COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Senate Budget May Allow Tax Reform to Add $1.5 Trillion to Debt

- While numerous policymakers have said tax reform should be revenue neutral and not add to record-high debt levels, the Senate Budget Committee is reportedly considering a plan to allow Congress to **add $1.5 trillion to the debt** under the auspices of tax reform.
- Debt-financed tax cuts would significantly worsen the nation's fiscal outlook and undermine possible growth effects from tax reform – higher debt slows economic growth.
- Some policymakers will claim $1.5 trillion of tax cuts is "revenue neutral" by invoking 'current policy' and 'dynamic scoring,' but even accepting these (weak) arguments would only justify $500 to $600 billion in tax cuts.
    - While policymakers want to assume the extension of roughly $450 billion in temporary tax breaks, many of these tax breaks are already expired, and policymakers explicitly intended to eliminate them under the 2015 PATH act. At most, the current policy argument could explain **$200 billion** of tax cuts.
    - While tax reform can help grow the economy and thus generate 'dynamic' revenue, dynamic effects are likely to total **$300 to $400 billion** on the high end. The Joint Committee on Taxation (JCT) and the Congressional Budget Office (CBO) are extraordinarily unlikely to find anything close to $1 trillion of dynamic feedback as some have claimed.
- The House budget resolution calls for revenue-neutral tax reform and at least $200 billion of net deficit reduction from spending cuts through reconciliation. Senators who care about the debt should pursue a similar path; there is no justification for true fiscal hawks to support adding over $1 trillion to the national debt.

Despite calls for revenue neutrality, policymakers may add $1.5 trillion to the debt. Speaker Ryan, Chairman Brady, Leader McConnell, and others have all said tax reform should be revenue neutral. The House Republican "Better Way" blueprint also set the goal of revenue neutrality for tax reform. Now, reports suggest the Senate budget resolution may include a reconciliation instruction allowing tax reform to add up to $1.5 trillion to the debt over a decade while exempting tax reform from PAYGO rules that prohibit legislation from increasing the deficit.

Debt-financed tax cuts would be bad for the budget and the economy. As we explained in Tax Reform Should Not Add to the Debt – Here's Five Reasons Why, tax reform that is revenue neutral or revenue raising would represent better fiscal, economic, and tax policy. Assuming $1.5 trillion of tax cuts, ***the national debt could exceed the size of the economy by 2028.*** Debt increases of this magnitude would also slow economic growth and undermine many of the positive effects of tax reform.

With debt held by the public at post-WWII record-high levels, gross debt recently crossing the $20 trillion barrier, and annual deficits projected to increase to $1 trillion by 2022, we cannot afford to enact tax reform that would add further to the debt.

Current policy and dynamic scoring cannot justify a $1.5 trillion tax cut. Advocates of this approach argue that a tax reform bill that increases the deficit by up to $1.5 trillion under standard budget rules would really be revenue neutral when the costs of extending expiring tax breaks are excluded (the so-called "current policy baseline") and dynamic effects are included. ***These arguments are weak to begin with, but even if accepted they only justify a tax cut of $500 to $600 billion – not $1.5 trillion.***

Use of a "current policy" baseline to justify tax cuts is a budget gimmick and contrary to longstanding budget practices (see full explanation here). Using a current policy baseline allows policymakers to avoid ever recognizing the cost of a policy. Using such a baseline is even less justified in the current case since the 2015 PATH Act made explicit decisions to allow many tax breaks to expire permanently.

Of the approximately $450 billion of claimed 'current policy' extensions, *$150 billion* comes from tax breaks that already expired at the end of 2016 *as intended by the PATH Act*. Another $250 billion is from assuming 'bonus depreciation' is extended at the current level of 50 percent even though it is scheduled to decline to 30 percent in 2019 and then disappear. At most, a current policy baseline would assume continuing at the 30 percent level that would reduce revenues by $150 billion. ***In other words, an actual current policy adjustment – if allowed – should total only <u>$200 billion</u>, not $450 billion.***

Additional revenue from economic growth should ideally go to deficit reduction and <u>should be based on reasonable estimates of dynamic scores that CBO/JCT might provide,</u> especially given that dynamic scores are uncertain and that various leaders on tax reform have said stronger economic growth is the key to addressing the deficit.

The best evidence of dynamic revenue suggests that JCT and CBO could score tax reform as generating $300 to $400 billion of dynamic revenue, not $1 trillion. Any dynamic assumptions should be based on the likely estimate from the scorekeepers, not based on outside groups or pulled from thin air. Importantly, dynamic effects will actually shrink and could turn negative if tax reform results in too much additional debt. Also importantly, large portions of the dynamic gains are likely to be "off-budget" and cannot legally offset tax reform. ***In any case, CBO and JCT will not find dynamic effects anywhere close to $1 trillion.***

Fiscal conservatives should support the approach from the House budget resolution, which called for revenue-neutral tax reform (using actual dynamic scoring from CBO and JCT) and proposed $200 billion in spending cuts. With debt at record-high levels and growing, Congressional budget resolutions should facilitate *deficit reduction*, not a massive expansion of the debt.