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Report Retort

Bush Treasury Dismisses "Supply-Side Economics"

By Robert S. McIntyre

For decades, most Republican politicians have treated as an article of faith that tax cuts, especially tax cuts for the rich, will "pay for themselves" through improved economic growth and resulting higher revenues. Critics deride this implausible belief as "voodoo economics" or "the free lunch theory." Its adherents prefer to call it "supply-side economics."

Oddly, the same GOP politicians who think tax cuts augment revenues also fervently hold exactly the opposite position, which they call "starve the beast." They insist that big tax cuts will so sharply *reduce* revenues that they will force steep cuts in government programs.

The apostle of these conflicting dogmas was President Ronald Reagan back in the 1980s. On the one hand, Reagan claimed that the way to stop Congress from providing what he saw as excessive public services was to "cut off their allowance." On the other hand, he also promised that he would pay for his huge increase in defense spending "with the revenues generated by the [even huger] tax cuts" he pushed through Congress in 1981. As it happened, of course, neither theory panned out.

Despite the sorry historical record, our current President, George W. Bush, and most of his fellow Republicans in Congress are ardent disciples of Reagan's contradictory belief system. In their ongoing and increasingly desperate search for proof of their faith — at least the part that holds that tax cuts are a blessing for the economy and the federal budget — Bush and Congress recently asked the Treasury Department to undertake a "dynamic analysis" of the economic and budgetary effects of making the Bush tax cuts permanent, rather than letting them expire after 2010 as current law provides.

On July 25, the Treasury Department released its report. Despite the fact that the Treasury is managed by Bush appointees who profess a deep affection for Bush's tax-cutting policies, the results offer no comfort to supply-side true believers.

Instead, Treasury's study found that extending Bush's tax cuts would have essentially no beneficial effect on the U.S. economy at all. But, the report casually implies, it could have grave consequences for the ability of our government to deliver the public services that Americans depend upon.

Specifically, the Treasury found that extending Bush's tax cuts might increase the size of the economy by a bit under one percent in the "long run." Or just as likely, it might *reduce* the size of the economy by about the same amount. Thirty years from now, when the "long run" apparently begins, that translates into plus or minus a few hundred dollars in per capita GDP in today's dollars. Put another way, over the next 30 years, per capita GDP is expected to grow by a total of about 50 percent. If the tax cuts are extended, the growth might be 49 percent or it might be 51 percent. Given the uncertainties of economic forecasting, that's no difference at all.

In making its projections, the Treasury looked at two possible scenarios. What's intriguing is that both assume a balanced federal budget starting in 2017, despite continuation of the Bush tax cuts. Treasury says it was forced to make this assumption because, by itself, "a permanent reduction in taxes . . . would lead to an unsustainable accumulation of government debt relative to GNP."

How can we get the budget into balance by 2017 and still keep the Bush tax cuts? Treasury offers these options: (a) slash government services by about a fifth or (b) "feed the beast," in Republican jargon, by increasing taxes in some way.

Double-decimating government services is actually the strategy that the Treasury claims would be most beneficial to the economy, although it declines to specify what programs would be cut. If the cuts were across-the-board, then they would require a 20 percent cut in Social Security, Medicare, defense, environmental protection, law enforcement, homeland security — in fact, in everything the government does. If some parts of the budget are exempted from cuts, then other parts would have to be cut by considerably more than a fifth. This is the dubious scenario under which the Treasury concludes that the "long run" economy would be about one percent bigger.

In Treasury's second scenario, the budget would be balanced in 2017 by an across-the-board increase in income tax rates. Because the Bush tax cuts so heavily favor the rich, this approach would retain net tax cuts for wealthy people, but mean net tax increases for almost everyone else. Under this second scenario, Treasury says that the "long run" GDP would be about one percent *smaller* than simply letting the Bush tax cuts expire after 2010.

You might wonder how Treasury can conclude that our economy would be better off, albeit only slightly, by helping finance bigger vacation mansions for millionaires versus, say, building reliable flood control around New Orleans. It just goes to show that Bush's Treasury hasn't been taken over by a bunch of liberal economists (unless "liberal" means having the ability to add and subtract). Indeed, the Treasury study itself points out that its methodology is highly simplified and subject to significant uncertainty. So its specific findings should be taken with a large grain of salt.

But besides dismissing the supply-side idea that extending the Bush tax cuts would be a boon for the economy, Treasury's report confirms an even more important point. So long as we recognize that we can't continue the Bush deficit-spending binge indefinitely, the real question is, which do we prefer: low taxes on the wealthy or continuation of essential federal programs? Treasury's study makes clear that we can't have both.

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