The loss of spending activity from expiration of the payroll tax cut would likely cause further economic damage.

Economists, like those at Goldman Sachs[4] and Moody's Analytics,[5] have warned that the tax cut's potential expiration is a significant threat to the U.S. economy. According to Moody's analysis, failure to extend the tax cut would result in approximately one million fewer jobs by the end of 2012 and lower GDP growth.[6]

The Payroll Tax Cut is an Effective Stimulus

The payroll tax cut is a more efficient bang-for-the-buck policy option than other tax-cut policies. The tax cut increases consumer purchasing power for workers at every income level, but since the payroll tax has a wage cap, the benefit of the cut is limited for higher-income earners. This ensures that the tax cut goes to those most likely to spend the additional money, and generate the most economic activity.

For those reasons, it is estimated that for every $1 in reduced federal revenue from the payroll tax cut, the economy expands by $1.27.[7] This makes the payroll tax cut more than three-and-a-half times more effective than making the Bush tax cuts permanent or cutting the corporate tax rate. Expanding the payroll tax cut, like in the president's proposal, would provide a new boost to the economy, while letting it expire would result in the loss of significant existing support.

Table 1

Fiscal Policy Multipliers (as of 2nd Quarter 2011)

Tax Cuts	Bang for the Buck
Payroll Tax Cut for Employees	$1.27
Payroll Tax Holiday for Employers	$1.05
Make Bush Income Tax Cuts Permanent	$0.35
Cut in Corporate Tax Rate	$0.32
Make Dividend and Capital Gains Cut Permanent	$0.39

Source: Moody's Analytics - The bang for the buck is the one-year dollar change in GDP for a given dollar reduction in federal tax revenue.

The Payroll Tax Cut Had a Major Impact in West Virginia

Approximately 900,000 people in West Virginia have benefited from the payroll tax cut, which will have provided roughly $500 million in tax relief in 2011.[8] Using the fiscal policy multiplier cited above, the payroll tax cut will have generated $635 million in economic activity for West Virginia this year. This boost has been critical as the economic recovery has begun to lose momentum.

By extending the payroll tax cut, policymakers can avoid increasing the risk of a renewed recession. However, a payroll tax cut extension should only be a part of a larger set of economic measures designed to grow the economy and shrink the jobs deficit, like those described in the president's plan on Thursday. Policies like the implementation of work-sharing and immediate investments in infrastructure will create jobs and spur economic growth, reversing the current slowdown.

Endnotes

1 Chuck Marr and Brian Highsmith, "Letting Payroll Tax Cut Expire Would Shrink Worker Paychecks and Damage Weak Economy," (Washington, D.C.: Center on Budget and Policy Priorities, September 7, 2011).

2 The White House, "The American Jobs Act," (http://www.whitehouse.gov/sites/default/files/jobs_act.pdf, September 8, 2011).

3 .Tax Policy Center Table T10-0279.

4 Goldman Sachs US Economics Analyst, "What Turns a Stall into a Slump," (Goldman Sachs Group, August 12, 2011).

5 Mark Zandi, "Global Policy Prescriptions: How Another Recession Can Be Avoided," (Moody's Analytics, August 26, 2011).

6 Augustine Faucher, "Debt Limit Deal Includes Significant Deficit Reduction," (Moody's Analytics, August 2011).

7 Zandi, 2011.

8 Marr and Highsmith, 2011.