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Revised May 14, 2003

NEW JOINT COMMITTEE ON TAXATION STUDY FINDS NEGATIVE LONG-TERM ECONOMIC EFFECTS FROM HOUSE TAX BILL

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The Joint Committee on Taxation (JCT) is the congressional body responsible for estimating revenue effects and providing technical assistance on tax legislation. A little-noticed study by the JCT released on May 8 suggests that the House-passed tax bill will not generate the long-run economic gains that the Administration and others have touted.[2] The JCT estimates suggest that, if anything, the long-run effect of the House legislation on the economy would be slightly negative. The study found that "…the positive business investment incentives arising from the tax policy are eventually likely to be outweighed by the reduction in national savings due to increasing Federal government deficits." The study also found the bill would provide no long-term increase in jobs.

The JTC conclusions are consistent with other recent studies of the 2001 tax legislation and the President's budget proposal. Those studies do not find significant long-run economic benefits from the proposals.

Deficit-financed tax cuts generally have two offsetting long-term effects on the economy. First, they may induce various economic benefits: Marginal tax reductions, for example, may encourage more work effort, and dividend tax reductions may induce a more efficient allocation of capital. Second, however, the expanded budget deficits that result from the tax cuts impose economic costs over the long term. In particular, the budget deficits reduce national saving. Reduced national saving results in either lower private investment (which reduces future income) or increased borrowing from abroad (which effectively mortgages future income). The budget deficit thus reduces future national income.

The net effect of the tax cut on the economy reflects the interplay between these positive and negative factors. The Joint Tax Committee found, as have many other analysts who have examined similar deficit-financed tax cuts, that the net long-term effect on the economy from the type of tax cuts that the Administration proposed and the House of Representatives has approved is, if anything, slightly negative.

Using a variety of models and assumptions, the JCT results show that the House plan would result in a *short-term* boost to the economy but would end up reducing the size of the economy (relative to the economy's size if the House plan is *not* enacted) in

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[2] The Joint Committee on Taxation report was printed in the *Congressional Record* on May 8, 2003, pages H3829-H3832.

the second half of the decade. Although the JCT does not report results beyond the 10-year window, the language of its report strongly implies that the effect would become more negative over time. For example, JCT states that "The simulations indicate that eventually the effects of the increasing deficit will outweigh the positive effects of the tax policy, and the build up of private nonresidential capital stock will likely decline." In the longer run, the JCT analysis of the House plan foresees the plan resulting in rising deficits and declining capital stocks, which are a key impetus to long-term growth.

A number of other recent studies have examined the long-run impact of certain tax-cut proposals and reached similar conclusions:

- Various analysts and institutions that have studied the 2001 tax cut, including the Congressional Budget Office, economists at the Federal Reserve, and economists at the Brookings Institution, have generally found that the long-term negative effects of the tax cuts due to larger budget deficits (and reduced national saving) will offset and potentially outweigh any positive effects on future output from the impact of reduced marginal tax rates.[3]

- The Congressional Budget Office recently analyzed the impact of the Administration's current budget and tax proposals, using a series of different models and a range of assumptions.[4] CBO found that the effects on long-term economic growth would generally be small and could be negative. (Administration officials have criticized the CBO study for including both the expenditure and the revenue proposals in the Administration's budget, despite the fact that the budget contains both types of proposals and both types of proposals would have economic effects. In any case, the new JCT analysis focuses exclusively on revenue proposals and still finds a negative effect.)

- Macroeconomic Advisors, the consulting firm that developed the macroeconomic model the President's Council of Economic Advisers uses, estimated that the President's tax cuts would have a negative effect on the size of the economy in the long run. The report finds that the Administration's proposals would reduce potential GDP in the long term: "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 saving 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,

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[3] See Alan J. Auerbach, "The Bush Tax Cut and National Saving," *National Tax Journal*, Volume LV, No. 3, September 2003; Congressional Budget Office, *The Budget and Economic Outlook: An Update*, August 2001; Douglas W. Elmendorf and David L. Reifschneider, "Short-Run Effects of Fiscal Policy with Forward-Looking Financial Markets," *National Tax Journal*, Volume LV, No. 3, September 2003; and William G. Gale and Samara R. Potter, "An Economic Evaluation of the Economic Growth and Tax Relief and Reconciliation Act of 2001," *National Tax Journal* Vol. LV, No. 1, March 2002.

[4] Congressional Budget Office, "An Analysis of the President's Budgetary Proposals for Fiscal Year 2004," March 2003.

> the plan will raise equilibrium real interest rates, crowd out private-sector investment, and eventually undermine potential GDP."[5]

These studies all find that the types of deficit-financed tax cuts proposed by the Administration and now moving through Congress do not spur significant long-term growth, because any benefits from the tax cuts are offset by the adverse effects of the enlarged deficits that the tax cuts engender.

[5] Macroeconomic Advisers, LLC, "A Preliminary Analysis of the President's Jobs and Growth Proposals," January 10, 2003.