BUDGET | HOUSE BUDGET COMMITTEE

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Chairman Diane Black

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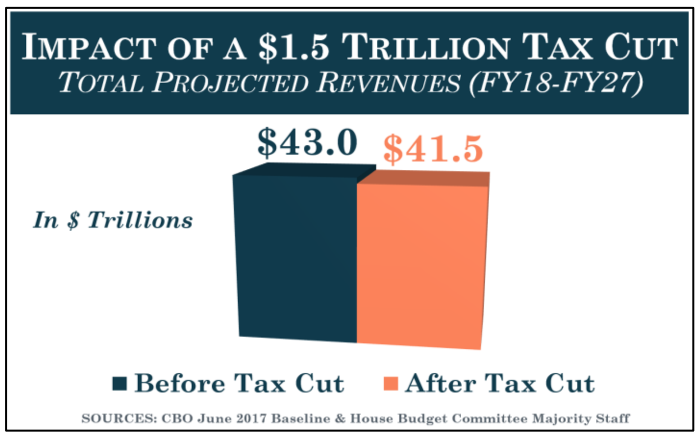
ESTIMATING THE EFFECTS OF TAX REFORM

As the Ways and Means Committee marks up its tax reform legislation this week, an ongoing question will be how much the measure will "cost" according to the Joint Committee on Taxation [JCT] and the Congressional Budget Office [CBO]. The recently adopted congressional budget resolution (H. Con. Res. 71) allows for up to $1.5 trillion in net tax cuts over the next 10 years through the filibuster-proof process of reconciliation. When JCT and CBO assess how the final Ways and Means bill accommodates this figure, Members and staff should understand some fundamental characteristics of the estimates. These features are well-known to those steeped in budget arcana, but they may not be so familiar to others.

What the Revenue 'Reduction' Means. Some will call a $1.5-trillion tax cut a revenue "loss" – but that is true only from one perspective. JCT and CBO compare the total effect on Federal revenues not to the current *year*, but relative to their *estimates of future revenues* under current laws. This "current-law baseline" projects Federal revenues will rise by a cumulative total of about $9.9 trillion over the next 10 years compared to 2017. Hence, a $1.5-trillion tax cut would still leave a revenue *increase* of at least $8.4 trillion – not counting the potential effects of improved economic growth – and total revenue will decline only slightly (see accompanying figure). In other words, the so-called revenue "reduction" is merely a product of Washington budget-speak; the Treasury cannot *lose* revenue it has not yet collected.

The Missing Links. If JCT and CBO follow their customary practices, they will not show this entire picture. Their cost estimate will present neither the current-law baseline nor the estimated net increase in total revenue after enactment of the tax cut. Only the *changes* in revenue will appear. While technically correct, this presentation will fail to reflect the full fiscal implications of the final tax reform measure, as described above.

Economic Effects. Most tax reform advocates do not assume all tax cuts "pay for themselves," as liberal, anti-tax-cut critics continually charge. Still, many economists acknowledge that the right kinds of tax changes will likely yield improved economic performance, which could lead to higher-than-expected revenues and a smaller deficit impact. The magnitude of these effects will depend on the specific tax policies enacted. Nevertheless, the House budget resolution and House Rules (H. Res. 5) require JCT and CBO to incorporate such macroeconomic, or dynamic, effects for budget enforcement purposes.



The Deficit Effect. None of the discussion above dismisses the potential deficit impact of tax reform legislation, whatever it might be. More important, though, is that the principal driver of deficits is *excessive government spending.* Spending is the root cause of every other fiscal consequence; it is the reason government taxes and borrows in the first place. Consequently, in the long run, the only reliable means of reducing deficits is controlling spending and promoting strong economic growth.

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