



THE MIDDLE-CLASS TAX CUTS' IMPACT ON CONSUMER SPENDING & RETAILERS

The National Economic Council
&
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The Middle-Class Tax Cuts' Impact on Consumer Spending and Retailers



PRESIDENT BARACK OBAMA PAYS FOR HIS LUNCH ORDER AT REID'S HOUSE RESTAURANT IN REIDSVILLE, N.C., OCT. 18, 2011.
(OFFICIAL WHITE HOUSE PHOTO BY PETE SOUZA)

"We should not hold the middle-class hostage while we debate tax cuts for the wealthy. We should at least do what we agree on, and that's to keep middle-class taxes low. And I'll bring everyone in to sign it right away so we can give folks some certainty before the holiday season."

- President Obama, November 14, 2012

Introduction

President Obama is committed to growing our economy from the middle out by ensuring a strong, secure, and thriving middle-class. That's why his top priority is promoting jobs and growth while reducing our deficit in a balanced and responsible way.

Since taking office, President Obama has repeatedly cut taxes for middle-class families to make it easier for them to make ends meet. A typical family making \$50,000 a year has received tax cuts totaling \$3,600 over the past four years – more if it was putting a child through college.

Now we face a deadline that requires action on jobs, taxes and deficits by the end of the year. If Congress fails to act, every American family's taxes will automatically go up - including the 98 percent of Americans who make less than \$250,000 a year and the 97 percent of small

businesses that earn less than \$250,000 a year. A typical middle-class family of four would see its taxes rise by \$2,200.

While the President is committed to working with Congress to reach compromises on areas of disagreement, there is no reason to delay acting where everyone agrees: extending tax cuts for the middle-class. There is no reason to hold the middle-class hostage while we debate tax cuts for the highest income earners.

Our economy can't afford that right now. New analysis by the President's Council of Economic Advisers (CEA) finds that:

- **Allowing the middle-class tax rates to rise and failing to patch the Alternative Minimum Tax (AMT) could cut the growth of real consumer spending by 1.7 percentage points in 2013.** This sharp rise in middle-class taxes and the resulting decline in consumption could slow the growth of real GDP by 1.4 percentage points, which is consistent with recently published estimates from the Congressional Budget Office.¹
- **Faced with these tax hikes, the CEA estimates that consumers could spend nearly \$200 billion less than they otherwise would have in 2013 just because of higher taxes.** This reduction of \$200 billion is approximately four times the total amount that 226 million shoppers spent on Black Friday weekend last year. As Figure 5 shows, this \$200 billion reduction would likely be spread across all areas of consumer spending.

American consumers are the bedrock of our economy, driving more than two-thirds of the overall rise in real GDP over 13 consecutive quarters of economic recovery since the middle of 2009. And as we approach the holiday season, which accounts for close to one-fifth of industry sales, retailers can't afford the threat of tax increases on middle-class families.

President Obama and Congressional Democrats have proposed to extend all the income tax cuts that benefit families who make less than \$250,000 per year.

The President has called on Congress to act now on extending all income tax cuts for 98 percent of American families and not to hold the middle-class and our economy hostage over a disagreement on tax cuts for households with incomes over \$250,000 per year. The Senate has passed this bill and the President is ready to sign it.

¹ See Congressional Budget Office. "Economic Effects of Policies Contributing to Fiscal Tightening in 2013." November 8, 2012. <<http://www.cbo.gov/publication/43694>>.

I. Middle-Class Consumers Drive the American Economy

THE MIDDLE-CLASS IS THE BACKBONE OF THE AMERICAN ECONOMY

- Consumer spending makes up roughly 70 percent of the American economy, as measured by Gross Domestic Product.
- Consumer sentiment is at its highest level since September 2007, after plummeting in the summer of 2011.
- The National Retail Federation is forecasting that holiday sales will grow 4 percent this year to \$600 billion. Last year, consumers spent around \$50 billion on Black Friday Weekend alone.
- The retail industry employs 15 million Americans, and has been responsible for 9 percent of total employment growth in the 40 months since the recession ended in June 2009.

After suffering the worst recession since the Great Depression, our economy has grown for 13 consecutive quarters. Although consumer spending has been restrained somewhat by the persistent effects of the financial crisis and the excessive amount of debt that households built up before the recession, consumers are still a key contributor to our current economic recovery.

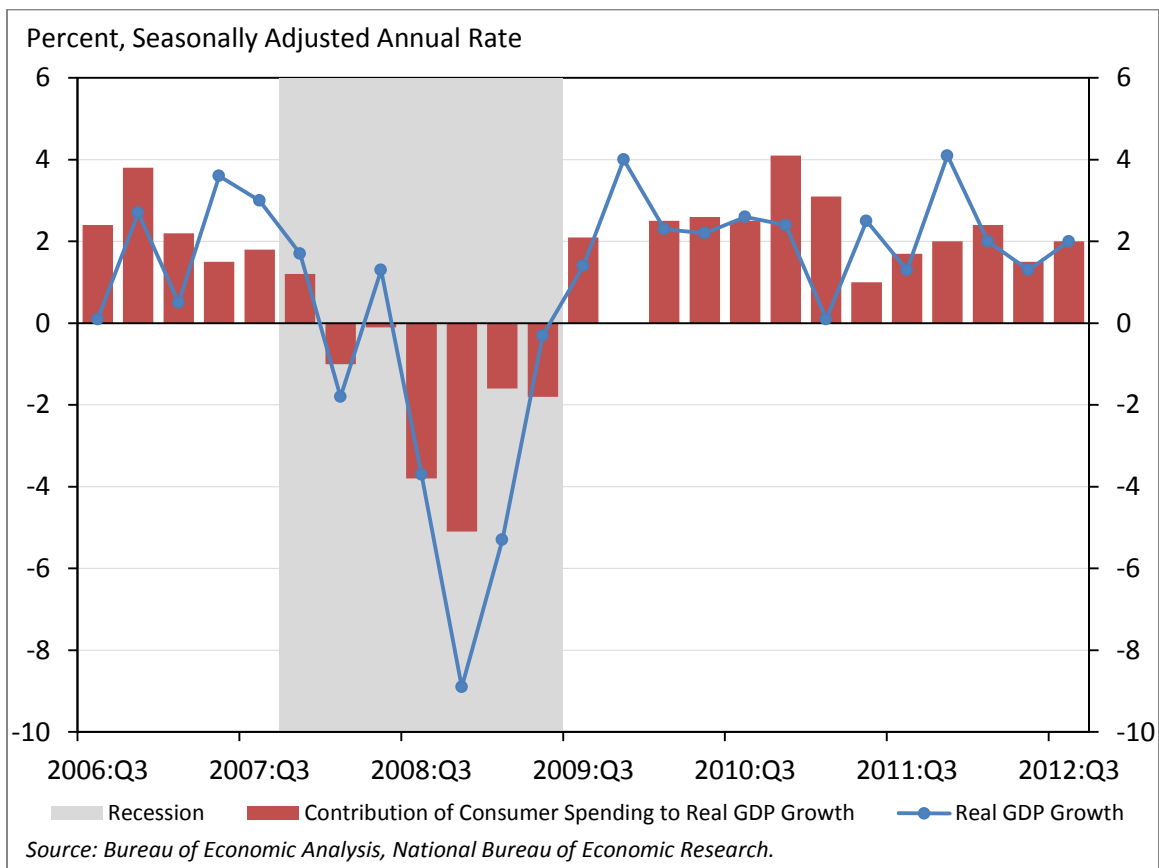
Consumer spending is the largest single component of our economy, accounting for roughly 70 percent of Gross Domestic Product (GDP). There is no question that capital investment, exports, and government spending on such activities as research and development and education drives our long-term competitiveness, supports our seniors, and protects our safety net. But the bulk of economic activity comes from American families buying basic necessities like clothing and healthcare; durable goods like cars and furniture; and the food and gifts that millions will enjoy over the holiday season.

Over the course of this year, American consumers are on pace to spend around \$5 trillion on retail sales. In the 13 quarters since the end of the recession in June 2009, consumer spending has accounted for 69 percent of the overall rise in GDP, after adjusting for inflation. (See Figure 1.)

When American families spend more on things like clothes, cars, furniture, and food, for example, this spending generates greater profit for businesses and increased demand that causes businesses to invest and hire more workers. This means that retailers hire more salespeople; farmers plant more acres, buy more seed and tractors, and hire more workers; auto makers need more equipment and resources; and there are more manufacturing, distribution, and sales jobs, just to give some examples. One cannot overstate the contribution

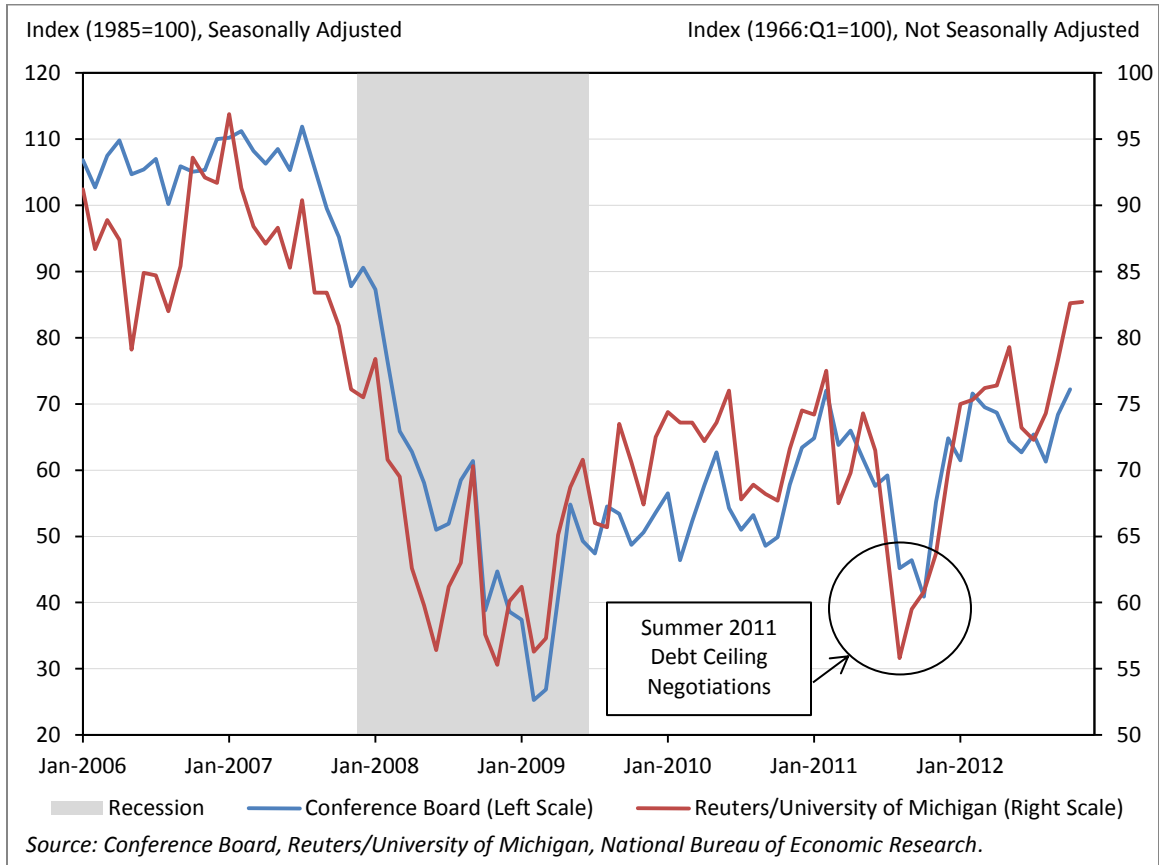
of a strong middle-class and vigorous consumer spending to building the foundation for jobs and economic growth.

Figure 1: Contribution of Consumer Spending to Quarterly Change in Real GDP



Today, consumer sentiment – which partly reflects how much households are willing and able to spend – is at its highest level in more than 5 years, since September 2007. (See Figure 2.) But we know that uncertainty about the fiscal outlook and its impact on middle-class families can dampen consumer optimism: in the midst of the debate over the debt ceiling last year, sentiment plunged to its lowest level since the end of the recession. And we know that concern over the “fiscal cliff” is rising – that’s why President Obama has stood for providing certainty to more than 100 million middle-class families that their taxes will not go up on January 1st. The hard-earned rise in consumer confidence will be at risk if the middle-class tax cuts are not soon extended with a minimum of political drama.

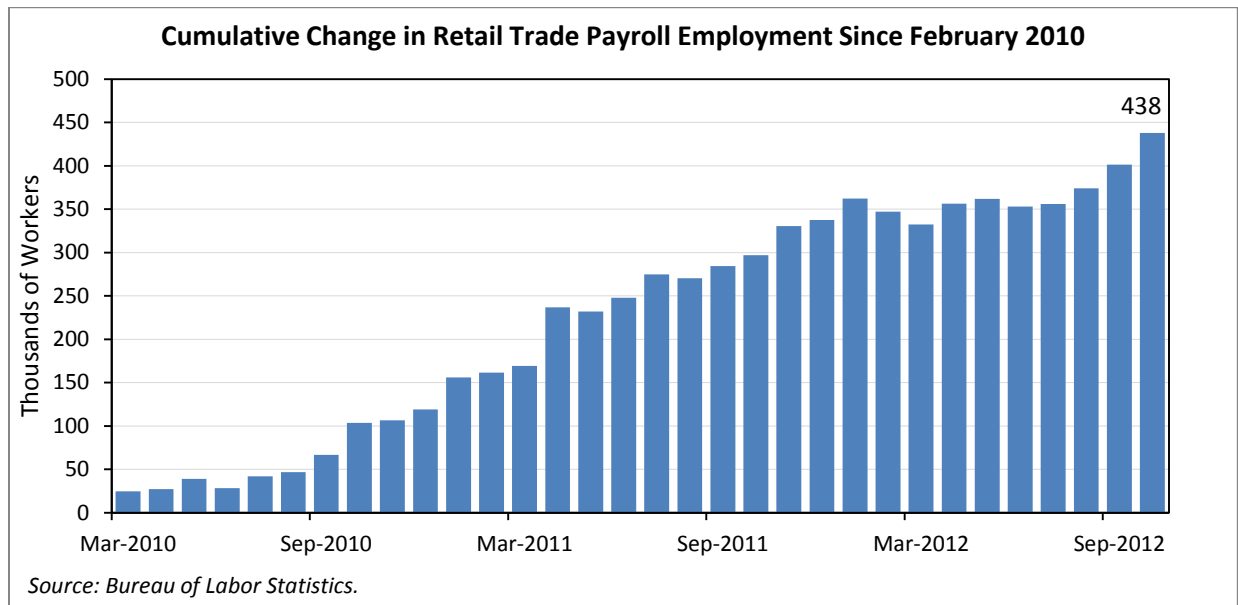
Figure 2: Consumer Sentiment is at a 5-year High, but Plummeted in the Last Fiscal Dispute



Millions of American Jobs Depend on the Retail Industry

The business of selling goods and services to millions of Americans is critical to the broader economy. The retail industry employs 14.8 million Americans, and has been a key part of the recovery. In the 40 months since the recession ended in June 2009, the retail industry alone has been responsible for more than 9 percent of overall employment growth and has added 438,000 jobs in the past 32 months. (See Figure 3.)

Figure 3: The Retail Sector Has Added 438,000 Jobs in the Past 32 Months

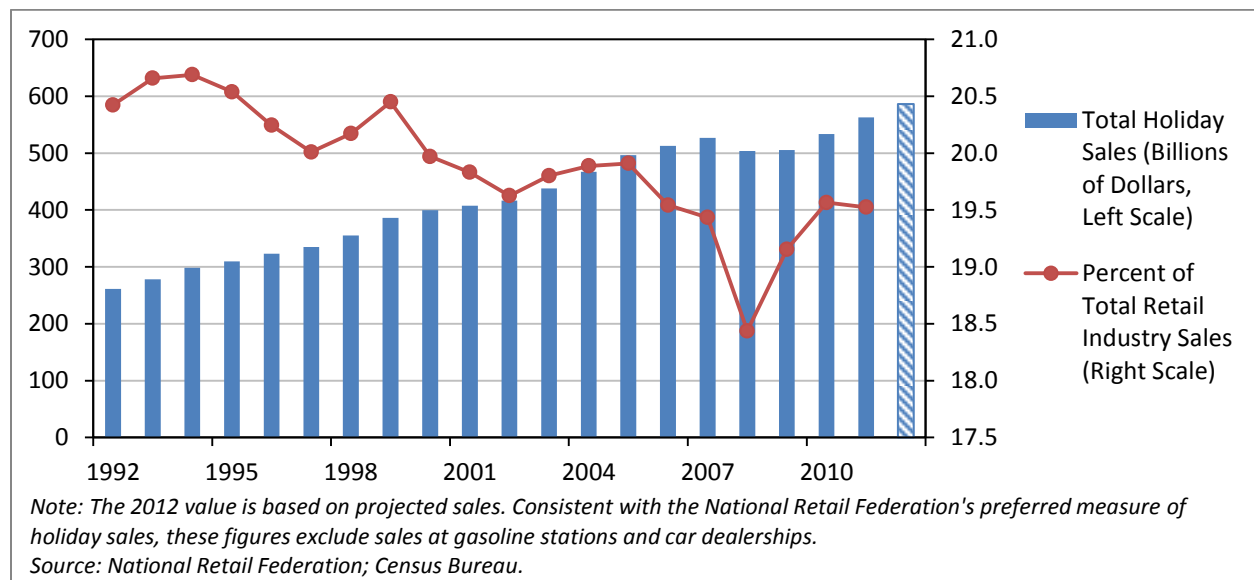


The Holiday Season is No Time to Threaten Middle-Class Pocketbooks

Consumer confidence over the next several weeks is particularly important: the National Retail Federation is forecasting that holiday sales will grow 4.1 percent this year to \$586.1 billion. Last year, Americans spent around \$50 billion on Black Friday weekend alone.

If Congress does not act on the President's plan to extend tax cuts for the middle-class, it will be risking one of the key contributors to growth and jobs in our economy at the most important time of the year for retail stores.

Figure 4: Holiday Retail Sales Account for Approximately One Fifth of Total Annual Retail Sales



II. The President's Council of Economic Advisers (CEA) Estimates Expiration of the Middle-Class Tax Cuts Could Reduce Consumption by \$200 Billion Next Year

POSSIBLE IMPACTS OF NOT EXTENDING THE MIDDLE-CLASS TAX CUTS ON THE ECONOMY

- The growth of real consumer spending could be cut by 1.7 percentage points in 2013.
- The growth of real GDP could slow by 1.4 percentage points.
- Consumers could spend nearly \$200 billion less than they otherwise would have in 2013 because of higher taxes.

If current law was made permanent — that is, if the economy went over the full “fiscal cliff” — the resulting fiscal restraint in fiscal year 2013 would be approximately \$500 billion, or more than 3 percent of GDP. A large amount of this fiscal contraction comes from two sources: failure to extend the 2001/2003 tax cuts for middle-income taxpayers, and failure to patch the Alternative Minimum Tax (AMT). If this hike in middle-class taxes were permanent, economic theory and recent experience says that nearly all of this rise in taxes would translate directly into reduced consumption. This initial contraction in consumption reduces demand for goods and services; this hurts the jobs and businesses that provide those goods and services, reducing household income and leading to further economic contraction.

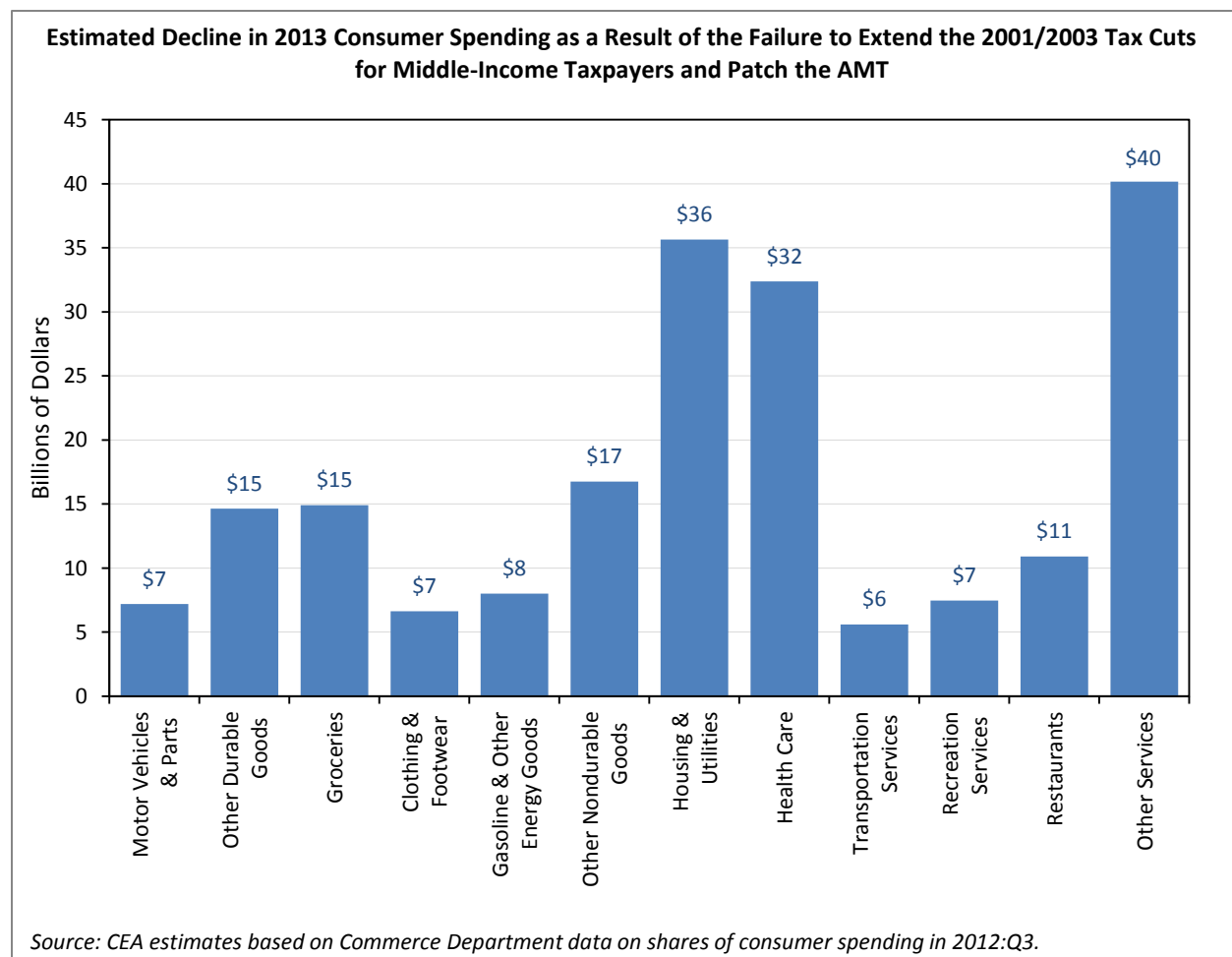
Taking account of these multiple channels, the President's Council of Economic Advisers (CEA) estimates that allowing middle-class tax rates to rise and failing to patch the AMT could cut the growth of real consumer spending by 1.7 percentage points in 2013. This sharp rise in middle-class taxes and the resulting decline in consumption could slow the growth of real GDP by 1.4 percentage points, which is similar to recently published estimates from the Congressional Budget Office.²

To put these figures in perspective, faced with these tax hikes, the CEA estimates that consumers would likely spend nearly \$200 billion less than they otherwise would have in 2013 because of higher taxes. This reduction of \$200 billion is approximately four times larger than the total amount that 226 million shoppers spent on Black Friday weekend last year, or roughly the amount American families spent on all the new cars and trucks sold in the U.S. in the last year. As Figure 5 shows, this \$200 billion reduction would likely be spread across all areas of consumer spending.

² See Congressional Budget Office. “Economic Effects of Policies Contributing to Fiscal Tightening in 2013.” November 8, 2012. <<http://www.cbo.gov/publication/43694>>.

These estimates focus only on the direct effects on the demand for goods and services, and do not include other channels that are likely to be very important as well. For example, allowing tax cuts for 98 percent of Americans to expire and not patching the AMT would likely shake consumer confidence and increase uncertainty among households and financial markets, potentially leading to an even more negative outlook than is portrayed by these estimates.

Figure 5: Expiration of the Middle-Class Tax Cuts Could Lower Consumer Spending by \$200 Billion Next Year



III. Independent Analysis and Business Leaders Confirm the Risks to Consumers and Retailers

INDEPENDENT ANALYSES REINFORCE NEED TO EXTEND MIDDLE-CLASS TAX CUTS

- The independent, non-partisan Congressional Budget Office (CBO) finds that extending the middle-class tax cuts would boost GDP by 1.3 percent and jobs by 1.6 million – at a higher “bang for the buck” than the high-income tax cuts.
- Mark Zandi of Moody’s Analytics finds that the economic impact of ending the middle-class tax cuts would reduce GDP by \$174 billion.
- Goldman Sachs finds a growth impact of more than one percent next year.

Independent Economic Analysis Clearly Demonstrates Why We Need to Extend the 2001/2003/2010 Tax Cuts for the Middle-class

The Administration’s analysis that failing to extend the middle-class tax cuts would hurt consumer spending and the retail industry is reinforced by estimates from independent forecasters like the Congressional Budget Office, and private-sector economists.

These independent analyses also agree that continuing the high-income tax cuts for the top two percent of Americans would have a much smaller economic impact, with less “bang for the buck” in terms of job creation and growth per tax dollar spent.

In a recent report breaking down each of the components of the “fiscal cliff,” the Congressional Budget Office (CBO) found that extending the middle-class tax cuts would boost GDP by 1.3 percent and raise employment by 1.6 million by the fourth quarter of 2013. Given that consumer spending makes up around 70 percent of GDP, the implications of the CBO report are clear – allowing the middle-class tax cuts to expire and letting taxes go up by an average of \$2,200 for a family of four will hurt consumer spending and our economy.

In the same report, the CBO also found that extending the middle-class tax cuts has a much larger impact and higher “bang for the buck” than extending the high-income tax cuts because “the income affected by the higher tax rate under this policy would be that of high-income taxpayers, who, in comparison with others, probably save a larger portion and spend a smaller portion of each dollar of reduced taxes.”

The President’s \$4 trillion deficit reduction plan includes up-front investments in policies like keeping teachers in the classroom and putting construction workers back to work that would create far more jobs in a far more effective way than continuing inefficient upper-income tax cuts. These investments were also included as part of the President’s American Jobs Act.

Independent economists estimate that the plan would create more than a million new jobs if the proposals Congress has not acted on were to pass. These types of proposals should be part of the conversation as we resolve the “fiscal cliff.”

In addition to the CBO, analysis from leading forecasters in the private sector also demonstrates the danger to the economy of allowing the middle-class tax cuts to expire:

- **Goldman Sachs, October 19, 2012:** A chart in the Goldman Sachs report shows that failing to extend the middle-class tax cuts and prevent the Alternative Minimum Tax from hitting middle-class families would reduce GDP growth by more than one percentage point in 2013.
- **Mark Zandi, Moody’s Analytics, June 14, 2012.** A chart in the Moody’s report shows that the economic impact of the ending the middle-class tax cuts would reduce real GDP by \$174 billion, compared to \$40 billion for the high-income tax cuts.

Retailers and Business Leaders have Voiced Concern about the Impact on Consumer Spending and the Economy

- **Mike Duke, CEO of Walmart, 11/14/2012:** “In many ways, Walmart's customers are at the center of this debate. They are middle-class Americans and those aspiring to join the middle-class. Our customers are working hard to adapt to the 'new normal,' but their confidence is still very fragile. They are shopping for Christmas now and they don't need uncertainty over a tax increase.”
- **Craig Jelinek, President and CEO of Costco Wholesale Corporation, 11/20/2012:** “I received a phone call on Saturday from President Obama, as part of the Administration's outreach to the business community to discuss current economic conditions and fiscal policy issues. I expressed strong support for the President's efforts to reach a compromise with Congress before the end of the year that avoids any tax increase on middle class taxpayers. Costco employs over 115,000 workers in the U.S., most of whom are middle class family wage earners. Likewise, the small businesses that make up the bulk of our business members employ thousands of working people who have borne the brunt of the recession. Now, with signs pointing to a modest economic recovery, it would be a particular burden on those working families to face higher income taxes. I encouraged the President to continue working with Congressional leadership to find a balanced solution to the deficit that will avoid middle class tax increases. It is imperative that both sides of the ‘aisle’ compromise...to eliminate uncertainty, and allow for continued economic recovery.”
- **National Retail Federation, 11/7/2012:** “Tax issues are ultimately tied to what Congress does or doesn’t do during the lame duck session in order to avoid the ‘fiscal cliff’ of tax hikes and federal spending cuts scheduled to take effect on January 1. Most of the \$500

billion in tax increases are as a result of the expiration of the Bush tax cuts for individuals, and could have a substantial impact on consumer spending. Some economists have warned of a recession if nothing is done.”

- **Terry J. Lundgren, Chairman, President and CEO of Macy’s Inc., 11/8/2012:** “With the election now behind us, it’s time for our elected representatives in Washington to come together to address our country’s most pressing problems. Primary among them is avoiding the fiscal cliff and reducing our national debt. These are not Democratic or Republican problems — they are American problems that affect every individual and industry, including fashion and retailing.”
- **Kevin Burke, President and CEO of the American Apparel & Footwear Association, 11/8/2012:** “I believe the economists who say the economy will slip back into a recession if [leaders in Congress] don’t do something. From a clothing and footwear industry perspective, the more confidence there is in the economy, the more we will be able to sell.”
- **Walgreens Statement on Fiscal Cliff, 11/21/2012:** “As we all know, resolving the federal revenue and spending issues to avoid the fiscal cliff is critical to our nation, our economy and further recovery, as well as America’s future global competitiveness. We understand that the decisions necessary to avoid the fiscal cliff are far from easy. But these important fiscal decisions are critical to families across America, like the customers and patients who depend on Walgreens for their consumer and health care needs. It is absolutely clear that we need to protect their jobs, health and economic future by avoiding the fiscal cliff, curbing the federal debt and bringing our nation to long-term, sustainable fiscal health.”

IV. The President's Plan Protects Middle-Class Families and the Retail Industry from a Substantial Hit

WHAT \$2,000 MEANS TO THE AVERAGE MIDDLE-CLASS FAMILY

- Two months of mortgage payments on their home
- Over three months of food and groceries.
- Nearly four semesters of college textbooks and supplies.
- A year and half of electric bill payments.
- Four months of car payments.

Last week, the President repeated his call for Congress to act on his proposal, which the Senate has passed – a one-year extension of the tax cuts for every family making under \$250,000 a year—98 percent of all Americans. That means all Americans – including the wealthiest Americans – get a tax cut. And 98 percent of Americans, and 97 percent of all small business owners, won't see their income taxes go up a single dime.

Under the President's proposal, the 98 percent of American families with incomes of less than \$250,000 per year would continue to benefit in full from the income tax cuts expiring at the end of 2012, including:

- The doubling of the Child Tax Credit to \$1,000 per child, and the extension of the credit to millions of working families that previously could not benefit from it.
- The 10 percent tax bracket, which will provide middle-class couples with a tax cut of up to \$890 next year.
- Marriage penalty relief, which reduces or eliminates marriage penalties for nearly 38 million couples.
- Lower tax rates on up to \$250,000 of income (\$200,000 for single filers).
- Under the President's plan, the income tax rates for high-income households would return to what they were under President Clinton, when the economy created nearly 23 million new jobs, we went from deficit to surplus, and businesses and investors did very well.

The President's proposal and legislation introduced by Congressional Democrats would provide certainty for the 114 million middle-class families whose taxes will go up on January 1 if Congress does not act. Without Congressional action:

- 114 million middle-class families will see their federal income taxes increase by an average of \$1,600.
- A typical middle-class family of four will see their taxes rise by about \$2,200 as a result of losing the combination of the expanded child credit, marriage penalty relief, and the 10 percent bracket.
- Over 35 million families will receive a smaller Child Tax Credit, and millions of low- and moderate-income working families with children will lose access to the Child Tax Credit altogether.
- 11 million middle-class families will no longer get help paying for college from the American Opportunity Tax Credit.
- Small businesses will be able to claim immediate tax deductions for only \$25,000, rather than \$250,000, of new investment.

Examples of Middle-class Families that Will See Their Taxes Rise if the Middle-class Tax Cuts Are Not Extended

- **Example 1: A typical middle-income family of four: a married couple with two children with income between about \$50,000 and \$85,000 would see a \$2,200 tax increase.**
 - A tax increase of \$1,000 because the Child Tax Credit will fall from \$1,000 to \$500 per child.
 - A tax increase of \$890 because of merging the 10 percent tax bracket into the 15 percent tax bracket.
 - A tax increase of \$310 because of the expiration of marriage penalty relief that provides a larger standard deduction for married couples.

Total Tax Increase on this Family if Congress Fails to Act = \$2,200

- **Example 2: A married couple with a 15-year-old at home and a 19-year-old in her second year at the state university; the couple's income is \$80,000.**

- A tax increase of \$550 because, instead of being able to claim the \$2,500 American Opportunity Tax Credit to help with college expenses, they will only be able to claim the Hope Credit worth \$1,950.
- A tax increase of \$500 because the Child Tax Credit will fall from \$1,000 to \$500 per child.
- A tax increase of \$890 because of the disappearance of the 10 percent tax bracket.
- A tax increase of \$310 because of the expiration of marriage penalty relief that provides a larger standard deduction for married couples.

Total Tax Increase on this Family if Congress Fails to Act = \$2,250

- **Example 3: A middle-income family with three young children: a married couple with three children with income of \$75,000 would see a \$2,700 tax increase.**
 - A tax increase of \$1,500 because the Child Tax Credit will fall from \$1,000 to \$500 per child.
 - A tax increase of \$900 because of merging the 10 percent tax bracket into the 15 percent tax bracket.
 - A tax increase of \$300 because of the expiration of marriage penalty relief that provides a larger standard deduction for married couples.

Total Tax Increase on this Family if Congress Fails to Act = \$2,700