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Economic Scene

Sometimes, a Tax Cut for the Wealthy Can Hurt the Wealthy

By ROBERT H. FRANK

WHEN market forces cause income inequality to grow, public policy in most countries tends to push in the opposite direction. In the United States, however, we enact tax cuts for the wealthy and cut public services for the needy. Cynics explain this curious inversion by saying that the wealthy have captured the political process in Washington and are exploiting it to their own advantage.

This explanation makes sense, however, only if those in power have an extremely naïve understanding of their own interests. A careful reading of the evidence suggests that even the wealthy have been made worse off, on balance, by recent tax cuts. The private benefits of these cuts have been much smaller, and their indirect costs much larger, than many recipients appear to have anticipated.

On the benefit side, tax cuts have led the wealthy to buy larger houses, in the seemingly plausible expectation that doing so would make them happier. As economists increasingly recognize, however, well-being depends less on how much people consume in absolute terms than on the social context in which consumption occurs. Compelling evidence suggests that for the wealthy in particular, when everyone's house grows larger, the primary effect is merely to redefine what qualifies as an acceptable dwelling.

So, although the recent tax cuts have enabled the wealthy to buy more and bigger things, these purchases appear to have had little impact. As the economist Richard Layard has written, "In a poor country, a man proves to his wife that he loves her by giving her a rose, but in a rich country, he must give a dozen roses."

On the cost side of the ledger, the federal budget deficits created by the recent tax cuts have had serious consequences, even for the wealthy. These deficits will exceed $300 billion for each of the next six years, according to projections by the nonpartisan Congressional Budget Office. The most widely reported consequences of the deficits have been cuts in government programs that serve the nation's poorest families. And since the wealthy are well represented in our political system, their favored programs may seem safe from the budget ax. Wealthy families have further insulated themselves by living in gated communities and sending their children to private schools. Yet such steps go only so far.

For example, deficits have led to cuts in federal financing for basic scientific research, even as the United States' share of global patents granted continues to decline. Such cuts threaten the very basis of our long-term economic prosperity. As Senator Pete Domenici, Republican of New Mexico, said: "We thought we'd keep the high-end jobs, and others would take the low-end jobs. We're now on track to a second-rate economy and a second-rate country."

Large deficits also threaten our public health. Thus, despite the increasing threat from micro-organisms like E. coli 0157, the government inspects beef processing plants at only a quarter the rate it did in the early 1980's. Poor people have died from eating contaminated beef but so have rich people.

Citing revenue shortfalls, the nation postpones maintenance of its streets and highways, even though doing so means having to spend two to five times as much on repairs in the long run. In the short run, bad roads cause thousands of accidents each year, many of them fatal. Poor people die in these accidents but so do rich people. When a pothole destroys a tire and wheel, replacements cost only $63 for a Ford Escort but $1,569 for a Porsche 911.

Deficits have also compromised the nation's security. In 2004, for example, the Bush administration reduced financing for the Energy Department's program to secure loosely guarded nuclear stockpiles in the former Soviet Union by 8 percent. Sam Nunn, the former United States senator, now heads a private foundation whose mission is to raise private donations to expedite this effort. And despite the rational fear that terrorists may try to detonate a nuclear bomb in an American city, most cargo containers continue to enter the nation's ports without inspection.

Large federal budget deficits and low household savings rates have also forced our government to borrow more than $650 billion each year, primarily from China, Japan and South Korea. These loans must be repaid in full, with interest. The resulting financial burden, plus the risks associated with increased international monetary instability, fall disproportionately on the rich.

At the president's behest, Congress has already enacted tax cuts that will result in some $2 trillion in revenue losses by 2010. According to one recent estimate, 52.5 percent of these cuts will have gone to the top 5 percent of earners by the time the enabling legislation is fully phased in. Republicans in Congress are now calling for an additional $69 billion in tax cuts aimed largely at high-income families.

With the economy already at full employment, no one pretends these cuts are needed to stimulate spending. Nor is there any evidence that further cuts would summon outpourings of additional effort and risk taking. Nor, finally, does anyone deny that further cuts would increase the already high costs associated with larger federal budget deficits.

Moralists often urge the wealthy to imagine how easily their lives could have turned out differently, to adopt a more forgiving posture toward those less prosperous. But top earners might also wish to consider evidence that their own families would have been better off, in purely practical terms, had it not been for the tax cuts of recent years.

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