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HOW THE BUSH TAX CUT COMPARES IN SIZE TO THE REAGAN TAX CUTS

The full report can be viewed at http://www.cbpp.org/2-6-01tax2.htm

On February 7, the Center on Budget and Policy Priorities issued an analysis, "How the Bush Tax Cut Compares in Size to the Reagan Tax Cuts." It compares the size of the President's proposed tax cuts to the Reagan tax cut. The National Taxpayers Union recently released a report arguing that President Bush's proposed tax cut is significantly smaller than the 1981 Reagan tax cut. The White House has begun to echo these claims and to suggest this shows the proposed tax cut is of a responsible size. The paper analyzes the claims. It finds:

- If the cost of the Reagan tax cut is adjusted (as it should be) for the impact of inflation and the subsequent 1982 tax increase (which scaled back the 1981 tax cut), the net tax cut is only moderately larger as a share of the economy as the proposed Bush tax cut, rather than being several times the size of the Bush tax cut.

  — Before 1985, frequent tax cuts were necessary just to prevent large tax increases over time because the tax code was not indexed to inflation. To see how this worked, assume the current tax code was not indexed to inflation. If a taxpayer's income merely kept pace with inflation, his or her purchasing power and standard of living would not increase. The taxpayers' tax liability *would* increase, however, because the standard deduction, the personal exemption, and the marginal tax brackets would not be adjusted for inflation.

  — The lack of indexing in the tax code before 1985 produced an automatic upward creep in tax collections over time. Policymakers cut taxes every few years to offset much or all of the tax increases that otherwise would occur, but the Congressional Budget Office was forced in constructing its revenue baseline to assume that taxes would rise over time relative to the size of the economy, because the baseline reflected current law.

  — The size of the Reagan tax cut was measured by using this inflated baseline, which increased the apparent size of the tax cut. As the Congressional Budget Office noted when the Reagan tax cut was first proposed, "a large share of the Administration's proposed tax cut would simply offset these tax increases."

  — Since 1985, the tax code has been indexed to inflation, and the baseline consequently no longer includes large, automatic tax increases over time. Under the current baseline, a tax cut that reduces tax burdens by a given amount would be scored as costing less than the tax cut would cost if it were measured against a baseline that did not include indexing. Comparing the Bush tax cut to the Reagan tax cut without adjusting the Reagan tax cut for the impact of inflation thus produces misleading results.

  — The 1981 tax cut was excessive, a conclusion to which David Stockman and others in the Reagan administration came not long after its enactment. As a result, the Reagan administration worked to scale back the tax cut one year later, in the Tax Equity and Fiscal Responsibility Act of 1982.

- Adjusting for inflation and the 1982 tax increase, the Reagan tax cut cost 2.1 percent of GDP. The Bush tax cut is projected to amount to 1.5 percent of GDP in 2010. The Bush tax cut is thus only modestly smaller than the adjusted Reagan tax cut, rather than being a small fraction of the Reagan tax cut.

- The Reagan tax cut occurred when marginal tax rates were higher than today. A reduction in marginal tax rates is therefore less critical today than in 1981.

- The Reagan tax cut was a major factor in generating large budget deficits, from which the nation took more than decade and a half to recover.