Insight

Macroeconomic Effects of H.R. 5376: the Build Back Better Act

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Executive Summary

As the debate around the Build Back Better Act (BBBA) continues, it is useful to determine whether the bill's spending provisions would reasonably result in positive macroeconomic effects that offset the drawbacks of its tax increases. To get a better sense of the potential economic impacts of the legislation under three different scenarios, the American Action Forum (AAF) commissioned John Diamond of Rice University to assess the macroeconomic implications of the tax and social spending proposals in H.R. 5376, the BBBA, as passed by the U.S. House of Representatives on November 19, 2021.[1] Diamond also estimated the macroeconomic effects of an alternative proposal that assumes the BBBA would reduce the deficit by $500 billion and scale back the expected spending accordingly. The results inform the desirability of the BBBA as passed by the House, as well any potential alternatives that could secure passage in the Senate.

- For this study, Diamond used techniques similar to those employed by the Joint Committee on Taxation (JCT) and Congressional Budget Office (CBO) and had autonomy on the data and necessary assumptions in the analysis. The congressional budget agencies estimated that the House-passed BBBA would raise a net $946 billion in new taxes (over 10 years) and spend, on net, $1.3 trillion, for a net deficit effect of $365 billion.

- In Scenario 1 (see Summary Table 1), Diamond estimated the effects of the BBBA as passed by the House. He found that the bill's negative impact on growth from higher taxes would outweigh its positive impact on growth from social spending. Specifically, he found the net impact of the legislation over the long-term would be to lower gross domestic product (GDP) by 0.5 percent, household spending by 0.3 percent, employment by 0.3 percent, and worker compensation by 0.8 percent.

- In Scenario 2, Diamond estimated the effects of the BBBA with the assumption that $130 billion in outlays would be devoted to infrastructure investment, which would have higher associated productivity effects. Under this scenario, the economic effects would be substantially similar to those achieved under Scenario 1, although under this assumption the long-run effects on private consumption and labor compensation would be incrementally smaller.

- In Scenario 3, Diamond estimated the effects of the BBBA with the assumption that $500 billion in tax increases is devoted to deficit reduction, with a proportional reduction (relative to the BBBA) in spending of $865 billion. Compared to Scenarios 1 and 2, Scenario 3 would be less harmful to long-run economic growth and would result in a slightly smaller reduction in GDP of 0.4 percent, but nevertheless in similarly reduced consumption, employment, and compensation.

Ultimately, the effects of the BBBA's tax increases would depress investment and result in a net negative impact on the size of the economy (GDP), employment, and standards of living (private consumption). To contextualize these effects, in 2033 the decline in employment would equate to a loss of about 650,000 jobs. The reduction in labor compensation would amount to about $350 per worker. These results suggest that the central conceit of the BBBA – that its higher taxes to finance new spending are pro-growth – is ultimately

unachievable under any plausible scenario.

Summary Table 1

(Percentage changes in aggregate variables, relative to steady state with no reform)

	% Change in Year					
Variable	**2023**	**2028**	**2033**	**2043**	**2073**	**LR**
BBBA w/ Spending Treated as Transfers (Scenario 1)						
GDP	-0.2	-0.3	-0.4	-0.4	-0.5	-0.5
Private consumption	0.1	0.0	0.0	-0.2	-0.3	-0.3
Employment (hours worked)	-0.4	-0.4	-0.4	-0.3	-0.3	-0.3
Labor compensation	-0.3	-0.3	-0.3	-0.4	-0.7	-0.8
BBBA w/ $130 Billion Treated as Infrastructure						
GDP	-0.2	-0.3	-0.3	-0.4	-0.5	-0.5
Private consumption	0.0	0.0	-0.1	-0.2	-0.3	-0.2
Employment (hours worked)	-0.4	-0.4	-0.3	-0.3	-0.3	-0.3
Labor compensation	-0.3	-0.3	-0.3	-0.4	-0.6	-0.7
BBBA with Deficit Reduction						
GDP	-0.2	-0.3	-0.3	-0.4	-0.5	-0.4
Private consumption	0.0	-0.1	-0.2	-0.3	-0.3	-0.3
Employment (hours worked)	-0.4	-0.4	-0.3	-0.3	-0.4	-0.4
Labor compensation	-0.2	-0.2	-0.2	-0.3	-0.3	-0.4

Introduction

In November of 2021, the House of Representatives passed the Build Back Better Act (BBBA), a budget reconciliation bill that would increase domestic spending by over $1 trillion and increase individual and business taxes to partially offset its new spending. Enactment of the BBBA has been the principle domestic policy priority for the Biden Administration and the congressional majority. It is currently stalled in the Senate, where it may ultimately remain. Alternatively, it may be amended and passed by the Senate with less spending, resulting in a net deficit reduction. That the BBBA's tax increases in isolation would be a drag on economic growth, productivity, and real wages is not controversial. Rather, the proposition offered by the administration and congressional proponents is that the benefits of the bill's spending would outweigh the consequences of its tax policy. As its proponents argue, the BBBA's overall impact of deficit reduction is appropriately tailored to the current macroeconomic environment. This study examines that argument under several assumptions. The

results should inform policymakers on the desirability and design considerations of the BBBA.

Conduct of the Study

The American Action Forum (AAF) commissioned John Diamond of Rice University to conduct this study because Diamond's approach to modeling the macroeconomic impacts of the BBBA is based on the same methods as those used by the Joint Committee on Taxation (JCT) and the Congressional Budget Office (CBO). In this way, it is consistent with analyses that Congress considers in its evaluation of legislation with significant macroeconomic effects. Diamond was given complete autonomy in his analysis of the proposals, data used in the analysis, and key assumptions.

Key Results

Diamond based his analysis on the revenue and cost estimates performed by the JCT and CBO for the House-passed BBBA.2 The congressional budget agencies estimated that the tax and spending proposals contained in the BBBA would increase revenue and outlays by $946 billion and $1.3 trillion, respectively, over the next decade, for a net deficit increase of $365 billion. The study estimates the macroeconomic economic effects of those tax and spending policies with the assumption that all of the BBBA's spending is treated as transfer payments. The study also estimates the effects of those policies with the assumption that $130 billion (10 percent of the overall assumed expenditure) would be devoted to investment in public infrastructure. The modeling of investment most closely reflects the effects of spending on traditional infrastructure. In this regard, the key factor is the productivity increase resulting from additional infrastructure. Diamond summarized these impacts by the elasticity of output (gross domestic product, or GDP) with respect to public capital. Diamond used a value 0.06, which is the long-run value assumed by CBO. Finally, Diamond assessed the effects of a hypothetical BBBA that assumes $500 billion of the revenues would be devoted to deficit reduction, with a proportional reduction in assumed spending (treated as transfer payments for the purposes of this estimate). A summary of the budgetary effects of the three BBBA scenarios modeled by Diamond is shown in Table 1.

Table 1: Budgetary Effects of BBBA Scenarios

Scenario (2022-2031)	Net Revenues	Net Outlays	Deficit
BBBA as passed by the House	**$946**	**$1,311**	**$365**
Transfer Payments **Scenario 1** **Scenario 2**		**$1,311** **$1,181**	
Infrastructure Investment **Scenario 1** **Scenario 2**		**$0** **$130**	

BBBA w/ Debt Reduction Scenario 3	**$946**	**$446**	**-$500**
Transfer Payments		**$446**	

The results for Scenario 1, which estimates the macroeconomic effects of the House-passed BBBA, are shown in Table 2, reproduced from Diamond. 3

Ultimately, the effects of the tax increases would depress investment, and result in a net negative impact on the size of the economy (GDP), employment, and standards of living (private consumption).

Table 2: BBBA as Passed by the House (Scenario 1)

	% Change in Year					
Variable	**2023**	**2028**	**2033**	**2043**	**2073**	**LR**
GDP	-0.2	-0.3	-0.4	-0.4	-0.5	-0.5
Private consumption	0.1	0.0	0.0	-0.2	-0.3	-0.3
Private investment in ordinary *K* in US	-1.2	-1.3	-1.4	-1.6	-1.8	-1.8
Stock of imported ordinary *K* in US	0.0	0.0	0.0	0.0	0.0	0.0
Stock of ordinary *K* in US	-0.1	-0.2	-0.4	-0.8	-1.2	-1.4
Stock of *FSK* in US	-0.1	0.0	0.2	0.5	0.6	0.6
Employment (hours worked)	-0.4	-0.4	-0.4	-0.3	-0.3	-0.3
Labor compensation	-0.3	-0.3	-0.3	-0.4	-0.7	-0.8
Real wage	0.1	0.1	0.1	-0.1	-0.4	-0.4
Total public capital stock	0.0	0.0	0.0	0.0	0.0	0.0
Transfers	6.5	6.5	6.5	1.6	1.5	1.8

The results for Scenario 2, which assumes 10 percent of the net outlays are treated as public infrastructure, are shown in Table 3, reproduced from Diamond. The economic effects are substantially similar to those achieved under the first scenario, though under this assumption, the long-run effects on private consumption and labor compensation are incrementally smaller.

Table 3: BBBA w/ $130 Billion Treated as Infrastructure (Scenario 2)

	% Change in Year					
Variable	**2023**	**2028**	**2033**	**2043**	**2073**	**LR**
GDP	-0.2	-0.3	-0.3	-0.4	-0.5	-0.5
Private consumption	0.0	0.0	-0.1	-0.2	-0.3	-0.2

Private investment in ordinary *K* in US	-1.3	-1.4	-1.5	-1.6	-1.8	-1.8
Stock of imported ordinary *K* in US	0.0	0.0	0.0	0.0	0.0	0.0
Stock of ordinary *K* in US	-0.1	-0.3	-0.4	-0.8	-1.3	-1.4
Stock of *FSK* in US	-0.1	0.0	0.1	0.5	0.6	0.6
Employment (hours worked)	-0.4	-0.4	-0.3	-0.3	-0.3	-0.3
Labor compensation	-0.3	-0.3	-0.3	-0.4	-0.6	-0.7
Real wage	0.1	0.1	0.1	0.0	-0.3	-0.4
Total public capital stock	0.1	0.2	0.5	0.6	0.6	0.6
Transfers	5.9	5.9	5.9	1.0	1.1	1.7

The results for Scenario 3, which assumes BBBA is scaled to achieve $500 billion in deficit reduction over the next decade, are shown in Table 4, reproduced from Diamond. Compared to Scenarios 1 and 2, Scenario 3 would be less harmful to long-run economic growth, resulting in a slightly smaller reduction in GDP of 0.4 percent, but nevertheless in similarly reduced consumption, employment, and compensation

Table 4: BBBA w/ Deficit Reduction (Scenario 3)

	% Change in Year					
Variable	**2023**	**2028**	**2033**	**2043**	**2073**	**LR**
GDP	-0.2	-0.3	-0.3	-0.4	-0.5	-0.4
Private consumption	0.0	-0.1	-0.2	-0.3	-0.3	-0.3
Private investment in ordinary *K* in US	-1.0	-1.1	-1.1	-1.2	-1.1	-1.1
Stock of imported ordinary *K* in US	0.0	0.0	0.0	0.0	0.0	0.0
Stock of ordinary *K* in US	-0.1	-0.2	-0.3	-0.6	-0.8	-0.8
Stock of *FSK* in US	0.0	0.2	0.3	0.5	0.6	0.6
Employment (hours worked)	-0.4	-0.4	-0.3	-0.3	-0.4	-0.4
Labor compensation	-0.2	-0.2	-0.2	-0.3	-0.3	-0.4
Real wage	0.1	0.1	0.1	0.1	0.0	0.0
Total public capital stock	0.0	0.0	0.0	0.0	0.0	0.0
Transfers	2.4	2.4	2.4	2.4	5.8	6.2

Implications for BBBA

Whether deficit-increasing, “investing,” or deficit-reducing, the BBBA would be harmful to economic growth. In each case, Diamond’s modeling finds that the legislation would have an adverse effect on GDP, private consumption, employment, and labor compensation, and would be partially financed through additional borrowing and market-distorting tax increases. Under any scenario, proponents’ assurances that the BBBA is pro-growth are dubious, at best.

[1] Affiliation is for identification purposes only.