Joint Economic Committee

Democratic Staff

Senator Jack Reed (D-RI) – Vice Chairman

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Rethinking the 2001 Tax Act One Year Later

Summary

Several provisions of last year's tax cut—the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)—have not yet taken effect. This study re-examines last year's tax cut by separating the 2001 Tax Act into two parts: the provisions that are currently in effect in 2002 and the remaining provisions that phase in over the life of the Act. It finds that the provisions yet to come are very costly, heavily skewed toward upper-income taxpayers, likely to have a negative impact on the economy, and will make tax filing more complex for millions of taxpayers.

Key findings include the following:

High but hidden costs. Provisions of EGTRRA that are not yet in place will cost about $600 billion over the 2003-2012 period, assuming that the tax cut is not allowed to expire in 2010. The phasing-in of many provisions holds down the cost in the early years. The costs are substantially higher once the tax cuts fully phase in, however, reaching $116 billion per year by 2012. In addition, some of the cost of future tax cuts is offset by tax increases associated with the scheduled expiration of certain provisions. The $116 billion cost in 2012 consists of new tax cuts of $143 billion and tax increases of $27 billion from expiring provisions.

Benefits skewed to upper-income families. Two-thirds of the income tax cuts yet to come benefit the 20 percent of taxpayers with the highest incomes. A full 60 percent of the benefits go to the 1 percent of taxpayers at the very top of the distribution. Including the effects of repealing the highly progressive estate tax tips the scales even further. More than 70 percent of the benefits from scheduled future income and estate tax cuts go to the 10 percent of taxpayers with the highest incomes.

The AMT hides the true cost and distribution. The tax cuts that take place after this year would be even more costly and even more skewed toward high-income taxpayers if the alternative minimum tax (AMT) did not take back most, and in many cases all, of the tax cut from millions of taxpayers.

No short-term stimulus. The tax cuts already in place may have provided some stimulus and moderated the recession that began in March 2001. Tax cuts that are not yet in effect provide little if any stimulus and will be harmful if their expected impact on the budget leads to higher interest rates.

Harm to long-run economic growth. Fewer than 20 percent of taxpayers will see any further cuts in tax rates. Overall, the reduction in marginal tax rates from tax cuts not yet in effect is one percentage point or less. The likely adverse effects on national saving and long-run growth from larger budget deficits will easily swamp any positive growth effects from those small marginal rate cuts.

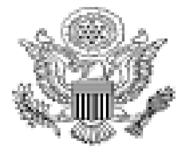
Greater complexity. EGTRRA did little to reduce the complexity of the tax code. Moreover, except for the scheduled repeal of restrictions on itemized deductions and personal exemptions, most of the simplifying provisions are already in place. The increased complexity for the millions of taxpayers who will be pushed on to the AMT by the future tax cuts will far overshadow those simplifying provisions.

Preserving a More Progressive Tax Cut. Rather than allowing the costly and heavily tilted future scheduled tax cuts to take effect, Congress could instead extend the tax cuts already in place with some modifications. One possibility is extending the tax cuts in place this year while accelerating to 2003 future scheduled increases in the child tax credit, the earned income tax credit, and the indexing of the 10-percent tax bracket. This would be less costly and more progressive than the full tax cut enacted in 2001, yet still provide tax relief to everyone helped by the original legislation.

Introduction

Sometime soon, Congress will need to address the unfinished business of the Economic Growth and Tax Relief Reconciliation Act of 2001. The 2001 Tax Act left a complicated pattern of future tax rules with provisions that phase-in over many years; others that expire after only a few years; and the complete "sunsetting" of the entire Act in 2011. Added to these complications is the unresolved issue of the individual Alternative Minimum Tax (AMT). The 2001 Tax Act sidestepped the costly problem of fixing the AMT. As a result, many millions more taxpayers will end up paying taxes under the AMT than would have been the case without the new tax law. Not only will these families need to deal with the complexity and tedium of figuring their income taxes two different ways, but also many will discover that because of the AMT, their taxes are no less than they would have been if the 2001 Tax Act had never been enacted.

Given new budget realities, it is appropriate to step back and evaluate the potential losses and gains from the remaining provisions of the 2001 Tax Act that have yet to take effect. The near-term federal budget environment has changed dramatically since last June when the Tax Act became law. Since then we have entered into a war on terrorism and have had official confirmation that the economy was in a recession. In January 2001, the Congressional Budget Office projected a cumulative budget surplus of $5.6 trillion over the years 2002-2011—a $3.1 trillion surplus excluding the off-budget transactions of Social Security and the Postal Service. Now, most of that surplus is gone. The latest CBO projections show a cumulative budget surplus of less than $1.7 billion in 2002-2011, and a deficit of nearly $600 billion over the same period outside the Social Security program. Recent information on tax collections through April of this year suggests that this summer's revised budget projections will be even bleaker. The claim that the 2001 Tax Act was easily affordable over the next ten years because of huge budget surpluses was dubious at the start. It is now clearly not credible.



While the short-term economic and budget outlook has changed, the longer-term situation has not. The 2001 Tax Act was never really affordable over the long term. We still face the retirement of the baby boom generation starting in less than a decade, and costs for medical care continue to climb. It would cost more than twice as much over the next 75 years to make EGTRRA permanent and to fix the individual AMT than it would to meet the total projected shortfall for Social Security.[1]

In this paper we re-examine the economic and distributional consequences of the 2001 Tax Act by dividing the tax cuts into two parts, those provisions currently in place and those to come after 2002. We compare the 10-year costs under the assumption that the tax cuts extend through 2012, the distribution across family income groups, the possible economic effects, and the impact on tax complexity of the two pieces of the tax cut. We also consider the economic and distributional effects of permanently extending the provisions of the 2001 Tax Act already in place with some modifications, but foregoing the most costly provisions scheduled for future years.

Reconsidering the 2001 Tax Act One Year Later

The 2001 Tax Act was the largest tax cut in 20 years. EGTRRA introduced a new 10 percent tax bracket, reduced marginal tax rates in higher-income tax brackets, substantially raised child tax credits and expanded the number of families receiving refundable credits, provided tax relief to married couples, increased incentives to save for education and retirement, and repealed the estate tax.

To reduce the 10-year cost of the legislation, Congress chose to phase-in pieces of the 2001 Tax Act over time and to allow some provisions to expire after a few years. Because the original tax bill would have reduced revenues beyond the 10-year budget window, a vote on the bill in the Senate would have been subject to a "point of order" requiring 60 votes for passage. To avoid that requirement, Congress instead voted to allow the entire 2001 Tax Act to expire after 2010.

As a result of the phase-in and eventual repeal of the 2001 Tax Act, what Congress really has enacted is a series of temporary tax cuts and offsetting tax increases in 2002 through 2010. The character of the tax cuts already in place in 2002 differs from the tax cuts and tax increases to come in terms of numbers of families affected, the economic characteristics of those families, and total costs.

Most, but not all, of the key provisions of the 2001 Tax Act that benefit low- and moderate-income families are already in place. These include the new 10 percent tax bracket, a $100 increase in the child credit, extension of the child credit to working families with little or no income tax liability, a new non-refundable credit for pension and IRA contributions, and new and expanded education incentives **(Table 1)**.

Future provisions that will benefit certain moderate- and lower-income families include further increases in the child credit, higher limits on the amount of the credit that is refundable, and new tax benefits for married couples.

Most of the tax cuts scheduled to take effect after 2002, however, help upper-income families. These provisions include further reductions in marginal tax rates in the four highest income tax brackets,

Table 1. Key Provisions of EGTRRA 2001
Provisions in Place in 2002 and Provisions That Take Effect in Future Years

	Provisions in place in 2002	Provisions that take effect after 2002	
Income Tax Rates			
New 10 percent tax bracket	Applies to the first $6,000 of taxable income for singles, first $10,000 for heads of households, and first $12,000 for married couples.	Starting in 2008 applies to the first $7,000 of taxable income for singles, and first $14,000 for married couples. No change for heads of households. Indexed starting in 2009.	
Upper tax rate reductions	Change in rate schedule from prior law in 2002: 15 percent → 15 percent 28 percent → 27 percent 31 percent → 30 percent 36 percent → 35 percent 39.6 percent → 38.6 percent	Rate schedule starting in 2004: 15 percent 26 percent 29 percent 34 percent 37.6 percent	Rate schedule starting in 2006: 15 percent 25 percent 28 percent 33 percent 35 percent
Limit on personal exemptions and itemized deductions	No change.	Repeal phased-in over 5 years starting in 2006.	
Child Credit			
Credit amount	Increased from $500 to $600 per child.	Increased to $700 per child in 2005, $800 per child in 2009, and $1,000 per child in 2010.	
Refundable credit	Refundable up to 10 percent of earnings in excess of $10,000, indexed for inflation after 2002.	Refundable up to 15 percent of earnings in excess of the threshold.	
AMT offset	Child credit applies against the AMT. The AMT no longer reduces refundable child credits or the earned income credit.	No further change.	
Dependent Care Credit	No change.	Increase eligible expenses to $3,000 per child, the top credit rate to 35 percent, and the income threshold for the phase-down of the credit to $15,000 in 2003.	
Taxes on Married Couples			
Standard deduction	No change.	Deduction for married couples set at twice the deduction for singles. Phased in over 5 years beginning in 2005.	
End of the 15 percent tax bracket	No change.	Set at twice that for singles. Phased in over 4 years beginning in 2005.	
Income level at which the earned income credit begins to phase out	Increased by $1,000 for married couples.	Increased by $2,000 in 2005, and $3,000 in 2008 for married couples. Indexed starting in 2009.	

Table 1 (continued). Key Provisions of EGTRRA 2001
Provisions in Place in 2002 and Provisions That Take Effect in Future Years

	Provisions in place in 2002	Provisions that take effect after 2002
Education Provisions		
Education Saving Accounts	Increase contribution limit from $500 to $2,000. Tax-free distributions for elementary and secondary school expenses.	No further changes.
Qualified Tuition Plans	Distributions are tax-deferred.	Starting in 2004, distributions are tax-free.
Employer-provided educational assistance	Permanently extended and expanded to include graduate education.	No further changes.
Student loan interest	Eliminate the 5-year limit for deductions of student loan interest and increase the income eligibility limits.	No further changes.
Deduction for qualified higher education expenses	Deduction of up to $3,000.	Deduction limit increases to $4,000 in 2004. Deduction expires after 2005.
Pensions and IRAs		
IRA contribution limit	Contribution limit increased from $2,000 to $3,000 with catch-up contributions of $500 for people age 50 or older.	Limit increases to $4,000 in 2005 and $5,000 in 2008. Indexed starting in 2009. Catch-up contribution increases to $1,000 in 2006.
Contribution limit for 401(k) and other defined-contribution plans	Contribution limit increased from $10,500 to $11,000, with catch-up contributions of $1,000 for people age 50 and older.	Limit increases by $1,000 per year until it reaches $15,000 in 2006. Catch-up contributions limit also increases by $1,000 per year through 2006. Both limits indexed starting in 2007.
Non-refundable credit for IRA and 401(k) contributions for low-income workers	Credit of up to $1,000 for singles with income of $25,000 or less and married couples with income of $50,000 or less.	Credit expires after 2006.
Alternative Minimum Tax		
Increased exemption	Exemption increased by $2,000 for singles, and $4,000 for married couples.	Exemption increase expires after 2004.
Estate and Gift Tax		
Estate tax	Effective exemption increased to $1 million. Top tax rate reduced from 55 percent to 50 percent.	Phased-in increase in the exemption to $3.5 million in 2009. Phased-in reduction in the top tax rate to 45 percent in 2007. Estate tax repealed in 2010.
Gift tax	Exemption of $1 million for gifts. Top tax rate reduced to 50 percent.	No further change in exemption. Top tax rate equal to top income tax rate of 35 percent in 2010.

Source: Joint Economic Committee, Democratic Staff.

repeal of the limits on personal exemptions and itemized deductions, further reductions in the estate and gift tax rate and increases in the estate tax exemption, and repeal of the estate tax in 2010.

In addition to those scheduled tax reductions, the 2001 Tax Act also contains provisions that would raise taxes for some taxpayers in the future. These tax increases include the expiration of the higher AMT exemptions now in place, repeal of the IRA tax credit for low-income workers, and repeal of the new deduction for education expenses.

Budgetary Impacts

Based on projections from the Congressional Budget Office and the Joint Committee on Taxation, if the tax cut were extended for an additional two years the total cost over the period 2002 to 2012 would be $1.6 trillion. In 2012 alone the tax cut would cost about $230 billion.[2]

To date, neither the CBO nor the JCT has provided official estimates that break out the cost of provisions that are already in place from those that are not yet in effect. The Democratic staff of the Joint Economic Committee has prepared estimates of these separate parts of EGTRRA that are consistent with the official estimates for the entire act.[3]

Permanently extending the provisions already in place in 2002 would cost $1.1 trillion in 2002 through 2012 in reduced tax revenues and increased outlays from refundable tax credits (**Table 2**). The cost in 2012 alone would be $118 billion. This includes $91 billion from "permanent" provisions that are in place in 2002, and an additional $27 billion from extending provisions currently in place but scheduled to expire before 2010—the higher AMT exemption amounts, the tax credit for IRA contributions, and the "above-the-line" deduction for educational expenses.

Provisions to come after 2002 carry a budgetary cost of $599 billion in 2002-2012 and $116 billion in 2012 alone. The cost in 2012 includes gross tax cuts totaling $143 billion—$97 billion from income tax reductions and $46 billion from repeal of the estate tax. The net cost is lower by $27 billion because some tax cutting provisions currently in place expire before 2010. The gross cost of provisions of the tax act that are still to come will account for over 60 percent of the total budgetary cost of the provisions that will be in place in 2012, if the tax cut is not allowed to expire in 2010.

The annual cost of provisions that are not yet in place rises sharply after 2003 (**Figure 1**). The cost of repealing the estate tax is particularly heavily back-loaded. The annual cost of estate and gift tax provisions currently in place is negligible in 2002 and about $5 billion in 2003. With no further cuts the cost would rise to about $10 billion by the end of the decade. This is a modest fraction of the annual cost of full repeal, which is about $55 billion in 2011 and 2012. The additional cost of full repeal in 2010 is more than double the cost of the estate tax reductions in place in 2009, by which time the estate tax exemption will have reached $3.5 million and the top estate tax rate will have dropped to 45 percent.

Distributional Effects

For some taxpayers, last summer's rebate is representative of the size of the annual tax cut they can expect over the life of the act. For others, however, the rebate was just a small downpayment

Table 2. Estimated Budgetary Effects of EGTRRA 2001, by Fiscal Year, Billions of Dollars

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002-2012
Provisions in Place in 2002													
"Permanent" Income Tax Cuts	-40	-75	-80	-84	-82	-80	-80	-80	-81	-81	-82	-81	-885
Estate and Gift Tax Cuts	0	0	-5	-5	-9	-6	-8	-8	-9	-9	-10	-10	-80
Total, "Permanent" Tax Cuts	-40	-75	-85	-89	-91	-86	-88	-88	-90	-90	-92	-91	-965
Continuation of Expiring Income Tax Provisions	0	0	0	0	-5	-10	-13	-16	-19	-21	-24	-27	-134
Total, All Provisions	-40	-75	-85	-89	-96	-96	-101	-105	-108	-111	-115	-118	-1,099
Provisions That Take Effect After 2002													
Income Tax Cuts	0	0	-1	-14	-29	-56	-65	-73	-81	-93	-97	-97	-606
Estate and Gift Tax Cuts	0	0	0	0	0	0	-5	-6	-7	-19	-44	-46	-127
Total, Tax Cuts	0	0	-1	-14	-29	-56	-70	-80	-88	-112	-142	-143	-733
Repeal of Expiring Income Tax Provisions	0	0	0	0	5	10	13	16	19	21	24	27	134
Total, All Provisions	0	0	-1	-14	-24	-46	-57	-63	-69	-91	-118	-116	-599
All Provisions													
Income Tax Provisions	-40	-75	-81	-98	-111	-135	-145	-153	-161	-174	-179	-178	-1,492
Estate and Gift Tax Provisions	0	0	-5	-5	-9	-6	-13	-15	-16	-28	-54	-56	-206
Total, All Provisions	-40	-75	-86	-104	-120	-142	-157	-168	-177	-202	-233	-234	-1,698

Source: Joint Economic Committee, Democratic Staff.

on the full tax cut promised by 2001 Tax Act. These findings presented below are based on an analysis of EGTRRA by the Democratic staff of the Joint Economic Committee using a microsimulation tax model similar to that used by the Congressional Joint Committee on Taxation, the Congressional Budget Office, and other tax analysts. The estimates are for income tax liabilities in calendar year 2010 and include refundable tax credits. They include the major provisions of the 2001 Tax Act except for the education and retirement saving provisions.

Income Tax Cuts

The difference between the distributions of the income tax cuts already in place and the tax cuts to come after 2002 is striking. Taxpayers with

incomes up through the 80th percentile of the income distribution (income of about $100,000 or less in 2010) would receive 53 percent of the total tax reduction in 2010 if only the cuts that were already in place in 2002 were continued out into the future **(Table 3)**. In contrast, those taxpayers can expect to receive only about one-third of the tax cuts scheduled to take effect after 2002. Tax cuts to come after 2002 are highly skewed towards higher-income families. About 60 percent of the future cuts go to the 1 percent of taxpayers at the very top (income of about $465,000 or more in 2010). Interestingly, taxpayers with income in the 91st through 99th percentile can expect a net tax increase on average from future scheduled provisions of the 2001 Tax Act. This is a result of the AMT, as discussed below.

Measured as the percentage change in after-tax income, the tax cuts already in place are generally progressive, with lower-income families having the largest increases in after-tax income, although the 20 percent of tax filers with the lowest income do receive a smaller increase than those higher up,

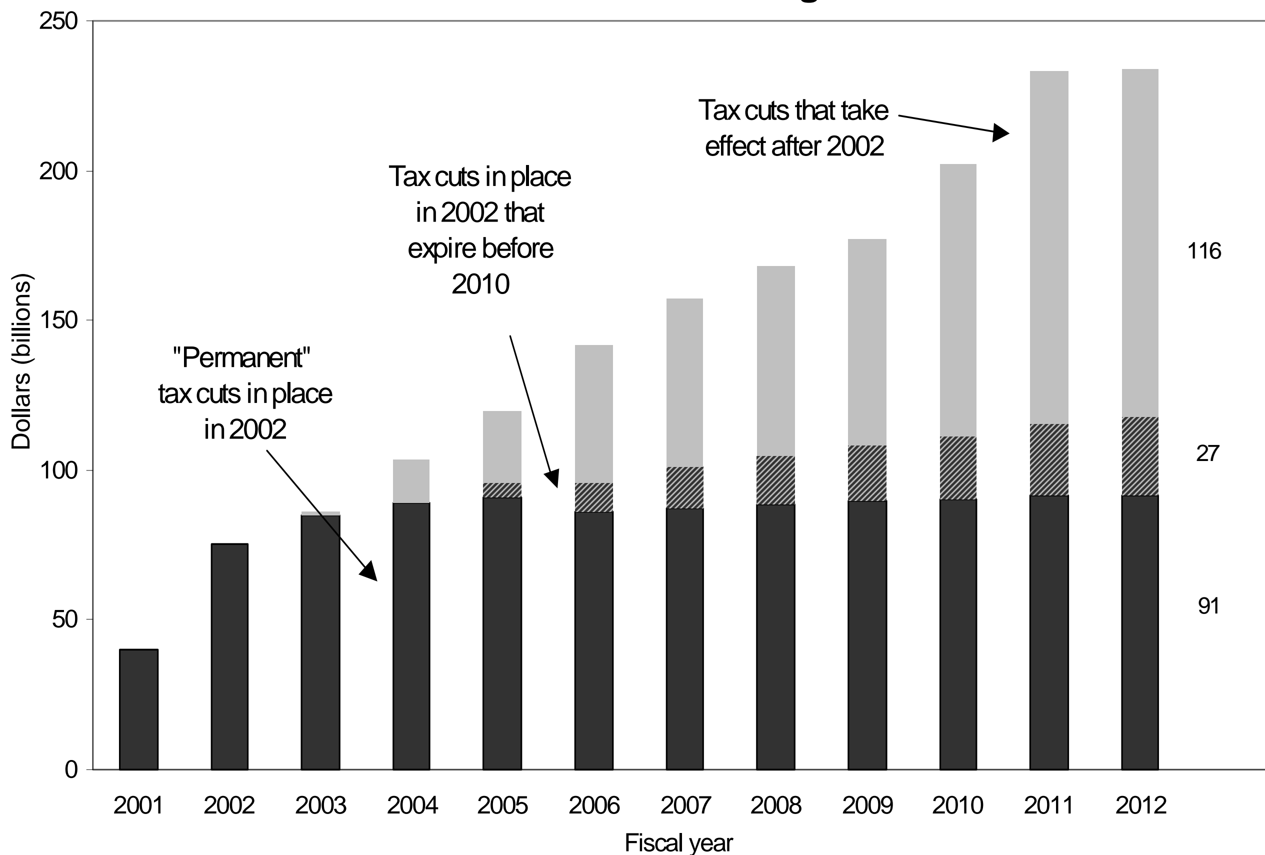


Table 3. EGTRRA Income Tax Cuts in 2010, by Income Percentile

Income Category (percentiles)	Total Tax Cut (millions)	Share of Total Tax Cut (percent)	Average Tax Cut (dollars)	Change in After-Tax Income (percent)
Full Tax Cut				
All Returns	166,403	100.0%	1,240	2.0%
1 - 20 percentile	2,725	1.6%	110	1.0%
21 - 40 percentile	16,261	9.8%	610	2.5%
41 - 60 percentile	21,853	13.1%	820	2.1%
61 - 80 percentile	32,865	19.8%	1,230	1.9%
81 - 100 percentile	92,579	55.6%	3,460	2.0%
81 - 90 percentile	21,153	12.7%	1,580	1.6%
91 - 95 percentile	7,774	4.7%	1,160	0.8%
96 - 99 percentile	6,577	4.0%	1,230	0.6%
Highest 1 percent	57,075	34.3%	42,670	4.5%
Tax Cuts In Place in 2002				
All Returns	90,327	100.0%	680	1.1%
1 - 20 percentile	2,148	2.4%	80	0.8%
21 - 40 percentile	10,551	11.7%	390	1.6%
41 - 60 percentile	12,894	14.3%	480	1.2%
61 - 80 percentile	22,114	24.5%	830	1.3%
81 - 100 percentile	42,550	47.1%	1,590	0.9%
81 - 90 percentile	15,473	17.1%	1,160	1.1%
91 - 95 percentile	7,860	8.7%	1,170	0.9%
96 - 99 percentile	7,579	8.4%	1,420	0.7%
Highest 1 percent	11,639	12.9%	8,700	0.9%
Additional Tax Cuts To Come After 2002				
All Returns	76,076	100.0%	570	0.9%
1 - 20 percentile	578	0.8%	20	0.2%
21 - 40 percentile	5,710	7.5%	210	0.9%
41 - 60 percentile	8,959	11.8%	330	0.9%
61 - 80 percentile	10,751	14.1%	400	0.6%
81 - 100 percentile	50,029	65.8%	1,870	1.1%
81 - 90 percentile	5,680	7.5%	420	0.4%
91 - 95 percentile	-86	-0.1%	-10	0.0%
96 - 99 percentile	-1,002	-1.3%	-190	-0.1%
Highest 1 percent	45,436	59.7%	33,970	3.6%

Note: See Notes on Tables and Figures.

Source: Joint Economic Committee, Democratic Staff.

Notes on Tables and Figures

Tables (3-7) and figures (2-3) showing the distribution of EGTRRA tax cuts include the following income tax provisions: 10-percent tax bracket, rate reductions in the four top income tax brackets, repeal of the restrictions on itemized deductions and personal exemptions, increase and expanded refundability of the child credit, increase in the dependent care credit, tax reductions for married filers, and the temporary increase in the alternative minimum tax exemption. They do not include education and pension provisions. Estate and gift tax cuts are distributed in the same proportion as the pre-EGTRRA distribution of total estate and gift taxes reported in Julie Ann Cronin, "U.S. Treasury Distributional Analysis Methodology," U.S. Department of Treasury, Office of Tax Analysis, Working Paper 85, September 1999, page 24.

Returns of tax filers claimed as dependents on other tax returns are excluded. Income is measured as adjusted gross income plus tax-exempt interest and non-taxable Social Security benefits. Returns with negative income are not included in the lowest income category but are included in the total.

Estimated income limits for the various percentiles in 2010 are:

Percentile	Income limit
1 – 20 percentile	$17,630
21 – 40 percentile	$32,510
41 – 60 percentile	$55,630
61 – 80 percentile	$99,940
81 – 90 percentile	$143,570
91 – 95 percentile	$196,530
96 – 99 percentile	$463,650

and the highest 1 percent has a slightly larger increase than taxpayers with lower incomes (**Figure 2**). The cuts to come after 2002, in contrast, are not progressive. The 1 percent of taxpayers with the very highest incomes will see an increase of 3.6 percent in their after-tax income as a result of those cuts while taxpayers in all other income categories will have an increase of less than 1 percent.

It is not surprising that the benefits of the tax cuts to come after 2002 are skewed towards higher-income taxpayers. The further reductions in tax rates apply only to the approximately 25 percent of taxpayers in the four highest income tax brackets. The disproportionately larger cut in the top tax rate applies to less than one percent of all taxpayers. Even most of the future tax reductions for married couples are not targeted towards lower- and moderate-income families. A recent study found that over 70 percent of the benefits from the increase in the standard deduction and all of the benefits from the extension of the 15 percent bracket for married couples go to families in the upper half of the income distribution.[4]

Estate Tax Repeal

The benefits from repeal of the estate tax are highly concentrated at the top of the distribution. Regardless of whether the burden of the tax is assigned to the estate making the payment or to the recipients of the inheritance, the estate tax is highly concentrated among high-income taxpayers. A recent analysis by the U.S. Treasury determined that taxpayers in the top fifth of the income distribution paid virtually all of the tax, with the top 1 percent of families paying over 60 percent of the total.[5]

EGTRRA provides for gradual reductions in the estate tax until 2010, when it is repealed. The increase in the estate tax exemption and the reduction in the top tax rate currently in place cost relatively little. By 2010, those provisions would amount to about 18 percent of the cost of full repeal. Adding in the benefits from future reductions in

the estate tax to the distribution of benefits from the income tax provisions widens the dramatic differences between the distributional effects of the tax cuts already in place and those of the cuts that are yet to come (**Table 4 and Figure 3**). Nearly 80 percent of the combined income and estate tax cuts to come after 2002 go to the 20 percent of taxpayers with the highest incomes in 2010, while just over 60 percent of the benefits go to the top 1 percent of returns.

Alternative Minimum Tax

A feature of the analysis that deserves mention is the impact of the individual AMT. Many taxpayers in the 60th to 99th percentiles (incomes between $55,000 and $465,000 in 2010) will see part, and in some cases all, of the tax cut they would have received under the 2001 Tax Act disappear because of the AMT.

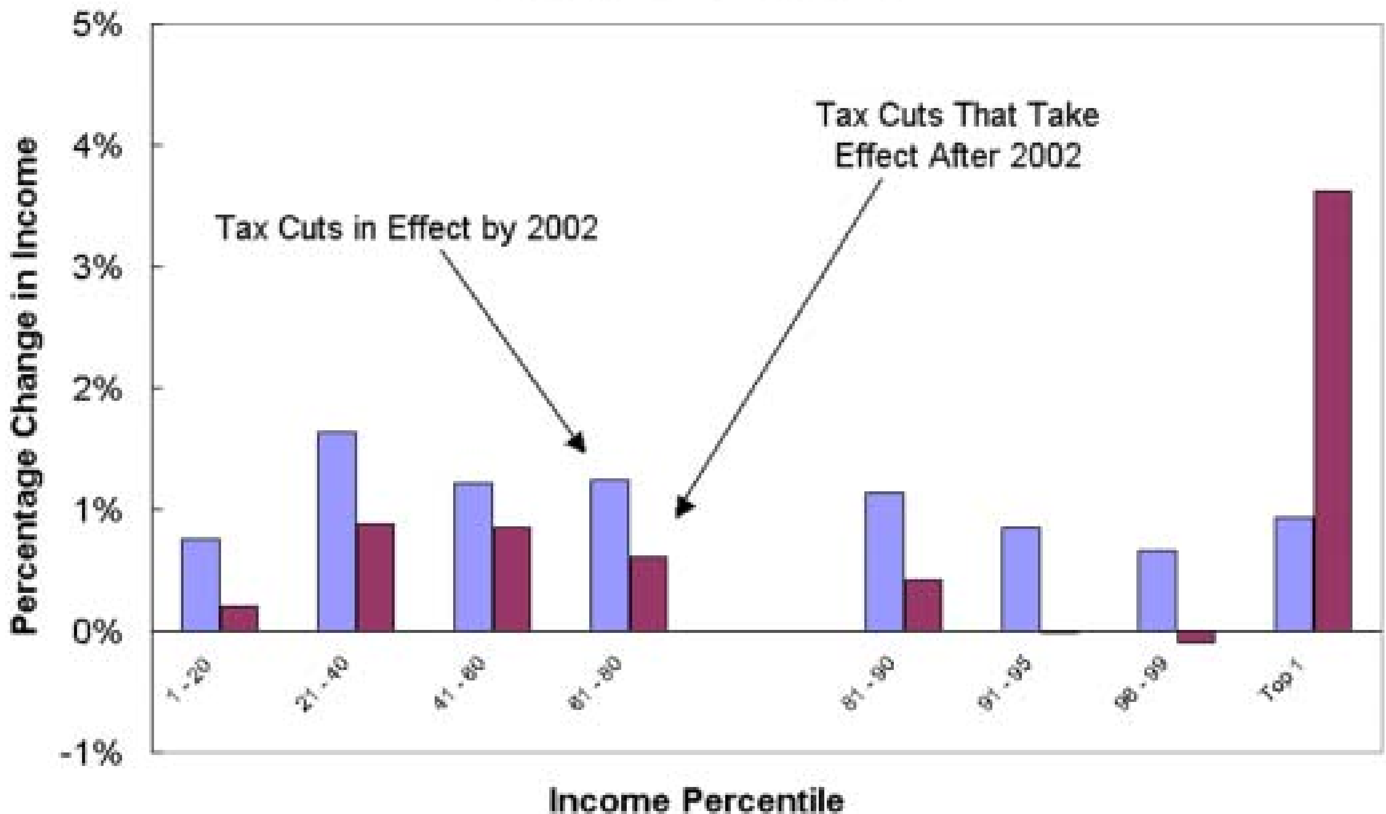


Table 4. EGTRRA Income Tax and Estate Tax Cuts in 2010, by Income Percentile

Income Category (percentiles)	Total Income Tax Cut (millions)	Total Estate Tax Cut (millions)	Combined Tax Cut (millions)	Share of Combined Tax Cut (percent)
Full Tax Cut				
All Returns	166,403	54,000	220,403	100.0%
1 - 20 percentile	2,725	0	2,725	1.2%
21 - 40 percentile	16,261	0	16,261	7.4%
41 - 60 percentile	21,853	0	21,853	9.9%
61 - 80 percentile	32,865	432	33,297	15.1%
81 - 100 percentile	92,579	53,568	146,147	66.3%
81 - 90 percentile	21,153	1,620	22,773	10.3%
91 - 95 percentile	7,774	2,808	10,582	4.8%
96 - 99 percentile	6,577	14,472	21,049	9.6%
Highest 1 percent	57,075	34,668	91,743	41.6%
Tax Cuts In Place in 2002				
All Returns	90,327	10,000	100,327	100.0%
1 - 20 percentile	2,148	0	2,148	2.1%
21 - 40 percentile	10,551	0	10,551	10.5%
41 - 60 percentile	12,894	0	12,894	12.9%
61 - 80 percentile	22,114	80	22,194	22.1%
81 - 100 percentile	42,550	9,920	52,470	52.3%
81 - 90 percentile	15,473	300	15,773	15.7%
91 - 95 percentile	7,860	520	8,380	8.4%
96 - 99 percentile	7,579	2,680	10,259	10.2%
Highest 1 percent	11,639	6,420	18,059	18.0%
Additional Tax Cuts To Come After 2002				
All Returns	76,076	44,000	120,076	100.0%
1 - 20 percentile	578	0	578	0.5%
21 - 40 percentile	5,710	0	5,710	4.8%
41 - 60 percentile	8,959	0	8,959	7.5%
61 - 80 percentile	10,751	352	11,103	9.2%
81 - 100 percentile	50,029	43,648	93,677	78.0%
81 - 90 percentile	5,680	1,320	7,000	5.8%
91 - 95 percentile	-86	2,288	2,202	1.8%
96 - 99 percentile	-1,002	11,792	10,790	9.0%
Highest 1 percent	45,436	28,248	73,684	61.4%

Note: See Notes on Tables and Figures.

Source: Joint Economic Committee, Democratic Staff.

For example, by 2010 taxpayers in the 91st to 95th percentile will receive an average tax cut of about $1,170 from provisions of the 2001 Tax Act already in place in 2002, while those with income in the 96th to 99th percentile will see an average cut of $1,420. Even though the tax cuts to come after 2002 include reductions in marginal tax rates in the four top tax brackets and repeal of the restrictions on itemized deductions and personal exemptions, the net effect of all future provisions will be to increase taxes for these taxpayers. This occurs because the higher AMT exemption amounts in place in 2002 expire in 2005.

Fewer than 2 percent of taxpayers are directly affected by the AMT in 2002. This percentage is projected to rise to over 35 percent in 2010 under the 2001 Tax Act, compared with fewer than 18 percent projected under prior law.[6] About 85 percent of taxpayers with incomes between $100,000 and $200,000 and 98 percent of taxpayers

Figure 3. Share of EGTRRA Total Tax Cuts in 2010, by Income Percentile

Percent of Total: 0% 10% 20% 30% 40% 50% 60% 70%

Tax Cuts in Effect by 2002

Tax Cuts That Take Effect After 2002

Income Percentile: 1 - 20, 21 - 40, 41 - 60, 61 - 80, 81 - 90, 91 - 95, 96 - 99, Top 1

Note: See Notes on Tables and Figures.
Source: Joint Economic Committee, Democratic Staff.

with incomes between $200,000 and $500,000 will be on the AMT in 2010.

Many taxpayers who would have been subject to the AMT under the law prior to the 2001 Tax Act will receive no benefit from the cut in tax rates. Of the 18 million taxpayers who would have been on the AMT in 2010 in the absence of the Tax Act, some 8.6 million will see their tax cut completely offset by the AMT.[7] The Tax Act will push about 17 million additional taxpayers onto the AMT in 2010. Those taxpayers will still receive a tax cut, but it will be less than the full amount that they would have received if not for the AMT.

The 2001 Tax Act, and particularly the provisions that take effect after 2002, would look quite different if Congress had addressed the AMT issue. One way to illustrate that difference is to compare the distribution of the tax cuts currently in place with that of the tax cuts to come after 2002, holding the AMT parameters constant in real terms at their 2002 values.[8]

Taxpayers in the 61st through 80th percentile would get twice the average tax cut from provisions that take effect after 2002 if the AMT were adjusted in this fashion **(Table 5)**. Instead of receiving no tax cut from future provisions of the 2001 Tax Act, taxpayers in the 91st through 95th percentile would see an average tax cut of $2,200 in 2010. Taxpayers in the 96th through 99th percentile would see an average tax cut of $2,800 in 2010, rather than the $200 tax increase they can now expect as a result of the expiration of some provisions of the 2001 Tax Act. There would be little change in the expected tax cut for taxpayers in the top 1 percent if the AMT were adjusted because their income is generally beyond the income range affected by the AMT.

Of course, the 2001 Tax Act would be much more expensive without the AMT take back. The cost of tax cut provisions scheduled to take effect after 2002 would be more than 80 percent higher than current projections if the AMT were adjusted for inflation.

Fiscal Policy Implications

Although the rationale for the 2001 Tax Act has changed from time to time before, during, and after it was enacted, a consistent argument for tax cuts that reduce marginal tax rates is the potential positive effect on household work and saving in the long term. EGTRRA was not a simple cut in tax rates, however, and other, more costly provisions of the Act do not carry the same potential benefits for economic growth. Most significantly, the Tax Act was far from revenue neutral. By raising federal deficits, the tax cut reduces national saving. In the long term, this will do much more to hurt economic growth than any likely positive effects from additional private saving or increased labor supply.

Short-Term Economic Stimulus

When the National Bureau of Economic Research officially announced last fall that the economy had fallen into a recession in March 2001, the motivation for the tax cut changed temporarily from arguments in favor of long-term growth to almost the completely opposite argument that the tax cut would provide short-term economic stimulus. A cut in individual income taxes provides effective short-term stimulus to the extent that it immediately boosts consumer spending and business investment, even if those increases come at the expense of spending and investment that

Table 5. EGTRRA Income Tax Cuts in 2010 With AMT Adjustment, by Income Percentile

Income Category (percentile)	Total Tax Cut (millions)	Share of Total Tax Cut (percent)	Average Tax Cut (dollars)	Change in After-Tax Income (percent)
Full Tax Cut with Adjusted AMT				
All Returns	254,132	100.0%	1,900	3.1%
1 - 20 percentile	2,727	1.1%	110	1.0%
21 - 40 percentile	16,268	6.4%	610	2.5%
41 - 60 percentile	22,422	8.8%	840	2.1%
61 - 80 percentile	47,038	18.5%	1,760	2.7%
81 - 100 percentile	165,527	65.1%	6,190	3.5%
81 - 90 percentile	46,384	18.3%	3,470	3.4%
91 - 95 percentile	27,474	10.8%	4,110	3.0%
96 - 99 percentile	33,913	13.3%	6,340	3.0%
Highest 1 percent	57,757	22.7%	43,180	4.6%
Tax Cuts In Place in 2002 with Adjusted AMT				
All Returns	114,585	100.0%	860	1.4%
1 - 20 percentile	2,149	1.9%	80	0.8%
21 - 40 percentile	10,556	9.2%	390	1.6%
41 - 60 percentile	13,090	11.4%	490	1.2%
61 - 80 percentile	25,190	22.0%	940	1.4%
81 - 100 percentile	63,507	55.4%	2,370	1.4%
81 - 90 percentile	19,894	17.4%	1,490	1.5%
91 - 95 percentile	12,766	11.1%	1,910	1.4%
96 - 99 percentile	18,976	16.6%	3,550	1.7%
Highest 1 percent	11,871	10.4%	8,880	0.9%
Additional Tax Cuts To Come After 2002 with Adjusted AMT				
All Returns	139,547	100.0%	1,040	1.7%
1 - 20 percentile	578	0.4%	20	0.2%
21 - 40 percentile	5,712	4.1%	210	0.9%
41 - 60 percentile	9,333	6.7%	350	0.9%
61 - 80 percentile	21,848	15.7%	820	1.2%
81 - 100 percentile	102,020	73.1%	3,810	2.2%
81 - 90 percentile	26,490	19.0%	1,980	2.0%
91 - 95 percentile	14,707	10.5%	2,200	1.6%
96 - 99 percentile	14,937	10.7%	2,790	1.3%
Highest 1 percent	45,886	32.9%	34,310	3.7%

Note: See Notes on Tables and Figures.

Source: Joint Economic Committee, Democratic Staff.

would have occurred in the future. A tax cut is more likely to help long-term economic growth to the extent that it leads to a sustained increase in household saving and labor supply.

The new 10 percent bracket is potentially the most effective provision of the tax cut as far as providing short-term stimulus. Some 96 million households received advance payments of their income tax cut for 2001 in the form of rebate checks sent out in July, August, and September of last year. The results for consumer spending were mixed, however. Initially there was little evidence that households spent the rebate checks as personal income rose but personal consumption expenditures remained virtually unchanged.

Economic theory and evidence suggest that consumers are likely to spend more out of a permanent tax cut than a temporary cut, and it may have taken some time for consumers to react to the initial tax rebates. As yet, however, there is no strong evidence to suggest that the tax cut has significantly helped to make this recession shallower and shorter than it would have been. Because low-income households tend to consume larger fractions of their income than do high-income households, the tax cut might have been even more effective as short-term stimulus if the rebates had been extended to even more lower-income households, such as those households who work and pay payroll taxes, but face no income-tax liability and hence did not qualify for the income-tax rebate.

Economic theory also suggests that households will consider changes in their lifetime income in deciding how much more or less to spend today. This has led some to argue that the future cuts to come after 2002 have had some effect in stimulating additional spending today.

Such an effect seems unlikely. Households are much more responsive to changes in current rather than future income for a number of reasons. Many households are simply constrained in the ability to borrow against future increases in after-tax income, even if they factor in those eventual increases.[9] Many households also heavily discount future income and instead follow rules of thumb based on current income in deciding how much to spend or save. These families would tend to adjust their spending habits only as current after-tax income rises.[10]

Finally, the adverse effects of the tax cut on the federal deficit and national saving can work against the economy in the short-term, via the upward pressure on longer-term interest rates. Although the evidence concerning the effect of federal deficits on long-term interest rates is not conclusive, a recent comprehensive review interpreted the empirical evidence to suggest that the tax cut could raise long-term rates by between 10 and 60 basis points in the first year, and by 75 to 110 basis points over the next 10 years.[11] This adverse effect on interest rates could easily offset the effect of the marginal tax rate reductions on the cost of capital, thus undermining the tax cut's ability to stimulate business investment.

Long-Run Economic Growth

Some proponents of the 2001 Tax Act argue that it is important for promoting longer-term economic growth because it reduces marginal tax rates—the tax on each additional dollar of earnings or income from capital—and thereby creates incentives for increased household labor supply and saving. In

addition, they believe that repeal of the estate tax will boost capital accumulation.

The case for strong work and saving incentives from the 2001 Tax Act is greatly overstated. Only a fraction of taxpayers will see any reduction in their statutory tax rate, the cumulative reduction in marginal tax rates is small, and a good portion of that decrease is already in place with the tax cuts in effect in 2002.

Fewer than 20 percent of taxpayers will see any further reduction in statutory tax rates from the provisions of the 2001 Tax Act that take effect after this year. Only about 30 percent of families and individuals filing tax returns receive any reduction in their tax rates from the fully phased-in 2001 tax cuts to begin with. Many taxpayers remain in the 15 percent tax bracket and thus receive no reduction in their tax rate, while others who would have had a rate cut will instead face a higher marginal rate because of the AMT.[12]

About one-third of the 30 percent of taxpayers who will see any reduction in their statutory tax rate are taxpayers who move into the 10 percent tax bracket. Because that rate cut is already in place in 2002, and because future rate cuts apply only to the four top income-tax brackets, less than one-fifth of tax filers will see any further cut in rates from provisions that take effect after this year.

The change in statutory tax rates does not capture the full effect of the 2001 Tax Act on marginal tax rates, however. Other provisions of the Tax Act such as the repeal of restrictions on itemized deductions and personal exemption will lower marginal tax rates for some. The net effect of all provisions of the Tax Act on marginal rates can be measured by the change in the effective marginal tax rate on different types of income—that is, taking account of not only statutory tax rates but all other phase-out and phase-in provisions of the tax code, how much tax is paid on an additional dollar of earnings or income from capital.[13]

Overall, the full effect of the 2001 Tax Act will be to lower the effective marginal tax rate on earnings by less than 2 percentage points, with about 40 percent of the reduction attributable to tax cuts already in place in 2002 (**Table 6**). Only people in the lowest and very highest income groups will see a reduction of more than 1 percentage point from provisions of the 2001 Tax Act scheduled to take effect after this year—the lowest income group because of changes to the phase-in rate for the child credit, and the 1 percent of taxpayers with the highest incomes because of the disproportionately larger reduction in the tax rate for the top income-tax bracket. Taxpayers with incomes in the 91st to 95th percentile will, on average, see an increase in the effective marginal tax rate on earnings owing to the phase out of the AMT exemption at higher income levels.

The change in the effective tax rate on income from capital is even smaller. The full 2001 tax cuts reduce the effective marginal tax on taxable capital income by just over 1 percentage point. The reduction in the marginal rate on all capital is much smaller, however, because a large portion of capital is lightly taxed or is not taxed at all. For example, housing, retirement saving, and a growing portion of saving for education are all either tax-exempt or tax-deferred. Furthermore, the 2001 Tax Act did not change other taxes on capital such as federal and state corporate income taxes. The change in the total effective marginal rate on all capital is well below one percentage point.

Table 6. Average Marginal Tax Rates Before and After EGTRRA, by Income Percentile

Income Category (percentiles)	Average Marginal Tax (percent) Pre-EGTRRA	EGTRRA as of 2002	Full Effect of EGTRRA
Average Marginal Tax Rate on Wages			
All Returns	27.2	26.5	25.4
1 - 20 percentile	3.7	0.7	-1.0
21 - 40 percentile	18.9	17.9	16.9
41 - 60 percentile	19.9	19.2	18.9
61 - 80 percentile	24.8	23.6	23.4
81 - 100 percentile	32.5	32.1	30.5
81 - 90 percentile	27.8	28.1	27.8
91 - 95 percentile	29.7	29.3	29.9
96 - 99 percentile	34.7	33.9	32.8
Highest 1 percent	40.0	38.8	32.4
Average Marginal Tax Rate on Capital Income			
All Returns	23.5	23.2	22.2
1 - 20 percentile	7.5	6.0	5.6
21 - 40 percentile	12.0	10.8	10.3
41 - 60 percentile	17.8	17.2	16.6
61 - 80 percentile	23.6	23.0	22.0
81 - 100 percentile	26.0	25.7	24.6
81 - 90 percentile	25.8	25.4	25.0
91 - 95 percentile	26.4	26.0	27.1
96 - 99 percentile	28.6	28.5	28.1
Highest 1 percent	25.0	24.7	23.0

Note: See Notes on Tables and Figures. The average marginal tax rate on w ages is w eighted by total w ages. The average marginal tax rate on capital income is the w eighted average marginal w eight on interest, dividends, and capital gains.
Source: Joint Economic Committee, Democratic Staff.

Any change in work and saving depends not only on the change in effective marginal tax rates but also on how households respond to changes in after-tax returns. An extensive body of empirical research over the past 20 years has found that marginal tax rates have very small effects on major economic decisions, such as whether to work, how many hours to work, or how much of one's income to save or consume.[14]

In terms of labor supply, tax rates have little effect on the decisions of primary earners, except through "income effects"– in the case of a tax cut the effect of higher after-tax income is to reduce labor supply, as people try to maintain a certain level of

consumption. The evidence suggests that changes in tax rates can have larger effects on secondary earners married to high-earning spouses, probably a reflection of those second incomes being largely discretionary.[15] In terms of saving, most research has found that the sensitivity of household consumption to changes in after-tax rates of return is very small.[16] Thus, reducing marginal tax rates is unlikely to boost private saving by anything but a small amount, and is unlikely to significantly increase the labor supply of anyone but those secondary earners who can afford not to work.

Economists agree that the most effective way to promote economic growth is to insure an adequate level of national saving. Unfortunately, the 2001 tax cut works in the opposite direction, because any potential increase in private saving will fall far short of the certain drop in public saving as federal deficits re-emerge.[17]

Putting all the pieces together, the CBO estimated that the 2001 Tax Act would have a small effect on GDP, in the range of plus or minus 0.5 percent after 5 years. It estimates that by 2006, the tax cut will decrease the average effective marginal tax rate on labor by 1.5 percentage points and the average effective tax rate on capital by 0.5 percentage points. This is equivalent to a 2.8 percent increase in the average effective rate of return to work and a 0.6 percent increase in the rate of return to capital. These small incentive effects will be more than offset by the negative effect from the decline in national saving if the federal government would have used the surplus to pay down the debt, and the result will be a decline in GDP.[18]

A recent study using a different model came to essentially the same conclusion as the CBO. The study concluded that the incentive effects from the tax cut through lower marginal tax rates would increase GDP in 2011 by about 0.95 percent, increased international capital flows to the U.S. would add another 0.37 percent to GDP, but the decline in total public saving would shave 1.63 percent from GDP, leaving a net reduction of 0.31 percent.[19]

Finally, there is little support for the claim that estate tax repeal would have a large impact on capital accumulation. The estate tax can indeed be viewed as a tax on the return to saving, but there is scant empirical evidence to suggest that it has any noticeable impact on total private savings. A lower estate tax may or may not increase saving by those wishing to leave a bequest. Even if it did, a larger bequest would increase the wealth of those receiving the bequest and thus tend to decrease their saving.[20] Moreover, it is a simple fact that very few people are affected by the estate tax. According to IRS statistics, in 1999, only two percent of the estates of people who died were subject to any estate tax, and more than half of all estate taxes were paid by the 3,300 largest estates, all of which were valued at over $5 million. Tax provisions in place in 2002 have already raised the estate tax exemption to $1 million, with an effective exemption of $2 million for married couples. Further increases in the exemption would still eliminate estate taxes completely for a large fraction of estates and cost much less than complete repeal.

Tax Complexity

Although the 2001 Tax Act contains some provisions that reduce the complexity of the tax code, the overall impact of the tax cut will be to increase the complexity of tax filing and

compliance for millions of taxpayers. Many of the complexity-reducing features are already in place in 2002, including simplification of some rules for EITC and no longer allowing the AMT to reduce the child credit, the adoption credit, and refundable credits. A significant simplification feature, the elimination of restrictions on itemized deductions and personal exemptions, does not begin to phase in until 2006, however, and is not fully in place until 2009.

Any positive features of the Act with respect to simplification will be overwhelmed by the added complexity for the millions of taxpayers who are pushed onto the AMT. The tax act will make future AMT modifications much more costly because many more taxpayers will be on the AMT.

While it would seem that eliminating the estate tax would greatly simplify tax planning for the families affected by the tax, that is not necessarily the case. Over the period when the estate exemption increases from 2002 through 2009, some individuals may need to re-write their estate plans a number of times to account for the changing tax law. Even when the tax is completely repealed, there will still be a need for estate tax planning. The new treatment of capital gains accrued by an estate will require taxpayers to keep records on purchases of assets for many years, even generations.[21]

Finally, there is the issue of the increased complexity of choice. While economists usually believe that unfettered choice is a good thing, one might wonder whether taxpayers really want to have to choose among a dozen different tax incentives for education, where each dollar of educational expenses can only benefit from one provision, or among a half dozen different ways to save for retirement, each with its own rules and requirements.

Possible Modifications

Permanently extending the provisions of the 2001 tax cut that are in effect in 2002 would provide a progressive tax cut that would reduce income taxes for all families except those that lose their tax cuts to the AMT. It would provide more AMT relief than allowing future scheduled provisions of the tax act to go into effect because it would maintain the higher AMT exemption currently in place.

It would be possible to keep certain prospective provisions of EGTRRA as part of permanent extension of the 2002 cuts. We explore three options: (1) indexing the end-points of the 10-percent bracket starting in 2003; (2) increasing the child credit for all families and the starting point for the EITC phase-out range for married couples; and (3) a combination of options one and two.

The first option would index the 10-percent bracket starting next year. The new 10-percent tax bracket created by EGTRRA applies to the first $6,000 of taxable income for singles, $12,000 for married couples, and $10,000 for heads of households. In 2008 the amounts increase to $7,000 for singles and $14,000 for married couples, but remain unchanged for heads of households. Starting in 2009, all three tax-bracket end points are indexed for inflation.

Indexing the 10 percent bracket starting in 2003 would provide consistent treatment with all other tax brackets. It would leave the end points of the 10-percent brackets in 2010 about where they would be under current law for married couples and singles, but higher than it otherwise would be

for heads of households. This modification to permanent extension of tax cuts in place in 2002 would mostly benefit the 60 percent of taxpayers with incomes above the 40th percentile (except for those taxpayers on the AMT) **(Table 7)**. It would raise the cost of extending the 2002 tax cuts by about $7 billion in 2010.

The second option would increase child credits and extend the EITC. Under current law, the child tax credit is currently set at $600 per child. It will increase to $700 in 2005, $800 in 2009, and $1,000 in 2010. The limit on child credit refunds, currently 10 percent of earnings above a threshold, is scheduled to increase to 15 percent of earnings in excess of the threshold starting in 2005. The beginning point of the earned income credit phase-out range for married taxpayers was increased by $1,000 in 2002, and is scheduled to rise by a total of $2,000 in 2005 and $3,000 in 2008, after which it will be adjusted annually for inflation.

Increasing the child tax credit to $1,000 starting in 2003, increasing the credit refund limit to 15 percent of earnings, and raising the starting point for the EITC phase-out by the full $3,000 scheduled increase would provide additional tax relief to moderate- and low-income families with children. Families with children and incomes between the 21st and 60th percentile would see a substantial increase in the tax cut they would receive relative to permanent extension of the 2002 provisions without these modifications **(Table 7)**. Higher-income families with children who could claim child credits would also receive some benefit. Permanent extension of the 2002 provisions with the enhanced child credits and EITC would cost about $19 billion more in 2010 than extending the 2002 provisions without these additional tax cuts.

Combining both options would give taxpayers with incomes up through the 40th percentile essentially the same average tax cuts as they would receive from fully implementing all provisions of the 2001 Tax Act. Families with incomes up through the 90th percentile would receive only slightly lower average tax cuts than the full EGTRRA cuts under this option. Families with incomes in the 91st through 99th percentiles would actually have slightly higher tax cuts under this option than under the full EGTRRA provisions because they would benefit from the extension of the higher AMT exemption levels that are currently in place but scheduled to expire in 2005. The option would cost about $27 billion more in 2010 than extending provisions currently in place without these additional tax cuts.

The modifications considered here would modestly slowdown the extension of the AMT to greater numbers of taxpayers by extending the higher AMT exemption currently in place. Without indexing the exemption and other parameters of the AMT, the temporary check on the AMT would be short lived. Unfortunately any permanent solution of the AMT problem is costly. Indexing the AMT exemption would cost about $370 billion in 2002 through 2012, for example, while outright repeal costs about $600 billion over the same period.[22]

Conclusion

Last year's tax cut was a work in progress, with provisions phasing-in and phasing-out and the whole cut scheduled for repeal at the end of 2010. Economic and budget conditions have changed substantially since EGTRRA was enacted. Under these circumstances, it is appropriate to reconsider the direction in which tax policy is headed over the next decade, and whether that path is still in

Table 7. Existing EGTRRA Income Tax Cuts in 2010 With Additional Provisions, by Income Percentile

Income Category (percentiles)	Total Tax Cut (millions)	Share of Total Tax Cut (percent)	Average Tax Cut (dollars)	Change in After-Tax Income (percent)
Tax Cut in Place in 2002 with Indexing of the 10% Bracket				
All Returns	97,565	100.0%	730	1.2%
1 - 20 percentile	2,232	2.3%	90	0.8%
21 - 40 percentile	11,631	11.9%	430	1.8%
41 - 60 percentile	14,957	15.3%	560	1.4%
61 - 80 percentile	24,309	24.9%	910	1.4%
81 - 100 percentile	44,364	45.5%	1,660	1.0%
81 - 90 percentile	16,561	17.0%	1,240	1.2%
91 - 95 percentile	8,296	8.5%	1,240	0.9%
96 - 99 percentile	7,742	7.9%	1,450	0.7%
Highest 1 percent	11,766	12.1%	8,800	0.9%
Tax Cut in Place in 2002 with Child Credit and EITC Increase				
All Returns	109,355	100.0%	820	1.3%
1 - 20 percentile	2,619	2.4%	100	0.9%
21 - 40 percentile	14,637	13.4%	550	2.3%
41 - 60 percentile	17,594	16.1%	660	1.7%
61 - 80 percentile	27,896	25.5%	1,040	1.6%
81 - 100 percentile	46,483	42.5%	1,740	1.0%
81 - 90 percentile	19,078	17.5%	1,430	1.4%
91 - 95 percentile	8,181	7.5%	1,220	0.9%
96 - 99 percentile	7,585	6.9%	1,420	0.7%
Highest 1 percent	11,639	10.6%	8,700	0.9%
Tax Cut in Place in 2002 with Indexing of the 10% Bracket, Child Credit and EITC				
All Returns	116,802	100.0%	870	1.4%
1 - 20 percentile	2,708	2.3%	100	1.0%
21 - 40 percentile	15,825	13.6%	590	2.4%
41 - 60 percentile	19,757	16.9%	740	1.9%
61 - 80 percentile	30,087	25.8%	1,120	1.7%
81 - 100 percentile	48,296	41.4%	1,800	1.0%
81 - 90 percentile	20,165	17.3%	1,510	1.5%
91 - 95 percentile	8,617	7.4%	1,290	0.9%
96 - 99 percentile	7,748	6.6%	1,450	0.7%
Highest 1 percent	11,766	10.1%	8,800	0.9%

Note: See Notes on Tables and Figures.
Source: Joint Economic Committee, Democratic Staff.

the country's best short-term and long-term interest.

Provisions that have not yet taken effect compose a substantial portion of the tax cut implemented last year. This analysis shows that the tax cuts to come in the future are costly and much less equally distributed than the tax cuts already in place. In particular, the additional tax cuts to come after 2002 are highly concentrated among the highest income taxpayers, in large measure because of the cuts in the top marginal tax rate and the repeal of the estate tax. Furthermore, the future cuts are likely to have a negative impact on the economy both in the short- and long-term.

Permanently extending the provisions of the 2001 Tax Act that are currently in place while repealing the most costly and inequitable provisions yet to take effect would be far less costly and would still provide a substantial portion of the full tax cut to most taxpayers.

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Endnotes

[1] The projected 75-year deficit for Social Security is 0.72 percent of GDP. On a long-term basis the 2001 Tax Act is projected to cost 1.86 of GDP. See Richard Kogan, Robert Greenstein, and Peter Orszag, "Social Security and the Tax Cut," Center for Budget and Policy Priorities, April 11, 2002.

[2] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2003-2012*, January 2002, p. 47 and The Joint Committee on Taxation, "*Estimated Revenue Effects of the "Tax Relief Guarantee Act of 2002," an Amendment in the Nature of a Substitute to H.R. 586.* JCX-28-02, April 17, 2002.

[3] The costs of most of the provisions of EGTRRA are estimated using a microsimulation tax model similar to that used by the JCT, the CBO, and other tax analysts. Estimates of calendar year liabilities and refundable tax credits were converted to fiscal year budget costs through a simple assignment of three-quarters of the calendar year amount to the current fiscal year and one-quarter to the next fiscal year. This procedure does not necessarily capture the true timing of how tax liabilities translate into budget receipts and outlays. Nor do these estimates include some of the behavioral effects that JCT includes in its estimates, such as shifts between taxable and nontaxable sources of income. Nevertheless, the budget costs estimated in this study are reasonably close to those reported by the JCT, generally within 5 percent or less of the JCT estimates of the same provisions. The estimates for education and retirement saving provisions and for estate tax repeal were not estimated using the model but are based on the most recent estimates from CBO and JCT of the revenue loss from a two-year extension of the Tax Act beyond 2010.

[4] Len Burman, Elaine Maag, and Jeff Rohaly, "The Effect of the 2001 Tax Cut on Low- and Middle-Income Families and Children," Urban Institute, April 2002.

[5] See Julie Ann Cronin, "U.S. Treasury Distributional Analysis Methodology," U.S. Department of Treasury, Office of Tax Analysis. Working Paper 85. September 1999.

[6] Donald Kiefer, Robert Carroll, Janet Holtzblatt, Allen Lerman, Janet McCubbin, David Richardson, and Jerry Tempalski. "The Economic Growth and Tax Relief Reconciliation Act of 2001: Overview and Assessment of Effects on Taxpayers," *National Tax Journal*, volume LV, no. 1, March 2002.

[7] These taxpayers may still benefit from other parts of the 2001 Tax Act such the education and pension provisions.

[8] The simulations index the 2002 exemption, the starting point for the 28 percent AMT tax bracket, and the AMT exemption phase-out threshold for inflation starting in 2003.

[9] In testimony before the Senate Banking Committee, Nobel laureate Joseph Stiglitz emphasized the point that there are liquidity constraints that prevent any large quantitative effect:
"you can't borrow against income that you're going to get in five years. The evidence in this particular episode is very strongly that it has not had any effect."
Testimony before the Senate Banking Committee Hearing on the Economic Outlook, March 12, 2002.

[10] Even economists who generally support the idea that households plan consumption and saving based on lifetime resources find it unlikely that anticipation of the future tax cuts plays any significant role in increasing current consumption. At a recent Senate Banking Committee hearing, Nobel laureate Robert Solow said:
"Even a believer in the permanent income hypothesis theory of consumption, like me, for instance, understands that permanent income is discounted, like other incomes, and increments to anticipated permanent income five years down the line will not generate very large amounts of consumption. I am perfectly at home and comfortable with that way of looking at consumption. But it cannot have any substantial quantitative impact, I think."
Testimony before the Senate Banking Committee Hearing on the Economic Outlook, March 12, 2002.

[11] William G. Gale and Samara R. Potter, "An Economic Evaluation of the Economic Growth and Tax Relief Reconciliation Act of 2001," *National Tax Journal,* volume LV, no.1, March 2002.

[12] Calculations from simulations of the tax law in 2010 using the Joint Economic Committee, Democratic Staff microsimulation model. Similar calculations by staff of the Office of Tax Analysis at U.S. Department of Treasury show that 24 percent of all filing units, and 37 percent of all returns

with tax liability, will receive at least some reduction in statutory tax rates under the fully phased-in 2001 Tax Act. See Kiefer, et. al., "The Economic Growth and Tax Relief Reconciliation Act of 2001: Overview and Assessment of Effects on Taxpayers," *National Tax Journal*, volume LV, no. 1, March 2002. p. 97.

[13] Because of discontinuities in tax rules, the effective marginal tax rate is measured as the change in taxes per each additional $100 of income.

[14] See, for example, Joel B. Slemrod, editor, *Do Taxes Matter?: The Impact of the Tax Reform Act of 1986*. MIT Press, 1990; and Slemrod, editor, *Does Atlas Shrug: The Economic Consequences of Taxing the Rich*, Harvard University Press, 2000.

[15] See Richard Blundell and Thomas MaCurdy. "Labor Supply: A Review of Alternative Approaches," in *Handbook of Labor Economics*, vol.3a, Orley Ashenfelter and David Card, editors. Elsevier Science, 1999; Mark R. Killingsworth and James J. Heckman, "Female Labor Supply: A Survey," in *Handbook of Labor Economics*, vol. 1, Orley Ashenfelter and Richard Layard, editors. Elsevier Science, 1986; Thomas A. Mroz, "The Sensitivity of an Empirical Model of Married Women's Hours of Work to Economic and Statistical Assumptions.' *Econometrica,* vol. 55, no. 4, July 1987; John H. Pencavel, "Labor Supply of Men: A Survey," in *Handbook of Labor Economics*, vol. 1, Orley Ashenfelter and Richard Layard, editors. Elsevier Science, 1986; and Robert K. Triest, " The Effect of Income Taxation on Labor supply in the United States*." Journal of Human Resources*, vol. 25, no.3, Summer, 1990.

[16] See Robert E. Hall, "Intertemporal Substitution in Consumption," *Journal of Political Economy*, 96(2), April 1988, pp. 339-357.

[17] While some economists claim that private saving may work to offset the declines in public saving (as households compensate for anticipated future burden implied by higher public debt), the empirical evidence of this sort of effect is very weak. See: Douglas W. Elmendorf and N. Gregory Mankiw, "Government Debt," in Handbook of Macroeconomics, Vol. 1, J.B. Taylor and M. Woodford, editors, Elsevier Science Press, 1999, pp. 1615-1699.

[18] Congressional Budget Office, *The Budget and Economic Outlook: An Update,* August 2001, pp. 34-35.

[19] See William G. Gale and Samara R. Potter, "An Economic Evaluation of the Economic Growth and Tax Relief Reconciliation Act of 2001," *National Tax Journal,* volume LV, no.1, March 2002.

[20] For further discussion see *Repealing the Estate Tax Would Not Promote Economic Growth*, Joint Economic Committee Democratic Staff, June 12, 2002.

[21] Prior to the 2001 Tax Act, heirs who sold inherited assets paid capital gains tax only on the appreciation in the assets after the date of inheritance. Under the new law, heirs who sell inherited assets must pay capital gains tax on the full appreciation of the assets, including the portion earned prior to inheritance. The law allows, however, an exclusion of up to $1.3 million of prior appreciation (with an additional $3 million exclusion for assets left to a surviving spouse).

[22] See Jerry Tempalski, "The Impact of the 2001 Tax Bill on the Individual AMT," U.S. Department of Treasury, Office of Tax Analysis, Mimeo, 2001.