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Considerations in Dynamic Scoring and Macroeconomic Modeling

The Link Between Tax Cuts, Inequality, and Growth

By Anna Chu March 2015

Introduction and summary

Under the simple rules of math, two plus two equals four. But House Republican congressional leaders' new fuzzy rules for evaluating the budgetary impact of legislation blur the lines of simple math.[1] Under their new rules, two plus two may soon equal five.

As an opening salvo for the 114th Congress, in a "largely party-line vote of 234-172," Republicans in the House adopted a rules package that included a provision asking the Congressional Budget Office, or CBO, and the Joint Committee on Taxation, or JCT, to use so-called dynamic scoring in their evaluation of a proposed legislation's budgetary impact.[2] Under the rule, CBO and JCT would have to arrive at one estimate of the economic impact of a proposed bill—a difficult and uncertain endeavor—and factor that into a final score of the bill's budgetary impact. This differs from current practice, where CBO and JCT provide, when requested, a range of estimates based on different assumptions and models of how the economy would respond to policy changes. Compared with dynamic scoring, this range of estimated impacts provides lawmakers with more information about the possible impacts of a proposed policy.

By requiring CBO and JCT to whittle down the range of macroeconomic estimates into one number for a final score, the rule would make CBO and JCT pick and choose which assumptions and models count in the macroeconomic analysis. If one of the assumptions is that a boost in the economy may lead to more people working and paying more taxes, then that additional tax revenue received by the government would offset the official cost of a bill. Thus, on paper, the proposal would have a lower official cost because of possibly uncertain and unrealistic assumptions that the proposal would generate economic growth. This move would make it easier for policymakers to enact more tax cuts based on the conservative trickle-down mythology that tax cuts for the rich grow the economy. It is especially telling that the rule introduced by House Republican leaders[3] would "for all practical purposes … apply almost exclusively to tax legislation."[4] It seems that since conservatives cannot get tax cuts through the front door, they are trying to get them through the side door instead.

CBO and JCT should not be forced to undertake dynamic scoring. But since the House passed the new rules package, responsible lawmakers should work with CBO; CBO's new director, Keith Hall; and JCT to ensure that the so-called dynamic scoring process is not hijacked as a vehicle to sell the conservative trickle-down mythology. Specifically, CBO and JCT should consider the following two issues:

- **The latest economic research.** A growing body of empirical research undermines the conservative economic mantra that tax cuts for the rich grow the economy.[5] CBO and JCT should ensure that their macroeconomic models reflect this growing empirical evidence. At the same time, more and more research suggests that rising inequality is holding back the nation's economic growth.[6] Given this, CBO and JCT should develop a macroeconomic model that considers how a proposed bill would impact inequality—and therefore economic growth. While this may be an evolving and time-consuming process, reasonable steps can be made toward this goal, including a CBO and JCT study on inequality's impact on economic growth.

- **The distributional impact of tax policies.** Given the evidence that for many households, market incomes are stagnant or declining,[7] and given the emerging evidence that rising income inequality is holding back economic growth,[8] CBO and JCT should conduct an analysis of the distributional impact of tax policies. If a proposed tax policy were to increase income inequality, CBO and JCT should determine how that increased inequality hurts economic growth and factor that into their dynamic score. Additionally, CBO and JCT should consider how tax cuts given to certain income brackets could impact consumption and demand.

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