



Policy Note

2007 / 1

THE APRIL AMT SHOCK: TAX REFORM ADVICE FOR THE NEW MAJORITY

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Anyone who reads a newspaper knows that most Americans have accumulated excessive levels of debt, and realizes that as interest rates climb, it becomes more difficult to service financial liabilities. To add insult to injury, wage growth has been slow, while prices—especially for energy—have risen sharply. What is not clear, however, is the fact that taxes have also been rising rapidly, relative to both income and government spending. In this Policy Note, we concentrate on the last issue, and argue that many middle-income earners will find themselves unprepared for the coming surprise in April.

Many of our colleagues, at the Levy Institute and elsewhere, have recognized the danger signaled by changes in household debt-to-income ratios. These have been rising on trend for decades, but their rate of climb accelerated sharply in the mid-1990s as the private sector began to run persistent deficits, with only a temporary respite during the recession of the early 2000s (Godley 1999, 2003). When the Federal Reserve (Fed) began to raise interest rates two years ago, debt service ratios once again started to climb, forcing households to devote more of their disposable income to satisfying debt and interest payments. Several recent Levy Institute publications have examined this issue (Papadimitriou, Chilcote, Zezza 2006; Papadimitriou, Zezza, Hannsgen 2006). Problems have

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The Levy Economics Institute is publishing this research with the conviction that it is a constructive and positive contribution to the discussion on relevant policy issues. Neither the Institute's Board of Governors nor its advisers necessarily endorse any proposal made by the authors.

been compounded during the past year, as rising energy prices absorbed an ever-growing share of household income. Higher energy prices, in turn, have fueled inflation as measured by the consumer price index (CPI). Furthermore, sluggish labor markets—which have added relatively few jobs even during the expansion of recent years—have generated slow growth of wages. As a result, increases in prices paid by consumers are outstripping meager wage gains. In response, consumers appear to have cut back spending and borrowing in recent months, as evidenced by dismal reports from the domestic automobile industry and the real estate sector.

What has received far less attention, however, is the squeeze placed on U.S. middle-income households by rapidly rising tax burdens. Indeed, many commentators have welcomed the “good” news that federal budget deficits appear to be on a falling trend, with government revenues growing much faster than spending. The new Democratic majority in Congress is promising comprehensive “tax reform” while calling for a return to “pay-as-you-go” budgeting. This requires that any tax reforms that reduce revenue would have to be offset by either “revenue enhancements” (increases in other taxes) or spending cuts, or both. We will argue that this would be a huge mistake, because debt-ridden consumers need tax relief. In this, we agree with Congressman Charles Rangel (the current chair of Ways and Means) in calling for substantial reform of the Alternative Minimum Tax (AMT). We disagree, however, with any attempt to replace revenue lost through such reform, because the overall tax burden is already excessive—and growing.

Comptroller General David M. Walker has been campaigning across the country on his “Fiscal Wake-Up Tour,” warning of a looming economic disaster based on projections of continuing budget deficits (Crenson 2006). This is part of a well-orchestrated attempt to convince Americans that their social safety net cannot be retained unless taxes are raised (or other government spending is cut) by prohibitive amounts. We have examined elsewhere the flaws in these long-term projections of shortfalls amounting to trillions of dollars (Papadimitriou and Wray 1999; Wray 2005). In this Policy Note, we will focus on the medium-term projections of the fiscal stance over the next decade. We will argue that, contrary to the position promoted by some policymakers, fiscal policy is, and will remain, excessively restrictive. Indeed, on the basis of current law, tax revenues will continue to grow much faster than income, generating a fiscal squeeze that will choke off expansions long before full employment is reached. For this rea-

son, we urge the new majority in Congress to retain at least some of President George W. Bush’s tax cuts while reforming the AMT to reduce the growing tax burden on middle-class families.

The Macroeconomic Setting

The housing industry played a major role in fueling the recovery after the last recession. It has been estimated that while the housing sector added 1.1 million jobs between 2001 and 2005, the rest of the economy actually shed 1.2 million jobs; housing investment grew at a 9 percent pace from 2002 through 2005 (Bajaj and Leonhardt 2006). However, in the last few months, the bottom appears to have dropped out of the market after a two-year campaign by the Fed during which it raised interest rates 17 times. Almost all of the recent housing market data are poor, with rising inventories of unsold homes and stagnating prices. According to Census Bureau data, housing cost burdens rose sharply across the country from 2000 to 2005, due to higher interest rates as well as cash-out financing and inflated purchase prices (Scott and Archibold 2006). The financial obligation ratio climbed steadily, from about 18 percent at year-end 2004 to above 18.7 percent at year-end 2005—almost as high as it had been at the close of 2001, when consumers cut spending going into recession (Valance 2006). Higher interest rates affect more than the housing market: nonmortgage interest payments have also grown quickly, up more than 25 percent since June 2004, to a total of \$231.4 billion as of June 2006 (Peters 2006).

To make matters worse, rising inflation combined with slow wage growth has eroded the real purchasing power of American wage incomes. Inflation was up 2.4 percent from June 2005 to June 2006 (Peters 2006; Uchitelle 2006). While job growth has been sluggish over the entire period since the last recession (at least, in comparison with job growth during the Clinton expansion), it slowed considerably in 2006. Preliminary numbers indicate that job growth declined, from 230,000 new jobs in August to only 79,000 in October, rising slightly to 132,000 in November (Uchitelle 2006). The real hourly pay of the median worker has actually fallen by 2 percent since 2003 (Bajaj and Leonhardt 2006). There have been only three extended periods since World War II during which pay hikes have been lower than the rate of inflation: the 1970s, the late 1980s, and the current period. The previous two episodes saw significant deterioration of consumer sentiments, and the current period is no exception. According to a poll by the University of Michigan, 57 percent of

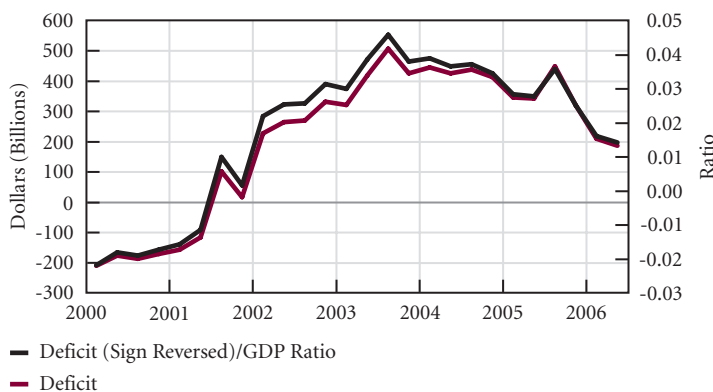
Americans say they expect to see widespread unemployment within the next five years (Uchitelle 2006).

Fiscal Drag

In addition to the pressures on households due to rising mortgage interest rates, stagnating home prices, and falling real wages, tax liabilities are rising quickly—at a pace far above growth of personal income or government spending. Of course, many welcome the “improvement” to the federal budget, as the deficit declines on trend. Figure 1 shows the budget deficit in both nominal terms and as a ratio of GDP. The flip side to deficit reduction, however, is deterioration of private sector finances, since the federal budget has “improved” only because the government is taking more out of the economy (taxes) relative to the amount it is putting in (expenditures). Numerous Strategic Analyses using the Levy Institute’s stock-flow macroeconomic model of the three sector balances—private, current account, and government—have warned of the continuing imbalance of these sectors. Suffice it to note that given the current U.S. trade deficit (around 6 percent of GDP), as the federal budget falls to about 2 percent of GDP, the private sector must run a deficit of about 4 percent of GDP. American households have been tapped out financially, and eventually the strain will become too great for them to continue spending far more than they earn. The rising tax burden that is reducing the federal budget deficit is adding to the squeeze.

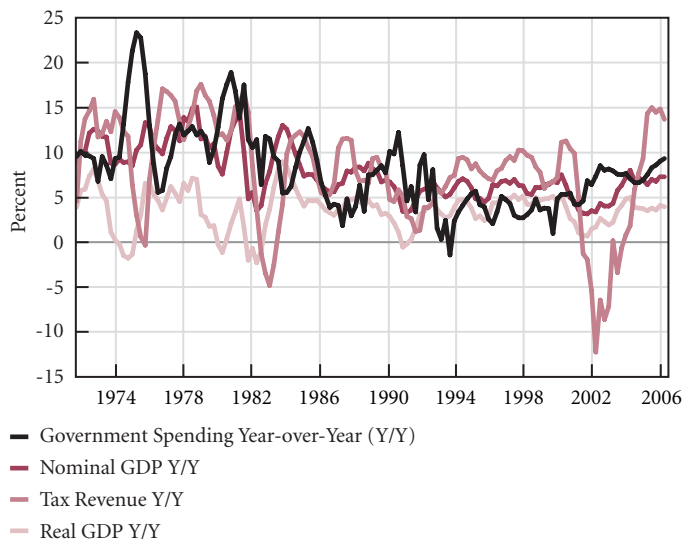
Figure 2 plots GDP growth rates (nominal and inflation-adjusted) along with the rate of growth of federal government spending and revenues, and illustrates the rising tax burden. Focusing on the growth of tax revenue over the last decade, it is obvious that there have been some fairly dramatic reversals. In the late 1990s, tax revenue was growing by as much as 10 percent per year, far more quickly than government spending (around 3 percent per year) or real GDP (about 4 percent per year). The “favorable” fiscal situation led, of course, to the Clinton budget surpluses of 1997–2000. For reasons we will explain below, economic expansions usually do lead to growth of tax revenue at a pace above the growth rate of GDP. At the same time, this phenomenon sets up a fiscal drag, especially if the growth of tax revenue exceeds by a large margin the growth of government spending. We warned at the time that the fiscal situation reached by 1998 would pull the economy into recession (Papadimitriou and Wray 2001). By June 2001, real GDP growth collapsed to zero, and tax revenue began an unprecedented four-year fall—by

Figure 1 Federal Budget Deficit and Deficit/GDP Ratio



Source: Bureau of Economic Analysis

Figure 2 GDP Growth vs. Government Revenue and Spending Growth



Source: Cesar Guerra, Valance Co., Inc.

March 2002, revenues were falling at an annual rate of 15 percent—partly due to tax relief but also in large measure a result of the recession. Only near the end of 2003 did tax revenues begin to rise, and the growth rate of revenues continued to climb through 2005. Revenues are now increasing at a rate of almost 15 percent on a year-over-year basis, far outstripping growth of government spending (growing half as fast), nominal GDP growth (less than 7 percent), and real GDP growth (just over 3 percent).

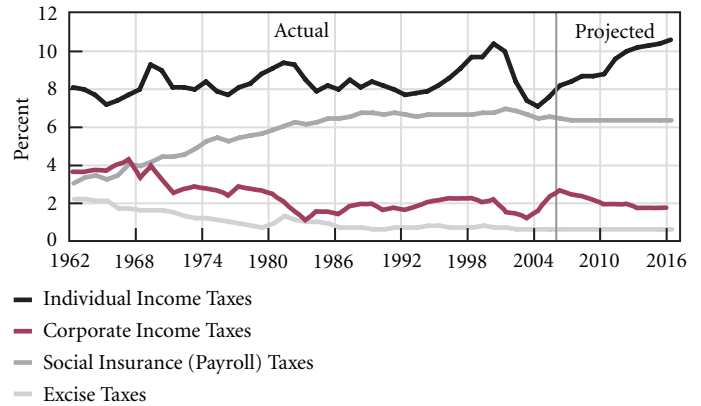
The current situation, with tax revenues growing five times faster than real GDP, is historically unusual, reminiscent of the period before the Reagan-era recession. However, the late 1970s and early 1980s was a period of high inflation, which drove tax revenue growth through “bracket creep.” The mounting real tax burden was somewhat moderated by the rapid growth of nominal income. Comparing tax revenue growth with the rate of growth of nominal GDP, one finds that the current period is even more unusual: there is no other extended period since the 1970s in which taxes have risen twice as fast as nominal GDP. Thus, the real tax burden is rising at a faster pace today precisely because nominal incomes are not growing very quickly. Finally, many of the previous periods that saw tax revenues increasing at more than 10 percent per year were followed closely by recession: 1972–74 (average = 12 percent); 1977–81 (average = 15 percent); 1999–2000 (average = 10 percent). The exceptions (1984–85, 1996–98) were during earlier stages of economic expansions, with average growth rates of tax revenues a bit lower than 10 percent.

Medium-Term Budget Projections

In its January 2006 Budget Outlook, the Congressional Budget Office noted that individual income tax receipts had increased by 14.6 percent over the previous year, and projected that tax revenues would again outstrip economic growth in 2006, with individual income tax receipts growing by 8.2 percent. Indeed, the CBO estimated that total federal tax revenues would continue to grow faster than the economy as a whole, rising from 17.5 percent of GDP in 2005 to 19.8 percent in 2016 (Table 1). All of this growth would be attributed to individual income tax receipts, which would climb from 7.5 percent of GDP in 2005 to 10.5 percent in 2016. The percent of GDP absorbed by taxes in 2016 would reach a level achieved only five times since WWII.

Figure 3 shows actual and projected revenues by source, as a share of GDP, from 1962 to 2016. About half of the dramatic projected rise in individual income taxes is driven by scheduled changes in existing tax laws. The most important of these includes higher statutory rates on capital gains and dividends beginning in 2009, a reduced AMT exemption (postponed until 2007), and the expiration of many other tax relief provisions in 2011. The balance of the projected rise is due to growth of distributions from tax-deferred plans and IRAs, “real bracket creep,” and rising numbers of taxpayers falling under provisions of the AMT. We will explore these issues in further detail in the next section.

Figure 3 Revenues by Source as a Share of GDP, 1962–2016



Source: Congressional Budget Office

The AMT and the Coming April Surprise

Detailed data on tax revenues are available from the CBO’s Monthly Budget Review. As reported on July 7, 2006, total tax revenues for the first three quarters of fiscal year 2006 came in at 13 percent, or \$206 billion, above revenues for the same period the previous year; by contrast, outlays were up only 8.6 percent, or \$165 billion, so the deficit shrank by \$41 billion. (The total federal budget deficit was \$248 billion in FY 2006, down \$71 billion from FY 2005; as a share of GDP, the deficit was 1.9 percent, down from 2.6 percent, per the CBO’s review of November 6, 2006.) This was the second-highest rate of revenue growth over the first nine months of any year for the past 25 years—exceeded only by 2005’s growth rate. Corporate income taxes were up 26 percent (\$52 billion). Individual income and payroll taxes withheld from paychecks were up by 8 percent (\$88 billion) when compared with those from the same nine-month period in 2005. However, nonwithheld individual income and payroll taxes were up 20 percent (\$59 billion). These nonwithheld taxes include quarterly payments as well as final payments for the year, and result from taxes owed on nonwage personal income, from changes in tax laws, and from the AMT. During 2005, individual income and payroll tax receipts increased by 14.6 percent; yet, while withheld taxes rose by just 4.4 percent, nonwithheld taxes rose by 32 percent. The significant jump in nonwithheld taxes was caused primarily by increased tax liabilities resulting from capital gains, as well as the temporary tax relief provided in 2004 by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (which led to an unexpected tax increase in 2005).

Table 1 Current and Projected Federal Tax Revenue as Percent of GDP, 2005–16

	Actual	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total 2007–11	Total 2007–16
Revenues															
Individual income taxes	7.5	8.1	8.3	8.6	8.6	8.7	8.7	9.5	9.9	10.1	10.2	10.3	10.5	8.8	9.6
Corporate income taxes	2.3	2.6	2.4	2.3	2.3	2.1	1.9	1.9	1.9	1.7	1.7	1.7	1.7	2.1	1.9
Social insurance taxes	6.5	6.4	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.3
Other	1.3	1.3	1.2	1.2	1.2	1.1	1.1	1.1	1.3	1.3	1.3	1.3	1.3	1.2	1.2
Total*	17.5	18.3	18.2	18.4	18.4	18.2	18.1	18.9	19.4	19.4	19.5	19.7	19.8	18.4	19.0
Outlays															
Mandatory spending	10.7	10.8	10.8	10.8	10.8	10.9	11.0	11.2	11.0	11.3	11.5	11.8	12.2	11.0	11.3
Discretionary spending	7.9	7.8	7.7	7.6	7.6	7.5	7.3	7.1	6.9	6.8	6.6	6.5	6.4	7.4	7.0
Net interest	1.5	1.7	1.8	1.9	1.9	1.9	1.8	1.8	1.8	1.7	1.7	1.6	1.6	1.8	1.8
Total*	20.1	20.3	20.3	20.3	20.3	20.2	20.1	20.2	19.7	19.9	19.9	19.9	20.2	20.2	20.1
Deficit (-) or surplus	-2.6	-2.0	-2.1	-1.9	-1.9	-2.0	-2.0	-1.4	-0.3	-0.4	-0.3	-0.3	-0.4	-1.9	-1.0

*Figures may not sum to total due to rounding.

Source: Congressional Budget Office

During an expansion, revenues from individual income taxes normally can be expected to rise faster than personal income by approximately 1 percentage point per year due to what is known as real bracket creep. This occurs as real economic growth raises real income and pushes taxpayers into higher tax brackets. However, the gap between growth of tax receipts and personal income growth has been running far above that, and is expected to remain between 2 and 4 percentage points for 2007. According to the CBO, this is an effect of “strong increases of nonwage income, along with added liabilities from the alternative minimum tax” (CBO 2006a, p. 85). The nonwage income that generates rising tax liabilities includes profits of S corporations, IRA distributions, and realized capital gains. However, of potentially greater importance in coming years is the revenue growth generated by the AMT.

Higher-income taxpayers are required to calculate taxes under both the AMT and regular income tax schedules. The AMT uses a different definition of income, has a higher tax rate, and excludes some exemptions allowed by the regular income tax method. The most important difference is that the AMT disallows credits for dependents, medical expenses, and state and local taxes, thus hitting married couples with children and those who live in high-tax states the hardest. Indeed, it is sometimes called the “blue state tax” because taxpayers on the East and West Coasts are more likely to lose their state and local tax credits due to the AMT—resulting in an average extra tax liability of \$6,813 (Montgomery 2006). Ironically, the impact of the AMT is greatest on those with incomes of \$100,000 to \$500,000, since most upper-income taxpayers already pay a higher rate through the regular income tax. The AMT also exacts a big penalty from larger families: in 2007, only 11 percent of taxpayers with no children will be subject to the AMT, while 40 percent of those with three or more children will fall under its provisions (Leiserson and Rohaly 2006). Furthermore, the “marriage penalty” is high. In 2006, those filing joint returns were five times more likely to pay the AMT than were single filers; by 2017, half of all joint filers will pay the AMT, while only 5 percent of those filing single returns will be subject to its steeper rates.

Originally enacted to prevent high-income taxpayers from taking full advantage of various tax preferences, the AMT is not indexed to inflation. In 1970, only 20,000 taxpayers were subject to the AMT. This figure rose to 4 million in 2005, and, unless Congress acts, it will reach 23.4 million in 2007 and 32.4 million in 2010 (Table 2). If Congress extends the Bush tax cuts that are

scheduled to expire beginning in 2008, reducing the regular tax bill below the AMT, the number will grow significantly larger, to nearly half of *all* taxpayers by 2017. Thus, each year greater numbers of middle-income earners fall under the AMT’s provisions, which, by limiting exemptions, deductions, and credits, result in higher tax liabilities. By 2010, half of all taxpayers with incomes between \$75,000 and \$100,000 will be required to pay the AMT. If the Bush tax cuts were extended, by 2017, 90 percent of filers with incomes between \$100,000 and \$500,000 would pay the AMT, and 64.3 percent of adjusted gross income (AGI) would be reported on their returns; if the tax cuts were allowed to “sunset,” 44.4 percent of AGI would be reported on their returns.

As the CBO (2006a) has noted, most taxpayers do not anticipate falling under the provisions of the AMT, recognizing the additional tax liability only when they file their returns. Thus, the majority of AMT taxes are not paid until the following year—with interest and penalties. The “April surprise” is compounded because of peculiarities associated with recent legislated tax changes—the Orwellian-named Economic Growth and Tax Relief Reconciliation Act of 2001, the Jobs and Growth Tax Relief Reconciliation Act of 2003, and the Working Families Tax Relief Act of 2004—which phase in and out various provisions that affect the AMT. For example, the 2004 law reduced the AMT bite for 2005, and was extended for 2006; without that extension, twice as many taxpayers—eight million—would have been required to pay the AMT in 2006 (Leiserson and Rohaly 2006). Unless the House and Senate agree on another extension, 18 million more households will be newly subjected to the AMT in 2007. Ironically, tax relief has pushed more families into the AMT camp, as lower regular tax rates mean that more taxpayers find the AMT tax liability higher. Under current law, many of the tax relief provisions passed during the first administration of George W. Bush will expire in 2011—allowing taxpayers to pay the (higher) regular income taxes rather than the AMT, so that AMT receipts could fall sharply, from \$97 billion in 2010 to \$43 billion in 2012 (CBO 2006b). However, by 2012, the number of taxpayers subject to the AMT will start to rise again because the AMT is not inflation-indexed, generating a sort of bracket creep as more middle-income earners find themselves above the AMT threshold. Due to the complexities associated with these tax provisions, not to mention the unpredictability of congressional maneuvers, the number of households hit with April surprises could be quite high over coming years.

Table 2 AMT Projected Revenue Growth, 2006–17

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total* 2006–17
Number of AMT taxpayers¹ (millions)													
Current law	3.5	23.4	26.5	29.3	32.4	18.5	20.9	24.0	27.2	31.0	35.1	39.1	
Current law extended ²	3.5	23.4	26.5	29.3	32.4	35.1	38.1	41.1	43.6	46.7	49.6	52.6	
Percent of taxpayers affected by AMT³													
Current law	4.0	25.9	28.8	31.1	33.6	17.8	19.8	22.5	25.1	28.2	31.6	34.7	
Current law extended	4.0	25.9	28.8	31.1	33.6	35.6	38.0	40.4	42.2	44.5	46.7	48.6	
AMT revenue⁴ (billions of \$)													
Current law	23.9	69.8	86.3	97.6	117.4	49.4	57.2	65.9	75.2	86.7	100.0	114.8	944.1
Current law extended	23.9	69.8	86.3	97.6	117.4	132.4	150.2	169.7	189.7	212.6	238.0	265.2	1,752.9
AMT revenue as a percentage of income tax revenue													
Current law	2.6	6.8	7.8	8.4	9.4	3.2	3.5	3.8	4.1	4.4	4.8	5.2	4.8
Current law extended	2.6	6.8	7.8	8.4	9.4	9.9	10.5	11.1	11.6	12.2	12.8	13.4	8.9
Percent of AGI on AMT returns													
Current law	15.2	43.2	47.0	49.0	52.3	26.9	29.3	32.3	35.1	38.2	41.4	44.4	
Current law extended	15.2	43.2	47.0	49.0	52.3	54.3	56.3	58.3	59.7	61.4	62.9	64.3	

*Figures may not sum to total due to rounding.

1. AMT taxpayers are defined as those with an AMT liability from Form 6251, with lost credits, or with reduced deductions.

2. Includes all 2010 sunset provisions in current law.

3. Taxpayers are defined as those filing returns with positive income tax liability net of refundable credits.

4. “Revenue” is actually calendar-year tax liability. Some of that liability would be paid in a subsequent year.

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1)

The AMT and Tax Reform

As a source of revenue for the federal government, the AMT is already important and will become increasingly so. Total AMT revenue amounted to \$24 billion in 2005. In 2007, 26 percent of taxpayers will be subject to the AMT, generating about \$70 billion in revenues. To put this in perspective, total revenue generated by estate and gift taxes in recent years has been \$25 billion annually; excise taxes have run about \$55 billion. Hence, elimination of the AMT would be nearly equivalent to dropping all estate, gift, and excise taxes for the current year. In 2010, AMT revenues will reach \$117 billion. As Table 2 shows, dropping the AMT would reduce federal government revenues by \$944 billion over the next decade if the Bush tax cuts were allowed to expire, or by \$1.75 trillion if the tax cuts were extended. For comparison, if all tax provisions that are due to expire before 2016 were extended—excluding those having to do with the AMT—the resulting reduction in projected revenue would total about \$2.1 trillion over the next decade (calculated from Table 4-10, CBO 2006a).¹ Indeed, elimination of the AMT would “cost” almost twice as much as the extension of the sum of tax breaks accorded estates and gifts, dividends, and capital gains. These, of course, are some of the provisions of the Bush tax cuts that are most likely to be considered for “sunsetting” by Democrats on the grounds that most of the benefits go to high-income earners.

Thus, even if Democrats were to allow the most controversial parts of the tax cuts to expire and instead adopt a “pay-go” rule, they would still have to come up with nearly \$500 billion in spending cuts or tax increases over the next decade to offset revenue lost through elimination of the AMT. Among the few remaining expiring provisions that are large enough to make a real difference are the expanded 10 percent bracket (\$262 billion of tax relief to low-income filers over the next decade) and the lower tax brackets (tax rates of 25, 28, 33, and 35 percent, elimination of which would generate \$385 billion more in revenue). It would appear to be quite unlikely that Democrats will allow these provisions to expire, raising tax rates across the board. The plethora of other provisions no doubt contains some items that can be dropped; however, most are so small that virtually all of them would have to be eliminated to offset revenue losses resulting from repeal of the AMT.

Hence, a better course of action is to reform the AMT without considering “offsets.” Because the AMT no longer targets “rich” taxpayers, it should be repealed. If Congress wants to increase the progressivity of the personal income tax, it can place limits on cer-

tain exemptions and tax credits above an AGI threshold that is indexed to inflation. Not only does current law require ever-rising numbers of middle-income taxpayers to fall under the AMT, but it also has numerous unfair features: it is complex, so that most taxpayers do not recognize additional liabilities until they file; and it targets married couples, homeowners who live in high-tax states, large families, those with high medical expenses, workers with unreimbursed employee expenses, families with child-care credits, plaintiffs who win lawsuits (who are not allowed to deduct lawyers’ fees), providers of Indian employment and of low-cost housing (tax credits are disallowed for a wide range of such “social purpose” activity), and so on. Elimination of the AMT would reduce income tax revenue by 9.4 percent in 2010—roughly 4 percent of projected federal revenue and 0.7 percent of projected GDP. Based on current law, individual income taxes will rise from 7.5 percent of GDP in 2005 to 8.6 percent in 2010; if the AMT were repealed, individual income taxes would rise to 7.9 percent of GDP. If the Bush tax cuts were extended through 2017, the total bite of the AMT would rise to \$265 billion; hence, repeal of the AMT would lower individual income taxes by more than 12 percent, or about 1.2 percent of GDP. Since total tax revenues are estimated to grow by about 2.2 percentage points over the next decade, elimination of the AMT would wipe out almost half of that increase. Extending all of the Bush tax cuts except for those concerned with tax breaks for estates and gifts, capital gains, and dividends would amount to a similar figure.² Thus, much of the scheduled rise in income taxes relative to GDP would be eliminated if Congress were to repeal the AMT and extend most of the tax relief provisions.

Conclusion

While the cause-and-effect is complex, with relatively robust growth driving tax receipts, we have examined some of the reasons that taxes rise so much faster than income. At some point, this will have an impact on consumer spending, as households and perhaps firms find themselves squeezed. As spending and income decline, tax revenue growth will begin to fall; however, based on the results shown in Figure 1, this appears to occur with a lag. As indicated by the rapid growth in receipts of quarterly payments made against nonwithheld income and payroll tax liabilities, many taxpayers are already aware that personal income taxes are outstripping income gains. Many others will not find out until they do their returns in April that the amount

of taxes being withheld is too low. Even if growth of spending and income were to begin to fall soon, the growth of tax liabilities could remain high for many months, adding to deflationary pressures. Given this restrictive fiscal stance, it is likely that the current expansion will soon come to an end.

Moreover, we are also concerned about the medium-term consequences of the structure of the tax code. Current tax law will generate revenue growth faster than GDP growth whenever the economy is expanding. This is due in part to scheduled sunseting of tax relief legislation passed in recent years, but also to provisions of the AMT. We would urge Congress to move quickly to reform or eliminate altogether the AMT, and to consider extending many of the tax relief provisions. Given the existing bias of current tax law toward rapid growth of revenues, there is ample room for reform without reducing individual income tax rates below their current levels—which are already arguably too high.

Notes

1. The majority of these provisions were enacted by the Economic Growth and Tax Relief Reconciliation Act and modified by the Jobs and Growth Tax Relief Reconciliation Act and the Working Families Tax Relief.
2. The “cost” of eliminating the AMT falls when tax provisions are not allowed to expire. Hence, if Congress were to approve extensions for all of the provisions scheduled to expire before 2016, the tax revenue reduction due to elimination of the AMT would fall. We have not attempted to calculate this complex interaction.

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