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A SMOKING GUN: PRESIDENT'S CLAIM THAT TAX CUTS PAY FOR THEMSELVES REFUTED BY NEW TREASURY ANALYSIS

By James Horney

In remarks on July 11 touting revised deficit projections in the Mid-Session Review of the Budget, President Bush once again claimed that tax cuts pay for themselves:

> "Some in Washington say we had to choose between cutting taxes and cutting the deficit….Today's numbers show that that was a false choice. The economic growth fueled by tax relief has helped send our tax revenues soaring. That's what has happened."[1]

These remarks mirror previous statements by the President, the Vice-President, and key Congressional leaders that the increase in revenues in 2005 and the increase now projected for 2006 prove that tax cuts "pay for themselves" — that the economy expands so much as a result of tax cuts that it produces the same level of revenue as it would have without the tax cuts.[2]

Economists and budget analysts outside of the administration have explained that these claims are not supported by data or economic theory.[3] *Now a Department of Treasury analysis, previewed in the Mid-Session Review itself and released on July 2, provides estimates of the potential economic effects of tax cuts that confirm what outside experts have consistently said — tax cuts do not come remotely close to paying for themselves.*[4]

The Treasury analysis concludes that making the President's tax cuts permanent — and paying for the tax cuts with future reductions in spending — *may* ultimately increase the level of economic output (national income) in the long run by *as much as* 0.7 percent. (An increase in the *level* of

[1] Remarks by the President on the Mid-Session Review, July 11, 2006: http://www.whitehouse.gov/news/releases/2006/07/20060711-1.html

[2] See Richard Kogan and Aviva Aron-Dine, "Claim that Tax Cuts 'Pay for Themselves' is Too Good to be True: Data Show No 'Free Lunch' Here," Center on Budget and Policy Priorities, revised June 14, 2006.

[3] Ibid.

[4] "A Dynamic Analysis of Permanent Extension of the President's Tax Relief," box on pages 3-4 of the *Mid-Session Review of the Budget for Fiscal Year 2007*. The full report can be found at: http://www.treas.gov/press/releases/reports/treasurydynamicanalysisreporjjuly252006.pdf

economic output of 0.7 percent — the Treasury's scenario for the long-run effects of extending the tax cuts if the cost of the tax cuts is offset by spending cuts starting in 2017 — would, if it occurred over 20 years, represent an increase of about 4/100^{ths} of one percentage point in the average annual growth rate of the economy over that 20-year period, a very small amount.[5])

Even if an increase in the level of economic output of 0.7 percent ultimately were to result from making the tax cuts permanent, the effect of this assumed additional economic growth would be to offset only a tiny fraction of the cost of the President's tax cuts. (Moreover, the Treasury analysis concedes that the effects may not be as great as this. In fact, in its alternative scenario that assumes the tax cuts are *not* paid for by cuts in spending, Treasury estimates that the effects of making the tax cuts permanent would be *negative* —that the level of output would be 0.9 percent lower in the long run than would have been the case if the tax cuts were allowed to expire.[6])

For instance, if there were a 0.7 percent increase in the level of economic output in 2016 (because Treasury has not yet released all of the details of its analysis, we do not know how much of an increase it assumes in that year[7]), that would represent an increase of $146 billion above what the Congressional Budget Office has projected for 2016.[8] If new revenues equaled as much as 20 percent of the additional output, the increase in revenues resulting from making the tax cuts permanent (assuming that the costs of the tax cuts will be offset by future spending cuts) would be $29 billion.[9] That amount represents less than 10 percent of the $314 billion that the Joint Committee on Taxation estimates extending the tax cuts will reduce revenues in 2016 (not counting the effects of extending Alternative Minimum Tax relief).

Thus, even if the Treasury's optimistic assumptions are accepted (and the full 0.7 increase in economic output that the Treasury estimates would occur in the long run has taken effect in 2016), the cost of the tax cuts in 2016 — taking into account "dynamic" effects — would still be *more than 90 percent* of the cost of the tax cuts under the standard cost estimates.

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[5] In this scenario, the Treasury analysis concludes that the increase in the annual growth rate will be significantly higher than 0.04 percentage points for several years following extension of the tax cuts but will then decline over time to zero (that is, the growth rate eventually will be the same as it would have been without the tax cut). For a discussion of possible confusion over the difference between an increase in the level of output and an increase in the rate of growth of output, see Jason Furman, "Treasury Dynamic Scoring Analysis Refutes Claims by Supporters of the Tax Cuts," Center on Budget and Policy Priorities, July 27, 2006].

[6] This is consistent with the conclusion reached by others, including the Congressional Budget Office, that cutting taxes without paying for the cuts may actually reduce output over the long term. See Kogan and Aron-Dine, "Claim that Tax Cuts 'Pay for Themselves' is Too Good to be True." The Treasury study assumes that the cost of the tax cuts will eventually have to be offset one way or the other to keep the federal debt-to-GDP ratio from spiraling out of control. In the study, the alternative assumption to the cost of the tax cuts being offset by spending cuts is that the cost will be offset by across-the-board increases in income tax rates after 2016.

[7] Since, according to Treasury officials, about two-thirds of the ultimate 0.7 increase in output would occur by 2016, the increase would be somewhat less than 0.7 percent in that year.

[8] The Administration's projections of the economy only extend through 2011.

[9] Using the same approach, the Treasury's analysis implies that the *reduction* in long-run level of output that would occur if the tax cuts are *not* offset by future spending cuts (Treasury estimates that the level of output would be 0.9 percent lower in the long run) would *increase* the cost of the tax cuts in 2016 by $38 billion above what the JCT estimated.