February 5, 2019

CBO Confirms GOP Tax Law Contributes to Darkening Fiscal Future

In a hearing last week, Congressional Budget Office (CBO) Director Keith Hall presented the agency's updated Budget and Economic Outlook. The report shows a darkening fiscal future, with trillion-dollar deficits and record debt levels expected within a decade.

Republicans tried to use the hearing as an opportunity to tout their 2017 tax law, but they conveniently ignored the role it played in exacerbating our fiscal challenges. More than a year since enactment, we have seen little evidence to date that the tax cut is meeting Republicans' promises. Returning the country to a sustainable fiscal path – and ensuring that we avoid repeating the same policy mistakes – can only begin with an honest accounting of the Republican tax law's impact on our nation's long-term economic and budgetary health.

Any Economic Growth from the GOP Tax Law is Slight and Short-Lived

The tax law boosted the economy last year, helping spur real GDP growth of 3.1 percent.[1] According to CBO's projections, however, that boost is waning. Real GDP growth is expected to slow to 2.3 percent this year and 1.7 percent next year. By 2023, the tax law's positive effect on economic growth will fade away entirely.

Beyond this temporary boost, the tax law does not change our longer-term path of growth. Between 2023 and 2028, CBO expects the economy to grow by an average 1.8 percent. That is slightly lower than the average growth rate CBO projected in June 2017, before the tax cuts were enacted (1.9 percent for 2023-2027). These estimates are also far below the Trump Administration's forecast of annual growth of at least 3 percent over the next several years.

While CBO estimates that the tax law will increase the size of the economy by an average 0.7 percent between 2018 and 2028, there is no evidence that it is making a meaningful difference for families that are struggling financially. Households with incomes of $25,000 or less, for example, saved an average $60 in 2018 from the tax cut, according to the Tax Policy Center. By comparison, the top 1 percent of households saw savings of more than $51,000 on average.

The tax law's growth effects, while modest, are unsurprising. Pumping money into the economy, whether via tax cuts or increased spending, can usually spur faster economic growth in the near term. But whether that growth is sustainable, equitably shared, and ultimately improves our long-run economic and budgetary outlook depends on how the fiscal stimulus is

[1] Measured from Q4:2017 to Q4:2018.

This document has not been reviewed and approved by the Democratic Caucus of the Budget Committee and may not necessarily reflect the views of all members.

designed. In particular, well-targeted fiscal stimulus during recessions can help avoid prolonged economic damage, ensuring higher growth – and a brighter fiscal future – down the line.

By contrast, research suggests that fiscal stimulus deployed when the economy is already strong – as the Republican tax law was – has a smaller impact on economic growth and is a greater burden on the federal debt. So, while the tax cut temporarily increased economic growth, it offers little bang for the buck and could harm our economy in the long-run.

GOP Tax Law Will Not Pay for Itself

Treasury Secretary Steven Mnuchin claimed that the tax law would not only pay for itself through higher growth, but would reduce the deficit by a trillion dollars. When asked whether these claims were true, Director Hall was unambiguous: No. As his testimony makes clear, "the economy isn't likely to grow quickly enough to shrink the budget deficit."

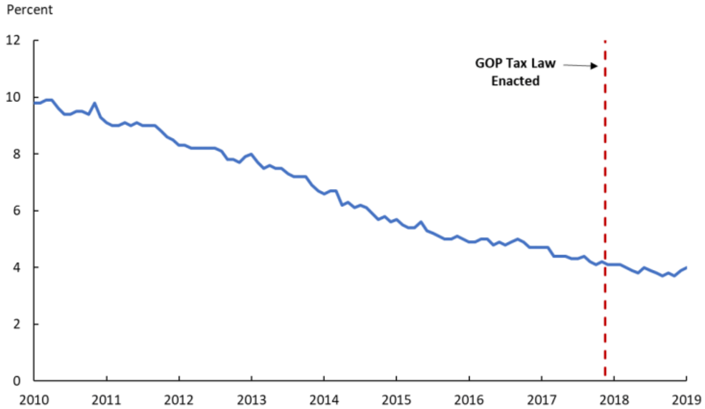
CBO projected that the tax cut will add $1.9 trillion to deficits over 10 years, even after accounting for any growth effects. We are already seeing this play out. The deficit grew 17 percent last year and is projected to grow another 15 percent this year even as the economy grew faster. The idea that tax cuts for the wealthy and corporations would allow us to grow our way out of debt – one of Republicans' favorite myths – has proven incorrect once again.

Republicans Are Coasting on President Obama's Recovery

Republicans pointed to other aspects of the economy's strength – including low unemployment and growing business investment – as evidence that their tax cut succeeded in turning the economy around. In reality, the economy's strength is largely a continuation of the economic expansion that began under President Obama and is now the second-longest on record. As the figures below show, the Republican tax cut has not visibly changed the trajectory of economic trends.

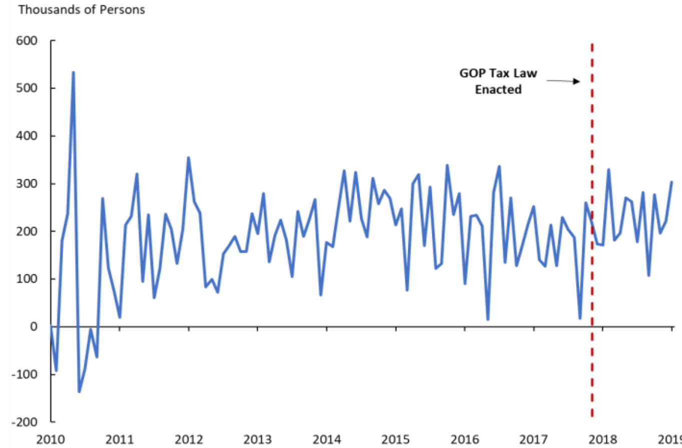
Unemployment, for example, has fallen to lows not seen in nearly 50 years – a much-needed development for American workers. But attempting to attribute this decline to the Republican tax cut ignores the unemployment rate's steady decline over the last decade. When President Obama entered office, the unemployment rate was 7.8 percent and rapidly climbing. By the time he left, the unemployment rate had fallen to 4.7 percent, more than 3 percentage points lower than at the start of his term and well below the 6.1 percent average rate over the last 50 years.

Unemployment Rate



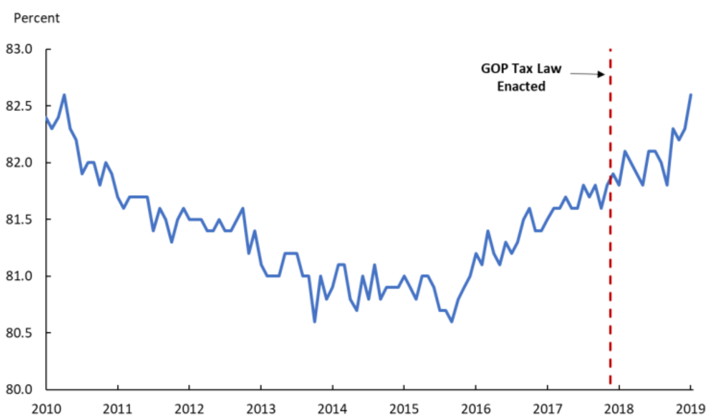
Source: Bureau of Labor Statistics

Nonfarm Jobs Added Each Month



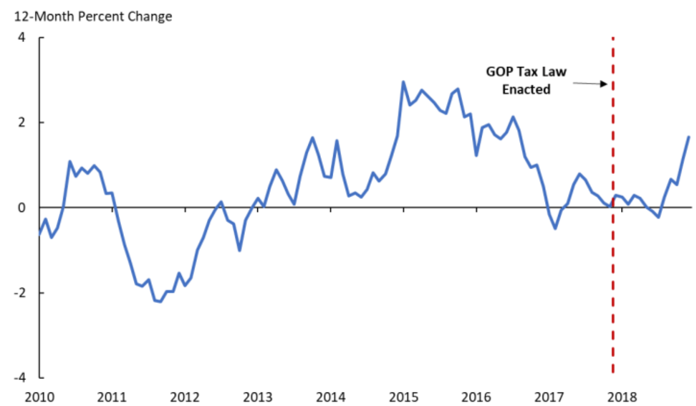
Source: Bureau of Labor Statistics

Prime-Age (25-54 years) Labor Force Participation Rate



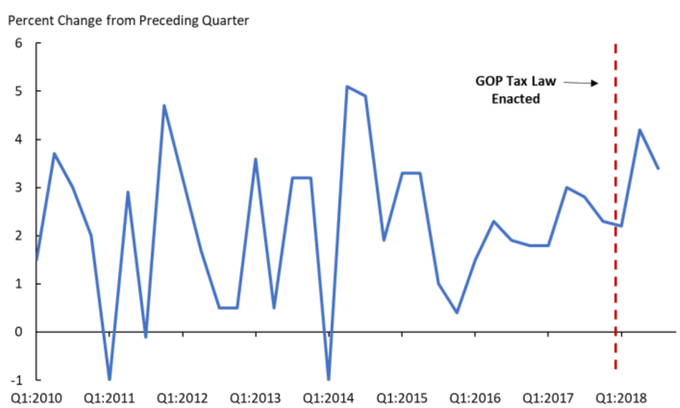
Source: Bureau of Labor Statistics

Real Hourly Wage Growth



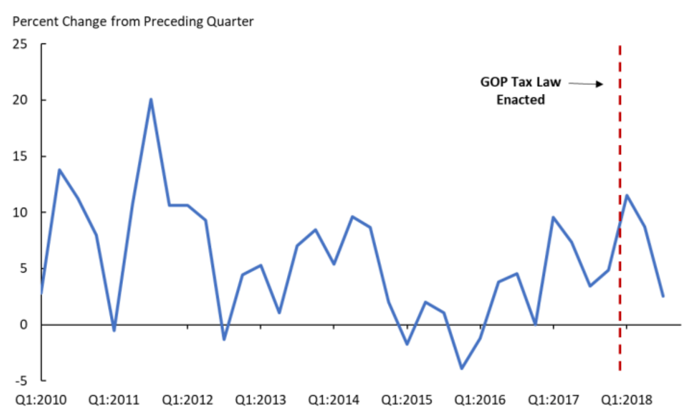
Source: Bureau of Labor Statistics. Data reflects average hourly earnings of production and nonsupervisory employees. Series adjusted for inflation using CPI-W.

Real GDP Growth



Source: Bureau of Economic Analysis

Real Private Nonresidential Fixed Investment Growth



Source: Bureau of Economic Analysis

GOP Tax Law Made History, But Not in the Way Republicans Claimed

President Trump said that the tax law "unleashed an economic miracle." While we have yet to see this miracle materialize, Republicans did achieve something unprecedented with their tax cuts: deficits are growing larger even as the economy grows stronger.

As Director Hall noted during his testimony, this is a new development in our history. During periods of low unemployment and strong economic growth, we would expect higher revenue to drive down deficits. In the last half-century, deficits averaged 1.5 percent of GDP in years when the unemployment rate was below 6 percent. In years when unemployment fell below 5 percent – as they have since 2016 – average deficits were just 0.7 percent of GDP.

In contrast, the deficit is projected to rise from 3.8 percent of GDP in 2018 to 4.2 percent of GDP this year, and average 4.4 percent of GDP over the next 10 years. Rather than use the strengthening economy as an opportunity to get our fiscal house in order, Republicans broke a well-established relationship between stronger growth and lower deficits.

Low Revenue is Straining Our Fiscal Outlook

Republicans like to claim that we have a spending – not a revenue – problem. But by any measure, the U.S. is taking in an unusually low level of revenue, a problem exacerbated by the 2017 tax law. This helps explain why deficits are getting larger despite a faster-growing economy. For example, as a share of GDP, revenue projected this year (16.5 percent) is nearly a percentage point below the 50-year historical average (17.4 percent).

And year-over-year revenue growth is far below where it should be, given the strength of the economy. The last time that annual real GDP growth was as high as the 3.1 percent in 2018 was in 2005, when revenue grew by 15 percent from the previous year. In 2018, revenue grew by just 0.4 percent. Similarly, over the last half-century, revenue has averaged 18.3 percent of GDP in years in which the unemployment rate has fallen below 5 percent. That is nearly 2 percentage points higher than projected revenue this year.

Revenue is also coming in lower than recent projections. In its June 2017 forecast, for instance, CBO predicted that we would spend 20.5 percent of GDP on outlays in 2018 and collect 17.7 percent of GDP in revenue. In actuality, spending was 20.3 percent of GDP – below what was forecast and consistent with the 50-year average – but revenue was only 16.4 percent of GDP. Contrary to Republicans' claims, last year's deficit was not the result of out-of-control spending.

Finally, our revenue shortage is especially striking in light of demographic trends that clearly lead to a growing need for Social Security, Medicare, and other programs crucial to Americans' retirement security. Despite an over-65 population that is more than 2.5 times larger than it was 50 years ago, we will collect revenue this year that is 2.6 percentage points lower as a share of GDP than we did in 1969. By 2029, when the over-65 population is expected to be one-third larger than it is today, revenue as a share of GDP will still be lower than what we collected 50 years ago.

Republicans Plan to Cut Vital Programs to Pay for Tax Cuts

Throughout the hearing, Republicans reiterated their goal of cutting vital programs in order to reduce the deficits their tax cuts exacerbated. While CBO projects rising spending on Social Security and health care programs will drive increases in government outlays going forward, Republicans' proposed solution – slashing Social Security, Medicare, and Medicaid – shows a fundamental misunderstanding of the problem.

Mandatory spending is projected to rise from 12.5 percent of GDP in 2018 to nearly 15 percent of GDP by 2029, the vast majority of which is due to increased spending for Social Security and Medicare. This growth is driven by an aging population and rising health care costs – not, as Republicans suggest, increasingly generous benefits. Mandatory spending dedicated to the population of Americans age 65 or older grew from 6 percent of GDP in 2005 to 7.5 percent in 2018, and is expected to rise to nearly 10 percent by 2029.

Republicans' proposal to cut these programs does nothing to account for the nation's changing demographics or address the underlying causes of rising health care costs. Rather than offer a real solution, Republicans propose to pay for their tax cuts at the expense of American seniors and families.

GOP Tax Cuts Were A Squandered Opportunity

In an effort to raise fear about the fiscal outlook, Republicans pointed to hypothetical spending proposals by Democrats – such as universal child care, housing support, and expanded tax credits for working families – while staying quiet about their tax cuts' impact on the debt. Despite the insincerity of this ploy, it provided a useful demonstration of the difference between Republican and Democratic budget priorities.

Republicans spent $1.9 trillion on tax cuts that primarily benefited the wealthy and corporations and in return will get a very meager 0.7 percent in additional economic growth over the next decade. The tax cuts are not solving any of the problems facing American families, from unaffordable child care and hospital bills, to the high cost of education, to decades-long wage stagnation and growing inequality. Moreover, the tax cuts did not fundamentally address the long-run economic challenges facing this country, such as climate change and a rapidly aging population. Making the situation far worse, Republicans want to offset the deficits they exploded through severe program cuts that endanger seniors' retirement security and place additional burdens on families.

When Republicans decided that spending trillions of dollars on tax cuts for the wealthy was more desirable than repairing our infrastructure or making education more affordable, they squandered our flexibility to make long-term investments in our economy and communities. Going forward, Democrats will instead support policies that invest directly in improving Americans' living standards, that foster sustainable and equitable economic growth, and that stabilize our fiscal outlook.