Tax Cuts for the Rich Aren't an Economic Panacea — and Could Hurt Growth

The tax framework that the Trump Administration and congressional Republican leaders announced on September 27 would provide massive tax cuts that would overwhelmingly benefit high-income and high-wealth individuals. Conservatives defend these tax cuts by claiming that they will boost economic growth. For example, House Speaker Paul Ryan has said, "if you want faster economic growth, more upward mobility, and faster job creation, lower tax rates across the board is the key — it's the secret sauce." Economic evidence contradicts these claims, however. In reality, tax cuts — particularly for high-income people — are an ineffective way to spur economic growth, and they're likely to *harm* the economy if they add to the deficit or are paired with cuts to investments that support the economy and working families.[1]

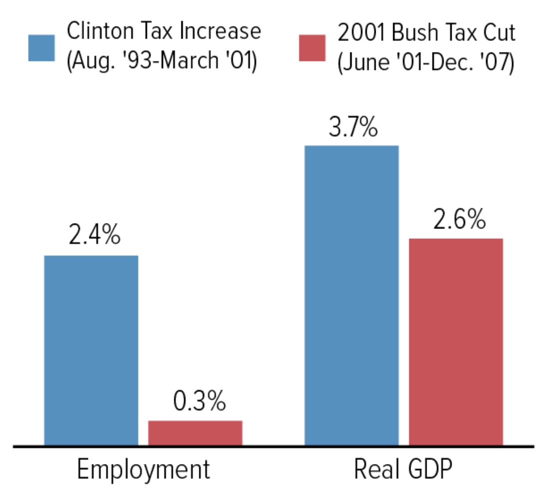
Tax Cuts for the Rich Haven't Accelerated Growth

History shows tax cuts for the rich are far from a surefire way to boost growth — and that higher taxes don't preclude robust economic and job growth.

- Job growth, economic growth, and small business job creation were much weaker following the George W. Bush tax cuts, which gave the biggest boosts to high-income households, than after the Clinton tax increases on high-income households. (See graph.)
- After the Bush tax cuts for the very highest-income households expired at the end of 2012, the economy continued to grow and add jobs steadily.
- In a comprehensive review of the literature, economists Bill Gale and Andrew Samwick conclude that "growth rates over long periods of time in the U.S. have not changed in tandem with the massive tax changes in the structure and revenue yield of the tax system that have occurred."
- When Kansas enacted large tax cuts overwhelmingly for the wealthy, Gov. Sam Brownback claimed the tax cuts would act "like a shot of adrenaline into the heart of the Kansas economy." But rather than seeing an economic boom since the tax cuts, Kansas' job growth, economic growth, and growth in small business formation have lagged behind the country as a whole.

Tax Cuts Didn't Supercharge Growth in the Bush Era

Cumulative annual growth rate in period following tax change



Note: Additional tax cuts were passed in 2003. Analysis ends the Bush tax cut period in December 2007 because the Great Recession began afterwards.

Source: CBPP analysis based on data from Bureau of Labor Statistics and Bureau of Economic Analysis.

CENTER ON BUDGET AND POLICY PRIORITIES | CBPP.ORG

These simple relationships aren't proof that tax cuts are bad for growth, or that tax increases cause growth — many other factors affect the economy at the same time. But they dispel claims that large tax cuts are a silver bullet for the economy.

Research Doesn't Support "Supply Side" Claims

Careful empirical research finds that tax cuts on high-income people's earnings or their income from wealth (such as capital gains and dividends) don't substantially boost work, saving, and investment — contrary to overstated "supply side" predictions.

- High-income people are unlikely to increase their work hours due to cuts in their tax rates, research shows. "Overall, evidence suggests [high-income Americans'] labor supply is insensitive to tax rates," Leonard Burman, co-founder of the Tax Policy Center (TPC), notes.

- Tax cuts on capital gains and dividends flow overwhelmingly to the wealthiest filers in the country, but do little to boost saving and investment. The non-partisan Congressional Research Service (CRS) concludes that capital gains tax rate changes appear to have "little or no effect" on private saving.
- Tax economist Joel Slemrod concludes that, "there is no evidence that links aggregate economic performance to capital gains tax rates," and TPC's Burman has explained, "there's no obvious relationship between capital gains, tax rates, and the rate of economic growth."
- The Bush tax cuts included sharp tax cuts on capital gains and dividends that proponents said would spur immediate business growth, but a recent study found "empirical evidence that the 2003 tax cuts had little impact on investment or employment." And, in the words of *The Wall Street Journal,* Federal Reserve economists found the 2003 tax cut "was a dud when it came to boosting the stock market."
- Tax cuts for high-income people also aren't an effective way to encourage entrepreneurship. In fact, on balance, research suggests that "higher tax rates are more likely to encourage, rather than discourage, self-employment," CRS concludes. One reason why: taxes may reduce earnings volatility. The government bears some of the risk of a new venture by allowing tax deductions for losses and, in return, it taxes the profits of successful businesses.

These research findings also square with renowned investor Warren Buffett's observation:

> "I have worked with investors for 60 years and I have yet to see anyone — not even when capital gains rates were 39.9 percent in 1976-77 [they are now 15 percent] — shy away from a sensible investment because of the tax rate on the potential gain. People invest to make money, and potential taxes have never scared them off."

Deficit-Increasing Tax Cuts Likely Hurt Growth

Tax cuts for the rich are likely to hurt growth if they increase deficits or are paired with cuts to investments that help working families and the economy.

- Most economists conclude, based on empirical studies, that large increases in deficits reduce national saving, meaning less capital would be available for investment in the economy and interest rates would rise. While interest rates — and the cost of government borrowing — are currently low (and are projected to stay low in the near term under current policies), they would not necessarily stay low if large, long-term tax cuts were enacted without paying for them.
- The drag from deficit-increasing tax cuts for the wealthy on the economy is a key reason why the non-partisan Congressional Budget Office estimated that allowing the high-income Bush tax cuts to expire and using the savings to cut the deficit would improve long-term economic growth.
- Financing tax cuts for the rich by cutting productive public investments that help support growth, such as education, research, and infrastructure, can also harm the economy, research suggests.
- A growing body of research suggests that investments in children in low-income families not only reduce poverty and hardship in the near term, but can have long-lasting positive effects on their health, education, and earnings as adults. Cutting programs that support low-income families to fund tax cuts for the rich could therefore also have negative long-run economic impacts.

By contrast, well-designed tax reform could spur growth by eliminating or scaling back inefficient tax subsidies and raising additional revenues to invest in national priorities and reduce deficits.

[1] For further information, see these analyses: Chye-Ching Huang and Nate Frentz, "What *Really* Is the Evidence on Taxes and Growth? A Reply to the Tax Foundation," CBPP, February 18, 2014, http://www.cbpp.org/research/what-really-is-the-evidence-on-taxes-and-growth; Chye-Ching Huang, "Recent Studies Find Raising Taxes on High-Income Households Would Not Harm the Economy," CBPP, April 24, 2012, http://www.cbpp.org/research/recent-studies-find-raising-taxes-on-high-income-households-would-not-harm-the-economy; Paul N. Van de Water and Chye-Ching Huang, "Budget and Tax Plans Should Not Rely on 'Dynamic Scoring,'" CBPP, updated November 17, 2014, http://www.cbpp.org/research/budget-and-tax-plans-should-not-rely-on-dynamic-scoring; Chuck Marr and Chye-Ching Huang, "Raising Today's Low Capital Gains Tax Rates Could Promote Economic Efficiency and Fairness, While Helping Reduce Deficits," CBPP, September 19, 2012, http://www.cbpp.org/research/raising-todays-low-capital-gains-tax-rates-could-promote-economic-efficiency-and-fairness.