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The House Republican Tax Plan Is Fiscally Irresponsible

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The tax bill approved by the House Ways and Means Committee on November 9 is fiscally irresponsible. The bill would cost nearly $1.5 trillion over the decade, according to Joint Committee on Taxation (JCT) estimates. But provisions in the bill that would phase in slowly or expire after several years obscure the bill's true cost and would almost certainly drive the ultimate cost even higher.

Further, the costs would continue beyond the ten-year window shown in the official cost estimates, adding substantially to the nation's debt burden. A new analysis by Penn Wharton economists that also takes into account the bill's effects on the economy and the interest burden from higher debt levels estimates that it would add roughly $3 trillion to the debt between 2028 and 2037, the next decade beyond the current ten-year budget window.

Current Fiscal Outlook Doesn't Support House Bill's Irresponsible Tax Cuts

Today's tax debates are taking place in a substantially different fiscal environment than when past tax cuts were debated. Compared to 1981, when the Reagan tax cuts were passed, and 2001, when the Bush tax cuts were enacted, revenues today are lower and the debt held by the public is considerably higher, measured as a percent of the economy. (See Figure 1.)

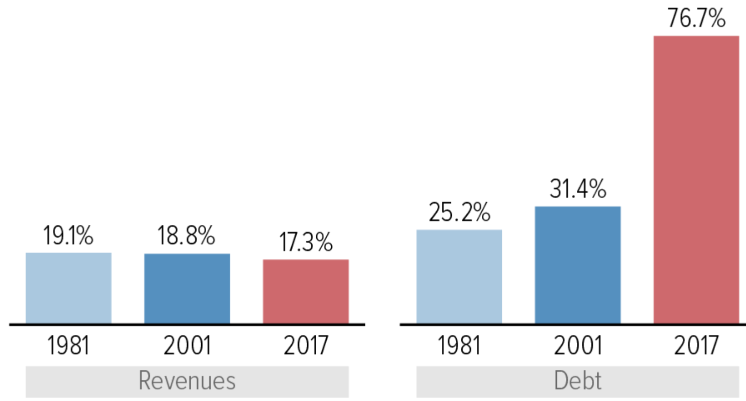
And the budget outlook is vastly different, particularly compared to when the 2001 Bush tax cuts were being considered.[1] In 2001, the federal government was running a surplus, the federal debt was shrinking, and large surpluses were forecast for the coming decade. Today's fiscal outlook is the opposite: deficits are growing and the debt is projected to rise from today's 77 percent of gross domestic product (GDP) to 91 percent in 2027, according to the Congressional Budget Office (CBO), due to rising health care and other costs associated with the retirement of baby boomers, as well as the significant ongoing costs of the Bush tax cuts. (See Figure 2.)

[1] Chuck Marr, "Unpaid-for Tax Cuts for Wealthy Even Less Defensible Now Than in Bush Era," Center on Budget and Policy Priorities, September 13, 2017, https://www.cbpp.org/blog/unpaid-for-tax-cuts-for-wealthy-even-less-defensible-now-than-in-bush-era.

FIGURE 1

Federal Revenues Lower, Debt Higher Than When Previous Tax Cuts Were Enacted

Percent of gross domestic product



Source: Congressional Budget Office

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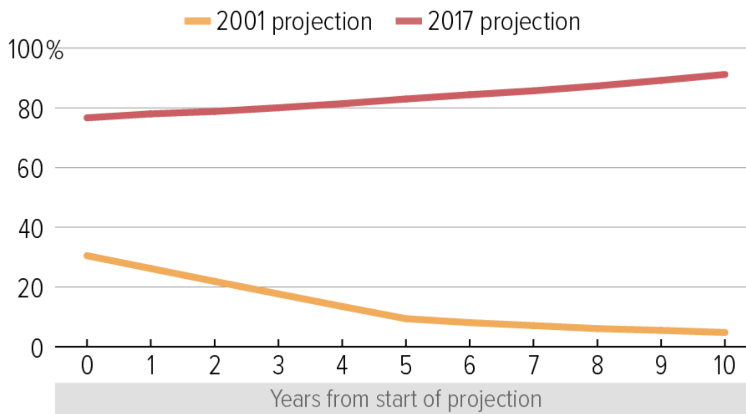
Despite these looming fiscal pressures, congressional Republican leaders have abandoned their earlier pledges to pursue revenue-neutral tax reform. Instead, they're aggressively advancing a costly tax cut. Together, the bill's revenue loss and associated debt service costs would add $1.7 trillion to deficits and debt between 2018 and 2027, and would bring the debt to 97 percent of GDP by 2027.

FIGURE 2

Fiscal Path Very Different Today Than When Bush Tax Cut Enacted

Ten-year projections of debt as a percent of gross domestic product (GDP)



Source: Congressional Budget Office

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Bill's True Cost Is Higher Than Advertised

The bill's cost is almost certainly understated in these estimates, however, because two of its major provisions would sunset (i.e., end) in 2023, in order to artificially hold down the bill's cost so that it complies with the rules established in the fiscal year 2018 congressional budget resolution, which restrict the size of the tax cut in this bill to $1.5 trillion over ten years.[2] These two provisions are:

A new $300 non-refundable tax credit for non-child dependents. This provision helps protect many middle-income people from facing a tax increase due to other provisions in the bill, such as the elimination of the personal exemption. But under the bill, this provision is slated to expire in 2023. That's a major reason that the number of people facing tax increases would rise over time, according to the JCT estimates. In response, Chairman Brady and other Republican lawmakers have said explicitly that policymakers would come back and extend the provision before it expires[3] — essentially acknowledging that the scheduled expiration of this tax credit in 2023 is a budget gimmick.

A generous deduction for business investments. The bill would let businesses deduct the cost of certain investments — such as in factories and equipment— in the year in which they're made, instead of following the current practice of deducting their cost over time as the factories and equipment wear out (i.e., as they "depreciate" or decline in value). This provision, known as "full expensing," would start immediately but then expire in 2023. With full expensing removed, businesses would pay more in tax than they would otherwise, as they couldn't deduct depreciation costs on investments they've already fully expensed. That's one of the main reasons that the JCT estimates show the bill's business provisions causing a tax *increase* on businesses in 2023.[4] Policymakers would very likely extend this provision, just as they have extended similar so-called "temporary" provisions that give businesses more generous deductions for investments in buildings and equipment.[5]

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[2] The budget resolution put in place a reconciliation process that allows a reconciliation bill that increases the deficit by no more than $1.5 trillion between 2018 and 2027 to pass in the Senate with only 50 votes (plus the Vice President). Technically, the permitted increase in the deficit is restricted to "on-budget" effects — that is, those outside Social Security and the Postal Service. The bill reported by the House Ways and Means Committee has on-budget revenue losses of $1.456 trillion over the decade, just under the $1.5 trillion allowed. Several provisions have an indirect effect on Social Security payroll revenues, which rise by $19 billion over the decade under the bill. When combined with the on-budget revenue changes, the net revenue loss on a unified basis is $1.437 trillion over ten years, according to JCT. See Joint Committee on Taxation, "Estimated Revenue Effects of H.R. 1, The 'Tax Cuts and Jobs Act,' As Ordered Reported by the Committee on Ways and Means on November 9, 2017," JCX-54-17, November 11, 2017.

[3] Richard Rubin, "Republicans Bank on Future Congresses to Keep Family Tax Credit," *Wall Street Journal*, November 3, 2017, https://www.wsj.com/articles/republicans-bank-on-future-congresses-to-keep-family-tax-credit-1509740274.

[4] Joint Committee on Taxation, "Estimated Revenue Effects Of The Chairman's Amendment In The Nature Of A Substitute To H.R. 1, The 'Tax Cuts And Jobs Act,' Scheduled For Markup By The Committee On Ways And Means On November 6, 2017," November 3, 2017, https://www.jct.gov/publications.html?func=startdown&id=5027.

[5] In particular, Congress has extended "bonus depreciation" on numerous occasions, including most recently in 2015, after it was first enacted on a "temporary" basis in 2008. See Chuck Marr and Brandon DeBot, "Ineffective 'Bonus Depreciation' Tax Break Should Remain Expired," Center on Budget and Policy Priorities, November 13, 2014, https://www.cbpp.org/research/ineffective-bonus-depreciation-tax-break-should-remain-expired and Joint Committee on Taxation, "Description of H.R. 2510, A Bill to Modify and Make Permanent Bonus Depreciation," September 16, 2015, https://www.jct.gov/publications.html?func=startdown&id=4828.

While there are no JCT estimates of the cost of extending these two provisions, the Committee for a Responsible Federal Budget estimates that continuing them after their expiration in 2023 would add roughly $400 billion to the cost of the bill over the decade.[6] These additional costs and the associated debt service would boost the debt-to-GDP ratio to 99 percent by 2027.

House Bill's Tax Cuts Would Have Substantial Long-Run Effects

The bill's cost will continue beyond 2027, adding to the nation's debt for years to come, a new analysis by economists at the University of Pennsylvania's Penn Wharton Budget Model finds.[7] The Bush tax cuts — which were first enacted in 2001 and then mostly made permanent following the "fiscal cliff" debate at the end of 2012 — provide an important lesson, as they represent a permanent loss of revenue that continues to add to the debt. (See box.) The cost of the Bush tax cuts, as amended, from 2001-2018 accounts for about one-third of the entire $15 trillion debt held by the public in 2018, we estimated in a 2013 study.[8]

Supporters of the House tax bill often claim that its positive effects on the economy will counter its large revenue losses, effectively removing any impact on the deficit. But the Penn Wharton estimates conclude otherwise. They estimate that the bill would increase the size of the economy above current projections by between 0.4 percent and 0.9 percent by 2027 — meaning it would only add between 0.04 percent and 0.1 percent to economic growth each year, on average. Further, the Penn Wharton study concludes that "this initial boost fades over time as more debt accumulates." Even after taking the bill's growth effects into account, Penn Wharton finds it would add *roughly $3 trillion* to the debt in the next ten-year period (2028-2037) beyond the official budget window.

Other estimates, such as those by the Tax Foundation, show higher economic growth effects from the House bill than Penn Wharton.[9] But the Tax Foundation's estimating model relies on assumptions that are well outside the economic mainstream.[10] For instance, the Tax Foundation

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[6] Committee for a Responsible Federal Budget, "House Tax Plan May Add Over $2 Trillion to the Debt," November 3, 2017, http://www.crfb.org/blogs/house-tax-plan-may-add-over-2-trillion-debt. Also, the package of amendments adopted at the end of the Ways and Means Committee consideration of the bill included a revenue-raising provision that would only take effect in 2023. The provision, which changes the tax treatment of research and experimentation expenditures, would raise $109 billion between 2023 and 2027. Businesses are likely to put significant pressure on policymakers to prevent the provision from going into effect; if they are successful, then the cost of the bill would be even higher.

[7] See Penn Wharton Budget Model, "The Tax Cuts and Jobs Act: Static Effect on Federal Tax Revenues," November 6, 2017, http://budgetmodel.wharton.upenn.edu/issues/2017/11/1/the-tax-cuts-and-jobs-act-effect-on-federal-tax-revenues and Penn Wharton Budget Model, "The House Tax Cuts and Jobs Act, Amended (11/9/17): The Dynamic Effect on the Budget and the Economy," November 13, 2017, http://budgetmodel.wharton.upenn.edu/issues/2017/11/13/the-house-tax-cuts-and-jobs-act-amended-11917-the-dynamic-effect-on-the-budget-and-the-economy.

[8] Emily Horton, "The Legacy of the 2001 and 2003 'Bush' Tax Cuts," Center on Budget and Policy Priorities, October 23, 2017, https://www.cbpp.org/research/federal-tax/the-legacy-of-the-2001-and-2003-bush-tax-cuts.

[9] Tax Foundation, "Details and Analysis of the 2017 Tax Cuts and Jobs Act," November 7, 2017, https://files.taxfoundation.org/20171107102758/Tax-Foundation-SR239.pdf.

[10] See Chad Stone and Chye-Ching Huang, "Trump Campaign's 'Dynamic Scoring' of Revised Tax Plan Should Be Taken With More Than a Grain of Salt," Center on Budget and Policy Priorities, September 15, 2017, https://www.cbpp.org/research/federal-tax/trump-campaigns-dynamic-scoring-of-revised-tax-plan-should-be-taken-with-more. Furthermore, there are known errors with the Tax Foundation's model that the Tax Foundation is currently

makes very aggressive assumptions about how certain tax changes affect decisions to work, save, and invest and thereby generates outsized estimates of the responses to various tax policy changes. It also ignores any impact of unpaid-for tax cuts on budget deficits and debt; in contrast, CBO and JCT assume, based on the empirical evidence, that higher deficits lead to a reduction in national savings and investment, ultimately lowering future economic output compared to what it otherwise would be. Yet even with these larger growth effects, the Tax Foundation still shows that the bill would fall far short of paying for itself, adding $1 trillion to deficits over the first ten years. (President Trump's Council of Economic Advisers also claims that a tax cut like the House bill would have large growth effects, particularly on workers' wages, but mainstream economists have sharply criticized those estimates as being highly implausible.[11])

Long-Run Effects of Tax Bills in the House and Senate

The tax bill is being considered under the special budget "reconciliation" process, but different rules apply to reconciliation bills in the House and Senate. In particular, certain rules, named after former Senator Robert Byrd, apply to Senate consideration of reconciliation bills.[a]

For example, while both houses have the same reconciliation instruction directing that the bill cannot cost more than $1.5 trillion over the 2018-2027 period, the two chambers face different requirements in the period after 2027. In the House, there are no restrictions on revenue losses after the ten-year window. But, in the Senate, one part of the Byrd rule prohibits an increase in the deficit in any year after 2027. Thus, the House bill as it now stands — which has large revenue losses beyond the ten-year window, as the Penn Wharton analysis shows — would violate the Senate's Byrd rule, which requires 60 votes to waive.

The Senate will need to take steps to address these out-year costs to avoid a Byrd-rule violation. The 2001 Bush tax cuts faced the same out-year problem, and policymakers chose to finesse it by sunsetting all of the provisions in the bill before the end of the ten-year window. That sunset, however, was an artificial constraint on the long-run cost of the Bush tax cuts. Policymakers subsequently continued the vast majority of the tax cuts on a permanent basis, rather than let them expire. When assessing the cost of any tax-cut bill that includes sunsets purely to comply with budget rules, history suggests that a much clearer picture of the bill's long-run effects requires assuming that policymakers will extend most or all the provisions beyond their sunset dates and likely make them permanent.

[a] David Reich and Richard Kogan, "Introduction to Budget 'Reconciliation,'" Center on Budget and Policy Priorities, updated November 6, 2016, https://www.cbpp.org/research/federal-budget/introduction-to-budget-reconciliation.

taking steps to correct. See Greg Leiserson, "The Tax Foundation's score of the Tax Cuts and Jobs Act," Washington Center for Equitable Growth, November 9, 2017, http://equitablegrowth.org/research-analysis/the-tax-foundations-score-of-the-tax-cuts-and-jobs-act/.

[11] Council of Economic Advisers, "The Growth Effects of Corporate Tax Reform and Implications for Wages," October 2017, https://www.whitehouse.gov/sites/whitehouse.gov/files/images/Corporate%20Tax%20Reform%20and%20Growth%20Final.pdf. See quote from Donald Marron in Nick Giampia, "Trump's corporate tax cuts won't increase wages by $4,000: fmr. acting CBO Director," FoxBusiness, October 17, 2017, http://www.foxbusiness.com/politics/2017/10/17/trump-s-corporate-tax-cuts-wont-increase-wages-by-4000-fmr-acting-cbo-director.html. See also Lawrence H. Summers, "Lawrence Summers: One last time on who benefits from corporate tax cuts," *Washington Post*, October 22, 2017, https://www.washingtonpost.com/news/wonk/wp/2017/10/22/lawrence-summers-one-last-time-on-who-benefits-from-corporate-tax-cuts/?utm_term=.b3d8a6ded4cd; and Chad Stone, "An Empty Pay-Raise Promise," *U.S. News & World Report,* November 10, 2017, https://www.usnews.com/opinion/economic-intelligence/articles/2017-11-10/gop-tax-plan-over-promises-and-under-delivers-on-middle-class-tax-cuts.