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Two Years of Evidence Show 2017 Tax Cuts Failed to Deliver Promised Economic Boost

In December 2017, just days before President Donald Trump signed the $1.9 trillion tax legislation that would create sweeping changes to the U.S. federal tax system, he told television viewers that "it's going to be one of the great Christmas gifts to middle-income people."[1]

For several months, the president had been selling the legislation on the claim that the tax cuts would "be rocket fuel for our economy."[2] His claim was critical to defending against the criticism that most of the tax cuts would go to corporations and the very wealthy—supposedly, the money would 'trickle down' to the middle class. The president and administration officials, often echoed by Congressional Republicans, claimed that as a result of the tax cuts:

- Business investment would jump.[3]
- GDP growth would skyrocket to between 4 and 6 percent.[4]
- Household incomes would increase between $4,000 and $9,000.[5]
- Job growth would accelerate.[6]
- The tax cuts would 'pay for themselves'—adding nothing to the federal debt, or even reducing it.[7]

These claims were not the president's invention; they originated with and were repeated by the most senior economic policy experts in his administration. Kevin Hassett, then the chairman of the president's Council of Economic Advisers (CEA), said that the median wage increase for workers due to the tax cuts could amount to $20,000 per year.[8] Treasury Secretary Steven Mnuchin said that "not only will this tax plan pay for itself, but it will pay down debt."[9] Gary Cohn, then the director of the National Economic Council (NEC), said that "we can pay for the entire tax cut through growth over the cycle."[10] Larry Kudlow, the second director of the NEC, claimed that "the deficit…is coming down, and it's coming down rapidly."[11]

Other economists were highly skeptical of these claims. Jason Furman, chairman of the CEA during the Obama administration, said that the White House claim of up to a $9,000 increase in household income due to corporate tax cuts was "more than a little far-fetched."[12] Austan Goolsbee, another former chairman of the CEA said that the administration's "trickle-down, magic-beanstalk…argument" was "nonsense."[13] Former Treasury Secretary Larry Summers said that he "would be hard pressed to give [the administration's tax analysis] a passing grade."[14]

Two years after the tax cuts were enacted, evidence clearly shows that the critics were right. Overall, the economy is not outperforming solid trends that predated implementation of the tax cuts and were inherited from the Obama administration.

- GDP growth has averaged 2.5 percent—exactly the same as the average in the quarters before the tax cuts, and nowhere near the 6 percent promised by the president.
- Business investment, which is essential to a stronger economy, lags substantially behind the average of the quarters that preceded the tax cuts.
- Household income increased only $550 in the first year after implementation of the tax cuts—far behind the previous three years and not close to the $4,000 to $9,000 or more per household that the administration had claimed.

The Congressional Budget Office now projects that the 2017 tax cuts will increase the national debt by $1.9 trillion over 11 years.[15] The tax cuts are not remotely on track to 'pay for themselves.' As a result, policymakers in the future may be pushed to make cuts to programs that are critical to middle-class families, like Social Security and Medicare, and forgo crucial investment in infrastructure and education that are essential to sustainable economic growth.

In addition, the almost $2 trillion hole in the budget may make the economy more vulnerable to the next recession because it will be far more difficult for Congress to find the will and resources to pass the fiscal stimulus necessary to jump-start the economy. This is especially concerning given that the Federal Reserve has less ability to fight the next recession because it cannot implement large rate cuts to stimulate the economy.

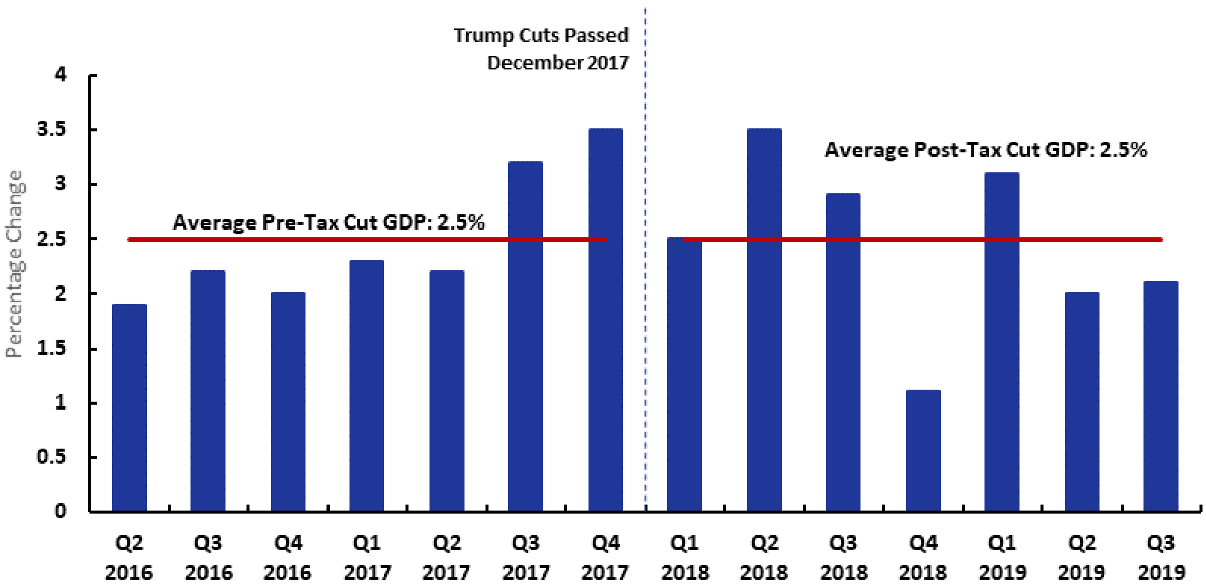
As a result, it is crystal clear that the 2017 tax cuts have not remotely achieved the economic miracle that the Trump administration promised. While die-hard defenders of the tax cuts likely will claim that the greatest benefits still lie in the future, the current trends suggest that those benefits will never be achieved and that the rationale for the tax cuts was unsound. By the time the experiment has fully run its course, Americans will already have paid a very steep price.

The promised hyper-acceleration of GDP growth did not occur

Donald Trump claimed that tax cuts would be “rocket fuel” for the economy and would boost GDP growth to as high as 6 percent annually—more than twice as fast as annual GDP growth in any of the last 10 years. However, economic growth has fallen far short of the administration’s estimates. In the seven quarters since the enactment of the tax cuts, real GDP growth has been the same as in the seven previous quarters—approximately 2.5 percent.

Economic Growth Has Been Roughly the Same Since the Passing of the Trump Tax Cuts

Real Gross Domestic Product



Source: Bureau of Economic Analysis/Haver Analytics

Note: Pre- and post-tax cut periods reflect the 7 quarters before and after passage of the Trump Tax Cuts.

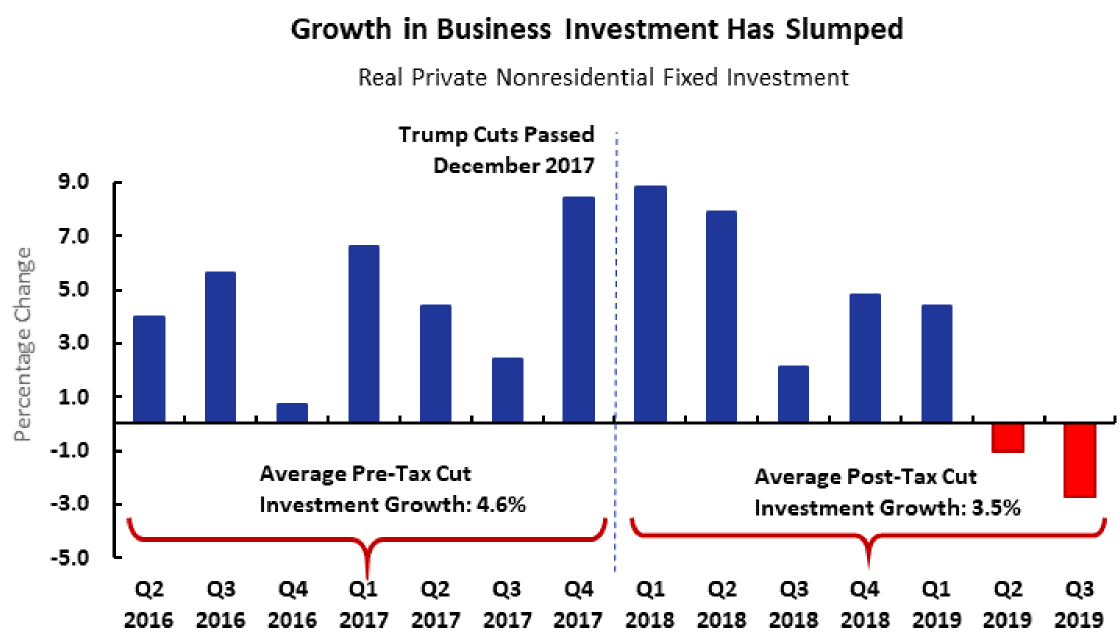
After the tax cuts went into effect in 2018, it briefly appeared that economic growth might have received a boost, with real GDP growth reaching 3.5 percent in the second quarter and 2.9 percent in the third quarter.[16] However, the mild effect soon dissipated, with the average growth rate falling to around 2 percent per quarter—about the same average growth rate as between 2011 and 2017.[17] Economists called the bump a short-term ‘sugar high,’ which would add little to long-term economic growth.[18]

The Congressional Budget Office estimated that the small positive impact of the 2017 tax cuts on GDP growth will diminish over time, and will result in an overall increase in GDP growth of just 0.7 percent between 2018 and 2028 over a scenario without the tax cuts.[19] With third-quarter real GDP growth at only 2.1 percent in 2019, it appears extremely unlikely that the economy will reach the 4 percent GDP growth promised by the Council of Economic Advisers, let alone the 6 percent claimed by the president.

The promised growth in business investment and job creation didn't materialize

Supporters of the president's tax legislation predicted that the $1.9 trillion tax cuts would spur massive growth in business investment, creating millions of additional jobs and supercharging long-term economic growth to such a degree that the tax cuts would 'pay for themselves.'

However, since the enactment of the tax cuts, growth of business investment has averaged just 3.5 percent, substantially below the 4.6 percent average growth of the previous seven quarters. Although there was a slight bump in business investment in the first two quarters after the tax cuts took effect, it subsequently fell below its long-term trend and has contracted in the most recent quarters. Nobel Prize-winning economist Paul Krugman wrote that "business investment was the entire rationale for the tax cut; it has been a complete dud."[20]



Source: Bureau of Economic Analysis/Haver Analytics
Note: Pre- and post-tax cut periods reflect the 7 quarters before and after passage of the Trump Tax Cuts.

For the most part, businesses did not use the $90 billion in savings they received in the first year of tax cuts to invest in fixed capital or to substantially raise wages. Instead, they mostly used it to issue dividends to shareholders or buy back shares of their own stock, hitting a record $806 billion in buybacks in 2018.[21] Stock buybacks reduce the total number of shares available, enriching the large shareholders who hold most of U.S. equities. Nearly half of American families own no stock, either directly or indirectly.[22]

A report by the Congressional Research Service finds that to the extent that there was any bump in business investment, it occurred despite the 2017 tax cuts, not because of them.[23] While the new law supposedly incentivized investment in structures, those types of investments grew at a much slower pace than investment in intellectual property products, which the law made more expensive.[24]

And in 2018, most corporations in the Fortune 500 avoided paying even the new lowered corporate tax rate of 21 percent. Nearly 400 corporations paid an effective federal income tax rate of only 11.3 percent in 2018; 91 of these corporations paid no federal income taxes at all, and 56 paid between zero and five percent.[25]

The tax cuts did not increase household incomes beyond existing trends

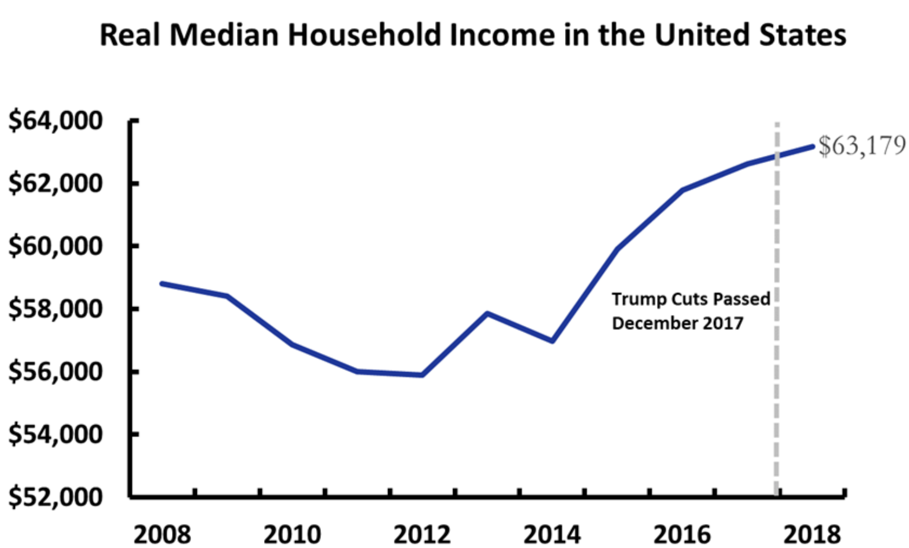
The president's Council of Economic Advisers claimed in its 2018 *Economic Report of the President* that "the corporate tax changes alone are expected to increase annual income for families by an average of $4,000."[26] Then-CEA Chair Kevin Hassett later said a $4,000 increase in the median wage was a conservative estimate and that in the long run the increase in wages for U.S workers due to tax cuts could amount to between $10,000 and $20,000.[27]

However, annual household income growth in the first year the tax cuts took effect lagged far behind the previous three years. It grew only $550 in 2018, compared to $850 in 2017, $1,900 in 2016 and $2,900 in 2015. The growth curve of real median income became flatter.

Hourly wages, another useful indicator of economic well-being, have risen 3.1 percent in the seven quarters since enactment of the tax cuts. However, the increase likely is due primarily to the extremely tight labor market, with an unemployment rate of 3.5 percent—only about a half point below the 4.1 percent unemployment rate that existed before the tax cuts were enacted.

Trump inherited a low unemployment rate of 4.7 percent from the Obama administration, which had fallen from a peak of 10 percent at the worst of the recession. Trends in job creation are up only slightly from before the tax cuts, and still lag job creation during the latter part of President Obama's tenure. This near decade long downward trend continues, though it has not accelerated under President Trump, and not since the tax cuts passed.

While economists expect some increase in wage growth over the next year, income growth will likely continue to fall far short of the administration's "conservative" estimate of a $4,000 increase, much less a $10,000 to $20,000 increase.

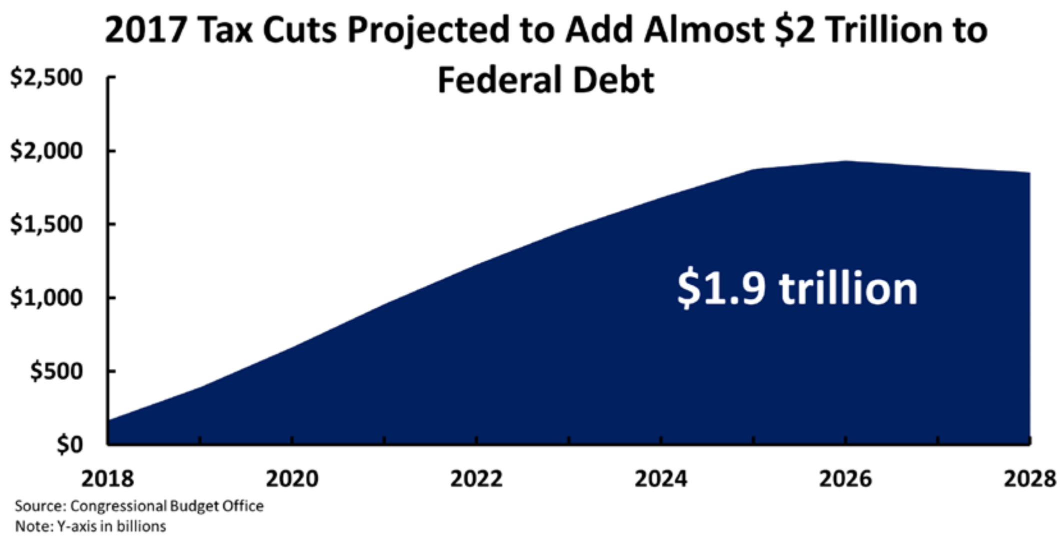


Source: U.S. Census Bureau, Federal Reserve Economic Data (FRED), St. Louis Fed.
Note: Dollar amounts are 2018 CPI-U-RS Adjusted

The tax cuts did not pay for themselves

The claim that tax cuts 'pay for themselves' has been right-wing economic orthodoxy since the 1970s. The 2017 tax cuts provide a real world test of that theory on a massive scale. Treasury Secretary Steve Mnuchin proclaimed that "not only will this tax plan pay for itself, but it will pay down debt."[28] Two years after the cuts and despite plenty of evidence to the contrary, Mnuchin maintains this view: "I'll stick with my projections that the tax deal will pay for itself." [29]

However, even before Trump signed the 2017 tax cuts into law, the Congressional Budget Office estimated they would cost $1.5 trillion over the first 10 years. CBO later revised its estimate, which now stands at $1.9 trillion.[30] In effect, the administration's estimate that the tax cuts would cost nothing appears to be off by approximately $2 trillion.



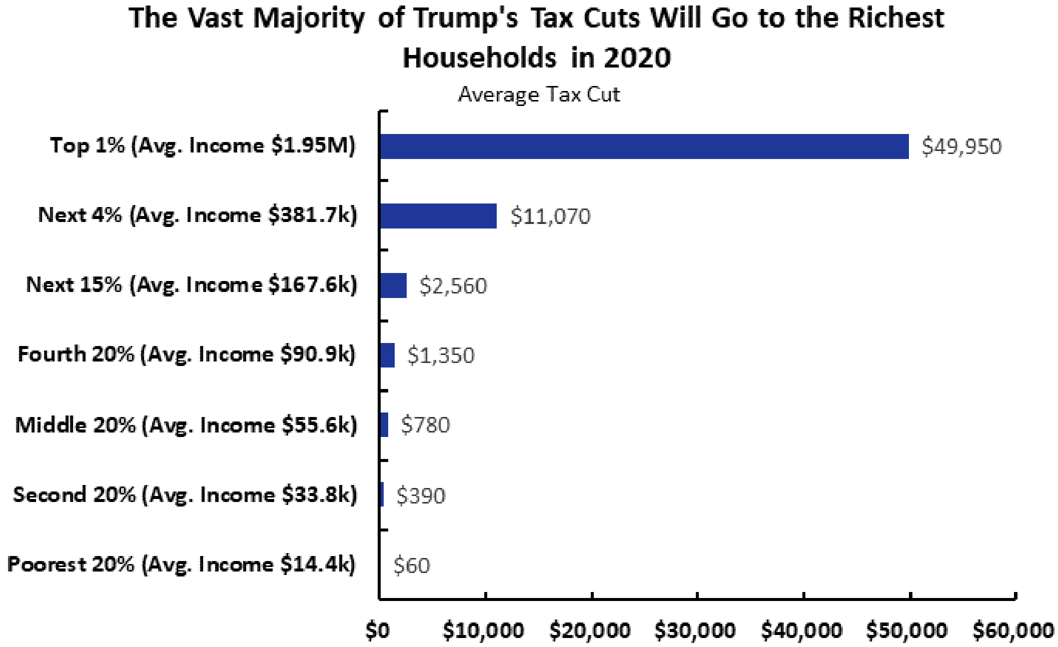
The federal deficit grew to nearly $1 trillion in fiscal year 2019 and will exceed $1 trillion in fiscal year 2020 due to increased spending and reduced revenues from tax cuts.[31] Economists estimate the TCJA will reduce federal revenues by $230 billion in 2019 alone.

The $1.9 trillion price tag of the 2017 tax cuts dwarfs the projected costs of investments that could have a substantial impact on future economic growth. For example, the tax cuts will cost more than twice as much as it would to repair the national highway system.

The "Christmas gift for the middle class" has gone instead to the very wealthy

Just a few weeks before he signed the 2017 tax cuts into law, Donald Trump made his oft-repeated claim that they were targeted to the middle class and not a boon for the rich. "This is not good for me," Trump said. "I have some very wealthy friends. Not so happy with me, but that's OK."[32]

The president's extremely wealthy friends should have been ecstatic. The personal income tax cuts were heavily weighted to the very wealthy, with the top 1 percent of households—those with average incomes of almost $2 million—projected to receive an average tax break of nearly $50,000 in 2020. Their tax cuts alone are worth more than the entire average annual income of households in the bottom 40 percent.[33]



Source: Institute on Taxation and Economic Policy, ITEP Microsimulation Model

Tax cuts for most Americans pale in comparison.[34] The poorest 20 percent of households that pay federal income tax, with an average income of less than $15,000, receive only about a $60 tax break. Middle-income households—those earning an average of about $56,000 receive about $780.[35] What is more, these “tax cuts” will eventually lead to tax increases for 53 percent of taxpayers, including 70 percent of middle income families.[36]

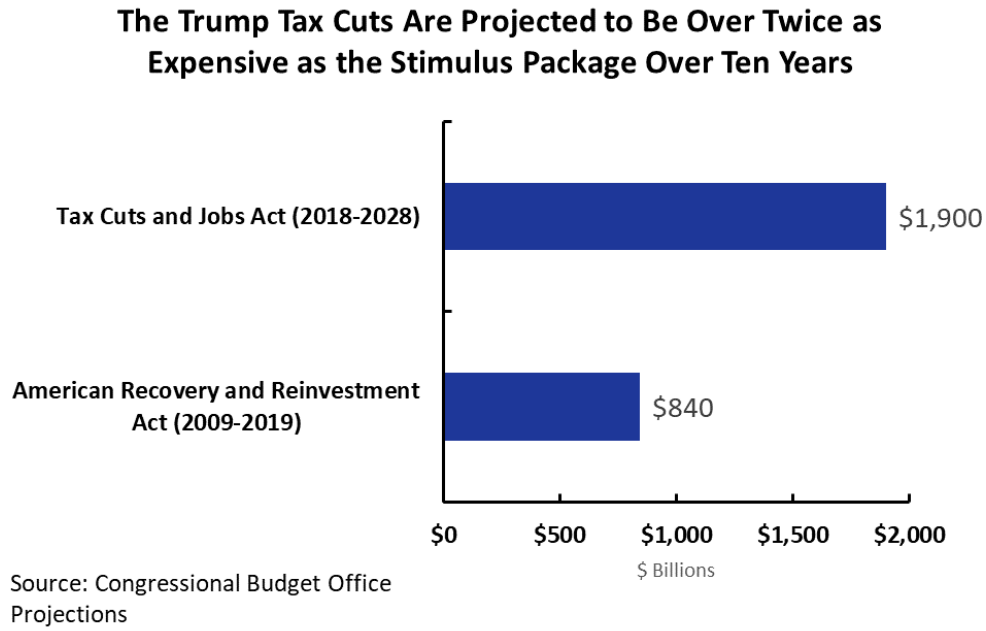
If one of the main purposes of the tax cuts was to stimulate the economy, Republicans designed them upside down; they should have weighted them toward the middle class and the poor. Research shows that low-wealth, low-income households and middle-class households are more likely to spend each dollar of income than the wealthy—increasing aggregate demand and economic growth.[37]

When the tax cuts went into effect in 2018, income and wealth inequality were both already elevated. The Gini coefficient, which measures income inequality, rose to a record 0.485 in 2018.[38] While the bottom 90 percent of American families holds less than one-quarter of all wealth, the wealthiest 1 percent holds about 40 percent.[39] The 2017 tax cuts directed the majority of tax relief to households that needed it least, missing an opportunity to reduce inequality and promote sustained economic growth.

The tax cuts may slow recovery from the next recession

Ironically, not only did the tax cuts do little to strengthen the economy in the long term, they may have made it significantly more difficult to recover from the next recession.

While increased federal spending is a critical tool for digging out of an economic downturn, the 2017 tax cuts have already put the federal budget further in the red. In fact, the tax cuts cost more than double the $840 billion price of the American Recovery and Reinvestment Act (ARRA), which was essential to helping the U.S. economy recover from the 2007-2009 recession.[40]



During the Great Recession, when the country needed massive stimulus, congressional Republicans vigorously opposed the ARRA.[41] In 2017, when Donald Trump inherited a strong economy from Barack Obama, he and congressional Republicans pursued the opposite strategy, pouring hundreds of billions of deficit-fueled dollars into the economy when it needed it least. As a result, it will be even more difficult for future policymakers to find the will and the resources to fight the next recession.

“What you are getting is a stimulus at the very wrong moment…the economy is already at full employment,” said former Federal Reserve Chairman Ben Bernanke. The tax cut stimulus “is going to hit the economy in a big way this year and next year, and then in 2020 Wile E. Coyote is going to go off a cliff.”[42] In addition, the Federal Reserve this year reduced interest rates to stabilize the economy amid the administration’s reckless trade wars. While the Fed was able to cut interest rates from 5.25 percent to near zero in response to the financial crisis and resulting Great Recession, it cannot play such a critical role in the next downturn because rates are already extremely low at between 1.50 and 1.75 percent.

Federal Reserve Chairman Jerome Powell has implied his hands may be tied in the next recession, and that Congress will need to play a bigger role by passing large macroeconomic stimulus, which may be extremely difficult to find the political will to do with such already high levels of debt. “In a downturn, it would also be important for fiscal policy to support the economy,” he said. “However, as noted in the Congressional Budget Office's recent long-term budget outlook, the federal budget is on an unsustainable path, with high and rising debt: Over time, this outlook could restrain fiscal policymakers' willingness or ability to support economic activity during a downturn.”[43]

Additional reading

The Economic Effects of the 2017 Tax Revision: Preliminary Observations, CRS Report

Trump's Tax Cut Underdelivers, Which Could Embolden Democrats Who Want It Reversed, *The Wall Street Journal*

No, the GOP Tax Plan Won't Give You a $9,000 Raise, *The Wall Street Journal*

The GOP Tax Cuts Didn't Work, *The Atlantic*

It's Official: The Trump Tax Cuts Didn't Pay for Themselves in Year One, *The New York Times*

GOP Leader Concedes Tax Cuts May Not Pay for Themselves as 2019 Deficit Grows, *The Washington Post*

In the Next Downturn, Fiscal Policy May Have to Step Up, *The Wall Street Journal*

Larry Kudlow Says Deficit Is 'Coming Down Rapidly,' But It Sure Doesn't Look That Way, *CNBC*

AP Fact Check: Trump Dubs Tax Cuts an "Economic Miracle," *The Associated Press*

Trump Touts Tax Plan's Benefits for Households, *The Wall Street Journal*

How FedEx Cut Its Tax Bill to $0, *The New York Times*

The Truth About the Trump Economy, *Project Syndicate*

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