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A Case for Killing All the Tax Cuts
By LAWRENCE HAAS

We take it as an article of faith in Washington that policymakers should extend President Bush's tax cuts for the 98 percent of American households that earn up to \$250,000 a year, at the very least. The economy, we seem to agree, is too weak to impose a tax increase on the vast majority of Americans.

The only question is whether to extend all of the Bush tax cuts or, as President Obama has proposed and most congressional Democrats advocate, let them expire on schedule at the end of 2010 for the top two percent of households.

But new economic and budget projections from the Congressional Budget Office (CBO), and a reading of the political tea leaves, makes me wonder whether we've got it wrong. For those who worry both about the nation's long-term fiscal future and its current political dynamics, there's a reasonable argument for letting not just the high-end Bush tax cuts, but all the tax cuts, expire. It goes like this:

In *The Budget and Economic Outlook: An Update*, the annual summer report that CBO issued late last week, the non-partisan agency estimated that the economy will grow just 2.0 percent in 2011, a much healthier 4.1 percent from 2012 to 2014, and then a disappointing 2.4 percent from 2015 to 2020.

Those projections assume that current law remains in place – that all of the Bush tax cuts expire on schedule, that Congress does not keep providing tens of millions of Americans with relief from higher taxes under the alternative minimum tax (AMT), and that annual appropriations hold steady in inflation-adjusted terms. Consequently, budget deficits drop sharply from the 9.9 percent of gross domestic product (GDP) in 2009 to between 2.5 percent and 3 percent of GDP from 2014 to 2020 (while debt held by the public rises to over 69 percent of GDP by 2020, from 36 percent at the end of 2007).

That's the official CBO estimate, as derived from CBO's requirement to assume that current law remains in place. But CBO does not live in a bubble, and its staff is not oblivious to political reality. Thus, CBO also illustrates what would occur, economically and fiscally, under more realistic political assumptions.

Under its "alternative fiscal path," CBO assumes that policymakers extend all of the Bush tax cuts except those for the wealthiest, continue to provide relief from the AMT, and hold future appropriations constant as a share of GDP.

In the short term, and reflecting the conventional economic wisdom that policymakers should extend most or all of the Bush tax cuts (at least temporarily), the economy performs much better. Specifically, growth would be 0.6 to 1.7 percentage points higher in 2011 (that is, 2.6 to 3.7

percent) than the official forecast of 2.0 percent cited above, while unemployment is 0.3 to 0.8 percentage points lower by the end of the year, CBO Director Doug Elmendorf wrote in a blog post about CBO's new report.

In the long term, however, the story is much different. Much larger budget deficits, which would reach 8 percent of GDP by 2020, and debt, which would reach nearly 100 percent of GDP by that year, would weaken the economy, Elmendorf wrote, reducing long-term economic growth as compared to CBO's official forecast.

In a rational world, policymakers would adapt these findings to the particulars of our economic and fiscal situation. They would, for instance, extend the Bush tax cuts – certainly for the 98 percent of non-wealthy Americans – for a year or two and then let them expire, giving the economy another short-term boost while significantly reducing deficits over the long run. They might even apply the savings over the next year or two from not extending the high-end tax cuts to provide more effective stimulus, putting money in the hands of families or businesses that would spend it quickly.

But the policymaking world and the rational world are different places, moving in different directions. Obama promises not to raise taxes on anyone making up to \$250,000 a year. Worse, Republicans (and even some Democrats) want to make all of the tax cuts permanent and, after November's elections, Obama will have to contend with a much more heavily-Republican Congress.

Politically, the only way to end the Bush tax cuts over the long run may be to let them expire now, on schedule. If so, then we should hope for gridlock this fall, with all the Bush tax cuts expiring by year-end simply because Obama and Congress could not agree on which ones to extend.

To be sure, that's not economically advisable in the short term (even if we assume CBO is right about the economy growing by 2 percent anyway in 2011). But it's fiscally vital over the long term. The question is whether the short-term pain – slower growth and higher unemployment – is worth the long-term fiscal and economic gain.

It's at least worth thinking about.