EPI Policy Memorandum

ECONOMIC POLICY INSTITUTE • SEPTEMBER 23, 2010 • POLICY MEMORANDUM #171

HOW TO LOSE OVER A MILLION JOBS

Sacrifice Investments to Cut Taxes for the Rich

BY ANDREW FIELDHOUSE AND REBECCA THIESS

Republican House Minority Leader John Boehner recently proposed a two-step job creation plan consisting of a full extension of Bush-era tax changes and cuts to domestic spending. His plan calls on Congress to cut non-security related spending back to fiscal year 2008 levels and to enact a two-year freeze on all current tax rates.[1]

Rep. Boehner claims these two policies will drive job growth more than any proposal of President Obama's. However, we find that this proposal would have a devastating impact on the struggling U.S. labor market while negligibly improving the fiscal outlook.

Specifically, we find:

- Relative to the president's budget request, the plan would reduce funding for domestic programs—which include investments in infrastructure, education, and research—by 22.7%, while extending the Bush tax cuts for top earners.[2]
- The Boehner plan would reduce the deficit by less than 5.5% in 2011.[3]
- Because reductions in spending are larger than the tax cuts, and because tax cuts for upper-income taxpayers are poor stimulus, the net job impact of the Boehner plan would be an estimated employment *reduction* of over 1 million jobs.

The Boehner plan, step 1: Cutting funding by 22.7%

The Boehner plan calls on Congress to cut non-security related spending back to 2008 levels. This would require a spending reduction in this category of $105 billion in 2011.[4] Maintaining Department of Defense, Department of Veterans Affairs, and Department of Homeland Security at the funding levels requested in the president's budget would exempt $673 billion from these cuts. Thus, to achieve the overall reductions, non-security funding would have to be cut to $356 billion—an across the board cut of 22.7% relative to the president's budget request and *6.9% lower than 2010 levels, adjusted for inflation*.[5]

Proposed savings on the scale of $100 billion suggest fiscal responsibility, however limiting reductions to a very narrow portion of the budget would result in drastic and politically unrealistic cuts to many human needs and investment programs. Savings of $105 billion would only close 7.8% of the projected 2011 deficit, based on the Congressional Budget Office's (CBO) estimate of the president's budget, and the reduction does not take into consideration the proposed tax cuts for the wealthy (CBO 2010b).

The Boehner plan, step 2: Tax cuts for the richest Americans

The next segment of Rep. Boehner's plan would freeze all current tax rates, meaning that the 2001 and 2003 Bush tax cuts would be extended for all taxpayers, regardless of income.[6] The proposal would also freeze the estate tax at its current rate of zero percent. President Obama has proposed to permanently cut taxes for 97% of Americans and allow rates to rise for joint filers making over $250,000 annually (TPC 2010). If the two-year tax freeze were made a permanent tax cut for high-income individuals—as Rep. Boehner has advocated—it would cost $629 billion more than President Obama's proposal over the next decade. In 2011 alone, Rep. Boehner's proposed individual income tax cuts would cost $30 billion more than the Obama approach (OMB 2010b).

Impact on deficits and jobs

Rep. Boehner's proposal would save $105 billion by cutting non-security discretionary programs; however, it would simultaneously increase the deficit by $30 billion to extend tax cuts for the 3% of the population with the highest incomes. Combining these two policies, his proposal saves on net $74 billion in 2011, which would reduce the deficit by only 5.5%.

The individual income tax cuts for the rich and the cuts to spending will have different impacts on overall employment, both because of their overall size and their per dollar effect on near-term spending. Using fiscal multipliers from the CBO to measure the separate impacts of the tax cuts and the spending cuts on gross domestic product (GDP), we found that GDP would *shrink* by 1.1%—or about $171 billion—due to this proposal (CBO 2010c).[7] The tax cuts themselves would modestly expand GDP, but permanent tax cuts demonstrate one of the lowest bang-for-the-buck options of any stimulus policies. The adverse impact of the spending cuts, meanwhile, would overwhelm the limited growth impact associated with the tax cuts, substantially decreasing output on net. Using a rule of thumb for the impact of government spending on employment, we estimate that this loss of GDP will correspond to a loss of roughly 1.1 million jobs, relative to a fiscal path that maintains spending at the president's proposed 2011 levels and a tax policy that did not extend tax cuts for upper-income taxpayers.[8]

Plan slashes investments in education, research, and infrastructure

Besides costing the economy jobs today, the Boehner economic plan would be detrimental to our investment deficit and longer-term growth. The nation's schools, roads, railroads, sewers, and energy grid need repair, not funding cuts.

If the 22.7% non-security discretionary cut were enacted across the board, it would undermine opportunities for our children and hurt American competitiveness in the 21st century. For example, spending on education would drop nearly $10 billion in one year alone. Funding for research at the National Institutes of Health would fall more than $7 billion. And spending on ground transportation and infrastructure investments would decrease nearly $8 billion—all in one year.[9] It is these cuts to investment that would account for much of the expected job losses and decrease in output. Rep. Boehner's plan to drive job growth would actually *slow* economic growth for years to come.

A confused rationale for cutting spending

Contrary to the misguided economics of Rep. Boehner, the expansion of the deficit serves a purpose: intentional deficit-financed spending has driven economic growth and brought our country out of a severe economic downturn. In an interview on CBS's "Face the Nation," Rep. Boehner told Bob Schieffer: "If we cut spending, we will help our economy. We will send signals to the markets, to the business community that Washington's attempting to get its fiscal house in order." This talking point is not supported by market data, and is misleading.

There is no evidence in the bond market that government deficit spending is crowding out private investment and raising interest rates; the Federal Reserve continues to hold short-term interest rates at record lows (and expects that resource underutilization will warrant exceptionally low rates for an extended period). Fears of a double-dip recession have recently sent the yield on 10-year Treasury notes to relatively low levels and the two-year Treasury note is trading well below its level at the peak of the financial crisis; if anything, the bond market is signaling that it wants *more* fiscal stimulus.

Finally, it should be noted that because interest rates are so low, it is a very cheap time for the federal government to borrow, and because private firms and households are deleveraging from high debt loads, it makes sense for the government to boost aggregate demand. As Paul Krugman (2010) has repeatedly pointed out, we are in a liquidity trap and many normal rules of macroeconomics—including the investment crowd-out mechanism—are not applicable. Given that the economic recovery is faltering and the economy remains more than 6% below potential, cutting federal investments would hurt job creation and slow the return to full employment. By putting more than a million Americans out of work and risking a double-dip recession, the Boehner economic plan would also reduce the tax base and increase federal spending on unemployment insurance, exacerbating the pressure on the deficit.

There is a better path to economic opportunity

Speaking in Ohio, President Obama rightly declared that he refuses to "cut back on those investments that will grow our economy in the future—investments in areas like education and clean energy and technology." These pro-growth investments largely come from the non-security discretionary budget—the same funds Rep. Boehner is trying to cut. Rep. Boehner's plan would tilt the tax code even more in favor of the wealthiest Americans while cutting support to the American middle class. Sacrificing investment in favor of tax cuts for the rich would undermine the economic recovery and cost roughly a million jobs, all while weakening the potential for American economic growth.

A real path to fiscal responsibility would prioritize job creation (actual job creation policies, not supply-side talking points masquerading as economics) and would delay tightening spending until the economy has recovered and unemployment has returned below 6% (Irons 2010). Tackling spiraling health care cost growth (an economic problem with budgetary implications, not vice versa) and modernizing a tax code that currently raises insufficient revenues would be the prudent way to address our long-term fiscal challenges. Rep. Boehner offers simplistic solutions to the wrong problems; cutting taxes for the rich is not an economic cure-all—indeed, it is among the least effective ways to stimulate economic activity (Zandi and Blinder 2010).

The way to reduce the deficit in the longer term *and* to rebuild the middle class is to put Americans back to work and invest in our future, not to cut targeted investments that are desperately needed, particularly in this time of economic weakness. By creating jobs and investing in infrastructure, research, education, and new energy sources, we can rebalance the economy and build a better America for the next generation.

Endnotes

1. All years are fiscal unless otherwise noted.
2. Tax cuts would be extended for individuals making over $200,000 and joint filers making more than $250,000 in adjusted gross income.
3. The Boehner proposal freezes all tax rates at 2010 levels, which means freezing the estate tax as it currently stands—at a zero percent rate. For the purposes of this paper, we focus on the macroeconomic impact of the discretionary spending cuts and the upper income tax cut extensions, specifically their effects on employment. Extending the repeal of the estate tax would have a negligible impact on employment, but it would come at a budgetary cost. The net impact of cutting discretionary spending and extending the upper income Bush tax cuts would reduce the deficit by 5.5% in 2011, but the deficit would be reduced by less if the one-year repeal of the estate tax were extended. Congress is currently debating whether or not to extend the upper income tax provisions, but it seems highly unlikely that the estate tax will not be reinstated in some form in 2011, so we do not build this part of the proposal into our budgetary assumptions. The Obama policy baseline used in this analysis assumes that the estate tax will be reinstated at 2009 levels, meaning a $3.5 million exemption ($7 million for joint filers) and a 45% top rate. If the estate tax were reinstated at a $5 million exemption ($10 million for joint filers) and 35% top rate, as Senate Minority Leader McConnell has proposed, the package of tax cuts for the wealthy and discretionary spending cuts would reduce the deficit by less than 5.5%.
4. The Boehner calculation uses a $1.128 trillion budget baseline for discretionary funding requested in the president's 2011 budget (all funding for foreign military operations and emergency funding are excluded from this baseline), but as the Center on Budget and Policy Priorities recently noted, this figure fails to fully fund the Pell Grant program (Horney and Greenstein 2010). Adjusting the president's discretionary budget request upward to match President Obama's policy, the proper baseline should be $1.134 trillion. The president's budget proposed converting the Pell Grant program from a discretionary to a mandatory program, but Congress has maintained the basic Pell Grant as a discretionary program. The budget baseline cited in the Boehner proposal appears to assume that the Pell Grant remains a discretionary program with $17.7 billion in budget authority for 2011, as was estimated in the March 2010 CBO baseline (Kalcevic and Humphery 2010). After adjusting for changes in the Pell Grant included in the health care reform reconciliation bill, the president's proposal would cost $23.2 billion in 2011, leaving a $5.5 billion funding gap relative to the CBO baseline. Consequently, we adjust both the baseline discretionary level for the Obama policy and Rep. Boehner's proposed reduction in spending by $5.5 billion. The Senate Budget Committee Chairman's Mark for Fiscal Year 2011 assumed that the Pell Grant shortfall would be filled and the $5.5 billion would be offset by the appropriators, and Rep. Boehner's proposal may have adopted the same treatment. Similarly, the proposed $99 billion cut needed to reach $1.029 trillion in 2011 is more accurately stated at $105 billion.
5. In an interview on Face the Nation, Rep. Boehner cited that his economic plan would cut non-security discretionary spending by roughly 22% but there is some uncertainty about the exact magnitude of the cuts due to the lack of specificity in the minority leader's proposal. The Center on Budget and Policy Priorities notes that the proposal would mean a cut of 22.4% relative to the CBO baseline and 22.7% relative to the president's budget (after adjusting the discretionary budget baseline for fully funding the Pell Grant program). We assume a 22.7% cut from the president's budget request for consistency with OMB Table 32-1 in the Analytical Perspectives, which is used in our calculations of the magnitude of program-specific cuts to budget authority.
6. The 2001 and 2003 tax cuts refer to the years of enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003, not fiscal years.
7. This calculation is based on fiscal multipliers published in CBO (2010c). The impact of the $104.7 billion non-security discretionary budget cut is assigned a multiplier of 1.75, the average of the low and high estimated output multiplier for purchases of goods and services by the federal government. The impact of the $30.5 billion upper-income tax cuts are assigned a multiplier of 0.4, the average of the low and high estimated output multiplier for a one-year tax cut for higher-income people. The spending cuts would decrease GDP by $183.2 billion and the tax cuts would boost GDP by $12.2 billion for a net decrease of $171.0 billion. This would reduce nominal GDP in 2011, as projected by CBO, from $15,148 billion to $14,977 billion, equal to a 1.1% decrease (CBO 2010a).
8. Bernstein and Romer (2009) use the rule of thumb that a 1% increase in GDP corresponds to an increase in employment of roughly 1 million jobs. Consequently a 1.1% decrease in GDP would correspond with 1.1 million job losses.
9. Author's calculations based on OMB (2010a). We assume an across-the-board 22.7% reduction in all 2011 discretionary budget authority. Function 400 (Transportation) discretionary budget authority would be cut by $7.7 billion to $26.0 billion. Function 500 (Education) discretionary budget authority for the elementary, secondary, and vocational education would be cut by $10.0 billion to $33.8 billion. Function 550 (Health) discretionary budget authority for the National Institutes of Health would be cut by $7.3 billion to $25.5 billion.

References

Bernstein, Jared, and Romer, Christina. 2009. "The Job Impact of the American Recovery and Reinvestment Plan." January. Available at: http://www.politico.com/static/PPM116_obamadoc.html

Congressional Budget Office (CBO). 2010a. "The Budget and Economic Outlook: An Update." August. Available at: http://www.cbo.gov/doc.cfm?index=11705

Congressional Budget Office (CBO). 2010b. "Preliminary Analysis of the President's Budget Proposals for Fiscal Year 2011." March. Letter to the Honorable Daniel K. Inouye. Available at: http://www.cbo.gov/ftpdocs/112xx/doc11231/index.cfm

Congressional Budget Office (CBO). 2010c. "Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output From April 2010 Through June 2010." August. Available at: http://www.cbo.gov/ftpdocs/117xx/doc11706/08-24-ARRA.pdf

Greenstein, Robert, and Horney, James. 2010. "Boehner Proposal Would Cut Non-Security Discretionary Programs 22 Percent, the Deepest Such Cut in Recent U.S. History: Tax-Cut Part of Plan Designed to Achieve Opposite of Orszag Fiscal Goal." Washington, D.C: Center on Budget and Policy Priorities. September. Available at: http://www.cbpp.org/files/9-10-10bud.pdf

Kalcevic, Deborah, and Humphery, Justin. 2010. "Memorandum: CBO March 2010 Baseline Projections for the Student Loan and Pell Grant Programs." Washington, D.C.: Congressional Budget Office (CBO). March. Available at: http://www.cbo.gov/budget/factsheets/2010b/studentloans.pdf

Krugman, Paul. 2010. Nobody understands the liquidity trap. July 14. *The New York Times:* The Conscience of a Liberal. http://krugman.blogs.nytimes.com/2010/07/14/nobody-understands-the-liquidity-trap-wonkish/

Irons, John. 2010. "Fiscal Consolidation Should Wait until Economic Recovery is on Track." Memorandum to the National Commission on Fiscal Responsibility. Washington, D.C.: Economic Policy Institute. July. Available at: http://epi.3cdn.net/5b2b1cfe90ba0963b6_pcm6iyh9i.pdf

Office of the House Republican Leader John Boehner. 2010. "House Republicans' Plan for Immediate, Bipartisan Action on the Economy." September. Available at: http://republicanleader.house.gov/UploadedFiles/HouseGOPEconomicPlanforSeptember.pdf

Office of Management and Budget (OMB). 2010a. "Analytical Perspectives, Budget of the United States Government, Fiscal Year 2011." Table 32-1. Budget Authority and Outlays by Function, Category, and Program. http://www.whitehouse.gov/sites/default/files/omb/budget/fy2011/assets/11msr.pdf.

Office of Management and Budget (OMB). 2010b. "Mandatory and Receipt Proposals." Midsession Review. Table S-9. http://www.whitehouse.gov/sites/default/files/omb/budget/fy2011/assets/32_1.xls.

Senate Budget Committee. 2010a. "The Chairman's Mark: FY 2011 Senate Budget Resolution." Overview of the Senate Budget Resolution. April. Available at: http://budget.senate.gov/democratic/documents/2010/Chairman%27s%20Mark_042110.pdf

Senate Budget Committee. 2010b. "Summary: Chairman's Mark: FY 2011 Senate Budget Resolution." Overview of the Senate Budget Resolution. April. Available at: http://budget.senate.gov/democratic/documents/2010/Chairman%27s%20Mark%20Summary_042110.pdf

Tax Policy Center (TPC). 2010. "T10-0236 - Tax Units with Tax Increase from Administration's Tax Proposal Relative to Full Extension of Tax Cuts, 2011." Washington, D.C.: Tax Policy Center. September 15, 2010. Available at: http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=2834&DocTypeID=7

Zandi, Mark, and Blinder, Alan. 2010. "How the Great Recession was Brought to an End." July 27. Available at: http://www.economy.com/mark-zandi/documents/End-of-Great-Recession.pdf