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The Bush Budget's Hidden Gold: Dynamic Scoring Comes to the Treasury

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All of the press commentary on President George W. Bush's 2007 budget proposal has paid virtually no attention to one of its most significant initiatives. And it is no wonder: how could a move to improve the way the government analyzes tax policy compete with cutting outdated programs, making the United States more competitive, and winning the global war on terrorism?

This little-noted initiative, however, may be historically important. Buried deep in the President's proposals for the Department of the Treasury is a plan to create a Dynamic Analysis Division within the Treasury's Office of Tax Analysis. This division would advise the President and other key policymakers on how proposed changes to U.S. tax policy would affect economic activity. Inside the Beltway, this type of analysis is called "dynamic scoring." Outside the Beltway, this is called "economics."

So why is this news? Hasn't the government been studying the effects of tax policy on the economy all along? Aren't Washington policymakers routinely advised about how tax changes will affect jobs and output and how those, in turn, will affect government revenues?

Surprisingly, the answer is often no. Until very recently, no official Washington agency produced estimates of the economic and tax-revenue effects of proposed tax policies. Congress's official tax policy scorekeeper, the staff of the Joint Committee on Taxation, began building this capability a few years ago and since has produced a few dynamic scoring documents. The Congressional Budget Office also recently began publishing its estimates of how the President's and Congress's budget plans (which include tax changes) would affect economic activity. However, all of these documents together still fit into a slim file folder. So far, the Treasury Department has done almost nothing to contribute to that literature.

Unless policymakers can see that some tax policy changes support more vigorous economic activity while others do not, they may (and indeed have) enact tax laws that are, at best, economically meaningless or, at worst, downright harmful. Dynamic scoring can help to sort the good from the bad.

Take, for example, the child tax credit. Advocates of the credit (now worth $1,000 per child) argued that it would put money into the hands of consumers, who would spend those funds, thus fueling economic activity. Had those policymakers been advised about the likely economic effects of this tax change, they would have learned that the credit would do nothing to lower the costs of working or investing—two of the biggest drivers of economic activity—and that cash windfalls almost always are saved, especially by taxpayers with children. There is nothing wrong with saving for a child's education,

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but it will not lead to the bump in current consumption that advocates of the child tax credit expected.

While the child tax credit has not done very much, if anything, for today's economy (as dynamic scoring would have projected), the same cannot be said for raising taxes to reduce the federal budget deficit. Advocates of this approach appear to argue that tax increases will not affect economic activity but that growing budget deficits do. Standard models of the economy, however, show that income tax increases are harmful to growth in employment, investment, output, savings, and even government revenues. They also show that deficits by themselves have little effect on interest rates. In short, raise taxes to reduce deficits, and the result will be higher unemployment, a slower pace of economic growth, and revenues that are not rising as quickly as static scoring predicted.

Dynamic scoring might not prevent bad tax policy from becoming law, but it would help. Furthermore, reporting the economic consequences of tax proposals will be enormously helpful in redesigning the tax system. The President has called for fundamental tax reform, and he and Congress will find fundamental reform a much easier exercise if routine and sophisticated dynamic scoring is in place when that task is tackled.

So, congratulations to the Bush Administration and particularly to the Department of the Treasury! This little-noted proposal may be the most important change in many, many years to the way tax policy is formulated.

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