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REMOVING ONLY THE "DIVIDEND" PROPOSAL WOULD REDUCE ULTIMATE COST OF PRESIDENT'S TAX AGENDA BY ONE-SIXTH OR LESS

by Richard Kogan and Robert Greenstein

The Administration's so-called "growth" package of new tax cuts would cost $726 billion through 2013, with the "dividend" proposal costing $396 billion of that amount, according to new estimates released March 4 by Congress's Joint Committee on Taxation. These figures represent, however, only a portion of the cost of the full agenda of tax cuts the Administration is proposing. The total tax package would cost $1.6 trillion through 2013, according to the Joint Tax Committee.

- The dividend proposal would account for only one-quarter of that cost.
- It would account for only one-sixth of the annual cost of the tax cuts when all of the proposed tax cuts were fully in effect.
- Removing only the dividend tax cut thus would leave a very expensive tax-cutting agenda that would substantially increase deficits and erode fiscal discipline.

Furthermore, the $1.6 trillion price tag for the Administration's tax-cut proposals substantially understates their impact on the budget and on deficits. The $1.6 trillion figure does not include the cost of extending Alternative Minimum Tax relief, which the Administration has proposed through 2005, to the years after that. The Administration has been clear that it intends to propose continued AMT relief in future budgets. Nor does the $1.6 trillion figure include the costs of the increased interest payments on the national debt that the tax cuts would generate. When these costs are taken into account, the total impact on the budget of the Administration's tax cutting agenda — that is, the total amount by which it would swell the deficit — would be approximately $2.7 trillion through 2013. Without the dividend tax cuts, the cost still would be $2.2 trillion.

Some Senators, concerned about the reappearance of substantial deficits, are seeking to reduce the overall size of the tax cut and are focusing their efforts on the "dividend" proposal. The size of the President's tax-cut plans is so large, however, that removing the dividend proposal would, by itself, provide only a minor victory in the battle for fiscal discipline. Such a victory may

The Dividend Proposal and the President's Overall Tax Proposals
Joint Tax Committee Estimates
(billions of dollars)

	Cost 2003-2013	Cost in 2013
"Dividend" Proposal	396	59
All Proposed Tax Cuts	1,575	339
Share Attributable to Dividend Proposal	25%	17%

appear large because the size of the *"growth" package* would be cut in half. But when the

Administration's overall tax agenda is examined, it becomes clear that the effect of removing the dividend proposal alone is much more modest.

- The cost of the Administration's tax-cut proposals through 2013 is $1.6 trillion, before taking account of the added interest costs or the costs of extending beyond 2005 the AMT relief that the budget proposes through that year. As noted, removing the dividend proposal would reduce this cost from $1.6 trillion to $1.2 trillion, a reduction of 25 percent.

- For several reasons, this 25 percent figure overstates the degree to which removing the dividend proposal would scale back the plan. Various elements of the tax-cut proposals would take effect in different years. As a result, a superior way to assess the impact of removing the dividend proposals is to consider the effect that such action would have on the cost of the proposed tax cuts when the tax cuts were *fully in effect.* The Joint Tax Committee estimates show that the Administration's tax-cut proposals would cost $339 billion in 2013 (not counting the increased interest payments or the cost of extending AMT relief). The Joint Committee estimates also show that the dividend proposal accounts for $59 billion — or one-sixth — of that amount. Removing the dividend proposal thus would reduce the ultimate cost of the tax proposals by only one-sixth.

- The degree to which the dividend proposal would contain costs and represent a gain for fiscal discipline becomes even smaller when a more comprehensive tally of the costs of the Administration's tax-reduction agenda is made. The Administration's tax-cut proposals, like all proposals to reduce revenues or increase expenditures, have a second cost; because these proposals would cause larger deficits than the government otherwise would run, they increase the size of the national debt and raise the cost of the interest payments that must be paid on the debt. To ascertain the full effect of the tax cuts on the budget, the increase in interest costs must be taken into account. In addition, the Administration's budget leaves out an inevitable cost — the cost of providing relief from the burgeoning individual Alternative Minimum Tax in years after 2005. The Administration's budget includes AMT relief through 2005, and senior Treasury officials have said that in 2005, the Administration will submit a proposal for ongoing relief. But the cost of the ongoing relief is not included in the current budget. The enactment of ongoing relief is, of course, inevitable; without AMT relief, the number of taxpayers subject to AMT will soar from about two million today to 43.5 million by 2013.

  When the cost of extending (through the rest of the decade) the AMT relief that the Administration has proposed through 2005 is added, along with the costs of the increased interest payments on the debt, the overall price tag of the Administration's tax cuts rises to $2.2 trillion. Removal of the dividend proposal would reduce this cost from $2.7 trillion to $2.2 trillion, leaving it at a very high level. The cost in 2013

Accelerating the Reductions In Income Tax Rates

From the standpoint of fiscal discipline, among the most dubious provisions in the Administration's "growth" package — along with the dividend proposal — is the proposal to accelerate both the reductions in income tax rates scheduled for 2004 and those scheduled for 2006. Accelerating the reductions scheduled for January 1, 2004 by six months or so would not itself affect long-term fiscal discipline much and might add a little stimulus this year, although there are much more effective and efficient ways to stimulate the economy. But accelerating the 2006 rate cuts is another matter.

Over the past two years, the long-term fiscal picture has changed astonishingly. In President Bush's first budget submitted in early 2001, his budget office (the Office of Management and Budget) forecast that even with his tax cuts and other proposals, the budget would remain in surplus through 2035. In the President's second budget, issued a year ago, OMB forecast that surpluses would return in 2005 and last through 2025. In his new budget, OMB forecasts that under Administration policies, the budget will be in deficit every year for the next 50 years, ultimately setting records for periods other than wars and swelling deficits to dangerous levels.

Moreover, the fiscal picture has continued to worsen in the weeks since the budget was released. CBO figures released on March 7 show a deficit of $1.8 trillion over ten years under the President's policies. And this does not reflect the costs of a war in Iraq and a possible long subsequent occupation. (Nearly 60 years after the end of World War II and 50 years after the end of the Korean War, we still have troops in Europe, Japan, and Korea.)

These dramatic changes suggest that policymakers should exercise considerable caution in fashioning the new budget. Two years ago, a group of bipartisan Senators, as well as Federal Reserve chair Alan Greenspan, suggested that a "trigger" be attached to the 2001 tax cuts. The trigger would be designed to assure that each new phase of the tax cut could be afforded before it was implemented. The deterioration of the fiscal outlook since 2001 exceeds the worst fears that proponents of a trigger had two years ago. In retrospect, it is unfortunate those calling for a trigger were not heeded.

This raises particular concerns about accelerating various tax cuts scheduled to take effect in future years, and in particular, the income tax rate reductions scheduled for 2006. It would be far more prudent for policymakers to wait to see whether the fiscal outlook deteriorates further and whether such tax cuts are affordable, rather than to rush them forward and lock them in now.

If, for example, the 2004 rate cuts but not the 2006 rate cuts were accelerated, some $60 billion would be saved, relative to the cost of the Administration's "growth" package. And the ultimate savings might be much greater. If Congress subsequently determined that the 2006 rate cuts were unaffordable — and the tax rates scheduled to take effect in 2004 remained in effect throughout the decade, rather than rates scheduled to take effect in 2006 — the savings through 2013 would exceed $200 billion.

It also may be noted that the rate reductions scheduled for 2006 have a peculiar quirk — they would reduce rates for very affluent individuals in the top tax bracket much more than for everyone else. Under the scheduled *2004* rate reductions, each of the top four rates will be reduced by one percentage point. By contrast, under the rate cuts scheduled for *2006*, the top rate will come down by a whopping 2.6 percentage points while the three rates below it again come down one point. As a result, the 2006 rate cuts are far more heavily tilted toward very wealthy individuals than any of the Administration's other income tax proposals, including the proposed dividend tax cut.

would fall from $613 to $531 billion, a reduction of 13 percent.[1] (A detailed Center analysis of the $2.7 trillion overall cost of the Administration's full tax-reduction agenda can be found at http://www.cbpp.org/1-22-03bud.pdf.)

In short, the cost of the tax cuts will remain very large if the dividend proposal is removed but the rest of the package remains intact. (This conclusion, and the figures provided in this analysis, are not affected by whether another controversial set of tax cuts in the President's budget — the proposals to expand tax-free savings accounts — is removed. The savings-account proposals have only a tiny cost through 2013, according to the Joint Tax Committee. The costs of those proposals eventually become very large, in years and decades after that.)

Finally, approval of a Congressional budget resolution that appears to remove the dividend tax cut while accommodating the rest of the Administration's tax-cut proposals could result in even smaller savings than those cited here. The history of the 2001 tax cut suggests that reducing the size of tax cuts allowed over ten years under a Congressional budget resolution does not necessarily improve *long-term* fiscal discipline much. In 2001, the President proposed tax cuts costing $1.64 trillion over ten years. When Congress debated the budget resolution that year, Senate centrists used their leverage to reduce the planned size of the tax-cut package to 76 percent of the requested size — i.e., to $1.25 trillion over the same ten-year period (plus $100 billion up front to provide immediate economic stimulus because of the slowing economy). One might consequently have assumed that the ultimate size of the tax cuts, when fully in effect, would be 76 percent as large as the President had sought. Such, however, was not the case. When the actual tax-cut legislation was designed and enacted, a series of gimmicks were employed so that the ultimate cost of the tax cut, *when fully in effect*, would approach the size the Administration had requested. These gimmicks included slow phase-ins and artificial sunsets. In the absence of the inclusion in a new budget resolution of provisions barring such gimmicks, it is unclear how much improvement in fiscal discipline will be achieved by simply reducing the multiyear target for tax cuts in the forthcoming budget resolution by approximately the cost of the dividend proposal.

[1] The dividend proposal constitutes 17 percent of the President's tax cuts in 2013 *excluding* the costs of AMT relief and interest (as shown in Table 1). Including these costs, as we do above, reduces the share attributable to the dividend proposal to only 13 percent. This reduction is explained entirely by including AMT relief. Including interest hardly changes the proportionate shares, just the total costs.