Insight

The Tax Cut and Jobs Act of 2017 and the Budget

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On November 1st, the Ways and Means Committee released its long-awaited House tax reform plan, now codified in the Tax Cut and Jobs Act of 2017 (TCJA). Accompanying the release of the tax bill was the revenue estimate performed by the Joint Committee on Taxation (JCT), which details its budgetary implications. On net, JCT estimates that the TCJA would lose $1,478.1 billion in revenues over the next 10 years, with roughly $5.5 trillion in gross revenue losses against $4 trillion in revenue-raising provisions. This insight examines this revenue loss against a plausible macro-economic feedback scenario informed by previous analysis performed by the Congressional Budget Office (CBO). It is possible that the TCJA could produce adequate growth to offset the majority of the revenue loss as estimated by the JCT.

Table 1: Revenue Effects of the Tax Cut and Jobs Act of 2017

Provision ($Billions)	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-2022	2018-2027
Individual Provisions												
New Tax Rate Structure	-67.6	-96.4	-100.4	-104.2	-108.5	-113.1	-117.3	-122.1	-127.3	-132.4	-477.1	-1,089.40
Increased Standard Deduction	-60.6	-85	-85.8	-88.4	-91.1	-94.2	-97.1	-100.4	-103.9	-106.9	-410.9	-913.4
Repeal of Deduction for Personal Exemptions	95.7	141	146.6	151.9	157.3	163	168.9	174.9	181.1	187.5	692.4	1,567.70
New and Expanded Personal Credits	-44.3	-86	-87.6	-89	-90.4	-64.2	-43.1	-43.8	-44.8	-46.7	-397.4	-639.90
Alternative Inflation Measure	0	0	0	0	0	1.3	4.9	7.8	10.4	14.7	0	39.20
25% pass-through tax rate	-24.8	-41.8	-44.1	-45.2	-45.9	-44.1	-44.9	-48.7	-52.3	-55.9	-201.9	-448
Other Individual Base-Broadening	61.2	118.2	123.9	132.1	140.5	149.3	158.5	168.6	179	190	576.2	1421.6
Repeal Individual AMT	-6	-72.8	-64.1	-67.6	-71.3	-74.7	-78.5	-82.7	-86.7	-90.9	-281.9	-695.5
Estate, Gift and GST	-1.3	-8.5	-9.3	-9.6	-10.6	-12.2	-14	-32.4	-35.8	-37.8	-39.3	-171.5
Sub-Total (Individuals)	-47.7	-131.3	-120.8	-120	-120	-88.9	-62.6	-78.8	-80.3	-78.4	-539.9	-929.2
Business Tax Reform												
Reduction in the Corporate Rate to 20%	-108.1	-135.7	-142.3	-142.8	-143.8	-147.6	-152.1	-156.3	-162.5	-170.4	-672.7	-1,461.50
Expensing of Qualified Property (5 Yrs)	-24.8	-22.9	-16	-11.3	-9.2	8.2	20.7	14.4	10	6	-84.3	-25
Repeal Corporate AMT	-6.8	-6.9	-6.6	-6.8	-7	-1.3	-1.3	-1.3	-1.2	-1.1	-34	-40.3
Limit Net Interest Deduction	8	17	18.9	18.9	17.8	17.7	17.3	17.7	18.9	19.8	80.6	172
Modification of Net Operating Loss Deduction	6.2	9.7	11.2	15.4	23.7	30.6	28.7	19.3	9.1	2.4	66.1	156
Other Net Business Tax Reform Provisions	0.3	9.8	19.2	25.2	29.3	45.8	58.5	54.9	56.2	52.1	84.4	352.3
Sub-Total (Business)	-125.2	-129	-115.6	-101.4	-89.2	-46.6	-28.2	-51.3	-69.5	-91.2	-559.9	-846.5
International Tax Reform												
Participation Exemption System	-14.5	-24.4	-19.2	-19.5	-19.8	-19.6	-20.9	-22	-22.2	-23.1	-97.4	-205.1
Deemed Repatriation	65.7	44.5	19.2	18.6	19	19.3	19.6	19.9	5.4	-8.1	167	223.1
Foreign High Return Provision	5	9	7.9	7.8	7.7	7.5	7.7	8.1	8.3	8	37.4	77.1
Excise Tax on Related-Party Payments	0	5.7	14.2	17.6	18.2	18.6	19.3	19.9	20.3	20.7	55.6	154.5
Other Net International Tax Reform Provisions	1.9	3.7	3	3	3.3	4	4.4	4.3	4.6	4.9	14.4	35.8
Sub-Total (International)	58.1	38.5	25.1	27.5	28.4	29.8	30.1	30.2	16.4	2.4	177	285.4
Exempt Organizations												
Sub-Total of Exempt Organizations	0.2	0.5	0.4	0.4	0.4	0.4	0.4	0.3	0.4	0.4	1.8	3.2
Sub-Total (Individuals)	-47.7	-131.3	-120.8	-120	-120	-88.9	-62.6	-78.8	-80.3	-78.4	-539.9	-929.2
Sub-Total (Business)	-125.2	-129	-115.6	-101.4	-89.2	-46.6	-28.2	-51.3	-69.5	-91.2	-559.9	-846.5
Sub-Total (International)	58.1	38.5	25.1	27.5	28.4	29.8	30.1	30.2	16.4	2.4	177	285.4
Sub-Total of Exempt Organizations	0.2	0.5	0.4	0.4	0.4	0.4	0.4	0.3	0.4	0.4	1.8	3.2
Total	**-114.6**	**-221.3**	**-210.9**	**-193.5**	**-180.4**	**-105.3**	**-60.3**	**-99.6**	**-133**	**-166.8**	**-921**	**-1487.1**

If there has been one persistently bad adage at the intersection of tax and budget policy, it is that tax cuts can "pay for themselves." Cuts in taxes reduce revenues. However, insofar as taxes raise the cost of labor and capital, they do suppress economic growth. Reducing taxes therefore tends to have a salutary economic effect, which has an associated revenue effect. Higher economic growth increases tax revenue, all else being equal. Indeed, CBO has a "rule of thumb" for estimating the revenue effect from economic growth. According to

CBO, a 0.1 percentage point annual increase in productivity growth (a fair proxy for GDP growth from tax reform) would improve the 10-year deficit by $273 billion.[1]

Separately, CBO has also done analysis examining the range of the feedback effects from tax changes based on its own economic models.

Table 2: Macroeconomic Feedbacks as a Percentage of the Conventional Estimate[2]

Modeling Assumption	Feedback (10 Yrs)
No Foresight	-3
Lifetime Foresight—Capital Immobile Across Borders	
Budget Stabilized by Government Spending Cuts	15
Budget Stabilized by Tax Increases	17
Lifetime Foresight—Capital Flows Freely Across Borders	
Budget Stabilized by Government Spending Cuts	19
Budget Stabilized by Tax Increases	21
Unlimited Foresight	
Budget Stabilized by Government Spending Cuts	19
Budget Stabilized by Tax Increases	28

Based on these analyses, it is entirely plausible that the TCJA would generate adequate macroeconomic feedback to substantially reduce its budgetary cost. Assuming a crude average of CBO's estimates suggests that the gross revenue reduction of $5.5 trillion could generate over $900 billion in macroeconomic feedback. Based on CBO's rule of thumb, this level of revenue growth would be consistent with a real GDP increase of about 3.2 percent over the next 10 years. This would represent a substantial improvement in the nation's growth outlook, but is well within the range of potential growth effects from tax reform.[3]

[1] https://www.cbo.gov/sites/default/files/115th-congress-2017-2018/reports/52370-outlook_1.pdf

[2] https://www.cbo.gov/sites/default/files/109th-congress-2005-2006/reports/12-01-10percenttaxcut.pdf

[3] https://www.aeaweb.org/articles?id=10.1257/aer.91.3.574