CENTER ON BUDGET AND POLICY PRIORITIES

820 First Street, NE, Suite 510, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-1056 center@cbpp.org http://www.cbpp.org

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IS THE BUSH TAX CUT NECESSARY TO AVOID A RECESSION?

The full report can be viewed at:
http://www.cbpp.org/2-22-01tax.pdf

On February 22, the Center on Budget and Policy Priorities released a report entitled "Is the Bush Tax Cut Necessary To Avoid A Recession?" The report argues that the proposed tax cuts are not an effective policy response to economic sluggishness for several reasons.

- **The current structure of the tax cut is backloaded.** The tax plan the White House has proposed would do little to lift the economy in the short run because its tax cuts are backloaded: 71 percent of the tax reductions over the next ten years would occur after 2006. These tax cuts would do little to boost families' spending power immediately and therefore do little to spur the economy in the months ahead.

- **Making the cuts retroactive is unlikely to solve the problem.** President Bush has said his tax-cut proposal should be accelerated in some manner with part of it made retroactive to the beginning of this year. The Bush administration has been vague, however, about just which elements of the tax cut should be accelerated. Depending on the details, as the paper explains, the acceleration may not do much to spur the economy in the short run.

- **Tax cuts are not an effective tool for managing the economy.** Most important, a large majority of economists believe that tax cuts are not an effective tool for managing the macro-economy. In many cases, such tax cuts take effect after the economy has already started to recover. Alan Greenspan noted in testimony on January 25, "Lately there has been much discussion of cutting taxes to confront the evident pronounced weakening in recent economic performance. Such tax initiatives, however, historically have proved difficult to implement in the time frame in which recessions have developed and ended."

- **It is far from clear that a recession looms**. The seriousness of the economic slowdown remains uncertain. CBO projects that while economic growth will slow in 2001, the economy will avoid a recession, with GDP rising by 2.4 percent, after adjusting for inflation. CBO forecasts that the economy will avoid a recession, rebound from its current, slower rate of growth, and enjoy a higher subsequent growth rate, without a tax cut. Private-sector forecasters similarly are doubtful that the economy will enter a recession. The average growth forecast for 2001 among the forecasters included in the latest Blue Chip Economic Indicators, published February 12, is 2.1 percent. While these rates of growth are lower than those of recent years, they indicate that most forecasters do not believe a recession will occur.

The Bush tax cut, as proposed, is not well-suited to addressing a possible economic slowdown since it is backloaded. Even if the tax cuts were accelerated, they would be unlikely to be passed in time to address the current sluggishness in the economy. Most economists believe that with the exception of a significant recession, macroeconomic fluctuations such as a decline in the growth rate should be addressed primarily by the Federal Reserve.