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POLICY POINTS

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EXAMINING THE PRESIDENT'S RECENT CLAIM ABOUT TAX CUTS, REVENUES, AND THE ECONOMY

In a January 3 *Wall Street Journal* opinion piece, President Bush made the following assertion: "It is also a fact that our tax cuts have fueled robust economic growth and record revenues." He argued that the budget should be balanced by 2012 but that his tax cuts should be fully exempt from actions to achieve that goal and should be made permanent for the sake of both the economy and the budget.

The President's assertion is belied by the evidence:

The years following the President's tax cuts have seen unexceptional economic growth and exceptionally weak revenue growth.

- The U.S. economy has always grown following recessions, regardless of whether taxes have been cut, have been increased (as occurred in the early 1990s), or have remained unchanged. Moreover, despite the large tax cuts enacted in 2001 and 2003, government data show that the current economic expansion is weaker than the average post-World War II economic recovery with respect to an array of critical measures, including economic growth, investment, employment, wages and salaries, and net worth. Employment growth has been slower during the current recovery than during *any* previous expansion since the end of World War II.

- In addition, revenues have actually *declined* over the current business cycle as a whole (i.e., since the peak of the last business cycle in March 2001), after adjusting for inflation and population growth. By contrast, in the comparable periods of the previous post-World War II business cycles, revenues *increased* by an average of 10 percent, after adjusting for inflation and population growth.

Total Real Per-Capita Revenue Growth in 22 Quarters after the Last Business Cycle Peak	
Current Business Cycle	-0.4%
Average for All Previous Post-World War II Business Cycles	9.8%
1990s Business Cycle (following tax increases)	10.7%

Revenue growth did pick up substantially in 2005 and 2006. But those increases need to be seen in context: they followed, and largely represented a rebound from, several years of extraordinary revenue declines. In 2001-2003, revenues fell in nominal terms for three consecutive years, the first time this has occurred since before World War II. Even with the stronger revenue growth of 2005-2006, revenues have yet to catch up merely to where they were at the start of the current business cycle, after adjusting for inflation and population

growth. In other words, far from performing robustly, revenue growth has performed poorly over the period since the President's tax cuts were enacted.

Appropriately measured, revenues have not hit "record" levels, and the tax cuts have contributed to a striking deterioration in the nation's finances.

- The Administration's claim that revenues are at record levels rests on the misuse of data. Analysts generally concur that to track revenues over time, revenues need to be measured in relation to the size the economy, since revenue levels naturally trend upward with economic growth. Indeed, in the half century from 1950 to 2000, revenues hit an all-time high in 34 out of 50 years (or more than two-thirds of the time). The period from 2001 to 2005 was the first five-year period since 1950 that real revenues did *not* hit a record high in any year.

  This is why government agencies and private analysts measure trends over time in revenues, expenditures and deficits *not* in dollar terms but as a *share of the economy*. When defending its record on deficits, the Administration itself has presented deficits as a share of the economy, and the same measure is the appropriate standard to use for revenues.

- In 2004, revenues were at their lowest level since 1959 when measured as a share of the economy. By 2006, revenues had (not surprisingly) increased significantly from that low base, but remained far below record levels as a share of the economy. (They also remained below the levels they had attained, as a share of the economy, in every year from 1995 to 2000.)

- Furthermore, the Administration's tax cuts have been accompanied by an exceptionally large deterioration in the federal budget. Between 2000 and 2006, the nation's budgetary position worsened by a greater amount than in all but one other six-year period since World War II, going from a surplus of 2.4 percent of GDP in 2000 to a deficit of 1.9 percent of GDP in 2006. (The worst six-year deterioration occurred between 1998 and 2004 and also reflected the impact of the tax cuts, as well as other factors.)

- The President now promises to balance the budget by 2012. Yet the budget would already have been balanced were it not for the tax cuts, even with spending on the Iraq War and Katrina reconstruction and relief. Based on the estimates of the Joint Committee on Taxation, the cost of tax cuts enacted since 2001 (including interest costs) amounted to $251 billion in fiscal year 2006; the federal budget deficit that year was $248 billion.

The Administration's own research shows that extending the tax cuts would reduce revenues substantially in future years.

- Contrary to the President's claim that his tax cuts increased revenues, a study issued in 2006 by the Administration's own Treasury Department confirms the common-sense belief, long held by mainstream economists, that tax cuts lose revenue. Even under the more fiscally optimistic of the scenarios that the Treasury study examined — a scenario that assumed the tax cuts would be fully paid for by cuts in federal programs — extending the tax cuts would lead to only a small increase in the size of the economy that would pay for *at most 10 percent* of the tax cuts' cost. Under this scenario, extending the tax cuts would reduce revenues by an average of more than $300 billion per year through 2016.

- Moreover, the President has proposed extending his tax cuts *without* proposing measures to pay for them. Studies by the Congressional Budget Office, the Joint Committee on Taxation, and various academic economists all have found that unpaid-for, deficit-financed tax cuts modestly *weaken* the economy over the long run and therefore can cost *more* than would otherwise be expected. Far from

contributing to future economic and revenue growth, extending the President's tax cuts without paying for them would likely be detrimental to the nation's economy, and would certainly be detrimental to the nation's finances.

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