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CBPP STATEMENT

Updated Wednesday, December 8, 2010

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STATEMENT OF ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, ON THE TAX CUT-UNEMPLOYMENT INSURANCE DEAL

The deal between President Obama and Republican leaders on tax cuts and unemployment insurance has two substantial positive aspects: its surprisingly strong protections for low- and middle-income working families and its stronger-than-expected boost for the economy and jobs. But it also has two deeply disturbing negative features: not only the extension of the high-end income-tax cuts, but also an egregious estate-tax giveaway that Senator Jon Kyl demanded for the estates of the wealthiest one-quarter of 1 percent of Americans who die.

Congress should approve this package — its rejection will likely lead to a more problematic package that does less for middle- and low-income workers and less for the economy. Then, in 2012, when the economy should be stronger, the President should make clear he will veto any legislation to extend either the high-end tax cuts or the weakening of the estate tax beyond the estate-tax parameters that were in place in 2009, and he should take that case to the country.

The Positives in the Package

In several respects, the package exceeds the expectations we and many other observers had set when the negotiations began.

- The 13-month extension of federal unemployment benefits is a major accomplishment. Only a few weeks ago, the House fell short of passing a three-month extension. The 13-month extension will prevent 7 million jobless workers from losing essential income support, without which they would have to cut their purchases substantially, causing the loss of many more jobs. The Council of Economic Advisers recently estimated that an end to these benefits would cause the loss of 600,000 jobs and cut already-inadequate economic growth by 0.6 percentage points by the end of next year, quite a large amount; Goldman Sachs recently made a similar estimate of the impact on economic growth.

- The package continues for two years all of the 2009 Recovery Act improvements in the Earned Income Tax Credit, the American Opportunity Tax Credit (which helps students from low- and middle-income families afford college), and the refundable component of the Child Tax Credit. These measures are simultaneously effective stimulus policy, desirable social policy, and admirable anti-poverty policy. They encourage work over welfare and help more Americans obtain a college education; they provide sound stimulus by putting money in the hands of hard-pressed working families that will spend it; and they substantially reduce child poverty.

- The package also contains a one-year reduction of 2 percentage points in the employee share of the Social Security payroll tax; workers will pay a 4.2 percent tax on their first $106,800 in wages, rather than 6.2 percent. This provision, which would replace the current "Making Work Pay" tax cut, would raise workers' take-home pay by $120 billion in 2011 (relative to current law) and consequently should provide some economic boost.

These provisions would protect low- and middle-income workers and their families and, by boosting their incomes, also preserve or create substantial numbers of jobs. Mark Zandi, chief economist of Moody's Analytics, estimates that federal unemployment benefits generate $1.60 in economic activity for every dollar in cost; the refundable tax credits generate about $1.20 to $1.40 in activity for each dollar in cost; and the payroll tax reduction generates about $1.25 for each dollar in cost. In other words, all of these measures rank high in "bang-for-the-buck" effectiveness.

The Negatives

But the package also extends President Bush's tax cuts for households above $250,000. The Tax Policy Center says these tax cuts average over $100,000 a year for people whose incomes exceed $1 million a year; the Congressional Budget Office ranks such an extension *last* among the tax and spending options it studied for spurring the weak economy and creating jobs; and Zandi ranks it near the bottom of his list of options.

The package's biggest disappointment is a provision that would shrink the estate tax well below its 2009 level for the next two years.

President Obama sought to reinstate the already-generous 2009 estate tax rules, under which the estates of 99.75 percent of people who die would be entirely tax free, according to the Tax Policy Center. Under the 2009 rules, the first $3.5 million of an estate ($7 million for couples) would be exempt from the tax, and the maximum tax rate on the taxable portion of estates would be 45 percent; the average *effective* tax rate on taxable estates would be below 20 percent.

But this was not good enough for Senator Kyl, who insisted on the inclusion of a proposal that he and Senator Blanche Lincoln have pushed for some time. Their proposal would exempt the first $5 million of an estate ($10 million for a couple) from the estate tax and set a maximum tax rate of 35 percent on the taxable portion of large estates. This would provide an estimated $25 billion in tax reductions over the next two years exclusively to the top one-quarter of 1 percent of estates. Those estates would receive an average tax break of about *$1 million each* — the bigger the estate, the more lavish the new tax break. Only the top one-seventh of 1 percent of estates would owe any tax at all, and their effective tax rate would average about 14 percent, based on Tax Policy Center estimates.

What Should Policymakers Do?

Despite the provisions concerning the upper-income tax cuts and the estate tax, which would squander billions of dollars while doing little to help the economy, policymakers should approve the package. The unemployment insurance and refundable tax credit provisions are essential to prevent large losses of purchasing power that would slow the economy — and large increases in hardship and poverty. The temporary payroll tax cut is also important for spurring economic growth. In all, the package provides $216 billion in unemployment insurance and low- and middle-income tax benefits — $120 billion for the payroll tax cut, $56 billion for unemployment insurance, and $40 billion for the refundable tax credits. (The high-end and estate tax provisions appear to total about $125 billion.)

Moreover, congressional defeat of the package would create a need for new negotiations with the Congress that takes office in January. That Congress will be more hostile to unemployment insurance and tax credits for low-income working families, just as insistent on continuing the Bush upper-income tax cuts, and aggressive in pushing for even more egregious estate-tax policies. Many in the new House majority favor estate tax repeal.

In addition, defeat of the package could lead to a protracted period during which *all* of the tax cuts have expired *and* federal unemployment benefits have ended, damaging the economy and even possibly tipping it into a double-dip recession.

The big concern about the package is that policymakers will extend again in 2012, and subsequently make permanent, the high-income and estate-tax provisions, thereby making our serious long-term fiscal problems considerably worse. This is a serious threat, and it is the fundamental danger in the package.

However, there is a potential remedy. In 2012, the economy should be stronger than it is today. In addition, Congress likely will have enacted some significant budget cuts, and the nation likely will be debating the sort of further cuts that various commissions have recently proposed, including cuts in Social Security and Medicare benefits for elderly widows and seriously disabled people with incomes as low as $20,000. At that point, the President will need to make clear that he will *veto any legislation extending the high-end tax cuts or the weakening of the estate tax beyond its 2009 parameters*, and he should use the bully pulpit to take this case to the country.

The country will not likely believe that millionaires should continue to get tax cuts averaging over $100,000 a year and multi-million-dollar estates should continue to receive $1 million average tax cuts while programs ranging from education to environmental policies to Medicare and possibly Social Security are on the cutting block.