- The Foundry: Conservative Policy News. - http://blog.heritage.org -

Hoover, FDR and Clinton Tax Increases: A Brief Historical Lesson

Posted By David Weinberger On October 20, 2010 @ 2:00 pm In Enterprise and Free Markets, Entitlements | No Comments

9
tweets

retweet

The obvious reason to prevent a tax hike by extending current tax rates is that doing so will prevent further economic harm [1] to an already flat economy. How do we know that tax increases will cause economic harm? Three examples: 1932, 1937 and 1993.

After the 1929 stock market crash, the Smoot-Hawley tariff of 1930 raised import prices and more importantly threw a bucket of cold water on global trade flows, helping send the economy into deep depression. The economy had very little chance to recover. Along with gross and ongoing monetary policy mismanagement, President Hoover raised taxes in 1932. The consequences were devastating. As Alan Reynolds points out [2]:

> President Herbert Hoover asked for a temporary tax increase…in June 1932, raising the top income tax rate from 25% to 63% and quadrupling the lowest tax rate from 1.1% to 4%. That didn't help confidence or the Treasury. Revenue from the individual income tax dropped from $834 million in 1931 to $427 million in 1932 and $353 million in 1933.

This caused a "double-dip" recession, sky-rocketing the unemployment rate to well above 20 percent. After 1933, the economy showed glimmers of recovery: unemployment dropped from near 25 percent in 1934 to under 15 percent in 1937, and economic activity was picking up. Contrary to Keynesian conventional wisdom, however, the recovery didn't come as a result of New Deal spending. Christina Romer, former chief economic advisor to President Obama, makes clear [3]: "Fiscal policy played a relatively small role in stimulating recovery in the United States." Rather, the initial recovery happened largely because of monetary expansion [3], the "money supply increased nearly 42 percent between 1933 and 1937," according to Ms. Romer.

Unfortunately, President Roosevelt made the same crucial mistake President Hoover made 5 years earlier, so the recovery didn't last. FDR raised taxes sharply in 1937 in an attempt to balance the budget. Once tax increases took effect, the economy collapsed into another recession – the second stage of the double-dip which lasted into WWII.

Late in 1945 under President Truman's leadership, Congress cut marginal tax rates and rather than sliding back into recession as many had feared, the economy soared toward full-employment.

As Burt Fulsom writes [4]:

> Congress reduced taxes. Income tax rates were cut across the board. FDR's top marginal rate, 94% on all income over $200,000, was cut to 86.45%. The lowest rate was cut to 19% from 23%, and with a change in the amount of income exempt from taxation an estimated 12 million Americans were eliminated from the tax rolls entirely.
>
> Corporate tax rates were trimmed and FDR's "excess profits" tax was repealed, which meant that top marginal corporate tax rates effectively went to 38% from 90% after 1945….By the late 1940s, a revived economy was generating more annual federal revenue than the U.S. had received during the war years, when tax rates were higher. Price controls from the war were also eliminated by the end of 1946. The U.S. began running budget surpluses.

The disastrous mistakes from Presidents Hoover and Roosevelt underscore the importance that Washington not raise taxes in a weak economy. But that doesn't stop the Left from advancing the notion. They point to Clinton's record as proof. After all, Congress pushed through a big tax increase under President Clinton, and the economy boomed, right?

Well, the truth is that the real boom didn't happen until after 1997, the year Clinton cut taxes. From 1993-1996, a time when the economy was recovering from recession so expected growth should be strong, real economic growth averaged 3.2 percent and 11.2 million jobs were added. During the period 1997-2000 real economic growth averaged 4.2 percent and employment increased by 11.5 million jobs.

Heritage senior fellow JD Foster adds [5]:

> The first period, from 1993 to 1996, began with a significant tax increase as the economy was accelerating out of recession. The second period, from 1997 to 2000, began with a modest tax cut as the economy should have settled into a normal growth period. The economy was decidedly stronger following the tax cut than it was following the tax increase.
>
> In summary, coming out of a recession into a period when the economy should grow relatively rapidly, President Clinton signed a major tax increase. The average growth rate over his first term was a solid 3.2 percent. In 1997, at a time when the expansion was well along and economic growth should have slowed, Congress passed a modest net tax cut. The economy grew by a full percentage point-per-year faster over his second term than over Clinton's first term."

The evidence is in: tax increases are damaging to economic growth and job creation no matter what point of the business cycle. In a weak economy, like ours today, tax increases are especially ill advised, as Presidents Hoover and Roosevelt discovered. But even in a bustling economy tax hikes hurt growth and prosperity, as they did in the 1990s under President Clinton. That we're having a national debate about this from an economic standpoint at a time of instability and weakness is a sign of deliberate disregard of historical precedence and favor of ideological righteousness over economic concern.

Article printed from The Foundry: Conservative Policy News.: **http://blog.heritage.org**

URL to article: **http://blog.heritage.org/2010/10/20/hoover-fdr-and-clinton-tax-increases-a-brief-historical-lesson/**

URLs in this post:

[1] further economic harm: **http://www.heritage.org/research/reports/2010/09/obama-tax-hikes-the-economic-and-fiscal-effects**
[2] points out: **http://www.cato.org/pub_display.php?pub_id=9671**
[3] makes clear: **http://elsa.berkeley.edu/~cromer/great_depression.pdf**
[4] writes: **http://online.wsj.com/article/SB10001424052702304024604575173632046893848.html**
[5] adds: **http://www.heritage.org/research/reports/2008/03/tax-cuts-not-the-clinton-tax-hike-produced-the-1990s-boom**

Copyright © 2008 The Heritage Foundation. All rights reserved.