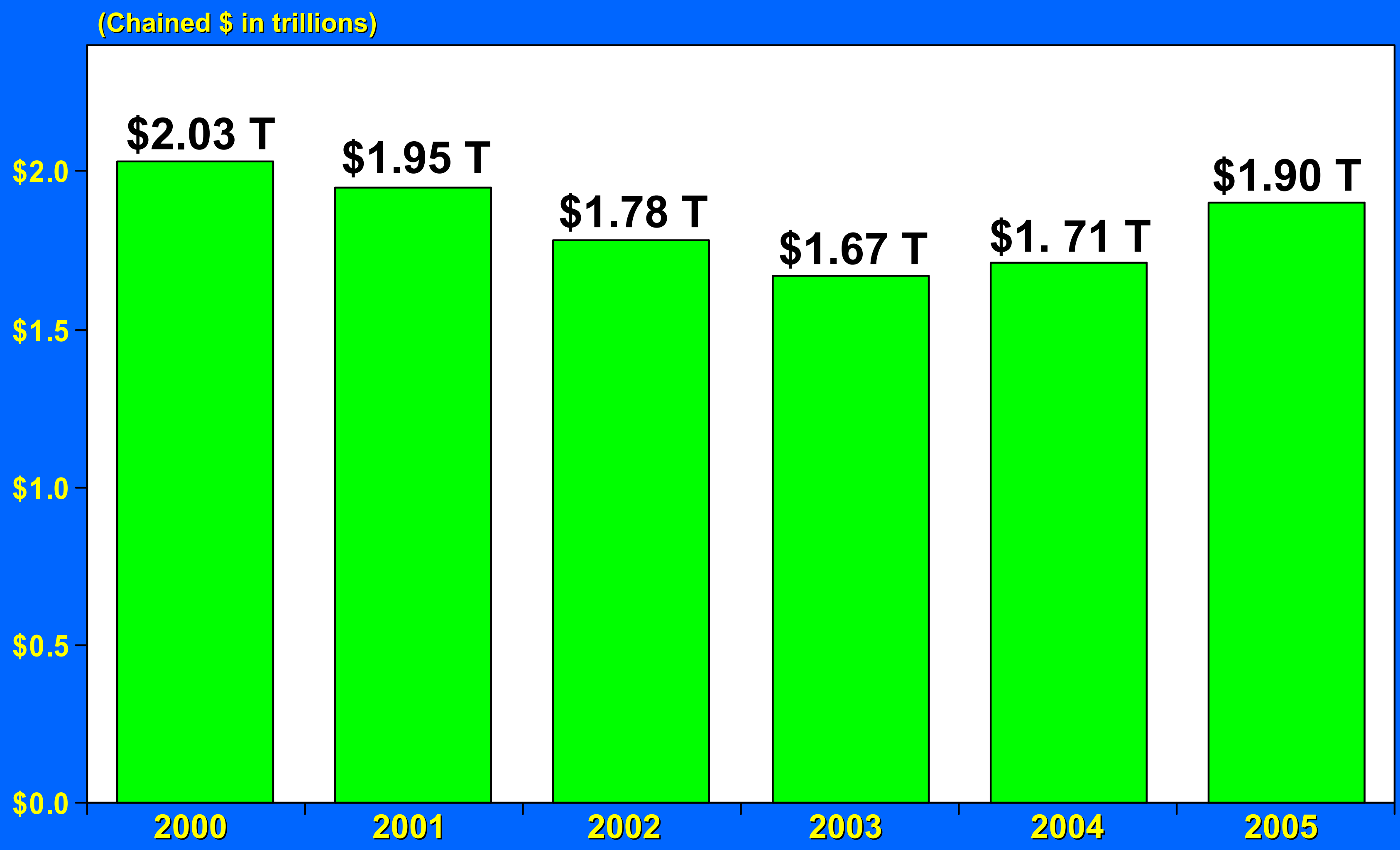
President Bush Claims Tax Cuts Generate More Revenue

"You cut taxes, and the tax revenues increase."

– President George W. Bush
Speech to Business and Industry Association of New Hampshire
February 8, 2006

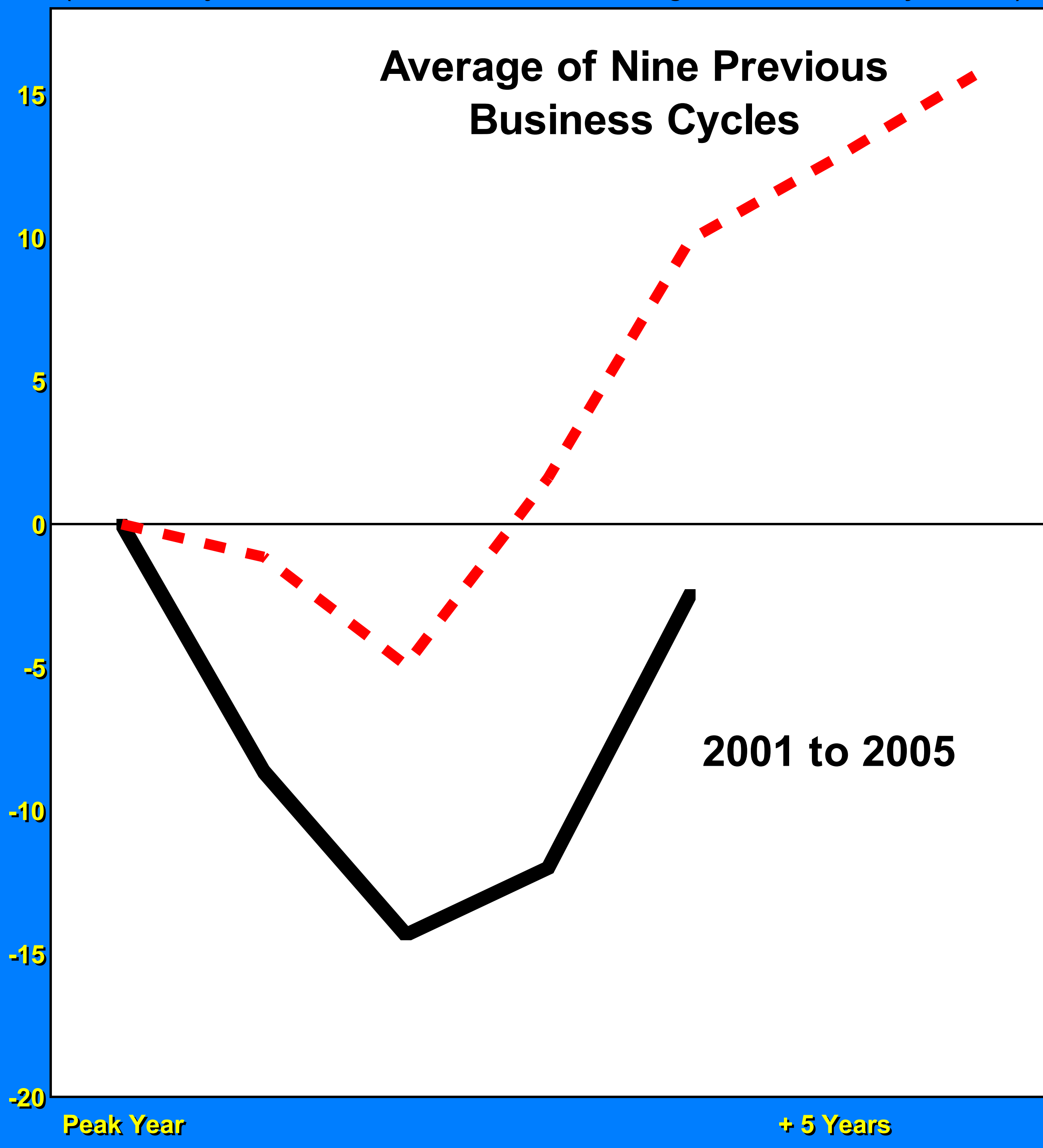
Real Revenues Have Declined 6.3 Percent Since 2000



Source: OMB

Real Federal Revenues Lag Far Behind Typical Recovery

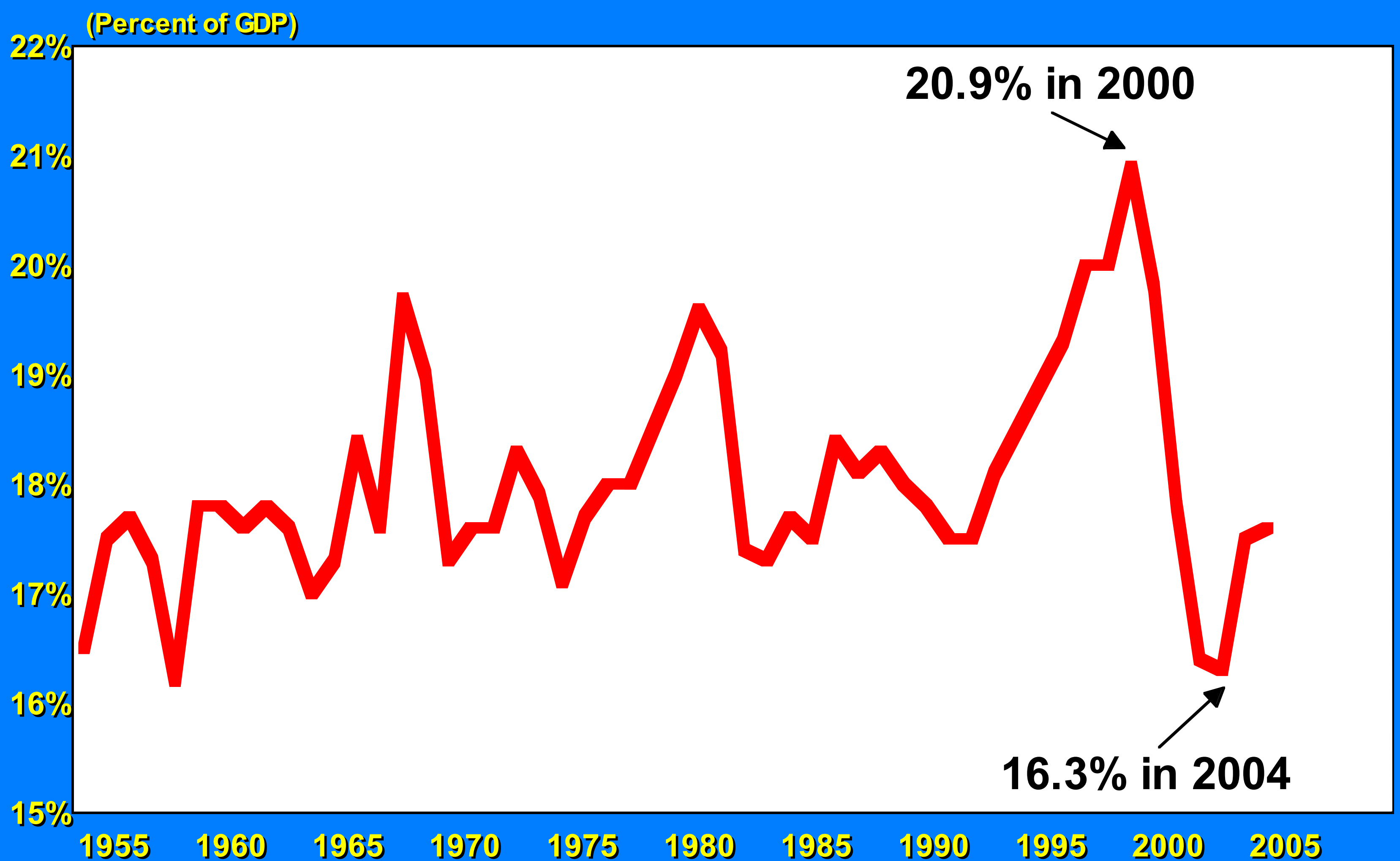
(Inflation-Adjusted Federal Revenues, Percent Change from Business-Cycle Peak)



Source: OMB, President's Budget for FY 2007, Historical Table 1.3

Revenues as a Percent of GDP

2004 Level is Lowest Since 1959



Source: CBO, OMB

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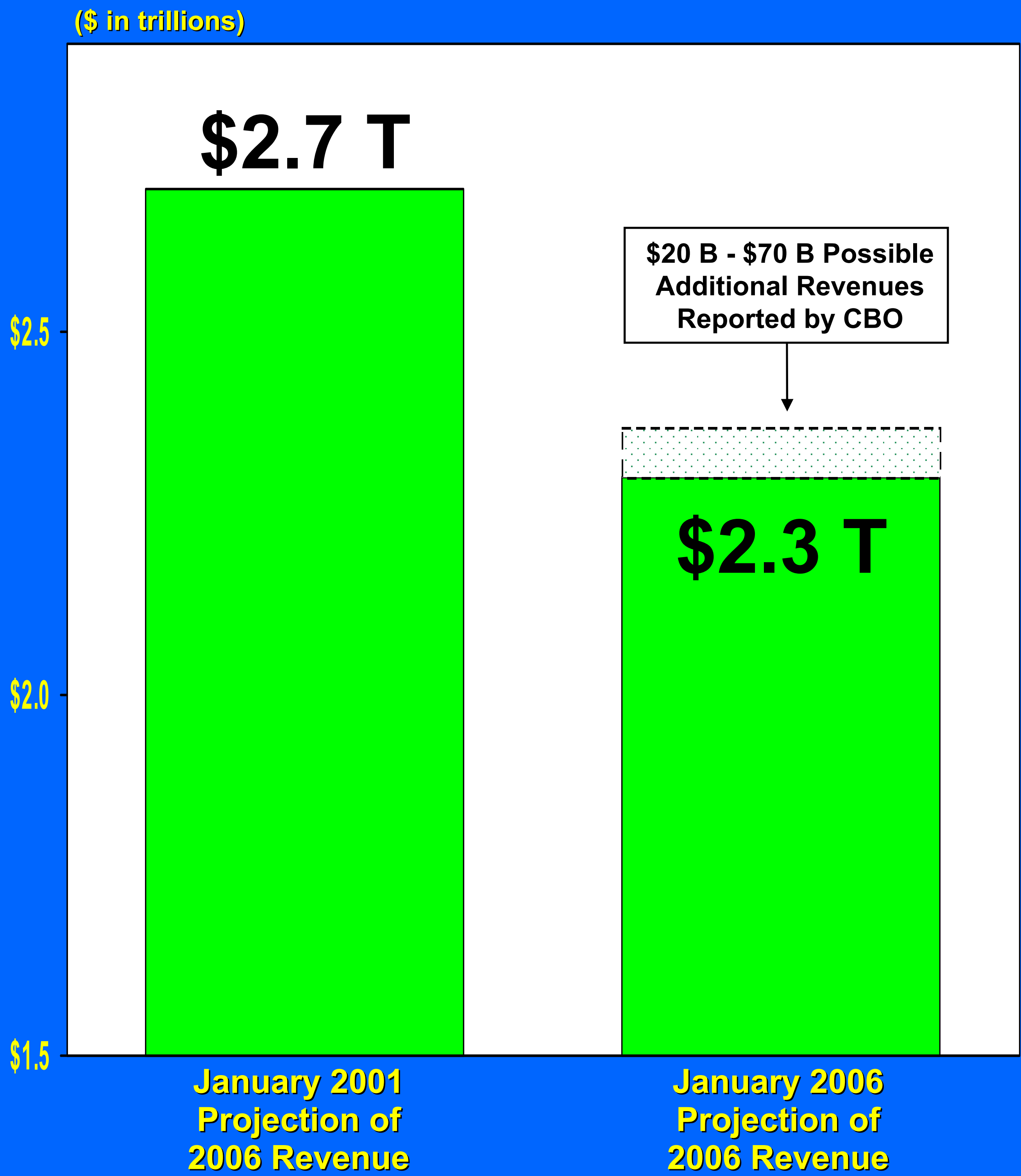
Revenues in 2006 Still Far Below Earlier Projections



Source: CBO

Former Federal Reserve Chairman Greenspan Rejects Claims That Tax Cuts Will Pay For Themselves

"It is very rare and very few economists believe that you can cut taxes and you will get the same amount of revenues."

– Former Federal Reserve Chairman
Alan Greenspan
Testimony before House Budget Committee
September 8, 2004

Fed Chairman Bernanke Believes Tax Cuts Do Not Pay for Themselves

"I don't think that, as a general rule, that tax cuts pay for themselves."

–Federal Reserve Chairman Ben Bernanke
Testimony before Joint Economic Committee
April 27, 2006

OMB Director Nominee Portman Believes Tax Cuts Do Not Pay For Themselves

"As a general matter, most tax cuts do not pay for themselves."

— OMB Director Nominee Rob Portman
Written Response to Questions Submitted Prior to Senate Budget Committee Nomination Hearing
May 10, 2006

Former Chairman of Bush Council of Economic Advisers Believes Tax Cuts Do Not Pay For Themselves

"[There is] no credible evidence that tax revenues ... rise in the face of lower tax rates."

"[An economist claiming tax cuts pay for themselves is like a] snake oil salesman who is trying to sell a miracle cure."

– Former Chairman of President's Council of Economic Advisers N. Gregory Mankiw
Introductory college economics textbook, "Principles of Economics," 1998

The Washington Post

Monday, May 15, 2006

Sebastian Mallaby

The Return Of Voodoo Economics

Republicans Ignore Their Experts on The Cost of Tax Cuts

Nobody serious believes that tax cuts pay for themselves, as I noted last week. But most senior Republicans flunk this test of seriousness.

In January, George W. Bush declared that, "by cutting the taxes on the American people, this economy is strong, and the overall tax revenues have hit at record levels." Regrettably, this endorsement of what his dad called voodoo economics was not a one-time oversight. The next month, Bush told a New Hampshire audience, "You cut taxes and the tax revenues increase."

Bush is not alone in this. Dick Cheney, allegedly a serious person, asserted in February that the "tax cuts have translated into higher federal revenues."

Bill Frist is sometimes taken seriously, not least by himself. And yet the Republican Senate leader is capable of saying: "Many people in Washington have long known a dirty little secret about tax-cut measures: When done right, they actually result in more money for the government."

Chuck Grassley chairs the Senate Finance Committee and ought to know about this stuff. But he mouths the following nonsense: "There is a mindset in both branches of government that if you reduce taxes you have a net loss, if you increase taxes you have a net gain, and history does not show that relationship."

And just last week Sen. Rick Santorum (R-Pa.) celebrated the extension of the Bush tax cuts by saying, "We've put these tax provisions in place and they've raised money."

Okay, so let's review this issue with the help of some experts. I'd like to cite Richard Kogan of the Center on Budget and Policy Priorities, because his work inspired this column. But to win over reasonable conservatives, I'm going to choose N. Gregory Mankiw of Harvard, a proponent of tax cuts who chaired the Council of Economic Advisers in the Bush White House. Mankiw is a top-notch economist hired by Bush and Cheney to advise them. And last year he published a paper on how far tax cuts pay for themselves, reporting enthusiastically that this self-financing effect is "surprisingly large."

How large, exactly? Mankiw reckons that over the long run (the long run being generous to his argument), cuts on capital taxes generate enough extra growth to pay for half of the lost revenue. *Hello, Mr. President, that means that the other half of the lost revenue translates into bigger deficits.* Mankiw also calculates that the comparable figure for cuts in taxes on wages is 17 percent. *Yes, Mr. President, that means every $1 trillion in tax cuts is going to add $830 billion to the national debt.*

Let's engage in what Bush might call the soft bigotry of low expectations and cut Republicans some slack. Hey, maybe they just overlooked that Mankiw paper? Or maybe, despite hiring Mankiw to head the Council of Economic Advisers, they later acquired reasons to doubt his judgment? In that case they should at least have listened to Douglas Holtz-Eakin, another conservative economist who worked in the Bush White House and who went on to run the Congressional Budget Office.

In a study published under Holtz-Eakin's direction last December, the CBO estimated the extent to which a 10 percent reduction in personal taxes might pay for itself. The conclusions confirm that the free-lunch mantra is just plain wrong. On the most optimistic assumptions it could muster, the CBO found that tax cuts would stimulate enough economic growth to replace 22 percent of lost revenue in the first five years and 32 percent in the second five. On pessimistic assumptions, the growth effects of tax cuts did nothing to offset revenue loss.

So Mankiw isn't with them. Holtz-Eakin isn't with them. Which raises a question: When top Republicans go around claiming that tax cuts pay for themselves, which economic authorities are they relying on? None, is the answer. These people's approach to government is to make economics up.

The Republicans' only argument is that tax receipts have boomed in the years since the 2003 tax cut. But the question is whether tax receipts increased because the tax cuts worked some kind of magic or because the economy was headed up anyway after the recession, thanks maybe to low interest rates resulting from the Asian savings glut. Friends, the reason we have economists is so that they can solve these puzzles for us. Ignoring their solutions is like ignoring the judgment of medical science in favor of faith healers and quacks.

Politicians are always speechifying about how the United States must lead the world in research to maintain its edge. But having the world's best economics research isn't particularly helpful if those same politicians are silly enough to tune it out. The truth is that American business excels at turning university research into world-beating products; the paranoia on this score is overdone. But American government is often lousy at turning research into policies. That's what we should fret about.

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Former CBO Director Dan Crippen Rejects Use of Dynamic Scoring

"CBO does not believe that 'dynamic scoring' by it and JCT, incorporating the macroeconomic effects of legislative changes into the process of estimating a bill's cost, would improve the analysis provided to the Congress. There is no objective way that Congressional staff can make assumptions about the actions of current and future Congresses, about public expectations of those actions, or about future monetary policy. Such assumptions would drive results and undermine their credibility. Favorable estimates would be sought for spending programs as well as for tax provisions. The current process may be far from perfect, but it is also far better than one that would require dynamic scoring."

–Former CBO Director Dan Crippen
Testimony before the House Budget Committee
May 2, 2002