

Background

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Setting the Tax Record Straight: Clinton Hikes Slowed Growth, Bush Cuts Promoted Recovery

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Abstract: *Despite evidence to the contrary, President Obama and his supporters insist that a tax increase will not impede economic recovery. They claim that the Clinton tax hikes spurred the boom of the 1990s and that the subsequent Bush tax cuts hurt the economy. Members of Congress must reject this faulty notion—and reject the President’s call for burdening Americans with higher taxes and an even slower economy.*

President Barack Obama and his allies in Congress and elsewhere continue to press for tax increases, whether as part of a deal to raise the government’s debt ceiling, or for any other reason. Even though common sense would dictate not raising taxes in the face of a badly weakened economy and almost non-existent job growth, the President and his supporters argue that tax hikes will not imperil the still-nascent recovery because the economy grew during the 1990s after President Bill Clinton raised taxes. The inference being that today’s economy could also absorb the blow of tax hikes and grow despite them. They also argue the converse: that the tax cuts passed during President George W. Bush’s tenure slowed growth and cost jobs.

This cursory and errant analysis of recent history has serious implications for policymaking today. If Congress raises taxes based on the faulty notion that tax hikes have no ill effects on economic growth, it will impede the still-struggling recovery and keep millions of Americans on the unemployment rolls far too long.

Talking Points

- President Obama remains insistent on raising taxes. He often argues incorrectly that the economy suffered no ill effects from the Clinton tax hikes and that the Bush tax cuts damaged the economy.
- The historical record shows that the President has his facts backwards.
- Tax hikes slow economic growth. The 1993 Clinton tax hikes slowed economic growth during that decade despite the common assumption that it was a period of rapid expansion. It was not until a tax *cut* later in the decade that growth took off.
- Lower tax rates pave the way for faster growth. The 2003 Bush tax cuts helped the economy recover from a recession and put it on stronger footing to grow in the face of growing headwinds.
- If Congress falls for faulty arguments and raises taxes, it will imperil economic recovery and make it even harder for millions of unemployed Americans to find work.

This paper, in its entirety, can be found at:
<http://report.heritage.org/bg2601>

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Clinton Tax Hikes Slowed Growth

A favorite liberal argument is to attribute the economy’s strong performance during the 1990s to President Clinton’s economic policies, chief among which was a huge tax increase. Clinton signed his tax hike into law in September 1993, the same year he took office. It included an increase of the top marginal tax rate from 31 percent to 39.6 percent; repeal of the cap on the 2.9 percent Medicare tax, applying it to every dollar of income instead of being capped to levels of income like the Social Security tax; a 4.3-cent increase in the gas tax; an increase in the taxable portion of Social Security benefits; and a hike of the corporate income tax rate from 34 percent to 35 percent, among other tax increases.¹

The economic defense of the Clinton tax hikes does not hold up against the historical facts. The economy did exhibit strong economic growth during the 1990s, but rapid growth did not occur soon after the tax hike—it came much later in the decade, when Congress *cut* taxes. After the 1993 tax hike, the economy actually slowed to a point below what one would expect, considering the once-in-a-generation favorable economic climate that existed at the time.

As for the overall economic recovery—that started well before President Clinton took office. In January 1993, the economy was in the 22nd month of expansion following the recession from July 1990 to March 1991.

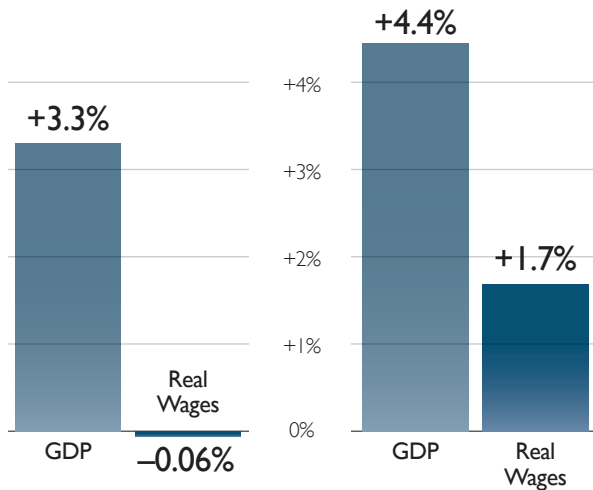
In addition to coming into office in the midst of an economic expansion, Clinton also benefited from a very unusual confluence of events that created a remarkably favorable environment for rapid economic growth:

- The end of the Cold War brought a sigh of relief to the world and a powerful dose of growth-enhancing certainty to the global economy.
- The price of energy was astoundingly low, with oil prices dropping below \$11 per barrel and averaging under \$20 per barrel, versus \$100 per barrel today.²

Tax Hikes Dampened Economy in the 1990s, While Tax Cuts Spurred Growth

In the **four years following the 1993 Clinton tax hike**, real GDP grew 3.3 percent annually, but real wages fell.

In the **four years after the 1997 capital gains rate cut**, real GDP and real wages had significantly higher annual growth.



Source: Heritage Foundation calculations based on data from U.S. Bureau of Economic Analysis and U.S. Department of Labor, Bureau of Labor Statistics.

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- The Federal Reserve had tamed inflation to an extent previously thought impossible, with inflation averaging 2 percent during the Clinton Administration.³
- The biggest wind at the economy’s back was, of course, a tremendous set of new productivity-enhancing information technologies and the explosion of the Internet as a powerful tool for commerce and communication, further increasing productivity.

With these factors clearing the way, the economy should have displayed spectacular and accelerat-

1. U.S. Department of the Treasury, Office of Tax Analysis, “Revenue Effects of Major Tax Bills,” September 2006.
 2. U.S. Energy Information Administration, “World Crude Oil Prices,” at http://www.eia.gov/dnav/pet/pet_pri_wco_k_w.htm (July 11, 2011).
 3. U.S. Department of Labor, Bureau of Labor Statistics, “Consumer Price Index for all Urban Customers,” at <http://research.stlouisfed.org/fred2/data/CPIAUCSL.txt> (July 12, 2011).

ing growth in the years immediately after Clinton entered the White House, but growth of that magnitude did not materialize until later in the decade.

From 1993 until 1997, the economy grew at a pedestrian 3.3 percent per year.⁴ While solid, this growth was certainly not exceptional. During that same time, real wages declined, despite the perception that the 1990s were an era of unmitigated abundance.⁵

It was not until after a 1997 tax cut, passed by the Republican-led Congress—a tax cut President Clinton resisted but ultimately signed—that the spectacular growth kicked in. While small in revenue impact, the 1997 cuts included a reduction of the capital gains rate from 28 percent to 20 percent. This opened the capital floodgates necessary for entrepreneurs to develop, harness, and bring to market the wonders of the new information technologies.

Business investment skyrocketed after the tax cut,⁶ and the economy grew at an annualized rate of 4.4 percent (33 percent faster than after the Clinton tax hike) from 1997 through the end of the Clinton presidency. Real wages reversed their downward trend and grew 1.7 percent per year during the same time.

Altogether, how much worse did the economy perform because of the Clinton tax hike? The data from the period do not provide a clear answer. What is clear is that the economy performed well below reasonable expectations given the favorable conditions existing in the years after the tax hike—and took off after the often-forgotten tax cut.

Bush Tax Cuts Promoted Strong Growth

Liberals also like to argue that the Bush tax relief hurt the economy and cost jobs. Again, the evidence runs to the contrary.

Unlike President Clinton, who entered office with a strong economic wind at his back, President Bush came into office on the precipice of a recession caused by the bursting of the “dot-com” bubble. President Bush entered office in January 2001; the recession began in March.

In addition to the recession, the peaceful conditions President Clinton enjoyed reversed course. The terrorist attacks of 9/11 brought on the beginning of the war on terrorism. There was no growth-enhancing advancement comparable to the tech boom to further boost the economy; energy prices were creeping up. Instead of swimming with the current, the economy was now fighting squarely against it to achieve even modest growth.

Faced with this new reality, President Bush pushed for tax cuts to revive the economy and set it on a stronger foundation for economic growth.

In June 2001, President Bush signed into law the first wave of tax cuts. The relief included reductions of marginal income tax rates and tax relief for families, for example, doubling the child tax credit from \$500 to \$1,000. To reduce the budgetary impact, Congress phased in the tax cuts over several years.

Since the tax cuts were slow to go into effect, they were slow to help the economy. In fact, the economy continued to lose jobs after the tax cuts even though the recession officially ended in November 2001.

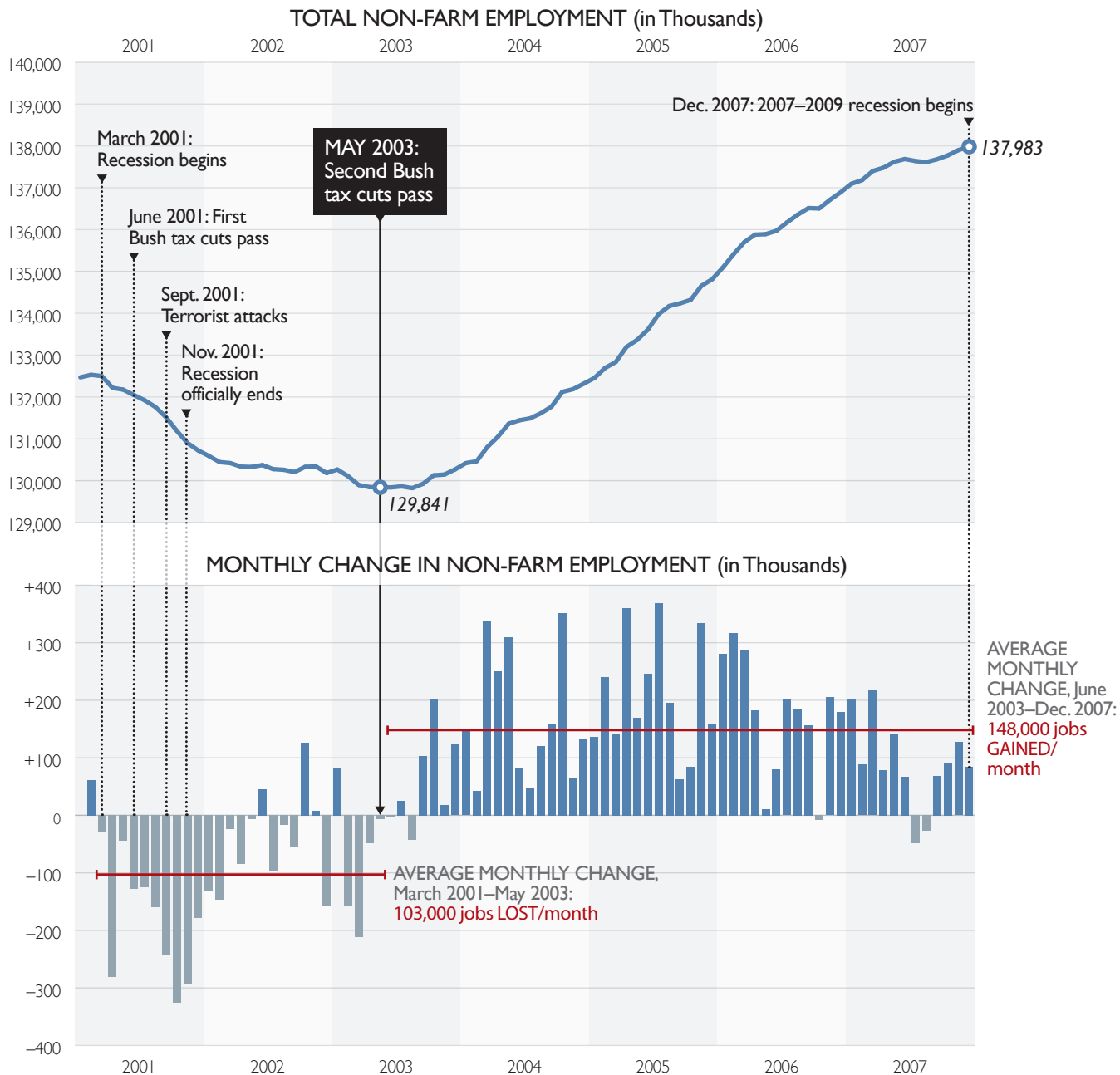
Realizing the error of its ways, in May 2003 Congress accelerated the tax cuts to make them effective immediately. In addition to reducing marginal income tax rates, Congress also lowered the tax rates on capital gains and dividends.

It was at this point that economic growth took off. From May 2003 until December 2007 (when the recession caused by the *global* financial melt-

4. Bureau of Economic Analysis, National and Income Product Accounts, Table 1.7.5, “Relation of Gross Domestic Product, Gross National Product, Net National Product, National Income, and Personal Income,” at <http://www.bea.gov/iTable/iTable.cfm?ReqID=9&step=1> (May 19, 2011).
5. Bureau of Labor Statistics, Current Population Survey (CPS), “Usual Weekly Earnings of Wage and Salary Workers News Release,” (quarterly) Table 1. “Median usual weekly earnings of full-time wage and salary workers by sex, quarterly averages, seasonally adjusted,” in constant (1982–84) dollars, at <http://www.bls.gov/cps/cpswktabs.htm> (July 11, 2011).
6. J. D. Foster, “Tax Cuts, Not the Clinton Tax Hike, Produced the 1990s Boom,” Heritage Foundation *WebMemo* No. 1835, March 4, 2008, at <http://www.heritage.org/research/reports/2008/03/tax-cuts-not-the-clinton-tax-hike-produced-the-1990s-boom>.

2003 Bush Tax Cuts Prompted Surge in Employment

From 2001 through early 2003, the U.S. was losing an average of 103,000 jobs per month. A full year after the end of the 2001 recession, job growth was still declining. Then in May 2003, the second Bush tax cuts were passed, lowering income, capital gains, and dividend tax rates. By the end of 2007, employment had risen by 8.1 million—an average of 148,000 new jobs each month.



Source: U.S. Department of Labor; Bureau of Labor Statistics, "Employment, Hours, and Earnings—National," Current Employment Statistics, Seasonally Adjusted, Total Non-Farm, All Employees, at <http://www.bls.gov/ces/> (July 12, 2011).

Chart 2 • B 2601 heritage.org

down occurred) the economy created 8.1 million jobs, or 145,000 a month. By comparison, after the beginning of the 2001 recession and before the 2003 tax cuts, the economy was losing 103,000 jobs a month.⁷

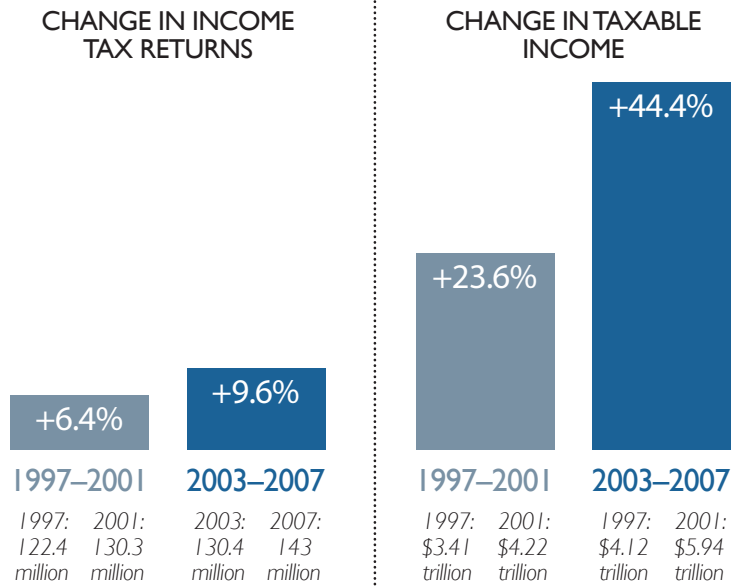
Those opposed to the tax relief argue that it blew a hole in the budget and dramatically increased deficits. Again, a look at the numbers disproves that argument. While receipts were below the historical level of 18 percent of GDP in 2003 as a result of the sluggish economy, they rebounded to above their historical norm by 2006 and grew further above their historical level in 2007.⁸ They clearly would have continued growing thereafter had it not been for the housing bust and global recession.

Tax revenue rebounded quickly because the tax cuts encouraged economic growth by increasing the incentives to work, save, invest, and take on new risk. These are the basic elements of economic growth. When those activities increase, tax revenues increase because more Americans work and earn more money. From 2003 to 2007, the number of tax filers rose by 9.6 percent, and taxable income, by 44 percent. By contrast, in the last four years of the previous expansion, from 1997 to 2001, these numbers grew by 6.4 percent and 23.6 percent, respectively.⁹ With income and taxpayers growing at such a fast clip it is not hard to see why tax revenue did not suffer from the tax cuts.

To be clear: The Bush tax cuts did not pay for themselves. Revenues, on balance, are lower as a

Number of Taxpayers and Taxable Income Grew Faster During Bush's Expansion than Clinton's

During the Clinton-era economic expansion, the number of taxpayers and taxable income grew at an impressive rate in the four years before the 2001 recession. But in the four years of expansion during the Bush years before the 2007 recession, both measures grew even faster.



Note: Figures have been rounded.

Source: U.S. Department of Treasury, Internal Revenue Service, "SOI Tax Stats—Individual Income Tax Returns Publication 1304," Table 1.1, "Selected Income and Tax Items, 2007, 2003, 2001, and 1999," at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=134951,00.html> (July 12, 2011).

Chart 3 • B 2601 heritage.org

result of the Bush tax relief. However, the Bush tax cuts did accelerate the recovery markedly, and they did, and still do, create the possibility of a permanently stronger economy which, in turn, means the net revenue cost of the Bush tax cuts is far less than the traditional static score implies.

In 2008, the last full year of the Bush presidency, the economy entered a severe recession brought on

7. Bureau of Labor Statistics, "Employment, Hours, and Earnings—National: Current Employment Statistics, Seasonally Adjusted, Total Non-Farm, All Employees," at <http://www.bls.gov/ces> (July 12, 2011).
 8. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2012: Historical Tables*, Table 1.2, at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/hist01z2.xls> (July 11, 2011).
 9. U.S. Department of the Treasury, Internal Revenue Service, "SOI Tax Stats—Individual Income Tax Returns Publication 1304," Table 1.1, "Selected Income and Tax Items, 2007, 2003, 2001, and 1999," at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=134951,00.html>

by the global financial meltdown. The 2001 and 2003 tax relief packages had made the economy more resilient against economic shocks, but no tax policy can protect an economy against the storm that struck that year. The tax cuts certainly did not contribute in any way to recession, nor can anyone credibly claim that these policies had something to do with the financial implosion that was global in origin and impact.

Even with a recession at the beginning of his presidency and another severe recession at the end, the economy still created more than 1 million net jobs during President Bush's tenure. The tax cuts he pushed Congress to pass are a major reason for that job growth.

Lessons for Today

It is vitally important for the millions of Americans looking for work today that Congress and President Obama learn and accept what really happened when President Clinton raised taxes and President Bush lowered them. The evidence is clear that the Clinton tax hikes stifled what should have been remarkable economic growth and the Bush tax cuts cleared the way for the economy to grow despite growing obstacles in its way.

President Obama insists that tax hikes must be part of a "balanced" approach to reducing the deficit. He defends his tax hike desires by pointing to the Clinton tax hikes as evidence that the economy can withstand higher taxes.

But if the Clinton tax hikes were powerful enough to slow an economy that had everything going in its favor, what would tax hikes today do to an economy that has everything working against it? The unemployment rate remains stuck over 9 percent and there appears to be little hope for it to fall in the near future.¹⁰ The President should not be looking for policies the economy can withstand, but for policies that will encourage it to grow.

At best, tax increases would slow the already stalled recovery, and at worst, would reverse it altogether. A slowed recovery or double-dip recession would further reduce the chances that the more than 14 million Americans currently looking for work would find a job in the near future.¹¹

The best way to grow revenues is to promote faster economic growth, which will increase the number of taxpayers and taxable income more rapidly. Tax hikes—whether through higher tax rates or slashing credits, deductions, and exemptions without offsetting reductions elsewhere—will not do the job. Under President Obama's current policies, spending will continue to grow at a faster rate than can be paid for by tax hikes—even assuming the huge tax increases the President insists upon. To add insult to injury, as history has shown, tax hikes would slow economic growth and make it even harder for unemployed Americans to find a job.

—Curtis S. Dubay is a Senior Analyst in Tax Policy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

(July 12, 2011).

10. James Sherk, "Years of High Unemployment Ahead at Recovery's Pace," Heritage Foundation *WebMemo* No. 3307, July 5, 2011, at <http://www.heritage.org/Research/Reports/2011/07/High-Unemployment-Remains-in-a-Weak-Economic-Recovery>.
11. Not only would tax hikes hurt the already ailing economy, they are also unnecessary. The Congressional Budget Office predicts that tax revenues will return to their historical average of above 18 percent of GDP by 2017 and grow thereafter with all current tax policies in place because of economic growth—assuming that growth finally takes hold. Curtis Dubay, "CBO Figures Once Again Prove Tax Hikes Unnecessary to Fix Budget," Heritage Foundation *Foundry*, June 25, 2011, at