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Administration Tax Cuts Are Unlikely to Increase Economic Growth Substantially And Will Not Pay for Themselves

The report on economic growth is at http://www.cbpp.org/3-3-03tax2.htm. The report on revenues is at http://www.cbpp.org/3-3-03tax.htm.

Two new analyses from the Center on Budget and Policy Priorities evaluate related claims made by some supporters of the Administration's tax-cut proposals, including the President: first, that the tax cuts will spur substantial long-term economic growth, and second, that this growth will increase revenues sufficiently to offset the long-term cost of the tax cuts, so long-term deficits will not increase. The analyses find little support for either claim, even in the analyses of the President's own economists and the projections of the Office of Management and Budget (OMB), the President's budget office.

Economic Growth and Tax Cuts

- **The 2001 tax cut will have only modest effects on long-term economic growth and these will be largely or entirely offset by the adverse economic effects of the enlarged deficits that will result.** That is the conclusion reached by institutions such as the Congressional Budget Office (CBO) and respected mainstream economists at Brookings and the Federal Reserve who have evaluated the 2001 tax cut. CBO estimates that the 2001 tax cut will make the economy 0.5 percent bigger or smaller by 2011, a marginal effect in either case.

- **Analyses of the likely economic effects of the Administration's new "growth" package are reaching comparable conclusions.** An analysis by Macroeconomic Advisers, a well-known consulting firm that developed the economic model the President's Council of Economic Advisers itself uses, finds the "growth" package would help shorten the recession but have slightly *negative* economic effects over the long term. Similarly, a statement recently issued by ten Nobel Prize laureates in economics and the President of the American Economics Association, along with several hundred other economists, warns that the "growth" package would ultimately harm the economy.

Average Annual Economic Growth over Selected Periods, Adjusted for Inflation and Size of Working-age Population

Calendar year and quarter (each period ends at a business-cycle peak)	Average annual GDP growth per working-age person
1948:4 to 1960:2	2.9%
1960:2 to 1969:4	3.1%
1969:4 to 1981:3	1.2%
1981:3 to 1990:3	2.0%
1990:3 to 2001:1	2.0%
2001 to 2008 (OMB estimate)	1.9%

- **The historical record does not show that tax cuts cause substantial increases in economic growth.** An ardent supply-sider would expect to find that economic growth was fastest in the 1980s, when marginal tax rates (especially at the top of the income scale) were lowest. Yet as the table at right shows, growth rates in the 1980s were *lower* than in the 1950s and 1960s and the same as in the

1990s, when marginal tax rates were significantly higher on those in the top income bracket. Put another way, the economy grew as quickly during the 1990s, when taxes were raised, as during the 1980s, when taxes were cut. The President's budget projects no faster economic growth in the coming decade, notwithstanding his new tax cuts.

Revenue Growth and Tax Cuts

- **The Administration itself does not appear to believe that the tax cuts will pay for themselves.** The *Economic Report of the President,* which the Council of Economic Advisers issued in February 2003, explicitly acknowledges that tax cuts are unlikely to pay for themselves. In addition, the President's budget issued in February projects that under the President's policies, total federal revenues will grow at a slower annual rate between 2001 and 2008 than in any comparable period over the last five decades. Most ominously, OMB now projects that under the Administration's policies, the budget will be in deficit every year for the next 50 years.

- **The historical record does not show that tax cuts pay for themselves.** When the large 1981 tax cuts were being debated, many supporters contended the tax cuts would more than pay for themselves. Conversely, when marginal tax rates on high-income individuals were raised in 1990 and especially in 1993, the claim was made that these tax increases would damage the economy and that income tax receipts consequently would grow more slowly in the 1990s than in the 1980s. In fact, income tax revenues hardly grew at all in the 1980s (after adjustment for inflation and increases in the size of the working-age population), whereas they grew 13 times as fast in the 1990s as in the 1980s.

Claims That Tax Cuts Increase Revenues
• President Bush said in November that the **deficit would have been "much bigger" without the 2001 tax cut,** meaning the tax cut is substantially more than paying for itself.
• In announcing his new "growth" package, the President said it would "lay the groundwork for future growth and future prosperity. That growth will bring the added benefit of **higher revenues for the government** — revenues that will keep tax rates low, while fulfilling key obligations…"
• Vice President Cheney has said that the proposed "growth" package would ultimately **more than pay for itself.**
• *The Washington Post* reported that "on February 8, press secretary Ari Fleischer said the [new tax] plan would **pay for itself**."
• *Congress Daily* reported on January 8 that House Majority Leader Tom Delay, referring to the "growth" package, "told reporters that the long-term revenues generated by tax relief would **more than cover the price tag of the cuts**."

No "Free Lunch"

The new Center analyses show that in tax policy — as in virtually all other aspects of policymaking — there is no "free lunch." The idea that tax cuts can spur sufficient economic growth to pay for themselves sounds too good to be true because it *is* too good to be true.

The nation already faces the prospect of mounting deficits that threaten to reach dangerous levels when the baby-boom generation retires in large numbers. Rather than helping to prepare for this difficult challenge, the Administration's tax cuts would aggravate the problem by making long-term deficits more severe.