

[Why tax cuts stimulate the economy](#) [1]

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On the blog this morning, Philip Salter cited a paper by Alberto Alesina and Silvia Ardagna of Harvard University which concluded that an economic 'stimulus' of tax cuts was more likely to boost growth than one based on greater government spending. I will tell you why.

First, tax cuts boost business everywhere. Employers who are struggling to pay their bills (including national and local taxes), are not likely to think about hiring more people. But a tax cut would make a crucial marginal difference to them. And remember: if every small business in the country had the confidence to hire one extra person, unemployment would be zero. A tax cut is both general and quick in its effect. Government spending, however, is not general. It is concentrated in sectors like road building and bureaucracy. It takes time for spending in the former to trickle out to the rest of the economy; and as for spending on the latter, well, we have too much of that anyway.

Spending programmes also take time. It can take years for road, rail or runway schemes to get off the drawing board, through the planning process, and then into construction. Indeed, given the record of past government projects, there's a good chance that any crisis will be long forgotten by the time the spending actually starts.

The other way of boosting government spending is to raise transfer payments ? raising welfare or pensions, for instance ? does give a fairly widespread boost to a lot of people. But while it is very easy to boost welfare spending, it is nigh impossible to cut benefits again when the economy has righted itself. So you just end up increasing government welfare spending over the long term, which isn't likely to make your economy any more dynamic.

And where is the money for any sort of government spending to come from? If it comes from higher taxes, that depresses business and employment all round. If it comes from increased borrowing, that just monopolizes investment funds that could have gone to ? more productive ? private businesses. And it adds to the debt and to the interest payments that burden taxpayers.

Sure, a tax cut might produce a short-term cut in government revenues that has to be funded, too. But the higher your taxes are, and the deeper you cut tax, the greater and quicker the stimulus. It also helps if people figure you really mean it and aren't going to raise taxes again. We don't need more government spending, and we don't need piffling schemes to 'encourage' employment. We need tax cuts, and a commitment to a low-tax future, and we need them now.

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