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MISSING THE POINT: THE ADMINISTRATION OFFERS ONLY GIMMICKS TO TRIM TAX CUTS

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Summary

Congress has agreed to limit the Administration's $726 billion tax-cut proposal to no more than $550 billion through 2013, and the tax cuts in the legislation may be held to $350 billion if the commitment that Senate Finance Committee Chairman Charles Grassley has made is honored. Yet contrary to some reports suggesting that the Administration has begun to compromise on its tax cuts, the Administration has so far refused to reduce the long-term costs of its proposals *at all*. Rather than considering substantive changes to its proposals to address concerns that its package of multi-year and permanent tax cuts is unaffordable over the long run, the Administration appears to be suggesting an array of timing gimmicks to squeeze its entire tax cut into a package that will be "scored" as costing $550 billion.

These gimmicks would not only fail to reduce the package's long-term cost but would further reduce the package's already limited effectiveness as short-term stimulus. The proposals the Administration appears to be suggesting are sharply at odds with Administration rhetoric that its proposals are urgently needed to address the current economic slowdown and to create jobs now.

- The Administration is reported to be recommending that its proposal to eliminate the taxation of dividends be phased in more slowly than its budget calls for, with the goal of a 100 percent exemption for dividends still being retained. It is also reported to be considering phasing in both its proposal to increase the child tax credit from $600 to $1,000 and the proposal to raise the amount that small businesses can write off when they invest in facilities and equipment. Phasing in these provisions would reduce the cost of the package through 2013 and help it fit within the $550 billion constraint. But such changes would have no impact on the measure's cost after 2013, the years when the baby-boom generation will be retiring in large numbers and deficits threaten to explode.

- Further, phasing-in these proposals would reduce their impact in 2003 and lessen their effectiveness in giving the economy an immediate boost. News reports indicate that the Administration is also considering delaying the effective date of the tax-cut proposals from January 1, 2003, as the Administration originally proposed, to the date that the legislation is enacted (likely to be sometime in June). Such a delay in the effective date would further reduce the package's stimulative effect in 2003.

The Administration's original $726 billion package itself is poorly designed as stimulus; only six percent of its tax cuts would be delivered in fiscal year 2003 and only 21 percent by the end of fiscal year 2004. The phase-ins and delayed effective dates the Administration is said now to be considering would result in even smaller percentages of the tax cut being provided in 2003 and 2004 when the economy is weak.

- Another option reported to be receiving strong consideration, especially among House Republican leaders, is to remove certain popular proposals from the package — such as the acceleration of tax relief for married couples and expansion of the child tax credit — in order to make room in the package for the dividend tax cut. Under this strategy, the married-couple and child credit provisions would instead be moved as separate pieces of legislation. The political calculation here is that, as separate measures, the marriage penalty relief and child tax credit provisions could secure 60 votes in the Senate; as a result, this maneuver could enable virtually the Administration's entire package to become law.

- Still another timing mechanism that Administration officials have reportedly suggested is to write the reconciliation package so its provisions expire at the end of 2010, three years before the end of the ten-year budget period. This maneuver would help the Administration and its allies meet the budget target without scaling back the tax cut. Then, in a subsequent year, the tax cuts would be extended beyond 2010 (with those who raised questions at that time about whether such extensions are affordable likely being branded as tax-increasers). This proposal is a somewhat more extreme version of a gimmick that was at the heart of the 2001 tax-cut law, under which all of the tax-cut provisions in that law were written to expire by the end of 2010, one year before the end of the ten-year budget period in use in 2001 when that law was written. It was this and other gimmicks employed in 2001 that, as House Ways and Means Chairman Bill Thomas aptly stated at the time, allowed tax-cut supporters "to get a pound and a half of sugar in a one-pound bag."

- A final gimmick that appears to be under consideration is to take "offsets" (i.e., measures that raise revenues or reduce spending) that the Senate or House has already passed to pay for the cost of other legislation and to incorporate these offset measures into the reconciliation bill and pass them a *second time*. This gimmick can be employed as long as the initial legislation that contains the offsets has not yet become law. For example, a Senate Finance Committee Republican staff member told *Congress Daily* last week that consideration is being given to taking revenue-raising measures that the Senate passed earlier in April to offset the costs of the CARE bill and to write these same measures into the reconciliation bill and pass them again.[1] Were these measures to be enacted in the reconciliation bill as a way to pack more tax cuts into that bill, however, the tax-cut provisions in the CARE bill would no longer have offsets and enactment of

[1] *Congress Daily*, April 25, 2003, p.2.

> the CARE bill — which the Administration also is pushing for — would increase the deficit. (The CARE bill is the name for the faith-based legislation that has passed both the House and the Senate in different forms.)

In short, despite serious concerns about its tax-cut proposals that have been raised by members of Congress and a broad range of economists, the Administration has so far offered only cosmetic changes. None of the Administration's proposals reported upon to date to trim its $726 billion "growth" package represent an honest attempt to reduce the package's long-term cost or improve its effectiveness as short-term stimulus. Moreover, some emerging plans — such as proposals to phase in the tax cuts over the decade — would make the tax-cut package even more ill-advised from a policy standpoint; such proposals would further weaken the plan's already limited ability to boost the economy now while it is sluggish and do nothing to reduce the package's long-term cost. The phase-in proposals stand in stark contrast to claims being made by the President and members of his Cabinet on their recent cross-country blitz that the plan would provide an immediate economic boost and generate large numbers of jobs now.

Congressional Action to Reduce the Tax Cut

The recently adopted congressional budget resolution provides for tax cuts totaling $1.3 trillion through 2013. Of this total, $550 billion in the House and initially $350 billion in the Senate will be considered under an expedited process — known as reconciliation — that protects the tax cuts from filibuster in the Senate. Senate Finance Committee Chairman Charles Grassley announced on April 11 that he made a commitment to Senators Olympia Snowe and George Voinovich to limit the tax cuts in the final House-Senate conference agreement on the reconciliation bill to $350 billion.

Grassley made his pledge to secure the support of Senators Snowe and Voinovich for the budget resolution so that it would pass in the Senate. During the debate on the Senate floor to limit the reconciliation tax cut to $350 billion, Senator Snowe said the effort to limit the package was intended to achieve two goals: to ensure that the package includes only proposals that would help boost the economy in the short run, and to moderate the package's impact on the long-term fiscal outlook. She stated:

> The amendment is a carefully calibrated balanced approach to respond to two compelling needs — first, to provide immediate, short-term stimulus to an economy that has lost 2.3 million jobs, and, second, to avoid driving up deficits over the long term which, in turn, lead to increased long term interest rates that would stagnate our economy….Our approach is simple — we differentiate between those aspects of the growth package that truly provide quick, short-term economic stimulus and those that do not.

Many respected economists have assessed the Administration's proposals and concluded that they would constitute a highly inefficient means of boosting the economy in the short term, would substantially increase deficits over the long term, and would have only a small effect — which could be either positive or negative — on long-term economic growth.[2]

[2] For summary of these findings, see "Economic Growth Claims Disputed by Broad Range of Economists," Center on Budget and Policy Priorities, April 17, 2003. http://www.cbpp.org/4-17-03tax2.htm

Congressional leaders and Administration officials now must fit their tax-cut proposals within the limits the budget resolution sets. How this is done will be of considerable importance.

The Dividend Tax Cut

The Administration has said it wants to maintain the full dividend tax cut. It has said it is willing to phase in the dividend proposal but not to scale it back. In a recent interview with the *Wall Street Journal*, Treasury Secretary John Snow suggested granting tax-free status to 50 percent of dividends in 2003, and then phasing in the remaining reduction by five percentage points a year so that 100 percent of dividends would be excluded from taxation by 2013.[3] This approach would have a lower cost through 2013 than the Administration's original proposal. But its cost after 2013 would be the same as that of the Administration's original plan.

The dividend proposal in the Administration's budget would reduce revenues by $396 billion between 2003 and 2013, according to the Joint Committee on Taxation. Over the following ten years, 2014 through 2023, the revenue losses would total $756 billion, assuming that the tax loss estimated by the Joint Tax Committee in 2013 continues to grow at the same pace as the economy (a standard estimating assumption that the Congressional Budget Office and forecasters use when making long-term projections). The option outlined by Secretary Snow that assumes a 50 percent rather than a 100 percent dividend exclusion in 2003 would cut the proposal's cost in half in 2003. But with the amount of the exclusion rising from 50 percent to 100 percent over the decade, the total savings through 2013 (relative to the original proposal) would be smaller; the proposal would cost about $321 billion over the period rather than $396 billion, just 19 percent less. In the decade from 2014 to 2023, the cost would be the full $756 billion.

No Long-Term Savings from Phasing in Dividend Tax Cut
(Revenue loss in billions of dollars)

	2003	2003-2013	2014-2023
Original Administration proposal	$8	$396	$756
Phased-in proposal	$4	$321	$756
Percent change due to phase-in	-50%	-19%	0%

Note: Estimates of the original Administration proposal for 2003 and 2003 through 2013 are from the Joint Committee on Taxation. All other estimates are from CBPP.

[3] Bob Davis, "Treasury's Snow Spells Out Room For Compromise on Tax-Cut Plan," *Wall Street Journal*, April 21, 2003. In the article, Secretary Snow also suggested that the Administration would consider abandoning its proposal to lower immediately the top marginal tax rate from 38.6 percent to 35 percent (the reduction is scheduled to occur under current law in 2006). Subsequent to the publication of the article, the Administration strongly reasserted its support for these top rate reductions, distancing itself from Secretary Snow's comments and maintaining that his comments had been misunderstood.

Impact of Phasing in Proposed Tax Cuts

In addition to phasing in the dividend tax cut, the Administration has suggested phasing in other aspects of its package, including increases in the child tax credit and in the amount of capital investment that small businesses can deduct immediately.[4] The child tax credit is scheduled to rise from its current level of $600 to $1,000 in 2010; the Administration's budget proposed to increase it to $1,000 immediately. Now, the Administration is reported to be considering options to slow down the acceleration of this increase. In a similar vein, the Administration's budget called for allowing small businesses to write off up to $75,000 of their investments in plant and equipment each year, starting in 2003, which would represent a substantial increase over the current limit of $25,000. Now the Administration is reported to be considering phasing in this increase over a two- to three-year period.

Once again, phasing in such proposals does nothing to reduce their long-term costs.[5] Eventually, all of these proposals would reach the full levels that the Administration has proposed. While doing nothing to lower long-term costs, however, phasing in these tax cuts would lessen their ability to boost the economy in the short run. If phased in, these tax cuts would be smaller in 2003, and result in less money being pumped into the economy now, while it is weak.

Another issue revolves around the date from which the tax cuts should be effective. The tax cuts in the Administration's "growth" package were designed to take effect on January 1, 2003 (i.e., to be retroactive to January 1). A January 1 effective date was intended to increase the size and thus the impact of these tax cuts in 2003, thereby enhancing their value as short-term economic stimulus. According to media accounts, some in the Administration are now suggesting that these tax cuts take effect only on the date of enactment, likely in June. Many economists have criticized the Administration's original proposal as being poorly designed to stimulate the economy in the short term and putting too little of its tax cuts up front. Delaying the effective date of these tax cuts by five to six months, as well as phasing in a number of the proposals over several years, would make the package even more inefficient and ineffective at boosting the economy in the short term.

In the past, some have defended the phasing in of tax cuts on the grounds that gradual implementation creates an opportunity to cancel or defer future tax cuts if the budgetary picture deteriorates and the tax cuts are found not to be affordable. This argument was made during the debate over the 2001 tax cut. The Administration and its supporters have since turned the argument on its head, however. Now they maintain that if, in 2001, Congress enacted tax cuts to take effect in the future, the tax cuts must be good enough to be implemented today. The Administration's posture makes clear that the phasing-in of tax cuts should not be regarded as a sign of fiscal prudence. To the contrary, it appears to be part of a strategy to secure as large tax cuts as possible: the strategy apparently entails phasing in various tax cuts when they are enacted in order to squeeze as many tax cuts as possible within a given budgetary limit, and then to look

[4] Laurence McQuillan, "White House Reworks Tax Plan to Lure Moderates," *USA Today*, April 21, 2003.

[5] Note that the increase in the child tax credit to $1,000 officially has no cost after 2010, because the tax credit expires in that year along with all other provisions of the tax-cut package enacted in 2001. A separate proposal in the Administration's budget calls for making permanent the child tax credit and other provisions of the 2001 tax cut.

for opportunities to come back in subsequent years and push for accelerating the measures that were enacted on a phased-in basis.

Other Gimmicks Also Under Consideration

Administration officials also have suggested other, even less subtle means of circumventing the limitations the budget places on the "economic growth" package.

- The Administration has raised the possibility that all of the provisions in the package be allowed to expire at the end of 2010 — three years before the end of the period the budget resolution covers.[6] This would help fit the package within the $550 billion total allowed under the budget without scaling the package back. Of course, the Administration has no interest in these tax cuts being temporary and truly expiring in 2010, and would surely propose in subsequent budgets to make the package permanent, just as it has with the 2001 tax cuts. Those tax cuts were similarly designed to expire artificially in order to create the illusion of lower initial costs.

- Another proposal is to remove some of the most popular tax-cut provisions from the reconciliation package and have Congress vote on these provisions separately, outside the reconciliation process. Rep. Jim McCrery, a Louisiana Republican who chairs the House Ways and Means Subcommittee on Select Revenue Measures, has proposed leaving the Administration's tax cuts for married couples, its increase in the child tax credit, and its small business investment incentives out of the package to make room for the entire dividend proposal.[7]

  This maneuver is a cynical one. It entails retaining the piece of the so-called "economic growth" package that is estimated to have the least immediate impact on the economy, while removing two elements that would offer more economic stimulus. According to the independent economic forecasting firm Economy.com, the dividend tax cut offers the least "bang for the buck" in terms of immediate economic stimulus of any proposal in the package, while the child tax credit and the married couple proposals would have substantially larger stimulative effects.[8] Those proposals are directed to a greater degree than the dividend tax cut to middle-income rather than high-income families. Middle-income families are more likely to spend, rather than save, additional funds they receive than households with higher incomes; only if the funds are spent will they provide immediate help to a sluggish economy.

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[6] Mike Allen and Jonathan Weisman, "Bush Eager to Preserve Bulk of Tax Cut Package," *The Washington Post*, April 24, 2003.

[7] Donald Lambro, "GOP Tax-Cut Plan Will Win," *Washington Times*, April 24, 2003.

[8] "The Need for Federal Government Aid to State Government," Economy.com, February 2003.

(It may be noted that the Economy.com analysis also found that two of the three proposals that would be the most effective as stimulus are *non*-tax measures: extension of the federal unemployment benefits program, which is scheduled to expire May 31, and the provision of fiscal relief to the states. Both of those measures scored substantially higher as stimulus in the Economy.com analysis than all of the tax-cut measures under consideration, including child tax credit enlargement and marriage penalty relief, with the exception of the proposal to accelerate the widening of the 10 percent tax bracket. The proposal to widen the 10 percent bracket rated modestly higher than state fiscal relief, but well below the extension of federal unemployment benefits.)

Conclusion

These various gimmicks and maneuvers represent ways that the Administration and the Congressional leadership could appear to be complying with the limits the congressional budget resolution established, without making meaningful changes to the Administration's original $726 billion tax-cut proposal. Such maneuvers technically would meet the letter of the budget that Congress adopted. But they would violate its spirit, make the nation's fiscal policy more reckless, and render our economic policies less rational and effective and more driven by ideology and political considerations.