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# NEWS RELEASE

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## GOVERNMENT BENEFIT PROGRAMS CUT POVERTY NEARLY IN HALF, ANALYSIS FINDS

### Social Security Reduces Elderly Poverty Sharply, But Study Shows Safety Net For Children Weakened In 1996

A new analysis of Census data finds that Social Security reduces the proportion of elderly living in poverty from 50 percent to about 12 percent and lifts 12 million elderly people out of poverty, while the Earned Income Tax Credit — a tax credit for low-income working families — now lifts more children out of poverty than any other government program.

*Strengths of the Safety Net*, by the Center on Budget and Policy Priorities, also finds the impact of government benefit programs in reducing poverty weakened modestly in 1996, especially among children. The study identifies this as a key reason the poverty rate failed to drop in 1996 despite economic growth.

Even so, the report found, government benefit programs have a large effect in reducing poverty. The incomes that families received through the private economy left 57.5 million people below the poverty line in 1996, the study reported. Government benefit programs lifted 27 million of these 57.5 million people out of poverty, cutting poverty nearly in half.

"An array of programs, led by Social Security, are having strong effects in reducing poverty," said Wendell Primus, the Center's director of income security and co-author of the study. "Without Social Security, poverty among the elderly would be widespread."

Primus noted that in the absence of Social Security and other government benefits, one of every two elderly people would have fallen below the poverty line in 1996. Primarily because of Social Security, fewer than one in 10 elderly Americans was poor that year.

Primus added that an examination of these data over time also shows that when government benefit programs have been strengthened, they have lifted larger proportions of people out of poverty, while fewer people have been lifted out when — as in 1996 — the programs have weakened.

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## Study Counts Certain Non-Cash Benefits and Taxes

The study uses unpublished Census data to compare the number of people with incomes below the poverty line *before* receipt of government benefits to those left in poverty *after* government benefits are counted. The difference reflects the number of people the safety net programs remove from poverty.

The study follows the recommendations of a 1995 National Academy of Sciences panel in counting certain non-cash benefits such as food stamps and housing assistance as part of income and in reflecting the effects on income of federal income and payroll taxes and the Earned Income Tax Credit. As a result, the study's measure of poverty after government benefits are counted shows somewhat lower poverty rates than the official Census Bureau poverty measure, which excludes non-cash benefits and the EITC and measures before-tax rather than after-tax income.

## Programs Cut Poverty Nearly in Half

In 1996, the study found, 57.5 million people — 21.6 percent of the U.S. population — had incomes below the poverty line before receipt of government benefits. After government benefits are taken into account, the number remaining in poverty was reduced to 30.5 million people, or 11.5 percent of the population. The study also found that government benefit programs reduce the *depth* of poverty — the degree to which families' incomes fall below the poverty line before receipt of government benefits — by two-thirds.

The study found that government benefit programs, sometimes referred to as safety net programs, have their most striking effects on the elderly. Some 50.1 percent of the elderly population would have been poor in 1996 in the absence of government benefits, the study reported. Government benefit programs lowered the elderly poverty rate to 9.2 percent.

The strong effect of government benefits in reducing poverty among the elderly is due overwhelmingly to Social Security. In 1996, Social Security was responsible for nine of every 10 elderly people lifted out of poverty by government benefit programs. The safety net programs lifted a total 13 million elderly people out of poverty, with Social Security responsible for lifting out 11.7 million of these 13 million people.

## Effect on Children Substantially Smaller

Government benefits lift from poverty more than four of every five elderly people who otherwise would be poor, the study found, but fewer than one in three children who otherwise would be poor. In 1996, government benefit programs lowered the child poverty rate from 23.6 percent before receipt of government benefits to 16.1 percent after receipt of benefits.

The Earned Income Tax Credit, expanded under Presidents Reagan, Bush and Clinton, emerged in 1996 as the single program removing the largest number of children from poverty, the study reported. The EITC, which offsets some or all of federal income and payroll taxes and, in many cases, also provides a wage supplement to low-income working families, lifted 4.6 million people — including 2.4 million children — from poverty in 1996.

Although the EITC has the largest effect in lifting children out of poverty, cash assistance and food and housing programs have a larger impact than the EITC in diminishing the severity of poverty among children. Many of the children whose families receive cash assistance are so poor that this aid renders them less poor rather than lifting them above the poverty line.

Since the EITC is available only to working families, its effects on children in those families are especially strong, the study found. Among working families, the EITC has a larger effect than any other program or category of programs both in reducing the number of poor children and in reducing the severity of poverty among those who remain poor.

The EITC's effects are largest in the South, the region in which wages tend to be lowest and the proportion of working families with poverty-level incomes is highest. Nearly half of all children in the South who were lifted out of poverty by government benefit programs were raised from poverty by the EITC.

## Weakening of the Safety Net for Children

The study found that despite the strengthened effects of the EITC in 1996, government benefits lifted out of poverty a smaller percentage of children who would otherwise have been poor than in the previous year. Overall, the benefit programs lifted about 400,000 fewer children from poverty in 1996 than in 1995.

This decline in the impact of the programs, while modest, was sufficient to prevent the child poverty rate, as well as the overall poverty rate, from dropping. Between 1995 and 1996, the poverty rate for children before receipt of government benefits declined modestly, reflecting improvements in the economy. But after receipt of government benefits, the child poverty rate remained essentially unchanged between the two years. The negative effect of a weakening safety net offset the positive effect of a growing economy, the study found.

From 1995 to 1996, the number of children receiving cash public assistance benefits fell 600,000, while the number receiving food stamps fell about 700,000. Improvement in the economy can explain only part of these declines, the study said. It noted that among children who were poor before receipt of government benefits, the proportions receiving public assistance and food stamps fell in 1996.

The welfare law enacted in August 1996 was not a major reason for this decline, according to the study, as few of the legislation's major impacts were felt that year. Many states already had policies in place that were causing caseloads to drop.

The study explained that with these state efforts continuing and the welfare law taking effect, the decline in the number of children receiving food stamps and cash public assistance became sharper in 1997, with the number of children receiving these benefits falling by much larger amounts than can be attributed to continued economic growth. This suggests the proportions of poor children receiving these forms of assistance are likely to have fallen significantly in 1997 and that the safety net's effect in reducing child poverty could be weakening further. Poverty data for 1997 will be available later this year.

## New Trend Could Reverse Long-term Pattern

This developing trend of a weakening safety net for families with children could begin to reverse a decade-long pattern. The Center's report compares the effects of government programs on poverty in 1987 and 1996, two similar points in the business cycle. During this period, significant changes in safety net programs occurred. In the years prior to enactment of the welfare law, the EITC expanded, more low-income disabled children became eligible for SSI, and food stamp benefits were improved. As a result, despite the modest weakening of the safety net between 1995 and 1996, government benefit programs still had a greater impact in reducing poverty in 1996 than in 1987.

But if safety net programs reduced poverty more in 1996 than in 1987, the economy had a smaller impact. The poverty rate as measured before receipt of government benefits — the measure that reflects the impact of the economy by itself — was actually higher in 1996 than in 1987, even though the unemployment rate was significantly lower.

"Despite remarkable progress in reducing unemployment, the economy is performing less well than in previous recoveries in lifting people out of poverty," study co-author Kathryn Porter said. "As a result, the role of the safety net in reducing poverty takes on added significance."

The Center on Budget and Policy Priorities is a nonpartisan research organization and policy institute that conducts research and analysis on a range of government policies and programs, and specializes in issues related to fiscal policy, social welfare and nutrition policy. It is supported primarily by foundation grants.

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# Strengths of the Safety Net

*How the EITC, Social Security and Other Government Programs Affect Poverty*

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*July 3, 1997*

# THE CLINTON TAX PLAN

by Robert Greenstein and Iris J. Lav

This analysis assesses three features of the Clinton tax plan unveiled on June 30 — its effects on different income groups, the extent to which its costs would grow after 2007 (i.e., in the years when the baby boom generation begins to retire), and the extent to which its child tax credit would assist low- and moderate-income working families. Its principal findings include the following:

- Analyses by the Treasury Department indicate that when fully in effect, the Clinton plan would give the 20 percent of Americans with the highest incomes about the same amount in tax cuts as the bottom 60 percent combined. This is an unusual characteristic for a tax plan proposed by a Democratic President.

- Yet the plan differs sharply in this regard from the House and Senate tax bills. Each of those bills would provide *five times as much* in tax cuts to the top 20 percent of the population as to the bottom 60 percent combined when their tax cuts are fully in effect.

- Most striking is the difference with regard to the wealthiest one percent of the population. The Treasury analyses show that the *Senate* tax bill would give the top one percent of the population as much in tax cuts as the bottom 60 percent of the population. The *House* tax bill would give the top one percent nearly 1½ times as much in tax cuts as the bottom 60 percent. By contrast, the Clinton plan would provide the top one percent less than one-tenth as much as the bottom 60 percent combined. (The Clinton plan would, however, give the top one percent more in tax cuts than the bottom 20 percent of the population.)

The Clinton plan and the House and Senate bills also differ substantially in the degree to which the costs of their tax packages grow over time.

- During the second 10 years, the period from 2008 through 2017, we estimate the Clinton plan would cost approximately $450 billion. While costing significantly more in the second 10 years than in the first 10 years, the Clinton bill's ultimate price tag is substantially below that of the House and Senate bills. The Senate bill is estimated to cost $650 billion during the second 10 years, while the House bill is estimated to cost more than $700 billion over this period.

- Both the House and Senate bills have "mushrooming" or "exploding" costs. Under both bills, the cost of the tax cuts is rising at an annual rate of between 11 percent and 13 percent at the end of the first 10-year period. This is more than double the projected rate of growth in the Gross Domestic Product, the basic measure of the size of the U.S. economy. As a result, the House and Senate bills would cause revenues to continue shrinking as a percentage of GDP at the same time the retirement of the baby boom generation causes federal expenditures for health care and retirement programs to rise sharply as a percentage of GDP. The House and Senate tax cuts thus would exacerbate the serious deficit problems the nation will face in those years.

  By contrast, the cost of the Clinton tax cuts is rising at the end of the initial 10-year period at about the same rate as the Gross Domestic Product, about five percent per year. The costs of the Clinton tax cut, while substantial, do not mushroom or explode after 2007. Revenues would not continue to shrink after 2007 as a percentage of GDP under the Clinton proposal.

The Clinton plan differs from the House and Senate bills in the extent to which it assists near-poor and lower-middle-income families, in part because of differences in the design of the child tax credit. To assess the Clinton child tax credit proposal, it is helpful to compare it to current and earlier Congressional proposals.

- The Clinton plan would provide the child tax credit to four million children in near-poor and lower-middle-income working families who would be ineligible for the credit under the Senate bill. It would provide the credit to six million such children who would not qualify for the credit under the House bill. Most of these children live in families that pay taxes *after* the effects of the Earned Income Tax Credit are taken into account.

- The Clinton plan would provide the child credit to several million fewer children in near-poor working families than would be the case under the Senate Democratic tax plan that Senator Tom Daschle offered last week. (The child credit in the Daschle plan contains the same design as the child credit in the original Contract with America.) The Clinton plan would provide the child credit to at least 10 million fewer children than would receive it under the House Democratic tax bill, offered by Rep. Charles Rangel.

- The prior tax plan whose child credit proposal is most like the credit in the Clinton proposal in its treatment of low- and moderate-income families is the 1995 Republican reconciliation bill. The Clinton plan and the vetoed 1995 bill would provide the child credit to the same number of low- and moderate-income children. The Clinton child tax credit is, however, modestly more generous than the child credit in the vetoed bill because it would provide a larger credit to some lower-middle-income families who would have received only a small, partial credit under the 1995 legislation.

These findings are discussed below.

## Distributional Effects

In releasing its tax proposal June 30, the Administration emphasized that the middle three-fifths of the population would get twice as large a percentage of the tax cuts under its plan as under the House and Senate bills. The group among the middle three-fifths of the population that would do best under the Clinton plan is the next-to-the-top income fifth. This income group, which constitutes the core of the upper-middle-class, would receive 35 percent of the Clinton tax cuts.

Accordingly, it is of interest to examine the proportion of the tax cuts that the *bottom three-fifths* of the population would receive under the Clinton plan and also to compare this to the share of the tax cuts that wealthier individuals would receive. This analysis, based on the Treasury Department's distribution figures, shows the following:

- The bottom 60 percent of households would get 33.5 percent of the Clinton tax cuts. At the same time, the top 20 percent of households would obtain 31.5 percent of the tax cuts. Since the Treasury tables do not reflect the effects of the estate tax cuts the Administration is proposing — and the estate tax cuts affect only the heirs of the wealthiest two percent of people who die — the tables significantly understate the degree to which high-income households benefit from the plans. Thus, the overall share of the tax cuts going to the top 20 percent would be at least equal to (and possibly greater than) the share of the tax cuts going to the bottom 60 percent.

- Such a pattern is unusual for a tax cut emanating from a Democratic White House. Yet it represents a vast departure from the tax bills the House and Senate have passed. The House bill would confer 67 percent of its tax cuts on the top 20 percent of the population. It would provide only 13 percent of its tax cuts to the bottom 60 percent of the population,

**How the Clinton, House, and Senate Tax Plans Distribute Their Tax Cuts**

| Income by Quintile | President Clinton | House | Senate |
|---|---|---|---|
| Lowest | 1.2% | 0.6% | 0.4% |
| Second | 10.1 | 2.5 | 2.7 |
| Third | 22.2 | 9.6 | 10.2 |
| Fourth | 34.6 | 20.0 | 21.3 |
| Highest | 31.5 | 66.8 | 65.0 |
| Top 10% | 11.7 | 47.3 | 42.3 |
| Top 5% | 6.5 | 34.9 | 28.2 |
| Top 1% | 2.6 | 18.8 | 12.5 |

Source: U.S. Department of Treasury

less than one-fifth as much. The Senate bill is similar — it, too, would provide just 13 percent of its tax cuts to the bottom 60 percent of the population while providing 65 percent of its tax cuts to the top 20 percent. Thus, under both the House and Senate bills, the 20 percent of households with the highest incomes would get five times as much in tax cut benefits as the bottom 60 percent of the population.

- The differences between the Clinton plan and the Congressional bills are sharpest in the degree to which they provide tax cuts to the top one percent of households. The House bill would provide 19 percent of its tax cuts to the wealthiest one percent of households. The wealthiest one percent would get nearly 1½ times as much in tax relief as the bottom 60 percent. (As noted, the bottom 60 percent would receive 13 percent of the House tax cuts.) Under the Senate bill, as well, the top one percent would get 13 percent of the tax cuts, about the same amount as the bottom 60 percent of the population would receive.

  By comparison, the Clinton plan would provide less than three percent of its tax cuts to the top one percent of households while directing more than 30 percent of the tax benefits to its bottom three-fifths of the population.

- Similarly, under the House bill, the top five percent of the population would get more in tax cuts than the bottom 80 percent combined, while under the Senate bill, the top five percent would receive nearly as much as the bottom 80 percent. By comparison, the Clinton plan would provide the top five percent of households with one-tenth of the tax cuts the bottom 80 percent would receive.

**Citizens for Tax Justice Analysis Also Finds Substantial Differences Between Clinton and Congressional Plans**

An analysis that Citizens for Tax Justice issued July 2 of the distributional effects of the Clinton plan, the House and Senate bills, and the House Democratic tax bill also finds sharp differences in the degree to which the Clinton plan and the House and Senate bills favor those at the top of the income scale. According to the CTJ analysis — which includes the effects of the estate tax cuts and excise tax extensions and increases in the various proposals — the top 20 percent of households would receive 83 percent of the tax cuts in the House bill and 82 percent of the tax cuts in the Senate bill, as compared to 48 percent of the tax cuts in the Clinton plan. The top one percent of households would receive 38 percent of the House bill's tax cuts and 33 percent of those in the Senate bill, as compared to nine percent of the Clinton tax cuts.

The inclusion of estate tax reductions in the CTJ analysis increases the proportion of the tax cuts the top 20 percent and top one percent of households would secure. The inclusion of the excise tax measures in the analysis appears to reduce the share of the net tax reduction going to middle- and lower-income groups and thereby further raise the proportion going to high-income groups.

In short, the differences between the Administration and Congressional plans in how the tax cuts would be distributed across the income scale are very large.

## The Costs in the Second 10 Years

Unlike the House and Senate tax bills, the Clinton plan is not heavily backloaded. It does not grow in cost in future years at rates that exceed the rate at which the economy is expanding.

The House and Senate tax bills are designed in a fashion that keep their costs artificially low in the initial years. But a number of their tax cut provisions — especially those primarily benefitting higher-income taxpayers — mushroom in cost over time. Under the House and Senate bills, most of the costs of the capital gains and estate tax cuts and Individual Retirement Account expansions are delayed until the last few years of the 10-year period from 1998 through 2007.

- Under both the House and Senate plans, approximately 60 percent of the $100 billion cost over 10 years of the capital gains and estate tax cuts and IRA expansions (including the education IRAs) are packed into the last three years from 2005 through 2007. In the House bill, 63 percent of the $98 billion cost of the three provisions occurs in the last three years. In the Senate version, 58 percent of the $105 billion cost of the three provisions is delayed until the last three years.

- In the House bill, the capital gains, estate, and IRA provisions together reach a cost of $25 billion in a single year in 2007, the tenth year. This is more than nine times the $2.7 billion annual average cost of these provisions from 1998 through 2002. In the Senate bill, the $24 billion cost of the three provisions in 2007 is more than six times the average annual cost of $3.7 billion in the first five years.

The cost of these provisions would continue to grow rapidly in years beyond 2007.

- For example, the backloaded "IRA-Plus" accounts included in both the House and Senate versions — in which contributions are not deductible but interest earnings on deposits are permanently free of tax — are growing in cost by more than $1 billion a year by 2007. In each succeeding year, the amount of interest earnings that are free of tax would increase, and the revenue loss to the Treasury would mount commensurately. The cost of the backloaded IRAs would continue to increase rapidly through much of the second decade, until the time at which withdrawals from these IRA accounts balance new deposits.

- The capital gains tax cuts also would continue to grow rapidly, particularly under the House bill that allows profits to be indexed for the effects of inflation. Indexing would begin in 2001. By 2007, when assets that are sold could qualify for a maximum of six years of inflation adjustment, the overall cost of the House capital gains tax cut is rising at a clip of nearly $2 billion a year. Capital gains indexing would result in explosive cost growth for several years subsequent to 2007, as the number of years for which assets qualify for inflation adjustment increases.

The rapid growth of the high-income provisions drives up the cost of the House and Senate tax plans as a whole at the end of the first 10-year period and through much of the second decade. In the final three years of the initial period, from 2004 through 2007, the House bill is growing at a rate of more than 11 percent annually while the Senate bill is growing at a 13 percent annual rate. These growth rates are more than twice as high as the 4.6 percent annual rate at which the Congressional Budget Office forecasts the economy will be growing in those years.

Taking account of the pattern of growth that each bill's tax cuts likely would follow in the second decade, we estimate the cost of the House bill will rise to more than $700 billion over the second 10 years the provisions are in effect, from 2008 to 2017. The Senate bill would have modestly lower — but still quite high — costs of approximately $650 billion in the second 10 years. (See the box on page 8 for an explanation of the methodology used in computing these estimates.)

In contrast to the House and Senate bills, the cost of the Clinton proposal is not substantially backloaded.

- The Clinton plan contains no provisions that continue to phase in beyond the first few years. By 2003, all provisions are fully in effect.

- The Clinton proposal does not include any tax cuts that deepen with each passing year, such as backloaded IRAs, capital gains indexing, or steadily rising estate tax exemptions.. In the final four years of the initial ten-year period, the Clinton tax cut grows in cost by just over five percent a year, only slightly faster than the rate of growth of the economy expected at that time.

- As a result, the costs of the Clinton plan would remain relatively stable over time in relation to the economy. In contrast to the Congressional plans, which would cost from $650 billion to more than $700 billion in their second 10 years, the Clinton plan would cost approximately $450 billion from 2008 through 2017.

The House and Senate plans would explode in cost at about the same time that the baby boom generation reaches retirement age. As a result, the House and Senate bills would cause revenues to shrink as a percentage of GDP just when the retirement of the baby boom generation causes federal expenditures for Medicaid, Medicare, and Social Security to begin to rise sharply as a percentage of GDP. The House and Senate bills would make the deficit problem the nation is expected to face at that time more serious and more difficult to solve.

The cost of the Clinton tax cuts would rise at a rate similar to economic growth at the end of the initial 10-year period and throughout the subsequent 10 years, a rate of about five percent per year. Revenues would not continue to shrink after 2007 as a percentage of GDP under the Clinton plan.

## The Child Tax Credit

Under the 1995 reconciliation bill that Congress passed and President Clinton vetoed, a family would have needed to owe income tax before the Earned Income Tax Credit is applied in order to qualify for the child credit. Under that bill, more than 20 million children — about one-third of all children — would not qualify for the child credit because their incomes are too low to owe income tax.

The low-income children who would not have qualified under the 1995 legislation fall into three categories:

**The Cost of the Tax Plans in the Second 10 Years**

The cost of the House, Senate, and Clinton tax plans in the second 10 years after enactment — from 2008 through 2017 — was estimated based on two sets of factors: the cost and growth patterns of each plan in the latter part of the first 10 years, and the types of tax cuts each plan includes.

According to the Joint Committee on Taxation's revenue tables, the cost of the Senate tax bill is growing at an annual rate of 13 percent in the years between 2004 and 2007, with the cost increasing an average of $4.3 billion a year during these years. The estimate for the subsequent 10 years used in this analysis assumes that the average rate at which the tax cut grows from 2004 through 2007 would continue through 2009. After that time, the growth rate would taper downward through 2012, falling back to the rate of GDP growth in 2013. (GDP growth is assumed to be 4.6 percent per year in line with the Congressional Budget Office forecast.) This is a conservative methodology, because the cost of the IRAs and several other tax breaks is likely to continue to grow at rates exceeding GDP throughout most of the second decade after enactment. Nevertheless, under these assumptions the cost of the tax cut would rise from $41.8 billion in 2007 to $81 billion in 2017, and the cost in the 10-year period would be $660 billion.

The cost of the House bill is growing at an annual rate of 11.4 percent from 2004 through 2007, with the cost increasing during those years an average of $3.7 billion year. Although the growth rate appears lower than in the Senate bill, the House bill is likely to have higher long-term growth than the Senate legislation. The House bill has the same backloaded IRA as the Senate bill. In addition, the capital gains indexing provision in the House bill is only beginning to phase in by 2007, at which time a maximum of six years of inflation adjustment can be taken into account. The cost of capital gains indexing would continue to increase at a rapid rate beyond the middle of the second decade and perhaps thereafter. Thus, to estimate the cost of the House bill in the second 10 years, the average rate at which the tax cut grows from 2004 through 2007 is assumed to continue through 2012. The growth rate is then assumed to taper gradually, falling back to the rate of GDP growth by 2017. Under these assumptions, the cost of the House tax cut would rise from $40.4 billion in 2007 to $99 billion in 2017, and the cost in the 10-year period from 2008 through 2017 would be $725 billion.

The cost of the Clinton plan is growing at a rate of 5.2 percent per year from 2003 through 2007, with the cost increasing an average of $1.6 billion a year. (The growth rate was calculated from 2003 rather than 2004 because the lower 3.8 percent growth rate from 2004 through 2007 did not seem to be representative of the plan's longer-term growth potential.) All provisions in the Clinton plan are fully phased in by 2003. Thus, the costs in the second 10-year period were estimated by assuming the rate of growth from 2003 through 2007 would continue through 2017. Using that procedure, the cost of the Clinton tax cut would increase from $34.1 billion in 2007 to $57 billion in 2017, and costs would total $455 billion in the 10-year period from 2008 through 2017.[1]

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[1] It should be noted that the cost estimates for the period from 1998 through 2007 for the Congressional bills is from the Joint Committee on Taxation, while the cost estimate for the Clinton bill was made by the Treasury.

- Children whose families do not owe income tax but still have a net tax liability, even after the EITC is taken into account, largely because their payroll taxes exceed their EITC.

- Children from working families that owe payroll taxes but receive an EITC equal to or greater than their payroll tax obligation, and consequently do not have a net tax liability from income and payroll taxes.

- Children from families that do not have earnings and thus do not pay the payroll tax.

The child tax credit in the Contract with America, unveiled in September 1994, would have covered most of the first of these three groups of children. It would have provided the child credit to families that owe no income tax before the EITC is computed but that still pay taxes because their payroll taxes, including both the employee and the employer share of the tax, exceed their EITC. (Most economists believe that workers effectively pay both the employer and the employee share of the tax, with the employer share of the tax being passed through to employees in the form of lower wages than would otherwise be paid.)

In writing tax legislation to implement the Contract in early 1995, the House Ways and Means Committee eliminated coverage for this group of families (i.e., for families that do not owe income tax but have a net federal tax liability because their payroll tax exceeds their EITC). At that time, the Ways and Means Committee dropped coverage for these families to free up funds in the tax bill for larger corporate tax cuts. The Senate Finance Committee then adopted the Ways and Means Committee's approach to the child credit in this area. As a consequence, the 1995 legislation provided the child credit only to families that owed income tax before the EITC is taken into account. It did not take payroll taxes into account.

The Senate Leadership tax plan that Senate Majority Leader Trent Lott introduced in January 1997 followed the same approach as the 1995 legislation. It would provide the child credit to families that owe income tax before the EITC is computed.

In recent weeks, however, a plethora of different child tax credit proposals have emerged. Some are more restrictive than the 1995 legislation. Others are more expansive.

- The tax bills the House and Senate passed last week contain restrictive child credit proposals. These bills would deny the credit to substantial numbers of near-poor and lower-middle-income children whose families

**Table 1**

| Income Thresholds for Child Credit (For a Two-Parent Family of Four 1997 Dollars) | Contract with America/ Daschle | 1995 Reconciliation Bill and January 1997 Senate Republican Leadership Tax Bill | Current Senate Bill | Current House Bill | Clinton Plan | House Democratic Plan (Rangel) |
|---|---|---|---|---|---|---|
| Income Level at Which Family Begins to Get Child Credit | $16,965 | $17,500 | $22,360 | $24,385 | $17,500 | $10 |
| Income Level at Which Family Gets Full Child Credit | 19,068 | 24,165 | 26,280 | 27,158 | 22,405 | $13,070 |

would have received the credit under the 1995 legislation. The House bill would deny the credit to six million children who would have qualified under the 1995 legislation. The Senate bill would deny the credit to four million such children.

- The House and Senate Democratic tax bills offered on the House and Senate floors last week were more expansive than the 1995 legislation. They would provide the child credit to millions of children in working poor and near-poor families that would not have qualified for it under the 1995 bill. (The Senate Democratic bill uses the same child credit design as the Contract with America.)

The Clinton plan charts a course between the current House and Senate bills on the one side and the Democratic alternatives on the other. It provides the credit to the *same number of low- and moderate-income children as would have received it under the 1995 legislation that Congress passed and the President vetoed.* The Clinton plan covers more of these children than the current House and Senate tax bills would, while covering fewer such children than the House and Senate Democratic tax bills and the original Contract with America would.

- As noted, the House bill would provide the credit to children whose families owe income tax after the EITC is subtracted. Families that owe no income tax after the EITC is applied but pay hefty payroll taxes would be denied the credit.

**Table 2**

**Child Credit For Near-Poor and Lower-Middle-Income Families Under Various Tax Plans**
(For a Two-Parent Family of Four)

| Family Income Level | Contract With America/ Daschle Bill | 1995 Reconciliation Bill/January 1997 Senate Leadership Bill | Senate Bill | House Bill | Clinton Plan | House Democratic Bill (Rangel) |
|---|---|---|---|---|---|---|
| $17,500 | $ 195 | $ 0 | $ 0 | $0 | $0 | $1,000 |
| 20,000 | 1,000 | 375 | 0 | 0 | 375 | 1,000 |
| 22,000 | 1,000 | 675 | 0 | 0 | 823 | 1,000 |
| 24,000 | 1,000 | 975 | 418 | 0 | 1,000 | 1,000 |
| 26,000 | 1,000 | 1,000 | 929 | 582 | 1,000 | 1,000 |
| 28,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 |

- The Senate bill would provide the credit to children whose families owe income tax after *half* of their EITC is subtracted. As noted above, the Senate bill would deny the credit to four million children who would have qualified for it under the 1995 legislation, while the House bill would deny the credit to six million such children.

- The Clinton plan would restore eligibility for these four million to six million children. Like the 1995 legislation, it provides the credit to families that owe income tax *before* the EITC is computed.

  It differs from the 1995 legislation in one respect. Several million near-poor and lower-middle-income families would get a larger child credit under the Clinton plan than under the 1995 legislation. Under the Clinton plan, a family that owes income tax amounting to less than $500 per child — and thus would otherwise qualify for a child credit of less than $500 per child — can use a second method when computing its credit. If the employee share of the family's payroll tax exceeds the family's EITC, the family's child credit is increased to cover the difference. This would enable several million families that otherwise would qualify for a small, partial child credit to receive a credit of closer to $500 per child. Those affected fall primarily in the $17,500 to $24,000 range for families of four. (See Table 2.)

- The Senate and House Democratic alternative tax bills would cover more children than the Clinton plan. The Senate Democratic proposal, offered by Minority Leader Tom Daschle, would have mirrored the child credit in the Contract with America in its treatment of low- and moderate-income working families. It would provide the child credit to families that owe tax when both the employee *and employer* shares of their payroll tax are taken into account, as well as their income tax (net of the EITC). It would provide the child credit to several million children from families that owe no income tax but pay more in the employee and employer shares of their payroll tax than they receive through the EITC. The families that would receive a child credit under the Daschle and Contract with America approaches, but not under the Clinton or Republican approaches, are typically working families with incomes close to the poverty line.

The House Democratic tax plan, offered by Rep. Charles Rangel, would cover the largest number of children. The Rangel proposal would extend a full or partial child credit to working families well *below* the poverty line, something none of the other plans would do. The Rangel plan accomplishes this result by providing a child credit to all working poor families that pay the payroll tax, including families whose payroll tax is smaller than their EITC.[1]

[1] The Rangel credit would allow the credit to offset the employee share of the payroll tax, up to the maximum credit of $500 per child.

CENTER ON BUDGET AND POLICY PRIORITIES

*July 3, 1997*

# TREASURY DEPARTMENT DATA INDICATE THE CURRENT CONGRESSIONAL TAX BILLS ARE TILTED AT LEAST AS MUCH TOWARD UPPER-INCOME FAMILIES AS THE TAX CUTS VETOED IN 1995

by Isaac Shapiro and Iris J. Lav

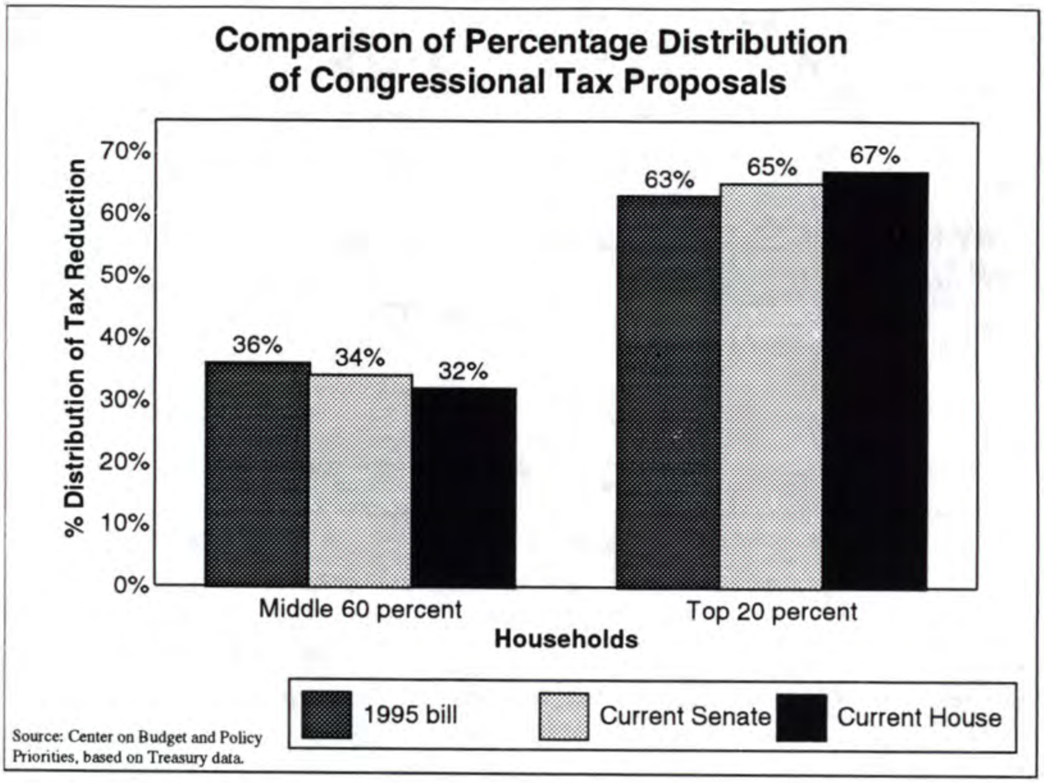
This analysis compares Treasury Department tables on the distributional effects of the tax cuts in the 1995 reconciliation bill that President Clinton vetoed to its tables on the tax bills the House and Senate passed last week. The comparison indicates that the current bills are tilted at least as heavily toward upper-income households, and probably more so, than the 1995 legislation. The Treasury tables show that when the tax cuts are fully in effect, the 20 percent of households with the highest incomes would receive a somewhat larger share of the tax cuts from the current bills than they would have received under the 1995 legislation. The broad middle class would receive a smaller share of the tax cuts from the current bills than from the 1995 bill.

According to distribution tables prepared by the Treasury Department now and in 1995:

- The wealthiest fifth of households would have received 63 percent of the tax cut benefits under the 1995 legislation, when the tax cuts were phased in fully. Under the current Senate bill, the top fifth of households would receive 65 percent of the tax cuts when the cuts are phased in fully. Under the House bill, the top fifth of households would receive 67 percent of the tax reduction.

- The broad middle class — the households that make up the middle 60 percent of the population — would have received 36 percent of the benefits from the 1995 tax package when the tax cuts were fully in effect. Under the current Senate bill, the broad middle would receive 34 percent of the tax cuts. Under the House bill, their share would be 32 percent.

- The House bill also would provide a larger share of the tax benefits to the very wealthiest households than the 1995 legislation would have provided. The House bill would ultimately extend 35 percent of its tax benefits to the top five percent of households, larger than the 31 percent of tax benefits that the top five percent would have received under the 1995 bill.




According to the Treasury tables, the Senate bill provides 28 percent of its tax benefits to the top five percent of taxpayers, a somewhat smaller share than the tables indicate would have been provided under the 1995 bill. But this difference between the Senate bill and the 1995 bill would narrow considerably, and perhaps reverse, if Treasury had examined the effects of the estate tax cuts.[1] As discussed later, the estate tax cuts in the Senate bill are much larger than in the 1995 bill. The Treasury tables do not include the effects of the estate tax cuts in any of these bills.

- Under both the current bills and the 1995 Congressional bill, the bottom fifth of the population would receive virtually no benefits from the tax cuts.[2]

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[1] Similarly, the Treasury tables indicate that the top one percent of households would receive a smaller share of the tax cut benefits under the Senate bill than under the 1995 proposal, excluding the effects of the estate tax cuts. These shares would likely be similar if the effects of the estate tax cuts were taken into account.

[2] The Treasury Department tables indicate that the bottom 20 percent of householders would receive 0.6 percent of the benefits from the House tax package and 0.4 percent of the tax benefits from the Senate tax package. As described later, however, the Treasury Department tables do not take into account the increased taxes households would pay as a result of provisions of the tax package that raise revenues, including the excise tax provisions. If the revenue-raising measures are taken into account, the bottom fifth of taxpayers are likely to face a small net tax increase under the House and Senate bills.

### Upper-Income Provisions in Current Bills Versus Provisions in 1995 Bill

Not only are the current House and Senate bills tilted at least as much to upper-income households — and somewhat less to middle-income households — than the 1995 legislation, but the average size of the tax cut for high-income households would be as large or larger under the current bills than the 1995 bill.

This finding might seem surprising. In descriptions of the current bills, the focus has been on the $85 billion net revenue loss that would occur between 1997 and 2002. By contrast, the 1995 legislation would have produced a net revenue loss of $195 billion over a comparable time period, according to the Joint Tax Committee.[3] That would seem to suggest the current bills are substantially smaller than the 1995 bill.

But the initial costs of the current bills are misleading, particularly when it comes to their high-income tax cut provisions. The high-income provisions in the current bills ultimately grow to about the same size as the provisions in the 1995 bill. Rather than reducing the size of these upper-income tax cuts, the House and Senate chose this year to delay their full implementation until beyond 2002.

When the high-income provisions are fully implemented, they bear a strong resemblance to the provisions in the 1995 legislation. In fact, the IRA expansions and estate tax cuts in the current House and Senate bills are more generous than those proposed in 1995.

In both the 1995 legislation and the current House and Senate bills, the three major provisions that benefit high-income taxpayers are the capital gains tax cut, IRA expansions, and estate tax cuts. The following discussion describes the major similarities and differences between the 1995 legislation and the current proposals in these areas.

***Capital gains income*:** Both the 1995 bill and the current House and Senate bills would dramatically reduce the rate at which capital gains income is taxed. The 1995 bill would have allowed half of capital gains income to be excluded from taxation, resulting in a maximum tax rate of 19.8 percent. The current House and Senate bills

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Under the 1995 legislation — which included reductions in the Earned Income Tax Credit not included in the current bills — the bottom fifth of taxpayers would have experienced small average increases in their tax bills, according to the Treasury tables.

[3] The $195 billion figure represents the net revenue loss for the period from 1996 to 2001, the first six years after the 1995 bill would have been implemented.

each would establish a maximum tax rate of 20 percent for capital gains income.[4] The 1995 legislation and the current bills are essentially equivalent for the highest-income taxpayers in the 39.6 percent tax bracket, who report a substantial portion of all capital gains income.

In addition, the 1995 bill would have allowed capital gains on assets held at least three years to be indexed for inflation beginning in 2001. The current House bill includes the same provision. The Senate bill does not.

The 1995 bill also reduced the rate at which capital gains income received by corporations is taxed from 35 percent to 28 percent. The current House bill would make a reduction from 35 percent to 30 percent while the Senate bill leaves the corporate capital gains tax rate unchanged.

In short, the capital gains cuts for the wealthiest households are similar in the 1995 bill and the House bill. The capital gains reductions in the Senate bill, while substantial, would be less sharp than in the other bills.

***Individual Retirement Accounts*:** The 1995 legislation would have gradually phased in higher income limits for deductible IRA contributions by taxpayers who are covered by an employer-sponsored retirement plan, lifting the limits for married couples from $50,000 to $100,000. The 1995 legislation also would have established new backloaded IRAs for which all taxpayers would be eligible, regardless of income or private pension coverage. Under the backloaded accounts, contributions would not be deductible but interest earned on funds in the account would be permanently free of tax. The current House and Senate bills both would establish the type of backloaded IRAs proposed in 1995. In addition, the Senate bill — like the 1995 legislation — would lift the income limits for deductible IRA contributions to $100,000.

The current House and Senate bills go beyond the 1995 legislation, however, because they also would permit additional IRA-like contributions to be made to education savings accounts. Under the Senate bill, taxpayers would be allowed to deposit an additional $2,000 per child annually, plus the amount of their child tax credit. Under the House bill, up to $5,000 per child per year could be deposited. The House and Senate bills place no limits on the incomes of taxpayers who could use these accounts. The education IRAs would work like the backloaded IRAs; contributions would not be deductible but interest earned on the accounts would be permanently free of tax if the funds were ultimately withdrawn for qualified education expenses. These provisions greatly expand the tax benefits available to taxpayers with children at

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[4] Capital gains would be taxed at 10 percent for taxpayers whose tax rate on ordinary income is 15 percent. Taxpayers in the 15 percent bracket, however, have very little income from capital gains.

higher income levels who have sufficient discretionary income to take advantage of the generous education IRA provisions.

*Estate Tax*: The 1995 legislation would have increased the amount of an estate that is exempt from taxation from $600,000 to $750,000. The House and Senate bills would provide a much greater increase in the exemption, from $600,000 to $1 million. All three bills then index the exemption limit. In addition, the Senate bill would allow an additional $1 million of the value of family farms and businesses to be excluded from taxation.

Each of these provisions — the capital gains tax cuts, estate tax reductions, and expansions of Individual Retirement Accounts — overwhelmingly benefits higher-income taxpayers. A recent Congressional Budget Office report found that the five percent of families with incomes exceeding $100,000 receive 75 percent of capital gains income in any year. Families with incomes exceeding $200,000 receive more than 60 percent of capital gains income. In addition, 95 percent of the benefits of IRA expansions would benefit the highest-income 20 percent of taxpayers, according to a Joint Committee on Taxation analysis of similar proposals in 1990. Finally, increases in the estate tax exemption would exclusively benefit heirs of the largest two percent of estates; other estates already are exempt from this tax.

## Treasury Tables More Accurately Reflect Distributional Effects than Joint Tax Tables

To conduct this analysis, the Center on Budget and Policy Priorities examined the tables produced by the Treasury Department in 1995 that analyzed the effects on different income groups of the tax legislation Congress passed in 1995.[5] The Center compared these tables to Treasury Department tables examining the distributional effects of the current tax bills.[6]

As the Center has described more fully in a separate analysis, the Treasury Department tables paint a much more accurate picture of the distributional effects of

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[5] U.S. Department of the Treasury, table on "Tax Provisions in the Revenue Reconciliation Act of 1995," November 21, 1995.

[6] U.S. Department of the Treasury, table on "Alternative Tax Cut Proposal: A Comparison of Distributional Impact," released as part of President Clinton's Tax Cut Proposal, Summary Documents, June 30, 1997.

the tax package than do tables issued by the Joint Committee on Taxation.[7] For example, the Joint Tax Committee tables go only through 2002. Yet the tax cuts benefiting high-income taxpayers are heavily backloaded and grow sharply in cost after 2002 according to the Joint Tax Committee's own revenue tables. Thus, the Joint Tax Committee's distribution tables fail to account for the vast majority of the tax cut benefits that high-income taxpayers would ultimately receive.

### Treasury Department Tables *Understate* Gain to Upper-income Households

The Treasury Department tables provide a conservative estimate of the extent to which the current tax bills would benefit high-income taxpayers, as compared to the extent to which the 1995 legislation could have benefited these individuals.

- The Treasury analyses do not include the effects of the estate tax cuts. By 2007, the estate tax cut in the House bill equals $5.6 billion a year, while the Senate estate tax cut equals $9.8 billion. The estate tax cuts in this year's bills are significantly larger than the estate tax cuts in the 1995 bill.

- The Treasury tables do not reflect the provisions of the current House and Senate bills that would raise revenues. The principal revenue raisers are increases in excise taxes that extract a somewhat larger percentage of income from low- and middle-income families than from high-income families. If these revenue raisers were included, the proportion of the net tax benefits going to upper-income households under the current bills would be higher than the Treasury tables indicate. The 1995 legislation did not include similar excise tax provisions.

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[7] "Do Chairman Archer's Criticisms of the Treasury Department's Distributional Analyses Have Merit? Why Treasury and Joint Tax Committee Analyses Differ," Center on Budget and Policy Priorities, July 3, 1997.

CENTER ON BUDGET AND POLICY PRIORITIES

*July 3, 1997*

# DO CHAIRMAN ARCHER'S CRITICISMS OF THE TREASURY DEPARTMENT'S DISTRIBUTIONAL ANALYSES HAVE MERIT?

## Why Treasury and Joint Tax Committee Analyses Differ

by Robert Greenstein and Iris J. Lav

In recent weeks, House Ways and Means Committee Chairman Bill Archer has issued press releases, sent a letter to the President, and made statements claiming that the Treasury Department has misused data on family incomes to portray the House tax bill inaccurately as being tilted toward the rich. For example, a June 12 Archer press release was entitled "The Trick in Treasury's Tables" and subtitled "Treasury Uses Misleading Method to Cook Their Books." Rep. Archer has charged that the Treasury is defining income in such a way as to increase families' incomes artificially, making families look richer than they actually are and the House and Senate tax bills appear more favorable to the wealthy than they really are.

In his press releases, letter and statements, Mr. Archer has contended that the House bill provides the bulk of its tax benefits to the middle class, not to the well-to-do. He has claimed the bill would provide 71 percent of its tax cuts to people with incomes between $20,000 and $75,000. By contrast, the Treasury analyses find that two-thirds of the tax cuts in the House and Senate bills would go to the top 20 percent of households when the tax cuts are fully in effect and that the top one percent of households would receive nearly as much or more in tax cuts as the bottom 60 percent combined.

These sharp differences raise important questions. Are Mr. Archer's criticisms of the Treasury analyses valid? What accounts for the very large differences between the Treasury analyses and the figures Mr. Archer cites, which portray the Congressional tax bills as primarily middle-class tax cuts?

As this analysis explains, an examination of Mr. Archer's charges concerning the Treasury analyses shows the charges to be without foundation. Analysis also indicates that the principal reason the Treasury figures and Mr. Archer's figures differ so sharply is that the figures Mr. Archer is using on the House bill's impact on different income groups distort the bill's effects in large ways.

- **The definition of income that Treasury has used in its analysis of the effects of the House and Senate bills on different income groups — and that Rep. Archer decries — was not conceived by the Clinton Administration to portray Republican tax plans unfavorably; it was**

**developed by the Reagan Treasury Department and has been in use for more than a decade.** It is the income definition that both the Reagan and Bush Treasury Departments used to analyze the effects of tax legislation. This income definition enjoys wide support among economists and tax analysts and carries no partisan bias.

Since the mid-1980's, the Treasury Department has classified families according to their "family economic income" when examining the effects of proposed tax changes on different income groups. In 1984, the Reagan Treasury Department wrote that this measure provides a "broader measure of income [and], therefore, provides a better yardstick for comparing families — that is, for determining their abilities to pay taxes and comparing tax burdens by income class."[1] The Bush Administration also used this measure to assess tax legislation such as the tax provisions of the 1990 budget agreement. Neither Mr. Archer nor other prominent Republican members of the Ways and Means Committee appear to have protested vigorously the use of this income measure by the Reagan and Bush Administrations.

- **No matter what definition of income is used, the House and Senate tax cuts tilt heavily toward upper income groups.** Last week, the Center on Budget and Policy Priorities and Citizens for Tax Justice released an analysis using the definition of income that the Congressional Budget Office uses in its analyses. That income definition is *narrower* than the definition the Treasury uses and also is narrower than the definition the Joint Committee on Taxation employs. The CBO definition is, in fact, closer to the Census Bureau's income definition — which Mr. Archer has indicated he favors — than any other definition used in analyzing the distributional effects of the tax bills. The CBPP/CTJ analysis found the House tax cuts to be even more heavily skewed toward those at the top of the income scale than the Treasury analysis did.

- **The Treasury analysis *understates* rather than overstates the degree to which the House and Senate tax cuts are tilted to the top.** The Treasury analyses understate the degree to which the tax bills favor those at high income levels because these analyses do not include the effects of the estate tax cuts in the House and Senate bills, which benefit the heirs of the wealthiest two percent of people who die.

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[1] Department of the Treasury, *Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President*, November 1984, pp. 57-59.

- **The income definition that Treasury employs does not have a large effect on Treasury's findings concerning the proportion of the tax cuts that would go to the top one percent of the population, the top five percent, the top 20 percent, and so on.** Mr. Archer's principal complaint seems to be that Treasury's definition of income makes too many families appear to have incomes over $75,000 or $100,000. He argues this makes it appear that a larger share of the tax benefits go to the affluent than is really the case. But the key figures in the Treasury tables — and the principal statistics that Secretary Rubin and other Treasury officials have been citing — are the figures on the proportion of the tax cuts going to the top one percent or the top 20 percent, *not* the figures on the percentage of the tax cuts that would go to those with incomes exceeding $75,000 or $100,000. The households in the top part of the income distribution are largely the same under the Treasury and Joint Tax analyses. As a result, the figures on the proportion of the tax cuts that would go to the various income quintiles and to the top one percent and five percent are not substantially affected by the definition of income used. (For a further discussion of this issue, see the box on page 6.)

Rep. Archer repeatedly contends, based on a Joint Tax Committee table, that 71 percent of the tax cuts the House bill provides would go to people with incomes between $20,000 and $75,000. Such a finding is sharply at odds with the Treasury analysis. But the reason that the Treasury's distributional analyses and the Joint Tax Committee's analyses differ so markedly is not that they use somewhat different definitions of family income. The sharp differences are instead the result of serious deficiencies in the Joint Committee's tables and methodology. These deficiencies cause the Joint Committee's tables to distort the effects of the tax legislation on different income groups.

- **The Joint Tax Committee *distribution* tables go only through 2002, but the Joint Committee's *revenue* tables show the principal upper-income tax cuts in the bill have little cost before 2002 and grow sharply after that.** For example, the Joint Committee's revenue tables show that the House capital gains and IRA tax cuts together would produce *no net revenue loss* in the years through 2002 but cost $50 billion from 2003 through 2007. The Treasury's distributional analyses address this issue; they measure the effects of the tax bill when its provisions are phased in fully. In so doing, the Treasury analyses follow the standard procedure for analyzing the effects of tax legislation on different income groups, a procedure the Joint Committee itself used until 1995.

- **The Joint Tax Committee tables make it appear as though the bill's large capital gains tax cuts constitute a *tax increase* imposed upon wealthy investors.** When capital gains tax rates are reduced, as they would be under the House and Senate bills, investors sell some assets sooner than they otherwise would in order to take advantage of the lower tax rate. As a result, investors would pay some capital gains taxes in the next few years that they would largely pay in later years if the capital gains tax rates were to remain unchanged. In addition, under the capital gains indexing provisions of the House bill, investors could elect to pay capital gains taxes in 2002 they otherwise would pay in subsequent years in return for the ability to use in future years the additional capital gains tax reduction that indexing provides. Investors would choose to follow these courses — selling more assets in the next few years and paying some capital gains taxes in 2002 they otherwise would pay later — only if they concluded they would make more money and secure even larger tax cuts over time by doing so. Nevertheless, the Joint Tax Committee treats the tax payments that investors would elect to make in the next few years, rather than in future years, as tax increases that would be imposed on them. The Joint Committee subtracts these "tax increases" from the tax cuts that wealthy individuals would receive, making the net tax cut these individuals would get appear to be very small.

  The use of this device thus has an anomalous effect — it makes the House bill's capital gains tax cut, under which wealthy investors would ultimately pay a lower rate of tax on capital gains income than middle-income families pay on interest in their savings accounts — appear to be a tax increase imposed upon wealthy investors. In the past, leading budget and tax experts such as former CBO director Robert Reischauer, Henry Aaron of the Brookings Institution, Jane Gravelle, one of the Congressional Research Service's leading authorities on tax policy, and Lawrence Lindsey, a conservative economist who recently served as a governor of the Federal Reserve, have sharply criticized and pronounced as invalid the methodology the Joint Tax Committee is using to measure the distributional effects of capital gains tax cuts. It may be noted that for years, the Joint Tax Committee used the same methodology the Treasury uses to assess the effects of capital gains tax cuts, but the Joint Committee changed its methodology in the fall of 1994.

- **The Treasury analysis does not contain the flaws that mar the Joint Tax Committee's distributional tables**. Treasury examined the effects of tax cuts when the cuts would be in full effect.[2] In addition, Treasury uses the standard methodology for analyzing the effects of capital gains tax cuts on different income groups. Finally, the Treasury analysis examines the distributional effects of the reductions the House bill makes in the corporate alternative minimum tax and the corporate capital gains tax, while the Joint Tax Committee tables ignore the effects of these corporate tax cuts. Most of the benefits of these corporate tax cuts would accrue to individuals who tend to be in the upper parts of the income scale.

The Treasury analysis finds that the House tax bill would provide 67 percent of its benefits to the top 20 percent of the population. It also finds that the wealthiest one percent of the population would get nearly 1½ times as much in tax cuts as the bottom 60 percent of the population. (An analysis conducted by the Center on Budget and Policy Priorities and Citizens for Tax Justice, which differed from the Treasury analysis in that it included the effects of the estate tax cuts,[3] estimated that an even larger proportion of the House tax cuts — close to 80 percent — would go to the top 20 percent of the population.)

If Mr. Archer disagrees so strongly with the Treasury analysis and the Treasury's income definition, there is a step he can take. He can ask the Joint Committee on Taxation to conduct an analysis of the distributional effects of the House tax bill when the bill is fully in effect (not in 2002), using the generally agreed-upon methodology for assessing the impacts of capital gains cuts (i.e., the methodology the Joint Committee itself used to use). The results of such a Joint Tax Committee analysis — using the Joint Committee's definition of income — would almost certainly mirror the results of the Treasury analyses that Rep. Archer has so sharply castigated.

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[2] For example, the Treasury methods take into account the future value of backloaded IRAs to taxpayers, while the Joint Committee analysis includes virtually none of the value of the proposed accounts.

[3] As noted earlier, neither the Joint Tax Committee tables nor the Treasury tables account for the effects of the estate tax cuts.

**Different Income Definitions Do Not Fundamentally Affect Distributional Analyses**

There are a number of different ways to measure income when conducting distributional analyses. The three governmental entities that examine income distribution issues and the impact of tax and budget changes on income — the Congressional Budget Office, the Joint Committee on Taxation, and the Treasury Department — each employ a different income definition. Some definitions count more non-cash income than others. But whatever income definition is used, the division of families (or taxpaying units) into income fifths, or quintiles, is accomplished the same way — families are ranked by income and then divided into fifths. In most cases, the families in the top fifth of the Treasury distribution and the families in the top fifth of the Joint Tax Committee distribution are the same or similar families. (This also holds true for other income quintiles.) As a result, the effects of tax policy changes on the various income quintiles, and on the top one percent and top five percent of the population, are not affected much by the income definition used.

In defining income, both the Joint Tax Committee and the Treasury Department count various items as income that the Census Bureau does not count. The Joint Committee counts contributions that a family's employer makes for the family's health and life insurance as well as for payroll taxes. The Joint Committee also counts as income the insurance value of Medicare. Treasury counts the employer contributions as income as well and also counts several additional items such as employer contributions to pension plans, profit-sharing payments, stock options, and the build-up of untaxed earnings in IRA and Keogh plans.[3] There is little debate among economists that these items have value to families and increase families' net wealth.

Reasonable people can differ about which of these non-cash income sources should be counted as income when assessing the impact of tax changes on different income groups. But such differences have little effect on distributional analyses of tax cuts. The proportion of the House tax cut that would go to each income quintile will be broadly similar regardless of how narrow or expansive the definition of family income that is being used.

If the Joint Committee on Taxation had looked at the impact of the House tax provisions when the provisions would be fully effective instead of just looking at their impact through 2002, and had used the traditional methodology to measure the impact of capital gains tax cuts on different income groups (a methodology the Joint Committee used until late 1994), the Joint Tax Committee tables would look similar to the Treasury tables. Furthermore, a recent Center on Budget and Policy Priorities/Citizens for Tax Justice study used the same definition of income that the Congressional Budget Office employs; this is a less expansive income definition than the Joint Tax Committee uses and the definition closest to the Census income definition that Mr. Archer apparently regards as the most appropriate income measure. The Center/CTJ study found the House tax bill to be somewhat more skewed toward higher-income taxpayers than the Treasury study did.

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[3] Both the Joint Tax Committee and the Treasury count capital gains income as part of family income but do so in a somewhat different way. The Joint Committee counts capital gains income when it is realized, i.e., when assets are sold. Treasury counts the annual accrual of capital gains as income.