



• Bill Drayton  
• Get America Working!

## Switching Taxes to Get America Working

**T**he country is needlessly stuck.

If we stimulate, we risk going over the debt cliff. If we merely stop adding debt, we risk leaving the economy in the ditch and official (i.e., hugely understated) unemployment stuck at destructively high levels.

America's opportunity is to see its situation through a far more realistic framework, to escape a framework as rigid and destructive as the gold standard that did so much to bring on the Great Depression.

If one lowered the price of labor and increased the price of its only substitute, things, we would employ more people and conserve our natural resources. Economics 101.

How could we do that. The simplest way would be (1) to eliminate payroll taxes, which would reduce the cost of hiring by roughly 17 percent, and (2) to keep the government budgets whole by adding equal new revenues by taxing things (materials, energy, land, pollution) roughly 12 to 13 percent.

**The most fundamental economic choice every business, indeed every country, makes is what mix of the two key ingredients in production—people vs. things (energy, materials, land)—it will put to work.**

The result would be a 30 percent change in the relative price of using people vs. things. That is a price signal no one would ignore. Companies would substitute people for energy. Farmers would make more compost and use less chemical fertilizers. Human capital sectors would grow faster and natural resource intensive areas would shrink as a percentage of the economy.

This idea is, in fact, the most powerful way to break out of the old framework. A country can grow and reduce debt if it finds ways to become structurally far more productive. That's a jujitsu move far beyond the ken of business cycle economics.

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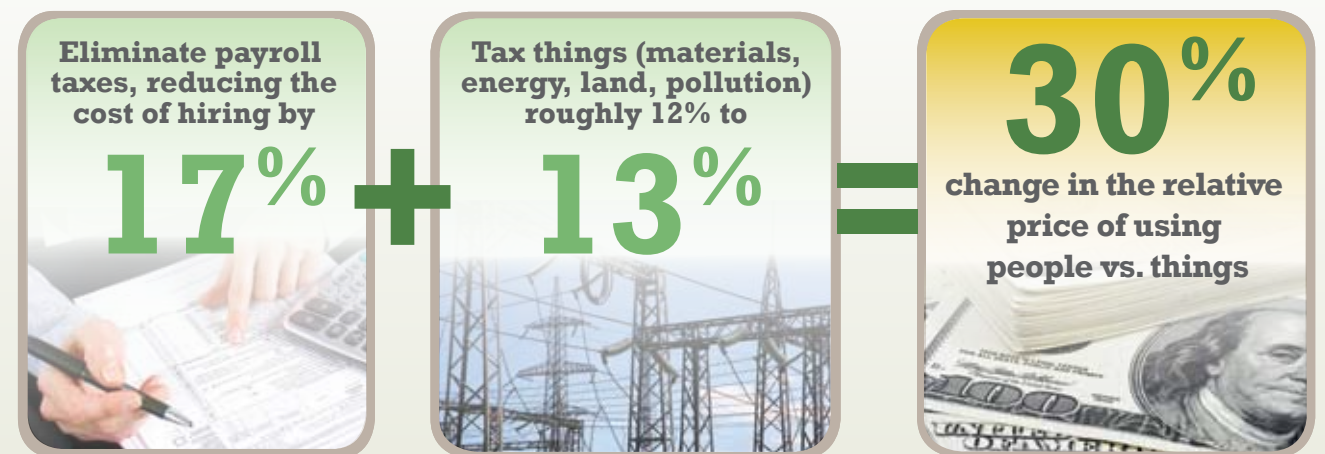
For decades, governments have put their hands on the scale by taxing employment more and more. Payroll taxes in the US have grown from 1 percent of federal revenues when they were first introduced in 1937 to 40 percent today. (Progressives accepted payroll taxes for valued programs, and powerful interests fought other taxes tooth and nail.) The result has been ever growing,

if largely invisible unemployment, and discouraged conservation. Actual unemployment in the US runs eight to ten times the official rate, which does not measure tens of millions<sup>1</sup> who have accepted the unavoidable but who suffer greatly from dependency, less freedom of choice, more illness and less satisfaction. Sixty-eight percent of retirees, for example, think it was a mistake to stop working. But they aren't counted.

The jujitsu is to change the relative price of people versus their only substitute—things. That means reversing the unintended price signal of the last decades by removing payroll taxes and adding compensating taxes on things. The decision-makers have myriad possibilities ranging from familiar options such as a gasoline tax (effective but sensitive) to pollution charges. Get America Working! has identified 22 options that together would at modest rates easily raise more than twice the payroll tax revenue. Consider just two examples:

- Every advanced economy except the US uses a Value Added Tax (VAT) as a major source of revenue. It is collected on the consumption of materials, energy and labor in stages as goods and services are produced and marketed. A non-labor VAT would produce hundreds of billions of dollars annually and send the clearest of messages.

### Lowering the Price of Labor, Increasing the Price of "Things":



**This is a price signal no one would ignore. This idea is the most powerful way to break out of the old framework. A country can grow AND reduce debt if it finds ways to become structurally far more productive.**





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This is not a radical idea. Across Europe and, increasingly, now Asia and Latin America, countries are cutting payroll taxes. The International Monetary Fund advises countries to cut payroll taxes to increase employment. Since 2000, more than a dozen European nations have reduced their payroll tax rates. The World Bank recently recommended

that Central European nations boost employment by cutting payroll taxes.

In 2007, just before the economic downturn, Get America Working! studied 22 OECD economies and found that countries with payroll taxes below 30 percent have, on average, 11.5 percent more of their population working than countries with payroll taxes over 40 percent.<sup>2</sup> Reducing payroll tax rates by just ten percent could boost employment by ten percent in the long term according to a leading labor economist.<sup>3</sup> Offsetting taxes on things—ranging from energy to materials (e.g., timber and iron)—would roughly double that impact.

For a major new idea to fly, it must pass three tests. (1) It brings major advantages; (2) The tools needed to make it work are both effective and do not offend key actors; and (3) It is a big political win.

This simple idea is very probably the greatest opportunity our economy and society has to break out on the upside. It would mean:

- Roughly 30 to 40 million fulltime equivalent, permanent new jobs over a capital cycle (usually five to 25 years, but likely to be very much faster if the change in relative prices is as substantial as 30 percent).
- A sustainable higher growth rate as we put America's largest unused resource, people and human capital, to work.
- Sharply reduced costs for individuals, families, business and government of paying for people not working.
- Huge reductions in many social costs. (Illness goes up sharply when a person is not contributing. Students who know there is no job ahead are demotivated. Drugs/crime/fear. And much more.)
- No debt incurred.
- The choice to cut taxes and/or invest in solving un-addressed common ills. Growing the economy and tax base at the same time that many public costs fall sharply makes this possible.

**This is an idea that can bring America back together because it is about growing, not dividing the pie.**



The idea works through the simplest, most effective, and most universally accepted tool—a price signal. There is/are no. (1) bureaucracies, (2) choosing of winners and losers, (3) delay, and/or (4) corruption. That is one of the reasons this idea has won support across the otherwise polarized ideological spectrum—from Charles Krauthammer to Paul Krugman and from Robert Reich to Richard Lugar.

The third prerequisite for an idea to fly is politics. Here is the alliance of forces each of which wins big once this idea goes into effect. (1) older people (two-thirds of men over 65 had a job in 1950; now 11 percent do); (2) those with disabilities; (3) many women; (4) young people. (5) those who have ever been institutionalized. (6) minorities; (7) many immigrants; (8) anyone who cares about any of the above; (9) anyone who cares for the environment; (10) workers (it is hard to push up wages with a 40 percent supply overhang in the labor market); and (11) almost all businesses (faster growth, less dependency and social ill costs, a good shot at lower taxes, etc.)

The chief political cost is fear that cutting payroll taxes will weaken Social Security. However, this tax shift (1) replaces a shrinking base (as the ratio of workers to

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beneficiaries worsens) with one that is growing (the value of natural resources increases with demand and scarcity), and (2) provides a growing overall economy able to afford a strong safety net. These realities explain why both big parties have advocated payroll tax cuts over the last five years.

As John Gardner (who was an early supporter) said, this is an idea that can bring America back together because it is about growing, not dividing the pie.

So what is the blockage. This is a new framework. People cannot act on it until they see it. That is where you can help.

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*William Drayton is board chair of Get America Working!, a nonpartisan, fuller employment policy citizen group that framed the payroll tax shifting proposal. Named by US News & World Report as one of America's 25 Best Leaders in 2005, he is a MacArthur Fellow who pioneered social entrepreneurship and founded Ashoka: Innovators for the Public, a citizen movement of social entrepreneurs worldwide. He's currently its CEO. He was previously a management consultant at McKinsey and Company, and faculty member at Stanford and Harvard, and assistant administrator of the Environmental Protection Agency (1977–1981) where he launched emissions trading among other reforms.*

