HOUSE BUDGET COMMITTEE

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Tax Cuts Lead to Massive Budget Deficits in the President's 2007 Budget: Budget in Brief #6

Administration's Tax Agenda Increases the Deficit — The Administration's stated tax agenda reduces revenues by $1.9 trillion over ten years (2007-2016), according to the Joint Committee on Taxation. When the cost of a ten-year repair of the AMT is factored in, the Administration's tax policies worsen the deficit by $2.7 trillion, before adding the extra cost of debt service.

The President's Budget Raises Taxes in the Form of Increased User Fees — Every one of the Bush Administration's budgets has included billions of dollars in new fees and user charges. Moreover, the amount of new fees in the budget grows every year. The President's 2002 budget included $4.9 billion in new fees over five years (2002-2007) while the 2007 budget includes $47.2 billion in new fees over five years (2007-2011) – a nearly ten-fold increase.

Tax Cuts Do Not "Pay for Themselves" — Some conservative economists claimed that the 2001 tax cuts would generate such remarkable growth in income that revenue collected would be higher after the tax cuts due to the expanded tax base, implying that the tax cuts would "pay for themselves." The deterioration in tax receipts since 2001 shows this not to be the case. The Administration's 2002 budget stated that the President's budget would "achieve historic levels of debt reduction" and the Administration projected that tax revenues would amount to $11.4 trillion between 2001 and 2005. After five years of budget deficits, the tax cuts have failed to produce the expected results, with the Treasury instead raising $9.7 trillion since 2001 – $1.7 trillion below the projected level.

OMB v. CBO: Different Estimates of the President's Budget

On February 9, the Budget Committee Democratic staff issued its detailed "Summary and Analysis of the President's Fiscal Year 2007 Budget." That report (at *www.house.gov/budget_democrats/*) analyzed the budget using the estimates submitted by the Office of Management and Budget. The Congressional Budget Office (CBO) has since re-estimated the President's budget, and this report uses CBO's estimates of spending and revenue.

The Joint Committee on Taxation estimates that the President's three major tax cuts cost $1.5 trillion between 2001 and 2014, without incorporating the additional costs of debt-servicing. Even the most ardent supporters of the tax cuts admit that the revenue growth claimed to be generated by the cuts would not be sufficient to compensate for the lost revenue. Josh Bolten, Director of the Office of Management and Budget, recently stated in a House Budget Committee hearing:

> Economists are in disagreement about the size of what the dynamic effect is, and I'm hopeful that they will come to some agreement soon. But you're right. I'm not arguing that a dollar of tax cut produces a dollar of tax revenue.

This comment reinforces the well-established notion that tax cuts do not "pay for themselves."

***Reductions in Revenue Cannot Be Blamed on Recent Events* —** Conservative economists point to the September 11th attacks as the justification behind the dramatic reversal in the budget outlook. But the economic impact of September 11th was temporary, a fact supported by both liberal and conservative economists. At a House Budget Committee hearing in 2004, Alan Greenspan stated:

> Immediately after 9/11 we had expected a very significant contraction in economic activity, which was likely to be prolonged. Within a matter of weeks, or a few months at the longest, it became quite evident that the economy had achieved a degree of resiliency which we had not expected it had, and it stabilized reasonably quickly and started to grow again at a fairly modest but eventually accelerating pace.

Massive Deficits Projected, Even under Most Optimistic Economic Scenario — Republicans have consistently justified the tax cuts with the belief that they will generate large gains in economic growth, which will in turn boost government tax revenues, but CBO's recent dynamic analysis of the President's budget – which estimates the impact of economic changes on the fiscal outlook – shows this not to be the case. In its analysis, CBO uses multiple economic models to estimate the impact of the Administration's policies on revenue and finds that even under the most optimistic scenario the President's budget still adds over $1.2 trillion to the national debt. And since CBO's analysis does not account for future AMT reform or extra debt servicing costs, its dynamic analysis greatly understates the true magnitude of the damaging cuts.

***The Budget Reduces Benefits for Certain Low and Middle-Income Taxpayers* —** The budget changes the eligibility guidelines for the Earned Income Tax Credit (EITC) and the Child Tax Credit so that certain taxpayers no longer qualify for these benefits. By making the standards for claiming these credits more stringent, the budget decreases the aggregate benefit of these two tax credits by $2.1 billion over five years and $5.0 billion over ten years. Since these benefits are most beneficial to low and middle-income taxpayers, particularly those who are working and have families, the inclusion of this cut makes the President's tax agenda more biased against working families.

The Omission of AMT Reform Greatly Understates the Cost of Tax Cuts — The President's budget includes an extension of tax cuts for capital gains and dividend income, but excludes any provision for repairing the AMT beyond 2006. If the AMT is not adjusted, an estimated 31 million taxpayers will be subject to the tax in 2010, making its reform nearly inevitable. Since the AMT "adds back" a significant portion of the extension of capital gains and dividend income tax cuts, it is important to consider the cost of the two cuts together when estimating the realistic cost of reform. Combining the cost of adjusting the AMT with the cost of the President's proposed tax cuts increases the deficit by $2.7 trillion over ten years, before accounting for the extra cost of interest payments or assuming an extension of the law allowing the deduction of non-refundable personal credits under the AMT.

Tax Cuts Provide the Most Benefit to the Most Fortunate — The bulk of the President's tax cuts are focused on those taxpayers at the top of the income distribution. The Brookings-Urban Tax Policy Center estimates that the extension of the President's tax cuts will result in almost half of the total tax cut, 45 percent, going to the four percent of filers with incomes over $200,000. Tax filers with incomes in excess of $1 million will receive an average tax cut in 2010 of approximately $155,000, about one hundred times the tax cut for the average taxpayer. In addition to raising concerns about fairness, a tax cut disproportionately targeted to the most fortunate distributes the benefits of the tax break in a way that does not adequately stimulate consumer demand for goods and services.

Revenues as a Percentage of GDP Are Near Lowest Level in Decades — Under the Administration's policies, revenues as a percentage of Gross Domestic Product (GDP) are estimated to be 17.5 percent for 2006. During the Bush Administration, revenues as a percent of GDP have averaged 17.6 percent – about a full percentage point below the average over the two decades prior to the start of the Bush Administration. Moreover, this situation would be worse if not for the contribution of social insurance taxes to the revenue stream. Without this off-budget revenue, the Administration's record on sufficient tax revenue is even more worrisome. For example, individual income taxes, which comprise the largest share of revenues in the budget, are at their lowest levels as a percentage of GDP since the 1960's.

The President's Tax Cuts Place Undue Burden on Social Security Revenues — The growth in the unified federal budget deficit would have been even greater if not for the Social Security surplus. By cutting taxes on unearned income, such as capital gains, inheritance, and dividend income, the President's tax agenda increases the reliance on payroll taxes and makes the tax code more regressive. Social insurance taxes now comprise 37 percent of federal revenues, up from 32 percent in 2000; the budget maintains this high proportion, collecting 36 percent of the revenue from social insurance taxes in 2011.