No. 801 February 14, 2002

Six Truths on How to Get the Economy Moving

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Even though the U.S. economy is underperforming, the Senate recently failed to pass any legislation that could improve matters. In the future, policymakers trying to revive the economy should bear in mind the following six truths about economic policy.

Truth #1: The most effective role for government is to decrease barriers to economic growth. High tax rates on working, saving, investing, and business development are among the biggest government burdens slowing the economy. Lowering these obstacles would trigger more jobs, higher incomes, and less poverty.

Despite the rhetoric of some politicians, government cannot "grow" the economy. The private sector, not government, creates jobs and produces prosperity. Government spending mislabeled as "economic stimulus" only misallocates resources that individuals, families, and businesses would use more efficiently.

Government can decrease existing barriers because it acts on the economy like a foot on the brake pedal of a car. The harder government pushes, the more the economy slows; the more government lets up, the faster the economy runs. Workers, investors, and businesses respond to incentives. The more government punishes (taxes) working, saving, investing, and business development, the less these activities occur. The less government punishes (taxes) these actions, the more they occur.

The tax cut President Bush signed into law in 2001 was a first step toward relieving government's heavy burden on the U.S. economy. However, government will unleash the economy only by lowering high tax rate hurdles permanently, immediately, and significantly.

Truth #2: Permanent tax cuts are better than temporary ones. Unfortunately, major provisions of the 2001 tax cut—reductions in income tax rates, repeal of death taxes—will expire in 2011. This policy also hurts the economy today. The reason: Temporary tax cuts yield at best only a temporary recovery. They do not change incentives to work, save, invest, and develop businesses. Instead, people shift the timing of their behavior. Taking your foot off the brake for a moment stops the braking only for that time.

Produced by the
Thomas A. Roe Institute for Economic Policy Studies

Published by
The Heritage Foundation
214 Massachusetts Ave., NE
Washington, D.C.
20002–4999
(202) 546-4400
http://www.heritage.org

This paper, in its entirety, can be found at: *www.heritage.org/library/execmemo/em801.html*

Permanent tax cuts spur permanent growth. Some advocate temporary tax cuts because they

may have a smaller effect on the federal budget than permanent tax rate reductions. As Heritage budget expert Brian Riedl writes in "What Really Is Turning the Budget Surpluses into Deficits," this view is misguided because the recession is an economic problem, not a budget problem. Politicians genuinely concerned about the budget should reduce wasteful government spending, not encumber the economy with high tax rates.

Truth #3: Tax cuts now are better than tax cuts in the future. Regrettably, major provisions of the 2001 tax cut will not take full effect until some time in the future: lower income tax rates in 2007, death tax rate cuts in 2010. This policy also hurts the economy now. Tax cuts in the future help the economy in the future, but taking your foot off the brake in the future does nothing to lessen the braking now. Tax rate cuts now would improve incentives and help the economy now. Future tax cuts are uncertain because politicians may delay or prevent them from occurring. Workers, investors, and entrepreneurs understand this risk and discount the likelihood that these tax cuts will materialize.

Senate Majority Leader Thomas Daschle (D–SD) criticized the 2001 tax cuts; Senator Edward Kennedy (D–MA) called for delaying scheduled cuts; and Representative Ellen Tauscher (D–CA) suggested postponing planned rate cuts if there were no budget surplus. But tax cuts delayed are tax cuts denied. Tax cuts subject to a budget surplus "trigger" likely will not happen because politicians will spend the money. Moving the tax cuts scheduled for the future to the present would decrease the drag on the economy now and remove uncertainty about whether the policy will take place.

Truth #4: Bigger tax cuts help the economy more than smaller ones do. The 2001 tax cut was small compared with President Kennedy's cuts in the 1960s and President Reagan's cuts in the 1980s. The more you remove your foot from the brake pedal, the greater the effect.

The 2001 legislation did not decrease the bias against investment. A real pro-jobs policy would eliminate, or at least reduce, tax rates on investment—i.e., dividends and capital gains. Government punishes investment several times by taxing corporations, dividends, and capital gains. These multiple taxes discourage investment. Lowering this obstacle would increase investment, stimulate business development, and create jobs.

Truth #5: Cutting tax rates on present and future behavior is better than giving rebates for the past. Tax rebates do not change behavior, because they do not improve incentives. On the other hand, pro-growth tax cuts decrease the punishment on present and future working, saving, investing, and business development. Additionally, "rebates" for people who did not pay income taxes are a big government giveaway that neither improves incentives nor helps the economy. Similarly, extending unemployment benefits may temporarily and marginally assist people out of work, but this policy also neither improves incentives nor helps the economy.

Truth #6: The aim of tax policy is to unleash the economy, not balance the federal budget. Although government cannot "grow" the economy, government can reduce its burden on the economy by lowering tax rates. High tax rates discourage the key foundations of economic expansion—working, saving, investing, and business development. Lower tax rates would trigger economic growth that would create more jobs, raise incomes, and decrease poverty.

Some politicians invoke the slogans "fiscal discipline" or "fiscal responsibility" as excuses not to cut tax rates. Only in Washington would these mottos mean government's taking *more* money while increasing spending on wasteful government programs. True fiscal discipline would entail government's taking *less* from people. Sadly, when some politicians cite "fiscal discipline," they mean fiscal discipline for American families, not for Washington.

Conclusion. The way to reverse the economic slowdown is to reduce government barriers to economic expansion imposed by high tax rates on working, saving, investing, and business development. The less government punishes these activities, the more these positive forces of economic growth will flourish. If government takes its foot off the brake—permanently, immediately, and dramatically—the economy will soar.

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