Let’s Try a Tax Cut That Might Actually Pay for Itself

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MarketWatch Blog by Geoffrey T. Sanzenbacher

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With a positive side effect for older households.

Hope springs eternal. Every time a tax cut is proposed, the promise is made: the increased economic growth will eventually result in more, not less, government revenue. For example, in 2017 we had Treasury Secretary Mnuchin exclaiming that the “Tax Cuts and Jobs Act (TCJA)” would “pay for itself with growth.” Guess what: according to the nonpartisan Tax Foundation, it didn’t. The TCJA shouldn’t feel too bad. It joins a long list of tax cuts that failed to deliver, including cuts during the Reagan and George W. Bush Administrations (the Bush cuts were largely renewed under Barack Obama). So, I was surprised to find evidence of a tax cut that might do the seemingly impossible: pay for itself.

The find came as I was doing research on a different topic – policies that might encourage low-income individuals to work longer to improve their often inadequate retirement resources. One that fit the bill was the Earned Income Tax Credit (EITC), a refundable credit that rises with earnings before phasing out. The EITC is one of the government’s largest anti-poverty programs. Its design – which yields no benefit to non-workers – has been found to encourage employment. So, I started writing an issue brief for the

Center for Retirement Research at Boston College (coming out this April) on how much an expansion of the EITC to more near retirees would increase their employment.

Right now, the EITC hardly serves these folks. The reason is simple: the EITC is much larger for households with children. But, just 15 percent of those ages 55 to 64 still have dependent children. Since so few workers approaching retirement use the EITC, little research has focused on how they might respond to an expansion of the childless benefit. Yet, due to the combination of poverty reduction and work encouragement, such an expansion has long enjoyed bipartisan (gasp!) support. A temporary expansion was even briefly implemented during COVID.

To look at how older workers might respond, I turned to work published in *The Journal of Public Economics* by Jacob Bastian and Maggie Jones. They examined how past increases in the generosity of the EITC altered economic outcomes like employment for lower-income individuals. They found that each time the EITC was increased by $1,000, single women were 5.1 percentage points more likely to be employed. However, they didn't look specifically at workers near retirement who might react differently if, for example, health issues get in the way of a return to work.

So, to look at near retirees' response, I adjusted their methodology slightly, splitting the sample into workers ages 25-54 and those ages 55-64. My findings were interesting, but hardly earth-shattering. A $1,000 increase in the EITC has a significant effect on single women approaching retirement, increasing their employment by 1.5 percentage points. This amount is roughly one-third the size of single women ages 25-54. Single men and married individuals near retirement were not significantly impacted. It turns out that the research energy focusing on younger individuals is appropriate –

the EITC impacts them more, perhaps with a positive side effect of encouraging some near retirees to work longer.

But, the Bastian and Jones paper showed me something beyond a methodology. It also showed how a tax cut – which an expansion of the EITC is – can pay for itself. How is such a feat possible in the face of so many failures? First, the EITC reduces dependence on needs-based government programs, since new workers are now earning income. Second, these new workers generate some payroll tax revenue. In the end, the authors found that 83 percent of the cost of EITC expansion ends up being paid for by these effects. The authors also point out that other research has shown that the EITC improves maternal health, decreases female incarceration, and improves kids' long-term outcomes. If these effects are considered, the program may completely pay for itself.

Sadly, I haven't heard the EITC discussed too much by the current administration. But, unlike re-upping the TCJA – which is currently under consideration by Congress – an expansion of the EITC may achieve a long-held but long elusive goal: a tax cut that pays for itself. And it does it while achieving a side effect near and dear to my retirement researcher heart – encouraging some individuals nearing retirement to work longer.