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PRESIDENT'S EXPECTED PUSH TO MAKE TAX CUTS PERMANENT IS IRRESPONSIBLE FISCAL AND ECONOMIC POLICY

By Aviva Aron-Dine

In his State of the Union address this evening, President Bush is expected to renew his push to make his signature tax cuts permanent. In recent weeks, Administration officials have offered three major arguments for this policy — (1) the tax cuts yielded strong economic growth over the past few years, (2) extending them would help the economy overcome its current weakness, and (3) extending them would improve the economy's performance over the long run. None of these claims bears up well under scrutiny.

1. **The economic expansion that began in 2001 has been weak by historical standards.** The Administration bases its claim that the tax cuts yielded strong growth on the economy's performance over the past seven years. But even setting aside the question of whether the tax cuts *caused* any of the growth that occurred, the reality is that the economy's performance since 2001 has been nothing to brag about. With respect to overall economic growth, as well as growth in consumption, investment, wages and salaries, and employment, the expansion that began in 2001 is either the weakest or among the weakest since World War II. Investment, wage and salary, and employment growth also have been weaker than during the 1990s, a period in which taxes were increased. (These comparisons held true even *before* the slowdown of the past few quarters began.¹)
2. **Making the tax cuts permanent would do little or nothing to stimulate the economy in the short run, since it would not put a dollar in anyone's pocket until 2011.** The Congressional Budget Office has concluded that extending the 2001 and 2003 tax cuts would have minimal effect on the economy in the near term.² Similarly, Brookings Institution economists Douglas Elmendorf and Jason Furman have listed this policy under the heading of "ineffective or counterproductive [stimulus] options."³ Simply put, measures to address short-term slack in the economy need to take effect in the short term. But the 2001 and 2003 tax cuts

¹ For further discussion, see Aviva Aron-Dine, Chad Stone, and Richard Kogan, "How Robust Is the Current Economic Expansion?" Center on Budget and Policy Priorities, revised January 14, 2008, <http://www.cbpp.org/8-9-05bud.htm>.

² Congressional Budget Office, "Options for Responding to Short-Term Weakness," January 2008.

³ Douglas W. Elmendorf and Jason Furman, "If, When, How: A Primer on Fiscal Stimulus," Brookings Institution, January 10, 2008, http://www.brookings.edu/papers/2008/0110_fiscal_stimulus_elmendorf_furman.aspx.

are not scheduled to expire until December 31, 2010, so extending them would have no direct effect on the economy until then.⁴

To its credit, the Administration did not insist on inclusion of its tax cuts in the bipartisan stimulus deal agreed to last week. But it continues to portray these tax cuts as good medicine for the current weak economy.

- 3. In the long run, making the tax cuts permanent would be more likely to *weaken* the economy than to strengthen it.** The President and other advocates of extending the tax cuts have not proposed any measures to pay for them. Thus, making the 2001 and 2003 tax cuts and Alternative Minimum Tax relief permanent would add \$4.3 trillion to deficits and debt over just the next ten years (2009-2018),⁵ and would substantially worsen the nation's already serious long-term fiscal problems.

All else being equal, larger deficits reduce national saving and thereby lower future national income. Studies by economists at the Joint Committee on Taxation, the Brookings Institution, and noted academic institutions all have found that the negative effects of added deficits and debt generally outweigh any positive economic effects of unpaid-for tax cuts. For example:

- In a 2005 study, the Joint Committee on Taxation examined the economic effects of reductions in individual and corporate tax rates and an increase in the personal exemption. It found, "Growth effects eventually become *negative* without offsetting fiscal policy [i.e. without offsets] for each of the proposals, because accumulating Federal government debt crowds out private investment" (emphasis added).⁶
- In 2004, Brookings Institution economist William Gale and then-Brookings economist (now CBO director) Peter Orszag examined the effects of extending the 2001 and 2003 tax cuts without offsets. They concluded that making the tax cuts permanent without paying for them would be "likely to reduce, not increase, national income over the long term."⁷
- University of California Berkeley economics professor Alan Auerbach simulated the economic effects of the 2001 tax cuts under various assumptions. He found that the only scenario under which the tax cuts increased the size of the capital stock and thus increased long-term economic output was one in which they were *fully paid for with spending cuts at the time they were enacted*.⁸ Fully offsetting the cost of the tax cuts would require cuts in government programs equal to the entire annual budgets of the Departments of Education, Homeland Security, State, and Veterans' Affairs *combined*.

⁴ For further discussion, including discussion of claims that extending the tax cuts would boost "confidence" and thereby boost the economy, see Aviva Aron-Dine, "Another Misdiagnosis: Marginal Rate Reductions and Extensions of Tax Cuts Expiring in 2010 Not the Right Medicine for the Economy's Short-Term Ills," Center on Budget and Policy Priorities, January 15, 2008, <http://www.cbpp.org/1-15-08tax.htm>.

⁵ The \$4.3 trillion figure includes \$3.6 trillion in lost revenues and \$700 billion in debt service costs. We include the cost of AMT relief because if AMT relief is not extended, the AMT will take back a quarter to a third of the value of the tax cuts. See Aviva Aron-Dine and Robert Greenstein, "Why the Cost of AMT Relief Should Be Included in Estimates of the Cost of Extending the President's Tax Cuts," Center on Budget and Policy Priorities, revised February 20, 2007.

⁶ Joint Committee on Taxation, "Macroeconomic Analysis of Various Proposals to Provide \$500 Billion in Tax Relief," JCX-4-05, March 1, 2005.

⁷ William Gale and Peter Orszag, "Bush Administration Tax Policy: Effects on Long-Term Growth," Tax Notes, October 18, 2004.

⁸ Alan J. Auerbach, "The Bush Tax Cuts and National Saving," National Tax Journal, September 2002.