



July 20, 2007

The Honorable John M. Spratt, Jr.
Chairman
Committee on the Budget
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

In response to your letter of June 28, the Congressional Budget Office (CBO) has examined how the budgetary costs of the Economic Growth and Taxpayer Relief Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) compare to projected budget deficits for 2007 through 2011.

Neither CBO nor the Joint Committee on Taxation (JCT) has a current estimate of the budgetary impacts of EGTRRA and JGTRRA. Therefore, the only readily available basis for such a comparison is the revenue effects of those laws as estimated by JCT at the time they were enacted. However, subsequent developments caused economic performance and other factors to differ from those upon which the projections were based. Consequently, if JCT were to make the same estimates today, the estimated revenue effects would be different. More fundamentally, measuring the actual impact of the revenue legislation requires gauging revenues and assessing economic performance in the absence of the legislation and then comparing those outcomes to the ones with the legislation. Such comparisons are difficult if not impossible to do, and the precise budgetary effects therefore typically can never be known with certainty.

JCT estimated the revenue effects of EGTRRA and JGTRRA at the time the acts were considered in 2001 and 2003, respectively. Taken together, those estimates imply a loss of revenues totaling \$165 billion in 2007. As you requested, CBO has calculated the debt-service costs that would result in 2007 from the legislation under an assumption that they were financed in full by additional debt rather than offset elsewhere in the budget. On that basis, CBO estimates that the revenue loss in JCT's projections would lead to additional debt-service costs of \$46 billion in 2007, for a total budgetary cost of \$211 billion. On the same basis, the agency estimates the total budgetary costs, including interest, for 2008 through 2011 to be \$233 billion, \$245 billion, \$269 billion, and \$215 billion, respectively.

Most of the economic developments not anticipated in CBO's baseline that have occurred since the enactment of the tax legislation (and that were therefore not

incorporated in JCTs estimates) appear to be unrelated to the changes in tax policy. The policies themselves, however, undoubtedly exerted at least some influence on the economy. By design, revenue estimates reflect a variety of behavioral responses to legislation, but they do not incorporate such potential macroeconomic impacts. Those economic feedbacks on today's budget, however, are likely to be modest. The short-term effects of EGTRRA and JGTRRA in stimulating aggregate demand in the economy have largely dissipated by now, and the supply-side effects of those policies are uncertain but are probably small. Some provisions of EGTRRA and JGTRRA increased incentives for people to work and save (which can increase growth), but other provisions had no effect on incentives. In addition, the two tax laws increased the budget deficit, and doing so tends to reduce economic growth over the medium and long term. At this point in time (several years after enactment), once those various factors have been taken into account, the overall impact of the tax legislation on the economy is likely to be modest.

CBO's analysis of the President's budgetary proposals for fiscal year 2006 provides a rough guide for the medium-run economic effects of EGTRRA and JGTRRA. CBO analyzed the effects of those proposals taken as a whole, but the major proposal in that budget was the extension of provisions of EGTRRA and JGTRRA that are set to expire in 2010.¹ That analysis found that, on average, the economic effects of the budget's proposals could add up to 2 percent to their cost or offset up to 9 percent of their cost over the 2011–2016 period, depending on the assumptions used. Applying those percentages to the projected budgetary cost of EGTRRA and JGTRRA in 2007 provides a rough estimate of the potential macroeconomic feedback effects excluded from the baseline estimates: Such effects could increase by up to \$3 billion or reduce by up to \$14 billion the estimated budgetary impact of EGTRRA and JGTRRA in 2007.² (To be sure, the actual effects could be significantly higher or lower than those estimates, but none of the economic developments since the laws' enactment has provided clear evidence that the estimates are biased either upward or downward.) The net result incorporating the estimated feedback effects would be a budgetary impact from EGTRRA and JGTRRA (including debt-service costs) of roughly \$195 billion to \$215 billion in 2007.

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1. Congressional Budget Office, *An Analysis of the President's Budgetary Policies for Fiscal Year 2006* (March 2005), Chapter 2. For 2011 to 2015, any proposals other than the extension of expiring tax cuts were relatively minor in terms of their net economic effects.
 2. Those estimates are broadly consistent JCT's estimates of the macroeconomic effects of JGTRRA. See Joint Committee on Taxation, *Overview of the Work of the Staff of the Joint Committee on Taxation to Model the Macroeconomic Effects of Proposed Tax Legislation to Comply With House Rule XIII.3.(h)(2)* (December 2003).


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CBO's latest baseline budget projections, released in March 2007, show a deficit totaling \$177 billion in 2007.³ (Under the procedures that govern CBO's baseline, that projection assumes that current laws and policies remain in place. Therefore, the estimate does not include legislation enacted since February. It also does not incorporate new information on tax receipts and spending since February. Taking account of those additional factors, CBO has since indicated that it expects a 2007 deficit of between \$150 billion and \$200 billion.) For 2008 through 2011, CBO's baseline budget projections show deficits of \$113 billion, \$134 billion, \$157 billion, and \$35 billion, respectively. (The agency will release updated baseline projections in August.)

I hope that this letter is useful to you. If you have any questions about it, please feel free to contact me at (202) 226-2700.

Sincerely,



Peter R. Orszag
Director

cc: Honorable Paul Ryan
Ranking Member

3. Congressional Budget Office, *An Analysis of the President's Budgetary Policies for Fiscal Year 2008* (March 2007).