CENTER ON BUDGET AND POLICY PRIORITIES

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ADMINISTRATION'S ECONOMIC GROWTH CLAIMS DISPUTED BY BROAD RANGE OF ECONOMISTS

The Administration has launched an aggressive campaign to build support for its tax-cut proposals, as concerns mount over the continued sluggishness of the economy and uncertainty over its recovery. In a recent speech, President Bush stated that "[t]he nation needs quick action by our Congress on a pro-growth economic package. We need tax relief totaling at least $550 billion to make sure our economy grows."[1]

Although the Administration has used the current economic slowdown to justify the need for its "growth" package, the plan is dominated by multi-year and permanent tax cuts that would continue to reduce revenues for many years after the economy is expected to have recovered. The plan would provide only modest short-term stimulus because the tax cuts are not well-targeted towards quickly increasing demand — for example, nearly four-fifths of the costs of the plan would not occur until after fiscal year 2004 and only six percent of the costs would occur in fiscal year 2003. The future costs of the package would offer no stimulus to the economy now, when it is weak and in need of a boost. The Administration and its supporters have defended these multi-year and permanent tax cuts as crucial by claiming they will have a substantial positive impact on the economy over the long run.

A significant number of prominent economists, however, have reached a much different conclusion. These commentators — ranging from business leaders to Nobel Prize-winning economists to financial analysts — have found that the President's tax-cut package is unlikely to produce substantial economic growth over the long run. Indeed, many have found that the Administration's proposals could have a *negative* impact on long-term economic growth because the tax cuts would increase deficits and reduce national savings.

Below are excerpts of key findings from various analyses of the President's proposals. Taken together, they present a strong case that the Administration's proposals represent an inappropriate response to the current economic slowdown and the nation's long-term needs.

Committee for Economic Development

The Committee for Economic Development, a distinguished independent research organization consisting of 250 corporate leaders and educators, reached the following conclusions in a major report it issued in March 2003, *Exploding Deficits, Declining Growth: The Federal Budget and the Aging of America*.

[1] "President Discusses the Economy with Small Business Owners," The White House, April 15, 2003.

> “Deficits do matter. To the extent deficits are paid out of domestic saving, they leave less money behind to finance investments in plant and equipment, research and technology, and human capital that makes us more productive. To the extent they are financed by foreigners, they increase our nation’s international debts, divert our future income to service those debts, and increase economic instability. In either event, deficits will reduce our future standard of living.”

> “The first step in climbing out of a hole is to stop digging. We cannot afford economic policy decisions today that further raise deficits tomorrow. Recent and pending tax and spending proposals by the Administration and decisions by the Congress should be considered and reexamined in this longer term context. ... We are concerned that the Administration’s 2004 budget would raise the ten-year 2004-2013 deficit by about $2.7 trillion and annual deficits ten years from now by about $500 billion.”

> “CED strongly opposes any short-term stimulus program that is not combined with a plan to restore longer-term budget balance. We are specifically concerned that the Jobs and Growth Package proposed by the Administration, which would raise the cumulative 2004-2013 deficit by about $920 billion (including interest) and raise the annual deficit ten years from now by about $100 billion, does not meet this test. As noted below, our objection to these proposals is not directed at their merits as tax policy, but at their destructive long-term fiscal impact.”

Nobel Prize-Winning Economists

In a statement issued on February 10, 2003 (“Economists’ Statement Opposing the Bush Tax Cuts”), 10 Nobel Prize-winning economists — George Akerlof, Kenneth J. Arrow, Lawrence R. Klein, Daniel L. McFadden, Franco Modigliani, Paul A. Samuelson, Robert M. Solow, Joseph Stiglitz, Douglass C. North, William F. Sharpe — and more than 400 other economists made the following points.

> “Regardless of how one views the specifics of the Bush plan, there is wide agreement that its purpose is a permanent change in the tax structure and not the creation of jobs and growth in the near-term. The permanent dividend tax cut, in particular, is not credible as short-term stimulus. As tax reform, the dividend tax cut is misdirected in that it targets individuals rather than corporations, is overly complex, and could be, but is not, part of a revenue-neutral tax reform effort.

> “Passing these tax cuts will worsen the long-term budget outlook, adding to the nation’s projected chronic deficits. This fiscal deterioration will reduce the capacity of the government to finance Social Security and Medicare benefits as well as investments in schools, health, infrastructure, and basic research. Moreover, the proposed tax cuts will generate further inequalities in after-tax income.

> “To be effective, a stimulus plan should rely on immediate but temporary spending and tax measures to expand demand, and it should also rely on immediate but temporary incentives for investment. Such a stimulus plan would spur growth and jobs in the short term without exacerbating the long-term budget outlook.”

International Monetary Fund

The International Monetary Fund commented on the Administration's tax proposals in a report, "World Economic Outlook: Growth and Institutions," issued earlier this month. On April 10, *The Wall Street Journal* included the following account of the IMF report and news conference in the article, "Review of World Economy Trims '03 Growth Forecast By a Half Point, to 3.2%."

> "The International Monetary Fund delivered a sharp rebuke of the Bush Administration's fiscal policy, saying the White House has proposed poorly timed and probably unnecessary tax cuts while failing to confront the looming costs of Medicare and Social Security.
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> "While Mr. Bush's proposed $725 billion in tax cuts over 10 years have some 'efficiency' merits, they might not take effect until after the economy most needs a boost, and 'if enacted in full they will significantly worsen the medium-term fiscal position,' the IMF said in its semiannual World Economic Outlook.
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> "The international lender, better known for scolding wayward developing countries than the U.S., its single biggest shareholder, does regularly give policy advice to rich economies. Its appraisal of U.S. policy, however, was unusually negative and specific, and contrasts with its support two years ago for Mr. Bush's first round of tax cuts.
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> "At a news conference, IMF research director Kenneth Rogoff said, 'Suppose for a moment we were talking about a developing country that had a gaping [trade] deficit year after year as far as the eye can see, a budget ink spinning from black into red, open-ended security costs and an exchange rate that has been inflated by capital inflows. With all that, I think it's fair to say we'd be pretty concerned.' The U.S. isn't a developing country, he said, but nonetheless, for the global economy 'the tax cut ... on top of ongoing security expenditures seems awkwardly timed.'"

Macroeconomic Advisers

Macroeconomic Advisers, a leading economic modeling firm (whose macroeconomic model is used by the President's Council of Economic Advisers), reached the following findings in its report, "A Preliminary Analysis of the President's Jobs and Growth Proposals" (January 10, 2003):

> "Initially the plan would stimulate aggregate demand significantly by raising disposable income, boosting equity values, and reducing the cost of capital. However, the tax cut also reduces national savings directly while offering little new, permanent incentive for either private saving or labor supply. Therefore, unless it is paid for with a reduction in federal outlays, the plan will raise equilibrium real interest rates, "crowd out" private-sector investment, and eventually undermine potential GDP. Our simulations suggest that by the end of 2004 the stimulus to aggregate demand associated with the plan would raise the level of real GDP by 1.6% and reduce the unemployment rate by 0.8 percentage point. However, by 2017 the effect would be to reduce the level of potential GDP by about 0.3% and raise long-term interest rates by about ¾ percentage point."

Congressional Budget Office

The Congressional Budget Office included the following findings in its report, "An Analysis of the President's Budgetary Proposals for Fiscal Year 2004" (March 2003):

> "The overall macroeconomic effect of the proposals in the President's budget is not obvious. ... CBO's analysis suggests the proposals, on net, would probably increase labor supply but decrease investment and the stock of capital.
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> "Largely because of these two opposing effects, the net effect on economic output could be either positive or negative — with the difference depending not only on how the private sector would respond to the proposals themselves, but also on how the proposals would influence what budgetary policies people might expect in the future. Importantly, regardless of its direction, the net effect on output through long-term changes to the supply side of the economy — including fundamental "inputs" such as labor supply or the stock of capital — would probably be small. Under most assumptions, the proposals' supply-side effects would raise or lower the level of output by less than a percentage point, on average, from 2004 to 2013."

Brookings Institution Economists

In testimony before the Senate Finance Committee on February 11, Brookings Institution economist Peter Orszag made the following observations.

> "The Administration's tax proposals are not well-designed for boosting growth in either the short run or the long run, since they would have only modest effects on demand in 2003 and would expand budget deficits in the long run. All else being equal, the expanded budget deficits would reduce national saving in the long run, exactly the opposite of what would be needed to boost growth."
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> "An important aspect of all the Administration's tax proposals — including making the 2001 tax cuts permanent, the new dividend proposal, and the new savings proposal — is that they are all deficit financed. The implied revenue losses are substantial: The tax cuts would amount to approximately 1.7 percent of GDP in FY 2013, for example. ...
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> "It is important to emphasize that deficit-financed tax cuts are unlikely to have significant positive effects on economic growth in the long term, and may well reduce it."

In addition, in an January 27 *Tax Notes* article, "The President's Tax Proposal: Second Thoughts," Brookings Institution economists William G. Gale and Peter R. Orszag included the following economic evaluation of the Administration's tax plan:

> "In the short run, the key economic difficulty is that the nation is not fully using the capacity it has available to produce goods and services....The primary macroeconomic issue in the short run is therefore to boost demand for the goods and services that firms could produce given current capacity. From that perspective, the administration's

> package is poorly designed, since it fails to target the middle-class and lower-income families who would be more likely to spend any tax cut...
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> "In the long run, the key to economic growth is to expand the capacity of the nation to produce goods and services. That capacity, in turn, depends on national saving. Yet the administration's plan will expand the budget deficit, which will have the effect of reducing national saving."

Goldman Sachs

Economic researchers at Goldman Sachs made the following statements in the Goldman Sachs report, "Budget Blues: Play It Again, Uncle Sam," issued March 14, 2003:

> "The long-term budget outlook is much worse than official government projections, with annual deficits apt to cumulate to more than $4 trillion over the next ten years. This reflects many factors, including the costs of the Bush administration's tax cut proposals, increased spending on defense and domestic discretionary programs, and the anticipated costs of fixing the alternative minimum tax and adding a prescription drug benefit for Medicare."
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> "Unfortunately, the sharp deterioration in the budget outlook does have negative economic consequences."
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> "However, much of the deterioration in the long-term budget outlook can be avoided. It depends critically upon the tax and spending decisions that are reversible or that are likely but have not yet been implemented. Unfortunately, this deterioration will lead to higher interest rates and lower capital formation than would otherwise be the case, harming the U.S. economy's long-term performance."

Concord Coalition

An opinion article ("No New Tax Cuts," *The New York Times*, April 9, 2003) by former senators Bob Kerrey, Sam Nunn, and Warren B. Rudman, former cabinet secretaries Peter G. Peterson and Robert E. Rubin, and former Federal Reserve chairman Paul A. Volcker — all members of the Concord Coalition, a federal budget policy group — stated:

> "The president has proposed a cut of $726 billion, which the House has already approved. The Senate has reduced the cut to $350 billion.
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> "Given the rapidly deteriorating long-term fiscal outlook, neither proposal is fiscally responsible. It is illogical to begin the journey back toward balanced budgets by enacting a tax cut that will only make the long-term outlook worse. Furthermore, the proposed tax cuts are not useful for short-term fiscal stimulus, since only a small portion would take effect this year. Nor would they spur long-term economic growth. In fact, tax cuts financed by perpetual deficits will eventually slow the economy.

“The tax cuts now before Congress do not pay for themselves. No plausible array of matching spending cuts or offsetting revenue increases has been, or will be, proposed to close the gap resulting from a large new tax cut.

“We believe that there should be no new tax cuts beyond those that are likely to provide immediate fiscal stimulus, and that avoid growing revenue loss over time. If, however, Congress decides it must approve a tax cut, it should pass the Senate's. While a $350 billion tax cut does not fit our definition of fiscal responsibility, it comes closer than a tax cut of $726 billion. Moreover, Congress should re-establish the pay-as-you-go rule in which tax cuts and entitlement expansions must be offset. The discipline of this rule greatly contributed to the elimination of budget deficits in the 1990's and is clearly needed again.

“Congress cannot simply conclude that deficits don't matter. Over the long term, deficits matter a great deal. They lower future economic growth by reducing the level of national savings that can be devoted to productive investments. They raise interest rates higher than they would be otherwise. They raise interest payments on the national debt. They reduce the fiscal flexibility to deal with unexpected developments. If we forget these economic consequences, we risk creating an insupportable tax burden for the next generation.”