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The Payroll Tax Needs a Vacation

By ROBERT H. FRANK

THE federal budget deficit is a distraction.

It's important, yes, and must be addressed. But by a wide margin, it's not the nation's most pressing economic problem. That would be the widespread and persistent joblessness that has plagued the labor market since the Great Recession began in 2008.

Almost 14 million people — 9.1 percent of the labor force — were officially counted as unemployed last month. But that's just the tip of the iceberg. There were almost 9 million parttime workers who wanted, but couldn't find, full-time jobs; 28 million in jobs they would have quit under normal conditions; and an additional 2.2 million who wanted work but couldn't find any and dropped out of the labor force.

If the economy could generate jobs at the median wage for even half of these people, national income would grow by more than 10 times the total interest cost of the 2011 deficit (which was less than $40 billion). So anyone who says that reducing the deficit is more urgent than reducing unemployment is saying, in effect, that we should burn hundreds of billions of dollars worth of goods and services in a national bonfire.

We ought to be tackling both problems at once. But in today's fractious political climate, many promising dual-purpose remedies — like infrastructure investments that would generate large and rapid returns — are called unthinkable, in the false belief that they would impoverish our grandchildren. Yet there are other ways to attack unemployment that could garner bipartisan support.

Perhaps the most promising is a payroll tax holiday. The payroll tax was originally meant to pay for Social Security, and in recent years, employees and employers have each contributed 6.2 percent of total salary — with no additional levies on salaries beyond $106,800. Congress should both declare an immediate payroll tax holiday for employees and exempt employers from making contributions for newly hired workers — and keep both provisions in effect until the end of next year.

The first step would increase take-home pay, thus stimulating spending and employment. And the employer exemption from taxes on new hires would make it substantially less expensive to hire additional workers.

Last December, Congress approved cutting the employee's contribution to the payroll tax to 4.2 percent of salary for the 2011 calendar year, a move that attests to the political viability of my proposal. President Obama has proposed extending the employee reduction through 2012, but in the face of dreary recent labor market data, stronger steps are needed.

Larry Seidman, an economist at the University of Delaware, has estimated that if employee payroll tax payments were suspended from next month through 2012, the unemployment rate by the end of that period would be one percentage point lower than it would have been otherwise. Private-sector employment would thus expand by about 2.4 million workers by the end of next year.

Even greater employment growth would result from the employer exemption on new hires. Companies aren't very likely to hire additional workers unless they can generate at least enough new income to cover their salaries, including all relevant taxes. The exemption would reduce the cost of hiring new workers by 6.2 percent — and even by conservative estimates, we can expect it to result in more than five million new hires.

Although payroll tax revenue has traditionally been designated to pay for Social Security benefits, Congress should make clear that these steps will have no effect on current or future retirement checks. The Treasury would have to issue new bonds to cover those payments in the short term. But the payroll tax holiday and cap need not compromise the long-term goal of deficit reduction.

Because these two measures would increase employment by more than seven million by the end of 2012, income tax revenue would rise accordingly. And higher employment would sharply increase both the employee and employer portions of the payroll tax, compared with what they otherwise would have been when the tax holiday ended.

Taking such steps to expand employment would improve the long-run deficit picture in other ways. Periods of high unemployment are periods of high social stress. Increasing employment would reduce divorce rates and result in better nutrition and parental care for children. It would also give many recent graduates a quicker start to their careers. These effects would yield permanent increases in lifetime earnings, with corresponding effects on tax revenue.

Higher demand would also accelerate business investment. Many companies aren't investing today because they already have enough capacity to produce more than people want to buy. Greater investment would bolster productivity and wages, which would also lead to permanently higher future tax revenue.

Enacting a payroll tax holiday, however, shouldn't end discussion of more forceful and effective proposals to stimulate employment. We need to keep posing hard questions to deficit hawks who argue that we shouldn't be hiring unemployed workers to maintain our crumbling roads and bridges, even though postponing such projects will make them much more expensive in the future. These projects don't impoverish our grandchildren. They enrich them.

The important point is that bringing down federal deficits is a long-run problem that cannot and should not be solved by gutting entitlement programs like Social Security and Medicare. Deficit reduction will require creative thinking about additional revenue sources and judicious decisions about future spending. But our immediate concern must be getting people back to work.

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