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SENATE REPUBLICANS EMBRACE ADMINISTRATION PROPOSAL THAT IS MORE TROUBLING IN KEY RESPECTS THAN THE HOUSE STIMULUS BILL

by Joel Friedman, Andrew Lee, and Robert Greenstein

Senate Republicans are rallying around the Bush Administration's economic stimulus package, which was presented to the Senate Republican caucus this week by Senator Charles Grassley, ranking member of the Senate Finance Committee. Although this plan is portrayed as being more moderate than the version the House passed last week, it has many of the same defects as the House measure and, in some key respects, is more troubling than the House plan. Indeed, the Administration proposals endorsed by the Senate Republicans are even less fiscally responsible than the House plan and more heavily tilted toward the wealthiest taxpayers.

Importantly, the Administration and Senate Republicans are proposing to accelerate the tax rate reductions scheduled to take place in 2004 and 2006 in *every one* of the upper income tax brackets — the 28 percent, 31 percent, 36 percent, and 39.6 percent brackets. (By contrast, the House bill would accelerate only the rate reductions scheduled in the 28 percent bracket.) According to the Joint Committee on Taxation, this one proposal costs $121.5 billion over ten years. More than three-quarters of its cost would occur *after* 2002 — that is, in years when forecasters expect the economy already to have recovered.

The effectiveness of this provision as a stimulus measure is further diminished because it disproportionately benefits the highest-income taxpayers. Some *55 percent of its benefits would go to the wealthiest one percent of taxpayers*. This upper-income group is much more likely to save (and not spend) an additional dollar in income than low- and moderate-income families. Tax cuts can only generate the needed stimulus if they are spent.

- The Joint Committee on Taxation estimates that the cost of accelerating all of the upper-bracket rate reduction would be $121.5 billion, with these costs occurring in 2002 through 2006. Of this amount, only $26.8 billion — a little more than one-fifth of it — would occur in 2002. Yet the consensus "blue chip" economic forecast issued October 10, 2001, projects that the recession will end in early 2002, with real economic growth reaching a robust 4.0 percent by the fourth quarter of 2002. Thus, the vast majority of these tax benefits would be provided after the economy has recovered. The chairmen and ranking members of the House and Senate Budget Committee cautioned in early October that measures should be considered for inclusion in a stimulus package only if a substantial portion of their impact would be felt within the next six months. Accelerating the rate reductions fails this basic test of efficacy as a stimulus measure.

The Administration/Senate Republican Plan and Its Costs

Senate Republicans have embraced four tax provisions proposed by the Administration: acceleration to 2002 of all of the upper-bracket rate reductions scheduled for 2004 and 2006, permanent repeal of the corporate Alternative Minimum Tax, a provision allowing businesses to immediately write off 30 percent of the cost of certain purchases they make (this provision would be effective for three years, through 2004), and a rebate for low-income workers. In addition, Senate Republicans appear to support a small package of assistance for unemployed workers that the Administration has proposed. (This package would not help the majority of the unemployed. For a discussion of this aspect of the Administration's plan, see Robert Greenstein, "The Administration's Stimulus Proposal: Is It A Sound and Balanced Package?" Center on Budget and Policy Priorities, revised October 9, 2001.)

An October 29 article in BNA's *Daily Tax Report*, citing a Republican document, showed the cost of the four tax provisions to be $89 billion in fiscal year 2002 and $175 billion over ten years. These figures are consistent with previous Joint Tax Committee cost estimates for these four proposals. Both the ten-year cost and the proportion of the cost that would be incurred *after* 2002 — when most forecasters expect the recession to be over and the economy to be growing at a reasonable rate — exceed the comparable figures for the House bill.

Administration/Senate Republican Stimulus Proposals
(in billions of dollars)

	2002	Ten years
Accelerate all upper-bracket rates	27	121
30 percent bonus depreciation	39	18
Repeal of corporate AMT	9	22
Rebate for low-income taxpayers	14	14
Total	89	175

Source: BNA's Daily Tax Report, October 29, 2001

- Accelerating *all* of the upper-bracket rate reductions is more costly and more skewed to high-income taxpayers than the most egregious provisions in the House bill. As noted, the House bill would accelerate just the scheduled reductions in the 28 percent tax rate, a provision that itself would benefit only the top one-quarter of tax filers. The House bill also would reduce the capital gains tax rate and send refund checks to corporations that have accumulated tax credits as a result of having paid the corporate Alternative Minimum Tax in past years. While the Administration does not include these two provisions in its plan, it substitutes for them the acceleration of the rate reductions in the 31 percent, 36 percent, and 39.6 percent brackets.

  Dropping the capital gains rate reduction saves $10 billion over ten years. Because the Administration would still repeal the corporate AMT, the savings from not making the AMT tax credits refundable amount to less than $3 billion over ten years. But the cost of accelerating all of the upper-bracket tax rate reductions is $68 billion more over ten years than the cost of speeding up only the reduction in the 28 percent rate. Furthermore, all of this $68 billion would be showered on the top five percent of tax filers.

- For a married couple with two children and an income of $66,550 or less, accelerating the upper-bracket rates would yield *no tax cut whatsoever*. For families with the highest incomes, on the other hand, the benefits would be enormous. Indeed, the higher a family's income, the greater the tax-cut windfall it would receive. As a result of the Administration's proposal to accelerate all of the rate reductions, a married family with two children that has income of $500,000 would receive a tax cut of about $9,500 in 2002, plus another $21,500 over the next three years, for a total break of about $31,000. If the family had annual income of $1 million — the average income for the top one percent of taxpayers — the family would receive about $25,000 from this provision in 2002 and $85,000 over four years. At a $5 million annual income, the family would likely receive more than $500,000 in tax cuts over the four years from this provision.

- Citizens for Tax Justice has found that 55 percent of the tax benefits from accelerating all of the upper-bracket rates would accrue to the top one percent of tax filers. More than four-fifths of the benefits would go to the top 10 percent of tax filers. But three-quarters of all tax filers — those who are in the 15 percent bracket or lower — would receive nothing from this proposal. Overall, accelerating all the top rates causes the Administration/Senate Republican package to be more even more skewed to the highest-income taxpayers than the bill passed by the House (see box on page 4).

Upper-Bracket Marginal Income Tax Rates, 2000

Highest Marginal Rate	Percent of Tax Filers Who Fit in This Bracket
28%	18.9%
31%	2.6%
36%	0.9%
39.6%	0.9%

Source: Congressional Budget Office

- Directing tax benefits to upper-income families is an ineffective way of generating stimulus. In recent testimony before the Senate Budget Committee, Brookings Institution senior fellows William Gale and Peter Orszag both emphasized that higher-income taxpayers have a lower propensity to consume than lower-income taxpayers.[1] Because accelerating the rate reductions benefits this upper-income

[1] William Gale, "Perspectives on the Stimulus Debate," Brookings Institution, testimony before the Senate Budget Committee, October 25, 2001. Peter Orszag, "Evaluating Economic Stimulus Proposals," Brookings Institution, testimony before the Senate Budget Committee, October 25, 2001

Administration's Plan More Skewed to Highest-Income Taxpayers Than House Bill

By proposing to accelerate all of the upper-bracket rate reductions, the Administration and Senate Republicans would direct even more benefits to the highest-income taxpayers than the corporate and individual tax cuts in the House-passed bill. Analyses by the Citizens for Tax Justice find that, under both the House measure and the Administration/Senate Republican plan, the top five percent of taxpayers — those with incomes over $153,000 — would receive more than half of the tax cuts these proposals would provide in 2002 (including the rebates to lower-income taxpayers that would be sent out at the end of 2001). Moreover, the top one percent of taxpayers — those with incomes over $384,000 — would do even better under the Administration/Senate Republican plan than the House measure, receiving 44 percent of the tax-cut benefits as compared to 35 percent under the House bill. (These estimates attribute the corporate tax cuts to individuals, based on their ownership of capital assets, such as stocks and bonds. This is comparable to the approach for examining the effects of corporate tax changes by income group used by the Treasury Department and the Congressional Budget Office.)

It should be noted that the figures cited here understate the extent to which the tax cuts would go to those at the top of the income scale, because these figures reflect only the tax cuts that would be provided in late 2001 and in 2002. After that period, the rebate for low-income taxpayers would end, while all of the other major tax provisions would remain in effect for at least another year or two and, in some cases, would remain in effect permanently. To address this shortcoming in the estimates cited above, the CTJ analysis also looks at the tax cuts in these packages *other than* the rebate. This provides a more accurate reflection of the distribution of the measure's effects in 2003, for example, when all of the major provisions except the rebate would be in effect. Excluding the rebate, the wealthiest one percent of taxpayers would garner 51 percent of the tax reductions proposed by the Administration and Senate Republicans and 41 percent of the tax cuts in the House bill.

These figures indicate that the tax cuts in both proposals are as skewed to those at the top of the income spectrum as the tax cuts in the large tax bill enacted this spring.

group, the proposal would have a "low bang for the buck." Or as economist Joseph Stiglitz, co-winner of the 2001 Nobel Prize in Economics, recently stated, because accelerating the rate reductions would solely benefit upper-income individuals, it "is not going to have a significant effect on consumption. It will only help some people's bank accounts."[2]

The Administration/Senate Republican proposal to accelerate all of the upper-bracket rate reductions also raises issues of fiscal responsibility, as it seriously weakens the ability of policymakers to ensure fiscal discipline over the long run. Recent estimates prepared by the Budget Committee chairs and ranking members show that, under even conservative assumptions about future fiscal policies, the budget surplus over the next ten years has largely disappeared. In light of this situation, policymakers will face tough fiscal decisions when the recession ends and

[2] Joseph Stiglitz, "Statement at Center on Budget and Policy Priorities Press Conference," October 12, 2001.

The Disappearing Budget Surplus

Recent estimates issued by the chairs and ranking members of the House and Senate Budget committees show that even without a stimulus package, virtually the entire non-Social Security surplus over the next ten years has disappeared. Their estimates show that only $53 billion of the non-Social Security surplus remains over the next 10 years.

Furthermore, as the Budget Committee chairs and ranking members have noted, this $53 billion surplus estimate itself is unrealistically optimistic, as it does not include the costs of a number of items that are likely to be enacted, including extension of an array of expiring tax credits that are always extended when they are scheduled to expire, the farm bill, prescription drug legislation, the costs of responding to future natural disasters, and legislation to remedy serious problems in the individual Alternative Minimum Tax that, if not addressed, will cause the number of filers subject to the AMT to skyrocket from 1.4 million this year to 35 million by 2010. The $53 billion non-Social Security surplus estimate also does not include the cost of extending the provisions of the large tax cut enacted this spring; all of the provisions of that tax cut expire between 2004 and 2010. Nor does it include the cost of any of the additional tax-cut bills that the House of Representatives has passed since June (such as those related to energy and charitable contributions) and that await action in the Senate. Under a realistic accounting, most of the *total* — or unified — budget surplus is gone.

a need to exert fiscal discipline returns. At that time, policymakers may wish to consider, along with other options, the deferral or cancellation of income-tax rate reductions that have not yet taken effect and that primarily benefit the most affluent individuals. Acting now to accelerate rate reductions scheduled for 2004 and 2006 would deny policymakers the option of deferring or cancelling these rate cuts before they take effect. Indeed, that seems to be the provision's principal purpose, as it cannot plausibly be seen as an efficient or effective stimulus mechanism.

The Committee for Economic Development, an organization of leading corporate executives and university presidents, issued a report in early October warning that the nation faces long-term fiscal difficulties and pointing to the gradual phase-in of provisions of the tax cut enacted this spring as providing a possible budgetary safety valve, since tax cuts could be deferred or removed before taking effect. Accelerating the rate reductions would substantially weaken this safety valve.

Aggravating these concerns, the Administration/Senate Republican proposal includes a House-passed provision that would allow businesses, in each of the next three years, to deduct 30 percent of the cost of certain investments in the year they are made. Keeping such a provision in effect for three years violates the principles laid out by the House and Senate Budget Committee chairs and ranking members, who called for all provisions to sunset after one year to the extent practicable. In his recent testimony, Bill Gale of Brookings noted that a three-year period is not only unnecessary for this provision but weakens its effectiveness as a stimulus measure. A three-year window gives firms little reason to invest *now*, when the economy is in need of stimulus, and more reason to hold off for a year or two to assess the economic situation.

Of particular concern, keeping this provision in effect long after the economic slowdown has ended is likely to result in the original rationale for sunsetting the proposal to have faded by the time the provision is scheduled to expire. By then, this tax break may have come to be viewed as a standard feature of the tax code, making it more likely that Congress will continue it, just as numerous other expiring corporate tax provisions are routinely extended each year. If this provision becomes part of the regular package of "tax extenders," its future costs will be very large. Joint Tax Committee estimates indicate that if this provision were to remain in effect for the next ten years rather than expiring after three years, its cost would be $265 billion over the coming decade — or nearly 15 times the $18 billion that is being shown as the cost of this provision as it is included in the House bill, with a three-year sunset.

Although Senate Republicans have attempted to distance themselves from the House-passed stimulus measure, they have done little to improve upon that package by embracing the proposals advocated by the Administration. In particular, the proposal to accelerate all of the upper-bracket rate reductions moves in the wrong direction, as it is one of the least effective and yet most costly of any provisions under consideration. With more than three-quarters of its $121.5 billion ten-year cost occurring after 2002 and the vast majority of the benefits flowing to high-income taxpayers who are less likely to spend these benefits, this proposal offers little of the immediate stimulus needed to boost the economy.