



TAX CUT SUPPORTERS PEDDLING “SNAKE OIL” WRITES HARVARD EXPERT

Tax policy driven by politics rather than sound economics

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The tax-cutting policies pursued by Republican administrations over the past three decades and embraced by the party’s current presidential nominee are the wrong medicine for our ailing economy, according to a new study by Jeffrey Frankel, Harvard University’s Harpel Professor of Capital Formation and Growth. In [*Tax Cut Snake Oil*](#), published today by the Economic Policy Institute, Frankel examines the impact of those tax cuts, documents the failures of the two dominant theories behind them, and proposes an alternative that would avoid the pitfalls of the Republicans’ favored approach to fiscal policy. He is presenting his findings today at noon at a joint Center for American Progress-EPI [forum on supply-side economics](#) at CAP headquarters.

The first theory, called the Laffer Hypothesis, provides the underpinnings of the largely discredited (at least among professional economists) supply-side economics. It holds that cutting taxes actually increases tax revenues and creates a surplus by accelerating economic growth. It has been explicitly endorsed by candidate McCain, even though it has been explicitly disavowed by his policy director, economist Douglas Holtz-Eakin. The second theory, known informally as “Starve the Beast,” recommends tax cutting as a way to force government to spend less. Neither theory has panned out in practice. Instead of higher revenues and smaller government, tax-cutting administrations brought us lower revenues, cuts in programs essential to the most vulnerable, massive spending increases elsewhere, and record-high budget deficits.

As Frankel’s analysis notes, not only are these two theories mutually contradictory (claiming, on the one hand, to increase revenues, and on the other, to shrink them), but neither theory reflects actual economic realities. The problem with these erroneous theories isn’t just a matter of academic dispute, because relying on them to justify tax-cutting policies has real-world consequences. As Frankel writes, “Previous presidents, including Ronald Reagan and George W. Bush, have ignored their chosen top economic advisors in favor of political advisors, launching the country onto paths of fiscal irresponsibility.”

Frankel’s examination of the historical data from the U.S. and from our OECD peer nations finds overwhelming evidence that, contrary to the “less is more” claims of the supply-siders, cutting taxes consistently leads to less, not more revenue.

Promises made to be broken?

Frankel offers evidence that even the most adamant government-shrinking “starve the beast” advocates may not really mean what they say. As a case in point he cites a study of the voting behavior of the 258 members of Congress who, along with George W. Bush, signed an unconditional pledge not to raise taxes. That study, by Brennan Kelly and

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William Gale, found that the members who signed the pledge, on average, voted for greater spending increases than their colleagues who did not sign it.

Even the presidents who sought to be seen as toughest on budgets, Ronald Reagan and George W. Bush, didn't walk their own talk. As Frankel writes, “[T]hey never proposed spending cuts anywhere near the scale necessary to improve the fiscal balances that they inherited. After this repeated historical pattern, why should anyone believe that the Republicans are serious about the messy task of getting spending under control, as opposed to merely giving feel-good speeches on the subject?”

A better way: Shared Sacrifice

Although official government forecasts have predicted a return to surplus in 2011, Frankel warns that these predictions, like those of the past, are unrealistically optimistic. He notes that the \$5 trillion 10-year cumulative *surplus* forecast in January 2001 turned into a \$5 trillion *deficit*. Frankel describes in detail how GOP supply-siders “game the system” to create falsely rosy forecasts and minimize the cost of their tax cuts to the nation’s fiscal health. He shows how John McCain’s tax proposals would worsen things by raising the size the budget deficit to about 3% of total GDP by the end of his second term.

What’s needed, Frankel concludes, is a return to the approach of shared sacrifice pursued successfully in the 1990s, when responsible fiscal policies laid the groundwork for boom times that benefited everyone. As a first step, he calls for an honest debate on taxes during this election season. As part of that debate he urges candidates to adopt positions that are internally consistent, that are based on real-world evidence that their approaches are effective, and to forgo the temptation to abandon sound economics in favor of political expediency.

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