Notoriously Inaccurate

by Richard W. Rahn

ECONOMIC FORECASTS COME ACROSS AS FAKE, SLOPPY OR UNKNOWABLE

The Congressional Budget Office (CBO) projected that 21 million people would be enrolled in the Obamacare insurance exchanges by 2016, back when the bill was voted on in 2010. The actual number turned out to be about 10 million — the projection being off by more than 100 percent.

If the actual results of Obamacare had been known at the time members of Congress voted, it almost certainly would not have passed — particularly given the number of House and Senate Democrats who were defeated, in part, because of their votes for it. Did the CBO provide hugely incorrect forecasts because they were under political pressure by the Democrats to report fake news of how beneficial the program would be, or were they sloppy in their work product, or did they pretend to know more than they could have possibly known?

When people hear the term "fake news," most often they think of political distortions or untruths — but much of what is reported about economic topics is also lacking context. Many reporters do not understand economic data and its inherent weaknesses, let alone economic forecasts which, even from official sources, are frequently not even close. Because economic reports and forecasts contain numbers, they appear to be more scientific than, for instance, political analyses and forecasts.

Despite many decades of major forecast errors, Congress continues to rely on CBO projections far more than is warranted. Most recently, the Republicans had been waiting in great anticipation of the CBO witch doctors' "scoring" of their various repeal-and-replace Obamacare plans.

The CBO is given the responsibility for "scoring" — that is, estimating the gains or losses in tax revenue from any tax change. If the results of such changes were merely a matter of arithmetic, the CBO would probably be reasonably accurate. But changes in tax rates cause people to behave differently — some people respond to tax increases by working less or "off the books." So, without knowing how people will respond, it is not possible to give an accurate forecast.

Some in Congress and the administration have discussed not cutting the capital gains tax rate to 15 percent as originally proposed, because they are worried about the alleged "tax revenue loss" from the tax rate cut. If the worriers knew more economic and tax history, they would worry a whole lot less. Over the past half-century, capital gains tax rates have been increased and reduced many times. As a result, good tax economists know that capital gains tax rates of more than 15 percent do not produce more revenue over the long run. (Many of us have written long explanations of why this is true — but for the moment, just remember that it is a discretionary tax — that is, the individual makes a decision as to when to sell something to realize a potential capital gain — and the tax rate has a major effect on such decisions.)

Many economic forecast errors are due to sloppy work, by relying on faulty models of how the national and world economy works. After the end of the great recession, both the Federal Reserve and the International Monetary Fund continued to forecast that the U.S. and world economy would grow much faster than they did. They made the same error for six years running because they were wedded to the wrong economic model — and refused to change, despite the obvious mistakes. Their forecasts became fake news, but they knew that their projections would be reported in an uncritical way by an ignorant and biased press.

Major economic policy mistakes are often made by politicians because of biased or sloppy work by economists, and by those who report on their work. The damage done by higher tax rates and unproductive government spending is normally underreported, as are the benefits of lower government spending and tax rates. The resulting policy mistakes cause millions of people to lose their jobs and suffer from unnecessarily reduced incomes.

The world would be better off if the balance of trade number was never reported — because it is misunderstood by many in the media and political class, including President Trump — and thus tends to lead to very bad trade policy. Does Virginia run a trade surplus or deficit with Florida — and does it matter? Assume that Canada, China and Germany were just states of the U.S., like New York or Iowa. If they were, no one would care about the trade balance between them and the other states. China, Mexico and Canada sell things to the U.S. to get dollars so they can buy things from the U.S. or invest in the U.S. Either way, it is to the benefit of the U.S. These countries do not hoard U.S. dollars in a cave someplace — ultimately, the dollars come back. The balance of trade number is much ado about nothing — perhaps not fake news, but largely irrelevant news. Trade barriers that are enacted because of trade balance numbers have the very real negative effect of causing a misallocation of world capital and labor, thus reducing human well-being.

Economists have much to be modest about when making predictions. Journalists who cover their pronouncements would do well to read economic history before uncritically feeding the latest gruel to the unwary public.

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