CENTER ON BUDGET AND POLICY PRIORITIES

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NEW DETAILS EMERGING ON EFFECTS OF RECENT TAX CUTS

The full report can be viewed at http://www.cbpp.org/8-25-04tax.htm

A new Center report, *Studies Shed New Light on Effects of Administration's Tax Cuts*, highlights data and analyses released in the past few weeks that provide a more complete picture of how the tax cuts enacted in 2001, 2002, and 2003 are affecting the economy, the budget, and different income groups. These data and analyses include:

- **Data from a new Congressional Budget Office report indicate that the tax cuts will exacerbate income inequality.**

  An August 13 CBO study shows that the tax cuts will raise after-tax incomes by a much greater percentage for the top one percent of households than for any other income group. As a result, the tax cuts will *increase* the share of the nation's after-tax income that goes to the top one percent and *decrease* the share received by the bottom 80 percent. Most economists believe changes in after-tax income are the best measure of how tax cuts affect different income groups, since after-tax income is the income a household can spend or save.

  Who Benefits the Most from the Tax Cuts?

	Average Income	Change in After-Tax Income
Lowest 20 percent	$16,600	1.5%
Second 20 percent	$38,100	2.2%
Middle 20 percent	$57,400	2.0%
Fourth 20 percent	$84,300	2.3%
81-90 percent	$116,600	2.5%
91-95 percent	$155,000	2.7%
96-99 percent	$243,100	2.8%
Top one percent	$1,171,000	5.3%

  Source: CBPP calculations based on CBO data for 2004. (These data exclude corporate and estate tax cuts. The CBO report also provides data that include the corporate tax cuts; these data show the tax cuts to be skewed even more toward those at the top.)

  Moreover, the CBO data cited in the table understate the degree to which the tax cuts are tilted toward high-earners because they do not include the effects of two tax cuts that mostly benefit very high-income households: the "bonus depreciation" business tax cut and the phase-out of the estate tax.

  Even before the tax cuts, incomes were growing fastest at the top of the income scale. An April 2004 CBO study showed that between 1979 and 2001 (the last year CBO examined), the average after-tax income of the top one percent of households rose by 139 percent ($409,000) after adjusting for inflation, compared to a 17-percent ($6,300) increase for the middle fifth of households and an 8-percent ($1,100) increase for the bottom fifth.

- **A new study by Mark Zandi, chief economist at the independent research firm Economy.com, finds the tax cuts were poorly designed as economic stimulus.**

  Zandi found that each $1 of tax cuts has produced only 74 cents of added economic demand the next year because the tax cuts were skewed toward high-income households, who are much less likely than other households to spend their tax cuts quickly.

An alternative stimulus package of temporary tax cuts aimed at low- and middle-income Americans, a temporary boost in unemployment benefits, and additional temporary aid to states would have generated more short-term demand ($1.20 for each $1 of cost) and thus produced much more economic and job growth, Zandi found. Such a package also would have cost much less than the enacted tax cuts, especially over the long term.

- **The Economic Policy Institute reports that 2.7 million fewer jobs have been created since passage of the 2003 tax cut than the Administration had predicted.**

  Through August, the economy has produced 1.6 million jobs since passage of the 2003 tax bill; this is just 38 percent of the 4.3 million jobs the Administration predicted would be generated over this period if its 2003 tax-cut plan were adopted.

  Recent economic data indicate that the job market remains lukewarm, with 144,000 jobs being created in August. This is less than half the average monthly job creation the Administration projected in the wake of the tax cuts. While a number of factors have likely contributed to the weakness in the job market, the tax cuts' flawed design must share part of the blame.

- **New Administration data show that the tax cuts have played a larger role than all other legislation enacted since the start of 2001 in creating the budget deficit.**

  The Office of Management and Budget's Mid-Session Budget Review, released July 30, shows that the tax cuts have accounted for 57 percent of the cost of all legislation enacted since the Administration took office. In other words, tax cuts have contributed more to the worsening fiscal situation than *all other new government policies combined*, including all new costs related to Iraq and the war on terrorism and all domestic spending increases. This finding contradicts recent claims that the tax cuts have contributed little or nothing to the deterioration of the federal budget.

- **A recent report by CBPP and the Urban Institute-Brookings Institution Tax Policy Center finds the tax cuts ultimately are likely to make most households *worse* off.**

  Some people have pointed to the August CBO study, which shows that all income groups receive at least some tax cuts, as proving that the tax cuts will leave everyone better off. That belief is based on the mistaken assumption that the tax cuts never have to be paid for. Eventually, the government must cover its bills by raising taxes or cutting spending. Financial markets will not tolerate persistent deficits of the size that are now forecast.

  The Tax Policy Center/CBPP study found that under the two scenarios it considered for paying for the tax cuts, more than three-quarters of households would end up worse off. That is, they would lose more from the tax increases and/or spending cuts instituted to pay for the tax cuts than they would gain from the tax cuts themselves.

  The reason for this finding is that because the tax cuts' gains are so heavily concentrated among high-income households, a similarly large share of the tax cuts' *costs* would have to be imposed on those same households if middle- and low-income households are not to end up worse off. This will be extremely difficult to accomplish unless key elements of the tax cuts are repealed or allowed to expire.