Tax Returns

A Comprehensive Assessment of the Bush Administration Tax Cuts

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CENTER ON BUDGET AND POLICY PRIORITIES

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Table of Contents

TABLES

Appendix Tables:

FIGURES

Executive Summary

The Bush Administration has stood in favor of tax cuts through thick and thin. In the midst of a booming economy and large projected budget surpluses, President Bush's top economic policy initiative — both as a candidate in 2000 and upon taking office — was to cut taxes. When the economy slowed, the Bush Administration's response also was dominated by tax cuts. Now, in the face of yawning deficits and its own pledge to reduce them, the Administration has again put forward large, permanent tax cuts as part of its most recent budget.

This analysis offers a comprehensive review of the Bush Administration's tax cuts. It assesses their costs, benefits to different income groups, and economic effects to date, as well as down the road. It both synthesizes previous findings about the individual tax measures and includes new findings about their combined effects, using new distributional analyses by the Urban Institute-Brookings Institution Tax Policy Center and fresh cost estimates by the Center on Budget and Policy Priorities.

The early returns on the effects of the tax cuts have not been good.

- The Bush tax cuts have contributed to revenues dropping in 2004 to the lowest level as a share of the economy since 1950, and have been a major contributor to the dramatic shift from large projected budget surpluses to projected deficits as far as the eye can see.

- The tax cuts have conferred the most benefits, by far, on the highest-income households — those least in need of additional resources — at a time when income already is exceptionally concentrated at the top of the income spectrum.

- The design of these tax cuts was ill-conceived, resulting in significantly less economic stimulus than could have been accomplished for the same budgetary cost. In part because the tax cuts were not as effective as alternative measures would have been, job creation during this recovery has been notably worse than in any other recovery since the end of World War II.

If the Administration's latest tax proposals — which would make permanent most of the tax cuts enacted in 2001 and 2003 and establish new tax cuts on top of that — are enacted, the long-term results are likely to be even more troubling. Over the next 10 years, total tax-cut costs will equal $3.9 trillion, reaching nearly $600 billion or 3.3 percent of the economy in 2014 alone. (These calculations include the effects of the higher interest payments caused by the tax cuts.) The resulting higher deficits will slow future economic growth, saddle future generations with sizable interest payments, and leave the nation ill-prepared not only for the retirement of baby boomers but also for responding to potential future crises — from security matters to natural or environmental disasters — the particulars of which are unknown today.

Pressure to reduce these deficits will mount. Because the tax cuts are so tilted toward the highest-income households — and become even more so over time, as some of the upper-income tax cuts phase-in — the burden of financing these lopsided tax cuts ultimately is likely to be borne disproportionately by households who gain only modestly from the tax cuts. This will be the case unless offsetting spending cuts or tax increases are enacted that reduce benefits or raise taxes primarily on high-income households. As a result, over the long term most Americans may well be net losers from the tax cuts.

Cost of Tax Cuts

The Tally So Far

The three rounds of tax-cut legislation (in 2001, 2002, and 2003) account for a substantial share of the nation's current deficit.

- The tax cuts would reduce revenues by $276 billion in 2004, according to Joint Committee on Taxation estimates. Further, the interest costs associated with the enacted tax cuts would equal $20 billion, using Congressional Budget Office assumptions. The total cost would therefore be $297 billion, or 2.6 percent of the economy (or GDP).

- Using these estimates, the cost of the tax cuts account for more than half of the 2004 deficit, which CBO estimates to be $477 billion or 4.2 percent of GDP. Based on these estimates, the deficit would have been 1.6 percent of GDP without the tax cuts.

Table 1
Tax Cuts and the 2004 Deficit (excluding economic effects)

	As Percent of GDP
2004 deficit *with* tax cuts	4.2%
Cost of tax cuts	2.6%
2004 deficit *without* tax cuts	1.6%

Source: CBPP calculations based on data from the Joint Committee on Taxation and the Congressional Budget Office

- These calculations, however, do not take into account the economic effects of the tax cuts. Most economic analyses suggest that the tax cuts have had some positive effect on the economy *in the short run* — at issue is the extent of this positive effect given their cost. These positive effects would make the short-run revenue losses associated with tax cuts somewhat smaller, and estimates of the deficit without the tax cuts somewhat higher. Nevertheless, even using the Administration's assumptions about the economic effects of its tax cuts, the tax cuts would still account for 45 percent of the 2004 deficit.

Indeed, the contribution of the tax cuts to the current deficit exceeds the contributions attributable to other factors, such as the economic downturn. A new CBO study finds that the direct effects of the business cycle account for only six percent of the 2004 deficit. Furthermore, when the cost of all legislation enacted since 2001 is considered, the tax cuts are found to cost more than all program increases combined, including increases in military expenditures, homeland security, and education spending. Domestic discretionary spending (which is funded on an annual basis) is now being singled out by the President and Congress for reductions. The cost of the tax cuts, however, is 18 times the cost of the increases in domestic discretionary spending.

In 2004, CBO estimates that federal revenues will fall to their lowest level as a share of GDP — 15.8 percent — since 1950. The revenue base will be smaller, as a share of the economy, than it was before programs such as Medicare, Medicaid, and the interstate highway system existed. In contrast, total federal spending in 2004 is not estimated to be at particularly high levels as a share of the economy. CBO projects that federal spending will equal 20.0 percent of GDP in 2004, a level that is lower than in the 22 years from 1975 to 1996.

Table 2
Historically Low Revenues, Not High Spending, Behind Current Deficit

	As Percent of GDP	
	Average, 1980-2003	**2004**
Spending	21.1%	20.0%
Revenue	18.5%	15.8%
Deficit	2.6%	4.2%

Source: Congressional Budget Office

Unprecedented Use of Gimmicks

Research by Brookings Institution economists William Gale and Peter Orszag underscores the extent to which the design of the tax cuts has relied on budget gimmickry. They found that in the 1990s, the practice of having tax cuts appear to expire — that is, of enacting tax cuts ostensibly scheduled to expire after a few years when the intention and likely actual outcome was to have the tax cuts become a permanent fixture of law — was employed on a modest scale. The practice exploded, however, with the 2001 tax-cut legislation.

Gale and Orszag, citing CBO data, show that at the start of 2001 the cost ten years down the road of extending all tax-cut measures in law that had a temporary status was $22 billion. By contrast, if the temporary tax-cut provisions in place today are all extended, their cost in ten years (i.e., in 2014) will be $431 billion.

The Administration has engaged in ongoing efforts to obscure the ultimate costs of its tax cuts. These efforts are reflected in the Administration's current budget, released in February 2004. The budget shows deficit figures only over the next five years, which obscures the likely growth of the deficit in the second half of the coming decade under the Administration's proposals, with the large deficits driven in significant part by its proposal to make the tax cuts permanent.

In addition, in its current budget, the Administration proposes new tax-advantaged savings and investment accounts that feature striking timing gimmicks. As a result, this proposal *raises* revenue over the first five years. But the proposal would cause increasingly large revenue losses after that. The proposal ultimately is likely to cost the equivalent of $35 billion a year.[1]

In a final, particularly audacious gimmick, in legislation sent to Congress on April 2, the Administration proposes a budget rule that would, for official purposes, make the cost of extending the 2001 and 2003 tax cuts *disappear*. If this change were enacted, the CBO would be required to show legislative proposals to make the tax cuts permanent as having *zero* cost.

The Long-Term Costs

If the tax cuts the Administration wants to make permanent are made permanent, current relief from the swelling Alternative Minimum Tax is continued, as most observers expect it will be (the Administration supports continuation of AMT relief but has not yet put forward a specific AMT proposal), and the additional tax cuts the Administration has proposed are enacted, the future costs of these tax cuts will be extremely large.

- Over the 10-year period from 2005 through 2014, the direct costs of the enacted and proposed tax cuts would total $2.8 trillion. The cost would equal 2.1 percent of the economy in 2014.

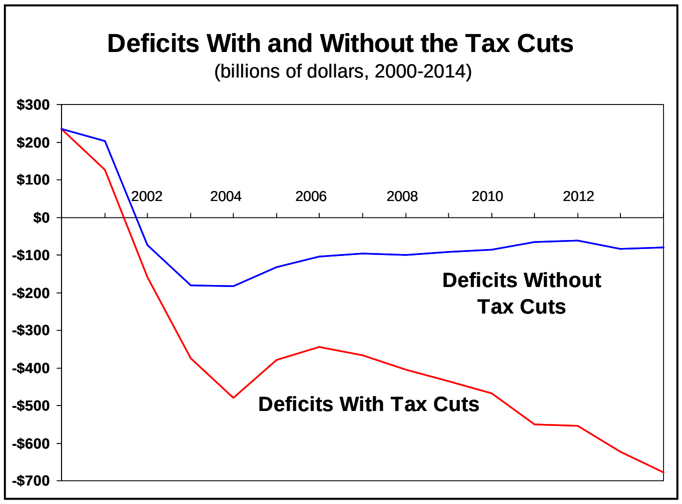
- From 2005 through 2014, the increased interest payments on the debt that result from the tax cuts would amount to $1.1 trillion. The interest payments would grow steadily with each passing year and in 2014 would equal $218 billion — or 1.2 percent of the economy. This amount alone is as large a share of the economy as the government now spends on all programs and activities under the Departments of Education, Homeland Security, Interior, Justice, and State *combined*.

- Considering both the direct costs of the tax cuts and the associated increase in interest payments, the tax cuts would increase deficits by nearly $4 trillion between 2005 and 2014.

[1] This estimate is based on analyses by the Urban-Brookings Tax Policy Center and the Congressional Research Service.

- Over the next 75 years, the cost of these tax cuts — assuming they are made permanent — would be more than the *combined* shortfall in the Social Security and Medicare Hospital Insurance trust funds.

Figure 1



In the absence of the tax cuts, the deficit picture over the coming decade would look very different. Without the tax cuts, the deficit would be under $100 billion in most years. With the tax cuts, the deficit is projected to grow to more than $675 billion by the end of the decade.[2] If the tax cuts are extended, revenues over this period will remain at quite low levels by recent historical standards. Over the next decade, average revenues as a share of GDP would be lower than the average levels of revenues in the 1960s, 1970s, 1980s, and 1990s.

Distribution of Tax-Cut Benefits

The benefits that the tax cuts provide to different groups vary dramatically. New data from the Tax Policy Center show the effects in 2004 of the tax cuts that have already been enacted, including the corporate and estate tax cuts, as well as the individual income tax cuts. The Tax Policy Center data show that the combined effect of the tax cuts in 2004 is as follows:

- The one-fifth of households in the middle of the income spectrum will receive an average tax cut of $647.

- The top one percent of households will receive tax cuts averaging almost $35,000 — or 54 times as much as that received on average by those in the middle of the income spectrum.

- Households with incomes above $1 million will receive tax cuts averaging about $123,600. The tax cuts for millionaires will cause their after-tax income to jump by 6.4 percent, nearly three times the percentage increase received by the middle fifth.

The overall shares of the tax cuts that are going to different households also are illuminating. The Tax Policy Center data show that:

[2] For a discussion of the methodology underlying these budget projections, see Richard Kogan, David Kamin, and Joel Friedman, "Deficit Picture Grimmer Than New CBO Projections Suggestion," Center on Budget and Policy Priorities, February 1, 2004. These estimates are consistent with projections that have been made by the Brookings Institution, Goldman-Sachs, and other independent analysts.

- In 2004, the middle 20 percent of households will receive 8.9 percent of the tax cuts.

Table 3

Distribution of Tax-Cut Benefits in 2004
(reflects tax cuts enacted since 2001)

Income Class	Average tax cut	% increase in after-tax income	% share of tax cut
Middle 20 percent	$647	2.3%	8.9%
Top one percent	$34,992	5.3%	24.2%
Over $1 million	$123,592	6.4%	15.3%

Source: Urban-Brookings Tax Policy Center

- By contrast, millionaires — totaling just 0.2 percent of U.S. households — will receive 15.3 percent of the tax cuts.[3] In other words, the small handful of millionaires will receive total tax cuts far larger than those received by the entire middle 20 percent of households.

- The tax cuts will confer more than $30 billion on the nation's 257,000 millionaires in 2004 alone.

As uneven as the distribution of the tax cuts is in 2004, their distribution will become still more uneven over time. This is because the tax cuts of most benefit to the middle class are already fully in place while some of the tax cuts of most benefit to high-income households — such as the eventual elimination of the estate tax — are only partly in effect now or have yet to take effect at all. If the tax cuts were fully in place today, the middle fifth of households would receive essentially the same tax cut that they are scheduled to receive under 2004 law, while the top one percent would receive tax cuts substantially larger than under 2004 law.[4]

Three "Middle-Class Provisions" Compared With Other Tax-Cut Provisions

In assessing the tax cuts and their distribution across different income groups, it is interesting to distinguish between three so-called "middle-class provisions" and all of the other tax-cut provisions enacted over the past few years. These "middle-class provisions" — which established the 10 percent tax bracket, expanded the child tax credit, and provided tax relief to married couples — were first enacted in 2001 and became fully effective in 2003, when their implementation was accelerated as part of the 2003 tax-cut package. This acceleration expires at the end of 2004, at which time the provisions return to their original phase-in path. These "middle-class provisions" have generally received broad bipartisan support, in contrast to many

[3] The share of tax cuts received by those with very high-incomes is also greater than their shares of national income and of taxes paid. For example, the Tax Policy Center data indicate that in 2004, in the absence of the tax cuts, millionaires would have an estimated 7.8 percent of after-tax income and 9.1 percent of before-tax income, and would pay 13.6 percent of all federal taxes. Their share of the tax cuts in 2004 — 15.3 percent — is larger than each of those other shares, a further indication of this group's outsized benefits from the tax cuts.

[4] The estimate of tax law being fully in effect today reflects only the Administration's proposal to extend most of the tax cuts enacted in 2001 and 2003, and does not include the effects of other tax-cut proposals in its fiscal 2005 budget.

of the other tax-cut provisions, which are dominated by the more contentious upper-bracket rate reductions, dividend and capital gains rate cuts, and the elimination of the estate tax.

These three "middle-class provisions" provide substantial help to the broad middle class, although it is sometimes overlooked that they provide significant tax benefits to high-income households as well. The middle fifth of households will receive an average tax cut of $547 in 2004 from these provisions. The top one percent of households will receive an average tax cut of $1,320 from these measures.

Table 4

Average Value of Tax-Cut Benefits in 2004

Income Class	Three "Middle-Class" Provisions	All Other Tax-Cut Provisions
Middle 20 percent	$547	$100
Top one percent	$1,320	$33,672

Source: Urban-Brookings Tax Policy Center

The distribution of these "middle-class provisions" stands in stark contrast, however, to the distribution of tax benefits under the remaining tax-cut provisions. *The top one percent of the income spectrum will receive an average tax cut of almost $33,700 from all of the other tax-cut provisions in 2004, while the middle fifth of households will receive an average tax cut of just $100.* The other tax cuts provide those at the top of the income scale with average tax benefits more than 300 times larger than the benefits that those in the middle of the income spectrum are receiving. This gap will widen even further over time.

Of particular note, these three "middle-class provisions" account for just one-third of the cost of the tax cuts over time. In other words, the vast majority of the tax cuts that benefit the middle class could have occurred at about one-third of the cost of the tax cuts that have been enacted or that the Administration is now proposing.

The Administration's Hesitant Support of Provisions That Help Lower-Income Households

The Administration has worked hard to create the impression that its tax cuts benefit all families, including those of modest means. In most cases, however, the Administration has accepted tax cuts for lower-income families only under pressure. When it has had the opportunity to initiate such tax cuts, it has consistently rejected them.

For example, when promoting his 2001 tax-cut plan in his first months in office, President Bush emphasized the benefits for low-income families with children by using an example of a waitress earning $25,000. As it turned out, the waitress he mentioned would have received no tax cut (or a small tax cut if she had significant child care costs) because the President's proposal provided no relief to families that owed no income tax but paid significant amounts of payroll tax. The Administration received substantial criticism in early 2001 on this score, and it ultimately agreed to Congressional changes to its child tax credit proposal that

The Very Well-Off: Big Winners on Two Fronts

The very well-off have been big winners on two fronts. They secured enormous gains in income in the 1980s and 1990s. They now are receiving extremely large tax cuts as a result of the 2001 and 2003 tax-cut measures. The Congressional Budget Office provides the most comprehensive data available on recent changes in incomes and taxes for different income groups; these CBO data cover years from 1979 until 2001. Just-released CBO data show:

- The average after-tax income of the top one percent of the population more than doubled over this period, rising from $294,300 in 1979 to $703,100 in 2001, an increase of $408,800. (CBO adjusted these figures for inflation and expressed them in 2001 dollars.) This represents an increase of 139 percent.

- By contrast, the average after-tax income of the households that make up the middle fifth of the U.S. population rose $6,300, or 17 percent, during this period. And the average after-tax income of the poorest fifth of households rose $1,100, or only eight percent.

- In combination with data on *before*-tax income from a study issued by the National Bureau of Economic Research, these CBO data indicate that before-tax income was more concentrated at the top of the income scale in 2001 than at any time in the previous 65 years (i.e., back to 1936), except for the years from 1997-2000.

provided significant aid to the waitress in the President's example and to millions of other low- and moderate- income working families with children.

A similar story played out in 2003. The President proposed accelerating most of the income tax cuts enacted in 2001 that were scheduled to phase in over time, but he rejected accelerating the child tax credit provision enacted in 2001 that is of benefit to low- and modest-income working families. A front-page story in *The New York Times* called attention to this omission the day after the 2003 tax bill was signed into law, generating a torrent of criticism. The Administration shifted positions in the face of this criticism, voicing support for accelerating the provision in question. But the Administration expended little effort on this score, and the acceleration has not been enacted.

The pattern continues in 2004. The President's budget proposes to make permanent every tax-cut provision enacted in 2001 and 2003 that predominately benefits people with high incomes. But the budget fails to extend — and thus would let die after 2006 — the provision of the 2001 tax-cut law that encourages greater retirement saving by working families with incomes under $50,000.

The Administration's Story

Anyone who has learned most of what they know about the tax cuts from President Bush's speeches and Administration press releases might find the foregoing discussion of the distribution of the tax cuts surprising. The Administration has consistently highlighted the tax benefits for the middle class and promoted its tax cuts as beneficial to a variety of sympathetic groups, such as small businesses. Unfortunately, much of the information it has put forward in this regard has been selective or misleading.

As one example, the Administration has consistently employed “averages” in a manner that falls far short of a reasonable use of statistics and overstates the benefits of the tax cuts to middle-income households. The Administration’s average tax-cut figures are skewed upward by the very large tax cuts that go to a small number of very high-income taxpayers. The large majority of U.S. households will receive less than the average tax cut the Administration cites. In fact, the typical (or median) household will receive less than half the amount the Administration describes as being the “average” tax cut.

Similarly, the President has repeatedly invoked the benefits his tax cuts, and especially his proposal to reduce the top income tax rate, provide to small businesses. Yet, according to Treasury Department data, the top rate reduction benefits only two percent of small business owners. In other words, 98 percent of small business owners are not in the top tax bracket. In fact, many more such individuals receive the Earned Income Tax Credit for lower-income working families than are in the top bracket.

Furthermore, the Administration’s definition of “small business owner” includes anyone who earns even one dollar of income that is classified as business income under the tax code. Under this definition, one need not actually run or own a major share of a business to be classified a business owner. This definition includes wealthy individuals whose primary income does not come from small business ownership or operation but who do some consulting or invest in real estate on the side. Many of those in the top tax bracket are better characterized as very-high-income individuals, such as corporate executives, with some business investments.

Economic Effects of the Tax Cuts

From the outset, the Administration has argued that its tax cuts are good for the economy. Initially, the Administration touted the long-term benefits of its tax cuts. When the economy weakened, the Administration changed its tune and justified its tax-cutting agenda as a way to strengthen a struggling economy and create jobs. The tax cuts were poorly designed to provide short-term stimulus, however, and the results on the job-creation front have been disappointing. Further, the tax cuts, by adding significantly to mid-term and long-term deficits, are likely to be a drag on the economy over the long run.

Poor Bang for the Buck

An examination of President Bush’s 2003 tax-cut proposal demonstrates how ill-suited his proposals have been to providing short-term economic stimulus. Economy.com, an independent economics research firm whose analyses have been used widely in recent years, conducted a study in early 2003 that examined the various stimulus proposals then under consideration. The study measured the amount of increased economic “demand” that each dollar of lost tax revenue or increased program spending would generate in the year after the benefit has been provided. (One rule-of-thumb to keep in mind is that proposals that put more money in the hands of low- and middle-income people generally provide more short-term stimulus than proposals that put more money in the hands of high-income people, because low- and middle-income people are more likely than high-income people to spend quickly any additional income they might have.)

The Economy.com assessments indicate that only 19 percent of the President's proposed 2003 stimulus package consisted of high "bang-for-the-buck" proposals — proposals that would yield more than one dollar of added short-term demand for each dollar of revenue loss. More than half of the Administration's package consisted of its proposal to eliminate the taxation of corporate dividends. Economy.com estimated that proposal would generate less than a dime of short-term stimulus for each dollar of revenue lost.

Moreover, the tax cuts the Administration proposed in 2003 would have been spread out over ten years. For purposes of helping the economy in the short run, only tax cuts that take effect when the economy is weak are important. A mere 5.5 percent of the Administration's proposed stimulus tax-cut package would have occurred in fiscal 2003 (that is, by the end of September 2003). Another 15.7 percent would have occurred in fiscal 2004. In combination, only about one-fifth of the proposed tax cuts would have been in effect by October 2004.

With only a small minority of the tax-cut proposals consisting of high "bang-for-the-buck" proposals and only a small percentage of the tax cuts taking effect by the end of fiscal 2004, the President's 2003 stimulus proposal can fairly be characterized as highly inefficient at providing short-term stimulus. Only four percent of the President's 2003 package consisted of high "bang-for-the-buck" tax cuts that would have been in effect by October 2004.[5]

Table 5
President's 2003 Stimulus Proposal

Percent of proposed tax-cuts that:	
Have high "bang for the buck"	19%
Affect economy in the short run	21%
Are effective stimulus	4%

The stimulus bill actually enacted in 2003 was modestly more efficient at providing short-term stimulus to the economy than the President's original proposal, primarily because it included state fiscal relief. Even so, just 8 percent to 14 percent of the cost of stimulus legislation enacted in 2003 consisted of high "bang-for-the-buck" short-term stimulus proposals.

These data provide credence to a statement issued in February 2003 and signed by 10 Nobel Price-winning economists and 450 other economists, which stated in part: "Regardless of how one views the specifics of the [2003] Bush [tax cut] plan, there is wide agreement that its purpose is a permanent change in the tax structure and not the creation of jobs and growth in the near-term."

[5] The President's proposals to accelerate the expansion of the 10 percent tax bracket and the child tax credit increase were the only two provisions whose "bang for the buck" exceeded $1, according to Economy.com. According to Joint Committee on Taxation estimates, these two provisions reduced taxes by $29.4 billion in fiscal years 2003 and 2004, or four percent of the $725.8 billion overall cost of the President's stimulus proposal through 2013.

Job Creation

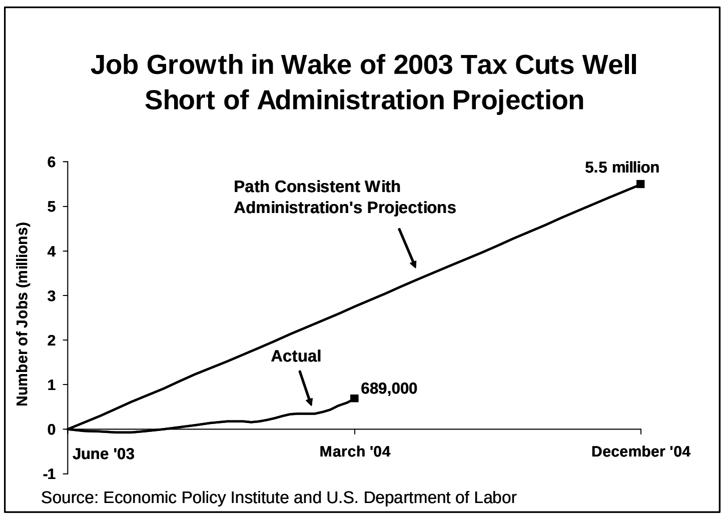
A principal Administration justification for its tax cuts, particularly over the past year**,** has been their importance for job generation. The tax bills passed by Congress were somewhat less inefficient at stimulating the economy than the President's original proposals. Even so, the results in this area have been poor.

- The Administration's February 2004 *Economic Report of the President* itself noted that: "The performance of employment in this recovery has lagged that in the typical recovery and even that in the 'jobless recovery' of 1990-1991."

- Employment remains substantially below its level at the start of the downturn, an unparalleled development this far into a post-World War II recovery. (Substantial job growth typically occurs by this point.) As of March 2004, there were still two million fewer jobs than when employment last peaked in March 2001.

For three years, the Administration has been claiming its tax cuts would boost employment. But for three years, actual job growth has fallen far short of Administration expectations. For example, since the summer of 2003, the Economic Policy Institute has been comparing actual job growth to the amount of job growth the Administration predicted would occur with the passage of the 2003 tax-cut bill. The Administration predicted that with the passage of the tax-cut measure, 5.5 million jobs would be created in the 18 months from June 2003 through December 2004. In the first nine months of this 18-month period, a relatively modest 689,000 jobs were created, just 13 percent of the Administration's projection.

Figure 2



President Bush and his Administration have highlighted a different labor market statistic — the relatively low unemployment rate of 5.7 percent (in March 2004). This level, however, is misleading. It does not reflect significant job growth and labor market strength; instead, it reflects an unusual decline in the number of people looking for a job. This decline is a sign of labor-market weakness, as it presumably indicates that people are dropping out of the labor force because they do not believe job prospects are promising. If labor force participation had been the same in March 2004 as in March 2001, when the downturn began, the unemployment rate in March 2004 would have equaled about 7.4 percent, rather than 5.7 percent.[6]

[6] The 7.4 percent calculation assumes that the increased number of job seekers would not have affected the number of jobs.

Job growth during this recovery might have lagged behind that of previous recoveries even if the recent economic policies had been better designed. Nonetheless, the exceptionally poor job growth of recent years suggests the Administration's tax cuts have largely failed to accomplish one of its stated policy goals. The inefficiency of the tax cuts when it came to providing short-term stimulus makes this failure less surprising.

GDP Growth

Despite the 2001, 2002, and 2003 tax cuts, overall economic growth has been below par. The economy hit its low point during the last quarter of 2001. So far during the recovery period, the economy has grown at an average annual rate of 3.6 percent, after adjusting for inflation. This growth rate compares unfavorably with the growth rate in seven of the eight previous recoveries since the end of World War II.

This recession was "shallow" so perhaps one might expect the rebound to be less steep. To account for this, growth can be assessed from the point when the economy last peaked until now; this measure takes into account that the decline in the economy was not as great in this downturn as in some other downturns. Even by this measure, the current recovery rates poorly. The amount of economic growth over the period since the pre-recession peak lags behind the average amount of growth achieved at the comparable stage of other post-World War II recoveries.

Undermining Future Growth

Over time, the tax cuts will become even less effective at generating economic growth. In the medium term, the tax cuts are likely to have little effect on the size of the economy, despite costing hundreds of billions of dollars each year. Studies by both the CBO and the Joint Committee on Taxation (both run by Republican appointees) have found that over the next ten years, the effects of the tax cuts on growth are likely to be small and could be either mildly negative or mildly positive.

In the long-term, the tax cuts would have more pernicious effects on economic growth. Large, persistent deficits can gradually eat away at the nation's economic foundation. The higher deficits to which the tax cuts significantly contribute will reduce national saving and thus over time result in less domestic investment (and more borrowing from overseas). The reduction in domestic investment and increased borrowing from abroad associated with budget deficits lowers the nation's future standard of living from what it would otherwise have been. As the International Monetary Fund concluded in a January 2004 report:

> "U.S. government finances have experienced a remarkable turnaround in recent years. Within only a few years, hard-won gains of the previous decade have been lost and, instead of budget surpluses, deficits are again projected as far as the eye can see."
>
> "…the recent emphasis on cutting taxes, boosting defense and security outlays, and spurring an economic recovery may come at the eventual cost of upward pressure on

> interest rates, a crowding out of private investment, and an erosion of longer-term U.S. productivity growth."

Moreover, the same IMF report, as well as a study by former Treasury Secretary Robert Rubin, Wall Street economist Allen Sinai, and Brookings Institution economist Peter Orszag, concludes that the large long-term deficits to which the tax cuts have substantially contributed could lead to damaging economic instability. Rubin, Sinai, and Orszag warn that the projected long-term budget imbalances have become so large that they ultimately could lead to serious "financial and fiscal disarray" caused by a "fundamental shift in market expectations and a related loss of confidence at home and abroad."

Plotting a Different Course

These findings suggest it is time to reconsider the tax cuts. The Administration disagrees. Its budget calls for making permanent nearly all of the tax cuts that were passed in 2001 and 2003, at an immense cost to the Treasury. It also proposes an array of new tax cuts and more budget gimmickry. For instance, it proposes a series of tax cuts related to savings that would, in all likelihood, *diminish* net national saving by substantially increasing the deficit. These proposals are designed to show increased tax revenues over the next five years but ultimately would cost approximately $35 billion a year.

These savings proposals continue two other undesirable patterns of the Administration's tax-cut policies. First, the tax-cut benefits from the proposals would go overwhelmingly to the nation's wealthiest individuals. Second, these tax cuts would harm already vulnerable *state* budgets. State income tax codes generally conform to the federal tax treatment of savings. As a result, if these savings-related tax cuts are enacted at the federal level, many states would experience revenue losses. Such revenue losses would be on top of the revenue losses many states are experiencing as a result of federal tax cuts enacted in 2001, 2002, and 2003.

A different policy course can be followed. Instead of pushing to make nearly all of the tax cuts permanent and institute new tax cuts on top, there should be an examination of which tax cuts should be extended, which should *not* be extended, and which should be scaled back or repealed. The tax code also needs reforms that would make it simpler and fairer, and doing so could raise needed revenues. Revenues could be raised by paring back or eliminating tax breaks that are ineffective or outmoded. Finally, revenue also could be raised by beefing up enforcement efforts aimed at corporations and households engaged in sophisticated schemes to hide their income from taxation.

I. Tax Cuts as a Cure for All Ills

The high priority the Bush Administration has given to tax cuts is no secret. In the context of budget surpluses, the Administration's biggest initiative in 2001 was its tax-cut proposal. In the context of efforts to boost the economy in 2002 and 2003, the Administration's response also was dominated by tax cuts. Now in the face of yawning deficits and its own pledge to reduce them, the Administration has again put forward large tax cuts.

The Administration has successfully advocated for individual income tax cuts, as well as for the eventual elimination of the estate tax. It has justified its tax cuts in the name of promoting economic growth and jobs, and in the name of helping small businesses, the elderly, and typical families.

The Administration's rhetoric in support of its tax cuts does not stand up well to scrutiny. Further, the Administration has largely dismissed discussion of the tradeoffs that tax cuts of the magnitude it has supported necessarily entail.

This report provides a comprehensive examination of the effects of the Administration's tax cuts. It examines the recipients of the tax cuts, the impacts the tax cuts have had on the nation's fiscal standing, and their effects on the economy. It synthesizes previous findings about the individual tax measures and includes new findings about their combined effects.

The report is divided into the following chapters:

- This introduction, which includes a quick summary of the basic provisions of the Administration's tax proposal that have been enacted, as well as its current proposals.
- An examination of the costs of the tax cuts, the unusual nature of their design, and their effects on the deficit.
- A description of how much various groups gain from the tax cuts.

- An assessment of the effects of the tax cuts on jobs and the economy.

- A concluding chapter, focusing on where we should go from here.

The Provisions of Each of the Tax Cuts

For 2001-2003, this analysis focuses primarily on the tax cuts that were enacted, as distinguished from the cuts that President Bush initially proposed. The enacted tax cuts mostly reflected the original intent of the Administration's proposals.

The first five appendix tables provide year-by-year details on the costs of each of the three tax-cut packages, as well as the Administration's most recent proposal.

2001 Tax Cuts

The 2001 tax-cut package was the largest of the three, featuring cuts in income tax rates, reductions in taxes for married couples, and an expansion of the child tax credit, among other provisions. The 2001 legislation also reduced the estate tax over several years, before eliminating it in 2010. The legislation was replete with phase-ins and other design gimmicks, and all of the tax cuts "sunset" (i.e., are scheduled to expire) at the end of 2010. Specifically, the package:

- Established a new 10 percent income tax bracket, which replaced the first part of the 15 percent bracket;

- Reduced the rates in the top four income tax brackets;

- Phased out (starting in 2007) existing limitations on itemized deductions, and limitations on the use of personal exemptions, for high-income taxpayers;

- Increased the child tax credit from $500 to $1,000 per child and created a new "refundable" component of the credit to make it available to families that earn more than $10,000 (in 2001 dollars) but do not earn enough to owe income tax;

- Reduced taxes on married couples by making changes to the Earned Income Tax Credit for married filers, increasing the standard deduction for married filers, and expanding the amount of taxable income covered in the 15 percent bracket for married filers;

- Increased the exemption and reduced the rates for the estate tax through 2009 (when the exemption will equal $3.5 million for an individual and $7 million for a couple) and then repealed the tax entirely in 2010;

- Expanded tax breaks for retirement savings, by increasing contribution limits for Individual Retirement Accounts and 401(k)s, creating a new "savers credit" for moderate-income families, and making other changes;

- Provided relief from the Alternative Minimum Tax through 2004;

- Expanded tax breaks for education-related expenses; and

- Included a number of smaller provisions, such as those relating to child care and adoptions.

2002 Tax Cuts

The tax cut enacted in 2002 focused on reductions in business taxes. The package was dominated by a provision that allowed businesses (primarily corporations) to take larger up-front deductions for investing in new machinery and equipment. The key provisions were designed to sunset within 18 months or two years. The 2002 tax cut, the smallest of the three tax cuts that have been enacted, bears less of an Administration imprint than the other two.[7] Specifically, the package:

- Included a "bonus depreciation" provision that allowed businesses to write off 30 percent of the cost of new investments immediately;

- Increased from two years to five years the period over which businesses could "carry back" losses, which allows businesses to make use of deductions for current losses to offset taxes paid in previous years; and

- Had provisions targeted to New York City to assist with the recovery from the September 11th attacks, as well as provisions extending a number of smaller tax breaks.

2003 Tax Cuts

The 2003 tax cut accelerated most of the income tax cuts that the 2001 bill had phased in over time by making them fully effective immediately. It also provided further relief to business. Last, it added a new tax-cut provision that dramatically reduced the taxation of income from dividends and substantially reduced the taxation of income from capital gains.[8] This package:

- Accelerated the expansion of the 10 percent bracket and the child tax credit, as well as relief for married couples (except for those provisions targeted on low- and moderate-income families). These accelerations are slated to expire at the

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[7] The 2002 economic stimulus tax bill also included the creation of the Temporary Extended Unemployment Compensation program, which provided additional weeks of federal unemployment insurance to unemployed workers who exhausted their regular, state-funded unemployment benefits. This provision has since expired.

[8] The 2003 tax-cut package also included $20 billion of state fiscal relief.

end of 2004, after which these tax cuts revert back to the phase-in path set forth under the 2001 tax-cut legislation;

- Accelerated the reductions in the four upper-bracket rates;

- Reduced through 2008 the tax rate on dividends and capital gains. The top tax rate was lowered to 15 percent for both dividend and long-term capital gains income; previously, dividends were taxed at regular income tax rates and the top long-term capital gains rate was 20 percent;

- Expanded from $25,000 to $100,000 the amount of investments that small businesses can immediately write off (or "expense");

- Increased from 30 percent to 50 percent the share of the cost of new investments that businesses can write off immediately and extended this "bonus depreciation" provision from its scheduled expiration in September 2004 to the end of 2004; and

- Increased AMT relief and extended it through 2005.

2004 Budget Proposals

As part of the budget it introduced in February 2004, the Administration again proposed sizable tax cuts. The large majority of the Administration's current tax-cut package consists of making permanent most of the tax cuts enacted in 2001 and 2003. But the Administration also proposed further tax cuts in areas such as savings, health care, charitable giving, and energy.

Despite mounting concerns over the nation's deficit problem, the Administration's interest in costly tax cuts has not diminished. This analysis now turns to the issue of the costs of these enacted and proposed tax cuts.

II. Tax-Cut Costs, Tax-Cut Designs, and the Deficit

During President Bush's three years in office, the nation's fiscal picture has swung sharply from surplus to deficit. The surplus stood at $236 billion or 2.4 percent of the economy (or gross domestic product) in 2000, the year before the Administration took office. For 2004, the Congressional Budget Office is projecting a deficit of $477 billion, or 4.2 percent of the economy. This swing of 6.6 percentage points of GDP is the sharpest deterioration in the nation's fiscal balance since World War II.

Assorted analyses by individuals from a wide-range of institutions — including experts from the Brookings Institution, the Committee for Economic Development, the Concord Coalition, Goldman Sachs, and the International Monetary Fund, as well as from the Center on Budget and Policy Priorities — have found that the deficit is likely to remain outsized for the foreseeable future and to balloon as the baby-boom generation retires in force.

What role have the tax cuts played in this change in the fiscal picture? What is the size of the tax cuts relative to other Administration initiatives and other national priorities? How will making the tax cuts permanent affect the nation's long-run fiscal picture? This chapter addresses these questions.

The Costs in 2004

The total effect of the three rounds of tax legislation already is considerable.

- Between 2001 and 2004, the tax cuts have cost $651 billion, including the increased interest payments on the national debt. These figures are based on the official cost estimates of the tax cuts prepared by the

Table II-1
Cost of Tax Cuts To Date
(in billions of dollars)

	2004	2001-2004
Tax cuts (direct cost)	$276	$618
Interest payments	$20	$33
Total cost	$297	$651

Source: CBPP calculations based on data from the Joint Committee on Taxation and the Congressional Budget Office the Joint Committee on Taxation, and reflect CBO assumptions about the interest costs associated with legislation that changes the deficit.

- In 2004 alone, the tax cuts and the associated interest costs will increase the deficit by $297 billion, or 2.6 percent of the economy.

- Based on these Joint Tax Committee and CBO estimates, the tax cuts are responsible for more than half of the 2004 deficit — or, stated another way, without the tax cuts the deficit in 2004 would be less than half as large, equal to 1.6 percent of GDP rather than 4.2 percent of GDP.

Table II-2
Tax Cuts and the 2004 Deficit (excluding economic effects)

	Dollars (In billions)	**As Percent of GDP**
2004 deficit *with* tax cuts	$477	4.2%
Cost of tax cuts	$297	2.6%
2004 deficit *without* tax cuts	$180	1.6%

Source: CBPP calculations based on data from the Joint Committee on Taxation and the Congressional Budget Office

- These calculations, however, do not take into account the economic effects of the tax cuts. Most economic analyses indicate that the tax cuts have had some positive effect on the economy *in the short run* (see Chapter IV for a fuller discussion of this short-term impact). These positive effects would make the short-run revenue losses associated with tax cuts somewhat smaller than the official estimates, and estimates of the deficit without the tax cuts somewhat higher (see box on page 7).

The nation's revenue base has deteriorated to a remarkably low level.

- Revenues will decline in 2004 to 15.8 percent of GDP, according to CBO estimates. *Revenues will constitute their lowest share of GDP since 1950*, or before programs such as Medicare, Medicaid, and the interstate highway system even existed.

- The drop in income tax collections has been even more marked. In 2004, federal income taxes — covering both individual and corporate income taxes — will fall to their lowest share of GDP since 1942.

- Without the tax cuts, federal revenues in 2004 would have been much closer to their modern historical average. In the absence of the tax cuts, federal revenues in 2004, measured as a share of the economy, would have been essentially at their average level from 1970 to 2003 rather than at their lowest level since 1950.[9]

[9] From 1970 to 2003, revenues averaged 18.3 percent of the economy. Without the tax cuts, revenues in 2004 would have equaled 18.2 percent of the economy, or 0.1 percentage point below the historical average.

Taking Into Account the Economic Effects of Tax Cuts

It may be argued that the analyses of the impact of the tax cuts on the deficit, particularly the 2004 deficit, do not present a complete picture of the role of the tax cuts because the economy would have been in even worse shape without the tax cuts. The effect of tax cuts on the economy in the short run are based on the view that if, during a downturn, the government puts cash into the hands of individuals by cutting taxes or increasing expenditures, some of this money will be spent and thereby stimulate the economy. If stimulated by the tax cuts, the economy could, in turn, generate more revenues than otherwise would have been the case, and any additional revenues would mitigate — but not fully offset — the cost of the tax cuts in the short run.

At issue is whether the economic effects of the tax cuts fundamentally alter the conclusions of the analyses in this report, which rely primarily on official cost estimates of the tax cuts and thus do not include these feedback effects on the economy. To answer this question, we examined the Administration's assumptions about the impact of the tax cuts on the economy in the short run and its assumptions about the additional revenues this extra growth would produce.[*] Under the Administration's assumptions, the effects of the tax cuts on the budget would be reduced, but only somewhat.

For instance, when the Administration's assumptions about the effects of the tax cuts on the economy are factored in, the tax cuts would reduce revenues by about $200 billion in 2004, rather than the $276 billion estimated by the Joint Committee on Taxation and shown in Table II-1. This implies that the tax cuts and associated interest costs would still account for about 45 percent of the 2004 deficit rather than just over 60 percent when the official cost estimates are used. Thus, even under the Administration's assumptions, the conclusions change little — the tax cuts continue to represent a major factor behind the size of the deficit.

Further, although it can be argued that the official estimates may overstate the revenue losses in the short run because of the positive effects of tax cuts, the opposite could be true when looking at the long run. Permanent tax cuts that add to the deficit may depress economic activity over the long run, because the negative effects on the economy of higher deficits generated by the tax cuts may outweigh any positive incentive effects created by the tax cuts. To the degree that this is the case, the long-run costs of the tax cuts may be larger than the official estimates, which are the basis of the analyses presented in this report. See Chapter IV for a more detailed discussion of the economic effects of tax cuts.

[*] Treasury Department, "April 15th Tax Day Reminder: Tax Relief Reinvigorated The U.S. Economy And Is Driving Job Creation," JC-1317, April 9, 2004; and Council of Economic Advisors, "President Bush's 2001 Tax Relief Softened the Recession," February 14, 2002.

These figures highlight the degree to which the tax cuts have raised the deficit. Their role far exceeds that attributed to any other factor, such as the economic downturn or increased spending. In a new report on the U.S. fiscal position, the International Monetary Fund determined that the tax cuts were the most important factor in the shift over the past four years from surplus to deficit.[10]

[10] International Monetary Fund, *World Economic Outlook*, Chapter II, April 2004.

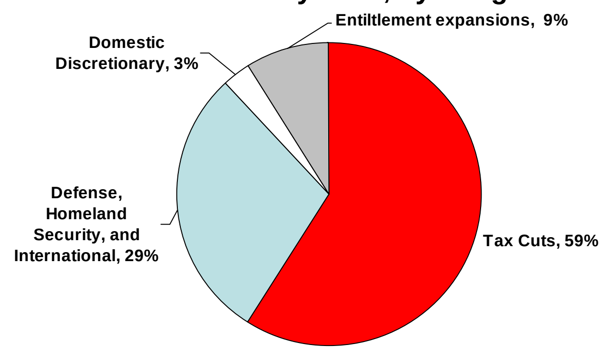
A recent CBO study finds that the effects of the business cycle account for only six percent of the budget deficit that CBO expects in 2004.[11] That is, if the economy were operating at its full potential in 2004, the deficit would be only 6 percent lower (or just $30 billion lower). The tax cuts also have far outstripped legislated spending increases, as explained below.

The Size of the Tax Cuts Versus Other Priorities

As measured by their costs, tax cuts have been the Administration's highest policy priority. When the cost of all legislation enacted since 2001 is considered, the tax cuts have cost more than all other initiatives combined, including increases in defense, homeland security, and education spending. The costs of the tax cuts dwarf the costs of increased domestic discretionary spending. Yet it is domestic discretionary spending that is now being singled out by the President and Congress for reductions.

Figure II-1

The Cost in 2004 of Tax and Spending Legislation Enacted Since January 2001, by Budget Category



Source: Congressional Budget Office data and CBPP calculations.

- As Figure II-1 shows, in 2004, tax cuts will account for 59 percent of the cost of legislation enacted since 2001.

- This is twice the combined cost of the defense, homeland security, and international spending increases.

- It is nearly 18 times the cost of increases in domestic discretionary spending (outside homeland security).

It also bears noting that total federal spending, even with these enacted increases, is not unusually large now as a share of the economy. CBO projects that federal spending will equal 20.0 percent of GDP in 2004, a level that is lower than in any of the 22 years from 1975 to 1996.

Costs to the States

A number of the provisions in the three federal tax cuts enacted since 2001 have reduced state as well as federal revenues, because of linkages between state and federal tax codes. Although some states have "decoupled" their tax systems from these recently enacted changes at the federal level, others have not. The states that have not decoupled are losing a total of about

[11] Congressional Budget Office, *The Cyclically Adjusted and Standardized-Budget Measures,* March 2004.

$9 billion during state fiscal years 2002 through 2005, a four-year period during which states have faced one of their most severe fiscal crises in half a century.[12]

The federal tax cuts that had the most significant impact in engendering state revenue losses include the following:

- The 2001 package not only eliminated the estate tax, but also phased out over four years (2002 through 2005) a tax credit that reduces the federal estate tax by one dollar for each dollar of *state* estate taxes paid. Every state in the nation levied an estate tax that was tied to this federal credit, with most states simply setting their own estate tax at a level equal to the federal credit. The elimination of this credit therefore effectively eliminated the estate tax in these states. (To date, 17 states and the District of Columbia have decoupled and maintain their own estate tax.)

- The "bonus depreciation" provision in the 2002 package that allowed businesses to write off immediately 30 percent of the cost of new investments — and that was expanded to a 50 percent write-off in 2003 — also has resulted in state revenue losses, because most states tie their depreciation tax rules to the federal depreciation rules. The majority of states, however, were reluctant to stick with this federal tax change, and about 30 states have decoupled.

Future Costs

Over the past three years, Congress and the President have resorted to unprecedented use of budget gimmicks to mask the long-term costs of tax cuts. The 2001 tax bill was rife with an unusual array of slow phase-ins, topped off by the entire bill being sunset at the end of 2010.[13, 14]

Research by Brookings Institution economists William Gale and Peter Orszag underscores the extent to which the design of the tax cuts relied on budget gimmickry.[15] Gale and Orszag found that in the 1990s, the practice of designing tax cuts that are slated to expire

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[12] Center on Budget and Policy Priorities, forthcoming report.

[13] Contrary to what some have claimed, the expiration of the entire 2001 tax-cut bill at the end of 2010 was not a direct result of a Senate rule. The Senate rule in question only came into play because the tax cuts increased the deficit after 2011; had the costs of the tax cuts been offset, they would not have had to expire. Moreover, the tax cuts in the legislation did not have to expire at the end of 2010 to comply with the Senate rule; rather, some or all of the tax cuts could have expired at the end of 2011. The tax cuts in the bill sunset one year earlier than necessary to reduce the 2001-2011 costs of those tax-cut provisions. This gimmick allowed more tax-cut provisions to be packed into the bill without breaching the amount allocated for the tax-cut legislation through 2011 under the budget plan Congress adopted in the spring of 2001. In the words of House Ways and Means Chairman Bill Thomas, the gimmick allowed Congress to put "a pound and a half of sugar into a one-pound bag."

[14] For a detailed analysis of the gimmickry in the 2001 tax-cut bill, see Joel Friedman, Richard Kogan, and Robert Greenstein, "New Tax-Cut Law Ultimately Costs as Much as Bush Plan: Gimmicks Used to Camouflage $4.1 Trillion Cost in Second Decade," Center on Budget and Policy Priorities, revised June 27, 2001.

[15] William Gale and Peter Orszag, "Should the President's Tax Cuts Be Made Permanent," *Tax Notes*, March 8, 2004, and "Sunsets in the Tax Code," *Tax Notes*, June 9, 2003.

when the actual intent is for them to continue was employed on a relatively modest scale, although this practice grew somewhat by the end of the decade. The practice then exploded with the tax-cut legislation enacted in 2001 and subsequent tax-cut measures.

- In January 2001, extending all tax provisions that were scheduled to expire over the coming decade would have cost $22 billion in 2011 (i.e., after ten years).

- By contrast, as of January 2004, the cost of extending all tax cuts set to expire amounted to *$431 billion* in 2014 (i.e., after ten years).

Long-term Costs of Bush Tax Cuts

To assess the long-term costs of the Bush tax-cut approach, it is necessary to make assumptions about which of the cuts the Administration seeks to continue and which it does not. The budget that the Administration issued in February 2004 simplifies this exercise, because it states which tax cuts the Administration now proposes to make permanent.

This analysis uses the Administration's proposal, which would make permanent most of the tax cuts enacted in 2001 and 2003. The Administration's budget, however, includes no relief from the Alternative Minimum Tax after 2005. The AMT was originally designed to ensure that very high-income taxpayers do not shelter so much income that they pay little or no income tax. Today the number of taxpayers subject to the AMT is about three million. That number will climb to about 46 million in 2014, according to Treasury Department estimates, assuming the tax cuts are made permanent and there is no further AMT relief after 2005.[16]

No one expects the AMT to grow so dramatically, however, as the consensus expectation is that AMT relief will be continued. Indeed, without continued relief, the AMT will over time cancel out an increasing share of the tax cuts that the Administration has promised to millions of families, and the Administration itself has announced it will propose an AMT relief measure next year. For these reasons, this analysis reflects CBO assumptions about the possible costs of extending AMT relief.[17]

Under the assumptions that the tax-cut provisions the Administration seeks to make permanent are made permanent, AMT relief is extended, and the Administration's new proposals are adopted, the costs of the tax costs in the years ahead would reach stunning proportions (see box on page 13 for a further discussion of the estimating assumptions).

[16] Treasury Department, "Fact Sheet: The Toll of Two Taxes: The Regular Individual Income Tax and the AMT," JC-1293, April 2, 2004.

[17] Congressional Budget Office, *The Budget and Economic Outlook, 2005-2014*, January 2004. See Tables 1.3 and 4.10. The CBO option for AMT relief assumes that the AMT exemption levels and income brackets will be adjusted for inflation after 2004 and that the current treatment of non-refundable personal credits for AMT purposes is continued.

- Over the 10-year period from 2005 through 2014, the direct costs of the tax cuts would total $2.8 trillion. The cost of these measures would be equal to 2.1 percent of the economy in 2014.

- From 2005 through 2014, the increased interest payments on the debt resulting from the tax cuts would amount to $1.1 trillion.

- The impact on the deficit of the tax cuts — which reflects both their direct costs and the associated interest payments — would total $3.9 trillion over the next ten years.

Table II-3
Cost of Bush Tax Cuts, Enacted and Proposed

	2005-2014 (in trillions)
Enacted tax cuts	$1.1
Administration proposals:	
Extend enacted tax cuts	$1.2
New tax-cut proposals	$0.2
Extend AMT relief *	$0.3
Tax cuts (direct costs)	**$2.8**
Interest payments	$1.1
Tax cuts (total cost)	**$3.9**

**Reflects only the incremental cost of AMT relief attributable to the enacted and proposed tax cuts; addressing the AMT problem that would exist in the absence of these tax cuts would cost an additional $258 billion. See box on page 13 for further details.*

Source: CBPP calculations based on data from Joint Committee on Taxation and Congressional Budget Office

- When the costs to date are also included, the total cost of the Bush tax cuts and associated interest costs would be $4.6 trillion over the 2001 through 2014 period.

- In 2014 alone, the tax cuts and higher interest payments would cost $598 billion, or 3.3 percent of the economy.

With the tax cuts, federal tax receipts over the next ten years would continue to constitute an unusually small share of the economy. The average level of federal revenues over the decade, measured as a share of the economy, would be lower than the average level in the 1960s, 1970s, 1980s, or 1990s.

The tax cuts continue to play a central role in the emergence of gaping federal deficits. As Figure II-2 shows, in the absence of the tax cuts, the deficit picture over the next ten years would look quite different. Without the tax cuts, the deficit would be under $100 billion in most years. With the tax cuts the deficit would grow to about $675 billion by the end of the decade.[18]

[18] For a discussion of the methodology underlying the budget projections, see Richard Kogan, David Kamin, and Joel Friedman, "Deficit Picture Grimmer Than New CBO Projections Suggestion," Center on Budget and Policy Priorities, February 1, 2004. In general, the expenditure projections assume full funding of the Pentagon's Future Year Defense Plan, sets homeland security spending at the level proposed in the President's Budget, uses the domestic discretionary spending level for 2005 proposed in the President's Budget and provides increases for inflation and population thereafter, and assumes current law for entitlements.
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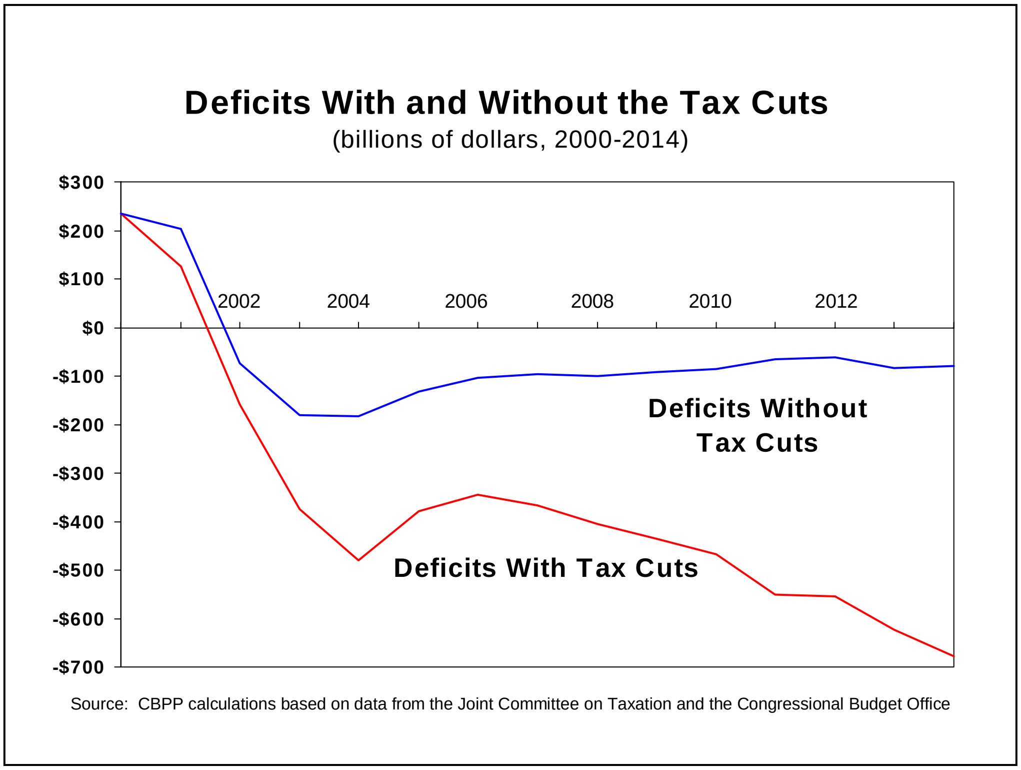
Figure II-2



Long-term Costs Compared with the Social Security and Medicare Shortfalls

The long-term costs of the tax cuts can also be assessed by comparing their costs to the magnitude of the shortfalls in the Social Security and Medicare Hospital Insurance trust funds. Those shortfalls will arise both due to the retirement of baby boomers and to the expectation that health care costs will continue to increase faster than the economy.

- Over the next 75 years (the time period over which the Social Security shortfall typically is measured), the cost of the tax cuts (including the Administration's current tax-cut proposals) is more than three times the size of the Social Security shortfall.

- The costs of the tax cuts will be slightly larger over the next 75 years than the *combined* shortfall in the Social Security and Medicare Hospital Insurance trust funds.

Which Tax Cuts Should Be Attributed to the Bush Administration?

This analysis assesses the impact of tax cuts enacted since 2001 and new tax cuts that the Administration is proposing. It attempts to isolate tax policies that can be attributed to this Administration in the 2005-2014 period. As a result, it does not include tax cuts that arguably preceded the Administration, even though the Administration may support the tax-cut policy.

For instance, a number of tax breaks that were first enacted before the Bush Administration took office are scheduled to expire in coming years. In the past, these temporary provisions have been routinely extended rather than allowed to expire, and thus are sometimes referred to as "extenders." Where applicable, the Bush Administration has proposed that these tax cuts be extended (or in the case of the research and experimentation tax credit, made permanent). Because these "extenders" pre-dated the Bush Administration and would likely have been extended in any event, this analysis does *not* include the cost of further extending these tax breaks as part of its assessment of the cost of the Administration's tax policy.

Similarly, the fact that the individual Alternative Minimum Tax will swell mightily in coming years if AMT relief is not provided results in part from the failure of policymakers to index the AMT to inflation. This problem pre-dated the Bush Administration; even before the Administration took office, addressing this problem would have been expensive. Providing relief from the AMT became much more costly, however, as a result of the Administration's tax cuts. Taxpayers pay the higher of their AMT or regular income tax; by lowering regular income taxes without making corresponding reductions in the AMT, the Administration's tax cuts resulted in more taxpayers becoming subject to the AMT than would have been the case without the tax cuts.

When considering the cost of long-term AMT relief, this analysis distinguishes between the cost of extending AMT relief in the absence of the 2001 and 2003 tax cuts and the cost after enactment of those tax reductions. Only the *additional* costs of providing AMT relief that resulted from the enactment of these tax cuts is attributed to the Bush Administration.

See Appendix Table 5 for the detailed cost estimates of these provisions.

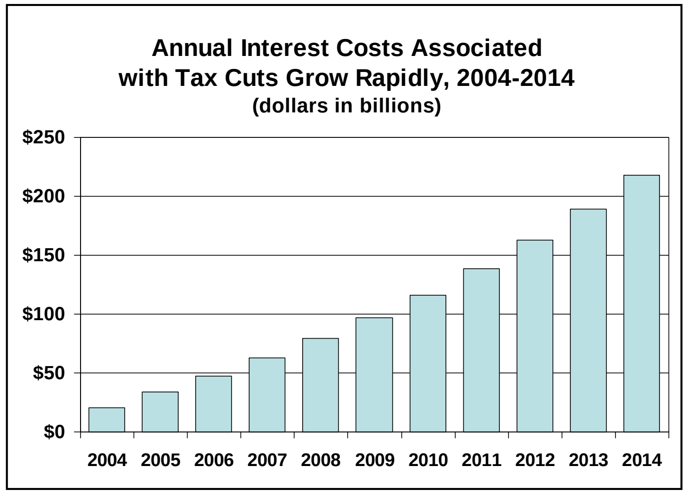
Passing Interest Payments on to Future Generations

By increasing deficits and the debt, the tax cuts significantly increase the amount the federal government must pay for interest on the debt. This underscores the degree to which the tax cuts benefit current taxpayers at the expense of future taxpayers. The tax cuts were adopted without paying for them directly; no offsets were enacted, and the tax cuts were financed in the short term through increases in the deficit. The tax cuts thus have resulted in an increase in the national debt, which requires the Treasury to pay more in interest payments than it otherwise would have to do.

In 2004, the increased interest payments that result from the tax cuts will be a relatively modest $20 billion, or 0.2 percent of the economy. These interest payments will grow steadily with each passing year, reaching $218 billion or 1.2 percent of the economy in 2014. Over ten years, the increased interest payments resulting from the tax cuts will amount to $1.1 trillion.

To put these figures into context, 1.2 percent of the economy — the cost of the added interest payments by 2014 — is the same share of resources that the government now devotes to all programs in the Departments of Education, Homeland Security, Interior, Justice, and State *combined.*[19]

Figure II-3



Continuing to Hide the Costs of the Tax Cuts

Throughout the past three years, the Administration has attempted in a variety of ways to downplay or obscure the costs of its tax-cut proposals. As the nation's fiscal situation deteriorated, the Administration refused for a period to admit there was a deficit problem, making it easier to argue that its tax cuts were affordable. After a while, the bleak nature of the fiscal situation could no longer be denied, but public statements by the President and other Administration officials have consistently ignored the tax cuts in explaining why the nation now confronts such large deficits. Moreover, the Administration has either put forward tax-cut proposals designed in a manner to obfuscate their full costs or readily acquiesced in Congressional designs that further obscured these costs.

Today, at a time when the Administration has finally admitted that deficits are an issue and pledged itself to deficit-reduction, obfuscation continues. Three examples from this year's budget substantiate this conclusion.

This year the Administration put out a budget that shows deficit figures only over the next five years, rather than providing a ten-year snapshot of the effects of budget policies as the CBO does. This approach has the convenient effect of concealing the marked worsening of the deficit — driven in part by the Administration's proposal to make the tax cuts permanent — expected under Administration policies in the second half of the coming decade. About eighty-five percent of the cost of making the tax cuts permanent would not occur until after 2009, the last year for which the Administration shows a deficit projection.

Further, the Administration has proposed to create new tax-advantaged savings and investment accounts. This proposal features timing gimmicks that allow it to *raise* revenue over the first five years. But the proposal would cause increasingly large revenue losses after that, and is ultimately likely to cost the equivalent of about $35 billion a year.[20] These high costs,

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[19] According to the Office of Management and Budget, the government will spend $62.8 billion in 2004 on the Education Department, $30.7 billion on Homeland Security, $10.0 billion on Interior, $23.5 billion on Justice, and $11.3 billion on State, for a total of $138 billion. This amount is equal to 1.2 percent of the economy in 2004.

[20] This figure is based on calculations by the Tax Policy Center, which estimates that the cost of the proposal after 25 years would be 0.3 percent of GDP, and the Congressional Research Service, which estimates that the long-run

according to a Tax Policy Center analysis, emerge "just as the baby boomers start to retire and the budget situation turns really bleak."[21] The Administration's budget provides barely a hint about the ultimate costs of this proposal.

In a final example from this year's budget, the Administration has proposed a change in budget rules that would, for official purposes, make the cost of extending the tax cuts *disappear*. The budget proposes to change the budget rules so the cost of extending the 2001 and 2003 tax cuts would be incorporated into the official budget "baseline." This would violate a main purpose of the baseline, which is to reflect current law and thereby provide a benchmark against which Congress can measure the costs of proposed changes in law. Under current law, the tax cuts are scheduled to expire in 2010. If this change in budget rules is enacted, CBO will have to show legislative proposals to make the tax cuts permanent as having *zero* cost.

Are They Worth the Cost?

The high cost of the enacted tax cuts is troubling, particularly given the demands that the retirement of the baby-boom generation will soon be placing on the expenditure side of the budget. Concerns about the cost of these tax cuts might be mitigated somewhat if the tax cuts were being used to address critical social or economic needs. As the next two chapters find, however, this is not the case.

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cost could reach $300 billion to $500 billion over a ten-year period. See Leonard Burman, William Gale, and Peter Orszag, "Key Thoughts on RSA and LSAs," Tax Policy Center, February 4, 2004; and Jane Gravelle and Maxim Shvedov, "Proposed Savings Accounts: Economic and Budgetary Effects," February 13, 2004.

[21] Burman, Gale, and Orszag, *ibid.*

III. Who Benefits from the Tax Cuts?

As with the enactment of any tax cut, a key question is "who benefits?" Throughout the debate on these tax cuts and after their enactment, the Administration has used certain statistics and specially tailored examples to create the impression that the benefits of these tax cuts have been spread widely and relatively evenly across the population. Yet a thorough examination of available information leads to a much different conclusion — that the tax cuts enacted since 2001 are of the greatest benefit by far to households with the highest incomes, with their unevenness growing over time.

Further, the large majority of the tax cuts that benefit a wide range of households consist of three so-called "middle-class provisions," which account for just one-third of the overall costs of the tax cuts. The other tax-cut provisions — which account for two-thirds of the costs of the tax cuts — provide only very small benefits to households in the middle of the income scale, but provide enormous tax cuts to high-income households. As far as lower-income families are concerned, the Administration has only reluctantly supported tax cuts for them.

The uneven distribution of the tax cuts exacerbates widening income disparities. This chapter examines just-released data from the Congressional Budget Office that show the tax cuts come in the wake of two decades during which income gains have become quite concentrated at the top, with income disparities reaching exceptionally wide levels.

The chapter relies heavily on new data produced by the Urban Institute-Brookings Institution Tax Policy Center, which are provided in detail in Appendix Tables 6 and 7. These data are used rather than government data because so little information has been made available by government agencies on the distribution of the tax cuts.[22]

[22] The type of comprehensive distributional data that had been developed by the Treasury Department during the 1990s has not been released. Instead, the Treasury Department has released only fragments of information on the effects of the tax cuts on various groups. By themselves, these fragments are often misleading. See Leonard E. Burman, "Treasury's New Distribution Presentation," Tax Policy Center of the Urban Institute-Brookings Institution, March 23, 2001; Isaac Shapiro, "New Treasury Distributional Table Departs Sharply From Previous Treasury Methodology," Center on Budget and Policy Priorities, revised March 9, 2001; and Joel Friedman, Robert Greenstein, and Isaac Shapiro, "Are Taxes Exceptionally Concentrated at the Top?" Center on Budget and Policy Priorities, April 15, 2004.

The Effects in 2004

New analyses by the Tax Policy Center distribute the effects of the tax cuts that have already been enacted, including the corporate and estate tax cuts, as well as the individual income tax cuts. The Tax Policy Center data show the combined effect of the tax cuts in 2004, and report the dollar value of the tax cuts, the share of tax cuts going to various households, and what percentage increases in "after-tax" income they produced.[23]

Dollar Value

As Table III-1 displays, the dollar benefits that the tax cuts provide to different groups vary dramatically. In 2004:

- The bottom one-fifth of households will receive an average tax cut of $27.
- The one-fifth of households in the middle of the income spectrum will receive an average tax cut of $647.
- The top fifth of households, by contrast, will receive tax cuts averaging $5,055, or nearly eight times as much as the average amount that those in the middle of the income spectrum are receiving.
- The top one percent of households will receive average tax cuts of nearly $35,000, while those with incomes exceeding $1 million will receive tax cuts averaging $123,600.

Share of Tax Cuts to Different Groups

Another way to assess the distributional effects of the tax cuts is to look at what share of the tax cut goes to different income groups. Table III-1 also shows that:

- The middle 20 percent of households will receive 8.9 percent of the tax cuts in 2004.
- Millionaires — totaling just 257,000 households or 0.2 percent of all households — will receive 15.3 percent of the tax cuts. These 257,000 households will receive a much larger share of the tax cuts than the 28.7 million households who make up the middle fifth of households.
- In 2004 alone, the nation's 257,000 millionaires will receive more than $30 billion in tax-cut benefits.

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[23] In its analyses, the Tax Policy Center examines the effects of the tax cuts on different "tax units." These "tax units" include individuals and married couples who file income tax returns as well as those who do not file (primarily because their incomes are below the minimum threshold for filing), but they do not count dependents of other taxpayers as separate tax units. This report uses the shorthand "households" instead of "tax units."

Table III-1

Distribution of Enacted Bush Tax Cuts, 2004

Income group	Average Tax Cut	Share of the Tax Cuts	Percentage Change in After-Tax Income
Lowest 20 percent	$27	0.4%	0.4%
Second 20 percent	$317	4.4%	1.9%
Middle 20 percent	$647	8.9%	2.3%
Fourth 20 percent	$1,186	16.4%	2.6%
Top 20 percent	$5,055	69.8%	4.1%
All	$1,448	100.0%	3.3%
Top one percent	$34,992	24.2%	5.3%
Above $1 million	$123,592	15.3%	6.4%

Source: Urban-Brookings Tax Policy Center

Some argue that the large dollar amounts and shares of the tax cuts received by those at the top of the income scale are to be expected, given the high incomes of this group and the large amount of taxes that these individuals pay. But the share of the tax cuts going to high-income households is substantially larger than their share of income. For instance, the 15.3 percent of the tax-cut total that will go to millionaires in 2004 is significantly larger than the 9.1 percent of before-tax income the Tax Policy Center data suggest they will receive this year. And, as is discussed further in the last section of this chapter ("The Administration's Story"), the share of the tax cuts going to high-income households also is larger than the share of taxes they pay; thus their share of taxes paid will decrease as a consequence of the tax cuts.

Percentage Changes in After-Tax Incomes

Another way to examine whether the gains to different groups are appropriately distributed is to examine how the tax cuts change the "after-tax" income of households at different income levels. Economists generally believe this is the most appropriate measure of the distributional impact of tax cuts, since after-tax income represents the best measure of the income a household has available to spend or save. The tax cuts are tilted to high-income households by this measure as well.

- For the bottom fifth of households, the tax cuts represent an average increase in after-tax incomes of just 0.4 percent in 2004. For households in the middle of the income spectrum, the tax cuts represent an increase in after-tax incomes of 2.3 percent this year.

- By comparison, the tax cuts will boost after-tax income among the top one percent of households by 5.3 percent, more than twice as much as the percentage increase for those in the middle of the income scale.

- For households with annual incomes of over $1 million, the tax cuts will cause their after-tax income to jump by 6.4 percent — nearly three times the percentage increase received by the households in the middle of the income spectrum.

Distribution Grows More Uneven Over Time

As uneven as the distribution of the tax cuts are in 2004, their distribution will become more uneven over time. The corporate tax cuts — which assist high-income households more than other households — phase out. But this decline in tax cuts at the top will be more than offset because several other tax cuts mostly benefiting high-income households — such as the eventual elimination of the estate tax — are only partly in effect now or have yet to take effect at all. Some of these tax cuts will not be fully implemented until 2010.

The Tax Policy Center's analysis shows that if the tax-cut provisions were fully in effect this year:[24]

- The middle fifth of households would receive tax cuts averaging $652, a mere $5 more than the $647 they are slated to receive this year.

- The top fifth of households would receive tax cuts averaging $5,432, nearly $400 more on average than they will receive this year.

- Households with incomes of more than $1 million would receive average tax cuts of $136,300, or $12,700 more than the average tax cut they will receive this year.

Moreover, the average tax cuts that the millionaire group would receive if the 2010 tax-cut provisions were in effect this year would raise their after-tax income by 7.1 percent, significantly larger than the 6.4 percent rise in after-tax income they will receive under 2004 law. By contrast, the average after-tax income gain for those in the middle of the income scale would be unchanged, at 2.3 percent.

The "Middle-Class Provisions" Compared with the Other Tax-Cut Provisions

In assessing the tax cuts and their distribution, it also is instructive to distinguish between three so-called "middle-class provisions" (the 10 percent bracket, the child tax credit, and relief for married couples) that enjoy broad bipartisan support, and the other tax-cut provisions, which

[24] The Tax Policy Center data examines the full effects of the tax cuts by estimating how large the tax cuts would now be if all the phase-ins in the tax cuts were completed. The Tax Policy Center has modeled the effects of the vast majority of future tax cuts, but not all of the effects. In particular, their data excludes the effects of tax cuts in areas such as health and savings.

Table III-2
Distribution of Three "Middle-Class" and All Other Tax-Cut Provisions in 2004

	Three "Middle-Class" Provisions			All Other Tax-Cut Provisions		
Income Class	**Average tax cut**	**Share of tax cut**	**Increase in after-tax income**	**Average tax cut**	**Share of tax cut**	**Increase in after-tax income**
Middle 20 percent	$547	16.8%	2.0%	$100	2.5%	0.3%
Top one percent	$1,320	2.0%	0.2%	$33,672	42.3%	5.1%
Over $1 million	$1,439	0.4%	0.1%	$122,153	27.5%	6.4%

Note: The three "middle class" provisions are the 10 percent bracket, the child tax credit, and relief for married couples.
Source: Urban-Brookings Tax Policy Center

are dominated by the upper-bracket rate reductions, the dividend and capital gains rate cuts, and the elimination of the estate tax.

These "middle-class provisions" do provide substantial help to the broad middle class, although it is sometimes overlooked that they benefit high-income households as well. Only the child tax credit phases out for those with incomes above a certain level. The 10 percent bracket offers the same tax-cut benefit to a family with income of $400,000 as it does to a family with $40,000 of earnings. The tax breaks for married couples are worth somewhat *more* to upper-income married couples than to couples in the middle of the income spectrum.[25]

- Overall, the benefits of these three provisions are fairly evenly distributed in dollar terms. The middle fifth of households will receive an average tax cut of $547 in 2004 from these provisions, while the highest-income fifth of households will receive an average tax cut of $1,558.

- In terms of the percentage increase in after-tax income in 2004, the increase from these three provisions is larger for households in the middle of the income spectrum than for high-income households.

The distribution of benefits under these three "middle-class provisions" stands in stark contrast to the distribution of benefits under the other tax cuts that have been enacted. The benefits of the other tax cuts, as shown in Table III-2, are sharply skewed to those with the highest incomes.

- More than 40 percent of the benefits of the other tax cuts in 2004 go to the top one percent of the income spectrum.

[25] For instance, when the three tax-cut provisions for married couples are fully in effect, nearly two-thirds of their annual cost results from the one provision that *only* benefits higher-income couples. This provision widens the 15 percent bracket, which benefits only families with incomes above the income level at which the 15 percent bracket ends. About one-third of married couples have incomes this high. The two-thirds of married couples who are in the 15 percent bracket or lower tax brackets do not benefit at all from this provision.

- The top one percent will receive an average tax cut of $33,700 from these provisions in 2004, more than 300 times the $100 average tax cut that middle-income households will receive from these provisions. Those with incomes of more than $1 million will receive an average tax cut of $122,200 from these provisions.

Indeed, the vast bulk of the tax-cut benefits for high-income households come from provisions outside the three "middle-class" provisions, while the vast majority of the tax-cut benefits for middle-income households come from those three provisions.

- Some 96 percent of the tax-cut benefits that the top one percent will receive in 2004 will result from these other provisions; for those with incomes over $1 million, some 99 percent of the benefits come from these provisions.

- In contrast, those in the middle of the income spectrum will receive 85 percent of their tax-cut benefits from the three "middle-class" provisions.

Finally, it is noteworthy that the three so-called "middle-class" provisions account for about one-third of the cost of the tax cuts that have been enacted or that the Administration is proposing, when they are fully in effect. Thus, *the vast majority of the tax cuts that benefit the middle class could have been provided at only one-third the cost of the tax cuts over time.*

The Administration's Hesitant Support of Provisions That Help Lower-Income Households

President Bush's initial push for his 2001 tax cut began by placing substantial emphasis on the benefits for low-income working families with children, personified in an example the President used in his second radio address about a waitress at a diner earning $25,000.[26] He said his plan would "wipe out her income tax bill entirely." It turned out, however, that the waitress he mentioned would have gotten either no tax cut or only a small tax cut (depending on her child care costs), because she already owed little or no income tax.[27] For such a worker, the principal federal tax is the payroll tax, not the income tax.

Indeed, the reason that lower-income workers would have received little or no tax benefit under the Administration's 2001 tax-cut proposal was that the proposal would have provided no relief to families who owe no income tax, even if they pay significant amounts of payroll taxes. The Administration could have addressed this matter by proposing to make the child tax credit fully or partially refundable and thereby aiding families who do not earn enough to owe income taxes, but it declined to do so.

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[26] President Bush, Radio Address to the Nation, February 3, 2001.

[27] Robert Greenstein and Isaac Shapiro, "Taking Down the Toll Booth to the Middle Class?" Center on Budget and Policy Priorities, February 6, 2001.

The Very Well-Off: Big Winners on Two Fronts

The very well-off have been big winners on two fronts. They secured enormous gains in income in both the 1980s and 1990s, and they then received extremely large tax cuts in 2001 and 2003. The Congressional Budget Office provides the most comprehensive data available on recent changes in incomes and taxes for different income groups. The latest data, which were just released, are for 2001.

The CBO data show that between 1979 (the first year covered in the CBO data) and 2001:

- The average after-tax income of the top one percent of the population more than doubled, rising from $294,300 in 1979 to $703,100 in 2001, for a total increase of $408,800, or 139 percent. (CBO adjusted these figures for inflation and expressed them in 2001 dollars.)
- By contrast, the average after-tax income of the middle fifth of the population rose a relatively modest 17 percent, or $6,300, reaching $43,700 in 2001.
- The average after-tax income of the poorest fifth of households rose 9 percent, or $1,100, over the 1979-2001 period.
- Income growth was more widespread in the 1990s than in the 1980s, with low- and middle-income households faring better in the 1990s. Yet while low- and middle-income households registered income gains in the 1990s, the most affluent households secured more dramatic gains, and income disparities widened further.

Because incomes grew fastest among the most affluent, this group's share of the total national income grew as well. Viewed together with data from a recent National Bureau of Economic Research study,* which covers a longer period and examines *before-tax* income, the CBO data suggest that the top one percent of the population received a larger share of the nation's before-tax income in 2001 than at any time since 1936, except for 1997-2000. In other words, except for the recent peak years of the stock market, income was more concentrated at the top in 2001 than in 65 years.

Average After-Tax Income by Income Group
(in 2001 dollars)

Income Category	1979	2001	Percent Change 1979-2001	Dollar Change 1979-2001
Lowest fifth	$13,000	$14,100	8.5%	$1,100
Second fifth	$26,300	$30,200	14.8%	$3,900
Middle fifth	$37,400	$43,700	16.8%	$6,300
Fourth fifth	$49,000	$61,000	24.5%	$12,000
Top fifth	$86,300	$133,700	54.9%	$47,400
Top 1 Percent	$294,300	$703,100	138.9%	$408,800

Source: Congressional Budget Office, *Effective Federal Tax Rates: 1979-2001*, April 2004.

*Thomas Pikety and Emmanuel Saez, "Income Inequality in the United States, 1913-1998," National Bureau of Economic Research, September 2001. Tables have been updated through 2000 at http://emlab.berkeley.edu/users/saez/

The Administration's proposal received substantial criticism on this score, and ultimately the Administration reluctantly agreed to Congressional changes to its child tax credit proposal that provided significant aid to the waitress in question and millions of other low- and modest-income families. The Congressional provisions benefiting these families were phased in over time.

Then, in 2003, the President submitted to Congress a new tax-cut proposal that called for making effective immediately most of the income tax cuts in the 2001 law that were scheduled to phase in. But his proposal did *not* call for accelerating the child tax credit provision benefiting lower-income families. This time, Congress stuck with the Administration's approach and left out low-income working families. The President's proposal — and the legislation enacted in 2003 — also failed to accelerate those tax cuts for married couples enacted in 2001 that benefit low- and moderate-income families, while accelerating the other two tax cuts for married couples that benefit middle- and high-income families. Further, it is worth noting that the relief for married couples with low and moderate incomes was originally included at the behest of Congress; it was not an Administration proposal.

The day after the 2003 tax bill was signed into law, a front-page story in *The New York Times* called attention to the failure to extend the child tax credit provision benefiting lower-income families;[28] this story generated a torrent of criticism. Faced with adverse publicity, the Administration shifted positions again and said it now supported acceleration of the low-income provision. But this change in position came too late, and the Administration did little to secure actual enactment of the provision. The acceleration of the low-income child tax credit provision has yet to be enacted.

The pattern continues in 2004. The President's budget proposes to make permanent every tax-cut provision enacted in 2001 and 2003 that predominately benefits people with high incomes. But the budget fails to extend — and thus would let die after 2006 — the provision of the 2001 tax-cut law that encourages greater retirement savings by working families with incomes under $50,000. That provision, known as the "savers' credit," provides a tax credit that partially matches contributions made by such families to pension or retirement accounts. In 2003, some 3.7 million moderate-income taxpayers used this credit. Like the other provisions discussed above, the savers'credit was added by Congress and was not part of the Administration's original proposal. It remains to be seen whether the Administration will ultimately support its extension.

The Administration's Story

Anyone who has learned most of what they know about the tax cuts from President Bush's speeches and Administration press releases might find the distributional discussion in this report surprising. The Administration has not mentioned the full extent of the tax cuts that high-income households will receive, how the distribution will grow more uneven over time, or how the tax-cut provisions the Administration highlights the most — the three "middle-class" provisions — constitute a minority of the tax cuts that have been enacted.

Instead the Administration has consistently highlighted any tax benefits to the middle class and promoted its tax cuts as beneficial to a variety of sympathetic groups, such as small

[28] David Firestone, "Tax Law Omits $400 Child Credit for Millions," *The New York Times*, May 29, 2003, page A1.

businesses and the elderly. The Administration also has claimed its tax cuts have increased the share of taxes paid by high-income households. The information it has put forward in these regards has often been selective or misleading, as discussed below.

Claim: Typical Households Gain Much from the Tax Cuts

From the President's first State of the Union speech to his most recent speech on why the tax cuts should be made permanent, the Administration has consistently employed a use of "averages" that does not represent a reasonable use of statistics and that paints a distorted picture of the tax-cut benefits going to the average or typical household. In a speech in February 2004 on making his tax cuts permanent, the President put it this way: "[This year] taxpayers will save, on average, $1,586 off their taxes."[29] Such presentations conveniently gloss over the following matters:

- This *average* tax cut is much larger than the tax cut that a typical middle-income household or family will receive. In generating these figures, the Administration has averaged the extremely large tax cuts that those at the top of the income spectrum will receive with the far more modest tax cuts that those in the middle of the income spectrum get.

- Tax Policy Center data indicate the average tax cut for households in the middle fifth of the population — the filers exactly in the middle of the income spectrum — would be $647 in 2004. This is only two-fifths of the $1,586 figure the Administration cites for the average taxpayer.

- Overall, 77 percent of households will receive less than the "average" tax cut of $1,586 the Administration touts, according to Tax Policy Center data. In other words, three of every four households will receive less than the "average."[30]

Another "typical family" that the Administration frequently highlights is a married couple with two children with earnings of $40,000. In one of his speeches arguing for passage of the 2003 tax bill, President Bush discussed this family in the following manner: "You'll hear all kinds of rhetoric about how this plan is not fair. Well, let me just describe to you what it means to the family of four making $40,000 a year. It means their taxes would go from $1,178 a year to $45 a year. That's what that means. That sounds fair to me."[31]

There are two fundamental problems with this statement. First, the President suggests that nearly all this family's federal taxes would be eliminated, when in fact the example only applies to federal individual *income* taxes. (Sometimes the Administration has stated this correctly and has said federal income taxes, sometimes it has not.)

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[29] President Bush, "President Bush Urges Congress to Make Tax Cuts Permanent," February 19, 2004.

[30] These figures follow standard practice and include households who owe no income tax but owe other types of federal taxes, such as payroll taxes. If only tax filers who owe income tax are considered, then 65 percent — or two of every three — would receive less than the average.

[31] President Bush, "President Calls for Tax Relief," May 6, 2003.

This is an important distinction. Among tax filers with wage earnings, 90 percent of those with income below $100,000 pay more in payroll taxes than in individual income taxes.[32] Payroll taxes are ignored in the Administration's example. When the family's payroll taxes are taken into account, instead of virtually all of the family's tax burden being eliminated, the family's combined federal income and payroll taxes would be reduced by 16 percent as a result of the 2003 tax cut.[33]

Second, all of this family's income tax cuts resulted from the three major "middle-class" provisions.[34] As noted, these three tax cuts ultimately represent about one-third of the cost of the tax cuts over time. Stated another way, the Administration's example unintentionally illustrates the point that the tax cuts of importance to middle-income families could be adopted at a much lower cost than the cost of the full package of tax-cut measures that were enacted and that the Administration urges be made permanent.

Claim: Reducing the Top Rate Is Essential to Small Business Owners

The President and the Administration repeatedly invoke the benefits that its tax cuts, and especially the proposal to reduce the top income tax rate, provide to small businesses. For instance, when reviewing the benefits of the 2003 tax cuts, a Treasury Department press release stated that about two-thirds of those in the top income tax bracket are "owners of flow-through entities, including small business owners and entrepreneurs." According to Treasury, these 400,000 small business owners would receive nearly 80 percent of the benefits of the top rate reduction enacted in 2003.

The Administration uses these figures to create the impression that the top rate reduction would broadly benefit American's small businesses. This impression is incorrect.

- The 400,000 small business owners represent only a tiny fraction of the nation's small businesses. Elsewhere in the same press release, the Treasury trumpets that 23 million small business owners will receive a tax cut from the package. This indicates that only 2 percent of these small businesses benefit from the top rate reduction (400,000 is 2 percent of 23 million).

- By contrast, Citizens for Tax Justice has estimated that 2.2 million small business tax filers receive the Earned Income Tax Credit (which benefits low- and moderate-income families).[35] This is many times larger than the number of small business filers who benefit from the reduction in the top marginal tax rate.

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[32] William Gale and Jeffrey Rohaly, "Three-Quarters of Filers Pay More in Payroll Taxes Than in Income Taxes," *Tax Notes*, January 6, 2003.

[33] This calculation follows the standard practice of attributing to workers the burden of both the employee and employer payroll taxes, with the employer portion being passed on to workers in the form of lower wages.

[34] The $1,133 tax cut in 2003 for this family from the 2003 tax-cut bill came from accelerating forward the expansion of the child tax credit, yielding this family $800; widening the 10 percent bracket, yielding $100; and increasing the standard deduction for married couples, yielding $233.

[35] The CTJ data are examined in the Center on Budget and Policy Priorities analysis, "Reducing the Top Tax Rates: How Much Benefit to Small Business?" May 3, 2001.

- Moreover, the Administration's definition of "small business owner" is a dubious definition: it includes anyone who receives as little as one dollar of income that is classified as business income under the tax code. One need not actually run or own much of a business to be classified as a "small business owner" by the Administration.[36] Indeed, by the Administration's definition, President Bush counts as a small business owner.

- Rather than being proprietors of small business concerns, many of the individuals whom the Administration characterizes as small business owners who are benefiting from the reduction in the top income tax rate are better characterized as high-income individuals who have some business investments on the side but gain so much income from *other* sources that they are in the top tax bracket. According to Tax Policy Center data, nearly 60 percent of those in the top bracket who have some business income actually receive more income from sources other than these businesses.

Claim: Dividend and Capital Gains Tax Cuts Provide Broad Help to Seniors

The Administration often touts the benefits of the 2003 tax-cut package for the elderly, implying that they benefit substantially from the reduction in tax rates for dividends and capital gains that was a prominent part of that package. At the signing ceremony for the 2003 tax-cut legislation, the President noted when discussing the dividend tax cut that "…the good news is that a lot of seniors rely on dividend income to meet their daily needs. And under this legislation, 12 million seniors will receive an average tax reduction of $1,401."

This seemingly impressive average tax-cut figure for the elderly is distorted for the same reasons discussed above — it is skewed upward by a small number of well-off elderly who will receive large tax breaks. According to Tax Policy Center data for 2003, under the 2003 legislation:

- More than half of those over age 65 will receive no tax cut whatsoever, and over 60 percent of the elderly will receive less than $100. The vast majority of the elderly — about 90 percent — will receive less than the $1,401 figure cited by the President as being the "average" tax cut for seniors.

- But the 24,000 elderly who have incomes in excess of $1 million will receive an average tax cut of over $90,000.

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[36] The Treasury press release hints at this when it refers to "owners of flow-through entities," which includes businesses organized as partnerships and S corporations. Such entities do not require partners or shareholders to be active participants in the business. Wealthy individuals can make passive investments in these entities and have little to do with the business. As a result, this definition includes wealthy individuals whose primary income does not come from owning or operating a small business. Many of these "small business owners" are better characterized as high-income individuals, such as corporate executives, with some business investments.

Similarly, most seniors will benefit little from the dividend and capital gains tax cuts in the 2003 bill. The benefits from those tax-cut measures are concentrated among a small number of elderly individuals with extensive wealth. According to Tax Policy Center estimates, nearly three-quarters of the elderly will receive no benefit from the cut in tax rates for dividends and capital gains, and 83 percent will receive less than $100.

Claim: High-Income Households Will Pay a Larger Share of Taxes After the Tax Cuts

The Administration's fiscal 2005 budget asserted that "The President's tax cuts have raised upper-income taxpayers' share of the tax burden even higher." This assertion, which Administration officials repeat in testimony before Congress and which was recently featured in a Treasury Department "fact sheet," is backed up by Treasury data showing that high-income taxpayers — such as the top one percent of taxpayers — will pay a larger share of the nation's income taxes in 2004 after the tax cuts have taken effect.[37] With this statistic, the Administration tries to create the impression that the tax cuts enacted since 2001 did not disproportionately benefit upper-income groups.

This statistic, however, is not especially meaningful for assessing the distribution of these tax cuts. Essentially, the statistic tells us that the upper-income group will be paying a slightly larger share of the *much smaller amount* of federal income taxes that will be collected after the tax cuts. Taken to its logical extreme, if all income taxes were eliminated except for a tax of $1 a year on the top one percent of households, these high-income households would be paying 100 percent of all income taxes. Yet such an outcome would represent a regressive change, because the progressive income tax code would essentially have been eliminated; the resulting federal tax code, dominated by the payroll tax, would be regressive. Moreover, the virtual repeal of the income tax would presumably lead to increases in other, less progressive taxes or to reductions in programs that primarily benefit middle- and low-income households, as most major federal programs do.

The Administration is able to reach its conclusion, that high-income households are paying a modestly larger share of federal income taxes, because it ignores taxes other than the income tax and because it ignores years after 2004. The Administration's figures leave out tax cuts enacted in 2001 that are scheduled to be phased in *after* 2004, including income-tax cuts benefiting only higher-income households that have not yet taken effect as well as the repeal of the estate tax. A more complete analysis by the Tax Policy Center shows that when all of the tax cuts are fully in effect, the top one percent will pay a slightly smaller share of all federal taxes as a result of the tax cuts, not a larger share.[38] In any event, as noted above, there are several other more appropriate ways to assess the distribution of the tax cuts, including examining their impact on after-tax income; under these approaches, higher-income households clearly benefit the most.

[37] See, for instance, Treasury Secretary John Snow's responses to questions on the distribution of the tax cuts when testifying before the House and Senate Budget Committees, on February 4, 2004, and February 13, 2004, respectively; and Treasury Department, "Fact Sheet: Who Pays the Most Individual Income Taxes?" April 1, 2004.

[38] This also holds true for the top five percent and the top 10 percent, income groups that the Administration highlighted in its fiscal 2005 budget as paying a larger share of income taxes after the tax cuts than before the tax cuts.

How Concentrated Are Taxes at the Top?

The Administration has also attempted to portray its tax cuts in a positive light by focusing on how concentrated taxes have become at the top, suggesting the large share of tax cuts going to high-income households simply reflects this concentration. A recent Treasury release, for instance, stated that "the individual income tax is highly progressive — a small group of higher income taxpayers pay most of the individual income tax each year." This Treasury release is misleading.

- *While the nation's tax code is progressive, it is not nearly as progressive as the Treasury fact sheet would lead one to believe.* The Treasury analysis shows that the one percent of taxpayers with the highest incomes paid 33.9 percent of federal individual income taxes in 2001. However, Congressional Budget Office data show that this group pays a substantially smaller proportion — 22.7 percent — of federal taxes overall, including payroll, excise, and other taxes. The progressivity of the tax system is further muted if state and local taxes are taken into account; most state and local tax systems are regressive.

- *High-income households paid a larger share of federal taxes in 2001 than in the first half of the 1990s — the years that the Treasury fact sheet covers — but this is due in significant part to high-income households receiving a larger share of before-tax income in the nation in 2001 than in the early 1990s.* In addition, even after taxes are taken into account, *after*-tax income increased much faster for high-income households over the 1990-2001 period than for any other income group. The CBO data show that from 1990 to 2001, the average after-tax income of the top one percent of the population jumped 41 percent, while the average after-tax income of the middle fifth of the population rose 14 percent. As noted in the text box earlier in this chapter, when the 1980s are included, this differential is even larger.

- *The tax burden on high-income households is not especially high by recent standards.* According to the CBO data, the top one percent of households paid a slightly smaller share of their income in federal taxes in 2001 than they paid in any year since 1992. Further, since 2001, the percentage of income they pay in federal taxes has dropped significantly as tax cuts targeted on them — such as the reduction in the top income tax rates — have taken fuller effect.

The Treasury release — "Fact Sheet: Who Pays The Most Individual Income Taxes?" April 1, 2004 — is discussed in greater detail in the Center publication "Are Taxes Exceptionally Concentrated at the Top?" April 15, 2004. The CBO data mentioned here are from their publication *Effective Federal Tax Rates: 1979-2001*, April 2004.

Tax Cuts Fail Test of Fairness

In a speech on his 2003 proposal last year, the President declared: "Under this plan, 92 million Americans receive an average tax cut of $1,083. That's fair."[39]

The President's use of averages and many of his other descriptions of the effects of the tax cuts do not provide a sound assessment of their fairness. The gains from the cuts are inordinately concentrated on high-income households, a group that already receives a share of national income that is unusually large relative to historic patterns. It is difficult to argue that it was necessary to provide such large tax cuts, at very high cost, to those at the pinnacle of American society — unless this was necessary on economic grounds. The next chapter of this report examines the economic impacts of the tax cuts.

[39] President Bush, "President Meets with Small Business Owners in Georgia," February 20, 2003. Note that the $1,083 figure refers only to the 2003 tax-cut measure, while the $1,586 figure cited earlier in this chapter takes into account all of the tax cuts enacted since 2001.

IV. Jobs and Growth?

At the heart of the Administration's justification for its tax cuts has been the argument that they are needed to strengthen the economy generally and to create jobs in particular. This chapter examines whether the design of the tax cuts is well suited to promote economic and jobs growth in both the short run and the long run. It includes discussion of what the economic trends since enactment of the tax cuts suggest about their effectiveness.

In the short run, the tax cuts have provided poor "bang for the buck." The large amount of resources dedicated to the tax cuts represented a missed opportunity to provide more stimulus to the economy or to accomplish other goals. In the long run, the effects of the tax cuts are likely to be negative, due to their adverse impact on the deficit.

Poor "Bang for the Buck" in the Short Term

The weakness of the economy in the last few years suggests that government stimulus was called for, and tax cuts do provide stimulus. But this line of thinking, often repeated by the President himself, does not mean all tax cuts provide the same boost to the economy and to job creation. Some tax cuts are better designed than others at providing a short-run boost to the economy; similarly, some spending programs are better than certain tax cuts at generating short-term stimulus. This section assesses whether the structure of the Administration's tax cuts were well suited to providing a quick boost to the economy.

The Structure of the Administration's Stimulus Approach

An examination of President Bush's 2003 tax-cut proposal is particularly illuminating. As part of the budget unveiled in early 2003, the President offered a series of tax cuts costing $726 billion through 2013, which he described as his economic growth package.[40] The large

[40] In 2003 the President also proposed other tax cuts — largely consisting of extending the provisions in the 2001 tax cut that were set to expire — totaling $849 billion through 2013. Less than one percent of these tax cuts would have occurred in either fiscal year 2003 or fiscal year 2004. These other tax cuts, by and large, were not part of what was enacted in the 2003 tax law, and are not discussed in this section of the analysis.

majority of the tax cuts, however, would not even have occurred in the short run, measured here as taking effect in the fiscal year in which they would be enacted or in the following fiscal year.

- A mere 5.5 percent of the proposed tax cuts that made up the economic growth package would have occurred in fiscal year 2003 (i.e., by the end of September 2003). Another 15.7 percent would have occurred in fiscal year 2004.

- Thus, only about one-fifth of the tax cuts in the economic growth package would have occurred by the end of fiscal year 2004.[41]

Moreover, the types of tax cuts put forward were not well designed to provide economic stimulus. A rule of thumb to keep in mind here is that proposals that put more money in the hands of low- and middle-income people generally provide more short-term stimulus than proposals that put more money in the hands of high-income people. This is because low- and middle-income people, by necessity, are more likely than high-income people to live paycheck to paycheck, and to spend fairly quickly any additional resources they might receive. High-income people are likely to save a larger proportion of any tax cut they get than are low- and middle-income people.

As a Congressional Budget Office study put it in a 2002 assessment of stimulus proposals: "tax cuts that are targeted toward lower-income households are likely to generate more stimulus dollar for dollar of revenue loss — that is, be more cost-effective and have more bang for the buck — than those concentrated among higher-income households."[42] The distribution data discussed in the previous chapter indicate that the tax cuts did not reflect CBO's conclusion and the above rule of thumb; they were skewed to the top and thus have not been "cost-effective" at generating stimulus.

The results of an Economy.com study of the stimulus proposals under consideration in early 2003 quantify the inefficiency of the proposals.[43] (Economy.com is an independent economics research group whose analyses have been used widely in recent years.) The Economy.com analysis assessed the proposals by examining how much each dollar of lost tax revenue or increased spending would generate in terms of increased demand in the year after the stimulus is provided.

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[41] The President's 2001 tax-cut proposal was even less geared towards a short-term boost. Just one percent of the tax cuts he proposed through 2011 would have occurred in fiscal years 2001 or 2002. Under the 2001 tax bill that was enacted into law (all of which expired in 2010), eight percent of the tax cuts occurred in fiscal years 2001 or 2002. This percentage would be lower if gimmicks in the designs of the cuts are taken into account.

The 2002 tax cut was more targeted on the short run. The President's budget released in February 2002 included an economic security plan that had specific dollar amounts to be dedicated to the plan in particular years. There were no tax proposals to reflect these costs; the dollar amounts were just placeholders. Within this economic security entry, the costs were concentrated in the first two fiscal years (2002 or 2003), but those two-year "economic security" costs made up only 19 percent of all the tax cuts the budget proposed through 2012. The stimulus bill Congress passed in March 2002 did concentrate its costs on the first two fiscal years.

[42] Congressional Budget Office, *Economic Stimulus: Evaluating Proposed Changes in Tax Policy,* January 2002, page 7.

[43] Mark Zandi, chief economist at Economy.com, "State Fiscal Drag," *Regional Financial Review,* March 2003.

Table IV-1
"Bang for the Buck" Provided by Different Provisions in the President's 2003 Tax-Cut Proposal

	Demand generated per dollar of cost (Economy.com)	Share of tax cuts and spending in President's package (2003-2013)
High "Bang for the Buck"		
Extend UI benefits	$1.73	0%
Widening of 10% tax bracket	$1.34	6%
State fiscal relief	$1.24	0%
Child tax credit	$1.04	12%
Total		19%
Lower "Bang for the Buck"		
Marriage penalty relief	$0.74	8%
AMT adjustments	$0.67	5%
Accelerate 2006 rate cuts	$0.59	10%
Small business expensing	$0.24	4%
Dividend tax reduction	$0.09	55%
Total		81%

- Economy.com found that reducing the taxation of dividends would be a highly inefficient means of boosting the economy, generating less than a dime of stimulus for each dollar of lost revenue. (A Goldman Sachs analysis produced a similar finding, estimating that this provision would provide eight cents of stimulus for each dollar in costs.[44]) Dividend tax cuts filter through to taxpayers only slowly; they also go primarily to high-income households who are unlikely to spend much of their increased income. Nonetheless, the Administration proposed to eliminate the taxation of corporate dividends at the individual level altogether, with this proposal representing more than half of the cost of its package.

- By contrast, the Administration proposed no aid to state governments, even though Economy.com found federal aid to state governments is excellent stimulus, in part because such aid can help prevent cutbacks in state spending or state tax increases that constitute a drag on a weak economy. The Administration also failed to propose any extended unemployment insurance (which Economy.com found would be very effective at boosting demand) or any other government spending proposal as part of this package. The neglect of the spending side is notable. Consistent with the Economy.com findings, a just-released International Monetary Fund study found that short-term boosts in demand are "generally larger for government spending increases than tax cuts."[45]

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[44] Goldman Sachs, "Fiscal Policy — In Search of Balance, Creativity and Grit," May 2, 2003.

[45] International Monetary Fund, *World Economic Outlook*, Chapter II, April 2004.

- Further, the Administration proposed only a relatively modest amount of tax cuts targeted on middle-income households.

- Altogether, as Table IV-1 on the previous page indicates, only 19 percent of the President's stimulus package consisted of "high bang for the buck" proposals — that is, proposals that would yield more than one dollar of added short-term demand for each dollar of revenue loss.

With only a small minority of the tax cuts occurring through the end of fiscal 2004, and with only a small minority of those tax cuts consisting of high bang-for-the-buck proposals, the President's 2003 tax-cut proposal can rightly be characterized as highly inefficient at accomplishing the goal of providing short-term stimulus. *A paltry four percent of the President's proposal consisted of high bang-for-the-buck tax cuts that would have occurred by October 2004.*[46]

The stimulus bill actually enacted in 2003 was modestly less inefficient at providing short-term stimulus to the economy than the President's original proposal, primarily because it included state fiscal relief. Even so, just 8 percent to 14 percent of the cost of legislation enacted in 2003 consisted of provisions offering high bang-for-the-buck stimulus in the short term.[47]

These facts provide credence to a statement signed by 10 Nobel Price-winning economists and 450 other economists in February 2003, which said, in part: "Regardless of how one views the specifics of the [2003] Bush [tax cut] plan, there is wide agreement that its purpose is a permanent change in the tax structure and not the creation of jobs and growth in the near-term."[48]

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[46] According to Joint Committee on Taxation estimates, the President's proposal to accelerate the expansion of the 10-percent tax bracket reduced taxes by $10 billion in fiscal years 2003 and 2004; his proposal to accelerate the increase in the child tax credit cost $19.4 billion in this period. These were the only two provisions whose "bang for the buck" exceeded $1. In combination, these two provisions reduced taxes by $29.4 billion in fiscal years 2003 and 2004. This amounted to only four percent of the $725.8 billion overall cost of the President's tax-cut proposal through 2013.

[47] Assuming the provisions in the 2003 bill that the President supports extending are in fact extended, the final cost of the bill would be $609 billion through 2013. The costs in fiscal years 2003 and 2004 of provisions related to the 10-percent bracket, the child tax credit, and state fiscal relief are estimated to be $49.5 billion, or eight percent of the legislation's likely overall costs. If, in contrast, none of the provisions in the 2003 tax cut are ultimately extended, the ten-year cost of the bill would be $350 billion, so the high bang-for-the-buck provisions would constitute 14 percent of the legislation's costs.

[48] The "Economists' Statement Opposing the Bush Tax Cuts" was released February 10, 2003.

Job Creation

"…this is a plan to encourage growth, focusing on jobs."
-President Bush, January 9, 2003, in a speech introducing his "Jobs and Growth" 2003 tax-cut package.

"For the sake of job growth, the tax cuts you passed should be made permanent."
-President Bush, State of the Union address, January 20, 2004, in arguing why his tax cuts should be made permanent.

A main theme, arguably *the* main theme, running throughout the Administration's arguments for its tax cuts is their importance for job generation. Yet one of the most notable trends of this recovery is that, despite the three tax cuts, job growth has been exceptionally weak relative to previous recoveries. This conclusion holds even when the positive March 2004 employment report — and the possibility that it may signal the beginning of significant, sustained job growth — is taken into account. In light of the inefficiency of the tax cuts in providing short-term stimulus, the failure of the economy to generate better results on the employment front is less surprising.

March 2004 saw the first really substantial employment gains during this recovery period, with jobs increasing by 308,000 from February. But through March 2004, job growth during this recovery has been much worse than in any other post-World War II recovery.[49, 50] The Administration itself recently confirmed the exceptionally weak nature of job growth during this recovery.

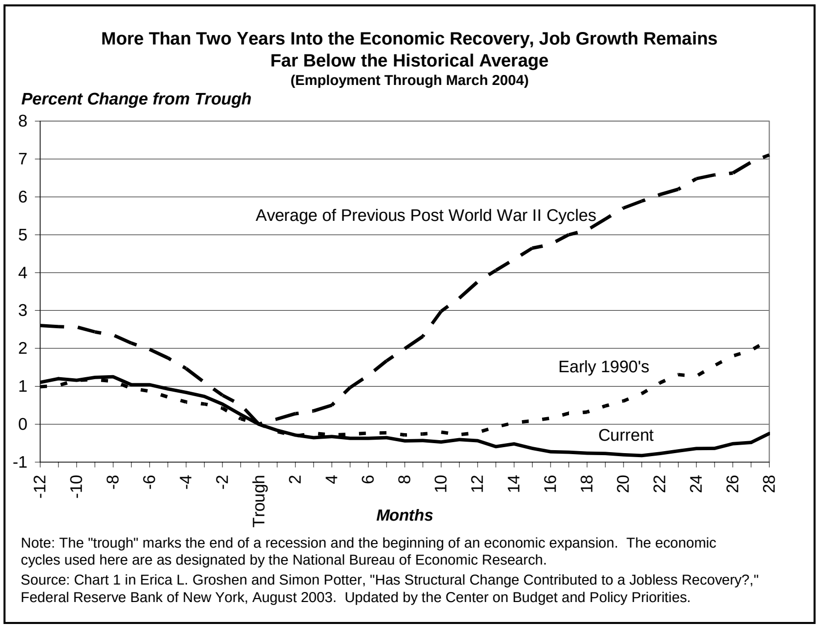
- The Administration's February 2004 *Economic Report of the President* put it this way: "The performance of employment in this recovery has lagged that in the typical recovery and even that in the 'jobless recovery' of 1990-1991."[51] This conclusion is shown graphically below, in a Center on Budget and Policy Priorities update of a Federal Reserve Board study. Employment remains

[49] This statement, like the calculations later in this chapter on economic growth during this recovery, excludes consideration of the short recovery from the first half of the "double-dip" recession of the early 1980s.

[50] Throughout, this analysis uses the "payroll employment survey" to estimate the number of jobs in the economy. A smattering of observers have recently noted how, over the course of the recovery, the "household survey" shows more positive employment trends than the payroll survey. While this is true, two points are worth noting. First, the household survey trends are not dramatically more positive; even if the household survey is examined, employment trends have been substantially worse in this recovery than in the average recovery since the end of World War II. Second, it is the payroll employment survey that is the standard measure of employment featured by the government and relied upon by economists. In recent months, the director of the Bureau of Labor Statistics, the Congressional Budget Office, and Federal Reserve Chairman Alan Greenspan have all concluded that the payroll survey remains preferable to the household survey. For instance, in response to a question during a February 11, 2004 Congressional hearing, Greenspan stated: "I wish I could say the household data were the more accurate [since it shows a stronger labor market]. Everything we've looked at suggests that it's the payroll data which are a series which you have to follow…."

[51] See page 48 of the *Economic Report of the President*.

Figure IV-1



substantially below its level at the start of the downturn, which is an unparalleled development this far into a recovery during the post World War II era.

It also is of interest to compare employment trends to the Administration's own predictions. For three years, the Administration has been claiming its tax cuts would boost employment, but for three years actual job growth has fallen far short of these projections.

- In the 2003 *Economic Report of the President*, for example, the Administration predicted that the average number of jobs in 2003 would be 1.7 million higher than the average in 2002. Instead, it was 406,000 lower. (See Table IV-2 below.)

- The Administration's latest *Economic Report of the President*, issued in February 2004, estimated that from October 2003 through the end of 2004, job growth would occur at a rate of 300,000 jobs per month. When this report was released, the chair of the President's Council of Economic Advisers stated that this job growth forecast reflected a rate of job growth "[t]hat is about average for a recovery."[52] So far over this period, however, jobs have grown at the average pace of only 121,000 per month. In other words, from October 2003 through March 2004, job growth occurred at a pace just two-fifths of what the Administration says is the average for a recovery. Only in one month — March

[52] Reuters News Service, "White House Advisor Sees Big Job Gains in 2004," February 10, 2004. For detailed examinations of the Administration's overly optimistic job growth projections, see two analyses that were jointly released by the Center on Budget and Policy Priorities and the Economic Policy Institute: "White House Backs Off CEA Prediction of 'Average' Job Growth," February 18, 2004; and "Missing the Moving Target," February 12, 2004.

Table IV-2

Predicted and Actual Job Growth

Month in which the Administration prediction was released	Years compared in the prediction	Year-over-year job growth, Administration prediction	Year-over-year job growth, Actual
February 2002	2002 vs. 2001	-100,000	-1,494,000
February 2003	2003 vs. 2002	+1,700,000	-406,000
February 2004	2004 vs. 2003	+2,600,000	?

Source: *Economic Report of the President*, 2002, 2003, and 2004.

2004 — did job growth achieve the monthly level the CEA chair had characterized as average.

- Since the summer of 2003, the Economic Policy Institute has been tracking how actual job growth has compared to the amount of job growth the Administration predicted would occur with the passage of the 2003 tax-cut bill. (See www.jobwatch.org.) The CEA predicted that with the passage of the Administration's tax-cut plan, 5.5 million jobs would be created in the 18 months from July 2003 through December 2004. In the first nine months of this period, 689,000 jobs have been created, or just 13 percent of the Administration's projection.

  To reach the 5.5 million target by the end of 2004, job growth would have to total 4.8 million over the next nine months, an implausible development that would require monthly job growth far in excess of what occurred in March 2004.[53]

In touting the success of his economic plan, President Bush has highlighted the relatively low official unemployment rate, which stood at 5.7 percent in March 2004. This level, however, is misleading, as it reflects what the Economic Policy Institute has described as the "uniquely large 1.2% decline in labor force participation that has occurred since the current recession began in early 2001. This decline represents a stark contrast to the past three business cycles, when labor force participation actually grew by an average of 0.4% of the working-age population over similar lengths of time."[54] The decline reflects weakness in the labor market, as it presumably indicates that people are dropping out of the labor force (or deciding not to enter the labor force) because job market prospects are unpromising.

If labor force participation had been the same in March 2004 as it was in March 2001 when the downturn began, the March 2004 unemployment rate would have equaled 7.4 percent,

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53 To achieve this outcome, job growth would have to *average* 535,000 per month over the next nine months. Job growth in March 2004 of 308,000 — the largest monthly increase since April 2000 — was far below that level.

54 Economic Policy Institute, *JobWatch*, March 2004.

not 5.7 percent. (This assumes the increased number of job seekers would not have affected the number of jobs in the economy.)

GDP Growth

When it comes to overall *economic* growth, the recovery has been stronger than when it comes to *job* growth. Still, despite the three tax cuts, overall economic growth has been well below par for this stage of a recovery.

The economy hit its low point during the last quarter of 2001. So far during the recovery period — which covers the two-year period through the last quarter of 2003 — the economy has grown at an average annual rate of 3.6 percent, after adjusting for inflation. This growth rate compares unfavorably to seven of the eight previous recoveries since the end of World War II.

- The only previous recovery during which growth was slower was from the first quarter of 1991 (the trough of the early 1990s recession) through the first quarter of 1993, when annual real GDP growth averaged 2.9 percent.

- Two years into the eight previous recoveries since World War II, the economy had grown at an annual average real clip of 5.7 percent. This is well above the average 3.6 percent real growth rate that has so far characterized the current recovery.[55]

To be sure, there was only a small overall decline in the economy during the recent downturn; in this respect, the downturn was "shallow," suggesting that the rebound also would be less sharp. But if we measure economic growth from when the economy last peaked (the first quarter of 2001) until now (2¾ years later), the current period continues to compare unfavorably with previous periods at a similar stage in the economic cycle.

- In the eight economic cycles — recessions and recoveries — prior to this one, annual real GDP growth averaged 3.2 percent over the first 2¾ years following the onset of the recession (the previous economic peak).

- In the recent period, the average annual real growth since the last economic peak (the first quarter of 2001) has been somewhat lower — 2.6 percent.

[55] This finding is not a result of slower population growth over the past two years. The working-age population has grown faster over the past two years than its average rate of growth during the first two years of the other post-World War II recoveries.

Not the Panacea That Some Claim: Tax Cuts and Growth

Advocates of tax cuts have frequently claimed that a reduction in rates would significantly increase economic growth. Some go as far as to claim that the tax cuts will spawn so much economic growth that they could "pay for themselves" by generating a flood of new revenues from a more rapidly expanding economy. (House Budget Committee Chair Jim Nussle made this claim just a month ago, echoing earlier statements by President Bush and Vice President Cheney.[*])

These claims are not supported by the leading studies in the field, and they are contradicted by the historical record. It is true that a reduction in marginal income tax rates could augment the incentives to save and work (often called "supply-side" effects), since Americans would pay a smaller share of their earnings in taxes. However, major economic studies indicate that these "supply-side" effects are likely to be quite small; Americans' decisions about how much to work and save are relatively insensitive to changes in tax rates.[**] Further, tax cuts can, indirectly, act as a major drag on economic growth — by either increasing federal deficits or leading to a reduction in government investment. On the issue of deficits, the economic literature is especially clear, concluding that government borrowing can result in significant and compounding harm to the economy over the long term.

History confirms the often weak relationship between tax rates and long-term economic growth. As three leading Brookings Institution economists report,

> "Historical evidence shows no clear correlation between tax rates and economic growth. The United States has enjoyed rapid growth both when taxes were low and when taxes were high. The strongest recent extended period of growth in U.S. history spanned the two decades from the late 1940's to the late 1960's, when the top marginal personal income tax rates were 70 percent or higher. Economic growth accelerated after the top marginal tax rate was increased from 31 percent to 39.6 percent in 1993. Comparisons across countries confirm that rapid growth has been a feature of both high- and low-tax nations."[***]

The evidence makes clear that the Bush tax cuts are very unlikely to have significant "supply-side" effects in terms of how much Americans save and work. And, given that these tax cuts have been fully deficit financed, they are, on balance, likely to do more harm than good to America's long-term economic prospects.

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[*] Chairman's Nussle's quote was reported in *The Daily Tax Report*, Bureau of National Affairs, March 17, 2004. For an examination of previous Administration statements, see Richard Kogan, "Will the Tax Cuts Ultimately Pay for Themselves," Center on Budget and Policy Priorities, March 3, 2003.

[**] For example, "overall, labor supply is not greatly affected by taxes," Joel Slemrod and Jon Bakija, *Taxing Ourselves: A Citizen's Guide to the Great Debate over Tax Reform*, (MIT Press: Cambridge, 1996), p. 106. Also, "saving is not very responsive to the after-tax rate of return," B. Douglas Bernheim and John Karl Scholz, "Savings, taxes and," in Joseph Cordes, Robert Ebel, and Jane Gravelle, eds., *Encyclopedia of Taxation and Tax Policy*, (Urban Institute Press: Washington, 1999), p. 326. Overall, marginal tax rate reductions have "only modest effects on broad income," Jonathan Gruber and Emmanual Saez, "The Elasticity of Taxable Income: Evidence and Implications," NBER Working Paper 7512, January 2000. For a more complete discussion of the academic literature on tax rates and economic growth, see Peter R. Orszag, "Marginal Tax Rate Reductions and the Economy: What Would Be the Long-Term Effects of the Bush Tax Cut?" Center on Budget and Policy Priorities, March 16, 2001, available at http://www.cbpp.org/3-15-01tax.pdf.

[***] Henry J. Aaron, William G. Gale, and Peter R. Orszag, "Meeting the Revenue Challenge," in *Restoring Fiscal Sanity*, eds. Alice M. Rivlin and Isabel Sawhill, (The Brookings Institution Press: Washington, D.C., January 2004), p. 84.

To What Degree Are These Unfavorable Results Attributable to the Tax Cuts?

A wide range of factors influence economic outcomes, many of which are outside the direct control of policymakers. Even if the Administration's economic policies were better designed, job growth during the recent recovery might have lagged that of previous recoveries. But the exceptionally poor job growth of recent years undercuts Administration claims that its tax cuts have accomplished one of its main policy goals — generating strong job creation. As noted, the remarkable inefficiency of the tax cuts in providing short-term stimulus makes this failure less surprising. The less-than-striking economic growth figures also make it harder to make the case for the wisdom of the Bush tax cuts.

Undermining Future Growth

Although there was widespread consensus on the need for temporary fiscal stimulus in response to the downturn, the design of the tax cuts prevented them from providing nearly as much stimulus as other approaches — including less expensive approaches — would have provided. Beyond the short run, what are the likely effects of the tax cuts on economic growth?

The Next Ten Years: Little Economic Return

In the medium term, the tax cuts — despite costing hundreds of billions of dollars each year — are likely to have little effect on the size of the economy. Studies by CBO and the Joint Committee on Taxation, both run by Republican appointees, have concluded that over the next ten years, the effects of the tax cuts on growth are likely to be small — and could be either negative or positive.

In August 2003, CBO analyzed the combined effect of the tax legislation enacted in 2001, 2002, and 2003. CBO found that the economic effects over the next ten years, while small, would likely be negative. CBO stated:[56]

> "…the tax legislation will probably have a net negative effect on saving, investment, and capital accumulation over the next 10 years."

> "The tax laws' net effect on potential output is uncertain during the first five years of the 2004-2013 projection period but will probably be negative in the second five years."

The Joint Committee on Taxation reached similar findings when examining a version of 2003 tax legislation.[57]

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[56] Both quotes can be found in Congressional Budget Office, *The Economic Outlook*, August 2003, page 45.

[57] The Joint Tax Committee report was printed on May 8, 2003, in the *Congressional Record,* pages H3829-H3832, and examined the House version of the 2003 tax cuts.

A new CBO study reaches similar, although less negative, conclusions. CBO examined the potential effects of the President's 2005 budget proposals, which include proposals to make most of the tax cuts permanent, and concluded they would have an ambiguous effect in the short run and probably lead to slight economic gains from 2010-2014. Claims of large economic gains are not borne out by the study.

The Long-Run Danger

CBO did not estimate economic effects beyond 2014. Because large persistent deficits have gradual corrosive effects, eating away at economic foundations as termites eat away at the foundation of a house, one would not expect to see pronounced negative effects from the tax cuts in the initial ten years. Such effects are more likely over a longer time horizon. A recent Brookings Institution study found that making the tax cuts permanent, rather than letting them expire, would boost the economy modestly for a short period after 2010, but have negative consequences over the long run. (The study's findings on the long-term effects of the tax cut are described in the box on the next page.)

The principal reason that the tax cuts are likely to prove damaging to the economy over time is that the higher deficits to which they contribute will reduce national saving and thus result in less domestic investment (and more borrowing from overseas). These outcomes would lower the nation's standard of living from what it would otherwise be, and the negative effects grow larger over time. Further, if ongoing deficits cause a sudden shift in the global perspective on whether it is sensible to invest in the U.S. economy and dollar-denominated assets, the consequences could eventually be severe.

Indeed, an International Monetary Fund report and a recent study by former Treasury Secretary Robert Rubin, Wall Street economist Allen Sinai, and Brookings Institution economist Peter Orszag — both released in January 2004 — have warned that the large long-term deficits to which the tax cuts are contributing could ultimately lead to extensive damage to the economy.

The IMF study scolded U.S. policymakers in unusually sharp terms. As *The New York Times* reported, ". . . the [IMF] report sounded a loud alarm about the shaky fiscal foundations of the United States, questioning the wisdom of the Bush administration's tax cuts and warning that large budget deficits pose 'significant risks' not just for the United States but for the rest of the world."[58] The IMF report stated: [59]

> "U.S. government finances have experienced a remarkable turnaround in recent years. Within only a few years, hard-won gains of the previous decade have been lost and, instead of budget surpluses, deficits are again projected as far as the eye can see."
>
> "…the recent emphasis on cutting taxes, boosting defense and security outlays, and spurring an economic recovery may come at the eventual cost of upward pressure on

[58] *The New York Times*, January 7, 2004.

[59] International Monetary Fund, "U.S. Fiscal Polices and Priorities for Long Run Sustainability," January 7, 2004.

Brookings Study on the Economic Effects of Making the Tax Cuts Permanent

A recent study by William Gale and Peter Orszag of the Brookings Institution finds that making the Bush tax cuts permanent would "reduce, not increase, the size of the economy in the long-term."[*]

Gale and Orszag also conclude that the economic effects would likely be negative in the short term, because interest rates would rise once the tax cuts were made permanent, as financial markets reacted to the worsening deficit outlook that making the tax cuts permanent would cause. The negative impact of higher interest rates would not be offset by fiscal stimulus in the short run because the tax cuts themselves would only kick in after 2010.

When the tax cuts do kick in after 2010, the impact on the economy would initially be positive, but these positive effects would be short lived. As Gale and Orszag state: "Over time…the adverse effects from deficit-financed tax cuts build and so the economic cost of extending the tax cuts would gradually rise after 2010. Thus, relative to not extending the tax cuts, extension may exert a modest positive effect on the economy for a short period after 2010, before the negative consequences from the larger deficits rise and eventually dominate the overall effect."

Gale and Orszag also disagree with the Administration argument that making the tax cuts permanent would help the economy by creating more certainty about the tax code. To the contrary, they state in a related paper that "Making the tax cuts permanent would not help resolve the fundamental uncertainty about future tax rates or future policy. The reason is that the true underlying source of uncertainty in fiscal policy is how the fiscal gap is going to be closed — what combination of revenue increases and spending cuts will be used. Enacting another fiscally unsustainable policy (making the tax cuts permanent) on top of the already unsustainable fiscal situation does not make the situation more stable, only less so."[**]

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[*] William G. Gale and Peter R. Orszag, "Should the President's Tax Cuts be Made Permanent?" Brookings Institution, February 24, 2004.

[**] William G. Gale, Matthew Hall, and Peter Orszag, "Key Points on Making the Bush Tax Cut Permanent," Brookings Institution, January 21, 2004.

> interest rates, a crowding out of private investment, and an erosion of longer-term U.S. productivity growth."
>
> "The United States is on course to increase its net external liabilities to around 40 percent of GDP within the next few years — an unprecedented level of external debt for a large industrial country. This trend is likely to continue to put pressure on the U.S. dollar… Although the dollar's adjustment could occur gradually over an extended period, the possible global risks of a disorderly exchange rate adjustment, especially to financial markets, cannot be ignored."

Similarly, the analysis by Rubin, Sinai, and Orszag cautioned that "the scale of the nation's projected budgetary imbalances is now so large that the risk of severe adverse consequences must be taken very seriously, although it is impossible to predict when such consequences may occur." Rubin and his colleagues warn that the budget deficits we face if we remain on our current policy course — by making the tax cuts permanent and continuing other tax and spending policies — could lead to “financial and fiscal disarray” and cause a “fundamental shift in market expectations and a related loss of confidence at home and abroad.” Rubin and his colleagues observe that while it is impossible to know at what point this change in market expectations might take place, once it occurs, it would “magnify the costs associated with any given underlying budget deficit and depress economic activity much more than the conventional analysis would suggest.”[60]

[60] Robert Rubin, Peter Orszag, and Allen Sinai, “Sustained Budget Deficits: Longer Run U.S. Economic Performance and the Risk of Financial and Fiscal Disarray,” Brookings Institution, January 4, 2004.

V. Who Will Pay the Piper?

To date, the Bush tax cuts have conferred the most benefits on the highest-income households, those least in need of additional resources, and have come at a time when income already is exceptionally concentrated at the top of the income spectrum. The tax cuts also have led revenues to drop as a share of the economy to the lowest level since 1950 and have been a major contributor to the return of large deficits. Their ill-conceived design has resulted in their providing significantly less economic stimulus than could have been accomplished with the same or lesser amounts of resources. Meanwhile, the jobs picture remains notably worse during this recovery than in any other recovery since the end of World War II.

Nonetheless, rather than taking stock of the developments and considering a mid-course correction, the Administration proposes further steps down the same path. The Administration's current budget would make permanent nearly all of the tax cuts that were enacted in 2001 and 2003, at a massive cost to the federal treasury. It also proposes an array of new tax cuts accompanied by more budget gimmickry.

For instance, the Administration proposes a series of tax cuts related to savings that would, by increasing the deficit, in all likelihood *diminish* national saving over the long term. In addition, these tax cuts are designed in a manner that obscures their costs; they ultimately would cost the equivalent of about $35 billion a year. Further, the benefits of these tax-cut proposals would go overwhelmingly to the nation's wealthiest individuals and also would harm already-vulnerable *state* budgets.[61]

The Administration's decision not to reconsider its tax-cut approach is disconcerting. To the degree that little is done to address the effects of the tax cuts on the deficit:

- The federal deficit will remain large, reducing national saving and eventually slowing economic growth;

[61] Robert Greenstein and Joel Friedman, "President's Savings Proposals Likely to Swell Long-term Deficits, Reduce National Saving, and Primarily Benefit Those with Substantial Wealth," Center on Budget and Policy Priorities, February 27, 2004.

- More of the task of shoring up the nation's fiscal position will be passed on to future generations; and
- Interest payments will mount. In 2014 alone, the increased interest payments that result from the tax cuts will total $218 billion, or 1.2 percent of the economy.

Passing on problems to future generations is generally an undesirable and ultimately irresponsible choice. This is especially true today. In just a few years, the baby-boom generation will begin to retire, and that will inevitably result in programs for the elderly such as Medicare and Social Security consuming a larger share of national resources. Only a few years ago there was a consensus that the nation should use the first decade of this century to prepare for this eventuality by paying down the debt and placing annual Social Security surpluses off limits so they would not be used to finance other programs. Such an approach would diminish interest costs and other burdens down the road. President Bush initially was part of this consensus. For example, in one of his early radio addresses he stated: "We're going to keep the promise of Social Security and keep the government from raiding the Social Security surplus."[62] The past three years, however, have deviated sharply from this seeming consensus.

Efforts to reduce deficits swollen by tax cuts entirely through cuts in domestic programs now are coming to the fore. This is the approach that has begun to emerge in the President's budget this year and in the budget plans Congress is currently considering. These proposals concentrate on reducing domestic discretionary programs outside of homeland security. Yet the recent modest increases in those programs pale in comparison with the effects of the tax cuts.[63] Moreover, total spending on this part of the budget — which includes programs such as education, child care, environmental protection, veterans' health, housing, and many other areas — already is slightly below its average level since 1970.

In addition, the savings that can (or should) be achieved through targeting this category of the budget can make only a small dent in the deficit problem; domestic discretionary programs outside homeland security constitute only about one-sixth of the federal budget. Indeed, the President's budget and the budgets that both the House and Senate have passed would *increase* the deficit above the level at which it otherwise would be, not reduce it. This outcome reflects the fact that the size of the tax-cut proposals in these budgets substantially exceeds the domestic discretionary spending reductions and other savings in the budgets.

Whatever approach is ultimately used to address the costs of the tax cuts, low- and middle-income households are likely to come out as net losers. The prime beneficiaries of the tax cuts are high-income households; the size of their tax cuts dwarf those received by the middle class. The ultimate costs of the tax cuts, however, are likely to be borne more broadly. To the degree that the tax cuts are ultimately "paid for" by program reductions, it is middle- and low-income households that are likely to be hit hardest by these cutbacks. To the degree that the tax

[62] Radio Address by the President to the Nation, March 3, 2001.

[63] As Figure II-1 on page 8 shows, in 2004 tax cuts will account for 59 percent of the cost of legislation enacted since 2001. Domestic discretionary spending increases (outside of Homeland Security) will account for just three percent.

cuts are *not* paid for — and lead to higher interest rates and other adverse economic effects — all households will be affected.

Instead of pushing to make nearly all of the tax cuts permanent and proposing new tax cuts on top, as the President is doing, policymakers should be examining which tax cuts should be extended, which should not be extended, and which should be scaled back or repealed. The tax code also needs reforms that would make it simpler and fairer, and doing so could raise needed revenues. Revenues could be raised by paring back or eliminating tax breaks that are ineffective or outmoded. Finally, revenue also could be raised by beefing up enforcement efforts aimed at corporations and households engaged in sophisticated schemes to hide their income from taxation.

Appendix Table 1: Cost of Enacted Bush Tax Cuts, by Provision

(In billions of dollars)

Provision	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Totals To Date 2001-2004	Totals Projected 2005-2014
2001 Tax Cut, EGTRRA[1]																
10% bracket	38	33	40	40	40	40	40	43	45	46	14	-	-	-	152	269
AMT exemption amount	*	2	3	5	4	-	-	-	-	-	-	-	-	-	10	4
Child tax credit	1	9	10	11	13	18	19	19	21	25	26	-	-	-	30	141
Education	-	2	3	4	5	3	2	3	3	3	1	-	-	-	10	19
Estate and gift tax	-	0	6	5	7	4	10	12	13	23	53	-	-	-	11	122
Marriage provisions	-	*	1	1	6	10	11	10	10	9	4	-	-	-	2	61
Miscellaneous	-	*	1	1	1	1	1	1	1	1	1	-	-	-	3	10
Pease and PEP[2]	-	-	-	-	-	2	4	5	7	9	6	-	-	-	-	33
Pensions and IRA	-	2	4	5	5	6	5	5	6	7	5	-	-	-	11	39
Timing shift	33	-33	-	7	-7	-	-	-	-	-	-	-	-	-	7	-7
Upper bracket rates	2	21	21	29	33	51	59	60	62	63	19	-	-	-	73	347
Subtotal: EGTRRA	**74**	**38**	**91**	**108**	**107**	**135**	**152**	**160**	**168**	**187**	**130**	**-**	**-**	**-**	**310**	**1,039**
2002 Tax Cut, JCWAA[3]																
5-year carryback of losses	-	8	7	-4	-3	-2	-1	-1	-1	**	**	**	**	-	10	-8
Bonus depreciation	-	35	32	29	**	-19	-18	-15	-12	-8	-5	-3	-1	-	97	-82
Certain extensions	-	1	3	3	3	2	2	**	**	*	*	*	-	-	6	7
Misc. provisions	-	-2	-4	**	2	1	2	2	1	1	*	*	-	-	-6	9
Tax benefits for NYC	-	*	1	1	1	1	1	*	*	*	**	**	-	-	2	3
Subtotal: JCWA	**-**	**43**	**38**	**28**	**3**	**-16**	**-16**	**-14**	**-11**	**-8**	**-5**	**-3**	**-2**	**-**	**109**	**-72**
2003 Tax Cut, JGTRRA[4]																
10% bracket	-	-	2	8	2	-	-	-	-	-	-	-	-	-	10	2
AMT exemption amount	-	-	1	10	6	-	-	-	-	-	-	-	-	-	12	6
Bonus depreciation	-	-	10	33	12	-9	-9	-8	-7	-5	-4	-2	-1	-	43	-34
Capital gains and dividends	-	-	4	18	21	23	26	27	19	10	-	-	-	-	23	125
Child tax credit	-	-	14	6	13	-	-	-	-	-	-	-	-	-	20	13
Marriage provisions	-	-	5	25	5	-	-	-	-	-	-	-	-	-	30	5
Small business expensing	-	-	2	3	4	1	-3	-2	-1	-1	-1	**	**		4	-3
Timing shift	-	-	6	-6	-	-	-	-	-	-	-	-	-	-	-	-
Upper bracket rates	-	-	10	39	20	6	-	-	-	-	-	-	-	-	48	26
Subtotal: JGTRRA	**-**	**-**	**53**	**136**	**82**	**21**	**14**	**17**	**11**	**4**	**-4**	**-3**	**-2**	**-**	**190**	**140**
Other Legislation Enacted Since January 2001[5]	1	1	4	4	4	3	1	**	-1	-1	**	-	-	-	10	5
Total without interest	**75**	**81**	**186**	**276**	**197**	**143**	**150**	**162**	**167**	**182**	**120**	**-6**	**-3**	**-**	**618**	**1,112**
Interest cost of tax cuts	*	3	9	20	34	46	58	71	85	99	112	121	128	134	33	889
Total with interest	**75**	**84**	**195**	**297**	**231**	**189**	**208**	**233**	**251**	**281**	**232**	**115**	**125**	**134**	**651**	**2,000**
Cost with interest as a share of GDP	0.7%	0.8%	1.8%	2.6%	1.9%	1.5%	1.6%	1.7%	1.7%	1.9%	1.5%	0.7%	0.7%	0.7%	1.5%	1.3%

Notes: * = Between $500 million and zero; ** = Between -$500 million and zero; May not add due to rounding; See notes after Table 5.
Sources: JCT and CBO data, CBPP calculations.

Appendix Table 2: Cost of Extensions and New Tax Cuts Proposed in the 2005 Bush Budget, by Provision
(In billions of dollars)

Provision	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Totals Projected 2005-2014
Extension of 2001 and 2003 Tax Cuts[6]											
10% bracket	4	6	7	4	3	3	36	51	51	52	218
Capital gains and dividends	-	-	-	2	13	14	29	31	33	35	157
Child tax credit	3	13	13	13	12	7	7	34	34	35	171
Education	-	-	-	-	-	-	2	3	4	4	13
Estate and gift taxes	1	1	2	2	2	2	29	51	55	61	206
Marriage provisions	5	5	3	1	*	-	6	8	8	7	45
Miscellaneous	-	-	-	-	-	**	*	1	1	1	3
Pease and PEP[2]	-	-	-	-	-	-	6	13	14	15	49
Pensions and IRA[7]	-	-	-	-	-	-	2	3	4	5	14
Small business expensing	-	4	7	5	4	3	3	3	3	3	34
Upper bracket rates	-	-	-	-	-	-	45	66	68	72	250
Subtotal: 2001 and 2003 tax cuts	**13**	**30**	**31**	**28**	**35**	**30**	**165**	**264**	**275**	**289**	**1,160**
Miscellaneous, Bush 2005 Budget	-4	6	8	12	17	20	22	23	25	27	156
Further AMT fix attributable to Bush tax cuts	5	15	18	23	29	35	41	48	55	64	333
Total without interest	**15**	**50**	**58**	**63**	**81**	**84**	**228**	**335**	**354**	**380**	**1,648**
Interest cost of tax cuts	*	2	5	8	12	17	26	42	61	83	256
Total with interest	**15**	**52**	**62**	**71**	**93**	**101**	**254**	**377**	**416**	**463**	**1,905**
Cost with interest as a share of GDP	0.1%	0.4%	0.5%	0.5%	0.6%	0.7%	1.6%	2.3%	2.4%	2.6%	1.3%

Notes: * = Between $500 million and zero; ** = Between -$500 million and zero; May not add due to rounding; See notes after Table 5.
Sources: JCT and CBO data, CBPP calculations

Appendix Table 3: Cost of Bush Tax Cuts, Enacted and Proposed, by Provision

(In billions of dollars)

Provision	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Totals To Date 2001-2004	Totals Projected 2005-2014
Bush Tax Cuts Extended																
10% Bracket	38	33	42	49	46	47	47	48	49	49	50	51	51	52	162	489
Bonus depreciation	-	35	42	62	12	-28	-28	-23	-18	-13	-9	-6	-3	-	140	-116
Capital gains and dividends	-	-	4	18	21	23	26	29	32	24	29	31	33	35	23	282
Child tax credit	1	9	24	16	28	32	32	33	33	32	33	34	34	35	50	326
Education	-	2	3	4	5	3	2	3	3	3	3	3	4	4	10	33
Enacted, temporary AMT reform	*	2	4	15	10	-	-	-	-	-	-	-	-	-	22	10
Estate and gift taxes	-	-	6	5	8	5	11	14	14	25	82	51	55	61	11	327
Marriage provisions	-	*	6	26	17	15	14	12	10	9	10	8	8	7	32	111
Miscellaneous	1	8	11	5	9	8	4	2	1	1	1	1	1	1	25	28
Pease and PEP[2]	-	-	-	-	-	2	4	5	7	9	12	13	14	15	-	82
Pensions and IRA	-	2	4	5	5	6	5	5	6	7	7	3	4	5	11	53
Small business expensing	-	-	2	3	4	5	4	3	3	2	2	2	2	3	4	30
Timing shifts	33	-33	6	*	-7	-	-	-	-	-	-	-	-	-	7	-7
Upper bracket rates	2	21	31	68	53	57	59	60	62	63	64	66	68	72	122	623
Subtotal: Tax Cuts Extended	**75**	**81**	**186**	**276**	**210**	**173**	**181**	**191**	**202**	**212**	**285**	**258**	**272**	**289**	**618**	**2,271**
Miscellaneous, Bush 2005 Budget	-	-	-	*	-4	6	8	12	17	20	22	23	25	27	*	156
Further AMT fix due to Bush tax cuts	-	-	-	-	5	15	18	23	29	35	41	48	55	64	-	333
Total without interest	**75**	**81**	**186**	**276**	**212**	**193**	**208**	**225**	**247**	**267**	**348**	**329**	**351**	**380**	**618**	**2,760**
Interest cost of tax cuts	*	3	9	20	34	48	63	79	97	116	138	163	189	218	33	1,145
Total with interest	**75**	**84**	**195**	**297**	**246**	**241**	**271**	**304**	**344**	**383**	**486**	**492**	**540**	**598**	**651**	**3,905**
Cost with interest as a share of GDP	0.7%	0.8%	1.8%	2.6%	2.0%	1.9%	2.0%	2.2%	2.4%	2.5%	3.1%	3.0%	3.1%	3.3%	1.5%	2.6%

Notes: * = Between $500 million and zero; ** = Between -$500 million and zero; May not add due to rounding; See notes after Table 5.
Sources: JCT and CBO data; CBPP calculations.

Appendix Table 4: Cost of Bush Tax Cuts, Enacted and Proposed, by Bill
(In billions of dollars)

Proposal	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Totals To Date 2001-2004	Totals Projected 2005-2014
Enacted																
EGTRRA	74	38	91	108	107	135	152	160	168	187	130	-	-	-	310	1,039
JCWAA[3]	-	43	38	28	3	-16	-16	-14	-11	-8	-5	-3	-2	-	109	-72
JGTRRA[4]	-	-	53	136	82	21	14	17	11	4	-4	-3	-2	-	190	140
Other legislation enacted since January 2001[5]	1	1	4	4	4	3	1	**	-1	-1	**	-	-	-	10	5
Subtotal: Enacted	**75**	**81**	**186**	**276**	**197**	**143**	**150**	**162**	**167**	**182**	**120**	**-6**	**-3**	**0**	**618**	**1,112**
Proposed, Bush 2005 Budget	-	-	-	*	10	36	39	40	52	49	187	287	300	316	*	1,315
Further AMT fix due to Bush tax cuts	-	-	-	-	5	15	18	23	29	35	41	48	55	64	-	333
Total without interest	**75**	**81**	**186**	**276**	**212**	**193**	**208**	**225**	**247**	**267**	**348**	**329**	**351**	**380**	**618**	**2,760**
Interest cost of tax cuts	*	3	9	20	34	48	63	79	97	116	138	163	189	218	33	1,145
Total with interest	**75**	**84**	**195**	**297**	**246**	**241**	**271**	**304**	**344**	**383**	**486**	**492**	**540**	**598**	**651**	**3,905**
Cost with interest as a share of GDP	0.7%	0.8%	1.8%	2.6%	2.0%	1.9%	2.0%	2.2%	2.4%	2.5%	3.1%	3.0%	3.1%	3.3%	1.5%	2.6%

Notes: * = Between $500 million and zero; ** = Between -$500 million and zero; May not add due to rounding; See notes after Table 5.
Sources: JCT and CBO data; CBPP calculations.

Appendix Table 5: Cost of Bush Tax Cuts, Enacted and Proposed, Plus Extension of Other Tax Provisions

(In billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Totals To Date 2001-2004	Totals Projected 2005-2014
Attributable to Bush Administration[8]																
Legislation Enacted Since January 2001	75	81	186	276	197	143	150	162	167	182	120	-6	-3	-	618	1,112
Extension of 2001 and 2003 tax cuts	-	-	-	-	13	30	31	28	35	30	165	264	275	289	-	1,160
Miscellaneous, Bush 2005 Budget	-	-	-	*	-4	6	8	12	17	20	22	23	25	27	*	156
Further AMT fix due to Bush tax cuts	-	-	-	-	5	15	18	23	29	35	41	48	55	64	-	333
Subtotal: Attributable to Bush	**75**	**81**	**186**	**276**	**212**	**193**	**208**	**225**	**247**	**267**	**348**	**329**	**351**	**380**	**618**	**2,760**
Not Attributable to Bush Administration[8]																
Extension of "extenders"	-	-	-	1	4	7	9	14	15	17	20	21	23	25	1	155
Further AMT fix not due to Bush tax cuts	-	-	-	*	4	12	15	18	23	27	32	35	42	49	*	258
Subtotal: Not attributable to Bush	-	-	-	**1**	**9**	**18**	**25**	**32**	**38**	**45**	**51**	**56**	**65**	**74**	**1**	**413**
Total without interest	**75**	**81**	**186**	**278**	**221**	**212**	**232**	**257**	**285**	**312**	**399**	**385**	**416**	**454**	**619**	**3,173**
Interest cost of tax cuts	*	3	9	20	34	48	65	83	102	124	149	177	207	240	33	1,230
Total with interest	**75**	**84**	**195**	**298**	**255**	**260**	**297**	**340**	**388**	**435**	**548**	**562**	**623**	**694**	**652**	**4,403**
Cost with interest as a share of GDP	0.7%	0.8%	1.8%	2.6%	2.1%	2.1%	2.2%	2.5%	2.7%	2.9%	3.5%	3.4%	3.6%	3.8%	1.5%	2.9%
Addendum																
Cost of extending expiring provisions[9]																
Extension of 2001 and 2003 tax cuts	-	-	-	-	13	30	31	28	35	30	165	264	275	289	-	1,160
Extension of "extenders"	-	-	-	1	4	7	9	14	15	17	20	21	23	25	1	155
Subtotal: Extending expiring provisions	-	-	-	**1**	**18**	**37**	**41**	**42**	**50**	**47**	**185**	**285**	**298**	**313**	**1**	**1,314**
Full cost of further AMT fix																
Further AMT fix due to Bush tax cuts	-	-	-	-	5	15	18	23	29	35	41	48	55	64	-	333
Further AMT fix not due to Bush tax cuts	-	-	-	*	4	12	15	18	23	27	32	35	42	49	*	258
Subtotal: Full cost of further AMT fix	-	-	-	*	**9**	**26**	**33**	**41**	**51**	**62**	**73**	**83**	**97**	**114**	*	**591**

Notes: * = Between $500 million and zero; ** = Between -$500 million and zero; May not add due to rounding; See notes after Table 5.
Sources: JCT and CBO data; CBPP calculations.

Notes:

1. EGTRRA is the Economic Growth and Tax Relief Reconciliation Act, Public Law No. 107-16, signed into law on June 7, 2001.
2. Pease and PEP are the limitations on itemized deductions and personal exemptions for high-income taxpayers. Under EGTRRA, these limitations are phased-out starting in 2007.
3. JCWAA is the Job Creation and Worker Assistance Act of 2002, Public Law No. 107-147, signed into law on March 9, 2002. The costs of the following three provisions in JCWAA are excluded: the temporary extension of unemployment insurance, TANF reauthorization, and payments to Puerto Rico.
4. JGTRRA is the Jobs and Growth Tax Relief Reconciliation Act, Public Law No. 108-27, signed into law on May 28, 2003. The cost of state fiscal relief in JGTRRA is excluded.
5. Other legislation enacted since January 2001 have had small effects on revenues in the 2001-2014 period includes such provisions as the Health Saving Accounts, enacted as part of the Medicare prescription drug legislation, and miscellaneous trade bills. Unpublished CBO data, March 2004.
6. This reflects the cost of extension as proposed by the Administration in its 2005 Budget. The Budget included the extension of all provisions in the 2001 and 2003 tax cuts, with the exception of the above-the-line deduction for qualifying higher education expenses, the savers' credit for lower and middle income families, and bonus depreciation. The Administration also did not propose the extension of the 2002 tax cut, including the five year carry-back of net operating losses for corporations.
7. The cost of extending the savers' credit for lower- and middle-income families is not included since the Administration did not propose extension of this provision in it 2005 Budget.
8. This analysis attempts to isolate tax policies that can be attributed to the Bush Administration in the 2005-2014 period. As a result, it does not attribute to the Administration the effects of tax cuts that arguably preceded its tenure, even though the Administration may support the tax-cut policy. In particular, the cost of further extending the regular "extenders" and part of the cost of AMT reform are not attributed to the Administration in this analysis. For more details, see the box on page 13.
9. This includes the cost of extending the 2001 and 2003 tax cuts, as proposed by the Administration, and the cost of extending the "regular" extenders.

Appendix Table 6: Distribution of Enacted Bush Tax Cuts in 2004*

Income group	Average Tax Cut (in 2004 Dollars)	Share of the Tax Cuts	Percentage Change in After-Tax Income
All Provisions			
Lowest 20 percent	$27	0.4%	0.4%
Second 20 percent	$317	4.4%	1.9%
Middle 20 percent	$647	8.9%	2.3%
Fourth 20 percent	$1,186	16.4%	2.6%
Top 20 percent	$5,055	69.8%	4.1%
All	$1,448	100.0%	3.3%
Top one percent	$34,992	24.2%	5.3%
Above $1 million	$123,592	15.3%	6.4%
Three "Middle-Class" Provisions**			
Lowest 20 percent	$15	0.4%	0.2%
Second 20 percent	$266	8.2%	1.6%
Middle 20 percent	$547	16.8%	2.0%
Fourth 20 percent	$874	26.8%	1.9%
Top 20 percent	$1,558	47.8%	1.3%
All	$652	100.0%	1.5%
Top one percent	$1,320	2.0%	0.2%
Above $1 million	$1,439	0.4%	0.1%
All Other Provisions			
Lowest 20 percent	$12	0.3%	0.2%
Second 20 percent	$51	1.3%	0.3%
Middle 20 percent	$100	2.5%	0.3%
Fourth 20 percent	$312	7.8%	0.7%
Top 20 percent	$3,497	87.9%	2.8%
All	$795	100.0%	1.8%
Top one percent	$33,672	42.3%	5.1%
Above $1 million	$122,153	27.5%	6.4%

*Reflects the individual income tax, corporate tax, and estate tax changes enacted since 2001. The estimates assume the policies that are in effect in 2004.

** The three "middle class" provisions are the establishment of the 10 percent bracket, the expansion of the child tax credit, and relief for married couples.

Source: Urban Institute-Brookings Institution Tax Policy Center, Table 04-0051 through Table 04-0056, April 15, 2004, www.taxpolicycenter.org

Appendix Table 7: Distribution of Bush Tax Cuts When Fully In Effect*

Income group	Average Tax Cut (in 2004 Dollars)	Share of the Tax Cuts	Percentage Change in After-Tax Income
All Provisions			
Lowest 20 percent	$19	0.2%	0.3%
Second 20 percent	$330	4.4%	1.9%
Middle 20 percent	$652	8.6%	2.3%
Fourth 20 percent	$1,132	14.9%	2.5%
Top 20 percent	$5,432	71.7%	4.4%
All	$1,516	100.0%	3.4%
Top one percent	$40,002	26.4%	6.1%
Above $1 million	$136,295	16.1%	7.1%
Three "Middle-Class" Provisions**			
Lowest 20 percent	$16	0.5%	0.2%
Second 20 percent	$316	9.4%	1.9%
Middle 20 percent	$594	17.7%	2.1%
Fourth 20 percent	$877	26.1%	1.9%
Top 20 percent	$1,558	46.3%	1.3%
All	$673	100.0%	1.5%
Top one percent	$1,320	2.0%	0.2%
Above $1 million	$1,439	0.4%	0.1%
All Other Provisions			
Lowest 20 percent	$3	0.1%	0.0%
Second 20 percent	$14	0.3%	0.1%
Middle 20 percent	$57	1.4%	0.2%
Fourth 20 percent	$255	6.1%	0.5%
Top 20 percent	$3,874	91.9%	3.1%
All	$843	100.0%	1.9%
Top one percent	$38,683	45.9%	5.9%
Above $1 million	$134,856	28.7%	7.0%

*Reflects the individual income tax and estate tax provisions enacted since 2001 that the Administration proposes to make permanent. (The Administration does not propose extending the corporate tax changes.) The estimates assume the policies in 2010, when all of the provisions are fully in effect, are applied in 2004.

** The three "middle class" provisions are the establishment of the 10 percent bracket, the expansion of the child tax credit, and relief for married couples.

Source: Urban Institute-Brookings Institution Tax Policy Center, Table 04-0057 through Table 04-0062, April 15, 2004, www.taxpolicycenter.org