Executive Summary

Among the most persistent of political myths is the assumption that the 1981 Reagan "supply-side" tax rate reductions caused the massive and persistent federal budget deficits of the 1980s.

In reality, out-of-control deficits were created when Congress dramatically increased government spending after the 1981 tax cuts.

"In reality, out-of-control deficits were created when Congress dramatically increased government spending after the 1981 tax cuts."

Here's why. In 1980, the Congressional Budget Office (CBO) projected cumulative budget surpluses of $578 billion over the five-year period, 1981-1985. The 1981 tax cuts did little more than offset these expected budget surpluses. Had spending been restrained to increase just fast enough to keep entitlement spending in line with inflation and demographic changes, the budget would have been in balance in 1985. In fact, by 1985, the 1981 tax cuts contributed absolutely nothing to the deficit. *The entire deficit by 1985 was a product of drastically increased spending.*

Rather than the 1981 tax cuts, it was the sudden collapse of Jimmy Carter's inflation and dramatic increases in federal spending that sparked the deficit explosion. **In other words, it is not even necessary to demonstrate that supply-side economics worked as advertised to prove that the origins and persistence of federal budget deficits since 1980 are not attributable to the 1981 tax cuts.**

After 1983, the Reagan tax cuts worked as advertised, and the economy began to grow robustly. By 1989, when Ronald Reagan left office after "seven fat years" of economic prosperity, the deficit was back down to 2.9 percent of GDP, almost exactly the same share as the day he assumed office in 1981 (2.7 percent).

To understand, one must begin with CBO's 1980 revenue and spending baselines. The supply-side critics stubbornly cling to the 1980 revenue baseline as the appropriate benchmark, but the assumptions that underlay it and the tax law in effect in 1980 were economically and politically unsustainable.

"…when Ronald Reagan left office, the deficit was back down to 2.9 percent of GDP, almost exactly the same share as the day he assumed office in 1981."

CBO assumed that the economy would grow between 1982 and 1985 at 3.8 percent, a rate "slightly higher than the postwar average." CBO offered no plausible explanation for how the staggering economy would shake off stagflation and zoom to above-average rates of growth.

The 1980 CBO revenue baseline was politically dubious as well. CBO itself acknowledged that revenue from income taxes was projected to grow to the highest levels in history, and was well outside the range that American voters and Congress would tolerate.

The key to the success of the supply-side critics was their ability to establish a growth path for revenues similar to the 1980 CBO baseline. The deficit was attributed to the so-called "revenue shortfall" from this economically questionable and politically preposterous baseline.

Defense spending is also targeted by the critics. A complete defense build-up, along with limiting entitlement spending to inflation and demographic changes, would have cut deficits in half through 1985, and the budget would have come into balance by the end of the decade.

Based on this myth that the 1981 tax cuts were responsible for large persistent federal deficits, more than 500 economists signed their name to a statement opposing 1996 Republican Presidential challenger Robert Dole's proposed 15 percent across-the-board tax rate reductions. They were all wrong.

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On the Origins and Persistence of Federal Budget Deficits Since 1980

By Lawrence A. Hunter

In 1981, President Ronald Reagan signed into law a sweeping package of "supply-side" tax rate reductions designed to reverse the "stagflation" (simultaneous inflation and economic stagnation) inherited from President Carter. The tax cuts were to be phased in through 1983.

Almost immediately, the political opponents of Ronald Reagan and the intellectual foes of supply-side economics began a relentless propaganda campaign to discredit supply-side policies and the Reagan economic program. There were two basic lines of attack. The first thrust was to deny that there were any beneficial effects of supply-side policies or to insist that these benefits were vastly overstated. Critics contended that tax policy did not have the broad, powerful effects on economic activity claimed by the supply-siders. Some of the critics went so far as to claim that supply side policies were "exactly the opposite" of what was needed. [1]

"In reality, the 1981 tax cuts were 'paid for' in their entirety."

The second, complementary thrust was to blame federal budget deficits on the 1981 tax cuts. This paper refutes this second critique of the Reagan supply-side tax reductions.

After enactment of the 1981 tax cuts, the supply-side critics successfully transformed their propaganda into conventional wisdom inside the Washington beltway, and the Congress was moved within a year to truncate the scheduled tax cuts before they were fully implemented. The effect of the 1982 legislation was to reduce the scheduled tax cuts by slightly more than a quarter. Even after the 1982 reduction in the tax cuts was signed into law, critics of the 1981 supply-side tax rate cuts continued their campaign of disinformation unabated. What began as unfounded conventional wisdom in the 1980s assumed mythical proportions in the 1990s, even among many conservatives—mainly so-called "deficit hawks."

In reality, the 1981 tax cuts were "paid for" in their entirety because they liquidated huge budget surpluses that the unindexed income tax would have produced in their absence under spending laws then in place—budget surpluses that would have emerged even when inflation collapsed after 1982—and they raised economic growth above what it otherwise would have been, recapturing revenues that were destined to evaporate in the more arid fiscal environment of a persistently weak economy. Out-of-control deficits were created when, subsequent to passage of the 1981 tax reductions, Congress dramatically increased government spending.

Background

Before the phase-in of the 1981 income tax cuts began—indeed before Ronald Reagan even took the oath of office—the accumulated weight of high tax rates and extraordinarily tight monetary policy by the Federal Reserve Board had begun to take their toll on the economy and the deficit. "Real," inflation-adjusted economic output declined at an annual rate of 10 percent in the second quarter of 1980, marking it as an official recession year. As a result, between 1979 and 1980, the federal budget deficit jumped by almost two-thirds when measured as a share of output, going from 1.7 percent of gross domestic product (GDP) to 2.8 percent.

Table 1
ACCOUNTING FOR THE 1980s EXPLOSION IN THE FEDERAL BUDGET DEFICIT

[1] Estimated from CBO calendar year numbers because CBO did not publish a Nominal GNP Baseline on a fiscal year basis in 1980.

[2] Includes automatic spending increases for entitlement programs to keep pace with inflation and demographic changes as provided for in 1980 law.

[3] To account for recession and collapse of inflation.

[4] To incorporate reduced revenue due to tax cuts.

[5] Beyond those provided for entitlement programs under 1980 law to keep pace with inflation and demographic changes.

Totals may not add due to rounding.

Sources: Congressional Budget Office, Office of Management and Budget, Economic Report of the President.

ACCOUNTING FOR THE 1980s EXPLOSION IN THE FEDERAL BUDGET DEFICIT

Year-by-Year Analysis (billions of dollars)	Actual	Projections Base Year - 1980						5-Year Total	Cumulative Surplus/Deficit(-)	
									Total	Change
	1979	1980	1981	1982	1983	1984	1985	1981-1985	1981-1985	1981-1985
CBO, February 1980 Baselines										
Nominal GNP Baseline - Fiscal Year[1]		$2,498	$2,787	$3,183	$3,522	$3,959	$4,458			
Revenue Baseline		$516	$582	$678	$781	$905	$1,053	$3,999		
Outlay Baseline[2]		$560	$603	$648	$685	$722	$763	$3,421		
1980 Surplus/Deficit (-) Baseline		**-$44**	**-$21**	**$30**	**$96**	**$183**	**$290**		**$578**	
Baseline Updates[3]										
Actual Nominal GNP - Fiscal Year	$2,448	$2,671	$2,986	$3,139	$3,322	$3,688	$3,952			
Updated 1980 Revenue Baseline		$551	$638	$680	$731	$832	$905	$3,785		-$214
Updated 1980 Outlay Baseline		$563	$592	$621	$658	$696	$734	$3,301		$120
Updated 1980 Surplus/Deficit(-) Baseline		-$12	$46	$60	$73	$135	$171		$484	-$94
Actual Revenues	$463	$517	$599	$618	$601	$666	$734			
Reduction in Revenue Attributable to 1981 Tax Cuts	$0	$0	$39	$62	$130	$165	$172	$568		
Adjusted Surplus/Deficit(-) Baseline[4]		**-$12**	**$7**	**-$3**	**-$57**	**-$30**	**-$1**		**-$84**	
Actual Outlays	$504	$591	$678	$746	$808	$852	$946			
Spending Increases[5]		**$28**	**$86**	**$125**	**$151**	**$156**	**$212**	**$730**	**-$813**	**$730**
Defense Spending		$3	$21	$44	$67	$82	$106	$320		
Non-Defense Spending		$25	$65	$81	$84	$74	$106	$410		
Actual Deficits	**-$41**	**-$74**	**-$79**	**-$128**	**-$208**	**-$185**	**-$212**	**-$813**	**-$813**	
Sources of Deficit										
Tax Cuts		0.0%	-8.7%	2.2%	27.4%	16.1%	0.5%	10.3%		
Spending Increases:		100.0%	108.7%	97.8%	72.6%	83.9%	99.5%	89.8%		
Defense Spending		10.7%	24.5%	35.2%	44.4%	52.7%	49.9%	39.4%		
Non-Defense Spending		89.3%	75.5%	64.8%	55.6%	47.3%	50.1%	50.4%		

Inflation-adjusted output continued to shrink in five of the next eight quarters so that by the end of 1982, the real economy was a full three percent smaller than the day Ronald Reagan assumed office. Not surprisingly, the federal budget deficit continued to balloon as the recession rolled on, jumping another 75 percent between 1980 and 1982, from $73.4 billion to $128 billion.

By 1983, the deficit had quadrupled over the level in 1979, hitting $208 billion, or 6.3 percent of GDP. The 1983 deficit was larger relative to the total economy than any deficit had been since 1947 and, as it turned out later, larger than at any time since then. Supply-side critics blame this explosion in the budget deficit on the 1981 tax cuts. In fact, barely more than one-quarter of the deficit eruption in 1983 was caused by the Reagan supply-side tax rate reductions, and virtually none of the persistent follow-on deficits in subsequent years resulted from the Reagan tax cuts. In order to see this fact clearly, one must take as a vantage point the year before the Reagan tax cuts were enacted.

The View From 1980

In 1980, the Congressional Budget Office (CBO) projected that the federal budget would be $96 billion in surplus in 1983 if Congress did not cut taxes, but did permit provisions already in law to increase entitlement spending sufficiently to compensate for inflation and the "natural" growth of beneficiaries caused by demographic changes.[2] [See row 5 in Table 1 labeled *"1980 Surplus/Deficit(-) Baseline."*] Over the five-year period, 1981-1985, CBO was projecting cumulative budget surpluses of $578 billion, or 3.2 percent of GNP.

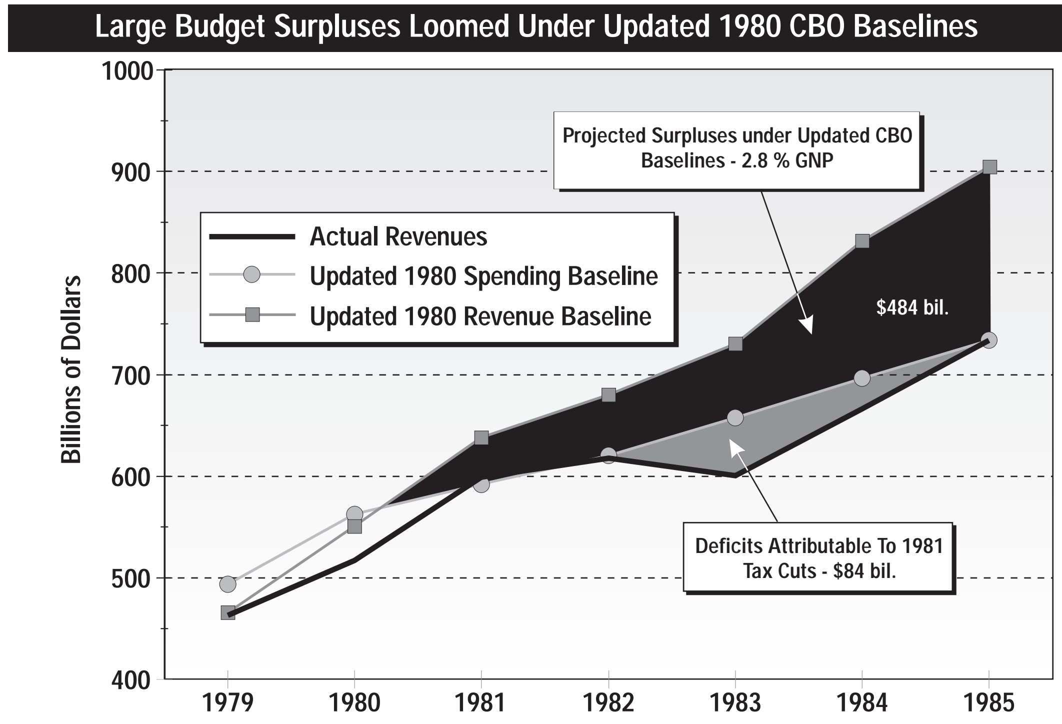
By 1983, the phase-in of the tax rate reductions was almost complete. Not only had the recessionary economy shrunk during the preceding three years of recession, but inflation also had collapsed, falling more than five percentage points beneath the rate CBO had forecasted for 1983 inflation just three years earlier. As a result of these two factors alone—recession and reduced inflation—1983 revenues under pre-1981 tax law would have fallen $50 billion short of the revenue projections CBO made in 1980. [Compare row 3 in Table 1 labeled "*Revenue Baseline*" to row 8 labeled "*Updated 1980 Revenue Baseline.*"] From 1983 to 1985, updated baseline revenues under pre-1981 tax rates would have been reduced from CBO's original estimate by a total of $271 billion due exclusively to the recession and lower inflation.[3]

"… the updated CBO baselines reveal that under pre-1981 law, huge budget surpluses still would have persisted as far as the eye could see under pre-1981 tax rates."

The important fact to note is that even though the size of the economy was some 1.2 percent smaller in 1983 than anticipated in 1980, and even though inflation collapsed thereafter, the updated CBO baselines reveal that under pre-1981 law, huge budget surpluses still would have persisted as far as the eye could see under pre-1981 tax rates. [See Figure 1.] And as Table 1 makes clear, the 1981 tax cuts did little more than offset the expected budget surpluses, even after adjusting the pre-tax-cut revenue baseline to account for a smaller economy and lower inflation. Had spending been restrained to increase just fast enough to keep entitlement spending in line with inflation and demographic changes, the budget would have been in balance in 1985. [Compare row 12 in Table 1 labeled "*Reduction in Revenue Attributable to 1981 Tax Cuts*" to row 10 labeled "*Updated 1980 Surplus/Deficit(-) Baseline.*")

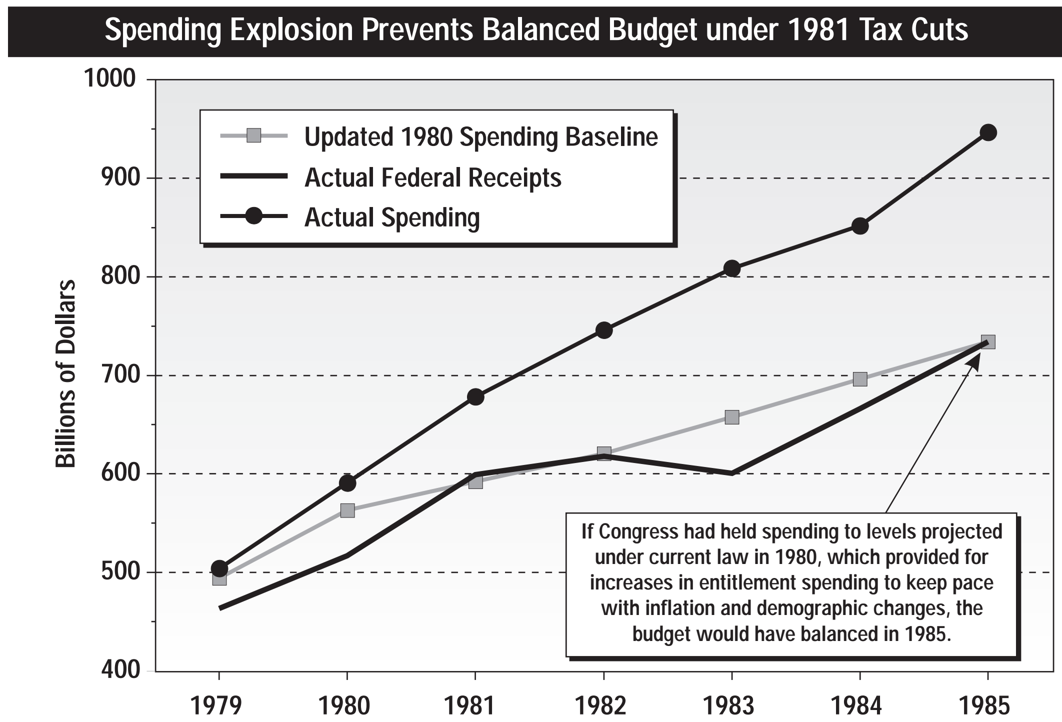
During 1981-1985, the nation would experience cumulative budget deficits amounting to $813 billion, of which only about $84 billion, or 10 percent, could be attributed to the 1981 tax cuts. And even this effect was short-lived, coming mainly in 1983 and 1984, before the cumulative growth-enhancing effects of the tax cuts began to compensate in part for the tax rate reductions. In fact, by 1985, the 1981 tax cuts contributed absolutely nothing to the deficit. *The entire deficit by 1985 was a product of drastically increased spending.* [See Figure 2.]

Figure 1
Large Budget Surpluses Loomed Under Updated 1980 CBO Baselines



After the 1981 tax cuts were enacted, spending increases shot above and beyond levels already provided for in law to accommodate inflation and demographic changes. In 1983, the deficit hit $208 billion, or 6 percent of GNP. Between 1981 and 1985, Congress accelerated the rate of spending growth well above what was justified by a falling inflation rate or demographic changes. In 1983, federal outlays were a staggering $151 billion higher than they would have been if entitlement spending had merely kept pace with inflation and demographic changes since 1980, of which about 44 percent was for rebuilding the nation's defenses. [See row 15 in Table 1 labeled "*Spending Increases…"*] In short, even after taking into account a smaller economy, less inflation and the full impact of

Figure 2
Spending Explosion Prevents Balanced Budget under 1981 Tax Cuts



the 1981 tax cuts, the 1983 deficit would have been less than $60 billion, or 1.7 percent of GNP, had spending not accelerated. [See row 13 in Table 1 labeled *"Adjusted Surplus/Deficit(-)…"*]

The year-by-year analysis in Table 1 is based on the very conservative and unrealistic assumption that the 1981 tax cuts had absolutely no stimulative effect on economic growth. For example, in updating CBO's 1980 revenue and spending baselines, CBO's 1980 economic assumptions on economic growth and inflation were replaced with actual values. No attempt was made to estimate how much of the improvement in economic growth and inflation were attributable to the 1981 tax cuts and thus not appropriately reflected in an update of the 1980 baselines. Instead, the updates of 1980 baselines assume that the economy would have performed equally well with or without the tax cuts.

"It was the sudden collapse of Jimmy Carter's inflation and dramatic increases in federal spending that sparked the deficit explosion between 1979 and 1983."

The effect of this presumption is to artificially inflate the update of CBO's 1980 revenue baseline and artificially exaggerate the difference between it and the revenues actually generated under the 1981 tax cuts. Therefore, row 12 in Table 1 labeled "*Reduction in Revenue Attributable to 1981 Tax Cuts*" almost certainly overstates the extent to which the tax rate reductions contributed to the deficit.[4] Nevertheless, Table 1 makes it clear that even under the assumption that the tax cuts had absolutely no stimulative effect on economic growth, it was the sudden collapse of Jimmy Carter's inflation and dramatic increases in federal spending that sparked the deficit explosion between 1979 and 1983. I**n other words, it is not even necessary to demonstrate that supply-side economics worked as advertised to prove that the origins and persistence of federal budget deficits since 1980 are not attributable to the 1981 tax cuts.**

After 1983, the cumulative effect of the Reagan tax cuts took hold, and the economy (and thus revenues) began to grow robustly. Consequently, the budget deficit began to decline as a share of GDP. By 1989 when Ronald Reagan left office, after "seven fat years" of economic prosperity, the deficit was back down to 2.9 percent of GDP, almost exactly the same share of GDP comprised by the deficit as the day he assumed office in 1981 (2.7 percent).

The Making Of A Myth

> ***"The great enemy of the truth is very often not the lie—deliberate, contrived and dishonest—but the myth—persistent, persuasive and unrealistic."*** *—John F. Kennedy*

An accurate accounting for America's deficit problem must begin with CBO's 1980 revenue and spending baselines contained in its economic and budget report to the Congress.[5] The idea behind the revenue and spending baselines is to give policy makers some notion of what would happen to revenue and expenditure patterns in the future if current tax and spending laws were left unchanged. Baselines are subject to error in part because they are dependent upon the accuracy of the economic assumptions that drive them. In Table 1, this source of error was removed from the baselines by updating them to account for actual economic events. **In other words, the baselines were updated to show what CBO economists would have projected in 1980 if they had possessed perfect economic foresight at the time.**

The roots of the myth that the 1981 tax cuts blew a hole in the federal budget deficit depends upon accepting as realistic the following assumptions that underlie the 1980 baselines:

- That real economic growth would average 3.8 percent a year and annual consumer price inflation would average about 10 percent for the 1980-1985 period without tax cuts.
- That revenues would grow from 20.1 percent of GNP in 1979 to 24 percent of GNP in 1985 without tax cuts.
- That spending under current law would decline to 17.3 percent of GNP in 1985, allowing entitlement spending to keep pace with inflation and demographic changes. At most, spending would comprise 19.9 percent of GNP in 1985 if spending for **all** federal programs were increased to keep pace with inflation and demographic changes.

And, therefore:

- That budget surpluses under current (1980) law would accumulate to $578 billion or 3.2 percent of total GNP for the period 1981-1985, with a single year surplus of $290 billion or 6.5 percent of GNP in 1985. (At a minimum, budget surpluses would accumulate to $416 billion—5.3% GDP—if all federal spending were increased to keep pace with inflation and demographic changes between 1981 and 1985, with a single year surplus of $236 billion—2.3% GDP—in 1985.)

"The 1981 tax cut was right on time and of exactly the right magnitude to keep the unindexed income tax from driving tax burdens to intolerable levels."

The updated baselines are arithmetically accurate estimates of how revenues and expenditures would have unfolded between 1981 and 1985 **if** 1980 law had remained unchanged throughout the period. While the myth-makers stubbornly cling to the revenue baseline as the appropriate benchmark against which to judge the "adequacy" of post-1981 revenues, an examination of the implications of those baselines should drive an objective observer to a quite different conclusion: 1980 tax law was economically and politically unsustainable.

CBO's 1980 revenue baseline is politically and economically dubious (even in its updated version), which makes it totally inappropriate and wholly unrealistic as a benchmark against which to judge the actual growth of revenues under the 1981 tax cuts. To begin with, the economic logic behind CBO's 1980 auto-pilot projection of revenue growth is internally inconsistent. On the one hand, the CBO report acknowledged that "without a tax cut … the increased tax burden under current law would reach an unprecedented level, constituting a significant fiscal drag on the economy," already on the brink of recession by this time. Nevertheless, CBO predicated its revenue projection on the assumption that the economy would grow on an inflation-adjusted basis between 1982 and 1985 at 3.8 percent, a rate "slightly higher than the postwar average."[6]

CBO offered no plausible explanation for the assumption that the staggering economy would spontaneously shake off stagflation and zoom to above-average rates of growth. Moreover, such an assumption was sharply at odds with the prevailing sentiment among supply-side critics at the time. For example, in 1982 Lester Thurow said, "The engines of economic growth have shut down here and across the globe, and they are likely to stay that way for years to come."[7]

The 1980 CBO revenue baseline was politically dubious as well. CBO itself acknowledged that revenue growth projected in its baseline was well outside the range that American voters and the Congress had been willing to tolerate historically. CBO observed that "in the past, the Congress has enacted income tax cuts that have, in fact, offset the effects of inflation on the progressive tax structure, as well as stimulated economic growth." The report noted that

Congress had cut taxes in 1964, 1969, 1971, 1975, 1976, 1977 and 1978. CBO concluded that without a tax cut, tax law then in effect would "significantly increase the tax burden on the average wage earner" and that "individual income taxes would rise to…the highest levels in history."[8]

The key to the success of the myth makers was their ability to establish a growth path for revenues similar to that set forth in the 1980 CBO revenue baseline as the conventional benchmark against which future tax policy must be measured. Thereafter, the "revenue loss" attributed to the 1981 tax cuts would be measured as the difference between actual revenues collected under the tax cuts and this economically questionable and politically preposterous revenue benchmark. The deficit would be attributed to the so-called "revenue shortfall" from this baseline.

"…the federal budget deficit problem resulted because Congress spent too much, not because the American people were taxed too little."

To sum up, the myth that the 1981 tax cuts caused the deficit to get out of control requires a remarkable suspension of disbelief with respect to the American public's willingness to take on higher and higher tax burdens and the economy's ability to prosper under them. The myth requires one to believe that with the economy slumping and tax burdens reaching unprecedented levels, and with inflation constantly pushing people into higher and higher tax brackets, the American people would gladly permit, and the economy would readily accommodate, the accumulation of enormous budget surpluses.

Figure 3 places federal taxing and spending in the 1980s into historical perspective. The solid black line and black squares represent actual federal spending and revenues as a share of GNP from 1960 to 1985. The two solid horizontal lines peg spending and revenue averages between 1960 and 1980—the appropriate benchmarks against which to measure what happened subsequent to the 1981 tax cuts. The dashed gray line and dashed gray line with gray circles represent respectively CBO's projections in 1980 of future spending and revenues. What is wrong with this picture?

Clearly, two anomalies stand out. First, CBO's projected revenues bear absolutely no relationship to the historical level of revenues, which deviate remarkably little around 18.5 percent of GNP. Indeed, post-1980 revenues, after the Reagan tax cut, look perfectly consistent with pre-1980 revenues. Based upon CBO's account of

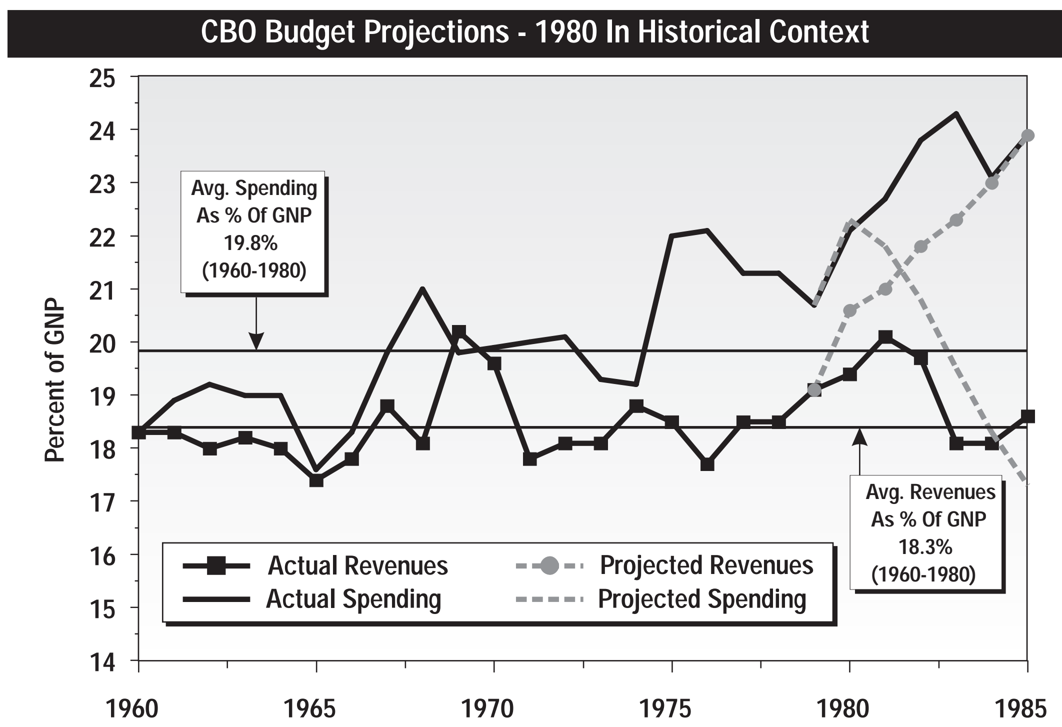


Figure 3
CBO Budget Projections—1980 In Historical Context

Congress' cutting taxes seven times in fourteen years, the 1981 tax cut was right on time and of exactly the right magnitude to keep the unindexed income tax from driving tax burdens to intolerable levels.

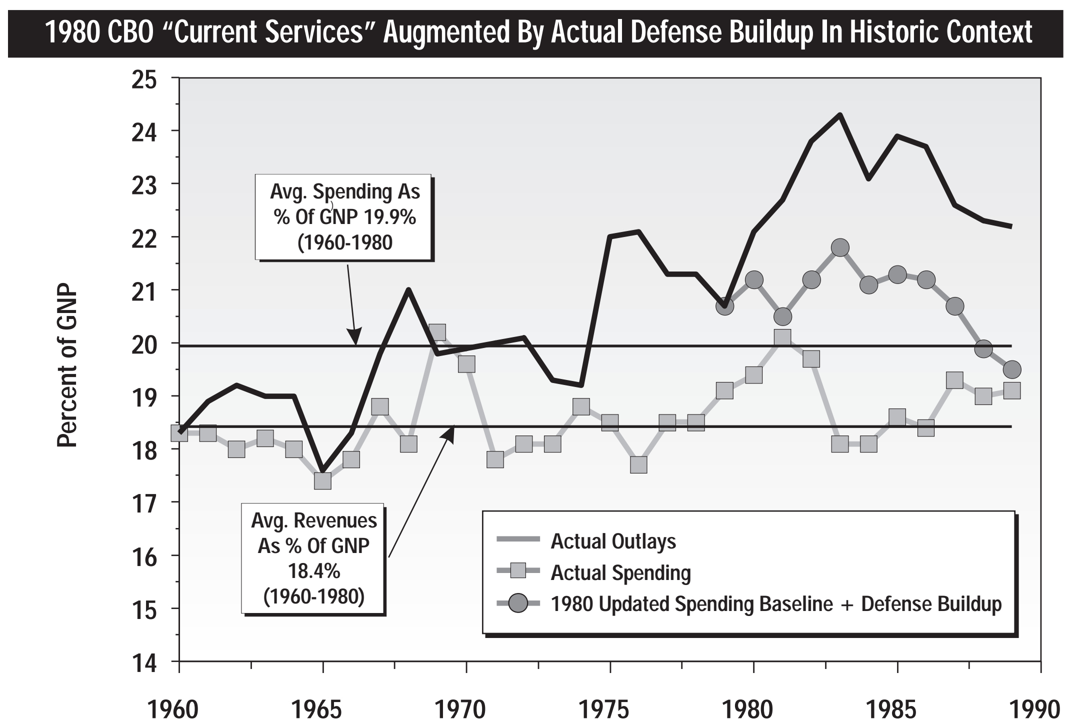
Second, notice how CBO's 1980 projected spending line returns to its historic range and how closely it tracks the historic path of revenues. Actual spending, on the other hand, soars upward after 1980, completely dislodged from its historic range. Instead of declining as a share of the economy as projected if Congress had merely increased entitlement spending to keep pace with inflation and demographic changes, actual spending heads off into the stratosphere. Figure 3 makes it clear that the federal budget deficit problem resulted because Congress spent too much, not because the American people were taxed too little.

What About Defense Spending?

As the confrontation with Communism approached its final denouement in the mid-1980s, the nation underwent a significant military buildup that was not incorporated into CBO's 1980 spending projections. When the critics of supply side economics are confronted with incontrovertible evidence that the 1981 tax cuts did not explode the deficit, they invariably point to this jump in defense spending as the co-villain in the deficit saga. They usually frame the issue as a false choice between cutting taxes and increasing defense spending, asserting that America could not have both and should not have tried. Again, the facts belie these assertions.

Figure 4 depicts what would have happened under the 1981 tax cuts with a complete defense build-up, assuming also that entitlement spending had increased sufficiently to keep pace with inflation and demographic changes. In Figure 4, the heavy solid lined marked by large solid circles traces out a projection of CBO's Updated 1980 Spending Baseline augmented by the defense spending increases that actually took place in 1980-1985 (taken from Table 1). Under this scenario, deficits would have been cut in half through 1985, and the budget would have come into balance by the end of the decade.

Figure 4: 1980 CBO "Current Services" Augmented By Actual Defense Buildup In Historic Context



Conclusion

British author Edward de Bono has observed that “a myth is a fixed way of looking at the world which cannot be destroyed because, looked at through the myth, all evidence supports that myth.” This truth is most aptly illustrated by the myth that the 1981 tax cuts were responsible for large persistent federal budget deficits. On the basis of this myth, more than 500 economists from across the country signed their name to a statement opposing 1996 Republican Presidential challenger Robert Dole’s proposed 15 percent across-the-board tax rate reductions. Referring to the 1981 supply-side tax cuts, their statement said in part:

> “The result [of the 1981 tax cuts] was a spiraling federal deficit and a huge rise in the national debt.…The tax cuts of the early 1980s were appropriately called a ‘riverboat gamble.’ The country lost the wager. Both the debt and the interest payments on it have continued to rise. We appeal to our fellow citizens and our political leaders not to repeat that tragic mistake.”

As the sage is reported to have said, “it’s not what we don’t know that hurts us so much as all those things we know so well that just aren’t true.” Never did a cliche apply to a situation more aptly than to Ronald Reagan’s supply-side tax cuts of 1981.

Endnotes

1 See Bosworth, Barry, *Tax Incentives and Economic Growth*, The Brookings Institution, Washington, D.C., 1984.

2 See The Congressional Budget Office, *Five-Year Budget Projections: Fiscal Years 1981-1985,”* February, 1980. The primary demographic changes to the population that affect federal spending is the faster-than-average growth rate in the over-65 population, which averaged about 2.2 percent a year between 1980 and 1985.

3 CBO’s baselines were updated by estimating what projections CBO would have made in 1980 if its economists had possessed perfect economic foresight. The first step in updating the 1980 revenue baseline was to estimate an ordinary least squares equation using CBO’s forecast of nominal GNP as the independent variable and the CBO revenue projection as the dependent variable. That estimated equation was:

$$(REV_t) = -186.02 + (0.275935)(NGNP_t)$$
$$R^2 = .998;$$
where REV_t = Revenues at time t
$NGNP_t$ = Nominal GNP at time t.

Updated revenue in each year was estimated by substituting the actual value of nominal GNP for that year into the equation and solving for revenues. The 1980 outlay baseline was updated by incrementally increasing each year beyond 1980 those outlays estimated to be subject to automatic increases under 1980 law by a rate equal to 2.2 percent plus the CPI for that year, where it was assumed that the over-65 population grew at an annual rate of 2.2 percent.

4 If the critics of supply-side economics are wrong, and the 1981 tax cuts actually did improve the economy’s performance, then the 1980 revenue baseline even as updated in Table I remains too high. To be precise, it remains too high in direct proportion to the amount by which nominal GNP is overstated by erroneously assuming that the economy would have done just as well under pre-1981 tax rates as it did under the lower, post-1981 rates. For every dollar that the revenue baseline is overstated, the difference between it and actual revenues (i.e., the “revenue loss” attributable to the tax cuts) also is overstated.

5 CBO, op cit.

6 Ibid.

7 *New York Times Magazine*, October 17, 1982.

8 CBO, *op cit.*, Chapter I.

About the Author

Dr. Lawrence A. Hunter is Chief Economist at Empower America. He served as a member of Presidential candidate Bob Dole’s Task Force on Tax Reduction and Tax Reform. During the 103rd and 104th Congresses, Dr. Hunter served on the staff of the Joint Economic Committee, first as Republican Staff Director and later as the Chief Economic Advisor to the Vice Chairman where he was the lead staff person in charge of puffing together the economic growth and tax cut component of the *Contract With America.* Prior to joining the JEC staff in 1993, Dr. Hunter was with the U.S. Chamber of Commerce for five years where he served first as Deputy Chief Economist and later as Chief Economist and Vice President. Dr. Hunter received his Ph.D. from the University of Minnesota in 1981.

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