



Tax Cuts Caused Economic Growth

Tax Policy Wire

April 25, 2006

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According to Raghuram Rajan, Chief Economist of the International Monetary Fund, the United States should adopt "revenue-enhancing measures," such as tax increases, to reduce its deficit.

However, the tax cuts that Congress adopted were instrumental in stimulating the economy after the recession and increasing tax receipts. At a time when global growth was practically stagnant, the U.S. economy was the world's engine of growth.

After the tax cuts were put in place, real GDP growth expanded from 0.8% in 2001, to 2.7% in 2003, to 4.2% in 2004. In 2005 GDP growth was 3.5%, and it is forecast to remain in this range in 2006. And the average annual growth rate of productivity since the business cycle peak in March 2001, at 3.4%, has been one of the best rates in over 30 years. Retail sales are almost 8% higher than a year ago, and construction spending is at a record high, 7.4% higher than this time last year.

Particularly impressive are the labor market data. In 2003 the media was full of "jobless recovery" stories, with the theme that corporate profits were expanding but the hiring of workers was left behind. Yet over the past year employment has increased by over 2 million jobs, of which 1.9 million have been in the private sector. The unemployment rate is at 4.7%, and the four-week moving average of initial jobless claims, a widely-watched indicator of the strength of our labor market, is 9% lower than a year ago.

Tax revenues have far exceeded projections. Earlier this month the Congressional Budget Office announced that tax receipts for the first half of the fiscal year were \$100 billion higher (11%) than in the same period last year. And in July 2005 tax receipts were almost \$100 billion higher than forecast. The tax revenues come from rising incomes and gains on investments and business earnings. Tax cuts have improved economic growth, and economic growth results in more tax receipts.

Some say that the tax cuts have nothing to do with the strong performance of the economy. But the economy is only following the path described by leading academic economists, such as Professor Harvey Rosen of Princeton and Professors William Gentry and Glenn Hubbard of Columbia University. In numerous articles in peer-reviewed journals, they have made the theoretical and empirical case that tax cuts result in additional incentives for people to work and for businesses to expand.

Both International Monetary Fund and European Union officials have been successful at persuading countries around the world to raise taxes to eliminate their deficits, with the result that growth in many countries abroad is far slower than in the United States. Rather than recommending U.S. tax increases, Dr. Rajan should suggest that Congress make the tax cuts permanent.

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