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The Bush Tax Cuts: The Least Effective Stimulus

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Abstract

In a New York Times op-ed, Bill Gale explains why extending the Bush tax cuts would provide little economic stimulus and would be bad fiscal policy.

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The usual joke about economics is that the questions never change, only the answers do. Supporters of the Bush tax cuts have now flipped that around – whatever the question, the Bush tax cuts are the answer.

The Bush tax cuts were never meant to be an economic stimulus package. They were designed in 1999 as part of then-Governor Bush's presidential platform. The intent was to return to the American taxpayer the emerging budget surpluses that had arisen under unprecedented economic prosperity. It's downright bizarre to consider extending those same tax cuts now as a way to turn around a faltering recovery in an era of a huge deficits.

Yes, there were rebates intended to stimulate the economy in the actual 2001 legislation, but they were added at the end of the process by the Congress and are not under consideration now.

Economic research over the past decade can explain why extending the original Bush tax cuts is not good stimulus policy. After the tax rebates in 2001, 2003, and 2008, households appear to have spent in relatively short order somewhere between 25 and 67 cents more for each dollar of tax cut. This makes tax cuts in general – even the parts of those tax bills that were intended to stimulate – a relatively weak way to help the economy compared to increases in government purchases, for which each dollar of increased deficit turns into an additional dollar of spending.

Also, high-income households are less likely than low-income households to spend much of their rebate. The Bush tax cuts in general – and tax cuts that only benefit high-income households in particular – favor the wealthy, and so are a particularly poor way to stimulate a weak economy.

The Congressional Budget Office recently considered 11 options for stimulating the economy and extending the tax cuts tied for least effective. Policy makers could do far more good for the economy in the short run by allowing the same increase in the deficit as would come from extending the tax cuts (or the tax cuts that help only high income households) and using the money instead to pay for infrastructure and investment programs and aid to the states so that they can avoid laying off workers. This would also help the long run deficit because if the tax cuts don't die now, they probably never will and so will create enormous future deficits.

Other Publications by the Authors

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