

Revised November 5, 2001

WAYS AND MEANS PACKAGE DEPARTS FROM BIPARTISAN PRINCIPLES FOR EFFECTIVE STIMULUS AND OFFERS LITTLE HELP TO THE UNEMPLOYED

by Joel Friedman and Robert Greenstein¹

In response to the economic downturn, the House Ways and Means Committee approved legislation on October 12 costing \$103 billion in fiscal year 2002 — and \$162 billion over ten years. The legislation consists overwhelmingly of tax cuts. More than 95 percent of its cost both in 2002 and over the next ten years consists of tax reductions. Moreover, as shown in the table below, between eight and nine of every ten dollars in the package over the next decade consist of tax cuts for corporations and businesses or tax cuts that disproportionately benefit upper-income families.

While the legislation showers tax-cut benefits on corporations and high-income individuals, it provides scant assistance to unemployed workers. Only a small fraction of unemployed workers would receive added unemployment insurance benefits when their regular benefits run out or secure any assistance in maintaining their health insurance. A significant majority of unemployed workers would receive no assistance under the legislation.

Percentage Share of the Costs in 2002 and Over Ten Years of the Provisions in the Ways and Means Package*		
	2002	10 years
Corporate and business tax cuts	68.6%	42.5%
Tax cuts primarily for upper-income taxpayers	14.5%	43.2%
Tax cuts primarily for low- and moderate-income taxpayers	13.3%	8.2%
Spending and tax provisions for unemployed workers	3.2%	4.0%
Extension of expiring tax provisions	<u>0.4%</u>	<u>2.0%</u>
Total	100.0%	100.0%

*Excludes technical amendments and revenue effects of unemployment trust fund changes.

The legislation also is inconsistent with bipartisan principles for a sound and fiscally responsible stimulus package that the chairs and ranking members of the House and Senate Budget Committees issued just two weeks ago. Those principles call for stimulus measures to be

¹ The discussion of unemployment insurance in the analysis is based on work by Wendell Primus of the Center on Budget and Policy Priorities. The discussion of extending health insurance coverage to the unemployed is based on work by Edwin Park and Leighton Ku of the Center.

temporary in nature and to have a quick effect on the economy. Many of the tax cuts in the Ways and Means package are permanent rather than temporary, however, and would do little to stimulate the economy now.

Essentially, the Ways and Means Committee has used the stimulus legislation as a vehicle to attach a number of tax cuts that have little to do with boosting the economy now or assisting unemployed workers but that have long been sought by powerful interest groups and that some in Congress have long favored for ideological reasons. Even Treasury Secretary Paul O'Neill criticized some of the elements of the Ways and Means package as "show business" designed to accommodate constituents.²

Some of these tax provisions provide major benefits to selected corporations. Changes in the corporate Alternative Minimum Tax included in the Ways and Means package would provide \$25 billion in 2002 to corporations subject to the AMT. According to an analysis by Citizens for Tax Justice, more than a dozen major corporations — including IBM, General Motors, and several energy companies — would each receive tax breaks of *over \$100 million* as a result of these changes. Companies would receive the vast majority of these AMT benefits as tax refund checks. The total amount of such checks that would be written to these corporations would exceed the total in "rebate" checks that would be sent to over 40 million low- and moderate-income taxpayers under the bill.

Certain other key provisions in the Ways and Means legislation heavily favor high-income taxpayers, the group that is most likely to have the resources to weather an economic downturn and least likely to spend its additional after-tax income. According to a separate analysis by Citizens for Tax Justice, the tax cuts in the Ways and Means legislation are as skewed to people at the top of the income spectrum as the tax cuts enacted in June (see box on page 9). In addition, several of the tax measures in the Ways and Means package would make the nation's already worrisome medium- and long-term budget outlook more problematic.

In fact, the threat the package poses to long-term fiscal discipline is more serious than an initial glance at the legislation might indicate. The official cost estimate that the Joint Tax Committee has issued for the legislation rests on the assumption that the biggest immediate tax cut in the package — the partial expensing of investments that corporations make — actually will expire at the end of three years, as the legislation calls for, rather than being extended at that time. The tax code is filled with corporate tax provisions that Congress initially established for a few years but that were extended whenever the provisions were slated to expire. Because the partial expensing provision is not limited to one year but continues for three years and will be in effect for a considerable period of time after the economy recovers, its link to the current slowdown as the rationale for its being temporary will be weaker by the time it is scheduled to expire. That increases the likelihood it will be extended. If that occurs — and there is little

² John D. McKinnon and Damian Milverton, "White House Signals It Intends to Block Huge Tax-Cut Bill Voted by House Panel," *The Wall Street Journal*, October 16, 2001.

question that there will be powerful corporate lobbying efforts to ensure partial expensing is extended when its scheduled expiration approaches — the cost of this package will grow by about \$250 billion over 10 years. If partial expensing remains in effect, the total cost of the package thus will exceed \$400 billion over the decade.

The Ways and Means legislation raises the following issues:

- **While including generous tax breaks for corporations and upper-income individuals, the Ways and Means legislation provides extremely limited assistance to unemployed workers.** The package speeds up the transfer of \$9 billion already slated to be shifted from the federal unemployment insurance trust funds to state unemployment accounts. It also provides states with \$3 billion through the Social Services Block Grant to provide health coverage for unemployed workers. These provisions are unlikely to offer much assistance to the unemployed or to provide much stimulus to the economy. The \$9 billion in transferred unemployment insurance funds *would simply go into state unemployment trust fund reserves*. States would not be required to use these funds to pay unemployment benefits or to make any other expenditures in the months ahead.

Indeed, many states would be likely to “bank” these funds so they have a larger reserve in their unemployment accounts and thus more protection against the possibility that the recession will prove deeper or more long-lasting than is currently anticipated. Many states would deposit these funds in their trust funds and wait to take further action until they know more about the extent of the downturn. This is borne out by Congressional Budget Office estimates. CBO projects that only *\$2.3 billion* of this \$9 billion would be spent in fiscal year 2002,³ and only \$3.6 billion would be spent overall, a pittance compared to the amounts of additional unemployment benefits provided in previous recessions. In the recession of the early 1990s, some \$35 billion in additional weeks of federal unemployment benefits were provided, as measured in 2002 dollars. (These \$2.3 billion and \$3.6 billion estimates include funds that would be spent on state administrative costs in operating the unemployment insurance program, as well as funds spent on benefits.)

³ In estimating the cost of this provision, CBO has provided a range for its estimates of the amount of these funds that would be spent in fiscal year 2002. The \$2.3 billion figure represents the high end of the range. The low end of the range is \$700 million, but that estimate is unrealistically low because it is based on CBO’s April economic forecast. That forecast assumed an average unemployment rate in FY 2002 of only 4.5 percent and is clearly obsolete. The more recent August CBO forecast assumed that the FY 2002 unemployment rate would average 5.1 percent. That forecast, as well, which was issued before the terrorist attacks and assumed no recession would occur, is more optimistic than most private forecasts. CBO’s \$2.3 billion estimate is based on unemployment rate assumptions that are more pessimistic than its August projection and more in line with the current consensus of private forecasters.

The \$3 billion the legislation provides for health insurance is inadequate as well. More comprehensive proposals to help the unemployed maintain health insurance by providing subsidies for COBRA premiums and additional Medicaid coverage for low-income unemployed workers and their families have been estimated to cost between \$16 billion and \$25 billion, or five to eight times the amount the Ways and Means package provides. Moreover, the Social Services Block Grant — the program through which the \$3 billion would be channeled — is a questionable vehicle for delivering these funds; the program has little or no experience in offering health insurance coverage. The Ways and Means Committee appears to have selected the Social Services Block Grant as the program to receive these funds primarily because the program falls solely within the Committee’s jurisdiction, while more appropriate programs to help the unemployed maintain health care coverage do not.

- **The Ways and Means package includes a number of permanent tax cuts, thereby departing from bipartisan principles that all provisions of a stimulus package be temporary.** The legislation includes four permanent tax cuts: a reduction in the capital gains tax rate, the repeal of the corporate Alternative Minimum Tax, a conversion into permanent law of what is now a temporary provision that allows deferral of taxation on certain income that businesses (primarily multinational corporations involved in banking, finance, and insurance) earn overseas, and changes to allow the cost of improvements to leased property to be depreciated over a shorter period. These permanent tax cuts violate the principles the chairs and ranking minority members of the House and Senate Budget Committees issued on October 4, which call for stimulus measures to be temporary, to last no more than 12 months to the extent that is practicable, and not to worsen the long-term budget outlook. Federal Reserve Chairman Alan Greenspan and former Treasury Secretary Robert Rubin have warned that if a stimulus package contains items that worsen the longer-term fiscal outlook, the package will risk pushing up long-term interest rates and thereby undercutting some of the stimulative effect the package otherwise might have.
- **The majority of the temporary provisions in the package would be in effect for two or three years, distorting the definition of “temporary” and increasing the likelihood that these provisions may be permanently extended.** The chairs and ranking members of the House and Senate Budget Committees called for stimulus proposals to have a large part of their impact on the economy in the next six months and to sunset within one year, to the extent practicable. Only one major tax provision in the Ways and Means package meets this test — the rebate for low-income workers. The spending provisions to aid the unemployed also would be temporary and end relatively quickly.

In contrast, all of the corporate tax cuts that are temporary would expire in either 24 months or 36 months and thus would extend beyond the period when the economy is expected to be in need of stimulus. The largest individual income tax cut — accelerating the implementation of the 25 percent tax rate — would entail costs over five years, of which only one-quarter 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. Given that the temporary corporate tax provisions would be in effect long after the economic slowdown ended, the original rationale for their sunset is likely to have faded by the time these provisions are scheduled to expire. By then, these corporate tax breaks may be viewed as standard features of the tax code, making it more likely that Congress will continue them just as it routinely extends other expiring corporate tax provisions each year. If these new tax breaks become part of the regular package of “tax extenders,” the future costs will be very large. Joint Tax Committee estimates indicate that if the partial expensing of business investment remains in effect for the next ten years rather than expiring after three years, the cost of this one provision will be \$265 billion over the coming decade — or nearly 15 times the \$18 billion cost of the three-year provision in the Ways and Means Committee package.

- **The provision to accelerate certain tax-rate reductions scheduled for 2004 and 2006 would reduce the ability of policymakers to ensure fiscal discipline over the long run, a matter of particular concern given that most or all of the total budget surplus over the next ten years has apparently disappeared.** New 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

Most Tax Provisions in the Ways and Means Package Extend Beyond One Year, When the Economy Is Expected to Have Recovered

Permanent Tax Provisions

Repeal of corporate AMT

Reduction in capital gains tax rate

Extension of provision allowing deferral of taxation of certain income earned overseas

Provision allowing improvements to leased property to be depreciated over shorter period

Tax provisions that expire after four years

Acceleration of reduction of individual income tax rate from 28 percent to 25 percent

Tax provisions that expire after three years

Partial expensing of corporate investment in certain capital assets

Five-year carryback of net operating losses

Increase in exemption for individual Alternative Minimum Tax

Tax provisions that expire after two years

Increase in small business expensing limit

Extension of 11 tax provisions that expire at the end of 2001

Increase in deduction for capital losses against ordinary income in 2001 and 2002

Provision expanding an exception that allows unemployed workers to make penalty-free withdrawals from retirement accounts to pay for health insurance*

Tax provisions that expire after one year

Supplemental “rebate” for low- and moderate-income taxpayers

Extension of Medical Savings Account provision that expires at the end of 2002

* Eligibility would be restricted to unemployed workers who receive unemployment compensation for four consecutive weeks between September 11, 2001 and December 31, 2002.

Note: Table excludes technical amendments and spending provisions.

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.

In light of this situation, policymakers will face tough fiscal decisions when the recession ends and a need to exert fiscal discipline returns. Policymakers may wish to consider at that time the deferral or cancellation of income-tax rate reductions that have not yet taken effect and that primarily benefit more affluent individuals. The Ways and Means provision that would accelerate rate reductions

scheduled for 2004 and 2006 would deny policymakers the option of deferring or cancelling those rate cuts before they take effect. Indeed, that seems to be the provision's principal purpose; it cannot plausibly be seen as an efficient or effective stimulus mechanism, since 75 percent of the tax cuts it confers would come after 2002 and the provision would benefit only the top quarter of the population, a group that tends to save rather than spend the bulk of additional income it receives.

- **Other tax measures in the package — such as the repeal of the corporate AMT — also could lead to large out-year costs.** The corporate AMT was enacted to prevent excessive use of tax avoidance schemes by corporations; its repeal would signal corporations that they can use existing tax breaks more aggressively. Moreover, repeal would be likely to spur corporations to push more vigorously for enactment of additional tax preferences that would further reduce future corporate income tax revenues, since new preferences would become more valuable in the absence of the AMT.
- **The capital gains tax cut, included against the advice of Fed Chairman Greenspan and former Treasury Secretary Rubin, would be especially ineffective as a stimulus mechanism and constitutes another permanent tax cut whose benefits would overwhelmingly accrue to the wealthiest Americans.** In Congressional briefings following the September 11 attacks, Greenspan and Rubin laid out principles that Congress should adhere to in developing an economic stimulus package. Although Greenspan and Rubin generally avoided specific policy recommendations, they singled out the capital gains tax rate as being inappropriate for economic stimulus legislation. Similarly, in a recent report, the Congressional Research Service found that “a capital gains tax cut appears the least likely of any permanent tax cut to stimulate the economy.”

The Congressional Research Service has also reported that nearly 80 percent of the benefits of a capital gains tax cut would flow to the top two percent of households. Research shows these high-income households tend to save more and spend less of any new income they receive. To stimulate the economy, tax-cut benefits must be spent.

- **The package includes corporate tax cuts that create little incentive for firms to undertake new investments.** As noted, the package proposes a permanent repeal of the corporate Alternative Minimum Tax. This tax was modified as part of the 1986 Tax Reform Act to prevent corporations from pyramiding so many tax breaks on top of each other that some corporations could largely or entirely escape income tax even while pulling down large profits. Although the corporate AMT may have to be adjusted temporarily to avoid unwanted interactions with other

temporary provisions in the package, permanent repeal of the corporate AMT cannot be justified as an effective stimulus mechanism. Indeed, corporate AMT repeal would be *ineffective* as a stimulus, since it would not induce corporations to undertake new investment. Eliminating the corporate AMT would simply reduce the taxes that corporations subject to the AMT must pay on their current income, the majority of which represents income earned on investments *made in previous years*. A recent Brookings Institution analysis finds that approximately 90 percent of the tax benefits in 2002 of repealing the corporate AMT would accrue to profits on old investments, rather than to profits earned on new investments. The Brookings analysis concludes that repeal of the corporate AMT would be highly inefficient as a stimulus.

Similarly, the provision of the bill that permanently extends the deferral of certain income that corporations earn overseas has little to do with increasing investment in the United States.

- **Provisions in the Ways and Means package also would worsen the fiscal situation in the states, where budgets are already under severe strain as a result of the economic slowdown.** Some 44 states use federal depreciation rules for their own corporate income taxes and would therefore be adversely affected by the Ways and Means proposal to provide more generous depreciation deductions by allowing partial expensing of business investment. States would likely lose approximately \$5 billion a year in state revenues from 2002 through 2004 as a result of this provision. This reduction in state revenues would come at a time when many states are falling into fiscal crisis and, because of balanced budget requirements, are being forced to cut programs and/or raise taxes amidst the downturn.

Taken as a whole, the Ways and Means legislation reflects a sharp departure from the bipartisan principles for economic stimulus that have emerged over the past few weeks in discussions among congressional leaders, the Administration, and respected economic advisers such as Alan Greenspan and Robert Rubin. One principle that has been stressed repeatedly is the importance of avoiding fiscal policies that will worsen the medium- and long-term budget outlook, since such policies have the potential both to exert further upward pressure on long-term interest rates and to worsen the nation's fiscal problems down the road. High long-term interest rates can dampen economic activity today, discouraging business and housing investment, and prevent the Federal Reserve's rate-reduction policy from being as successful as it otherwise would be in stimulating the economy.

Despite what appeared to be bipartisan acceptance of this principle, nearly \$60 billion — or almost 40 percent — of the \$162 billion ten-year cost of the package would occur after 2002, when the economy is likely to have recovered. Furthermore, those figures understate the full

Ways and Means Tax Provisions Skewed to High-Income Taxpayers

An analysis of the Ways and Means Committee package by Citizens for Tax Justice finds that the corporate and individual tax cuts in the legislation would flow disproportionately to the highest-income taxpayers. The top five percent of taxpayers — those with incomes over \$153,000 — would receive more than half of the tax cuts the legislation would provide in 2002 (including the rebates to lower-income taxpayers that would be sent out at the end of 2001). The top one percent of taxpayers — those with incomes over \$384,000 — would receive 35 percent of these tax-cut benefits. (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 just cited 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 this period, the rebate for low-income taxpayers would end, while all of the other major tax provisions of the bill 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 the Ways and Means package *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 five percent of taxpayers would receive 60 percent of the tax cuts. The wealthiest one percent of taxpayers would garner 41 percent of the tax reductions.

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

extent of the fiscal problems the Ways and Means proposal may cause. The “out-year” cost will be much greater than \$60 billion if some of the temporary corporate tax cuts are extended when they are about to expire. As noted, a large push to extend these tax breaks is a virtual certainty when they are about to end.

The following sections of this analysis review in more detail four of the most troubling aspects of the Ways and Means package: the limited nature of its measures to assist the unemployed, its capital gains tax cut, its acceleration of the reduction of the 28 percent tax rate, and its repeal of the corporate AMT.

Benefits for Unemployed Workers

The Ways and Means package includes provisions to enhance unemployment insurance and health benefits for unemployed workers. But these provisions are small and of questionable design. They provide insufficient funding and use ineffective means of disbursing the funds.

Unemployment Insurance

The Ways and Means package would accelerate the transfer of approximately \$9 billion of funds from the federal unemployment trust funds to state unemployment accounts. These are funds that already are slated to be transferred to the state accounts under current law. The Ways and Means provisions would speed up the transfer.⁴

Despite the speed-up of this transfer, the proposal would not provide immediate assistance to unemployed workers. These funds would simply be deposited in state unemployment accounts and boost state unemployment insurance reserves. For the funds to be taken from the reserves and used to augment unemployment benefits, state legislatures would have to pass new laws to that effect. In most states, this could not take place until at least early next year, and any actual benefit changes probably would not be implemented until April 1 or later.

More important, only a modest portion of these funds would likely be used to increase unemployment benefits. Early in a recession, many states would be expected to hold these funds in their reserves and take a “wait and see” attitude to determine how long the recession will last and how much of their reserves ultimately will need to be drawn down. In other words, many states are likely to use the funds primarily to strengthen the solvency of their unemployment insurance accounts so they have greater certainty that they can operate their unemployment benefit insurance programs without having to borrow from the federal government, increase unemployment insurance taxes, or reduce unemployment insurance benefits if the recession endures. As a result, CBO projects that only \$2.3 billion of the transferred funds would be spent in fiscal year 2002 on added unemployment benefits and program administrative costs combined (and that only \$3.6 billion would be spent over the next ten years).

With so little likely to be spent, the proposal offers little in the way of benefits to the unemployed and would do little to pump money into the economy quickly. This is in sharp contrast both to the federal response to the recession of the early 1990s and to legislation (H.R. 3022) introduced in recent weeks by Rep. Ben Cardin and a bipartisan group of Ways and Means members.⁵

⁴ Under the current CBO baseline, \$40 billion will be transferred over the next ten years from federal UI trust funds to state unemployment accounts under a provision of UI law known as the Reed Act. About \$4 billion would be transferred at the end of fiscal year 2002, and about \$3 billion to \$5 billion each year thereafter. The Ways and Means proposal advances some \$9.3 billion of these funds to states earlier than the states otherwise would receive these funds.

⁵ The Ways and Means Committee members co-sponsoring the legislation include Democratic Representatives Rangel, McDermott, Stark, Coyne, and Levin and Republican Representatives English and Houghton.

- In the last recession, \$28.5 billion of federal funds — or \$35 billion when measured in 2002 dollars — were used to provide additional weeks of unemployment benefits.
- The Congressional Budget Office projects that under the Cardin proposal, \$26 billion would be expended on unemployment benefits over the next two years. The proposal would provide an additional 13 weeks of benefits to unemployed workers who exhaust their UI benefits after September 11. It also would raise the level of weekly unemployment benefits, require that UI coverage be broadened to include workers laid off from part-time jobs who otherwise meet all UI eligibility criteria (such as mothers with young children who work 70 percent or 80 percent time), and require the use of recent wages in determining eligibility for benefits so that low-wage workers with recent work histories are not disqualified solely because older earnings data — rather than more current data — are used. These provisions would be temporary, expiring at the end of calendar year 2002.

The Ways and Means proposal is even more limited than the bare-bones unemployment insurance proposal the Bush administration unveiled October 4. Under the Bush proposal, no additional weeks of benefits would be provided until mid-March to workers who have exhausted their regular unemployment benefits. Moreover, additional weeks of benefits would be provided starting in mid-March only to workers who were laid off after September 11 and who resided in one of the small number of states that would meet the Administration's restrictive criteria to provide these benefits. The Labor Department estimates that if the incipient recession is comparable in depth to the recession of the early 1990s, about \$5 billion in additional weeks of unemployment benefits would be provided under the Administration's proposal.

Nevertheless, the Administration's rather spartan proposal would guarantee additional weeks of benefits to *some* workers in hard-hit states. Under the Ways and Means bill, unemployed workers who exhaust their 26 weeks of regular unemployment benefits and cannot find a job likely would fail to receive any additional benefits in a substantial majority of states, including a number of states with quite high unemployment rates. In most cases, additional weeks of benefits would be provided only in states that elected to provide these benefits and to finance them from state unemployment accounts, something few states are likely to do.⁶

Compounding this problem, the \$9 billion in funds that would be transferred to state unemployment accounts would be allocated among the states *not* on the basis of current need or unemployment levels but in accordance with where the revenues in the federal unemployment trust fund were collected. As a result, the level of funds allocated to many states would bear little

⁶ Additional weeks of benefits also could be provided in states that qualify to pay "extended unemployment benefits," but few, if any, states are likely to qualify because the level of unemployment needed for a state to qualify to pay extended benefits is very high. In many states, the unemployment rate would have to rise to close to nine percent before extended unemployment benefits could be provided.

relationship to the need for additional unemployment benefits for laid-off workers in those states.

The Ways and Means approach is similar to a block grant in which funds are allocated in a manner that does not match need and in which the funds can be placed in reserve rather than used. Each state would simply receive a speed-up of funds it would have received anyway.

In every previous recession of the last 30 years, federal legislation has guaranteed that unemployed workers in every state who exhaust their regular unemployment benefits are entitled to additional weeks of federally funded benefits. The Ways and Means proposal breaks sharply with historical precedent in this area.

Health Insurance Coverage

The Ways and Means package includes two provisions to assist unemployed workers with health insurance coverage. The first proposal is a \$3 billion grant to states through the Social Services Block Grant. This amount is less than one-fifth of the \$16 billion to \$25 billion that more comprehensive plans would cost. Those alternatives — such as a plan developed by Senators Max Baucus and Edward Kennedy, the chairmen of the Senate Finance and Senate Labor and Human Resources Committees — would subsidize 50 percent to 75 percent of COBRA premium costs through June 30, 2003 for laid-off workers who qualify for COBRA and also would establish a temporary state Medicaid option to cover low-income unemployed workers who cannot afford the remaining COBRA premium, are ineligible for COBRA because they worked for a small business, or worked for firms that did not offer health insurance. (The Baucus-Kennedy proposal, which would subsidize 50 percent of COBRA premiums, would cost \$16 billion. Otherwise similar proposals that would subsidize 75 percent of COBRA premiums would cost \$25 billion.) Because of the limited funds that the Ways and Means legislation would provide, this provision of the Ways and Means bill would maintain health insurance coverage for only a very small fraction of unemployed workers.

In addition, the Social Services Block Grant is a questionable mechanism for providing health care coverage for unemployed workers and their families. State SSBG programs have no experience in identifying families' health insurance needs or offering health insurance.

The second proposal would allow more unemployed workers to withdraw funds without penalty from individual retirement accounts (IRAs) and employer-based pension arrangements (such as 401(k) and 403(b) plans) to pay for health insurance premiums. Under current law, individuals eligible for unemployment insurance benefits for 12 consecutive weeks can make penalty-free withdrawals from IRAs equal to the cost of their health insurance premiums. The Ways and Means legislation would permit people who collect unemployment for four consecutive weeks between September 11, 2001 and December 31, 2002 to make such early withdrawals from both IRAs and other pension arrangements.

This proposal would do little to help low- and moderate-income unemployed individuals who are at risk of losing their health insurance, since most low- and moderate-income workers lack significant IRA or pension savings. While 89 percent of families with incomes above \$100,000 had retirement accounts in 1998, only six percent of families with annual incomes below \$10,000 and 25 percent of families with incomes between \$10,000 and \$25,000 participated in IRAs or employer-based pension plans. Even when low- and moderate-income workers do contribute to IRAs or have an employer-based pension plan from which withdrawals could be made, the amounts they have in these accounts are typically so modest — the median value of retirement accounts in 1998 was \$8,000 for families with incomes between \$10,000 and \$25,000 — that COBRA premiums would quickly deplete the accounts. The annual cost of family health insurance premiums is now about \$7,000 a year.

Capital Gains Tax Cut

The Ways and Means legislation would reduce the top capital gains tax rate from 20 percent to 18 percent and cut the lower 10 percent capital gains rate to 8 percent. This capital gains tax cut would do little to spur the economy over the next few quarters. In testimony before the Senate Finance Committee on September 25, both Alan Greenspan and Robert Rubin advised Congress against reducing the capital gains tax rate as a way to stimulate the economy in the short run.⁷ A Congressional Research Service report issued September 17 reached a similar conclusion, finding that “a capital gains tax cut appears the least likely of any permanent tax cut to stimulate the economy in the short run.”⁸ Even proponents of capital gains tax cuts typically acknowledge that such tax cuts are aimed at the long run and have little to do with boosting the economy in the short term. The *Washington Post* reported House Ways and Means Committee Chairman Bill Thomas admitting last month that “he doesn’t consider it a short-term recovery tool.”⁹

A reduction in the capital gains tax rate not only offers little in the way of short-term stimulus but also provides few benefits to the economy in the long term. Credible analysis has not substantiated claims that a capital gains rate cut would raise investment and risk-taking in the long run and thereby boost economic growth. A study undertaken by the Congressional Budget Office in 1998, in which CBO examined a permanent reduction in the capital gains tax proposed by then-Speaker Newt Gingrich, concluded the proposal would increase private saving and the

⁷ Richard Stevenson, “Congress Gets Plea to Drop Tax Benefits for Investors and Widen Economic Relief,” *The New York Times*, September 26, 2001.

⁸ Jane G. Gravelle, “Economic and Revenue Effects of Permanent and Temporary Capital Gains Tax Cuts,” Congressional Research Service, September 17, 2001.

⁹ Allan Sloan, “The Buck Stopped Here in Deference to Humanity,” *The Washington Post*, September 18, 2001.

size of the economy by only minuscule amounts.¹⁰ While some studies that have been touted by proponents of a capital gains tax cut are said to show large, positive effects, CBO found the studies achieved these results by relying on faulty and inappropriate assumptions.

Specifically, CBO found that reducing the top tax rate on long-term capital gains from 20 percent to 15 percent — a larger reduction than the Ways and Means package would make — would cause an increase in private saving of only 0.3 percent and add about 0.06 percent to the capital stock after ten years. CBO projected that the increase in the size of the U.S. economy after ten years would amount to about \$2 billion or \$3 billion — or *less than two one-hundredths of one percent of GDP*, an amount that is little more than rounding error in the measurement of GDP in a \$10 trillion economy. The effects of the smaller capital gains proposal in the Ways and Means package would be even more minuscule.

A capital gains tax cut also would be highly regressive and provide additional tax subsidies to the same high-income individuals who received a highly disproportionate share of the tax cut enacted in June and whose share of national income, according to the latest available data, is larger than it has been since before World War II.¹¹ High-income taxpayers who have the largest portfolios of assets — and who consequently pay the bulk of the capital gains taxes — would reap windfall benefits from the proposed capital gains tax cut. Congressional Research Service estimates show that the two percent of the population with the highest incomes — those with incomes exceeding \$200,000 — pay 80 percent of capital gains taxes.¹² They thus would likely receive 80 percent of the tax cut the Ways and Means provision would provide. (Similarly, the highest-income eight percent of taxpayers pay more than 90 percent of capital gains taxes and would be expected to secure more than 90 percent of the capital gains tax cut.) These high-income taxpayers are the group least likely to use tax-cut benefits in a way that would generate economic stimulus, by increasing consumer purchases.

Accelerating Tax Rate Reductions

The tax-cut package enacted in June lowered the 28 percent individual income tax rate to 27 percent on July 1, 2001, with further one-percentage point reductions scheduled for 2004 and 2006. Accelerating these scheduled rate reductions, by implementing the 25 percent rate in 2002

¹⁰ Congressional Budget Office, “An Analysis of the Potential Macroeconomic Effects of the Economic Growth Act of 1998,” CBO Memorandum, August 1998.

¹¹ Thomas Piketty and Emmanuel Saez, “Income Inequality in the United States, 1913-1998,” NBER Working Paper 8467, September 2001.

¹² Jane G. Gravelle, “Capital Gains Taxes: Distributional Effects,” Congressional Research Service, September 24, 1999.

instead of in 2006 — as the Ways and Means bill would do — would be a poorly targeted and ineffective means of stimulating the economy.

More than three-quarters of the cost of this proposal would be incurred *after* the economy has recovered. According to Joint Committee on Taxation estimates, the proposal would cost \$53.7 billion, making it the most expensive proposal over ten years in the package. Only \$12.8 billion of the cost — or less than 24 percent — would result in 2002. The remainder would occur in 2003 through 2006, years in which the economy should already have recovered from the current slowdown.

Accelerating the implementation of the 25 percent rate would exclusively benefit the top one-quarter of all tax filers — not middle-income taxpayers, as supporters of this proposal frequently claim. Internal Revenue Service data and Congressional Budget Office analyses show that more than three-quarters of all tax filers either have no taxable income (because their income is less than their deductions and exemptions) or face a marginal tax rate of no more than 15 percent.¹³ Fewer than one-quarter have incomes sufficiently high to be in the 28 percent bracket or a higher bracket.

These more affluent taxpayers are likely to save more — and spend less — of a tax cut than taxpayers with lower incomes. Yet for the economy to receive the desired boost in the short run, tax-cut beneficiaries must spend their extra dollars. Saving these dollars has no short-term stimulative effect and will not speed economic recovery.

Moreover, the taxpayers who would benefit the most from this proposal are those in brackets *higher than* the 28 percent bracket, because it is only these individuals who would be able to apply the lower tax rate against the full amount of income that the 28 percent bracket covers.¹⁴ A married taxpayer with taxable income of \$50,000 (and gross income of close to \$65,000) has \$3,300 of income that falls in the 28 percent bracket. This taxpayer would receive a tax cut of \$66 next year as a result of dropping the rate from the 27 percent rate that otherwise would be in effect in 2002 to 25 percent. By contrast, a taxpayer with taxable income of more than \$112,850 — the top of the bracket — would receive a tax cut of more than \$1,300 next year, since the two percentage-point rate reduction would be applied to more than \$66,000 in income (i.e., to the full amount of income that falls in the 28 percent bracket).

¹³ David Campbell and Michael Parisi, “Individual Income Tax Rates and Tax Shares, 1998,” IRS Statistics of Income, Spring 2001, Tables 1 and 5. Committee on Ways and Means Committee, U.S. House of Representatives, “2000 Green Book: Background Material and Data on program: Withing the Jurisdiction of the Committee on Ways and Means,” October 6, 2000, Table 13-21.

¹⁴ In 2002, the 28 percent bracket for married taxpayers begins with taxable income of \$46,700 (which corresponds to a minimum of \$60,550 in adjusted gross income if the taxpayer has no children and higher levels if the taxpayer has children) and ends with taxable income of \$112,850.

Those who would receive the largest tax cuts from this proposal — those in tax brackets higher than the 28 percent bracket — constitute the top five percent of tax filers. These individuals — who also would benefit the most from the bill’s capital gains tax cut and receive windfall tax reductions from other provisions of last spring’s tax cut legislation as well — have a low “propensity to consume.”

It makes intuitive sense that families with lower incomes, and thus a wider range of unmet needs, are more likely to spend an extra dollar of after-tax income than a high-income family and that high-income families are more likely to save a greater portion of an extra dollar. Research confirms these common-sense assumptions. For example, a National Bureau of Economic Research paper published last year found that the propensity to save rises with income.¹⁵ It concluded that “the rich do save more, whether the rich are defined to be the top 20 percent of the income distribution...or the top 1 percent.” Given these facts, including the acceleration of tax-rate reductions in a stimulus package makes little sense.

Accelerating these rate reductions also represents unsound policy at a time when a premium should be placed on fiscal prudence. Locking in these rate cuts would weaken the nation’s ability to address future fiscal pressures. The economic and budget outlook has changed dramatically in the last few months; policymakers will have to consider significant adjustments to budget policies when the recession ends, especially in light of increased defense and security expenditures. One advantage of having the enacted rate reductions phase in over time is that if the need for resources to meet other contingencies grows, policymakers will have the option of postponing or cancelling future rate cuts. Doing so would generate additional revenues without increasing current tax rates. If the scheduled rate reductions are implemented sooner, however, these lower rates will be locked in, and undoing the rate reductions if the nation’s fiscal difficulties intensify will entail enacting tax increases.

The Committee for Economic Development, an organization of leading corporate executives and university presidents, issued a report in early October warning of the long-term fiscal difficulties the nation faces. The report points 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. The Ways and Means legislation would weaken this safety valve. At a time when future expenditure needs are highly uncertain, fiscal prudence militates against accelerating future tax rate cuts.

Repeal of the Corporate AMT

The corporate Alternative Minimum Tax was implemented in response to actions by a number of large, highly profitable corporations to use tax breaks so aggressively that they largely

¹⁵ Karen E. Dynan, Jonathan Skinner, and Stephen P. Zeldes, “Do the Rich Save More?” National Bureau of Economic Research, Working Paper 7906, September 2000.

or entirely escaped paying income tax. The AMT is designed to ensure that such corporations cannot avoid paying income tax in this manner. Its elimination would likely lead to a situation in which profitable corporations again escape the income tax.

Moreover, the Ways and Means proposal would not simply eliminate the corporate AMT. It also would make existing corporate AMT credits “refundable.” These credits essentially represent the amount of Alternative Minimum Tax that corporations have paid in previous years. A corporation can use these credits only to offset regular corporate income tax in years that the income tax it owes exceeds the amount it would owe under the corporate AMT. Corporations that routinely pay the AMT (or that do not owe much in corporate income tax) thus are not able to make full use of these credits. By making these accumulated credits refundable, the Ways and Means legislation would create windfalls for these corporations. The Treasury would be required to write large checks worth millions of dollars to many of these companies.

According to an analysis by Citizens for Tax Justice, 13 major corporations would receive tax breaks of more than \$100 million each as a result of these changes to the corporate AMT.¹⁶ Energy companies — such as ChevronTexaco and Enron — make up nearly half of these 13 companies. The biggest winner would be IBM, which alone would receive \$1.4 billion, and General Motors and General Electric, which would receive \$833 million and \$671 million, respectively.

Some temporary adjustments to the corporate AMT may indeed be needed to ensure that the AMT does not unintentionally weaken the impact of other temporary provisions in the package. But neither total repeal of the corporate AMT nor making the AMT credits refundable is necessary for these purposes.

Furthermore, these permanent changes are unlikely to stimulate new investment by these corporations, because the tax-cut benefits would not be conditional upon the corporations’ making new investments. In a recent analysis, Brookings Institution senior fellows William Gale and Peter Orszag estimate that in 2002, approximately 90 percent of the tax reductions from eliminating the corporate AMT would consist of tax cuts on profits from *old* investment — that is, investments made in years before 2002 — rather than new investment.¹⁷ The Brookings analysis concludes that repealing the corporate AMT consequently would do little to provide short-term stimulus. Gale and Orszag observe that “elimination of the corporate alternative minimum tax is an extremely blunt and inefficient approach to encouraging new investment in the short run.”

¹⁶ Robert McIntyre, “House GOP ‘Stimulus’ Bill Offers 13 Large, Low-Tax Corporations More Than \$100 Million in Tax Rebates Each,” Citizens for Tax Justice, October 16, 2001 updated.

¹⁷ William Gale and Peter Orszag, “Evaluating President Bush’s Tax Stimulus Package,” Brookings Institution, October 9, 2001.

In addition, repealing the corporate AMT may signal to corporations that aggressive use of tax breaks to avoid paying income taxes is now acceptable, and corporate lobbyists are likely to see this as an opportunity to seek enactment of more tax preferences in the years ahead. Many potential corporate tax breaks would be more lucrative and attractive in the absence of the corporate AMT, which limits the use that corporations can make of such tax breaks.

These concerns are based on historical evidence. Prior to modification of the corporate AMT as part of the 1986 tax reforms, a number of major corporations routinely avoided paying taxes. A survey conducted by Citizens for Tax Justice found that 130 of the nation's 250 largest corporations — or more than half of them — paid no federal income taxes in at least one year between 1981 and 1985.¹⁸ It was to address this problem that the corporate AMT was enacted in the first place. Repealing it could be an invitation for such practices to return.

¹⁸ Robert S. McIntyre, "Statement Concerning the Alternative Minimum Tax Before the Senate Finance Committee," Citizens for Tax Justice, May 3, 1995.