CENTER ON BUDGET AND POLICY PRIORITIES
820 First Street, NE, Suite 510, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-1056 center@cbpp.org www.cbpp.org

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Accelerating Rate Cuts a Poor Stimulus and Reduces Congressional Flexibility

The full report can be viewed at http://www.cbpp.org/1-22-03tax.htm

The Center on Budget and Policy Priorities has released a new report examining the Administration's proposal to accelerate the scheduled reductions in the top four income tax rates so the rates scheduled to take effect in 2006 do so in 2003 instead. As the report, entitled *Accelerating Top Rate Reductions Is Ineffective Stimulus and Reduces Flexibility to Address Future Budget Challenges,* explains, this proposal has several weaknesses, including:

- **Little impact this fiscal year, when it's most needed.** Only 13 percent of the proposal's $74 billion cost, as estimated by the Joint Tax Committee, would occur in fiscal 2003, when the economy is most in need of stimulus. The remainder would occur in fiscal years 2004, 2005, and 2006 — all years when the recovery is expected to be underway.

- **Targeted on high-income families and thus less effective as a stimulus.** As the table at right shows, the proposal would benefit only about the top one-quarter of tax filers, since only they have incomes high enough to place them in the four highest tax brackets. Moreover, in 2003, over half of the proposal's benefits would go to the top *one percent* of tax filers, and over 35 percent would go to those with incomes exceeding $1 million. The latter group would receive an average tax cut in 2003 of $63,400 from this provision, according to the Tax Policy Center. (A major reason is that the tax rate in the uppermost bracket would decline 2.6 percentage points in 2006 — from 37.6 percent to 35 percent — compared to a one-point decline in the other three top brackets in 2006.) The Tax Policy Center's analysis shows that the proposal is even more skewed toward the wealthy than the Administration's proposal to exempt corporate dividends from individual taxes.

Upper-Bracket Marginal Income Tax Rates, 2003

Highest Marginal Rate	Percent of Tax Filers Who Fit in This Bracket
27%	22.8%
30%	2.9%
35%	0.9%
38.6%	0.7%

Source: Tax Policy Center

  Targeting the tax cut on higher-income taxpayers reduces its effectiveness as a stimulus because these families are more likely than lower-income families to save rather than spend a portion of any new funds they receive. Only if these funds are *spent* will they help stimulate the economy. As the Congressional Budget Office has stated, "tax cuts that are targeted toward lower-income households are likely to . . . be more cost effective . . . than those concentrated among higher-income households."

- **Makes future budget problems more difficult to address.** The federal budget outlook is continuing to deteriorate. Deficits threaten to reach unmanageable and economically damaging levels in coming decades as a result of a combination of tax cuts, the coming retirement of the baby-boom generation, pressure for a prescription drug benefit for seniors, continued increases in defense and homeland security spending, and a possible war and subsequent nation-building in Iraq. This suggests deferring action on the scheduled rate reductions now rather than accelerating them. Accelerating the reduction in income tax rates is likely to lock them in and remove them from future debates on how to address the nation's increasingly serious fiscal problems, since any effort to restore rates to their current levels — or even to the levels to which they are scheduled to drop in 2004 — will then be labeled a tax increase.

Significant sums are involved. For example, accelerating the rates scheduled for 2006 and maintaining them throughout the coming decade would cost over $200 billion more through 2013 than accelerating and maintaining the rates scheduled for 2004.