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THE CONGRESSIONAL BUDGET OFFICE VS. REALITY
(Average Annual GDP Growth for Five-Year Periods after Major Policy Changes)

Date of Forecast and Period	CBO (%)	Actual (%)	Average Error (%)
February 1983 for 1983-1987	3.62	4.62	-28
January 1996 for 1996-2000	2.38	4.32	-82
January 2011 for 2011-2015	3.24	2.20	+32

Sources: CBO, BEA

Stuck on Stupendous Mistakes

by Richard W. Rahn

GOVERNMENT ECONOMISTS UNDERESTIMATE THE SIZZLE OF TAX CUTS

What do you call someone who keeps making the same mistake over and over and fails to learn from others who have made a similar mistake? If one doesn't know history and basic math, and the fact that people adjust their behavior on the basis of incentives, then one should not prove ignorance by commenting on the likely effects of tax changes.

Much of commentary on the proposed tax cut legislation leads one to think that 1980s never happened, and the basic laws of economics have been repealed. It should be easy to understand that a percentage change in a tax rate and a percentage change in tax revenue are not the same thing. As Art Laffer of Laffer Curve fame endlessly points out, there are two tax rates where the government collects no tax revenue — zero and 100 percent. At 100 percent, people stop engaging in taxable activities, so we know that the tax and growth-maximizing rate must be less than 100 percent. The actual maximizing rates depend on the specific tax. It is possible to have a high tax rate on cigarettes because they are addictive (up to the point where it is cheaper to obtain black-market cigarettes as in New York City). In contrast, the tax rate on capital gains needs to be low, because people can choose whether or not to realize a capital gain — to some extent, it is a voluntary tax.

We are constantly being told that a tax rate cut will result in much greater deficits, which is true in the short run for many taxes if wasteful government spending is not cut. But in the longer run, a properly structured tax cut will cause higher economic growth, resulting in a much bigger economic pie, and thus government can take a smaller percentage and still have the same or greater revenue. A number of years ago, I calculated that the Reagan tax cuts "paid for themselves" in about seven years as a result of the bigger economic pie and many more at work with higher wages.

Back when the 1978 capital gains tax rate reduction was proposed, the Congressional Budget Office (CBO) forecast that the rate reduction would lose more than $1 billion (that was back in the day when a billion was big money). Others, including yours truly, forecast the rate reduction would probably result in $1 billion of extra revenue. I turned out to be wrong: The first-year revenue gain was more than $2 billion, but at least I had the direction of my sign right. Despite further changes in the capital gains tax rate, the CBO continued to not only get the number wrong but the direction. (The empirical evidence has shown that capital gains rate cuts result in an almost immediate revenue gain.)

It is almost impossible to be precisely correct when making economic and tax revenue forecasts. But some organizations, like the Tax Foundation, have a track record of smaller errors than most. Many in the media appear to be know-nothings either because they are or they have a political agenda, such as when they refer to the Tax Policy Center (a creation of two liberal policy organizations, the Urban Institute and the Brookings Institution) as "nonpartisan." The Tax Policy Center claimed huge negative effects from the proposed Republican tax plan before it even had the details — not very professional, but very political.

The Wall Street Journal reported on Jan. 23, 1984: "Back in mid-1982, when a pack of critics was baying at Reaganomics, even the supply siders at the U.S. Chamber of Commerce were feeling the heat. [T]he Chamber's top economist, Richard Rahn, and his supply siders called the 1983 recovery almost on the nose. They predicted 3.2% real growth in gross national product. The official outcome was 3.3%." Subsequent revisions by the government put the number at 4.6 percent; so again my team was wrong but far less wrong than the others, who were trapped in the old Keynesian models. The CBO projection made in February 1983 forecast 2.1 percent growth for 1983 (less than half the actual number).

What the CBO missed in the 1980s was the incentive effects of the Reagan tax rate cuts and deregulation. What they missed in the 1990s was the positive effects of both the capital gains tax rate cut and the real reductions in government spending as a result of a compromise between President Clinton and the House Republicans led by Newt Gingrich. In the period from and after 2011, the CBO and the other official forecasters (e.g., the Federal Reserve and International Monetary Fund) were stuck in the Keynesian belief (contrary to the evidence) that big increases in government spending would increase economic growth and real job creation.

Congress should not let itself be bound by the CBO projections of the tax changes, given that the office is still using models that fail to adequately account for changes in behavior. A good tax bill should not die on a cross of the CBO.

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http://www.washingtontimes.com/news/2017/oct/9/tax-cuts-are-still-misunderstood/

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