Center for American Progress

# Fact Versus Fiction in Latest Supply-Side Debate

## To Sustain Supply-Side Myths, Heritage Foundation Miscalculates Economic Growth and Ignores the Job Creation Records in Clinton and Bush Eras

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## Introduction

Under President Bill Clinton, the U.S. economy grew for 32 straight quarters. During that time, overall annual real economic growth averaged 3.8 percent, and each month, an average of nearly 240,000 net new jobs were created. Under President George W. Bush, the U.S. economy grew for only 25 straight quarters. And during that expansion, economic growth averaged just 2.6 percent, and only 86,000 jobs were created per month.

These are difficult facts for the right wing to explain. After all, President Clinton did the one thing that right-wing, supply siders say you absolutely cannot do if you want to have good economic outcomes—he raised taxes. And for his part, President Bush did the one thing that those same people promise will result in enormous economic gains—he cut taxes.

The economic records of the Clinton and Bush presidencies are so clear and so stark that they serve as painful reminders to supply siders everywhere that their ideas have been tested and that they have failed in spectacular fashion.

So it is no surprise that these same supply siders who promised doom and destruction if President Clinton's rate hikes were passed and who similarly promised dramatic growth and millions of new jobs if President Bush's tax cuts were passed are now tying themselves in knots trying to prove that they were right all along. Given how well the economy performed under Clinton and how poorly it performed under Bush, this is no easy task.

Trying to prove something that is so obviously untrue usually requires some pretty acrobatic rhetorical tricks and some funny number crunching. And the newest contribution to this genre of distorted economic history, a report from the Heritage Foundation, contains plenty of both.

Heritage's new "policy backgrounder" makes two central claims. First, that the Clinton-era economic boom only began in earnest after he signed a tax cut into law in 1997. And second, that the Bush-era tax cuts, especially the second round in 2003, helped spark an economic "surge." The first claim is just wrong, relying on a very strange demarcation between the time periods. The second claim is only true if considered completely out of the context of recent history.

Fundamentally, the Heritage report is a crude, though valiant, attempt to prove something that most everyone who lived through the past 20 years simply knows to be false. This issue brief delves into the details to expose just how off base the Heritage report is.

## Capital gains tax cut in 1997 had little noticeable effect on the U.S. economy

When President Clinton proposed tax rate increases in 1993 to help close the federal budget deficit, acolytes of the supply-side theory of economics, including the Heritage Foundation itself, gravely warned of catastrophe, predicting slower growth and fewer jobs. Of course, we know now that none of that came to pass. In fact, the economy thrived under the Clinton tax code, a truly uncomfortable fact for supply siders.

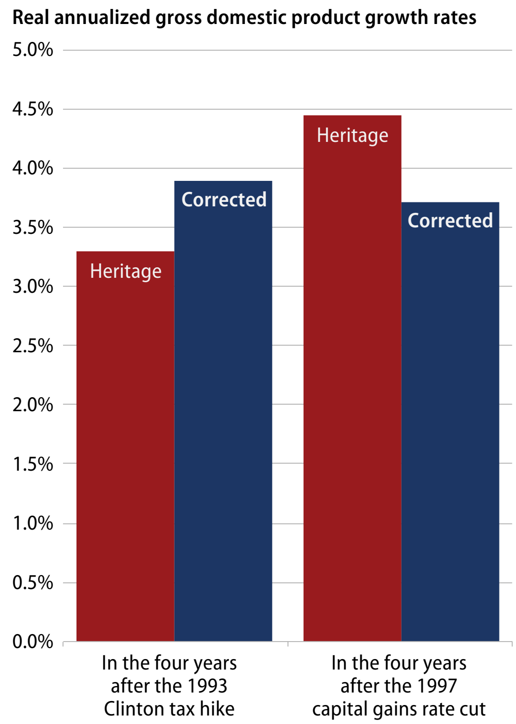
If supply siders admit what almost everyone else knows, that the economy performed extremely well after President Clinton's tax hike, then it would undermine their entire worldview. This explains why the Heritage Foundation feels the need to make the incredible claim that after the tax increases of 1993, economic growth was "certainly not exceptional," and that "it was not until after a 1997 tax cut … that the spectacular growth kicked in."

To bolster this claim, Heritage offers a graph that shows average annual economic growth in "the four years following the 1993 Clinton tax hike," and "the four years after the 1997 capital gains rate cut." This graph shows that after the tax hike, the economy grew at an annualized rate of 3.3 percent, but after the tax cut, it grew by 4.4 percent. (see Chart 1)

It is true that from the start of 1993 through the end of 1996, economic growth averaged 3.3 percent per year. First, it's worthwhile to point out that 3.3 percent is still very good, certainly outpacing average GDP growth during the Bush administration. But in fact,

### Heritage versus reality

How the conservative think tank's misinformation stacks up against what actually happened




Source: Bureau of Economic Analysis

Heritage has to cook the books to even get it down to 3.3 percent. While 3.3 percent accurately reflects the annual growth rate from the beginning of 1993, the Clinton tax increases weren't enacted at the start of 1993. They weren't signed into law until the third quarter of 1993, August 10 to be exact.

Similarly, growth did average 4.4 percent from the beginning of 1997 through the end of 2000, but the capital gains tax cut of which Heritage is so enamored wasn't enacted at the beginning of 1997 either. It was signed into law in August 1997. The Heritage graph misallocates fully six quarters of economic data into the wrong categories.

This matters a great deal. The first three quarters of 1993, which Heritage apparently believes came after the tax hikes were enacted, averaged just 1.8 percent of economic growth. The first three quarters of 1997, which Heritage counts as coming after the tax cut, averaged 4.8 percent growth. In short, Heritage counts three low-growth quarters that occurred before the tax increases were even enacted as if they'd happened "in the four years following the 1993 Clinton tax hike."

At the same time, Heritage takes away three very high-growth quarters that actually occurred prior to the enactment of the tax cuts and assigns them to the "four years after the 1997 capital gains rate cut." The effect is to drag down the average growth rate of the first category, and artificially boost the average growth rate of the second.

When all the quarters are properly allocated, the picture looks very different. In the four years starting with the fourth quarter of 1993—the first full quarter after the enactment of the Clinton tax increases—the economy grew at an average annualized rate of 3.9 percent. In the four years starting with the fourth quarter of 1997—the first full quarter after the capital gains rate cut was signed into law—economic growth averaged 3.7 percent. It's hard to see how slightly slower growth suggests that the 1997 tax cut sparked the economic boom.

To be clear, the four years that immediately follow the 1997 tax cut do include the first two quarters of the 2001 recession, which brings down the overall average for the period. Excluding those two quarters, economic growth averaged 4.2 percent in the period after the 1997 tax cut. That's slightly higher than the 3.9 percent in the four years that followed the 1993 tax hikes but it's a far cry from the "33 percent" improvement in economic growth that Heritage claims was sparked by the 1997 tax cut.

The simple fact is that there isn't a whole lot of difference, in terms of overall economic growth rates, between the period after the 1993 tax increases and the period after the 1997 tax cut.

Nor is there much difference between the two periods in terms of job creation. In fact, the economy added new jobs at a slightly higher rate in the post-1993 tax increase years than it did in the post-1997 tax cut years. From the enactment of the tax increases to the enactment of the tax cut, the economy created an average of 245,000 new jobs each month. From the enactment of the 1997 tax cut to the beginning of the 2001 recession, the economy added a slightly lower average of 223,000 new jobs each month.

Given the fact that the 1997 tax cut did not, as Heritage would have us believe, spark an economic boom, it is not at all surprising that job creation didn't spike up either.

Heritage also makes the related claim that "after the 1993 tax hike, the economy actually slowed to a point below what one would expect, considering the … favorable economic climate." This contention rests upon the fact that, by the time Clinton took office, the economy was already "in the 22nd month of expansion following the recession from July 1990 to March 1991." It is absolutely true that the economy had enjoyed 10 quarters of positive economic growth before the passage of the Clinton tax hikes. But in those 10 quarters, economic growth averaged just 2.9 percent. And recall that after the tax hikes, growth averaged 3.9 percent. It is hard to see how those numbers suggested to Heritage that the "Clinton tax hikes slowed growth."

## Poor job growth following the 2003 tax cuts

In addition to the impressive success of the Clinton economy, tax hikes and all, supply siders also have to grapple with the spectacular failure that was the Bush tax cuts. Those tax cuts were a supply sider's dream come true. They cut marginal income tax rates, cut the top rate on capital gains down to its lowest level since the 1930s, and delivered huge breaks to people at the top of the income spectrum. Under their theory of the world, that "tax relief" should have trickled down throughout the economy, boosting growth, and incentivized the wealthy to create lots of new jobs.

In fact, back in 2001, the Heritage Foundation was predicting that President Bush's package of tax cuts would do just that, yielding hundreds of thousands of new jobs and sparking faster economic growth. Suffice it to say, their predictions came up more than a bit short.

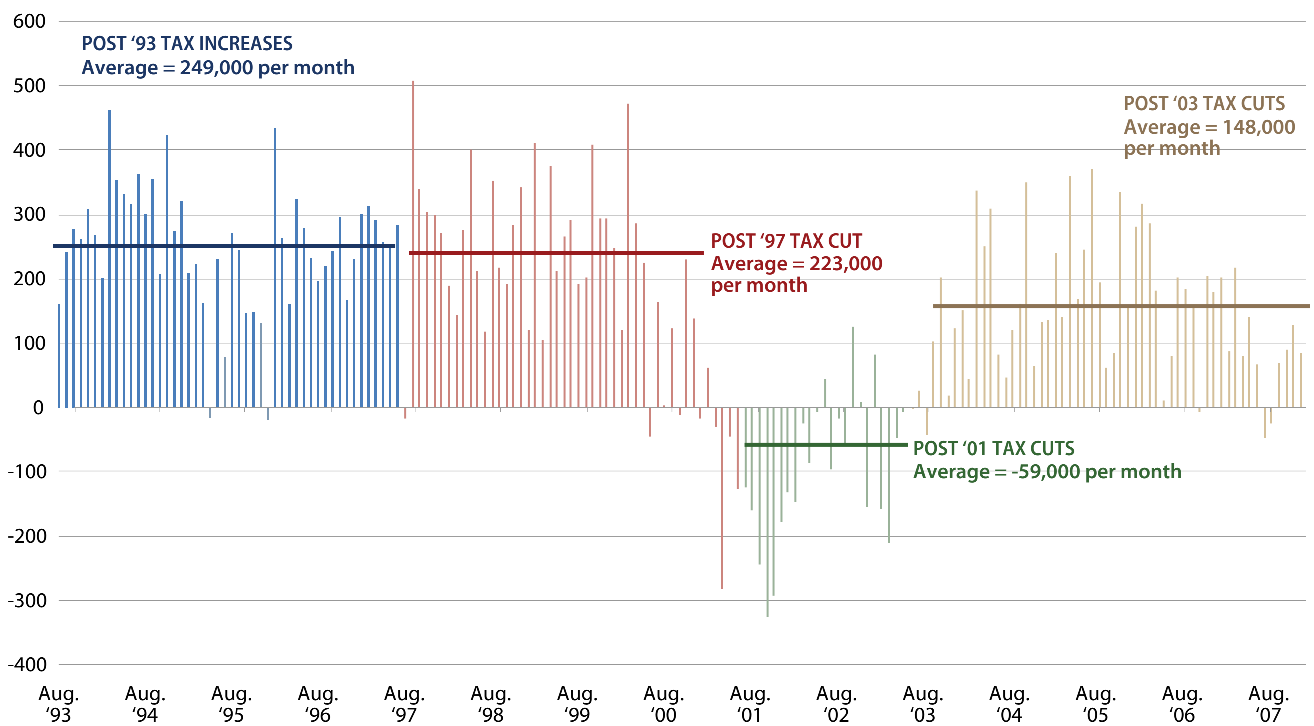
The failure of the Bush tax cuts to accomplish any of their stated goals was a serious blow to supply-side supporters. But rather than grappling with the implications of that failure, the Heritage report instead claims that the problem was that the 2001 round of tax cuts "were too slow to go into effect" (a concern that went strangely unexpressed by Heritage at the time). Once Congress realized "the error of its ways," says the report, and accelerated those tax cuts in 2003, they "prompted a surge in employment" and "economic growth took off."

These claims rest on the fact that from May 2003 (when the second round of tax cuts passed) through December 2007 (the beginning of the Great Recession), the economy created an average of 148,000 jobs a month. Certainly, that was better than the 96,000 jobs per month that the economy had been shedding, on average, after the passage of the 2001 tax cuts, but it is hardly anything to brag about. Over the past 60 years, during economic expansions, the economy added an average of 168,000 new jobs each month. The post-2003 pace was more than 20,000 jobs short of being merely average.

And job creation from 2003 through 2007 fell even further short of what it had been under President Clinton and his higher tax rates. From start to finish, during the Clinton administration, job creation averaged 237,000 per month. In just the years after the Clinton tax increase but before the tax cut of 1997, job creation averaged an even better 249,000 a month. (see Chart 2)

**Job creation was strongest under higher tax rates**

Change in total non-farm employment, in thousands, August 1993-December 2007




Note: Averages exclude recessionary periods. Source: Bureau of Labor Statistics

Neither did the 2003 tax cuts spark a huge surge in overall economic growth. The U.S. economy grew at an annualized rate of 2.9 percent from the third quarter of 2003 to the end of 2007, when the Great Recession began. Compared to the near 4 percent annual growth under President Clinton's higher tax rates, 2.9 percent is pretty weak. Note also that the economic growth rates after the passage of the 2003 tax cuts are even worse than Heritage's own, erroneous calculations for growth rates after the passage of the Clinton-era tax increases.

The only way to justifiably claim the 2003 tax cuts were a success is to compare the economy in years following their enactment with the even more dismal years following the 2001 tax cuts. As soon as any other comparisons to recent history are made, it is obvious that the 2003 tax cuts, just like their 2001 counterparts, were a failure.

## Heritage or your own eyes?

Some sympathy is due to the Heritage Foundation. It is not easy or simple to prove a case that is not only so clearly false but is also one that most people already know to be false because they actually lived through it. On top of that, this Heritage report faces the added pressure of trying to repair an economic theory, central to their particular worldview, which has been very badly damaged by recent history. Given all that, it is not surprising that the report relies on miscategorized data and narrow context.

Heritage's herculean effort notwithstanding, the facts are simple:

- Heritage wrongly claims that the Clinton tax hikes "slowed economic growth." In fact, in the aftermath of the Clinton tax increase, the economy grew at an impressive 4 percent per year, adding an average of around 240,000 new jobs every month.

- Heritage misstates that it was not until after the 1997 capital gains tax rate cut that "growth took off." In fact, growth rates changed little after the 1997 tax cut, and the pace of job creation actually slowed slightly.

- Heritage wrongly concludes that the 2003 Bush tax cuts "prompted a surge in employment." In fact, job growth following the second round of Bush tax cuts was below the historical average and fell well short of the pace of job creation under Clinton and his higher tax rates.

The two worst things to happen to the supply-side theory of economics were the Clinton administration and the Bush administration. Clinton raised taxes and the economy flourished. Bush cut them and the economy languished. These are inconvenient facts for the Heritage Foundation but they are facts nonetheless.

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