ISSUE BRIEF

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Clinton Tax Hikes Slowed Growth

Curtis S. Dubay

President Obama argues that President Clinton's economic record is proof that the current economy would grow if Congress passed the tax hikes he has long proposed. The American public should not fall for this misleading argument.

The historical record is clear: The economy grew slower than it should have in the years after Clinton's 1993 tax hike. The strong economic growth that is associated with his presidency occurred only after he agreed with Congress to cut taxes in his second term.

President Obama's cursory and errant analysis of recent history has serious implications for policymaking today. If Congress raises taxes based on the faulty notion that tax hikes have no ill effects on economic growth, it will impede the still-struggling recovery and keep millions of Americans on the unemployment rolls far too long.

Unexceptional Growth. A favorite liberal argument is to attribute the U.S. economy's strong performance during the 1990s to President Clinton's economic policies, chief among which was a huge tax increase.

Clinton signed his tax hike into law in September 1993, the same year he took office. It included an increase of the top marginal tax rate from 31 percent to 39.6 percent; repeal of the cap on the 2.9 percent Medicare tax, applying it to every dollar of income instead of capping it to levels of income like the Social Security tax; a 4.3 cent increase in the gas tax; an increase in the taxable portion of Social Security benefits; and a hike of the corporate income tax rate from 34 percent to 35 percent, among other tax increases.[1]

The economic defense of the Clinton tax hikes does not hold up against the historical facts. The economy did exhibit economic growth during the 1990s, but it was well below potential. Moreover, rapid growth did not occur soon after the tax hike—it came much later in the decade, when Congress *cut* taxes. After the 1993 tax hike, the economy actually slowed to a point below what one would expect, considering the once-in-a-generation favorable economic climate that existed at the time.

As for the overall economic recovery, it started well before President Clinton took office. In January 1993, the economy was in the 22nd month of expansion following the recession from July 1990 to March 1991.

In addition to coming into office in the midst of an economic expansion, Clinton also benefited from a very unusual confluence of events that created a remarkably favorable environment for rapid economic growth:

- The end of the Cold War brought a powerful dose of growth-enhancing certainty to the global economy;
- The price of energy was astoundingly low, with oil prices dropping below $11 per barrel and averaging under $20 per barrel, versus near $100 per barrel today[2];
- The Federal Reserve had tamed inflation to an extent previously thought impossible, with inflation averaging 2 percent during the Clinton Administration[3]; and
- A tremendous set of new productivity-enhancing information

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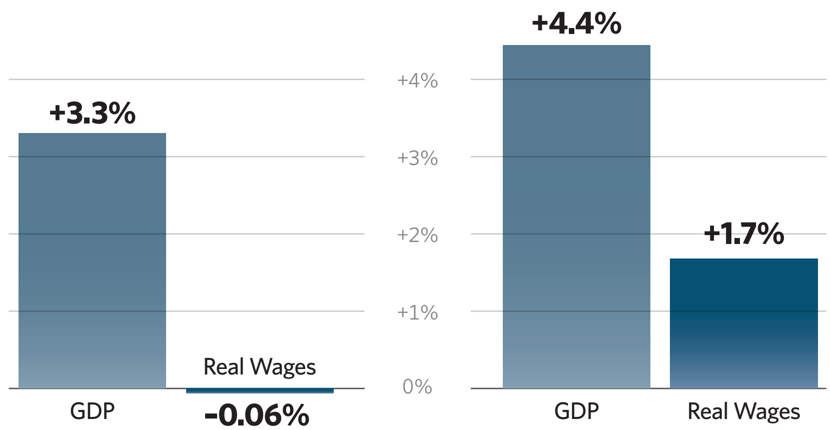
The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

CHART 1

Tax Hikes Dampened Economy in the 1990s, While Tax Cuts Spurred Growth

In the ***four years following the 1993 Clinton tax hike,*** *real GDP grew 3.3 percent annually, but real wages fell.*

In the ***four years after the 1997 capital gains rate cut,*** *real GDP and real wages had significantly higher annual growth.*



Source: Heritage Foundation calculations based on data from U.S. Bureau of Economic Analysis and U.S. Department of Labor, Bureau of Labor Statistics.

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technologies emerged—including the explosion of the Internet as a powerful tool for commerce and communication—which further increased productivity.

With these factors clearing the way, the economy should have displayed spectacular and accelerating growth in the years immediately after Clinton entered the White House, but growth of that magnitude did not materialize until later in the decade.

From 1993 until 1997, the economy grew at 3.3 percent per year.[4] While solid, this growth was certainly not exceptional. During that same time, real wages declined, despite the perception that the 1990s were an era of unmitigated abundance.[5]

It was not until after a 1997 tax cut, passed by Congress—a tax cut President Clinton resisted but ultimately signed—that the spectacular growth kicked in. While small in static revenue impact, the 1997 cuts included a reduction of the capital gains rate from 28 percent to 20 percent. This opened the capital floodgates necessary for entrepreneurs to develop, harness, and bring to market the wonders of the new information technologies.

Business investment skyrocketed after the tax cut,[6] and the economy grew at an annualized rate of 4.4 percent—33 percent faster than after the Clinton tax hike—from 1997 through the end of the Clinton presidency. Real wages reversed their downward trend and grew 1.7 percent per year during the same time.

Altogether, how much worse did the economy perform because of the Clinton tax hike? The data from the period do not provide a clear answer. What is clear is that the economy performed well below reasonable expectations given the favorable conditions existing in the years after the tax hike—and took off after the oft-forgotten tax cut.

Lessons for Today. President Obama defends his tax hike desires by pointing to the Clinton tax hikes as evidence that the economy can withstand higher taxes. But if the

1. U.S. Department of the Treasury, Office of Tax Analysis, "Revenue Effects of Major Tax Bills," September 2006.
2. U.S. Energy Information Administration, "World Crude Oil Prices," http://www.eia.gov/dnav/pet/pet_pri_spt_s1_d.htm (accessed September 4, 2012).
3. U.S. Department of Labor, Bureau of Labor Statistics, "Consumer Price Index for All Urban Customers," http://research.stlouisfed.org/fred2/data/CPIAUCSL.txt (accessed September 4, 2012).
4. U.S. Department of Commerce, Bureau of Economic Analysis, National and Income Product Accounts, Table 1.7.5, "Relation of Gross Domestic Product, Gross National Product, Net National Product, National Income, and Personal Income," http://www.bea.gov/iTable/iTable.cfm?ReqID=9&step=1 (accessed September 4, 2012).
5. Bureau of Labor Statistics, Current Population Survey, "Usual Weekly Earnings of Wage and Salary Workers News Release," (quarterly) Table 1. "Median usual weekly earnings of full-time wage and salary workers by sex, quarterly averages, seasonally adjusted," in constant (1982–1984) dollars, http://www.bls.gov/cps/cpswktabs.htm (accessed September 4, 2012).
6. J. D. Foster, "Tax Cuts, Not the Clinton Tax Hike, Produced the 1990s Boom," Heritage Foundation *WebMemo* No. 1835, March 4, 2008, http://www.heritage.org/research/reports/2008/03/tax-cuts-not-the-clinton-tax-hike-produced-the-1990s-boom.

Clinton tax hikes were powerful enough to slow an economy that had everything going in its favor, what would tax hikes today do to an economy that has everything working against it?

Economic growth is slow and declining. The unemployment rate remains stuck over 8 percent, and there appears to be little hope for it to fall in the near future.[7] The President should not be looking for policies that the economy can withstand but for policies that will encourage it to grow.

At best, tax increases would slow the already stalled recovery and, at worst, would reverse it altogether. A slowed recovery or double-dip recession would further reduce the chances that the more than almost 13 million Americans currently looking for work would find jobs in the near future. To make matters worse, President Obama's tax hikes would add even more Americans to that already-too-large figure.

*—**Curtis S. Dubay** is a Senior Analyst in Tax Policy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.*

7. James Sherk and J. D. Foster, "Sluggish Labor Market in July," Heritage Foundation *Issue Brief* No. 3691, August 3, 2012, http://www.heritage.org/research/reports/2012/08/sluggish-labor-market-in-july.