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ECONOMIC VIEW

Why Wait to Repeal Tax Cuts for the Rich?

By ROBERT H. FRANK

ON the campaign trail, Barack Obama said he wanted to eliminate the Bush tax cuts for top earners upon taking office in January. Now he seems to favor letting those cuts expire as scheduled, at the end of 2010.

His apparent concern is that raising anyone's taxes immediately might worsen the economic crisis. As Mr.

Obama's senior adviser, David Axelrod, said when asked on Fox News about the delay, "The main thing right now is to get this economic recovery package on the road, to get money in the pockets of the middle class, to get these projects going, to get America working again, and that's where we're going to be focused in January."

Of course, the government's first priority must be to stimulate spending as quickly as possible, deficits be damned. But it's important to get the biggest possible stimulus for any given deficit. To that end, it would make sense for Mr. Obama to stick with his original timetable. Eliminating the Bush tax cuts right away would make it possible to generate a much larger immediate increase in total spending.

Higher tax rates for top earners wouldn't appreciably reduce their spending. A robust finding in behavioral research is that people are extremely reluctant to accept cutbacks in their standard of living.

With few exceptions, high-income taxpayers earn substantially more during their lifetimes than they spend, generally bequeathing the surplus to heirs or charities. If these taxpayers faced slightly higher rates, they would have ample resources to maintain their current lifestyles, so most would keep spending as before. The only consequence would be that, years from now, they would leave smaller bequests.

The added revenue from eliminating the Bush tax cuts would pay for larger temporary tax cuts for low- and middle-income families than the permanent ones now planned. And because these families spend most or all of their post-tax income, the immediate effect would be an increase in total spending roughly equal to the additional revenue from repealing the cuts.

As an option, the extra revenue could be used to raise unemployment insurance benefits and extend them more broadly. Or it could increase eligibility for food stamps. These steps, too, would have the immediate effect of bolstering total spending by almost the full amount of the additional revenue.

Still another option would be to use the added revenue to increase grants for road maintenance in cities and states. Here again, 100 percent of the distributions would be spent immediately.

But the additional stimulus would not stop there. When someone spends an extra dollar this way, others receive an extra dollar of income, some portion of which they spend, creating still more income for others.

Appearing before the Senate Budget Committee last month, Mark Zandi, chief economist at Moody’s Economy.com, testified that because of this multiplier effect, each dollar of new federal spending would generate roughly $1.50 of additional demand.

In short, we'd get a lot more stimulus for any given budget deficit if we scrapped the Bush tax cuts immediately and steered the resulting revenue to people who would spend it.

Those who oppose repealing the cuts will offer the same argument they used to promote them during Mr. Bush's first term — an argument echoed during the presidential campaign by Senator John McCain, when he invoked Joe the Plumber.

In a nutshell, the claim is that low tax rates for top earners prompt small businesses to create jobs. Although this idea went largely unchallenged during the presidential campaign, it flies in the face of everything we know about the economic logic of hiring decisions.

It rests implicitly on the premise that business owners will hire new workers whenever they can afford to do so. What matters, however, is not whether owners can afford to hire, but whether hiring will increase their profit.

If the goods produced by additional workers can be sold for at least enough to cover their salaries, hiring makes economic sense, no matter how poor a business owner might be. But if additional workers won't produce enough to cover their salaries, hiring is a losing move, even for the richest owners. The after-tax personal incomes of business owners are irrelevant in hiring decisions.

Yet wouldn't tax cuts encourage additional hiring by owners who need cash to cover recruiting and training costs before the new workers start generating extra revenue? In normal circumstances, owners short of cash would borrow to cover those costs if they expected additional workers to be productive enough to cover not just their salaries but also the loan repayment. But in the current crisis, bank loans may not be readily available, so tax cuts could help. It would make far more sense, however, to offer hiring loans — as Mr. Obama proposed during the campaign.

IN any event, the most important barrier to current hiring is not an absence of credit but the fact that not enough people want to buy what companies are selling. To eliminate this demand deficit as quickly as possible, the Bush tax cuts on top earners should be repealed right away, freeing money for more effective use.

Although the first concern of the new administration must be to get the economy back on its feet, economic justice was a central theme of Mr. Obama's campaign. In the wake of the 9/11 attacks, and with the nation embroiled in two wars, Americans were poised to respond to a call for national sacrifice. Instead, President Bush and Congress enacted huge tax cuts for the wealthiest families.

The Bush tax cuts widened income inequality and drove deficits to record levels. Referring to those cuts, Mr. Obama said that “people didn’t need them, and they weren’t even asking for them.”

Economic fairness and economic growth are sometimes conflicting goals. But not here. Repealing the Bush tax cuts immediately is not just the fairest policy option but is also the most efficient.

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