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Economic Policy Institute

Bush's Tax and Budget Policies Fail to Promote Economic Growth

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The economic evidence is clear: the president's tax changes have not worked to improve the health of the economy. Business investment, employment, and wages have all underperformed past recoveries. Furthermore, the choices made in the president's budget put at risk the future health of the nation by running massive deficits and by cutting back on important national investments in education, science, and energy.

1 Tax Policy

Bush's tax policy has created a ballooning federal budget deficit that threatens our future prosperity. Between early 2001 and September 2005, tax changes reduced revenue by $870 billion. The tax cuts that favor the most prosperous cannot be defended on grounds of fairness. But the president has tried to justify them as promoting a stronger, more prosperous economy for everyone. In fact, however, the tax changes since 2001 have failed to spur business investment,

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jobs, wages, or overall growth.

The rhetoric for the tax cuts was appealing: by taxing income less, businesses would be encouraged to make new investments and people would work harder, knowing that they would keep more of what they earn. It has not worked out that way. Business investment has failed to recover at a normal rate and labor force participation has fallen. Rather than people coming into the workforce at higher rates, the opposite has happened. If the workforce had grown with the population since 2001, there would be 3 million more people between the ages of 20 and 65 in the workforce.

Business Investment

According to proponents of the tax cuts, cutting corporate income taxes and personal income tax rates was supposed to "improve the investment incentives of America's businesses." Small business owners, especially, were supposed to respond to lower individual tax rates by investing more and hiring new workers. In addition, more than $200 billion of cuts were specifically tied to business investment, reducing the cost as a way to encourage purchases of equipment, software, structures and machinery.

The cuts were an utter failure. Business investment has always recovered after a recession, but this was the most sluggish recovery in memory. As a result, business investment has grown 65% more slowly since the peak of the business cycle five years ago than the average for similar periods after nine cycle peaks in the last 60 years. (A business cycle includes a recession and the expansion until the next recession. The peak of a business cycle occurs just before a recession.)

In the recession and recovery of 1990-1994, instead of cutting taxes, Presidents George H.W.Bush and Bill Clinton signed tax increases into law. Yet businesses' investment grew much faster during that recovery than it has dur-

ing the last four years.

The Bush tax cuts have been a waste precisely because they were targeted at business owners and the wealthiest Americans, rather than the average consumer whose increased demand and consumption would have made it sensible for businesses to invest.

Employment

Business investment didn't take off, and neither did job creation. Even now, after five years of huge tax cuts, one million more people are officially unemployed than when George Bush took office, and millions more have left the labor force.

President Bush has noted that 2 million jobs were created over the course of 2005, and that we have added 4.6 million jobs since the decline in jobs ended in May 2003. This is not evidence that the tax cuts are working.

When the third round of tax cuts passed in 2003, one of the Bush administration's major selling points was the claim that the economy would create 5.5 million jobs from July 2003 through the end of 2004—almost one and a half million more jobs than would be expected in a normal recovery. Instead, only 2.4 million jobs were created, 1.7 million less than the number we were told to expect *with no tax cut.*

Job growth remains abnormally slow. Last year's 2 million new jobs represented a gain of only 1.5%. With normal growth, we would have created 4.6 million jobs last year.

Wages and Income

Not surprisingly, since job growth has been so poor, the tax cuts have also failed to create substantial wage and salary growth. Most Americans depend on their wages and salaries for their standard of living. In a healthy economy, wages

and salaries should rise along with rising national income and productivity. A record long period of job decline followed by sluggish job growth has created slack in the labor market and pulled down wage growth below inflation growth in the last two years. Last year, middle income wages grew less than inflation (2.4% vs. 3.4%), reducing their buying power.

The Overall Economy

The tax cuts failed to produce the burst of economic activity the president promised. Instead of doing better than in past business cycles, the economy has grown sluggishly, at a rate far slower than in previous cycles. The most common measure of economic activity, the Gross Domestic Product (GDP), grew only 13.8% since the first round of tax cuts were passed in early 2001, averaging 2.7% per year. The average for similar periods in the past was far better—growing 16.3% or 3.2% per year.

Table 1: Economic Performance: Comparison with Past Cycles[1] Percent growth from peak through 19 quarters, or 58 months

	Cycles		Percent Below
	Past	Current	Past Cycles
Business Investment	18.6%	6.5%	65%
Employment	7.1%	1.0%	86%
Gross Domestic Product	16.3%	13.8%	16%

[1]Past recoveries include the nine recessions prior to the 2001 recessions and dating back to November, 1948. Business investment is spending on structures, equipment and software. Sources: Authors calculations from Bureau of Labor Statistics and Bureau of Economic Analysis data. Business cycle dates are from the National Bureau of Economic Research. Note: A previous version of this document excluded structures in the investment calculation and contained annualized growth rates.

2 Deficits

Not only have the tax cuts failed to improve economic performance, they have weakened our economy looking down the road because of their impact on the deficit. It makes sense to go into debt to strengthen our economy. But, in this case, future generations of Americans will be saddled with interest payments on debts that have not made our economy stronger.

Over the previous four years (2002-2005) the Bush administration has added $1.3 trillion to the debt, which puts at risk the long-term health of the economy. The president's latest budget proposal would add an additional $1.6 trillion over the next six years (2006-2011). Additional spending on Iraq and for permanent reform of the Alternative Minimum Tax would add more debt to this total. The administration continues to claim that we are "on track" to cut the deficit in half by 2009. Despite similar claims in previous years, the deficit is set to grow - not shrink - in 2006.

Large and persistent deficits pose long-term threats to the health and stability of the economy. Deficits can lead to lower national savings, national investments, and thus lower economic growth in the future. With the personal saving rate now less than zero, it is even more damaging for the federal government to run massive deficits.

Also, with a large share of federal debt in the hands of foreign governments, large deficits increase our vulnerability. If foreign governments were to become less willing to own U.S. debt, it could lead to severe economic consequences such as higher interest rates and a dramatic economic slowdown.

3 Budget Policy

The health of our economy, both now and in the distant future, relies upon us making the right choices about how to collectively invest in our future. As Hurricane Katrina vividly demonstrated, shortchanging investments can have devastating consequences—both in human and financial costs. The president's budget shortchanges investments in education, science, energy research, and programs that enhance economic security.

Education

A modern economy depends upon a skilled and well-educated workforce. A sound educational system not only yields benefits to individuals, but it also makes our overall economy strong and internationally competitive.

Unfortunately, the president's budget fails to make the necessary investments to keep the American workforce strong. The president proposes a 3.8 percent, $2.1 billion, cut in the Department of Education's fiscal year 2007 budget. Education funding overall would be cut by $3.1 billion in 2007 and by $36 billion over the next five years after adjusting for inflation.[2] The cuts are even deeper when rising enrollment is taken into account. While the president has proposed several new education initiatives, they are more than offset by the underfunding of No Child Left Behind and the elimination of other important programs.

Science

Modern economic growth depends upon technological advancement, scientific exploration, and the ability to put new scientific discoveries to use in the mar-

[2]Estimates are from sub-function 501-503 and derived from OMB data as compiled by Center on Budget and Policy Priorities, see http://www.cbpp.org/2-9-06bud-spreadsheet.htm.

ketplace. The president's budget, however, fails to maintain an adequate commitment to science and technology.

The president's budget cuts overall funding for science and technology by approximately $600 million. The president wants to cut the National Oceanic and Atmospheric Administration (NOAA) science and technology budget by $32 million and overall appropriations by $133 million.

The president's budget either flatlines or cuts most programs at the National Institutes of Health. For example, the National Cancer Institute is slated for a $39 million cut, and the National Institute of Allergy and Infectious Diseases is set for a $20 million reduction.

The president does propose to increase the budget of the National Science Foundation by $439 million (to $6.145 billion). However, the president signed a bill in December 2002 authorizing the doubling of the NSF budget in five years. The president's proposal is $3.655 billion short of this goal.

Energy

The president's declaration that "America is addicted to oil" and his promise to reduce Middle Eastern oil imports captured the nation's attention during his 2006 State of the Union Address. There is little doubt that the health and stability of the U.S. economy would be strengthened if we were more independent of foreign sources of oil.

Although the Biomass and Biorefinery R&D program gets a $29 million boost over the estimated fiscal year 2006 levels, other important programs for reducing our oil consumption are cut. For example, a variety of programs that would improve engines, help develop lightweight materials, and deliver other efficiency gains are cut from $183 million last year to $166 million.

While the president proposes to increase some renewable energy programs

—most notably, solar energy programs with a $66 million boost—the overall energy efficiency and renewable energy budget is cut $26 million from last year's appropriations.

Economic Security and Risk-Taking Behavior

The president continues to promote policies that would weaken our nation's safety net. For example, the president's plans for Social Security Privatization and for heavy reliance on Health Savings Accounts shift additional risk onto individuals.

Economic growth often requires individuals to strike out in new directions by starting a small business, going back to school, or starting a new and different job. These changes often involve additional risk to individuals, and if the safety net is weakened, people may be discouraged from making this leap. Thus, an insecure society can also be a slow-growing one as well.