TrendMacrolytics

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On the Byrd Rule and Extension of the 2003 Tax Cuts

Wednesday, February 8, 2006

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A story in the ***Wall Street Journal*** this morning disclosed that **Senate Democrats** have threatened to invoke the **Byrd Rule** against extending the **2003 tax cuts on dividends and capital gains** under 2006 **budget reconciliation**. In short, the Byrd Rule says that tax cuts enacted within the **filibuster-proof** reconciliation framework cannot have **net revenue costs** beyond five years. Extended the 2003 tax cuts to 2010 from their current **sunset** of 2008 would have that property, because the official **scoring** of the **Joint Committee on Taxation** assumes that capital gains realizations and dividends would temporarily accelerate in the sunset year, creating a hangover negative revenue effect in subsequent years. It is ironic that JCT takes such tax-optimizing behavior into account, when it eschews **"dynamic scoring"** that would give **pro-growth tax cuts** the credit they deserve for accelerating **economic activity** and consequent tax revenues. The fact is that the 2003 tax cuts on capital gains have more than paid for themselves in greater than expected capital gains tax receipts already, and the **federal budget deficit** today is lower than it was before the tax cuts were enacted in May 2003 -- all due to revenue growth, not **spending restraint**.

The *Journal* story portrays the Democrats' parliamentary move as a great surprise to the **Republicans**, and a death-blow to extension. But our sources close to the process assure us that it is anything but a surprise, and indeed that it has been fully anticipated. The planned solution is for the **House/Senate conference committee** to include revenue raising provisions -- that is, new taxes -- that would kick in in the years beyond 2010, in order that the legislation is not revenue negative, on balance, beyond the five-year horizon. Such a move will probably succeed in overcoming the obstacle created by invocation of the Byrd Rule, but its consequence would be to escalate what is already an ongoing policy of **brinksmanship** in tax policy. In addition to **tax relief** set to sunset unless legislation is enacted to extend it, now we would have **tax increases** set to automatically kick in unless legislation is enacted to stop it. It means that, increasingly, **tax policy** is evolving into a one-year-at-a-time process. While we may very well get a result this year that extends provisions critical for continued economic growth, the price is a policy environment of increasing instability and risk. TM

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