

## Tax Cutting: Why the Limited Enthusiasm?

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Tax cuts have not been an easy sell lately. The public has responded with only lukewarm enthusiasm to the promise of reduced taxes as a major campaign issue both in 1996 and 2000. Yet tax cuts seemed to sell so well during the Reagan campaign. What's the difference and why?

One answer has been put forward in slightly different versions by Alan Schick of the University of Maryland, Frank Sammartino of the Urban Institute, and columnist Robert Samuelson. A significant portion of the population pays little or no income tax. In one sense the income tax has moved back toward its status in the 1950s, when low- and moderate-income individuals did not pay income tax. In those days, the personal exemption offset a much larger percentage of income, whereas today child credits and the refundable earned income tax credit provide significant offsets. Either way, the only way to give a "tax cut" to those with zero or negative taxes is to make their tax burden even more negative.

Tax burdens have shifted not only because of past tax cuts for low- and moderate-income taxpayers. Income tax burdens simultaneously have grown at the top because the distribution of income has itself become highly concentrated. The primary source of those tax increases has been a progressive tax system indexed only for inflation. In that type of tax, average tax rates rise for those whose incomes increase faster than the price level. According to the Congressional Budget Office, close to 30 percent of income taxes are paid by returns in the top 5 percent of the income distribution and four-fifths by those in the top 20 percent.

So much income tax has been concentrated at the top that it's hard to cut income taxes without distributing a significant portion of the cuts to those in the top half of the income distribution. If one looks through George W. Bush's tax cut, for instance, one sees that he has made a significantly more progressive income tax proposal than one with a proportional cut in taxes. His provisions include an expansion of the child credit and larger percentage cuts in tax rates to those near the bottom (for example, through a drop of one-third in the bottom rate from 15 percent to 10 percent).

Moderate-income individuals also pay much less today in excise taxes, so there's only so much cutting that can take place there as well. The one major tax that they are likely to pay is the social security tax. Even here, for those with children and less than, say, \$20,000 of income, the net tax payment is still small because the EITC will often offset not only all income taxes but most of the social security taxes as well. The difficulty with cutting the social security tax, however, is that the social security system is out of balance for the long-run. Simply reducing taxes would only exacerbate that problem and leave proponents of such cuts subject to the criticism that they are providing inadequate financing for future benefits.

The growth in the economy presents another reason why tax cuts have not taken off in popularity. In good times, the amount of benefit such cuts provide is fairly minor relative to other sources of improvement in well-being. Take a family whose income has increased by 5 percent a year. Suppose also that this is a middle-income family paying an average rate of about 10 percent of its income in income taxes. If income taxes were cut by one-fifth for all families, it would represent a gain for our family of about 2 percent of income. Yet such a sizable tax cut would represent substantially less than the 1-year increase in family income achieved independently of the tax system. Moreover, the tax cut would not be repeated every year, so that years of multiple income growth would soon swamp almost any tax cut in relative importance.

Mind you, this is not an argument that tax rates should always go up and that taxpayers don't care about taxes. It is merely a reminder that when push comes to shove, income taxes are only one of many factors -- and certainly not the most important -- affecting individuals' well-being. A very similar argument could be made about most expenditure changes being proposed. People may or may not like them, but, generally speaking, expenditure changes will have only a modest impact on their economic status.

Contrast the current situation with that occurring in the late 1970s. High inflation led to very high tax increases on middle-income taxpayers. The economy was beginning to stagnate, providing little increases in income, and even individuals who were doing OK were scared about the high rate of inflation. Tax revolts against rising property taxes and rising income taxes began to gain momentum, and Ronald Reagan's campaign took advantage of the discontent to push for an agenda of smaller government.

Today's economy is nothing like that of 1980. Taxpayer dissatisfaction with taxes is modest compared to its former level. A tax cut may or may not be favored by the majority of taxpayers, but it does not seem to be nearly as important an issue to most voters as are such items as education and crime. Unlike the former period of stagnation and inflation, today people are not longing to try major policy initiatives to try to move toward better economic times. In the end, the popularity of tax cuts are dependent on who pays the taxes (and who then gets the cuts), whether a weak economy leads the public to demand change, and how the size of a tax cut fares relative to other factors affecting economic well-being. Under today's economic conditions, a tax cut is going to sell mainly if it is believed to be the best use of the money, but there is unlikely to be any overwhelming momentum behind it -- or behind any other budgetary change for that matter.

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