TAX POLICY CENTER
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MACROECONOMIC ANALYSIS OF THE TAX CUTS AND JOBS ACT

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The Tax Policy Center has released an analysis of the macroeconomic effects of the Tax Cuts and Jobs Act as passed by Congress. We find the legislation would boost US gross domestic product (GDP) 0.8 percent in 2018 and would have little effect on GDP in 2027 or 2037. The resulting increase in taxable incomes would reduce the revenue loss arising from the legislation by $186 billion from 2018 to 2027 (around 13 percent). Because most of the individual provisions expire after 2025, we expect deficits (not including interest costs) would decline by $415 billion from 2028 to 2037, and macroeconomic feedback would boost the deficit savings by $3 billion over that interval. Including macroeconomic effects and interest costs, the legislation is projected to increase debt as a share of GDP over 5 percentage points in 2027 to 97 percent of GDP, and almost 4 percentage points in 2037 to 117 percent of GDP.

The Tax Cuts and Jobs Act (TCJA) would make major changes to the individual and corporate income taxes, estate and gift taxes, and certain federal excise taxes, and it would repeal the Affordable Care Act's individual mandate. [1]

The Tax Policy Center has analyzed the macroeconomic effects of the legislation. We find the following:

- The legislation would increase GDP relative to the Congressional Budget Office baseline projection 0.8 percent in 2018 and by diminishing amounts in subsequent years. There would be little impact on GDP in 2027 or 2037.
- The increase in output would boost revenues, offsetting about 18 percent of the increase in deficits projected under the legislation over two decades without accounting for macroeconomic feedbacks.

[1] This analysis is based on the conference report for the Tax Cuts and Jobs Act as filed on December 15, 2017. The text and descriptions of the bill and estimated revenue effects are available at https://rules.house.gov/conference-report/hr-1. The Tax Policy Center released a distributional analysis of this bill on December 18, 2017; see http://www.taxpolicycenter.org/publications/distributional-analysis-conference-agreement-tax-cuts-and-jobs-act.

- Macroeconomic feedback would reduce the projected effect of the legislation on the size of the national debt 0.8 percent of GDP in 2027 and 0.7 percent of GDP in 2037, relative to the projected levels under conventional revenue-estimating methods.

EFFECTS ON OUTPUT

The proposed legislation would affect output primarily through its influence on aggregate demand, labor supply, and saving and investment.

Aggregate Demand

The legislation would increase aggregate demand (and therefore economic output) in two main ways. First, it would reduce average tax rates for most households over the first few years after enactment, increasing after-tax incomes. Households would spend some of that additional income, increasing demand for goods and services. These economic benefits would be modest because most tax reductions would accrue to high-income households, who spend a smaller share of any increases in after-tax income than do lower-income households. Second, by allowing businesses to elect to immediately deduct (expense) new investment over the next five years, the legislation would encourage firms to increase their near-term investment, further increasing demand. Increases to businesses' cash flows from lower average tax rates would also increase investment demand. The boost in demand would raise economic output relative to its potential level for several years until higher interest rates and prices cause output to return to its long-term potential level. Because the economy is currently near full employment, the impact of increased demand on output would be smaller and diminish more quickly than it would if the economy were in recession.

Labor Supply

The legislation would modestly reduce effective tax rates on labor income (i.e., wages and salaries for employees and self-employment income for others) through 2025, primarily by reducing marginal income tax rates for most workers. The resultant increase in the after-tax wage rate would increase labor supply, mostly by encouraging lower-earning spouses to enter the work force or work additional hours. This effect would be reversed after 2025 because the expiration of most individual income tax provisions, together with the retention of slower indexation of tax brackets, would raise marginal tax rates and reduce labor supply.

Saving and Investment

Largely because the plan would reduce the corporate income tax rate and temporarily allow businesses to expense investment, the legislation would significantly increase the after-tax returns of saving and investment. That would encourage saving, foreign capital inflows, and investment.

Although the legislation would increase incentives to save and invest, it would also substantially increase federal budget deficits through 2025. Higher budget deficits would push up interest rates, which would discourage investment. After 2025, the legislation is projected to reduce federal budget deficits. Together with increases in private saving that would push down interest rates and encourage business investment.

Output

Taking all these effects into account, we estimate that the legislation would boost GDP 0.8 percent in fiscal year 2018, mostly because of its effect on aggregate demand (table 1). The estimated boost to output diminishes over the first few years primarily because the effects of aggregate demand fade and are not fully offset by the increase in labor supply and the increase in the capital stock from increased investment. The boost to output drops sharply after 2025 primarily because the expiration of most individual income tax provisions increases marginal tax rates on labor income, reducing labor supply. In 2027 and later years the legislation would have little effect on GDP.

TABLE 1

Dynamic Effects on GDP of the Tax Cuts and Jobs Act

FY 2018–37

	Fiscal Year										
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2037
	GDP ($ billions)										
Before macroeconomic feedback	19,926	20,661	21,378	22,168	23,037	23,948	24,899	25,889	26,917	27,985	41,419
After macroeconomic feedback	20,077	20,800	21,493	22,279	23,157	24,075	25,032	26,029	26,944	27,978	41,420
	Percentage change in GDP caused by macroeconomic feedback										
	0.8	0.7	0.5	0.5	0.5	0.5	0.5	0.5	0.1	0.0	0.0

Source: The GDP forecast through 2027 is from CBO, *The Budget and Economic Outlook: 2017 to 2027* (January 2017) and for 2028–37 is from CBO, *The 2017 Long-Term Budget Outlook* (March 2017); macroeconomic feedback estimated using TPC's macroeconomic models.
Note: CBO = Congressional Budget Office; GDP = gross domestic product.

EFFECTS ON THE BUDGET

The increase in output from the legislation would raise taxable incomes for individuals and businesses. That would in turn alter the impact of the proposal on the federal budget deficit, reducing it (relative to the impact before macroeconomic feedback) by $28 billion in fiscal year 2018 without including interest costs. Between 2018 and 2027 the estimated feedback effect is a cumulative $186 billion, and between 2028 and 2037 it is a cumulative $3 billion (table 2). Macroeconomic feedback effects would reduce the increase in the federal budget deficit from the plan about 13 percent over the first decade and boost estimated deficit reduction by about 1 percent over the second decade. Over the full 20 years, it would reduce the increase in the federal deficit as conventionally estimated by about 18 percent.

TABLE 2

Deficit Effects of Tax Proposals in the Tax Cuts and Jobs Act

Billions of dollars, fiscal years 2018–37

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018–27	2028–37
Increase in deficit without macroeconomic feedback or interest costs	136	280	259	221	178	138	120	115	41	-33	1,454	-415
Impact of macroeconomic feedback on the deficit without interest costs	-28	-25	-20	-19	-21	-22	-23	-25	-5	1	-186	-3
Increase in deficit with macroeconomic feedback and without interest costs	108	255	239	201	158	116	97	90	36	-32	1,268	-418

Sources: Joint Committee on Taxation (JCT) and Urban-Brookings Tax Policy Center (TPC) macroeconomic models.
Notes: Estimates without economic feedback for fiscal years 2018–27 are from JCT, *Estimated Budget Effects of the Conference Agreement for H.R. 1, the "Tax Cuts and Jobs Act" (JCX-67-17)*; estimates for fiscal years 2028–37 are TPC calculations based on extensions of JCT estimates. Estimates of impact on the deficit caused by macroeconomic feedback are calculations using TPC's macroeconomic models.

EFFECTS ON DEBT

The legislation would have an additional effect on deficits and the national debt because of its impact on debt service. Dynamic effects would alter that additional impact by reducing the size of the projected additions to federal debt and by increasing interest rates. Dynamic effects reduce the impact on the primary (or noninterest) deficit and therefore also reduce the amount of additional debt that accumulates and, consequently, the additional debt service costs. That effect is offset modestly because the legislation is projected to increase interest rates (and therefore the debt service cost per dollar of debt) over the first decade. Over the second decade, the legislation is projected to reduce interest rates and debt service costs per dollar of debt. Interest rates are projected to rise in the short term because the legislation would boost aggregate demand and output, leading the Federal Reserve to increase interest rates to avoid a surge in inflation. Interest rates are projected to fall after 2025 because reduced government borrowing and increased private saving would push down the price of borrowing (interest rates). We project that including additional interest costs, but not including macroeconomic feedbacks, the legislation would increase US debt by about $1.8 trillion (or 6.3 percent of GDP) in 2027 and by about $1.9 trillion (or 4.6 percent of GDP) in 2037. Including macroeconomic effects, the projected impact on the debt would fall to about $1.5 trillion (or 5.5 percent of GDP) in 2027 and about $1.6 trillion (or 3.9 percent of GDP) in 2037 (table 3). Compared with debt level projections using conventional revenue-estimating methods, macroeconomic effects reduce the increase in the amount of federal debt about 0.8 percent of GDP in 2027 and about 0.7 percent of GDP in 2037.

TABLE 3

Effects on Debt Service Costs of the Tax Cuts and Jobs Act

Trillions of dollars

	2018–27	2028–37
Increase in deficit without interest costs		
Without macroeconomic effects	1.5	(0.4)
With macroeconomic effects	1.3	(0.4)
Increase in interest costs		
Without macroeconomic effects	0.3	0.6
With macroeconomic effects	0.3	0.5
Increase in deficit		
Without macroeconomic effects	1.8	0.2
With macroeconomic effects	1.5	0.1
Increase in federal debt (end of period)		
Without macroeconomic effects	1.8	1.9
With macroeconomic effects	1.5	1.6
GDP (last year of period)		
Without macroeconomic effects	28.0	41.4
With macroeconomic effects	28.0	41.4
Increase in ratio of federal debt to GDP (end of period, in percentage points)		
Without macroeconomic effects	6.3	4.6
With macroeconomic effects	5.5	3.9

Sources: Joint Committee on Taxation (JCT) and Urban-Brookings Tax Policy Center (TPC) Macroeconomic Models.
Note: GDP = gross domestic product. Estimates without macroeconomic effects for fiscal years 2018–27 are from JCT, *Estimated Budget Effects of the Conference Agreement for H.R. 1, the "Tax Cuts and Jobs Act" (JCX-67-17)*; estimates for fiscal years 2028–37 are TPC calculations based on extensions of JCT estimates. The GDP forecast without macroeconomic effects through 2027 is from CBO, *The Budget and Economic Outlook: 2017 to 2027* (January 2017) and for 2028–37 is from CBO, *The 2017 Long-Term Budget Outlook* (March 2017). Macroeconomic effects were estimated using TPC's macroeconomic models.