Constructing a Current Policy Baseline After Tax Reform

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In the final days of 2017, the first comprehensive reform of our tax code in more than three decades became law. The “Tax Cuts and Jobs Act” (TCJA) significantly revised both the corporate and individual tax codes, lowering rates and simplifying compliance. In doing so, the bill also significantly altered federal revenue expectations, giving Congress a new base from which to plan its spending priorities. Through analyzing existing revenue projections and making some reasonable assumptions as to likely extensions of policy, we can help create a new “current policy” baseline - in other words, a baseline that adheres most closely to realistic projections of both revenue and Congressional action that might impact it.

In order to avoid facing a filibuster, the reconciliation process was used to pass tax reform. This meant that the provisions in the TCJA needed to be compliant with the Senate’s Byrd Rule dictating that the legislation adheres to the cost estimate established in the budget resolution and that it does not increase deficits outside of the bill’s budget window. Because of this, many of the individual income tax provisions are set to expire in 2025. Figure 1, below, shows the CBO’s pre-TCJA baseline projection of revenues along with an adjusted post-TCJA baseline including JCT’s non-dynamic score of the bill’s changes in revenue.

Figure 1. Static Revenue Baseline Before and After TCJA (in Trillions)

Under CBO’s pre-TCJA baseline, annual revenues would rise from $3.32 trillion in 2017 to $5.16 trillion in 2027, totaling $43.01 trillion from 2018-2027. Under JCT’s conventional score (excluding macroeconomic feedback) of the TCJA, revenues would continue to rise, though at a somewhat lower rate through 2025. After many individual income tax reduction and credit provisions expire under the law in 2025, revenues would increase at a faster rate, exceeding CBO’s baseline projection for 2027. Receipts will total $41.56 trillion over the next decade, or, $1.45 trillion less than the pre-TCJA 2017 baseline.
As we noted in a previous edition of The Baseline, CBO uses a flawed “current law” baseline for revenues, which generates estimates based only on what is written in law while ignoring frequent Congressional actions to extend policies that would otherwise expire. Tax reductions are frequently written as temporary measures in order to avoid triggering the Byrd Rule or to stay under statutory pay-as-you-go limits. TCJA includes a raft of provisions, including individual income tax rate reductions, that are scheduled to expire in 2025 despite widespread belief that Congress is likely to either extend or make them permanent. A more accurate baseline would take into account such extensions when estimating future revenue. Now that TCJA has passed, we can utilize existing estimates to help build that realistic baseline.

Figure 2, below, shows a projection of revenues that would occur if the expiring provisions are extended (excluding full expensing, as explained in the note below). JCT’s analysis of the TCJA Conference Report included scores for 16 major items that will expire (there were additional items below a plus or minus $50 million threshold). NTUF estimated the revenue impact of extension of these policies by extrapolating the average annual rate of change for each provision before the scheduled expiration date in JCT’s score. A few provisions expired after one or two years, including preserving the deduction for medical expenses over 7.5 percent of adjusted gross income through 2018 and the craft beverage modernization and tax reform which sunsets in 2019. In these cases, the figures assumed continuation at the same revenue level through the budget window. Assuming extension of these policies shows further revenue reduction of $353 billion over the next ten years under a current policy baseline, before accounting for macroeconomic feedback.

1 Charts and figures above exclude a score for making the full expensing provisions permanent. The tax reform bill allows for 100 percent full expensing for qualifying assets through 2022. In subsequent years the allowable depreciation percentage would be phased out after 2026. JCT estimated that this section would reduce revenues by $124.3 billion through 2023, then increase outlays by $37.9 billion through 2027. It was not possible to extrapolate the revenue impact of making this provision permanent. While full expensing shows revenue losses in early years, it is a powerful pro-growth provision that could be expected to actually increase revenue in out years. As the Tax Foundation stated, “Full expensing of capital investments is probably the single most significant tax change lawmakers could make to encourage economic growth.” In order to simplify creation of a new baseline, this paper excludes changes made to expensing.
The figures above exclude consideration of tax reform's macroeconomic feedback, as does CBO's recent letter addressed to Senator Ron Wyden (D-OR) reporting on the debt and deficits under the TCJA. As the business and individual tax changes help improve investment and wage growth, additional revenues will “feed back” into the federal treasury, reducing the tax bill’s “score” significantly.

Under the JCT’s dynamic score of the TCJA (see Figure 4), economic growth will generate revenue feedback of $385 billion through 2027. This likely represents a very conservative estimate, as many organizations have criticized JCT’s growth projection for being too anemic. Even small changes in growth would have a significant impact in revenues. According to the CBO last year, each 0.1 percent increase in GDP can be expected to boost revenues by roughly $315 billion over the next ten years. Under the Tax Foundation’s modeling of the bill, macroeconomic feedback will contribute roughly $1 trillion in revenue, with annual receipts surpassing CBO’s baseline after 2023.
In 2018, Congress will likely move to alter the caps enacted in the Budget Control Act (which have saved $7,400 per household in spending), and will begin again the process of crafting a budget resolution and an appropriations process. Lawmakers are also expected to consider another round of tax extenders soon. The previous short-term Tax Relief Extension Act of 2015 was scored at $154 billion in the first year, but at $87 billion over a decade with dynamic feedback. The new cost would be higher if the provisions are built into the policy baseline.

Only by having accurate estimates can Members of Congress make informed decisions about how to reduce deficits. By adding in reasonable assumptions as to extensions of policy and the dynamic impact TCJA is expected to create, we have constructed a more accurate baseline to help inform Congressional decisions on spending. The analysis shows that Congress has an additional $353 billion worth of spending restraint to pursue in the next decade if it wishes to both extend tax relief and prevent additional deficit impact, a task that shouldn’t prove exceptionally difficult given that this amounts to barely more than 0.8 percent of revenue.