Seven Myths About the GOP Tax Reform

John Carney

December 4, 2017

After a decade of economic contraction and listless growth, Americans demanded a new set of policies that would "make America great again." And Republicans responded by passing a dramatic overhaul to the tax code that aims to break the hold of what liberal economists call "secular stagnation."

The passage of the bill was greeted by the unedifying spectacle of the Democratic opposition, many in the mainstream media, and many leading economists joining to mislead the public about the Republican tax proposals. It played out almost as a Shakespearean play-within-a-play. But instead of Hamlet's production of a play about the assassination of a king, we saw the blue-checkmarks of economics and budgets performing a miniature version of the resistance-without-regard-for-truth that has been performed by America's orthodox elites ever since Donald Trump's election.

Many of the reports about the tax plan, however, are demonstrably false. Others are not even wrong. Below are the top seven myths that critics of the tax overhaul have put forward–and the evidence that disproves them.

MYTH #1: They're cutting taxes on millionaires while raising them for the middle class and the poor.

FACT: Middle-income Americans are the biggest winners under the tax bill.

Despite the ocean of ink and cloud-stuffing pixels spilled out to prove this point–and the more hyperbolic critics have described the tax bill as "class warfare" against the middle class and the poor–it is obviously wrong. The Senate bill, for example, cuts taxes for every income bracket and slashes the tax bill for nearly all taxpayers. In fact, middle-class Americans would see the largest deductions in their tax bills.

Here are the facts, all according to the nonpartisan Joint Committee on Taxation.

- *Middle-income Americans win the most.* People earning between $40,000 and $70,000 would see their tax bills falling by 7.1 percent. People with incomes between $20,000 and $30,000 would see a 10.4 percent decline in their tax bills. Millionaires get just a 5.3 percent cut.

- And most middle-income *Americans win.* Eighty-one percent of taxpayers earning between $50,000 and $75,000 get a tax cut under the Senate bill, according to the JCT. For people earning between $75,000 and $100,000, 84 percent get a tax cut. The same with those earning $100,000 to $200,000. Just 80 percent of those earning a million dollars or more get a tax cut.

- *A lot of families will owe no taxes at all.* Most married couples with children earning less than $60,000 per year will have no income tax liability at all. That's because under the Senate bill, the child tax credit rises to $2,000 per child. (Note, this is not from JCT but from the MarketWatch tax calculator.)

- *It's actually the wealthy that disproportionately* pay *higher taxes under the bill.*Very few people would face a tax increase under the Senate bill, and those people are disproportionately wealthy. According to the JCT, just 10 percent of taxpayers earning between $50,000 and $75,0000 will get a tax increase under the Senate bill, largely from the loss of some deductions. That number is actually probably too high, however, because it was done before Senator Susan Collins of Maine proposed an amendment to preserve the deduction for state and local property taxes up to $10,000. For lower levels of income, the numbers are much smaller. In the $20,000 to $30,000 range, for example, just 5.6 percent will see taxes rise. Around 19.2 percent of millionaires, however, will pay more in taxes because of the loss of deductions.

One of the reasons critics of the tax cuts say the bill actually raises taxes on the middle class is that many of the cuts to individual tax cuts are set to expire after 2025 in order to comply with Senate budget rules. And it is true that if those tax cuts were allowed to expire, then taxes would go up for many Americans. But there's no reason to expect Congress will allow the tax cuts to expire, particularly if Republicans keep control of either the House or the Senate. You don't have to take our word for it, though. The New York Times explained all this years ago: temporary tax cuts are typically extended or made permanent.

When opponents of the tax bills say the expiration dates mean the Senate bill hikes taxes on the middle class, they're not telling the truth.

MYTH #2: Tax cuts will blow up the budget deficit.

FACT: Budget deficits depend on economic growth, not tax policy.

Many journalists have demanded that Republicans accept the projections of The Joint Committee of Taxation will result in an additional $1 trillion of federal debt over the next decade. Others site the more conservative Tax Foundation projection of around $500 billion in taxation. But

Republican leaders, including Susan Collins and Majority Leader Mitch McConnell, are right to reject these demands.

The forecasts of budget deficits are not facts–they are forecasts. Senators who refuse to kowtow to them are not denial reality, they are refusing to make policy based on often unreliable projections (which are built on obviously flawed models).

Budgetary projections are notoriously unreliable because of uncertainty over factors such as interest rates, employment, and inflation. "In every year between 1992 and 1999, all forecasters underestimated the two-year growth in economic output," the CBO said in its 2007 assessment of its own forecasts, the forecasts of so-called Blue Chip economists, and those of the executive branch. "Between 2004 and 2006, all three forecasters expectations for real output growth proved too optimistic; however, the errors in the Administration's forecasts and the Blue Chip consensus were smaller than those in the forecasts that the CBO made during those years." Longer term forecasts, such as those that look out five years or more, have often been way off base due to unexpected shifts in productivity. "Five year forecasts of the growth of real GDP made between 1991 and 1999 were too pessimistic. On average, actual growth exceeded all three forecasts' projections of growth by more than a percentage point. Those errors largely resulted from the investment boom of the late 199s," the CBO reported.

In the following period, from 2000 to 2003, the CBO and other forecasters went the other way: overestimating the five-year average growth. And in almost every period, the CBO over-estimates long-term interest rates because it always assumes that interest rates will move back to "historical levels" and that higher deficits lead to higher interest rates. Both these assumptions are wrong. Long-term interest rates have been in decline since the early 1980s and rising budget deficits–even the enormous rise we witnessed following the financial crisis–have been accompanied by falling long-term rates.

The budget deficit is largely a function of economic performance, which is uncertain. When the economy booms, budget deficits tend to be lower because government safety-net expenditures are lower and revenue from taxes on profits and income rises. When economic growth is slow or the economy contracts, budget deficits tend to be higher.

The budget forecasts, however, are largely a function of historical economic performance. When growth has been good, the forecasts are too optimistic. When it has been bad, they're too pessimistic.

We do not even have to look back to ancient history to see forecast errors by the official budget trackers. In 2016, the CBO said the United States economy would grow by 2.7 percent and the yield on 10-year Treasuries would be 2.8 percent. Instead, the economy grew by a paltry 1.6 percent and the 10-year averaged 1.84 percent for the year, never rising above 2.5 percent.
In fact, the CBO budget projections outside of just a two year window are no better than randomly throwing darts and the longer term projections can be changed by small changes to assumptions about interest rates and productivity. This does not mean we should not have a CBO or a JCT. It's valuable to have projections and over time these can become more accurate. But it

means that journalists should not cite the forecasts as if they were facts. Or pour scorn on political figures who refuse to accept the forecast.

In this case, Republican leaders have very good reason to doubt the official forecasts. First, the projections claim that there will be little to no additional growth from the tax cuts. That claim depends on the assumption that the Federal Reserve will push back against growth by raising rates. Second, the projections appear to make the error of simply assuming that weak productivity and investment trends of the past decade continue–the same mistake of fighting the last war that the official forecasts make time and time again. Third, a small upside deviation from the projection–increased growth of just 0.4 percentage points higher–would erase the projected deficit.

To put it differently, if the official projections are too low by a full percentage point–as they were back in the late 1990s–we will be worried about what to do with our mounting budget surplus.

Finally, on a more technical note, the $1 trillion budget deficit forecast is an artifact of the law rather than reality. It assumes that nearly $500 billion in expiring tax cuts would be allowed to expire if not for this bill. But that's unlikely or at least unknown. So the actual amount of revenue lost because of these particular tax cuts is overestimated.

MYTH #3: Millions will lose health insurance.

FACT: Ending the Individual Mandate does not take insurance away from anyone or make insurance unaffordable.

The Senate bill removes the Obamacare individual mandate. According to the Congressional Budget Office, this means that 13 million additional Americans will be uninsured in 10 years than would be if the mandate stayed in place. The overwhelming majority of these people do not lose insurance, however, they simply do not buy insurance because they are no longer forced to buy insurance.

Ironically, the CBO even said that these people would be losers under the tax cuts because they would lose the benefit of the subsidies for health insurance. That's not because they cannot get the subsidies–the bills do not cut those at all. In fact, they will likely lead to increases in the subsidies. It's because people who do not buy insurance do not get the subsidies for buying insurance. Saying they "lose out" is like saying I lost $20 because I didn't buy a $100 television on Black Friday when they were 20 percent off. Sure, I didn't get the sale but I have an extra $80 in my pocket and do not own a television I did not need.

There is a risk that premiums could rise somewhat when those freed from the mandate leave the individual market. But Senator Susan Collins and others have received assurance from Republican leaders that they will dedicate more funding to subsidize these markets to prevent premiums from rising.

MYTH #4: Social Security, Medicare, and the social safety-net will get defunded because we cut taxes.

FACT: Tax cuts do not mean any spending falls.

Nothing in the tax bill touches entitlements or the social safety net. When people make this claim, they are making an elementary mistake of assuming that a government that collects less in taxes will have to spend less. That's simply not true. In fact, when revenue fell unexpectedly because of the Great Recession, government spending rose. It was simply funded by borrowing more from investors whose demand for Treasury bonds was climbing dramatically.

The underlying theory here is that government can be deprived of revenue and that this tames its spending. At one time, conservatives who wanted to cut government spending actually advocated this as a tactic to try to "starve the beast." But that's not the way the government works.
As William Niskanen of the Cato Institute wrote in a 2006 paper:

Orthodox price theory, of which Friedman and Becker are among the leading exponents, is unambiguous in concluding that reducing the price of a good or service increases the amount demanded. Reducing the current tax burden of federal spending has much the same effect as a price control, increasing the amount demanded relative to that supplied from current revenues, an effect that Friedman and Becker have consistently and correctly opposed in private markets.
In other words, tax cuts make government seem cheap. So the people's representatives vote to give us more of it.

Liberal economists agree. Peter Orszag and William Gale found in in a 2004 paper critical of the Bush tax cuts:

"The 'starve the beast' strategy may simply not work as a political equilibrium. We have in mind that policy-makers jointly go through periods of fiscal restraint and fiscal largesse, and the restraint or largesse occurs simultaneously on both the tax and spending sides. That is, periods of fiscal largesse tend to generate declines in taxes and increases in spending (as shares of gross domestic product). Periods of fiscal discipline tend to provide declines in spending and increases in taxes."

And since the budget deficit is likely to be lower than projected, even if this theory were right there's no reason to think it requires spending cuts.

MYTH #5: The bill creates a tax break for private jets.

FACT: The bill simply codifies the existing taxes on jets.

For this one, let's just let the New York Times tell the story:

It may look like a giveaway to rich people who own their own private jets. But the aviation industry and legislators, including a liberal Democratic senator who helped inspire the provision, said it only reinforces the status quo.

And the provision, part of the Senate Republicans' tax plan under consideration this week, is expected by one tally to cost federal coffers $500,000 over 10 years, an infinitesimally small amount in congressional bookkeeping.

The New York Times goes on to explain that the provision in this bill closely mirrors a bill introduced earlier by Ohio's liberal Democrat Senator Sherrod Brown.

MYTH #6: The bill takes money away from schools and teachers.

FACT: The Senate bill expands the deduction for teachers and increases funding for schools

This is one you may have seen on Facebook, where it is making the rounds and confusing a lot of people.

- *The Senate bill expands the deductibility of classroom expenses for teachers.* While the earlier House bill did eliminate the $250 deduction teachers can take for classroom expenses, the Senate bill expands it to $500. In truth, however, even the House bill makes most teachers better off because the the doubling of the standard deduction far outweighs the loss of the income adjustment from the teacher's expense.

- *The Senate and House bills provide for increased school funding.* An amendment introduced by Ted Cruz, the Texas Republican, would allow parents to use a special tax-free college savings program called a "529 account" to pay for kindergarten through high school. That's likely to prompt more parents to use the program and increase overall funding for education in the United States. The House bill has a similar provision.

- *Senator Collins' property tax provision restores school funding.* A lot of the worries about school funding stem from concerns that ending the state and local tax exemption would lead state residents to demand cuts to taxes that fund schools. That was never likely to begin with because parents strongly value effective schools and the education lobby is expert at defending school budgets. Now, however, that scenario is nothing but a fantasy because Senator Collins secured an amendment to the Senate bill that protected the deduction for property taxes, which are the primary taxes that fund schools.

MYTH #7: The bills will bankrupt graduate students and hurt people with college debt.

FACT: The higher standard deduction makes the student loan deduction irrelevant, and grad students will likely benefit from the change in the way tuition is charged.

The House bill would repeal the tax deduction for student loan interest, while the Senate bill leaves that intact. It's unlikely that any taxpayer with student loans would be worse off under the House bill than current law because the standard deduction is so much higher. Of course, they'll be better off under the Senate bill where they get both.

The House bill also contained a provision that would tax tuition waivers, which prompted alarm from a lot of graduate students. That's gone in the Senate bill, which keeps the waived tuition tax-free. But the alarm was never justified. The current (ridiculous) system has colleges charge tuition that they then waive. Why go through this circular process? Because in many cases the colleges use grants from government and other institutions to pay for the tuition. So they create fictional tuition charges that they never intended to charge in order to secure grant money, which is income for the college.

If this fictional tuition charge were taxed, the colleges would risk losing many of their graduate students because the degree would become unaffordable. The most likely result is that colleges would simply end the fiction and cancel tuition. Grant funding would have to be done on a new basis instead of pretending the grad students were being charged tuition.