Dynamic scoring: the magic math Republicans might use to make their tax cut dreams come true

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Conservatives in Congress led by Paul Ryan are thinking of bringing back an accounting gimmick from the 1970s called dynamic scoring. Used by Ronald Reagan to help sell the country on gigantic income tax cuts, dynamic scoring seemed to have run its course during George W. Bush's administration. But a somewhat more restrained version could have serious implications for the ongoing conversation around corporate income tax reform — leading to deeper rate cuts or fewer loophole closings.

1) What is dynamic scoring?

When policy proposals are put forward in Congress, their impact on the budget is often estimated (or "scored") by the Congressional Budget Office and the Joint Committee on Taxation.

Dynamic scoring — in its simplest and least-controversial framing — is the idea that when estimating the budgetary impact of changes in tax policy, you ought to take into account changes to the economy induced by the policy change.

This sounds like a reasonable idea on its surface, but it's important to understand that people aren't really arguing about the general principle. The crux of the argument is something more specific.

Many conservatives want these budget estimates to say that large tax cuts will have a relatively small impact on the deficit — or even that they make the deficit smaller. These are ideas that have little support in the academic literature, but have been important to conservative politics for decades. In particular, both Ronald Reagan and George W. Bush succeeded in enacting tax policies that were justified in part based on these ideas. Even more dramatically, some conservatives cite an idea known as the Laffer Curve to argue that tax cuts increase growth so much that tax revenues actually rise.

Dynamic scoring is controversial because of those kinds of claims, not because the idea that scoring should be dynamic is controversial.

2) What is the Laffer Curve?

The Laffer Curve is, according to legend, a simple idea economist Arthur Laffer sketched on a napkin while meeting with Dick Cheney and Donald Rumsfeld in 1974 (when they led the conservative faction of the Gerald Ford administration). Jude Wanniski, another conservative economist present at the meeting, actually coined the term.

At the time, Ford was considering a proposal to raise taxes in order to trim the budget deficit. But Laffer argued that a tax hike would slow US economic growth so much that it would actually be counterproductive from a deficit reduction standpoint. The basic idea of the curve is that sometimes lower tax rates lead to *more* tax revenue by boosting economic growth.

Laffer-style arguments became increasingly influential in the GOP as the 1970s continued. During the Carter years, proponents of a massive tax-cut bill — sponsored by Rep. Jack Kemp (R-NY) and Rep. William Roth (R-Delaware) — argued that the bill's growth-boosting powers would actually help reduce deficit.

During the 1980 GOP primary, Ronald Reagan campaigned on support for Kemp-Roth, which George H.W. Bush derided as "voodoo economics." Reagan won the primary and then the general election and in 1981 signed a bill cutting tax rates. In 1996, Kemp became Bob Dole's vice-presidential nominee and Dole ran on a Laffer-style platform. Later on, George W Bush and members of his administration repeatedly argued that his tax cuts would boost revenue even though PhD economists in his administration generally argued the opposite.

Over the last six years, Laffer-style arguments have become less prominent on the right. Kevin Williamson penned a long takedown of Laffer-nomics for National Review, Paul Ryan's various budget frameworks haven't relied on Laffer arguments, and Mitt Romney ran in 2012 on a plan to pay for tax rate cuts with higher taxes on the poor and middle class.

3) So do tax cuts boost economic growth?

This is really the key question. And the credible research on the matter is very very mixed.

A Brookings survey from William Gale and Andrew Samwick concluded that the growth impact of a deficit-financed tax cut (the kind of thing the Bush administration proposed) "is either small or negative" but that a tax cut financed by reductions in wasteful spending or social assistance for the elderly would boost growth.

A recent Congressional Research Service report concluded, similarly, that "claims that the cost of tax reductions are significantly reduced by feedback effects do not appear to be justified by the evidence."

A crucial issue for understanding the dynamic effects of tax cuts that are financed with spending cuts is that spending cuts have a dynamic impact on growth, too. In a 2004 meta-analysis, Peter Nijkamp and Jacques Poot found that there's no systematic correlation between the level of taxation and the level of economic growth. But they found that spending on education and infrastructure boost growth. In other words, a tax cut that's financed by cutting useful spending could actually hurt growth.

Of course, which spending is useful and which is not is very much a matter of political debate. This, ultimately, is why the CBO and JCT have traditionally eschewed efforts to modeled macroeconomic effects.

4) How does tax scoring work now?

You shouldn't let the dynamic scoring controversy confuse you into thinking that right now the government produces completely static estimates of how tax policy impacts the economy. The Congressional Budget Office, the Joint Committee on Taxation, and the Treasury Department all incorporate two kinds of dynamic factors into their estimates.

Demand-side effects: Lower taxes mean more money in the pockets of households, which boost consumer spending and grows the economy. But on the other hand, higher budget deficits mean higher interest rates, which depresses business investment and purchases of houses and durable goods. Official government tax policy estimates take both of these opposing factors into account — and they generally show that tax cuts boost the economy when the Federal Reserve is keeping interest rates low but not otherwise.

Behavioral effects: If you raise the gasoline tax, people will consume somewhat less gasoline. If you raise the cigarette tax, people will smoke less and may buy more black market cigarettes. The government is well aware of these things, and attempts to incorporate them into tax estimates.

Proponents of dynamic scoring sometimes act as if current practices ignores the way lower tax rates can change behavior, but this simply isn't the case.

5) Can we take a break from all this macroeconomic modeling?

Absolutely. This whole debate came about because of the political success Ronald Reagan enjoyed from overblown claims about the positive revenue impact of tax cuts. So here's a taste of Reagan Youth's wildly overblown anti-Reagan songwriting. Enjoy:

6) What do current scoring methods leave out?

Right now, the CBO, the JCT, and other government agencies consider what's known as the *microeconomic* consequences of changes in tax-related incentives. What dynamic-scoring proponents want is a model of *macroeconomic* consequences. They think that a country with lower tax rates will see more investment in physical and human capital, leading to more productivity, and more economic growth.

Critics of current scoring methods, such as the Cato Institute's Daniel Mitchell, argue that the status quo is hopelessly biased in favor of big government. Mitchell regards it, for example, as self-evidently ridiculous that the current CBO model says higher tax rates would lead to faster economic growth via lower deficits. Economists at the Heritage Foundation argue that switching to dynamic methods would "open[] the doors for fundamental, pro-growth tax reform that will be critical to confronting and overcoming the nation's unsustainable fiscal and economic outlook."

Of course a big issue here is that people sharply disagree about how much tax rates actually influence economic growth. There are models under which rate cuts are a major economic game-changer and models in which they are not. Empirically, economic growth after the Reagan tax cuts seems to have been mostly driven by demand-side factors, but the whole terrain is enormously contested.

7) Has dynamic scoring ever been tried?

Yes. Back in 2006, the Bush administration's Treasury Department put together a "dynamic" analysis of the president's proposal to make the tax cuts he'd enacted in 2001 and 2003 permanent. As Jane Gravelle wrote for the Congressional Research Service, that analysis estimated that the resulting budget impact would be 7 percent smaller than what was suggested by conventional scoring methods.

But this had little political impact. Critics of the tax cuts were complaining that this would lead to massive deficits overall. Making those deficits 7 percent less massive wasn't a political game-changer in the way that a Laffer curve argument would have been. Consequently, the whole episode passed with relatively little comment. The most optimistic model that the Bush administration felt was credible still ended with the conclusion that the Bush tax cuts substantially decreased revenue.

8) Why are we talking about dynamic scoring now?

Two reasons. One is that the Republican takeover of Congress starting in 2015 gives the GOP an opportunity to either change the scoring rules, change the personnel in charge of the scoring, or both.

The other is that there's more buzz about corporate tax reform. The general idea here is that you could eliminate some tax loopholes, lower tax rates, and end up with a simpler more growth-friendly tax code that still raises the same amount of revenue. Most people are for this in principle. The problem arises when it comes to eliminating specific loopholes, since each loophole has its advocates. Adopting a "dynamic" approach — especially a very optimistic one — lets you cut rates more deeply while closing fewer loopholes.

Importantly, unlike with the debate over the Bush tax cuts, even small changes can make a big difference here. A 7 percent reduction in the estimated revenue loss lets you close 7 percent fewer loopholes, broadening the set of companies that will favor your reform.

9) Why does the score matter?

That is an excellent question. Members of Congress are free to vote for whatever bills they want regardless of its score. If the CBO says a bill will explode the deficit but you like the bill anyway, you can still vote for it. If the CBO says a bill will explode the deficit but you think their model is wrong, you can vote for it. Economic modeling is really difficult, and political debates legitimately involve both empirical and moral issues.

Practically speaking, the scores matter because perceptions matter in politics. "Congress passes revenue-neutral tax reform" sounds better than "Congress passes deficit-increasing corporate tax cut."

Still, even that effect shouldn't be exaggerated. In the past, Republicans haven't hesitated to vote for tax measures that the CBO says will increase the deficit. That's because they have a strong preference for low tax rates. This is the main issue in American tax politics, and it's not going to change regardless of what happens to CBO scoring rules.