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THE SIMPLE STORY: TAX CUTS LOSE REVENUES

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New projections issued by the Congressional Budget Office on January 25 indicate that the tax cuts enacted over the last few years will do little if anything to promote long-term economic growth, but most assuredly will reduce revenue collections and increase deficits.

Tax cuts reduce the average rate of revenue growth; tax increases do the opposite

The table below displays economic growth rates and revenue growth rates from one business-cycle peak to another, covering the period since the late 1940s. The table shows that *economic* growth has been very much the same over most recent business cycles. Periods when taxes were cut and tax burdens were low were *not* periods of more rapid economic growth.

But there is a large difference in the rates of *revenue* growth. The average annual rate of revenue growth both during the 1980s and from 2001 forward — two periods that began with large tax cuts — is far below average. By contrast, in the 1990s, a period that began with substantial tax increases, the rate of revenue growth was substantially higher.

In short, the main effect of cutting taxes has been to lose substantial revenues and to swell budget deficits, not to increase economic growth. As the table also shows, the average rate of revenue growth that CBO expects over the period 2000-2015 is extraordinarily low.

Economic growth and revenue growth during selected periods[i]
(All economic and revenue figures are expressed as average annual growth rates, adjusted for inflation and population growth, i.e., average real per-person growth rates).[ii]

Fiscal years	GDP growth	Growth of income tax receipts	Growth of payroll, excise, estate, & other tax receipts	Growth of total tax receipts	Growth of total tax receipts if capital gains are excluded
1948 – 1979	2.4%	1.8%	3.1%	2.3%	n.a.
1979 – 1990	2.0%	0.2%	2.9%	1.3%	1.3%
1990 – 2000	2.0%	4.2%	1.9%	3.2%	2.9%
2000 – 2015[iii]	2.0%	0.1%	0.8%	0.4%	0.6%

[i] In each case, the period chosen is the final fiscal year before the start of a recession. That fiscal year is as close as we can get to a "business-cycle peak," given that we are dealing with fiscal years. Economic growth is measured over the same fiscal-year periods, for comparability, and differs slightly from that which would be seen if it were measured on a calendar-year basis, or on a quarterly basis between official

business-cycle peaks. The first year of every period represents the base year from which growth is measured; e.g., the period 2000-2015 uses 2000 as the base year and measures the growth that occurred in 2001 and each subsequent year through 2015.

[ii] To be sure, tax cuts do not permanently slow the average annual growth rate of revenues. Rather, they reduce revenues to a new, lower level as the tax cuts phase in. Thereafter, revenues tend to grow at normal rates (slightly faster than the economy), but since they are growing from a lower base level, total revenues continue to be lower than what they would have been without the tax cuts. Thus, in comparing the level of revenues before a set of tax cuts to the level of revenues at any point after the tax cuts, the average growth rate is reduced because the end point is reduced.

[iii] Figures after 2004 are taken from CBO's *Economic and Budget Outlook*, January 25, 2005. The revenue levels reflect CBO's official revenue baseline, adjusted for the assumed continuation of expiring tax provisions and indexation of the Alternative Minimum Tax. The adjustments are shown in Table 1-3 of the CBO report.