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ACCELERATION OF UPPER-BRACKET RATE REDUCTIONS WOULD BE COSTLY AND INEFFECTIVE AS A STIMULUS MEASURE

Proposals to accelerate reductions in upper-bracket marginal tax rates enacted in June but not scheduled to take effect until 2004 and 2006 would be a poorly targeted and ineffective means of stimulating the economy. Further, by permanently locking in costly tax cuts, these proposals seriously weaken the ability of policymakers to ensure fiscal discipline over the long run.

Poorly Targeted

The Administration and the Senate Republicans are proposing to accelerate rate reductions in *every one* of the upper-income tax brackets — the 28 percent, 31 percent, 36 percent, and 39.6 percent brackets — at a ten-year cost of $121.5 billion, according to the Joint Committee on Taxation. By contrast, the House-passed bill would accelerate only the scheduled rate reductions in the 28 percent bracket, at a ten-year cost of $53.7 billion. Less than one-quarter of the costs associated with either of these proposals would be incurred in 2002, when the economy will be in need of short-term stimulus. The remaining three-quarters of the costs would occur *after* 2002 — that is, in years when forecasters expect the economy already to have recovered.

Proposals to accelerate scheduled reductions in upper-bracket marginal tax rates

	Cost (in billions)		Share of cost occurring:	
	2002	Ten Years	In 2002	After 2002
Accelerate all upper-bracket rate reductions	26.8	121.5	22%	78%
Accelerate only 28% rate reductions	12.8	53.7	24%	76%

Ineffective Stimulus

The effectiveness of these provisions as economic stimulus is further diminished because they disproportionately benefit the highest-income taxpayers. Research has shown that this group is much more likely to save (rather than spend) additional income it receives than low- and moderate-income families are. Tax cuts can only generate the needed stimulus if they are spent.

According to the Congressional Budget Office, only 23 percent of tax filers pay income taxes at the 28 percent rate or higher. Thus, even the House proposal to accelerate just the 28 percent rate would exclusively benefit the top one-quarter of taxpayers — not middle-income taxpayers, as the supporters of this proposal frequently claim. Accelerating all the rates is even more skewed to those with the highest incomes. Some 55 percent of the benefits of accelerating all of the rates would go to the wealthiest one percent of taxpayers, according to the Citizens for Tax Justice.

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

For a married couple with two children and an income of $66,550 or less, accelerating rate reductions in the 28 percent bracket (as well as in the other upper brackets) would yield *no tax cut whatsoever*. This family — and families of four with lower incomes — thus would receive no benefit from either the House bill or the Senate Republican proposal. For families with higher incomes, on the other hand, these proposals offer very large tax-cut benefits. Under the Senate Republican proposal to accelerate all of the upper-bracket rates, the higher a family's income, the greater the tax-cut windfall it would receive.

- A married couple with two children that has an annual income of $1 million — the average income for the top one percent of taxpayers — would receive about $25,000 in tax cuts 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 accelerating the upper-bracket rates.

Yet directing tax benefits to upper-income families is a highly ineffective way of generating stimulus. In recent Congressional testimony, Brookings Institution senior fellows William Gale and Peter Orszag both emphasized that higher-income taxpayers have a lower "propensity to consume" (that is, to spend rather than save each additional dollar of income) than lower-income taxpayers.[1] Because proposals to accelerate rate reductions benefit upper-income taxpayers, they 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]

[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.

[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.

Fiscally Irresponsible

The proposals to accelerate upper-bracket rate reductions also raise major issues of fiscal responsibility. 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 (see box). In light of this situation, policymakers will face tough fiscal decisions when the recession ends and 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 primarily benefit the nation's 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.