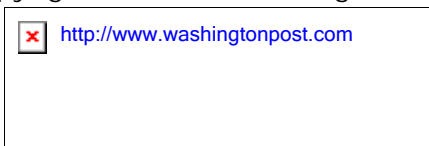




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SECTION: OUTLOOK; Pg. B01**LENGTH:** 1251 words**HEADLINE:** NEW YORK If tax cuts were a ...**BYLINE:** Anna Bernasek**BODY:**
NEW YORK

If tax cuts were an art form, President Bush would be the Picasso of the policy world. It's hard not to admire his genius. The president's tax package is meticulously crafted to appeal to the eye. Deft illusions such as sunset clauses make a huge tax cut appear as a slender \$ 350 billion over 10 years, and the symbolism of child tax credits draws us in. But taxes aren't about aesthetics. What really matters is whether these tax changes are good for what ails our economy.

They aren't likely to kick-start the economy. To understand why, try this simple exercise. By now, you've probably made a rough calculation of how much money you'll get back from the newly enacted tax package. For most of us, it's anywhere from a couple of hundred dollars to a few thousand. Now think about what's happening in your own town and state. How much have your property taxes gone up recently? And how much more are your state taxes likely to increase? Factor those in and you're probably not going to be as far ahead as you'd thought.

That calculation has a lot of economists scratching their heads about just how effective this package will be at boosting the economy. And that's where the trouble lies. If the tax package doesn't boost the economy, or if it doesn't boost it much, those alluring tax cuts could do more harm than good.

To see why, look at who gets the extra money in the first place. A little bit goes to everyone but most of the money goes to the well-to-do, who are least likely to spend it. To counter that tendency, the president has included a \$ 400 increase in the child tax credit, which promises to put money primarily in the hands of middle-income earners as early as July. Those families are thought to be among those most likely to spend any extra money they get, and if the economy is going to get a lift from these cuts, it will depend on them.

The trouble is, most families are worried about job security and their prospects for the future. So in the current uncertain economic environment, there's no guarantee they will spend their extra dollars.

In fact, our most recent experience with tax rebates has shown that you can't count on them

to stimulate the economy. In a National Bureau of Economic Research paper, two highly regarded economists, Matthew Shapiro and Joel Slemrod, found that most households saved their 2001 tax rebates of \$ 300 (for individuals) or \$ 600 (for married couples) or used the money to repay debt. As a result, the tax cuts of 2001 provided very little lift to the sluggish economy.

But what if every family that gets a \$ 400 check does spend it? The total boost to the economy would be a mere \$ 14 billion. And in a \$ 10 trillion economy, counting on \$ 14 billion in spending to ignite growth seems pretty insignificant.

There is one other way the tax package could stimulate the economy immediately. And that's via a \$ 20 billion assistance program to state and local governments over the next 12 months.

Cash-strapped state and local governments will be able to spend that money in a heartbeat. The trouble is, it won't be nearly enough to turn around their fiscal problems. Economists have calculated that the combined deficit for state and local governments for this year alone will total \$ 80 billion. The result will almost certainly be pretty hefty increases in state and local taxes across the country, and that could be significant enough to offset any money that does find its way into the economy from the federal tax cuts.

Okay. So the worst thing is these cuts won't do much to boost the economy, right? Wrong. Some of those elegant political illusions in the package might have unintended consequences that will turn out to hurt the economy.

To understand why that might be the case, start with those sunset clauses, which will expire after one to five years -- barring future congressional action -- and which therefore make the cost of the tax package appear smaller than it is. The sunset is a gimmick that creates a lot of unnecessary confusion and unnecessarily complicates the tax code. All of which is a drag on economic activity.

Practically every key initiative -- like the income tax cuts, child tax rebate, dividend and capital gains cuts -- expires between 2004 and 2011. How are taxpayers supposed to keep track of what expires when, and plan accordingly? And more importantly, if people know those cuts are temporary, will they change their behavior and spend the money?

For instance, one initiative is supposed to encourage investors to buy stocks by cutting dividend and capital gains taxes. But since those cuts may or may not be phased out in a few years, there's a fair degree of uncertainty attached to the changes. And since investors don't like uncertainty, they may not be encouraged to buy more stocks.

Ultimately though, the biggest form of uncertainty from the sunset clauses has to do with the true state of our nation's fiscal position. As with the old British Empire, the sun rarely sets on a tax break. So if the government extends the sunset clauses through 2013, then the tax package ends up costing \$ 800 billion or more over 10 years instead of \$ 350 billion. And that makes a big difference to the health of our national finances.

The federal budget deficit is already expected to hit \$ 400 billion this year, or 4 percent of GDP, and next year it could be even higher. Add tax cuts worth \$ 800 billion or more over the next 10 years to those mounting deficits and our **national debt** would soon reach levels not seen since the bad old days of reckless fiscal policy in the Reagan era.

And this brings us to how the latest tax cuts could damage the economy: By putting off the hard decisions about spending and taxation, the government is creating an expectation of a looming budget crisis and long-term economic problems. That's exactly the wrong message

to be sending to businesses, households and investors right now. No matter what size tax breaks companies, families and investors end up with, they won't spend much if they're worried about the future.

Right now, if the administration wants to stimulate the economy, it needs everyone -- especially those in corporate America -- to spend. Without a pick up in business investment over the next few months, the economy is likely, at best, to stagnate. At worst, it could slide back into a recession.

It's true that some provisions in the new tax package are favorable to small business but overall, corporate America has not been clamoring for more tax cuts to encourage investment spending. What firms want to see is growing demand. That alone offers the hope of future profits and promotes risk taking and investment. But the tax cuts do too little to mend the finances of overstretched American consumers and not enough to inspire confidence in the nation's fiscal health.

If the tax cuts don't boost the economy, firms won't spend on new plants and equipment, and the economy will be in trouble. To make matters worse, the prospect of ballooning government debt will ultimately keep long term interest rates higher than they otherwise would be, further discouraging business investment.

Reviving confidence in our long-term prospects is essential if we're going to get this economy moving again. And that takes more than a clever illusion.

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[◀ prev](#) Document 2 of 2

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