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NEW "MIDDLE-CLASS" TAX-CUT BILL REPRESENTS CYNICAL POLICYMAKING

by Robert Greenstein

The "middle-class" tax-cut legislation that the House and Senate approved last night reflects an exercise in cynicism unusual even for Washington, D.C. Its "middle-class" label cloaks several significant deficiencies. For example, the legislation benefits high-income households considerably more than the middle class, and even though the bill emerged out of dormant legislation designed to help low-income working families, the revised legislation treats these families unfavorably.

Another Deficit-Financed Tax Cut

The legislation increases the deficit significantly, despite the availability of a way to pay for it. It also busts the widely-trumpeted $350 billion limit on last year's tax-cut legislation, and does so by violating standard Congressional procedures and thereby denying senators an opportunity to consider alternatives under which the costs of those tax cuts would be paid for.

- The legislation reduces tax revenues by $146 billion over ten years and adds over $200 billion to deficits when the associated interest costs on the national debt are taken into account, thereby worsening the nation's fiscal future. Its costs could have been paid for. The Senate and House have each passed measures in recent months that raise significant amounts by closing abusive corporate tax shelters. But instead of using these savings to help finance the "middle-class" tax-cut extension bill, the Congressional leadership decided on deficit-financing for this legislation. This course allows the leadership to use the tax-shelter savings to finance a new array of special-interest corporate tax breaks as part of the corporate tax-cut bill, which is what both the House and Senate versions of the corporate tax bill would do.

- While failing to move the tax-shelter *savings* from the corporate tax bill to this legislation, the Congressional conference committee that crafted the middle-class extension bill moved $13 billion in largely corporate tax-cut *costs* out of the corporate tax bill and into the middle-class extension legislation. This may have been done to create room to pack $13 billion more in special-interest tax breaks into the corporate tax legislation, which Congress is expected to take up after the election.

- In designing the "middle-class" tax cut bill as they did, Congressional leaders have continued the process of cheapening discourse on policy matters in Washington, D.C. A year ago, Congressional leaders purported to limit the cost of the 2003 tax-cut bill to $350 billion when it became clear that the Senate, concerned about the alarming growth in the deficit, would not approve a bill with a larger price tag. But Congressional leaders shoehorned an array of expensive tax cuts into the $350 billion limit through a gimmick: they wrote the 2003 tax-cut bill so that the principal provisions that could be said to be "middle-class" provisions would expire on December 31, 2004. (The tax cuts heavily targeted on very high-income households were written in for a longer duration.) This was done so that Congressional leaders could then push through legislation to extend these "middle-class" tax cuts shortly before the 2004 elections and thereby bust the $350 billion limit. Members who opposed the measures to extend these "middle-class" tax cuts without paying for them would face the prospect of attack ads branding them as politicians who wanted to raise ordinary families' taxes.

- Despite this rather cynical attempt to circumvent the $350 billion limit that the Senate had set last year, it appeared for awhile this year that this ploy might not work. A bipartisan group of senators formed a slender majority to call for all tax cuts and entitlement increases, including these tax-cut extensions, to be paid for. So, in their next cynical move, Congressional leaders designed a process to *deny* members of the Senate the ability to debate — and to vote on — proposals to offset the costs of these tax-cut extensions. The legislation that was rammed through Congress was not first considered in the Senate Finance Committee or on the Senate floor. Instead, a conference on a largely unrelated bill was used as a vehicle to which to attach these tax-cut extensions. As a result, Senators could only vote "yes" or "no" on the conference report; there was no opportunity for them to amend it to add offsets. Those who voted no can expect to be branded as tax-increasers.

Middle-Class Families Aren't the Main Beneficiaries and Could End Up Net Losers

The legislation is *not* the middle-class package it is portrayed as being. Indeed, when it is paid for — as it eventually will have to be, given the large, persistent deficits we face — middle-class households are likely to lose more from the steps taken to pay for the tax cuts than they will gain from the tax cuts themselves.

- Data from the Urban Institute-Brookings Institution Tax Policy Center show that the families in the middle of the income scale — those in the middle 20 percent of the income distribution — will receive an average tax cut of $162 in 2005 from this legislation. By contrast, those in the top fifth will get an average tax cut of $1,317, and those in the $200,000 - $500,000 income range will get an average tax cut of $2,390.

  More than two-thirds of the tax cut — 70 percent of it — will go to those in the top fifth. Some 47 percent of the tax cut will go to those in the top tenth of the income spectrum. But families in the middle 20 percent of the income scale will get only 9 percent of the bill's tax cuts, a peculiar result for a bill promoted as a middle-class tax relief package.

- Moreover, by using deficit financing for these measures, Congress is borrowing from the future. Eventually, the costs of these tax cuts will have to be paid for — through cuts in programs, tax increases, or a combination of the two. Tax Policy Center data further show that under the most likely ways of ultimately paying for these cuts, middle-class families are likely to wind up *worse off*, on average — that is, what they will lose as a result of the budget cuts or tax increases that ultimately must be adopted to make up for the bill's revenue losses will likely outweigh what they get from the tax cuts. (For a discussion of this issue and the Tax Policy Center findings, see an accompanying analysis, "Many Middle-Class Families Likely to Wind Up As Net Losers From The 'Middle-Class' Tax Cuts," Center on Budget and Policy Priorities, September 21, 2004.)

Rejecting Proposals to Help Low-Income Working Families

In several respects, the bill treats low-income working families less favorably than those who are better off. It provides "marriage penalty" relief for all households *except* those with low incomes. It doesn't address the ongoing erosion of the Child Tax Credit for the working poor, which has made full-time minimum-wage workers ineligible for the credit. Finally, the Congressional conference committee that crafted the legislation rejected an attempt to fix this erosion of the child credit in part on the grounds of error rates in the Earned Income Tax Credit, but then rejected the Administration's own proposal for simplifying the EITC and reducing errors in it.

- The 2003 tax-cut bill accelerated the major tax cuts enacted in 2001 for high income people as well as those for middle-income families. That bill failed, however, to accelerate either of the two tax-cuts provisions enacted in 2001 that aid low-income working families — a provision extending the Child Tax Credit to some working-poor families and a provision providing marriage-penalty relief to such families. The new legislation accelerates *one* of these two provisions (the Child Tax Credit provision) *by one year* — from 2005 to 2004 — at a cost of $2 billion. This provision accounts for 1.4 percent of the legislation's cost. The legislation *fails* to accelerate the other provision, which provides marriage-penalty relief to low-income working families, despite the fact that the bill maintains the full acceleration of marriage-penalty relief for those in the upper parts of the income scale.

  As a result, working-poor married families will have to wait until 2008 to receive the full marriage-penalty relief that the 2001 legislation accords them. Meanwhile, families with incomes of more than $1 million continue to receive total tax cuts (from the various tax cut bills enacted since 2001) that exceed $100,000 per household a year, on average.

- In crafting the middle-class extenders bill, the Congressional conference committee compounded these problems. The committee added a number of corporate tax-break provisions to the package but *voted down* a proposal to address a significant problem that has arisen in the component of the Child Tax Credit for the working poor. When this component of the Child Tax Credit was established as part of the 2001 tax-cut legislation, it was limited to low-income working families with earnings of at least $10,000. The $10,000 figure was selected in part so that children with a parent who works full time throughout the year at the minimum wage would be covered. The $10,000 entry point for the low-income employment of the credit has been raised each year since 2001, however. It now stands at $10,750 and will be increased further to $11,000 next year. Those below this level — including families with a full-time minimum wage worker — now are *in*eligible. Full-time, minimum-wage work pays $10,700. (In addition, the Child Tax Credit benefits provided to working-poor families with incomes modestly above this level have fallen as a result of the increase in the $10,000 entry point.)

The annual upward adjustment in the $10,000 entry point is based on the assumption that the wages of these low-paid workers will fully keep pace with inflation. (The entry point is adjusted upward each year by the inflation rate.) But the wages of these workers have not, in fact, been keeping up with inflation. To the contrary, the minimum wage has remained frozen at $5.15 an hour, and the incomes of low-income workers in general have edged down in the past few years rather than increased.

This issue was put before the conference committee by Senator Blanche Lincoln (D-Arkansas), who offered a modest remedy to address it. The remedy was voted down even as the corporate tax-cut extensions were added.

- One argument made against the proposal to remedy this problem in the low-income component of the Child Tax Credit was that the Earned Income Tax Credit — a separate low-income tax credit — has a significant error rate, and Congress should not improve one low-income tax credit while there are problems in another low-income credit. (Such a concern does not seem to apply to corporate tax shelter abuses; their presence does not deter Congressional leaders from adding new corporate tax breaks.)

  This argument, made by Senator Don Nickles, seem dubious for another reason, as well — the EITC is a separate credit from the Child Tax Credit, and the issues involved in the increase in the entry point used for the low-income component of the Child Tax Credit are quite distinct from issues of errors in the EITC, which stem in part from the EITC's complexity. Furthermore, Senator Lincoln also offered an amendment in the conference committee to include in the legislation a widely praised proposal that the Bush Treasury Department designed — and President Bush's budget includes — to simplify the EITC and significantly reduce errors in it. Republican conferees, including Senator Nickles, voted down the Administration's own EITC simplification/error reduction proposal, a proposal that has won acclaim from tax experts across the political spectrum.

> (Next year, some of the same Congressional leaders who voted not to include the Administration's EITC proposals may cite problems in the EITC as a reason to include cuts in the EITC in the Congressional budget resolution, which could lead to EITC changes that effectively raise taxes on working-poor families. If that occurs after these leaders declined to accept the Administration's EITC simplification/error reduction package, it will be a further display of cynicism.)

In short, both the legislation and the process used to develop it — and to deny the Senate a vote on proposals to offset its cost — represent the latest step in the continuing slide toward fiscal irresponsibility, the thwarting of normal democratic processes, and favoritism toward the comfortable and well-off accompanied by neglect of working-poor families who need help the most.