WHY THE SLOW U.S. ECONOMIC GROWTH?

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dx.doi.org/10.18374/JABE-13-4.3

ABSTRACT

The slowness of the current U.S. economic expansion reflects the more progressive Federal taxation and transfer payment functions that have created disincentives for capital formation and new business formation. The combination of increasing transfer payments to households and higher tax rates leads to more demand for leisure, slowing the increase in labor supply. Likewise a more progression tax code discourages savings and encourages current consumption at the expense of future consumption. Sixty percent of U.S. households receive more, on average, in the value of their transfer payments than they pay in terms of Federal taxes -- the combined Federal income tax, payroll tax and excise taxes, according to a Congressional Budget Office study. That leaves 40% of households effectively paying all net Federal taxes. In comparison, 30 years ago only 20% of households received more in the value of their transfer payments than what they paid in taxes, according to the CBO. Our argument is that the more progressive nature of the tax and spending functions during the last three decades reduced incentives for work, capital formation and business formation which has resulted in slower output growth. Transfer payments have increased in inflation-adjusted terms by a factor of two to three over the past 30 years for all five household quintiles in this study. In the meantime, the Federal tax burden on the bottom 60% of households has declined after adjustment for inflation. This more progressive nature of the tax and transfer payment functions leads to an increasing demand for leisure and a slowing in the growth of labor supply.

Keywords: *Slow Growth, Progressive Transfer Payments, Progressive Federal Taxation, Quintiles, Micro-Foundations, Supply Side, Labor Supply, Leisure*