What would it take to replace the pay working-class Americans have lost?

By Neil Irwin
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Poor and working-class Americans have fallen behind over the last generation, receiving few of the gains of an expanding economy. But we could change that by using one of the most powerful tools in the federal government's policy arsenal.

President-elect Donald J. Trump says he will do this by using large tax cuts on business and to wealthy families to encourage more business investment, while aiming to create more high-paying jobs in construction and manufacturing by spending more on new infrastructure projects and renegotiating trade deals.

But another, more direct approach is possible, one aimed at turbocharging the wages of people who have lost out on the economic gains of the last few decades. That could be done by expanding a tax credit that is already in place and enjoys bipartisan support. With the help of some smart policy wonks in Washington, I examined using tax policy this way. We found that it could work, but at no small cost.

On the positive side: You could replace every dime of income that the bottom 20 percent of earners have lost compared with the average family since 1979 by radically expanding a tax credit. But the main problem is this: It would be really expensive, at more than $1 trillion over the next decade, and therefore a hard sell in any political environment.

The lessons from this project have more relevance for the Trump administration — which isn't likely to embrace this kind of technocratic wonkery — than it might seem at first glance.

Consider that Mr. Trump is betting on lower taxes on businesses and the investor class unleashing faster economic growth and preventing the budget deficit from skyrocketing. But he may want to consider hedging his bets. Policies that funnel direct benefits to lower-income workers might complement his trickle-down approach.

Put another way, as long as you're cutting taxes by $6 trillion (that is the high-end direct cost estimate of Mr. Trump's plan from the Tax Foundation), carving out $1 trillion for workers who haven't seen large raises in years may just pay some dividends.

The background is that economic growth has far outpaced income growth for decades. Gross domestic product for each person in the United States was 78 percent higher in 2015 than in 1979. But the average income for those households at the 20th percentile of the income distribution rose only 6.9 percent in that span.

The reasons for this gap are endlessly debatable. Here are a few: The modern economy offers higher rewards for those with advanced education; globalization has diminished the prospects of the industries where working-class Americans once found lucrative jobs; a decline in the power of labor unions has left workers with less negotiating leverage.

Whatever the true cause, it is clear that the tax code could fix at least some of the imbalance. And there is already a program on the books that supplements the take-home earnings of working-class Americans. It is the earned-income tax credit, often simply called the E.I.T.C., and it could be used much more aggressively.

The earned-income tax credit already supplements the wages of people at the lower end of the pay scale, especially those with children. In its current form, for example, a married couple with two children that makes $30,000 a year receives a tax credit of $4,201.

The earned-income tax credit is accepted across the political spectrum: Both President Obama and the House speaker, Paul D. Ryan, favor expanding it. It rewards only those who work, is efficiently administered through the tax code and phases out automatically as a person's income rises.

How much more money in tax credits would be required to replace the income shortfall left by poorer people in recent decades?

Experts at two Washington think tanks — Bob Greenstein, Chuck Marr and Chye-Ching Huang of the nonprofit Center on Budget and Policy Priorities, along with the staff of the Tax Policy Center — examined that question at my request. The first step was to design a tax credit expansion that would raise the income of the bottom 20 percent of families to where they would be if they shared equally in the gains since 1979. That meant figuring out a tax change that would put an extra $2,889 in the pockets of a family of three that in 2013 made $20,420.

An increase in benefits also helps families with somewhat higher incomes. For example, a family of four making $40,000 would receive about $6,000 a year in this expanded E.I.T.C., compared with the $2,142 they get now. The benefits wouldn't completely phase out for a family of four until they hit nearly $70,000 of income.

So what would it all cost? The Tax Policy Center crunched the numbers: The policy would deplete federal coffers by $1.02 trillion over a decade.

That is serious money.

There are many ways of raising it, none of them easy.

If you wanted to soak the wealthy to pay for it, for example, you could enact a 5.6 percentage point surtax on families with income over $1 million, as Senate Democrats once proposed — yet that would cover only about 45 percent of the cost. If you favor a more business-friendly approach, you could give companies tax incentives to repatriate money they are stashing abroad. But that would get you only about 30 percent of the way there.

So even if you conclude that a radical expansion of tax credits for working-class Americans is desirable, the politics of paying for it are somewhere between very hard and impossible. But that is where the Trump presidency comes in.

Mr. Trump's campaign tax plan already implies a far greater reduction in federal revenue than this idea does. He may be betting that lower taxes on businesses and the wealthy will spur investment that increases the productive potential of the economy — a classic Reagan-era "supply side" approach to taxes.

But skeptics may argue that what ails the economy right now is inadequate demand for goods and services, and that working-class people don't have enough money. If they had extra cash in their pockets from an expanded E.I.T.C., they would be more likely than millionaires to spend the money, many economic studies suggest. That means that including help for the working class in any tax overhaul would add a "demand side" source of economic growth.

That won't solve the problems of working-class Americans. The dissatisfaction with the modern global economy that helped propel Mr. Trump to office is deep rooted. It involves a feeling of lost possibility that a bit of money alone won't solve. That is especially true for people who once saw manufacturing jobs as both a pathway to a middle-class income and a sense of purpose in life.

But while technocratic solutions involving tweaking the tax code won't relieve the angst of Trump voters, if there are going to be big tax cuts in the months ahead, there is an economic rationale for spreading the benefits beyond the top.