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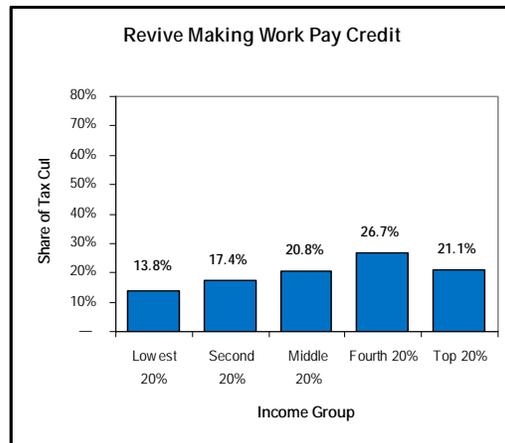
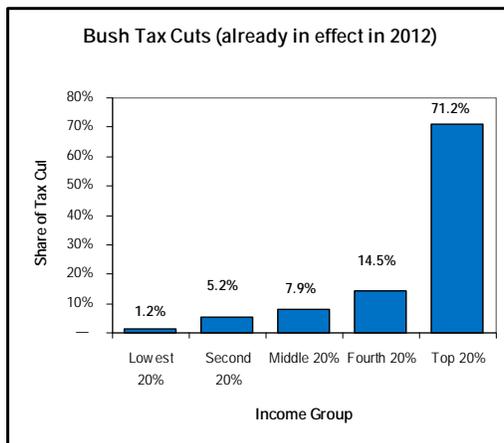
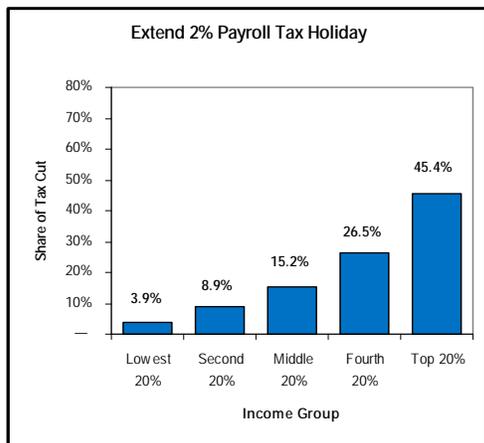
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## Comparing a Payroll Tax Holiday to Other Tax Breaks More Effective than Bush Tax Cuts, Less Effective than Making Work Pay Credit

President Barack Obama’s recent proposal to extend the 2 percent payroll tax holiday, which is currently in effect through 2011, is neither the most effective policy, nor the least effective policy, for boosting the economy. The estimates provided here compare the effectiveness of the payroll tax holiday and other policy options in putting money in the hands of low- and middle-income Americans who, according to mainstream economists, are likely to spend it quickly and thereby provide an immediate boost to the economy.

About 28 percent of the payroll tax cut, which is opposed by Congressional Republicans, would go to the poorest 60 percent of taxpayers, compared to just 14 percent of the income and estate tax cuts that the same Republican lawmakers have promoted for years. The Making Work Pay Credit, which was previously championed by President Obama, would be much better targeted, with more than half of the benefits going to the poorest 60 percent of taxpayers.

Distribution of Tax Policy Options and Recently Enacted Tax Breaks in 2012



Source: Institute on Taxation and Economic Policy tax model, September 2011

The non-partisan Congressional Research Service and mainstream economists like Mark Zandi generally find that measures that put money in the hands of lower income people will do more to mitigate a recession than measures that put money in the hands of the wealthy or businesses.<sup>1</sup> They find that the most effective policies are not tax cuts, but direct spending

<sup>1</sup> Congressional Budget Office, “Estimated Impact of the American Recovery and Reinvestment Act on

measures. However, if Congress and the President feel compelled to address the economy with tax cuts, those targeted towards low- and middle-income people would be most effective.

Comparison of Tax Policy Options and Recently Enacted Tax Breaks, Impacts in 2012							
U.S. Taxpayers		Extend 2% Payroll Tax Reduction		Bush Tax Cuts (already in effect in 2012)		Revive Making Work Pay Credit	
Income Group	Average Income	Average Tax Cut	Share of Tax Cut	Average Tax Cut	Share of Tax Cut	Average Tax Cut	Share of Tax Cut
Lowest 20%	\$ 13,441	\$ -188	3.9%	\$ -141	1.2%	\$ -313	13.8%
Second 20%	28,006	-429	8.9%	-610	5.2%	-397	17.4%
Middle 20%	44,818	-729	15.2%	-932	7.9%	-473	20.8%
Fourth 20%	72,944	-1,272	26.5%	-1,706	14.5%	-609	26.7%
Next 15%	126,619	-2,039	31.9%	-3,752	23.9%	-621	20.5%
Next 4%	276,795	-2,569	10.7%	-8,555	14.5%	-77	0.7%
Top 1%	1,648,765	-2,691	2.8%	-77,119	32.8%	—	0.0%
ALL	\$ 77,085	\$ -945	100.0%	\$ -2,318	100.0%	\$ -448	100.0%
Addendum							
Lowest 60%	\$ 28,756	\$ -150	28.1%	\$ -561	14.3%	\$ -394	52.0%
Top 5%	\$ 551,181	\$ -1,297	13.5%	\$ -22,267	47.3%	\$ -63	0.7%

Note: "Bush tax cuts" include the extension of 2001 and 2003 income tax cuts and the partial extension of the 2001 estate tax cut that were included in the compromise signed into law in December (the Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010). This does not include additional tax cuts championed by President Obama and included in that law, such as the lower earnings threshold for the refundable portion of the Child Tax Credit, or the increased EITC for married couples and larger families.

The tax compromise enacted at the end of 2010 included a one-year payroll tax holiday reducing Social Security taxes paid by working people by two percentage points in 2011. For most people that simply means that the part of the Social Security payroll tax that is paid directly by employees is reduced from 6.2 percent to 4.2 percent.<sup>2</sup>

The same compromise legislation also extended the income tax cuts enacted under President Bush in 2001 and 2003, and partially extended the estate tax cuts enacted under Bush in 2001, for two years (2011 and 2012).

The compromise did not extend the Making Work Pay Credit, which was included in the economic recovery act that was enacted in early 2009 and was in effect for 2009 and 2010. The credit was a maximum of \$400 for unmarried taxpayers and \$800 for married couples, and was phased out for higher incomes.<sup>3</sup>

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Employment and Economic Output from April 2011 Through June 2011," August 2011. <http://cbo.gov/ftpdocs/123xx/doc12385/08-24-ARRA.pdf>; Mark Zandi, "Washington Throws the Economy a Rope," Moody's Analytics, January 22, 2008. [http://www.economy.com/dismal/article\\_free.asp?cid=102598](http://www.economy.com/dismal/article_free.asp?cid=102598)

<sup>2</sup> Wage income up to \$106,800 (this cap rises in most years with wage growth) is subject to Social Security payroll taxes. Employees and employers each directly pay 6.2 percent of the employee's wages up to the cap. Economists agree that even the employer-paid tax is ultimately borne by workers, over the long run, in the form of lower wages or benefits. Self-employed individuals pay both parts of the tax directly.

<sup>3</sup> Specifically, the Making Work Pay Credit was the lesser of \$400 (\$800 for a married couple) or 6.2 percent of wages. This made it the equivalent of a payroll tax holiday limited to \$400/\$800. The credit was reduced for unmarried taxpayers with adjusted gross income (AGI) in excess of \$75,000 and completely phased out for those with AGI in excess of \$95,000. The credit was reduced for married couples with AGI in excess of \$150,000 and completely phased out for those with AGI in excess of \$190,000.