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Jobs, Taxes, and the Goldilocks Economy

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The economy is growing steadily. Like Goldilocks's breakfast, the economy is neither too hot nor too cold. It is growing, adding jobs, increasing wages, and staying well away from a recession. Because it is not entering an inflationary boom the Federal Reserve can keep interest rates low. The economy is in a steady expansion.

That is why Congress should not impose a triple whammy of tax hikes on the American workers who are doing so much to keep the economy growing. Three different tax hikes are being discussed in Congress to pay for more spending: the automatic tax hike from the Alternative Minimum Tax (AMT); raising the cap on wages that are subject to payroll taxes; and repealing the Bush tax cuts. Each of these tax hikes—and especially all three together—would impose strong disincentives to work, save, and invest. This would be a heavy blow to American workers. The economy is growing at a good pace, and Members of Congress should not do anything to harm that.

Steady Growth. The economy is growing steadily. It increased at a 3.5 percent pace in the fourth quarter of 2006, above expectations and up from 2.0 percent in the third quarter. The economy grew 3.4 percent in 2006, slightly more than in 2005.[1] This growth rate is above historical averages but is still moderate enough to ease fears that the economy could enter an inflation-induced bubble.

Job creation is also steady. Entrepreneurs and businesses created 111,000 new jobs in January, most of those in professional and business services, education, and health.[2] Revisions to earlier figures also revealed that employers created over 400,000 more jobs in 2006 than the government had previously estimated.[3] That is good job growth, but not excessive.

The unemployment rate increased a statistically insignificant 0.1 percent to 4.6 percent in January.[4] Again, this is low but not excessively so. The unemployment rate was lower in the late 1990s, but that proved unsustainable when the tech bubble collapsed in 2000. Aside from the tech bubble, unemployment has not been as low as 4.6 percent since the mid-1970s. The economy is doing well but is not growing so quickly as to raise concerns of an illusory bubble.

Average wages are also growing, rising 0.2 percent in January to $17.09 an hour. Over the past year, wages have risen 4.0 percent.[5] This solid growth means that American workers are seeing their paychecks rise and that American families are better off than they were last year. But this growth is not so rapid as to raise concerns that it is a sign of rising inflation.

From economic growth to job creation to unemployment to wages, the economy is growing steadily. Workers are doing better and businesses

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are creating new jobs. Yet there are no signs that America is in a bubble or that the Federal Reserve needs to clamp down on rising inflation. That is why the Federal Reserve left interest rates unchanged for the fifth straight time when it met in Washington last week.

Congress Should Not Hit Workers with a Triple Whammy. When the economy is doing well, Congress should stay out of the way. Unfortunately, some ideas being floated on Capitol Hill would impose a heavy blow on the American workers who have created this "Goldilocks" strong economy. With the reinstatement of pay-as-you-go (PAYGO) budgeting and pledges to end deficit spending, new spending—especially on entitlements—must be paid for with either spending cuts or tax increases. Because Congress is reluctant to cut spending, three tax hikes may be in the works for American workers: the AMT, which will ensnare millions more taxpayers; an increase in the Social Security wage cap; and the repeal of some of the Bush tax cuts.

The Payroll Tax. Social Security payments are based on what workers have paid in Social Security taxes. Since benefits are capped, payroll taxes are only levied on the first $97,500 of income. Now some Members of Congress want to remove that cap. That would raise the top marginal tax rate to 53 percent for many workers, a level not seen since the stagflation of the 1970s that would seriously reduce the incentive to work. Although not all workers would be hit hard, it would hike taxes on 10.3 million American workers, including almost three million small business owners.[6] Top tax rates of over 50 percent are not the way to keep America's economy growing.

The Bush Tax Cuts. Prominent members of Congress—including Speaker Pelosi—have called for repealing the Bush tax relief for the financially successful. They have discussed raising the top income tax rates to 36 and 39.6 percent and repealing the reduced tax rates on savings and investment that Congress passed in 2003. These proposals would raise taxes on 4.7 million taxpayers and reduce incentives for them to save and invest in the economy. But this investment is key to economic growth.[7] Socking it to the financially successful may make for appealing class warfare rhetoric, but reducing incentives to work, save, and invest will not keep the economy growing.

The AMT. The Alternative Minimum Tax is a Nixon-era plan to ensure that a small number of extremely well off taxpayers could not avoid paying taxes by hiring creative tax accountants. It requires taxpayers to recalculate their taxes using an alternative schedule and then pay the higher levy. The AMT is not indexed for inflation and now threatens to ensnare tens of millions of middle class taxpayers. Unless Congress takes action, the AMT will hit an additional 20 million taxpayers this year, forcing them to pay an average of $3,000 more a year in taxes.[8]

1. Department of Commerce, Bureau of Economic Analysis, "Gross Domestic Product: Fourth Quarter 2006 (Advance)," January 31, 2007 at *bea.gov/bea/newsrelarchive/2007/gdp406a.pdf*.
2. Heritage Foundation calculations based on Bureau of Labor Statistics, "Employment Situation News Release," Table B-1, February 2, 2007, at *www.bls.gov/ces/cesbtabs.htm*.
3. Department of Labor, Bureau of Labor Statistics, "The Employment Situation: January 2007," February 2, 2007, at *www.bls.gov/news.release/pdf/empsit.pdf*.
4. *Ibid*.
5. Heritage Foundation calculations based on Bureau of Labor Statistics, "Employment Situation News Release," Table B-3, February 2, 2007, at *www.bls.gov/ces/cesbtabs.htm*.
6. David John and Rea S. Hederman, Jr., "Raising the Wage Cap: No Painless Solution to Social Security's Fiscal Woes" Heritage Foundation *WebMemo* No. 1319, January 22, 2007, at *www.heritage.org/Research/SocialSecurity/wm1319.cfm*.
7. These numbers are based on the Center for Data Analysis tax model and the following policies: increasing the top two marginal tax rates, raising the tax rate on capital gains to 20 percent, and ending the dividends exclusion.
8. Rea S. Hederman, Jr., Alison Acosta Fraser, and William Beach, "The Triple Whammy of Taxes: How the AMT, Repealing the Bush Tax Cuts, and the Social Security Wage Cap Would Raise Taxes on Millions of Americans," Heritage Foundation *WebMemo* No. 1334, February 1, 2007, at *www.heritage.org/Research/Taxes/wm1334.cfm*.

Conclusion. Americans are enjoying a "Goldilocks" economy. Economic growth is neither too hot nor too cold. Rather, it is growing steadily without entering either an unsustainable bubble or sliding into a recession. To maintain this solid growth, Congress should "Do no harm." The economy and American taxpayers cannot afford the triple whammy of tax hikes being discussed in Washington. Higher taxes would seriously reduce incentives to work, save, and invest—especially with top tax rates exceeding 50 percent—and derail today's solid expansion.

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