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Tax Cuts for the Wealthy Do Not Pay for Themselves

The House will consider a tax bill this week that provides massive giveaways to the wealthy, imposes tax increases on millions of middle-class families, and increases federal budget deficits by $1.5 trillion over ten years. For decades, Republican leaders have peddled the myth that we need not worry about the deficit effects of giving large tax cuts to wealthy taxpayers. Under their repeatedly disproven "supply side" theory, they claim these tax cuts will spur so much new economic activity that the new revenues generated will offset most or all of the direct revenue loss caused by the tax cuts.

- There is no evidence to support these claims.
- The last few decades provide numerous examples of Republican claims about the economic and fiscal effects of tax cuts (and tax increases) for the wealthy that failed to materialize.
- Instead, what happens is that such tax cuts predictably lead to higher deficits, and then Republicans point to these deficits to call for deep spending cuts to programs and services that are important to the middle class and families struggling to get by.
- Experts do not expect the current tax plan to yield different results. This plan is another in the long line of proposals designed to shrink government and damage programs that American families rely on.

Contrasting Results under Presidents Clinton and Bush

The contrasting fiscal policies and economic performance during the Clinton and second Bush administrations illustrate the fallacy of Republican claims about the relationship between tax cuts for the wealthy and economic growth.

President Clinton began his Administration in 1993 with a deficit-reduction package that raised taxes on upper-income taxpayers. His proposal passed without a single Republican vote. Many Republicans predicted it would lead to an economic disaster and thus fail to reduce deficits. After all, the supply-side thinking goes, if tax cuts for the wealthy will significantly increase economic growth, then tax increases on wealthy taxpayers must shrink the economy. Instead, a few years after passage of the Clinton tax increase, the United States enjoyed strong economic growth.

President Bush began his Administration in 2001 with an unpaid-for tax cut that largely benefited the same wealthy taxpayers who saw their taxes go up under Clinton. Most Republicans enthusiastically supported President Bush's tax cuts as promoting economic growth. After passage of the Bush tax cuts, the United States experienced a remarkably weak economic recovery, and the federal budget moved from record surpluses to record deficits.

The sharp difference in economic performance during the Clinton and Bush administrations does not mean that tax increases are always good for the economy or that tax cuts are always bad. However, it does clearly show that cutting taxes for the wealthy does not generate huge economic or fiscal benefits. The top marginal tax rate is simply not a significant determinant of economic growth. Its impacts are not large enough to override other factors, such as the rate of labor force growth or the fluctuations of the business cycle.

The Reagan-era Tax Cuts Did Not Generate Strong Growth

Congressional Republicans often cite the economic performance during the Reagan Administration as justification for their current round of tax cuts. The supply-side theory holds that tax cuts for the wealthy promote economic growth by encouraging the holders of wealth to make more investments that would make the economy more productive. However, growth during the Reagan years was driven primarily by growth in the labor force, not growth in productivity. The economy grew during the 1980s primarily because more of the baby-boom generation was entering its prime working years, and the share of women participating in the workforce was steadily increasing. Neither of those long-term demographic trends had anything to do with cutting taxes for the wealthy. Interest rate cuts by the Federal Reserve and increased defense spending also contributed to economic growth in the Reagan years. Again, neither of those policies bore any relationship to the tax code.

Tax cut advocates' reliance on the Reagan example is also undercut by the fact that the economy went into recession soon after passage of the Reagan tax cuts. Strong growth did not begin until after the 1982 tax increase – the largest peacetime tax increase in history as a share of the economy – took effect. Again, this does not mean that a tax increase led to economic growth. But it certainly provides evidence that changes in taxes are not the driving force behind the economy.

The Kansas Experiment

In 2012, the state of Kansas went all-in on supply-side tax cuts. The tax-cut initiative championed by Kansas Governor Sam Brownback had much in common with the current House Republican bill: cutting rates and creating a special loophole for "pass-through" business income. Proponents of the tax cuts dismissed analysis showing that it would dramatically increase Kansas' budget deficit and argued that it would spur the economy instead. Advocates of the Kansas legislation hailed it as a model for the nation that would demonstrate the effectiveness of supply-side economics.

That tax cut turned out to be a disaster for Kansas. The state saw a steep decline in revenue, and its economy grew at barely half the national rate, with job creation lagging even further behind the national average. Kansas' debt level increased, and its credit rating fell. Earlier this year, the Republican-controlled Kansas legislature overrode Governor Brownback's veto and rolled back much of the tax cut.

The Kansas experiment clearly failed. Nevertheless, congressional Republicans seem determined to duplicate that failure on a national level.

Growth and the House Republican Tax Bill

Tax cuts can offer some economic stimulus. A $1.5 trillion tax cut effectively means $1.5 trillion in additional deficit spending. That will modestly increase economic growth in the short term, although the benefits will likely be undercut eventually by the drag created by higher deficits. Much of that drag occurs outside the ten-year budget window.

The short-term stimulus will likely generate some additional revenues. But this short-term feedback effect will not come anywhere near the level necessary to offset the bill's costs. The Joint Committee on Taxation (JCT) macroeconomic estimate for the current bill is not yet available but it is unlikely to produce dramatic savings. Since the House began requiring macroeconomic estimates for major tax bills, the JCT has provided feedback estimates for two major bills. JCT estimated that a bill making various temporary tax provisions permanent would generate feedback that would cover about 10 percent of the bill's cost, while a bill permanently extending bonus depreciation incentives was credited with feedback covering about 5 percent of costs.

We do have some macroeconomic analyses of the broad framework of the proposal. The Tax Policy Center estimated that the dynamic feedback would be about two percent over ten years and actually negative in the second decade. Wall Street investment firm Goldman Sachs also saw little effect from the proposal – an increase in GDP growth of 0.1 to 0.2 percentage points in the next two years, and smaller effects in subsequent years, with a dynamic feedback of about 20 percent. A Penn-Wharton analysis of an early version of the House bill found revenue feedback would be between eight and 20 percent.

The credit rating agency, Fitch Ratings, has revised its debt forecast for the United States as a result of the pending tax bill. It indicated that it believes the tax cuts may lead to a short-term boost but not lead to a permanently higher growth rate. It now expects growth to peak at 2.5 percent next year and drop to 2.2 percent in 2019. These are below the growth levels the economy has seen in recent months.

It is clear that the tax bill will not generate enough growth to offset more than a small fraction of its $1.5 trillion cost. And over the long term, as the effects of increased deficits begin to drag growth down, the growth rate could end up lower than it would be without the tax cuts.

What Republican Tax Cuts Are Really About

The latest Republican tax bill is just step one of the GOP's three-step plan to give to the rich and make American families pay for it.

- <u>Step 1</u>: Cut taxes for the rich, and claim that economic growth will pay for it.
- <u>Step 2</u>: Pretend to be shocked when the deficit explodes; insist that the only way to fix it is through more spending cuts.
- <u>Step 3</u>: Cut important benefits for American families, like Medicare, Social Security, and education assistance, while doing nothing to make millionaires pay their fair share.