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GOP Tax Plan Supporters Cherry-Pick the Facts

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The expert estimates of how much the House and Senate versions of the Tax Cuts and Jobs Act will cost in lost revenue over the next decade, after the projected economic-growth impacts of the legislation are factored in, range from $516 billion to $1.7 trillion. Yet Senate Majority Leader Mitch McConnell said over the weekend of the Senate bill that "I not only don't think it will increase the deficit, I think it will be beyond revenue-neutral."

Why would he say something like that? The simplest answer is that he's being cynical and dishonest. But there is another possibility: Maybe he believes what he reads in the opinion pages of the Wall Street Journal!

The Journal's editorial board -- editorial writer Jude Wanniski in particular -- was largely responsible in the 1970s for popularizing the notion that cutting marginal tax rates can increase tax revenue. The idea, as expressed in economist Arthur Laffer's famous Laffer curve, is that beyond a certain point, high rates reduce incentives to work and increase incentives to engage in tax avoidance so much that revenues drop. This is not a controversial assertion; what's controversial is whether real-world tax rates are anywhere near that inflection point. In 1963, when the top marginal rate was 91 percent, they were almost certainly above it. In 1980, with the rate at 70 percent, they may still have been. In his book "The Growth Experiment Revisited," economist, former Federal Reserve governor and frequent Republican adviser Lawrence B. Lindsey makes a credible case that cuts in rates for the top few tax brackets in 1981 actually did result in revenue gains. Other economists differ, with estimates of the revenue-maximizing top individual income tax rate ranging from 43 percent to 83 percent.

So far, so good. Tax rates affect economic behavior, and high marginal rates bring diminishing returns. But the 1981 tax legislation did a lot more than just cut rates for a few people in high brackets, and it was far from revenue-neutral overall. Lindsey's estimate is that it recouped "well over one-third" of its estimated cost. A 2006 study by the conservative Heritage Foundationestimated that making the George W. Bush tax cuts of 2001 and 2003 permanent would similarly recoup about a third of the lost revenue; several of the estimates about the current tax bills, notably those of Congress's Joint Committee on Taxation, come out in around that territory as well. 1

Which brings us back to the opinion pages of the Wall Street Journal. Wanniski died in 2005 and had stopped contributing to the Journal long before that. Since the mid- 1990s, the paper's most prominent tax-cut advocate has been Stephen Moore. He has played this role mainly as an outside contributor based variously at the Cato Institute, Club for Growth, Free Enterprise Fund and Heritage Foundation, but he also put in some time as a Journal editorial board member in the 2000s. I went through his Journal oeuvre over the weekend, and I have to admit that he's pretty good at writing columns. He's also extremely good, though, at leaving the misleading impression that the Reagan tax cuts of 1981 and the George W. Bush tax cuts of 2001 and 2003 were big revenue boosters. There are many examples of this, but to keep this from going on forever, I'll focus on two:

From Oct. 24, 2000 (in a piece co-authored with Laffer):

Tax revenues grew by $52 billion per year in the 1980s, versus just $35 billion per year after tax increases in the 1970s. ... From 1980 through 1990, federal tax receipts doubled to $1,035 billion from $517 billion.

From June 13, 2005:

Last week the Congressional Budget Office released its latest report on tax revenue collections. The numbers are an eye-popping vindication of the Laffer Curve and the Bush tax cut's real economic value. Federal tax revenues have surged in the first eight months of this fiscal year by $187 billion. This represents a 15.4% rise in federal tax receipts over 2004. Individual and corporate income tax receipts have exploded like a cap let off a geyser, up 30% in the two years since the tax cut.

So ... that sounds like evidence that tax cuts cause tax revenue to go up! If I were a regular reader of the Journal who didn't spend an inordinate percentage of my time of my playing around with federal revenue data -- if I were Mitch McConnell, say -- I might find this convincing. Certainly easier to understand than a macroeconomic analysis from the Joint Committee on Taxation.

But Moore's examples don't show what he says they show. The first thing to understand is that the natural tendency of tax revenue is to go up from year to year. That's partly because of inflation, partly because of economic growth. So the fact that revenue rises in the years after a tax cut does not in itself signify much of anything at all. It's a compared-to-what issue. Economists address this with models of what they think would happen or would have happened without the tax cut.

Moore has no such models, so, in the case of the 1980s, he uses the recession-riddled 1970s as a comparison case. Because of inflation and the fact that the economy had had 10 more years to grow, tax revenue did in fact rise faster in dollar terms in the 1980s than in the 1970s. But in percentage terms, it rose faster in the 1970s. So while it sounds impressive that revenue doubled from 1980 to 1990, it more than doubled (it rose 253 percent) from 1970 to 1980. Some of that difference can be chalked up to inflation, too, but revenue also doubled from 1990 to 2000, with inflation even lower. Also, almost half the increase in federal tax receipts in the 1980s came from Social Security payroll taxes, which far from being cut in the Reagan years were actually increased multiple times (with the rate going from 10.16 percent in 1980 to 12.4 percent in 1990). Plus, there were substantial income tax hikes enacted in 1982 and 1984.

As for the Bush tax cuts, Moore simply cherry-picked a favorable time period. In January 2002, he and co-author Lawrence Kudlow had blamed falling tax revenues on "the steep decline in corporate profits, the continued stock market slide, and the loss of 1.7 million jobs since March 2001." Fair enough. Three years later, though, Moore was giving all the credit for the end of that recession and stock market slide to tax cuts. Less than three years after that, the economy was tanking again. I don't think the 2001 and 2003 tax cuts are to blame for that, but it's pretty clear they have been revenue losers; in 2012, the Congressional Budget Office put the tally from 2001 to 2011 at $1.5 trillion.

None of this necessarily means the 2001 and 2003 tax cuts were a bad idea. It is also certainly noteworthy, given how big some of the 1980s tax cuts were (the top income tax rate fell from 70 percent to 28 percent over the course of the decade), that revenue didn't collapse. But in general, when you cut taxes, the result is a cut in tax revenue relative to what would have happened if you hadn't cut taxes. Which is what everybody should expect, right? That's why they call them tax cuts.

Here's the long view on U.S. income tax revenue, adjusted for inflation. I've left out Social Security and Medicare payroll tax revenue because it hasn't been the focus of any of the big tax cuts in recent decades.

Income Taxes Since 1934

U.S. individual and corporate income tax revenue, in 2016 dollars*

Sources: Office of Management and Budget, Bureau of Economic Analysis

*Adjusted using gross domestic product deflator

And here's the annual growth rate, by decade:

Income Tax Revenue By Decade

Annualized increase in real* income tax revenue

Sources: Office of Management and Budget, Bureau of Economic Analysis

*Adjusted using gross domestic product deflator

So, the 1940s, a time of huge increases in taxes, also saw ... huge increases in tax revenue. Big surprise! Since then it's been a mixed bag. The 1960s, which saw a big tax cut in 1964 but also surreptitious annual tax increases every year as rising inflation pushed taxpayers into higher brackets (the 1981 tax bill ended this by indexing brackets to inflation), were big for revenue growth. But during the 1970s those inflation-induced tax hikes were even bigger, and revenue growth slowed. I wouldn't make too much of the contrast between the 2000s and the 2010s -- having the worst recession in 75 years hit its low point two months before the start of the 2010 fiscal year skews the numbers a bit. But it is probably not entirely a coincidence that the two decades that started out with big Republican-led income tax cuts were also among the decades with the slowest growth in income tax revenue. Again, that's why they're called tax cuts.