HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. ■ Ranking Democratic Member

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October 13, 2004

Setting the Supply-Side Record Straight

Dear Democratic Colleague:

Those who believe that we can enact large tax cuts and balance the budget at the same time often point to the 1980s for justification. Never mind that the 1980s produced the largest budget deficits to that point in history. The argument is that the economy was extraordinarily strong, and that revenues poured into the Treasury. Without excessive growth of domestic spending, the argument goes, the budget would have been balanced.

It would be good news if the nation could cut taxes and enjoy higher revenues at the same time. However, the record of supply-side tax cuts falls short.

For one thing, the core of the supply-side argument, that tax cuts advocated by President Reagan and the current president breed faster economic growth, is not supported by the data. Some tax-cut advocates believe that their theory was borne out by the fact that the economy grew at all in the 1980s. But a more reasonable standard shows that the economy grew more slowly in the supply-side years of 1981-1993, and 2001 to the present, than it did in the rest of the post-World War II era (See the first chart. Time periods were divided at the quarters of Presidential inaugurations, where possible. Data are available beginning with the first quarter of 1947.) And if the economy grows more quickly without oversized tax cuts, how can those tax cuts yield higher revenues?

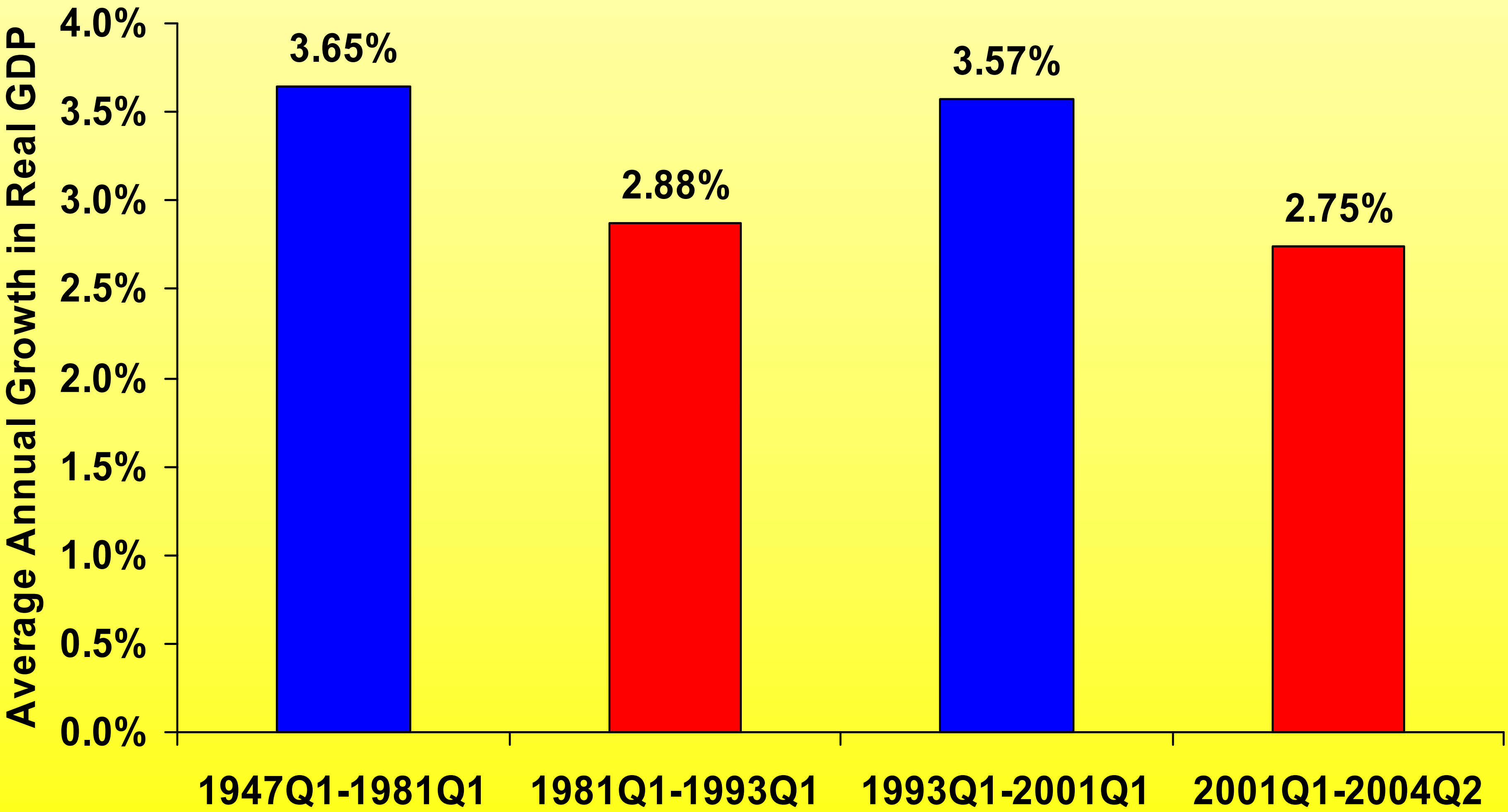
The answer is that they cannot, and the evidence bears that out. Revenues grew more slowly over 1980 through 1992 than in the post-War years before or since. (See the second chart. Time periods were divided so that President Reagan's 1981 tax cuts were included in the record of his Administration, and President Bush's 2001 tax cuts were included in his.) Of course, since 2000, revenues have actually declined in nominal dollars, marking the longest such period in modern U.S. history.

So what happened to the budget in the 1980s? The answer is that the revenue growth of the 1947-1980 period would have been enough to exceed the growth of domestic non-interest spending, or even of defense spending, which grew somewhat faster. However, because revenue growth declined so much, the nation piled up a sharply larger national debt. Then, because of that faster debt growth, the government's net interest costs skyrocketed. Debt begat interest, and interest begat debt. The federal government fell into a classic national debt vicious cycle.

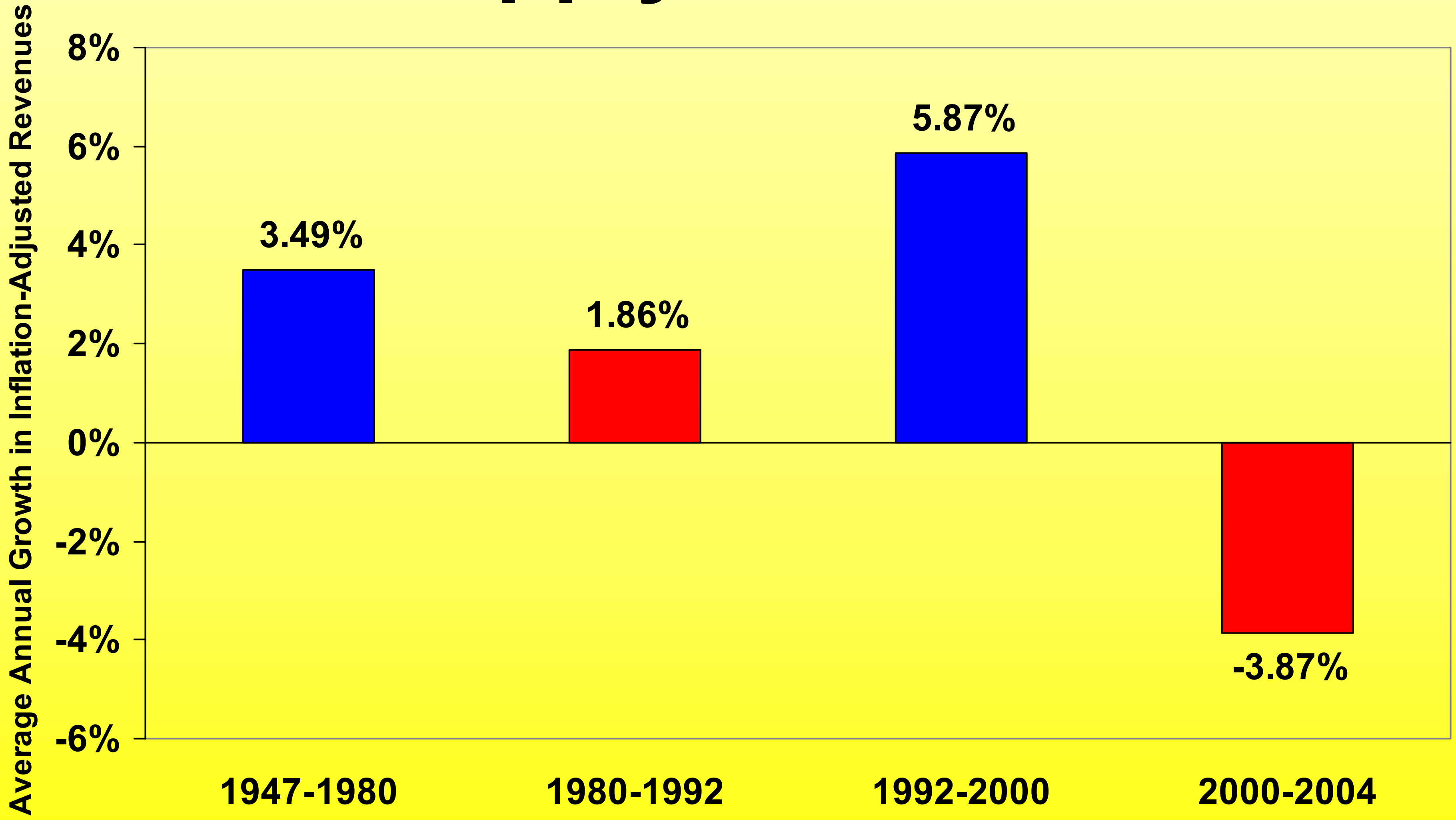
Some still believe that we can have it all, and that large tax cuts, disproportionately targeted to those who need the help the least, are not a problem. But the experience of the 1980s shows that this is not the case. Once a nation's budget gets out of hand, it can take decades to escape the accumulating deficits and debt.

Sincerely,
/s
John M. Spratt, Jr.
Ranking Democratic Member

Real Economic Growth Was Slower In Supply-Side Years



Revenue Growth Was Slower In Supply-Side Years



Fastest Growing Reagan - Bush I Spending Category Was Interest