

by William G. Gale and Laurence J. Kotlikoff

## Effects of Recent Fiscal Policies On Children

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In this report the authors explain why recent and proposed fiscal policies — the tax cuts, proposals to make them permanent, and the Medicare prescription drug bill — will hurt economic prospects for most of today's children and all future generations. The programs will leave economic growth largely unchanged, but will redistribute resources from future to current generations and, within each generation, from low- and middle-income families toward an affluent minority. Those effects, they explain, exacerbate the effect of underlying federal budget trends and processes that will place significant, imminent pressure on funding for children's programs. They conclude that expanded investments in children are both feasible and desirable.

The future promise of any nation can be directly measured by the present prospects of its youth.  
— President John F. Kennedy,  
February 14, 1963.

We will not deny, we will not ignore, we will not pass along our problems to other Congresses, to other Presidents, and other generations.  
— President George W. Bush,  
January 28, 2003.

### I. Introduction

Today's children represent the future of the country. The notion that children and future generations should have better living standards than current generations is central to universally shared views of economic progress.

Public policies often assist children directly. Spending programs provide education, nutrition, and physical and mental healthcare. Many of those programs are appropriately regarded as productive investments in the future of the country. Reliable evidence from controlled social experiments shows that those interventions can improve health and education outcomes, and reduce activities that have negative consequences (such as crime, drug use, and teenage childbearing). Research also shows that the expenditures required for the programs can generate substantial rates of return

in terms of lower government costs and higher revenues in the future.<sup>1</sup>

Perhaps less obviously, policies that do not focus explicitly on children can have significant effects on youth and future generations. For example, programs that raise productivity and economic growth, pay down the public debt, clean up the environment, improve the nation's infrastructure, or invest in research and experimentation can improve lifetime prospects for today's children and future generations. Likewise, other policies that do not explicitly focus on children or on future generations can have negative consequences for those groups. The indirect effects of policy choices on children are potentially at least as important as the direct effects, especially because the indirect effects typically receive less attention.

This article examines the direct and indirect effects of one set of policies — the tax cuts and the Medicare spending increases that have been proposed and enacted since January 2001 — on the long-term economic prospects of today's and tomorrow's youth. Those proposals were not typically discussed in terms of their effect on children, other than a few vague claims to being "pro-family."<sup>2</sup> Nevertheless, we show

<sup>1</sup>For a careful analysis of these issues, see the contributions in Sawhill (2003).

<sup>2</sup>For an exception to the general rule, see Burman, Maag, and Rohaly (2002), who provide a detailed analysis of the effects of the 2001 tax cut on families and children.

that those recent fiscal policies will significantly and adversely affect both future generations as a whole and a substantial majority of children in the current and each future generation.

The starting point of our analysis is the finding from several studies that recent fiscal policies will not increase (and could well reduce) the size of the economy in the long term, relative to what would have occurred had the policies not been introduced. Therefore, rather than raise the amount of resources available for future generations, the policies will mainly *redistribute a fixed (or declining) amount of resources*. The recent tax cuts, proposals to make them permanent, and the Medicare prescription drug bill will conservatively cost the federal government more than \$34 trillion in present value in increased (noninterest) expenditures and reduced revenues. Those initiatives are best thought of as loans, though, not grants.<sup>3</sup> They must eventually be financed with either tax increases or spending cuts in the future, and the patterns of repayment are not necessarily linked to who receives the benefits. The resulting redistribution will occur through two broad channels: across generations and within generations. In both cases it will hurt economic prospects for the majority of today's and future youths.

The policies will redistribute resources across generations by increasing the fiscal burdens placed on future generations and reducing the burdens placed on current generations. By increasing spending and cutting taxes now, but not increasing economic growth, recent fiscal policy actions imply either cuts in future spending or increases in future taxes to keep the government budget in balance. The precise magnitude of the intergenerational burdens created is not currently available but plausibly runs in the tens of thousands of dollars per child today and in the future on a lifetime basis.

The policies will also redistribute resources within generations. Examined in isolation, the recent tax cuts give benefits to most families.<sup>4</sup> But it is misleading to look at who benefits without also considering how the tax cuts will be financed. Under plausible ways of paying for the tax cuts, most families with children will be worse off; they would be better off without the tax cut plus financing than with those policies.

The inter- and intragenerational redistributions noted above will exacerbate the effects of several federal budget trends that, taken together, will create significant pressure to reduce federal funding for children in the future. For example, the difference between federal revenues and spending on interest, defense, and elderly entitlements represents the amount left over to fund all other federal initiatives, including those for children. That difference is slated to fall by two thirds, from 8.6 percent of GDP in 2000 to 2.8 percent in 2014.

The decline will put significant pressure on all federal programs, but especially on programs that invest in children, because many such programs must be

<sup>3</sup>We thank Sara Watson for this terminology.

<sup>4</sup>We are unable to provide estimates of the within-generation distributional effects of the Medicare bill.

annually funded and therefore face political battles and trade-offs every year. A related problem is that most recent social initiatives have been enacted through tax changes rather than as spending programs. But unless they are refundable, which has proven controversial, tax subsidies cannot help the 25 percent of all children who live in families that face no income tax and who are presumably the most economically vulnerable youth.

The federal tax cuts will also squeeze state budgets, since many state income taxes are linked to the federal system. Because many children's programs are funded through the states, the resulting state budget pressures could be as damaging to prospects for children as the pressures at the federal level (McNichol and Harris 2004).

If recent policies have such deleterious effects on children and future generations, it is natural to ask if there are better ways to deploy the resources. We outline the factors supporting a comprehensive set of investments in today's children, as well as the changes in federal taxes, spending, and budget processes that would enable and protect those changes.

Section II describes the tax cuts and the Medicare bill. Section III discusses their effects on economic growth. Sections IV and V examine redistribution across and within generations. Section VI explores federal budgetary issues. Section VII discusses a program of investment in children. Section VIII concludes.

## II. Recent Tax and Spending Policies<sup>5</sup>

The last three years have seen a series of substantial tax cuts and legislated spending increases.<sup>6</sup> Under the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the top income tax rates fall over time, a new 10 percent tax bracket is created, the estate tax is gradually reduced and eventually repealed, and the taxation of taxpayers with children, married filers, and those who save for education or retirement falls. Those provisions generally phase in slowly over time and all of them expire by the end of 2010.

The Jobs and Growth Tax Relief, Reconciliation Act of 2003 (JGTRRA) accelerated many, but not all, of the income tax cut provisions of the 2001 tax cut. The 2003 tax cut also expanded investment incentives for small business, and introduced new tax cuts for dividends and capital gains. In between those two tax cuts, the Job Creation and Worker Assistance Act of 2002 provided temporary accelerated depreciation for new investments and extended a variety of minor provisions

<sup>5</sup>The three tax cuts are described in JCT (2001, 2002, and 2003) and analyzed in Burman, Maag, Rohaly (2002), Gale and Potter (2002) and Burman, Gale and Orszag (2003). The proposal to make the tax cuts permanent is described in OMB (2004) and analyzed in Gale and Orszag (2004). The Medicare bill is described in CBO (2004).

<sup>6</sup>We do not examine other policies — for example, increased homeland security expenditures, the reconstruction of New York City, the war on terrorism, or the war in Iraq — because the consequences are difficult to quantify.

that were scheduled to expire. JGTRRA expanded the depreciation provisions in the 2002 tax cut.

The tax bills contain two pieces of “unfinished business” that must be addressed in any discussion of the long-term effects of the legislation. First, all of the provisions of all of the tax cuts are to sunset — that is, be repealed — by the end of 2010. Some provisions “sunset” twice. For example, the child credit is set at \$1,000 through the end of 2004, then falls to \$700 in 2005, before rising to \$1,000 by 2010, and falling to \$500 (its value before the 2001 tax cut) in 2011. President Bush has repeatedly proposed making permanent almost all of the provisions of the 2001 and 2003 tax cuts, most recently in his fiscal 2005 budget, released in February 2004 (Gale and Orszag 2003a, 2004).

The second piece of unfinished business regards the alternative minimum tax. The AMT operates parallel to the regular income tax, with a different income definition, allowable deductions, and rate structure (Burman, Gale, Rohaly 2003). Taxpayers who are eligible to pay AMT must calculate their taxes under both the regular and alternative tax and pay the higher liability. Originally intended to capture very high-income taxpayers who were aggressively sheltering income, the tax has now crept down toward those with moderately high incomes and is threatening to engulf middle-income taxpayers in the near future. Today, only about three million people face the tax, almost all of them high-income filers. But under the proposal to extend the 2001 and 2003 tax cuts, the number of AMT taxpayers will rise to more than 40 million by 2014. That growth will cause problems related to tax complexity, equity, and efficiency. It is unlikely that policymakers will tolerate this projected growth in AMT coverage.

The AMT is growing for two reasons. First, the tax is not indexed for inflation, so that even nominal income growth due solely to inflation will push more people into the AMT over time. Second, the 2001 and 2003 tax cuts reduced regular income tax liabilities without corresponding adjustments to the AMT. Growing AMT problems due to the nonindexation for inflation should not be attributed to the costs of the 2001 and 2003 tax cuts. But the costs of fixing the AMT so that the 2001 and 2003 tax cuts do not force more people into the AMT are legitimately considered part of the unspecified costs of the AMT.

We deal with the “unfinished business” associated with 2001 and 2003 tax cuts by assuming the tax cuts are made permanent, as proposed by the president, and the number of AMT taxpayers remains at the levels that would have obtained in the future years under pre-2001 tax law.<sup>7</sup>

<sup>7</sup>To do this, in each year, we allow the refundability of all personal credits under the AMT, and then raise the AMT exemption until the number of AMT taxpayers, under the tax cuts and the AMT change, is the same as it would have been under pre-2001 law. See Burman, Gale, and Rohaly (2003) for further discussion.

Under the Medicare Reform Act of 2003, beginning in 2006, the federal government will subsidize prescription drug coverage in various ways. The law also creates a variety of additional changes in the structure of Medicare payments and health savings accounts.

### III. Effects on Long-Term Economic Growth<sup>8</sup>

In the long run, an economy can grow only by expanding its capacity to generate income. That requires an increase in the supply of labor and capital, an improvement in technology, or increased efficiency in the use of economic resources. In the long term, the recent tax cuts (and the proposals to extend the 2001 and 2003 tax cuts) will affect economic growth through several direct and indirect channels.

#### A. Direct Effects of Tax Cuts

First, taxes directly affect peoples’ and firms’ behavior. Lower tax rates raise the reward to working, saving, and investing. Holding real income constant, those lower marginal rates induce more work effort, saving, and investment through standard incentive effects. Such incentive effects are strongly emphasized by advocates of tax cuts. But incentive effects are by no means the only effects, nor are they necessarily the largest effects of tax cuts.

In addition to improving incentives, tax cuts also raise people’s after-tax income, reducing the need to work, save, and invest. That is, after a cut in income tax rates, an individual can obtain the same (or more) after-tax wages and after-tax investment income as before with less work and less saving than was previously the case.

The recent tax cuts incorporate both incentive and income effects. Those policies raise the marginal return to work, which raises the amount of work through the incentive effect, but they also increase households’ after-tax income at every level of labor supply, which reduces labor supply through the income effect. The net effect on labor supply is ambiguous in theory. Similar effects also apply to saving.

Most analyses, however, expect that the direct effects of the tax cuts will have positive but moderate effects on long-term labor supply and saving (see CBO 2001 and Gale and Potter 2002). On the other hand, simulation studies (Auerbach and Kotlikoff, 1986) suggest the opposite.

#### B. Indirect Effects of Tax Cuts

In addition to their direct effect of private agents’ behavior, tax cuts indirectly affect economic growth. Tax cuts reduce government saving — that is, they raise the budget deficit. Although some people used some of the tax cuts to increase their own saving, recent evidence suggests that households did not save anywhere near all of the recent tax cuts.<sup>9</sup> That is con-

<sup>8</sup>For an extended discussion and documentation of the channels through which the tax cuts may affect economic growth, see Gale and Potter (2002).

<sup>9</sup>See Gale and Potter (2002) and Shapiro and Slemrod (2001, 2002).

sistent with a large body of direct and indirect evidence that shows that, holding other factors constant, sustained deficits tend to reduce national saving, which is the sum of private and public saving.

The decline in national saving from the recent tax cuts is a crucial element of the effect on economic growth because, given standard national accounting identities, the reduction in national saving must be matched by a reduction in domestic investment or a reduction in net foreign investment. In either case, the capital owned by Americans declines, which in turn reduces future national income and future living standards (relative to their level in the absence of the deficit) (Gale and Orszag 2003b).

### C. The Net Effects of Tax Cuts

The net effects of tax cuts on economic growth is the sum of the direct effects and the indirect effects outlined above. Several studies have examined the effect of the 2001 tax cut on growth.<sup>10</sup> The Congressional Budget Office (CBO) (2001) concludes that EGTRRA may raise or reduce the size of the economy, but the net effect is likely to be less than 0.5 percent of GDP in 2011. The effects on the economy after 10 years — that is, the long-term growth effects — can be gleaned from a similar CBO (2002) macroeconomic analysis of tax reform proposals. That study found that tax cuts uniformly reduced long-term GDP (relative to the baseline) unless they were paid for with sufficient spending cuts. Elmendorf and Reifschneider (2002) use the Federal Reserve macro model and find that a persistent cut in personal income taxes equal to 1 percent of GDP reduces long-term output and has only a slight positive effect on output in the first 10 years. Auerbach (2002) estimates that EGTRRA will reduce the long-term size of the economy unless it is financed entirely by spending cuts. Gale and Potter (2002) estimate that EGTRRA will have little or no effect on GDP over the next 10 years and could even reduce it, and that GNP is likely to fall because of the decline in national saving.

Two recent studies examine proposals very similar to JGTRRA. Macroeconomic Advisers (2003) estimated that the president's tax cuts would reduce the size of the economy in the long run. More recently, the Joint Committee on Taxation estimated the macroeconomic effect of the administration's 2003 tax cut proposals (Congressional Record 2003). Using a variety of models and assumptions, the JCT results, show — strikingly — that the 2003 tax cut would *reduce* GDP relative to the baseline in the second half of the decade. Although the JCT does not report results beyond 10 years, the

<sup>10</sup>Empirical studies of the growth effects of actual U.S. tax cuts are relatively rare, in part because the United States had only one major tax cut between 1965 and 2000. Feldstein (1986) and Feldstein and Elmendorf (1989) find that the 1981 tax cuts had virtually no net effect on economic growth. That may be surprising, given the incentives created by the large marginal rate cuts embodied in the 1981 tax cut. But the rate cuts also created income effects, and the act increased tax sheltering activities, so the direct effects may have been small, though positive. The act also created significant budget deficits, so the indirect effects were large and negative.

language implies that growth would continue to decline.<sup>11</sup>

In summary, while there is no doubt that tax policy can influence the economy, it is by no means obvious that a tax cut will ultimately lead to a larger economy. Tax cuts will reduce economic growth to the extent that they reduce national saving and create positive income or wealth effects.<sup>12</sup> A fair assessment would conclude that well-designed tax policies can increase growth, but there are many stumbling blocks along the way, and there is no guarantee that all tax cuts will improve economic performance. The evidence and analyses to date suggest that the recent tax cuts, even if made permanent, will not improve long-term growth prospects and could in fact hurt them.

### D. Effects of the Medicare Bill

We know of no explicit analysis of the effects of the Medicare spending bill on future economic growth, but we surmise that the effect will have to be negative. The Medicare bill will reduce national saving, and therefore future national income, in at least three ways. First, without other policy changes, the bill will substantially raise long-term deficits. Second, the bill increases government transfer spending to a group that is largely already retired and hence is likely to consume rather than save the funds. Third, the bill would likely reduce the need for private saving for retirement.

## IV. Fiscal Burdens on Future Generations

The notion that the tax cuts and the Medicare drug bill will transfer resources from future generations to current generations of adults, and thereby impose substantial burdens on today's children and future generations, is based on several steps. First, the policies have massive costs. If the tax cuts are made permanent, the AMT is addressed, and the Medicare bill remains intact, the estimated present value of the reduced federal revenues and increased federal expenditures exceeds \$34 trillion.<sup>13</sup> That is the equivalent of more than three years of GDP.

(Text continued on p. 1286.)

<sup>11</sup>For example, after noting that the residential capital stock falls but nonresidential capital rises in the first 10 years (with the overall capital stock falling), the JCT notes that "the simulations indicate that eventually the effects of the increasing deficit will outweigh the positive effects of the tax policy, and the build up of private nonresidential capital stock will likely decline." Thus, in the longer run, the JCT analysis of the plan foresees rising deficits, and declining residential and nonresidential capital stocks. Taken together, those imply declining GDP and GNP over time.

<sup>12</sup>The positive effects of a tax cut can also be diminished or eliminated by restrictive reactions from the monetary authorities or from state or foreign governments.

<sup>13</sup>Auerbach, Gale, and Orszag (2004) project the costs of the tax cuts at \$18 trillion. Under a slightly different set of assumptions, the 2004 Medicare Trustees Report projects the costs of the new prescription drug bill at \$16.6 trillion. The costs of the Medicare bill would be higher under the assumptions used by Auerbach, Gale, and Orszag.

Table 1 EGTRRA, JGTRRA, and Administration's FY2005 Budget Proposal Distribution of Individual Income and Estate Tax Change by Cash Income Percentiles, 2010 <sup>1</sup>						
Cash Income Class <sup>2</sup>	Percent of Tax Units With Tax Cut	Percent Change in After-Tax Income <sup>3</sup>	Percent of Total Tax Change	Average Tax Change (\$)	Average Federal Tax Rate <sup>4</sup>	
					Pre-EGTRRA	Proposal
<b>Among All Tax Units</b>						
Lowest Quintile	15.8	0.3	0.3	-26	3.4	3.1
Second Quintile	69.0	1.9	4.1	-387	9.6	7.9
Middle Quintile	83.9	2.1	7.5	-699	16.4	14.6
Fourth Quintile	96.3	2.5	14.9	-1,391	21.1	19.2
Top Quintile	99.3	4.3	73.0	-6,818	28.0	24.8
All	72.8	3.4	100.0	-1,867	23.7	21.1
<b>Addendum</b>						
Top 10 Percent	99.3	4.5	55.5	-10,359	29.2	26.0
Top 5 Percent	99.3	4.9	43.8	-16,340	30.3	27.0
Top 1 Percent	98.8	6.3	29.8	-55,681	32.4	28.1
Top 0.5 Percent	98.8	6.8	24.6	-91,952	33.2	28.6
Top 0.1 Percent	98.8	7.5	14.8	-275,440	35.0	30.2
<b>Among All Tax Units With Children*</b>						
Lowest Quintile	11.8	0.3	0.2	-29	-11.1	-11.5
Second Quintile	87.2	3.4	5.4	-742	1.2	-2.1
Middle Quintile	97.2	4.1	9.2	-1,380	15.0	11.5
Fourth Quintile	99.4	3.4	16.2	-1,937	20.2	17.5
Top Quintile	99.8	3.8	68.8	-6,028	27.7	25.0
All	82.6	3.7	100.0	-2,473	23.8	21.0
<b>Addendum</b>						
Top 10 Percent	99.7	3.7	49.3	-8,256	29.1	26.4
Top 5 Percent	99.7	4.0	38.5	-12,937	30.4	27.6
Top 1 Percent	99.3	5.9	27.6	-49,577	33.2	29.3
Top 0.5 Percent	99.4	6.5	22.9	-85,599	34.1	29.8
Top 0.1 Percent	99.2	6.9	13.5	-256,245	35.5	31.0

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0304-2).  
\* With children means with dependent children living at home.  
<sup>1</sup>Calendar year. Baseline is pre-EGTRRA law. Includes provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) affecting the following: marginal tax rates; the 10 percent bracket; the child tax credit; the child and dependent care credit; the standard deduction, 15 percent bracket, and EITC for married couples; pension and IRA provisions; and estate tax exemption, rates, and state death tax credit. Excludes education and corporate tax provisions. Includes the extension of the 15 percent tax rate on qualified dividends and capital gains (0 percent for lower-income taxpayers) and acceleration of the indexation of the 10 percent bracket proposed in the administration's FY2005 Budget. To keep the number of AMT taxpayers equal to its value under pre-EGTRRA law, the use of nonrefundable credits regardless of AMT liability has been extended and the AMT exemption has been increased to \$54,000 for married couples filing jointly (\$38,250 for singles and heads of household).  
<sup>2</sup>Tax units with negative cash income are excluded from the lowest quintile but are included in the totals. Includes both filing and nonfiling units. Tax units that are dependents of other taxpayers are excluded from the analysis. For a description of cash income, see <http://www.taxpolicycenter.org/TaxModel/income.cfm>.  
<sup>3</sup>After-tax income is cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax.  
<sup>4</sup>Average federal tax (individual income tax, net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax) as a percentage of average cash income.

Cash Income Percentile <sup>2</sup>	Units With Tax Increase			Units With Tax Cut			All Tax Units	
	Number (thousands)	Percent of Total	Average Tax Change (\$)	Number (thousands)	Percent of Total	Average Tax Change (\$)	Average Tax Change (\$)	% Change in After-Tax Income
<b>Lump Sum Financing<sup>3</sup></b>								
Lowest Quintile	30,526	100.0	1,844	13	0.0	-4,456	1,841	-21.7
Second Quintile	30,690	98.7	1,508	391	1.3	-708	1,480	-7.4
Middle Quintile	29,156	93.8	1,288	1,929	6.2	-642	1,168	-3.5
Fourth Quintile	24,914	80.1	852	6,170	19.9	-1,042	476	-0.9
Top Quintile	3,222	10.4	640	27,865	89.6	-5,598	-4,952	3.1
All	119,049	76.6	1,381	36,385	23.4	-4,518	0	0.0
<b>Addendum</b>								
Top 10 Percent	805	5.2	842	14,740	94.8	-9,002	-8,492	3.7
Top 5 Percent	369	4.7	880	7,404	95.3	-15,237	-14,473	4.3
Top 1 Percent	66	4.2	1,154	1,488	95.8	-56,236	-53,814	6.1
Top 0.5 Percent	25	3.2	1,254	752	96.8	-93,104	-90,086	6.7
Top 0.1 Percent	3	2.0	1,676	152	98.0	-279,114	-273,573	7.4
<b>Proportional Financing<sup>4</sup></b>								
Lowest Quintile	30,436	99.7	207	104	0.3	-1,252	202	-2.4
Second Quintile	24,891	80.1	345	6,191	19.9	-465	184	-0.9
Middle Quintile	23,763	76.4	616	7,322	23.6	-621	324	-1.0
Fourth Quintile	24,714	79.5	783	6,371	20.5	-930	432	-0.8
Top Quintile	19,921	64.1	1,866	11,166	35.9	-6,468	-1,128	0.7
All	124,231	79.9	692	31,202	20.1	-2,761	-1	0.0
<b>Addendum</b>								
Top 10 Percent	11,686	75.2	2,637	3,859	24.8	-15,874	-1,959	0.9
Top 5 Percent	5,896	75.9	4,183	1,876	24.1	-28,968	-3,819	1.1
Top 1 Percent	631	40.6	13,235	923	59.4	-46,072	-22,003	2.5
Top 0.5 Percent	218	28.1	24,161	559	71.9	-64,639	-39,709	2.9
Top 0.1 Percent	28	17.7	70,641	128	82.3	-171,221	-128,397	3.5

*Source:* Urban-Brookings Tax Policy Center Microsimulation Model.  
<sup>1</sup>Baseline is pre-EGTRRA law. The AMT exemption is increased to keep the number of AMT taxpayers equal to that of pre-EGTRRA law.  
<sup>2</sup>Returns with negative cash income are excluded from the lowest income class but are included in the totals.  
<sup>3</sup>Lump sum financing amounts to \$1,867 per tax unit.  
<sup>4</sup>Proportional financing amounts to about 2.6 percent of cash income among those with positive cash income.

Second, the government's intertemporal budget constraint shows that fiscal policy is a zero-sum game, generationally speaking. Current and future generations must collectively pay in the form of net taxes for what the government spends, including the cost of serving its debt. The less current generations pay toward the government's bills, the more future generations will have to pay, and vice versa. If the recently enacted policies generated economic growth, of course, then although future generations had to pay higher taxes or receive smaller benefits to pay for current policies, those payments would be offset somewhat by the increase in economic activity that the policies created. As described above, however, there is not likely to be any positive long-term growth from recent and proposed fiscal

policies, so the fiscal burdens created are pure transfers from future generations to today's generations.

Third, the longer it takes for any corrective actions (either tax increases or spending cuts) to be taken, the more likely it is that the burdens will fall on future generations rather than current generations.

Those three factors suggest that recent fiscal policies will place burdens on future generations, where the burdens could plausibly run into the tens of thousands of dollars per child (Gokhale and Smetters 2003, Gokhale 2003). Precise estimates, however, depend on when the fiscal correction begins and how it is structured (which taxes rise and which spending programs are reduced). Developing and implementing a method to perform those calculations is a top priority for future research.

## V. Distributional Effects Within a Generation

Whereas the previous section examined how the costs of paying for recent fiscal policies will be distributed across generations, this section examines the distribution of gains and losses within the current generation. We focus here on the tax cuts.

### A. The Tax Cuts Ignoring Financing

Table 1 shows the distributional effects in 2010 of the administration's proposal to make the tax cuts permanent, including the AMT adjustment noted above. The table shows that the tax cuts provide a larger percentage increase in after-tax income for high-income households than for low-income households. If the tax cuts were made permanent, filers with income in the top 1 percent would receive a 6.3 percent increase in after-tax income, and filers in the middle 60 percent of the income distribution would receive between a 1.9 and 2.5 percent increase in after-tax income. Filers in the bottom quintile would receive an increase of just 0.3 percent of income.

Appendix Table 1 shows similar calculations by income level. Taxpayers with income above \$1 million would receive average annual tax cuts of \$151,000. That is higher than the *income* of about 91 percent of tax-filing units.<sup>14</sup>

Although the tax cuts tend to favor high-income households over low-income households — controlling for income — the tax cuts were more favorable to taxpayers with children than those without. Table 1 shows that the tax cuts raise after-tax income by 3.7 percent for filers with children compared to 3.4 percent for all filers. In the middle 60 percent of the income distribution, the tax cuts raise after-tax income for filing units with children by about double the increase for all units. Relative to all filing units, the tax cuts provide more assistance to filing units with children in the bottom 80 percent of the income distribution, and less assistance in the top 20 percent.<sup>15</sup> This is the sense in which the tax cuts are often described as “pro-family” or “pro-children.”<sup>16</sup>

<sup>14</sup>Another approach is to look at the size distribution of the tax cuts. Appendix Table 2 shows that about 27 percent of filing units will receive no tax cuts at all, while another 21 percent will receive less than \$500 per year.

<sup>15</sup>Appendix Table 2 shows that the distribution of the size of tax cuts for filing units with children is more generous than the distribution for all filing units. About 17 percent of filing units with children receive no tax cut, compared to 27 percent among all taxpayers and (not shown) 31 percent among filers without children.

<sup>16</sup>A related issue is how parents allocate the proceeds of their tax cut. It is not necessarily the case that every dollar that goes to families with children actually is used to the benefit of the child. We assume that it takes 70 percent as much to provide for a child as it does for an adult, a common assumption in family studies. Under that assumption, Appendix Table 3 shows that if the tax cuts were made permanent about 42 percent of tax cuts would go to taxpayers with children and about 17 percent of the tax cut would be allocated to children.

### B. The Tax Cuts Plus Financing

An important caveat to the results above is that they do not include the effects of any reduced spending or increased taxes that would be used to finance the tax cuts. Intuition about how severe those effects may be can be gleaned by considering the implications of different ways of financing the tax cuts, as in Table 2. The top panel shows that if the tax cuts are financed by equal lump sum levies (either higher taxes or lower spending) on each filing unit, fully three-quarters of all filing units would be worse off under the tax cuts plus financing than if the tax cuts had never taken place. That includes more than 99 percent of filing units in the bottom 40 percent of the income distribution, more than 90 percent in the middle quintile, and more than 80 percent in the fourth quintile. Only in the top quintile are most taxpayers better off.

The bottom panel of Table 2 shows the distributional effects if the tax cuts are financed in a manner that is proportional to income. In that case, almost 80 percent of households are worse off, including virtually everyone in the bottom quintile, and more than 75 percent of households in each of the next three quintiles. In summary, Table 2 shows that once plausible methods of financing of the tax cuts are considered, the vast majority of filing units will be worse off.

The implications for filing units with children are also negative but are not quite as stark as the results for all taxpayers. Table 3 shows that if the tax cuts are financed with equal lump sum levies, 61 percent of filing units with children would be worse off. Perhaps more importantly, though, more than 97 percent of filing units with children and in the bottom 40 percent of the income distribution would be worse off, as would 78 percent of those in the middle quintile and 61 percent in the fourth quintile.

With proportional financing, 56 percent of filers with children are worse off, including virtually all filers with children who are in the bottom quintile. Also, most filing units with children in the top two quintiles would be worse off. Interestingly, most filing units with children in the second and third quintiles would be better off. For those groups, the increase in the child credit helps considerably, and their burdens under proportional financing are relatively low. Nevertheless, the main conclusion from Table 3 is that once the financing of the tax cuts is considered the notion that the tax cuts are “pro-family” falls by the wayside for most American families.<sup>17</sup>

## VI. Budgetary Pressures

The redistribution noted above will combine with existing budgetary trends and rules to create significant pressure on children's programs. (See Steuerle (2003) for a related analysis.) Table 4 provides a simple

<sup>17</sup>Appendix Tables 4 and 5 mirror Tables 2 and 3 in showing the distributional effects of including financing for all filing units and for filing units with children, respectively, but show the results by income level rather than by income percentile.

Cash Income Percentile <sup>2</sup>	Units With Tax Increase			Units With Tax Cut			All Tax Units	
	Number (thousands)	Percent of Total	Average Tax Change (\$)	Number (thousands)	Percent of Total	Average Tax Change (\$)	Average Tax Change (\$)	% Change in After-Tax Income
<b>Lump Sum Financing<sup>3</sup></b>								
Lowest Quintile	7,930	99.8	1,842	13	0.2	-493	1,838	-18.7
Second Quintile	8,530	95.7	1,194	385	4.3	-416	1,125	-5.1
Middle Quintile	6,350	78.2	765	1,775	21.8	-508	487	-1.5
Fourth Quintile	6,263	61.4	554	3,930	38.6	-1,066	-71	0.1
Top Quintile	923	6.6	526	12,960	93.4	-4,495	-4,161	2.6
All	30,113	61.2	1,122	19,078	38.8	-3,334	-606	0.9
<b>Addendum</b>								
Top 10 Percent	244	3.4	679	7,023	96.6	-6,635	-6,389	2.9
Top 5 Percent	101	2.8	795	3,518	97.2	-11,411	-11,071	3.4
Top 1 Percent	20	2.9	1,126	656	97.1	-49,188	-47,710	5.6
Top 0.5 Percent	7	2.1	1,104	319	97.9	-85,530	-83,732	6.4
Top 0.1 Percent	1	1.5	1,388	63	98.5	-258,350	-254,378	6.9
<b>Proportional Financing<sup>4</sup></b>								
Lowest Quintile	7,862	99.0	212	80	1.0	-903	201	-2.0
Second Quintile	3,312	37.1	340	5,604	62.9	-468	-168	0.8
Middle Quintile	2,522	31.0	357	5,602	69.0	-679	-357	1.1
Fourth Quintile	5,736	56.3	558	4,456	43.7	-920	-88	0.2
Top Quintile	7,971	57.4	2,014	5,911	42.6	-3,526	-345	0.2
All	27,495	55.9	834	21,695	44.1	-1,456	-176	0.3
<b>Addendum</b>								
Top 10 Percent	5,838	80.3	2,482	1,430	19.7	-10,763	-123	0.1
Top 5 Percent	2,941	81.3	3,835	677	18.7	-21,580	-921	0.3
Top 1 Percent	238	35.1	10,792	439	64.9	-31,744	-16,794	2.0
Top 0.5 Percent	63	19.3	21,841	263	80.7	-47,072	-33,805	2.6
Top 0.1 Percent	8	12.2	69,360	56	87.8	-132,451	-107,906	2.9

*Source:* Urban-Brookings Tax Policy Center Microsimulation Model.  
<sup>1</sup>Baseline is pre-EGTRRA law. The AMT exemption is increased to keep the number of AMT taxpayers equal to that of pre-EGTRRA law.  
<sup>2</sup>Returns with negative cash income are excluded from the lowest income class but are included in the totals.  
<sup>3</sup>Lump sum financing amounts to \$1,867 per tax unit.  
<sup>4</sup>Proportional financing amounts to about 2.6 percent of cash income among those with positive cash income.

way of summarizing this point. In 2000 federal revenues exceeded the sum of outlays on interest payments, defense and homeland security, and elderly entitlements by 8.6 percent of GDP. By 2004 the figure fell to 2.9 percent of GDP. Under plausible assumptions about policy trajectories, we estimate that by 2014 the figure will be 2.8 percent of GDP. By 2030 the difference is likely to turn negative (Auerbach, Gale, and Orszag 2004).

It is worth noting that most of the decline through 2014 is due to underlying budget trends. The tax cuts and the Medicare bill account for about one-third of the change. But it is also worth emphasizing that, from the perspective of providing resources for children,

recent fiscal policies have effects that are both substantial and counterproductive. Those fiscal policy actions will have to be paid for eventually, with some combination of higher taxes and lower spending. Table 5 shows that to finance the costs of making the tax cuts permanent (including the AMT fix described above) and the Medicare bill in 2014 would require one of the following options or changes of a similar magnitude:

- a 53 percent cut in Social Security benefits;
- a 63 percent cut in Medicare benefits;
- complete elimination of the federal component of the Medicaid program, plus additional cuts;
- a 13 percent cut in all noninterest spending;



	Extend Tax Cuts in FY2005 Proposal <sup>1</sup>	+ AMT Reform <sup>2</sup>	+ Medicare Cost <sup>3</sup>	Memo: 2014 Baseline Revenue/Spending (\$ billions) <sup>4</sup>
<b>Revenue Loss in 2014</b> (in \$ Billions)	287	367	440	
Required Percentage Change in*				
<b>All Non-Interest Outlays</b>	-9	-11	-13	3,278
<b>Discretionary Spending</b>	-25	-32	-38	1,149
Defense, HS, International	-44	-56	-68	651
Other	-58	-74	-88	498
<b>Mandatory Spending</b>	-13	-17	-21	2,129
Social Security	-35	-44	-53	827
Medicare	-41	-53	-63	698
Medicaid	-82	-105*	-126*	348
All Three	-15	-20	-23	1,873
<b>All Spending Except:</b>	-38	-49	-58	754
Interest, Social Security, Medicare, Medicaid, and Defense and Homeland Security				
<b>Revenue</b>				
Payroll Tax	24	31	38	1,173
Corporate Tax	90	115	138	320
<sup>1</sup> Authors' calculations using Tables 1-2 and 4-10 of The Budget and Economic Outlook: Fiscal Years 2005-2014. This includes making the 2001 tax cut permanent as well as extending the dividend and capital gains components of the 2003 tax cut. AMT exemption reverts to its 2000 level in 2006 and remains unindexed. About 40 million taxpayers would be on the AMT in 2014 under this proposal.				
<sup>2</sup> Includes the cost of extending the AMT treatment of nonrefundable credits and raising the AMT exemption so that the number of AMT taxpayers is the same as would occur under pre-EGTRRA law in 2014, using the Tax Policy Center Microsimulation model. About 20 million taxpayers would be on the AMT in 2014 under this scenario.				
<sup>3</sup> Authors' calculations extrapolating 2014 cost from growth rate of cost in 2013 in CBO (2004).				
<sup>4</sup> Congressional Budget Office. 2004. The Budget and Economic Outlook: Fiscal Years 2005-2014. Table 1-2.				
* Percent cuts which exceed 100 are arithmetic artifacts. No program can be cut more than 100 percent.				

- a 58 percent cut in all spending other than interest, defense, homeland security, Social Security, Medicare, and Medicaid;
- a 88 percent cut in all domestic discretionary spending;
- a 38 percent increase in payroll taxes; or
- a 138 percent increase in corporate tax revenues.

The table shows that the tax cuts and Medicare bills will create substantial pressure to cut all government programs. As emphasized by Steuerle (2003), however, prospects for retaining or increasing funding for children's programs may be particularly problematic. Spending programs are divided into two types: entitlements or mandatory spending; and appropriated or discretionary spending. Mandatory spending follows rules that are enshrined in the law. Every year, even in the absence of any congressional action, payments are made according to the existing law. Discretionary spending, in contrast, is annually appropriated. Therefore, discretionary programs face battles every year and are the most likely to be cut first when budgets are tight. Mandatory programs may be altered, too, of course, but in the absence of specific congressional action, the programs live on.

The key point for the welfare of children is that several key programs for children — including Head Start, WIC, Title I education funding, and others — are discretionary programs. Hence, they have a second-class citizen status in the budgetary process. In contrast, the vast majority of spending on, for example, the elderly, occurs through mandatory programs.<sup>18</sup>

A second key characteristic of federal budgeting is that almost all recent social policy initiatives have occurred on the tax side of the ledger, typically as credits or deductions. That is problematic for children's programs because almost one half of all children live in households that do not pay any federal income tax after adjusting for existing credits.<sup>19</sup> Unless the tax credit is

<sup>18</sup>In the aggregate, the ratio of overall mandatory spending on children's programs to discretionary spending on children's programs is about 2 to 1, roughly the same as the overall budget. (We thank Richard Kogan for this information.) From that perspective, children's programs are at no greater risk than any other program. But if one considers interest, elderly entitlements, defense, and homeland security to have elevated status in the budget process, then, as shown in table 4, children's programs face significantly greater risk.

<sup>19</sup>The source of this figure is the TPC tax microsimulation model.

**Table 5**  
**Budget Squeeze, 2000, 2004, and 2014**

	2000 Percent of GDP	2004 Percent of GDP	2014 Percent of GDP
Revenue <sup>1</sup>	20.8	15.8	17.8
Net Interest <sup>2</sup>	2.3	1.4	2.2
Defense and Homeland Security <sup>3</sup>	3.1	4.1	3.7
Elderly Entitlements <sup>4</sup>	6.9	7.4	9.1
Revenue Net of Selected Spending	8.6	2.9	2.8

*Source:* Carasso and Steuerle (2004).  
<sup>1</sup>2000 actual estimate from CBO (2001). 2014 estimated using CBO(2004) projection and subtracting cost of extending tax cuts and AMT policy, as illustrated in Appendix Table 1.  
<sup>2</sup>2000 actual estimate from CBO (2001). 2014 estimate from Gale and Orszag (2004).  
<sup>3</sup>2000 actual estimate from CBO (2001). 2014 estimate from Gale and Orszag (2004).  
<sup>4</sup>Includes Social Security, Medicare, Medicaid (for the elderly), and Supplemental Security Income.

made refundable, which Congress has resisted in recent years, the subsidy cannot help those children.

Proposed cuts along the lines described above are already materializing. To reduce the budget deficit, but preserve and make permanent the tax cuts described above and accommodate the Medicare bill, the administration's fiscal year 2005 budget, released in February 2004, proposes significant reductions, starting mainly in 2006, in programs that help children, including education, head start, WIC, and low-income housing assistance (CBPP 2004, Every Child Matters 2003). Those reduced levels will apparently be the starting point for next year's budget proposals (Andrews 2004, and Weisman 2004).

In addition to all of the pressures noted above, the projected aging of the population provides an additional source of concern — namely, the potential for a shift in political preferences regarding spending on children. Poterba (1997) shows that between 1960 and 1990 states with a higher fraction of elderly residents had significantly lower levels of per-child spending on public K-12 education, controlling for other factors, and notes that the results support models of generational competition in the allocation of public resources. The implication is that as the nation steadily ages over the next several decades, political support for children's programs could decline.

## VII. Toward a Pro-Child Fiscal Policy

Well-designed investments in children are needed, feasible, available, and would have desirable effects. The substantial projected budget deficits facing the nation and the burdens created by recent fiscal policies are a key justification for new investments in children. Deficits reduce national saving, reduce future national income, and impose higher fiscal burdens on future generations. It is only appropriate to equip future generations with the human capital and other resources needed to address the problems current generations bequeath to them. While it will create pressure to cut all spending, the current fiscal situation helps justify increased investment in children on both equity and economic grounds.

Another justification for expanded investment in children is that the usual patterns of economic growth may not lift children's prospects sufficiently. For ex-

ample, from 1967 to 2002, real income per capita more than doubled, and the poverty rate fell by two-thirds for the elderly and one-sixth for the overall population. Yet the poverty rate for children was essentially the same in 2002 — one out of six — as in 1967.<sup>20</sup>

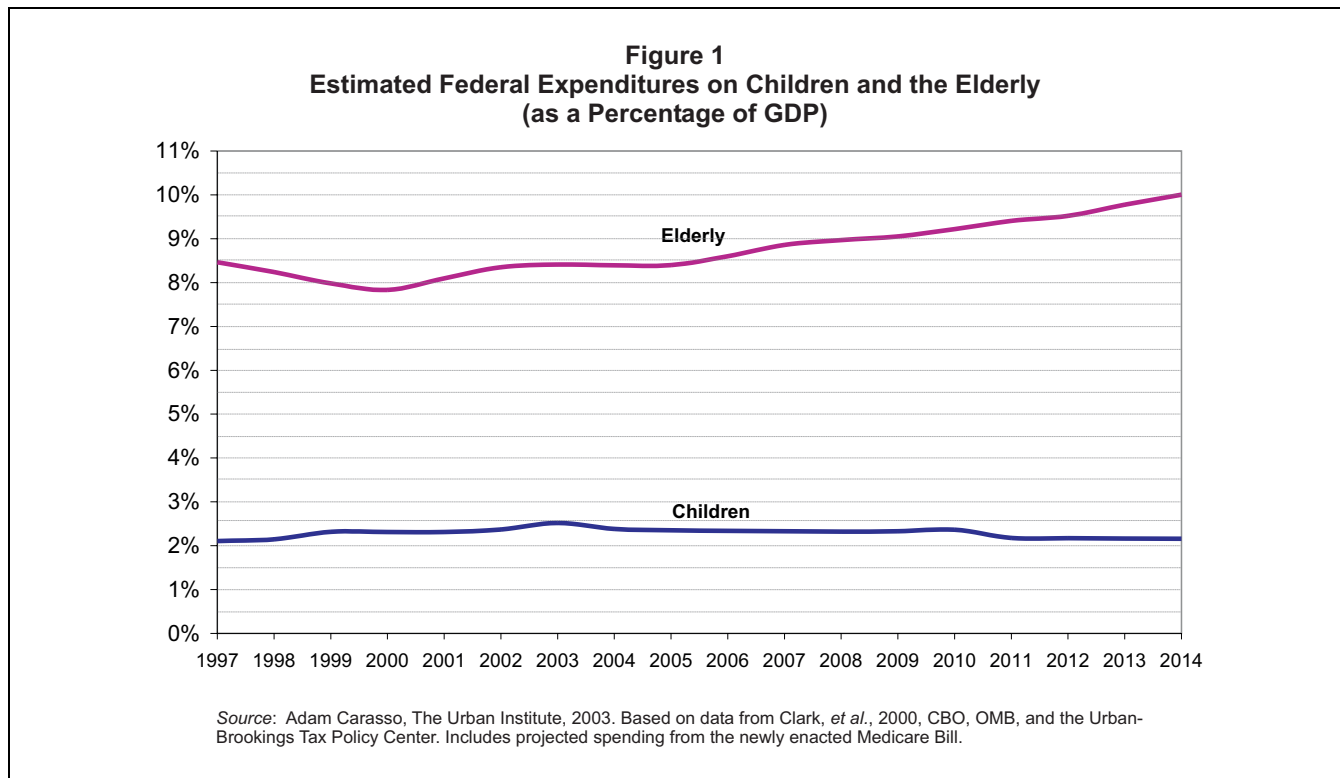
An expanded program would certainly be feasible. Federal spending for the elderly is three times as much as spending for children and is projected to increase between 2000 and 2014 by as much as the current level of children's spending (Figure 1).<sup>21</sup> Certainly, if the nation can marshal resources to assist the elderly, it can provide resources to invest in children. European countries, for example, routinely make substantial investments in the education and care of young children.

Well-chosen investments in children also face a good chance of success. At the micro level, the implicit rate of return in spending programs that invest in children, and the resulting changes in behavior in many targeted early childhood programs, can be substantial (see footnote 3). Also, it is worth noting that the massive infusion of resources for the elderly over the last 50 years has been extraordinarily successful in reducing poverty and increasing life span. A similar national effort for children could provide equally dramatic results for the prospects of today's youth and future generations.

Best of all, relative to recent fiscal policies or past investments in the elderly, an ambitious, broad-based program of investment in children would be less expensive, more conducive to growth, and fairer to future generations and today's children. As outlined in Sawhill (2003), those programs include: a substantial child allowance, increased earnings supplements for low- and moderate-income families with children, increased parental leave, expanded after-school programs, marriage promotion demonstrations, improved health services such as universal prenatal/perinatal

<sup>20</sup>Council of Economic Advisers (2004), U.S. Census Bureau (2003). For other measures of the welfare of children, see The Foundation for Child Development (2004).

<sup>21</sup>If state spending on children were included, total public spending on children would be closer to spending on the elderly but would still lag behind. Furthermore, federal spending on the elderly is slated to rise substantially in the next few decades in response to the increase in the elderly population and higher per capita healthcare expenditures. There are no such scheduled increases for federal spending on children.



screening, insurance for all children under the age of 18, intensive intervention for severe behavioral and emotional issues, early childhood education, universal preschool for four-year-olds, and improved neighborhoods for poor children.

At least two major changes in federal fiscal policies would probably be required to enact such a program. First, all or most of the 2001, 2002, and 2003 tax cuts would have to be allowed to expire as scheduled (by 2010). In our view, this is the most important policy issue affecting prospects for increased funding for children over the next five years. If the tax cuts are made permanent, federal financial prospects will be extraordinarily tight for the foreseeable future. If the cuts are allowed to expire, more than 2 percent of GDP in revenue would be available, a relatively small part of which could finance an enormously ambitious and expansive program of investment in children.

Second, changes in the budget process may also help establish and protect those changes, and remove children's programs from the annual vicissitudes of budgeting. One way to do that would be to establish a trust fund or independent board to oversee spending on children's programs (Gale and Sawhill 1999).

### VIII. Conclusion

This report links traditional public finance concerns with the economic prospects for children. Traditionally, public finance analyses focus on issues such as the effects of tax and spending policies on economic growth, the level of tax revenues, and the distribution of tax burdens. Analyses of children's issues traditionally focus on issues like the availability of good

schools, healthcare, safe neighborhoods, and affordable housing. Those topics appear to differ on the surface, but they are closely connected. A healthy and skilled labor force is a crucial determinant of economic growth. The amount of funding available for education, healthcare, or safe neighborhoods depends critically on the level of revenues. And the affordability of housing or other goods depends in part on the level and distribution of tax burdens. Therefore, fiscal policy and children's issues are linked strongly by a set of overlapping concerns.

The link is tightened by the realization that the fate of funding for federal children's programs depends critically on the evolution of tax revenue and outlays on interest, defense, and entitlements for the elderly.

The link — between tax and fiscal policy on the one hand, and traditional children's issues on the other — is sealed by the realization that recent policies, which ostensibly had little or nothing to do with children, will have enormous consequences for youths in today's and future generations.

In essence, all of those issues — tax cuts, Medicare, and so forth — are really "children's issues" and should be debated as such. Assessments of current and future fiscal policies should include prominent assessments and public discussion of how they affect children in today's and future generations.

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Appendix Table 1 EGTRRA, JGTRRA, and Administration's FY2005 Budget Proposal Distribution of Individual Income and Estate Tax Change by Cash Income Class, 2010 <sup>1</sup>								
Cash Income Level (thousands of 2003 dollars) <sup>2</sup>	Tax Units <sup>3</sup>			Average Federal Tax Rate <sup>5</sup>				
	Number (thousands)	Percent of Total	Percent With Tax Cut	Percent Change in After-Tax Income <sup>4</sup>	Percent of Total Tax Change	Average Tax Change (\$)	Pre-EGTRRA	Proposal
<b>Among All Tax Units</b>								
<b>Less than 10</b>	20,774	13.4	5.9	0.1	0.0	-6	3.1	3.0
<b>10-20</b>	27,902	18.0	53.1	1.3	2.0	-208	6.3	5.0
<b>20-30</b>	21,378	13.8	80.0	2.3	4.2	-573	13.0	11.0
<b>30-40</b>	16,596	10.7	83.4	2.1	3.9	-684	16.6	14.8
<b>40-50</b>	12,306	7.9	89.2	2.1	3.7	-879	18.5	16.8
<b>50-75</b>	20,306	13.1	97.7	2.5	9.6	-1,377	21.3	19.3
<b>75-100</b>	12,845	8.3	99.2	3.4	11.6	-2,623	23.3	20.7
<b>100-200</b>	17,016	10.9	99.3	3.6	24.5	-4,177	25.8	23.1
<b>200-500</b>	4,600	3.0	99.3	3.3	12.5	-7,868	28.4	26.0
<b>500-1,000</b>	779	0.5	98.9	5.6	8.2	-30,484	30.2	26.3
<b>More than 1,000</b>	374	0.2	98.9	7.1	19.5	-151,748	34.0	29.3
<b>All</b>	155,433	100.0	72.8	3.4	100.0	-1,867	23.7	21.1
<b>Among All Tax Units With Children*</b>								
<b>Less than 10</b>	5,340	10.9	0.7	0.1	0.0	-7	-11.9	-12.0
<b>10-20</b>	7,696	15.6	66.0	2.1	2.4	-376	-5.1	-7.3
<b>20-30</b>	6,149	12.5	94.8	4.3	5.7	-1,128	7.7	3.7
<b>30-40</b>	4,093	8.3	97.3	4.1	4.7	-1,389	15.6	12.1
<b>40-50</b>	3,461	7.0	98.5	3.6	4.3	-1,509	18.2	15.2
<b>50-75</b>	6,783	13.8	99.6	3.3	10.5	-1,883	20.2	17.5
<b>75-100</b>	5,092	10.4	99.9	4.1	13.1	-3,137	22.7	19.5
<b>100-200</b>	7,749	15.8	99.8	3.2	23.4	-3,675	25.1	22.7
<b>200-500</b>	2,199	4.5	99.6	2.4	10.1	-5,563	28.2	26.6
<b>500-1,000</b>	343	0.7	99.4	5.2	7.7	-27,423	31.2	27.7
<b>More than 1,000</b>	152	0.3	99.3	6.8	18.0	-143,721	34.8	30.4
<b>All</b>	49,191	100.0	82.6	3.7	100.0	-2,473	23.8	21.0

*Source:* Urban-Brookings Tax Policy Center Microsimulation Model (version 0304-2).  
\* With children means with dependent children living at home.  
<sup>1</sup> Calendar year. Baseline is pre-EGTRRA law. Includes provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) affecting the following: marginal tax rates; the 10 percent bracket; the child tax credit; the child and dependent care credit; the standard deduction, 15 percent bracket, and EITC for married couples; pension and IRA provisions; and estate tax exemption, rates, and state death tax credit. Excludes education and corporate tax provisions. Includes the extension of the 15 percent tax rate on qualified dividends and capital gains (0 percent for lower-income taxpayers) and acceleration of the indexation of the 10 percent bracket proposed in the Administration's FY2005 Budget. In order to keep the number of AMT taxpayers equal to its value under pre-EGTRRA law, the use of nonrefundable credits regardless of AMT liability has been extended and the AMT exemption has been increased to \$54,000 for married couples filing jointly (\$38,250 for singles and heads of household).  
<sup>2</sup> Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see <http://www.taxpolicycenter.org/TaxModel/income.cfm>.  
<sup>3</sup> Includes both filing and nonfiling units. Tax units that are dependents of other taxpayers are excluded from the analysis.  
<sup>4</sup> After-tax income is cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax.  
<sup>5</sup> Average federal tax (individual income tax, net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax) as a percentage of average cash income.

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Appendix Table 2 EGTRRA, JGTRRA, and Administration's FY2005 Budget Number of Tax Units by Size of Tax Cut, 2010 <sup>1</sup>			
Income Tax Cut (\$)	All Tax Units <sup>2</sup>		
	Number (thousands)	Percent of Total	Average Tax Change (\$)
0	42,027	27.0	0
1-100	3,148	2.0	-50
101-500	29,551	19.0	-362
501-1,000	19,587	12.6	-728
1,001-2,000	26,140	16.1	-1,372
2,001-5,000	28,938	18.6	-3,197
5,001-10,000	4,279	2.8	-6,308
10,001-50,000	1,219	0.8	-21,874
Over 50,000	352	0.2	-235,658
All	155,433	100.0	-1,867
Income Tax Cut (\$)	Tax Units With Children <sup>3</sup>		
	Number (thousands)	Percent of Total	Average Tax Change (\$)
0	8,531	17.3	0
1-100	692	1.4	-50
101-500	2,509	5.1	-303
501-1,000	6,096	12.4	-752
1,001-2,000	13,062	26.6	-1,423
2,001-5,000	15,572	31.7	-3,213
5,001-10,000	2,043	4.2	-6,224
10,001-50,000	517	1.1	-22,769
Over 50,000	148	0.3	-156,526
All	49,191	100.0	-2,473

Source: Urban-Brookings Tax Policy Center Microsimulation Model.  
<sup>1</sup>Calendar year. Baseline is pre-EGTRRA law. The AMT exemption is raised to keep the number of AMT taxpayers equal to that of pre-EGTRRA law.  
<sup>2</sup>Both filing and nonfiling units are included. Filers who can be claimed as dependents by other filers are excluded.  
<sup>3</sup>With children means with dependent children living at home.

Appendix Table 3 Share of 2001 and 2003 Income Tax Cuts Spent on Children, 2010 <sup>1</sup>					
Family Unit	Tax Filing Units			Marginal Propensity to Spend on Kids	Percent of Tax Cut Spent on Kids
	Number (thousands)	Percent of Total	Percent of Total Income Tax Change		
No Kids	106,243	68.4	58.1	0.0	0.0
1 Parent, 1 Kid	13,738	8.8	3.2	0.41	1.3
1 Parent, 2 Kids	6,691	4.3	2.0	0.58	1.1
1 Parent, 3+ Kids	1,641	1.1	0.7	0.68	0.5
2 Parents, 1 Kid	11,226	7.2	11.7	0.26	3.1
2 Parents, 2 Kids	10,836	7.0	15.3	0.41	6.3
2 Parents, 3 Kids	3,908	2.5	7.5	0.51	3.8
2 Parents, 4 Kids	822	0.5	1.0	0.58	0.6
2 Parents, 5+ Kids	328	0.2	0.5	0.64	0.3
All	155,433	100.0	100.0	0.17	17.0

<sup>1</sup>Calendar year. Baseline is pre-EGTRRA law. The AMT exemption is raised to keep the number of AMT taxpayers equal to that of pre-EGTRRA law.

Appendix Table 4 EGTRRA, JGTRRA, and the Administration's FY2005 Budget Proposal With Cost of Financing Included <sup>1</sup> Distribution of Tax Change by Cash Income Class, 2010								
Cash Income Level (thousands of 2003 dollars) <sup>2</sup>	Units With Tax Increase			Units With Tax Cut			All Tax Units	
	Number (thousands)	Percent of Total	Average Tax Change (\$)	Number (thousands)	Percent of Total	Average Tax Change (\$)	Average Tax Change (\$)	% Change in After-Tax Income
<b>Lump Sum Financing<sup>3</sup></b>								
<b>Less than 10</b>	20,769	100.0	1,862	5	0.0	-3,069	1,861	-29.3
<b>10-20</b>	27,851	99.8	1,665	51	0.2	-1,916	1,659	-10.3
<b>20-30</b>	20,620	96.5	1,363	758	3.5	-596	1,294	-5.2
<b>30-40</b>	15,572	93.8	1,302	1,025	6.2	-632	1,183	-3.5
<b>40-50</b>	11,215	91.1	1,157	1,091	8.9	-747	988	-2.4
<b>50-75</b>	16,824	82.8	807	3,483	17.2	-1,043	490	-0.9
<b>75-100</b>	4,312	33.6	544	8,533	66.4	-1,413	-756	1.0
<b>100-200</b>	1,089	6.4	740	15,927	93.6	-2,519	-2,311	2.0
<b>200-500</b>	214	4.7	910	4,386	95.3	-6,339	-6,001	2.5
<b>500-1,000</b>	36	4.6	1,036	743	95.4	-30,049	-28,618	5.3
<b>More than 1,000</b>	8	2.2	1,573	366	97.8	-153,247	-149,881	7.0
<b>All</b>	119,049	76.6	1,381	36,385	23.4	-4,518	0	0.0
<b>Proportional Financing<sup>4</sup></b>								
<b>Less than 10</b>	20,733	99.8	167	41	0.2	-1,161	165	-2.6
<b>10-20</b>	24,828	89.0	309	3,073	11.0	-362	235	-1.5
<b>20-30</b>	15,877	74.3	425	5,502	25.7	-590	164	-0.7
<b>30-40</b>	12,734	76.7	640	3,862	23.3	-597	352	-1.1
<b>40-50</b>	9,956	80.9	733	2,350	19.1	-726	455	-1.1
<b>50-75</b>	16,694	82.2	773	3,613	17.8	-998	458	-0.8
<b>75-100</b>	7,311	56.9	832	5,534	43.1	-1,202	-44	0.1
<b>100-200</b>	11,389	66.9	1,086	5,628	33.1	-2,710	-170	0.1
<b>200-500</b>	3,818	83.0	3,833	782	17.0	-14,725	680	-0.3
<b>500-1,000</b>	298	38.2	11,010	481	61.8	-23,645	-10,403	1.9
<b>More than 1,000</b>	87	23.2	39,353	287	76.8	-100,681	-68,186	3.2
<b>All</b>	124,231	79.9	692	31,202	20.1	-2,761	0	0.0

Source: Urban-Brookings Tax Policy Center Microsimulation Model.

<sup>1</sup>Baseline is pre-EGTRRA law. The AMT exemption is increased to keep the number of AMT taxpayers equal to that of pre-EGTRRA law.

<sup>2</sup>Returns with negative cash income are excluded from the lowest income class but are included in the totals.

<sup>3</sup>Lump sum financing amounts to \$1,867 per tax unit.

<sup>4</sup>Proportional financing amounts to about 2.6 percent of cash income among those with positive cash income.

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Appendix Table 5 EGTRRA, JGTRRA, and the Administration's FY2005 Budget Proposal With Cost of Financing Included <sup>1</sup> Distribution of Tax Change by Cash Income Class Among Tax Units With Children, 2010								
Cash Income Level (thousands of 2003 dollars) <sup>2</sup>	Units With Tax Increase			Units With Tax Cut			All Tax Units	
	Number (thousands)	Percent of Total	Average Tax Change (\$)	Number (thousands)	Percent of Total	Average Tax Change (\$)	Average Tax Change (\$)	% Change in After-Tax Income
<b>Lump Sum Financing<sup>3</sup></b>								
Less than 10	5,335	99.9	1,862	5	0.1	-549	1,860	-25.2
10-20	7,646	99.3	1,503	50	0.7	-415	1,491	-8.2
20-30	5,410	88.0	903	739	12.0	-460	739	-2.8
30-40	3,150	77.0	771	943	23.0	-502	478	-1.4
40-50	2,530	73.1	692	931	26.9	-550	358	-0.8
50-75	4,386	64.7	539	2,396	35.3	-1,031	-16	0.0
75-100	1,140	22.4	433	3,952	77.6	-1,762	-1,270	1.6
100-200	325	4.2	588	7,423	95.8	-1,913	-1,808	1.6
200-500	61	2.8	850	2,138	97.2	-3,826	-3,696	1.6
500-1,000	9	2.7	1,011	334	97.3	-26,295	-25,556	4.8
More than 1,000	2	1.5	1,605	150	98.5	-143,984	-141,854	6.7
All	30,113	61.2	1,122	19,078	38.8	-3,334	-606	0.9
<b>Proportional Financing<sup>4</sup></b>								
Less than 10	5,311	99.4	171	30	0.6	-1,106	164	-2.2
10-20	4,904	63.7	313	2,792	36.3	-353	71	-0.4
20-30	1,401	22.8	367	4,748	77.2	-620	-395	1.5
30-40	1,271	31.0	353	2,823	69.0	-670	-353	1.0
40-50	1,613	46.6	401	1,848	53.4	-676	-174	0.4
50-75	4,080	60.2	546	2,703	39.8	-925	-40	0.1
75-100	1,921	37.7	750	3,171	62.3	-1,333	-547	0.7
100-200	4,834	62.4	1,199	2,915	37.6	-1,057	350	-0.3
200-500	1,940	88.2	3,891	259	11.8	-4,224	2,935	-1.2
500-1,000	106	30.8	9,435	237	69.2	-14,932	-7,424	1.4
More than 1,000	23	15.5	37,618	129	84.5	-76,970	-59,264	2.8
All	27,495	55.9	834	21,695	44.1	-1,456	-176	0.3

Source: Urban-Brookings Tax Policy Center Microsimulation Model.  
<sup>1</sup>Baseline is pre-EGTRRA law. The AMT exemption is increased to keep the number of AMT taxpayers equal to that of pre-EGTRRA law.  
<sup>2</sup>Returns with negative cash income are excluded from the lowest income class but are included in the totals.  
<sup>3</sup>Lump sum financing amounts to \$1,867 per tax unit.  
<sup>4</sup>Proportional financing amounts to about 2.6 percent of cash income among those with positive cash income.