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To tax or not to tax

By Joseph Picard

The tax cuts enacted under President George W. Bush in 2001 and 2003 are due to expire in 2011. The Democrats, who currently control Congress and the Presidency, are poised to let them expire, with the possible exception of tax cuts for people making under $250,000 a year.

Republicans, on the other hand, are for keeping the tax cuts, which mainly benefit the nation's wealthiest people.

Senate Minority Leader Mitch McConnell, R-KY, said this weekend on national television that allowing the tax cuts to expire was tantamount to raising taxes.

"Raising taxes in the middle of a recession is not a good idea," McConnell said.

Alan Greenspan, the former Federal Reserve Chairman, who originally favored the Bush tax cuts, is now in disagreement with McConnell and the majority of Congressional Republicans.

"I think they should follow the law and let them lapse," Greenspan said last week in reference to Congress and the tax cuts.

Greenspan explained that the nation has to "come to grips" with the problem of escalating deficits and, because the tax cuts have greatly contributed to the deficit, they should be let to expire, so that the government can capture and use the revenues.

Greenspan is for letting all the Bush tax cuts die away at the end of 2010, as scheduled. But Democrats are under pressure from their President to keep cuts in place for middle-class Americans.

President Obama has pledged not to raise taxes on those making less than $250,000. He does not want to back down on such a promise, especially in this mid-term election year, and especially when Republicans, led by McConnell, are already raising the specter of a tax increase.

But beyond politics, keeping the middle class tax cuts in place, while eliminating those for the wealthiest Americans, makes economic sense, at least in the short run, said Chuck Marr, director of federal tax policy studies for the Center on Budget and Policy Priorities.

"The higher tax cuts are simply unaffordable and they should be sunsetted," Marr said. "We should take that money and channel it to policies that have more potential for job creation. It's an unsustainable fiscal task without removing the tax cuts for the wealthy."

Marr noted, however, that studies have shown that the American middle class currently has the lightest federal tax burden in U.S. history.

"At some point, if we are to address the deficit and move toward a healthy economy, taxes will have to rise on the middle class," he said, adding that now, however, is not the time for that.

"Because of the current economic situation, it would be wise to extend the middle class tax cuts for the near term, and phase them out over time," Marr said.

The Bush tax cuts gave middle class families subsidies for college expenses, a higher child-care credit, relief from the marriage penalty and a lower income tax rate on a couple's first $14,000.

If Congress chooses to extend the tax cuts for only those earning under $250,000, it would cost the government $2.46 trillion in lost revenue over ten years, according to the Congressional Joint Committee on Taxation.

Extending the tax cuts for everyone would mean $3.17 trillion in lost revenue over the same period, according to the Congressional Budget Office.

In other words, $710 billion more would be lost to government coffers if all the tax cuts are extended.

But McConnell and other Republicans are saying that tax cuts stimulate the economy.

"There's no evidence whatsoever that the Bush tax cuts actually diminished revenue," McConnell said. "They increased revenue, because of the vibrancy of these tax cuts in the economy."

Several sources have pointed out that, contrary to McConnell's assertion about no evidence, the Congressional Budget Office has reported that Bush administration policies increased the deficit by $539 billion, and almost half of that increase was due to lost revenues from the tax cuts.

"When President Kennedy cut marginal tax rates, when Ronald Reagan cut marginal tax rates, when President George W. Bush imposed those tax cuts, they actually generated economic growth," said Rep. Mike Pearce, R-IN. "They expanded the economy."

Chris Edwards, director of tax policy studies at the Cato Institute, said that, while statements like those of McConnell and Pearce do not apply to all tax cuts, they do apply to some.

"With most tax rate cuts the government will get less money," Edwards said. "But all tax rate cuts are not created equal and cutting certain rates will bring the government more money and stimulate the economy."

Edwards said that, for example, when the corporate tax rate is raised - and it will rise when the Bush tax cuts expire, from 15 percent to 40 percent - the government will not bring in more revenue, as expected.

"Corporations will find legal means of pushing their profits overseas, where the corporate tax rates are low, and the U.S. government will get less in tax revenues from them," Edwards said.

Lowering the corporate rate, as Presidents Clinton and George W. Bush did, increased revenues from corporations, Edwards said.

But Maya MacGuineas, of the Committee for a Responsible Federal Budget, said that current tax cuts did not increase revenues enough to offset the costs to the government.

"Tax cuts do increase revenue, but nowhere near enough to offset the costs of the cuts," MacGuiness said. "Our current fiscal situation is far worse than what Kennedy and Reagan faced. To be fiscally responsible, you must offset tax cuts by cutting spending. To extend the tax cuts without finding a way to offset the costs, you may have the effect of further upsetting financial markets by being so fiscally irresponsible."

McConnell and the Republicans have said that cutting spending is what the Congress and the Obama administration ought to be doing. But, as Marr from CBPP pointed out, the Republicans, when in power, did not practice what they are now preaching.

"They gave us the tax cuts without paying for them, two wars without paying for them, and a Medicare prescription drug plan without paying for it - all of which increased the deficit," he said. "The Obama health care plan, by contrast, is fully paid for."