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Senate Republicans Take Big First Step Towards $1.5 Trillion Deficit-Increasing Tax Cut

Justifications for Revenue Loss Rooted in Wishful Thinking and Faulty Logic

By Chye-Ching Huang and Joel Friedman

The Senate Budget Committee will vote on a budget resolution this week that allows the Senate to move forward with tax-cut legislation that could add $1.5 trillion to deficits over the next decade.[1] If the tax plan that President Trump and Republican congressional leaders unveiled last week — which delivers 80 percent of its tax cuts to the top 1 percent of households, according to the Tax Policy Center (TPC)[2] — is any guide, the tax cut will be skewed toward high-income households, which have reaped most of the income gains of recent decades. Such a tax cut likely would ultimately hurt many Americans, because the resulting increase in deficits and debt would raise the pressure for cuts in programs that help low- and middle-income people or that produce long-term economic benefits. The majority of Americans could ultimately lose more from the program cuts than they would gain from the tax cuts.

Some Senate Republicans are reportedly preparing to argue that the $1.5 trillion deficit increase should not be a concern. They appear prepared to contend that even though they haven't yet drafted their tax-cut bill, it will generate so much additional economic growth over the next decade that the resulting higher tax revenues will offset most of the $1.5 trillion cost. They also argue that the more than $400 billion ten-year cost of extending a series of tax cuts that are due to expire or have already expired should be entirely disregarded, on the grounds that Congress would take the fiscally irresponsible step of extending these tax cuts anyway without paying for them. The justifications for dismissing the $1.5 trillion cost defy both evidence and logic.

[1] Senate Budget Committee, www.budget.senate.gov/taxreform.

[2] "A Preliminary Analysis of the Unified Framework," Tax Policy Center, September 29, 2017, http://www.taxpolicycenter.org/publications/preliminary-analysis-unified-framework.

Major Step Towards $1.5 Trillion in Deficit-Increasing Tax Cuts

Republican congressional leaders have made clear that they plan to use budget "reconciliation" to pass major tax legislation in the coming months.[3] Reconciliation bills can pass the Senate with a simple majority — that is, with only Republican votes — rather than the 60 Senate votes that most legislation requires. To use this process, Congress must first approve a budget resolution that creates a "reconciliation instruction" for tax legislation, setting deficit or revenue targets for the legislation over a number of years.[4]

Last week, the Senate Budget Committee unveiled a budget resolution that authorizes tax cuts that add $1.5 trillion to deficits over ten years and paves the way for using the reconciliation process to speed their passage.[5] Also last week, President Trump and Republican congressional leaders unveiled a tax plan that is heavily skewed toward high-income households, the group that has reaped most of the income gains of recent decades.[6]

Rather than requiring the $1.5 trillion cost to be offset through revenue-raising measures such as closing unproductive, inefficient, or low-priority tax breaks, the budget resolution would allow the tax cut's cost to add to future deficits, thereby exacerbating the nation's long-term fiscal challenges. Those higher deficits, in turn, would almost certainly fuel demands in coming years for budget cuts in a wide range of government programs, likely including programs that provide important services and benefits for tens of millions of low- and moderate-income Americans.

President Trump and many Republican lawmakers have repeatedly cited the projected growth in debt that we already face — *before* accounting for a tax cut that adds $1.5 trillion to deficits — to justify their proposals for substantial budget cuts in programs that help families meet basic needs like Medicaid and SNAP (food stamps), as well as in investments that can help build a stronger economy in the future like education and research.[7] If policymakers implement such budget cuts

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[3] Elana Schor, "McConnell plans to pass tax bill with just GOP votes," *Politico*, August 1, 2017, http://politi.co/2w3uhmL.

[4] David Reich and Richard Kogan, "Introduction to Budget 'Reconciliation,' Center on Budget and Policy Priorities, November 9, 2016, http://bit.ly/2u7gqK1.

[5] Rappeport and Kaplan.

[6] CBPP, "Trump Campaign and House GOP Tax Plans Violate Mnuchin Rule," April 25, 2017, http://bit.ly/2xmWIzw.

[7] For example, President Trump's budget states, "When debt levels keep increasing, more and more of the Nation's resources are required to service that debt and are diverted away from Government services that citizens depend on. To help correct this and reach our budget goal in 10 years, the Budget includes $3.6 trillion in spending reductions over 10 years, the most ever proposed by any President in a Budget." Office of Management and Budget, "A New Foundation for American Greatness," 2017, p. 9, http://bit.ly/2qRsDnZ. For analysis of the budget's proposals, see Guillermo Herrera and Joel Friedman, "Unpacking the Trump Budget's Tax and Spending Plans and Unrealistic Assumptions," CBPP, June 29, 2017, http://bit.ly/2wIvAvD. Similarly, the policy statement for the budget passed out of the House Budget Committee states, "Meeting the government's fiscal challenges will be a daunting task, requiring conviction and resolve. Governing is hard. . . . This committee's budget significantly reduces spending and reforms government programs to put us on a sustainable spending path." House Budget Committee Chairman Diane Black, http://bit.ly/2u8dmPg. For analysis of its proposed cuts, see Isaac Shapiro, Richard Kogan, and Chloe Cho, "House GOP Budget Cuts Programs Aiding Low- and Moderate-Income People by $2.9 Trillion Over Decade," CBPP, September 5, 2017, http://bit.ly/2u81n7F.

down the road to help reduce deficits that their tax cuts have enlarged, low- and many middle-income households are likely to lose considerably more than they gain from the tax cuts.[8]

Further, because the resolution instructs the Senate Finance Committee to make changes to deficits, not revenues, the committee can use cuts in programs under its jurisdiction — including Medicaid, Medicare, and Supplemental Security Income for poor seniors and people with disabilities — to pay for more tax cuts *on top of the $1.5 trillion*. As a result, there is potentially an immediate threat to some of these programs, if Republicans seek to expand their tax-cut plan beyond $1.5 trillion.

If anything, a major tax bill should *raise* revenue to help finance existing federal commitments and meet critical national needs now and in the future.[9] At a minimum, tax legislation shouldn't *lose* revenue, which would increase the nation's long-term fiscal challenges and make harsh cuts to key programs more likely. The nation's fiscal outlook is far different today than it was in 2001, when President Bush's costly tax cuts — also enacted through the reconciliation process — were justified in part because of projections at that time of large budget *surpluses* and declining debt in the years ahead (see box).

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[8] For analysis of President Trump's tax plan, see Isaac Shapiro and Chye-Ching Huang, "Vast Majority of Americans Would Likely Lose From Trump Tax Cuts, Once They're Paid For," CBPP, August 17, 2017, http://bit.ly/2wXMDGr. A $1.5 trillion tax cut that was similarly distributed and financed would generate a comparable pattern of winners and losers.

[9] Paul N. Van de Water, "Federal Spending and Revenues Will Need to Grow in Coming Years, Not Shrink," CBPP, September 6, 2017, http://bit.ly/2fphrff.

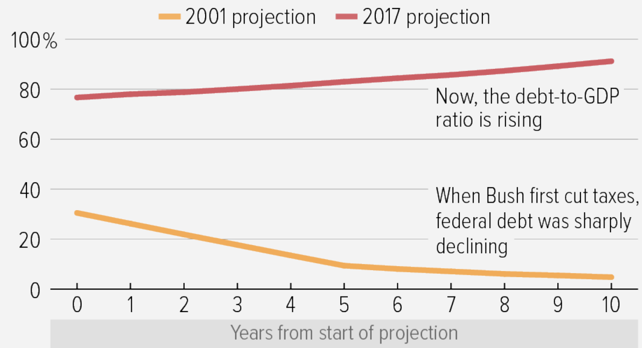
Repeat of a Bad Idea from 2001, But Outlook Is Now Far Different

The Senate budget resolution provision allowing tax cuts that add $1.5 trillion to deficits is reminiscent in some ways of President Bush's 2001 tax cuts, which also were enacted through the fast-track budget reconciliation process. But a new deficit-financed tax cut today would be even less fiscally responsible than the 2001 tax cuts turned out to be, because the country's fiscal context has reversed dramatically.

One main justification for the 2001 Bush tax cuts was a wave of projected budget surpluses and a much lower level of federal debt, which was projected to shrink and ultimately to disappear altogether. Federal Reserve Chair Alan Greenspan cited the potential disappearance of federal debt — and the specter of the federal government then investing its budget surpluses in the private sector — as a reason for enacting tax cuts at that time.[a] Similarly, then-Senate Finance Committee Chairman Charles Grassley argued that "we can pay down the national debt. We have a tax surplus. We can give tax relief to every taxpayer."[b]

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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The situation could not be more different today, in part because of the impact on deficits and debt of the Bush tax cuts' substantial revenue losses. The Congressional Budget Office expects federal deficits and debt to rise in the future — even before accounting for $1.5 trillion in new tax cuts — from today's 77 percent of gross domestic product (GDP) to 91 percent in 2027.[c] The Senate budget resolution repeats the same mistake as 2001's unpaid-for tax cuts, but at a time when the nation faces the added challenge of rising debt and the need for more federal revenue, not less.

[a] John M. Berry, "Greenspan Supports a Tax Cut," *Washington Post,* January 26, 2001, http://bit.ly/2u81n7F.

[b] *Congressional Record—Senate,* S2180, March 13, 2001, http://bit.ly/2wgzOX3.

[c] Chuck Marr, "Unpaid-for Tax Cuts for Wealthy Even Less Defensible Now Than in Bush Era," CBPP, September 13, 2017, http://bit.ly/2flUndv.

Dismissing a $1.5 Trillion Increase in Deficits

Congress's non-partisan scorekeepers, the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT), will provide cost estimates that will figure heavily in determining whether the tax cut bill that Congress writes complies with the reconciliation instruction that the forthcoming congressional budget resolution contains.

For purposes of assessing compliance with the reconciliation instruction's planned authorization of tax cuts that add $1.5 trillion to deficits, CBO and JCT will use their standard estimating methods. Though described as "static scoring," such estimates account for various ways that tax cuts can affect the behavior of individuals and corporations. But CBO and JCT won't use "dynamic scoring" for these purposes; dynamic scoring seeks to accomplish the considerably more difficult and uncertain task of estimating how tax cuts would affect the size of the overall U.S. economy. (CBO and JCT will likely provide a "dynamic estimate" of how the bill might affect the size of the economy and, hence, revenue levels, but for informational purposes only rather than for purposes of assessing compliance with the revenue target.)

Some Senate Republicans are preparing nevertheless to argue that the $1.5 trillion estimated deficit increase would *not* increase deficits and debt. News accounts and their own statements indicate that they plan to use two main arguments,[10] neither of which withstands scrutiny.

Wishful Thinking About Economic Growth

The first such argument is that the tax cuts will boost economic growth so much that they will generate $1 trillion or more of additional revenue over the coming decade, offsetting most of the tax cuts' cost.

This assumption is highly problematic for a number of reasons. First, it's based on a bill that doesn't yet exist. Senate Republicans can't estimate how much their tax plan would boost growth before they know its details.

Second, by claiming credit for the benefits of economic growth up front, once their bill is drafted, GOP leaders won't be bound by JCT and CBO's assessment of its impact on the economy, which is likely to be much more modest than GOP leaders are assuming. In other words, if JCT and CBO find that the tax bill would have only a small impact on economic growth that generates far less than $1 trillion in additional revenues, the reconciliation instructions still would allow for the full $1.5 trillion in deficit increases. Such an outcome is likely, because JCT and CBO use mainstream estimating models and almost certainly won't show the large dynamic effects that Senate Republicans apparently intend to assume and take credit for.

Diminishing JCT and CBO estimates and analysis in this way is, unfortunately, consistent with recent statements by some GOP senators who have criticized JCT's dynamic estimates in favor of other estimates that would be much more favorable to large tax cuts.[11] Senate Budget Committee Republican Bob Corker, for instance, said recently that "we should take other things into account other than Joint Tax and CBO. I think it's fair for us to get outside help." Corker seemed to be referring to potential estimates of big economic effects by outside groups that favor large tax cuts and whose analysis of these matters is well outside the mainstream.[12]

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[10] See Siobhan Hughes and Richard Rubin, "Senate Republicans Reach a Deal on Budget," *Wall Street Journal*, September 19, 2017, http://on.wsj.com/2f9ZWvv. "[CBO] projects that the U.S. will collect about $43 trillion in tax revenue over the next decade. Republicans would prefer to start with a slightly lower number, meaning a lower hurdle to get over when accounting for the impact of tax cuts, because there are more than $400 billion in expired or expiring tax breaks that they assume would be extended anyway. And they also want to assume that their tax plan, which isn't written yet, would increase economic growth and thus partly pay for itself with new tax revenue. The Senate parliamentarian, Elizabeth MacDonough, balked at that accounting, said Sen. John Thune (R., S.D.). Instead, Republicans will start with the CBO projection and set a tax-cut number that includes the cost of extending expiring tax cuts and an assumption about how much revenue from economic growth they might get."

[11] For example, see Senator Ted Cruz, "Tax Reform Should Focus on Creating More Jobs, Higher Wages, and More Opportunity," speech before the Tax Foundation, September 13, 2017, http://bit.ly/2xx8Nl7; Senator Hatch saying of CBO, "They're wrong about everything," as reported by Alan Rappeport, September 19, 2017, http://bit.ly/2xmvV6r.

[12] See Alan Rappeport, "In Battle Over Tax Cuts, It's Republicans vs. Economists," *New York Times,* September 22, 2017, http://nyti.ms/2xmSl7C.

In contrast, estimates from analysts who are in the mainstream are likely to be consistent with JCT and CBO, and to indicate that Senate Republicans have made highly unrealistic assumptions about the economic effects of their tax proposals. TPC, for instance, found that the dynamic effects of the House GOP's "Better Way" tax plan would reduce its price tag by only about $60 billion, or 2 percent, over ten years.[13] TPC also concluded that President Trump's tax proposals — from both his campaign and his presidential tenure to date — would likely *slow*, not boost, economic growth over time because their large cost would lead to higher deficits and interest rates that, in turn, would lead ultimately to reduced investment.[14]

Since a tax package costing $1.5 trillion would similarly add to deficits, it, too, would risk adversely affecting long-term growth. To meet the rosy cost assumptions that Senate GOP leaders apparently intend to make, the tax-cut package would have to ignite economic growth so robust that the growth would not only overcome the adverse economic effects that a large revenue-losing tax cut otherwise would have, but on top of that, also would produce roughly $1 trillion over ten years in added revenue.[15]

To defend their arguments, some Republican lawmakers likely will point to the results of models that produce more favorable estimates of the impact of tax cuts on economic growth than the mainstream models JCT and TPC typically employ.[16] Yet all involved in the process should take estimates well outside the analytic mainstream with a large grain of salt.[17]

To justify their rosy assumptions, some Republican lawmakers may point to a JCT analysis of the tax reform plan that former Ways and Means Committee Chair Dave Camp developed in 2014, which found that it could boost revenues by as much as $700 billion over ten years due to higher growth. But the Camp plan was roughly *revenue neutral* (that is, it didn't increase deficits) under *conventional* estimating methods, so it didn't need to overcome the growth-reducing efforts of much higher deficits resulting from the plan's tax cuts. Furthermore, JCT analyzed the Camp plan using two different models and a range of assumptions that resulted in eight separate estimates of the

[13] Benjamin R. Page, "Dynamic Analysis of the House GOP Tax Plan: An Update," Tax Policy Center, June 30, 2017, http://tpc.io/2uKUhlt.

[14] Tax Policy Center, "The Implications of What We Know and Don't Know about President Trump's Tax Plan," July 13, 2017, http://tpc.io/2ufiHX7.

[15] The "Big Six" statement signed by congressional leaders and senior Administration officials shared key components with the House and Trump plans, including specifying costly, regressive tax-cut policies but few specifics on revenue-raising provisions. The White House, "Joint Statement on Tax Reform," July 17, 2017, http://bit.ly/2u2OXJg.

[16] For example, Senator Cruz cited the Tax Foundation estimates of his plan during the presidential campaign. Jennifer Rubin, "The pluses and minuses in Ted Cruz's tax plan," *Washington Post*, October 30, 2015, http://wapo.st/2jTvc7o. Further, Treasury Secretary Mnuchin has signaled that the Trump Administration may also provide its own estimates of the economic impact of tax plans, which may be based on assumptions that are far outside the mainstream. For discussion of one such assumption, see Chye-Ching Huang and Brandon DeBot, "Corporate Tax Cuts Skew to Shareholders and CEOs, Not Workers as Administration Claims," CBPP, August 16, 2017, http://bit.ly/2ue6Czp.

[17] 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, Relies on Assumptions Well Outside the Mainstream," CBPP, September 15, 2016, http://bit.ly/2wJRRZI.

added revenue from stronger growth, with the estimates ranging from *$50 billion to $700 billion*.[18] The $700 billion estimate was produced by using the most generous set of assumptions by far, as well as a model that itself makes unrealistic assumptions about how businesses and households behave in response to tax cuts and also assumes that future Congresses will enact deficit-reduction measures to stabilize the debt as a share of the economy. Those questionable assumptions make it imprudent to rely on that model's results.

A Free Pass for More Than $400 Billion in Tax Cuts

Some Republican senators also argue that policymakers should ignore the more-than-$400 billion cost of including provisions in the tax package that make permanent the dozens of temporary corporate and individual tax cuts that otherwise will expire under current law or already have expired. They argue that Congress would extend these tax cuts anyway without paying for them.[19] They essentially use the potential for policymakers to take one fiscally profligate action to justify another.

Such logic is flawed and represents risky fiscal policy. When policymakers first enacted these provisions on a temporary basis, their estimated costs were predicated on the fact that the tax cuts would be temporary. Now, Senate Republicans don't want to account for the costs of extending those tax cuts, essentially treating that as a "free lunch."

Under this logic, lawmakers could routinely enact so-called "temporary" tax cuts or other measures in the future, count only the temporary costs, and subsequently make the tax cuts permanent as if that carried *no* additional cost. They could add to deficits without ever having to reckon with the full cost of their actions.

[18] See Paul Van de Water and Chye-Ching Huang, "House 'Dynamic Scoring' Rule Likely Will Mean More Tax Cuts — Not More Information," CBPP, January 5, 2015, http://bit.ly/2wOlBQx.

[19] See Hughes and Rubin.