

## INFORMED BUDGETEER

## INCHING TOWARD DYNAMIC SCORING . . .

- Interest in dynamic scoring is on the rise again. Three House committees held hearings over the past two weeks on the subject. The *Bulletin* focuses on statements given by the Director of the Congressional Budget Office (CBO) and the Chief of Staff of the Joint Committee on Taxation (JCT).
- On January 5, 1997, the House expressed its strong interest in dynamic scoring by adopting a rule (rule XIII, sec. 3(h)(2)), which states that the JCT, in response to a request from the Chairman of the Ways and Means Committee (in consultation with the ranking member), shall render a dynamic estimate of major tax legislation to be used only for informational purposes. The rule further defines a “dynamic estimate” as a projection based on assumptions concerning probable effects of macroeconomic feedback, and says that the estimate shall include a statement identifying all assumptions.
- First, let’s review current practice to illustrate that cost estimates are already somewhat dynamic. Revenue estimates require two pieces of information: the proposed change in the tax rate and the resulting change in the tax base. A truly static estimate would assume that the tax base does not change in response to a change in the tax rate. For example, a static estimate of a proposed tax on luxury cars would simply multiply the tax rate by a baseline value of luxury cars sold. If JCT and CBO produced static estimates, they would ignore the fact that the tax would discourage purchases of luxury cars.
- But they don’t. JCT and CBO’s estimates of the budgetary impact of spending and tax proposals incorporate a wide variety of behavioral responses. For tax proposals, microeconomic changes incorporated into an estimate include the effects related to the timing of economic activity, effects related to shifting income between taxable and nontaxable categories, effects on supply and demand, and interactions with other taxes. The same principles apply to spending estimates. CBO’s estimates for the farm bill, for example, include anticipated behavioral effects on crop prices and production.
- Still, some members and outside fiscal policy experts believe that current estimating practices do not provide complete information because they do not take into account effects that policy changes might have on investment and labor supply. For example, advocates of tax reductions on income or capital gains contend that those proposed policies carry too high a price tag, because current cost estimates do not incorporate the revenue-raising impacts of increased economic activity.
- CBO Director Dan Crippen testified before both the House Budget and the House Rules Committees on the question of dynamic scoring. Crippen acknowledged that changing how the economy works is the objective of many legislative proposals; thus, CBO and JCT should inform the Congress about the likely macroeconomic effects of all legislation that might affect the budget.
- However, CBO does not believe that it can incorporate the macroeconomic effects of legislative changes into a cost estimate. Crippen suggests that macroeconomic feedback information can be more usefully presented in ways other than in a cost estimate, such as separate reports or in descriptions of the economic assumptions underlying a baseline
- CBO’s cost estimates could not include macroeconomic effects in a useful and credible way for four reasons, according to Crippen. First, the macroeconomic consequences of legislative decisions today will be influenced by policy decisions in the future. Current spending increases or tax cuts must be financed with either lower spending, more borrowing, or higher taxes in the future. Such future decisions about financing frequently determine the macroeconomic effects of policies currently under consideration.

(See Dynamic Scoring continued on page 2)

## . . . MEASURING UP CBO

- Even while some are harping again that congressional estimators should start using exotic new estimating techniques, perhaps the rest of us budgeteers forget that CBO and its 230 employees are there every day “getting it done”. (Even when its building was closed last fall for three weeks because of anthrax, CBO continued to produce estimates.)
- CBO’s largest component – the Budget Analysis Division (BAD) with 76 employees – not surprisingly produces the lion’s share of CBO’s measurable output. Together with the Tax Analysis (revenues) and Macroeconomics Analysis (forecast) Divisions, BAD prepares the budget baseline which serves as the point of departure for estimating budgetary effects of legislation. As the table below shows, CBO is on a pace this year to produce 700 formal estimates of the cost to the federal government of proposed authorizing legislation. Most of those estimates (about 650) include companion estimates of the cost that the legislation would impose on state and local governments and the private sector. CBO also produces 250-275 estimates of appropriation bills.

Our Congressional Budget Office at Work			
Cost Estimates	2000 actual	2001 actual	2002 projected
Federal Government (Auth. Comm.) <sup>a</sup>	896	450	700
State and Local <sup>a</sup>	690	390	650
Private-Sector & Unfunded Mandates <sup>a</sup>	670	420	650
Appropriation Bills	260	250	275
Total Cost Estimates	2,516	1,510	2,275

Source: CBO

a/: Cost Estimates are tracked on a calendar year basis. CBO believes the unusual drop in 2001 resulted from a significant increase in legislative activity at the end of 2000.

- But even these figures do not fully reflect the quotidian responsiveness of CBO to the legislative rhythms of Congress. CBO’s 2003 budget justification points out that it prepared 450 formal cost estimates during 2001 and “an even larger number of informal estimates for proposals or options being considered by the Congress.” CBO further notes that “[i]n recent years, the number of those less formal requests from Congress for CBO assistance has been growing. As a result, the number of informal responses. . . – in the form of staff memorandums, letters, or telephone responses – has increased significantly, as has the time needed to satisfy those requests.”
- A recent example of these time demands is CBO’s work on the farm bill enacted last week. When the farm bill came out of committee in November and passed the Senate in February, CBO prepared cost estimates relative to CBO’s April 2001 baseline. But for the past three months, Senator Domenici has requested that CBO prepare an alternative set of estimates relative to CBO’s most recently updated baseline so Congress could have the latest and best information. However, CBO had to defer that work while it continued to prepare estimates for the Agriculture authorizing committees as they conferenced the final farm bill. It wasn’t until the first cost estimate was done based on the final conference language and the older baseline that CBO was able to prepare an analogous estimate scored against the newest baseline. While not ideal (it probably would have been better if Congress waited to receive both estimates at the same time), the latter CBO estimate was still useful for the Senate debate.
- The rest of CBO not only assists BAD in meeting all this workload, but also produces annually about 25 major-length program analysis reports and about 25 CBO statements for congressional testimony. On top of all this are the regular periodic CBO reports required by law. Without all these consistently strong, dependable CBO products, it’s safe to say that Congressional understanding of the budgetary consequences of legislation would not be as informed.

- Second, there are often offsetting macroeconomic effects. Tax cuts result in increased after-tax income and therefore reduce the incentive to work. However, cuts in marginal rates also increase the incremental payoff from work and boost work incentives. Third, to attribute any short-run stimulative effects to legislation, estimators must assume that monetary policy will remain constant. Most analysts would have little confidence in such an assumption.
- Fourth, the reaction of taxpayers to specific policy changes may be based as much on their perceptions of a change as on the enacted provisions. For example, do taxpayers assume that last year's tax cuts will expire as scheduled under current law, or that some will and not others? Crippen concludes that things that seem to be straightforward are quite arbitrary and CBO should not be put in a position of making arbitrary decisions.
- JCT Chief of Staff Lindy Paull testified before the House Ways and Means Subcommittee on Oversight. She agrees that the standard revenue estimate may not convey the complete picture of the long-term budgetary impacts of a proposal. That is why since 1995, JCT has been evaluating the feasibility of incorporating the macroeconomic effects of tax legislation. Substantial progress has been made to develop a model that will assess the potential macroeconomic effects of tax law changes, but significant challenges remain.
- Paull noted that in order to provide dynamic scoring point estimates year by year, analysts would have to decide on a single set of assumptions for four things: the effects of the business cycle on the economy; changes in Fed policy; reactions of international capital markets; and budgetary scoring conventions on the expenditure side.
- JCT Chairman Thomas and JCT staff have invited a "blue ribbon" panel of macroeconomic modeling experts to review JCT's work and make suggestions for both modeling improvements and for the type of information that should be included in these analyses. In the near future, the JCT staff expect to be able to produce comparative analyses of the long-term growth and associated revenue feedback effects of major tax proposals, and to attach "macroeconomic feedback notes" containing this analysis to revenue estimates of those proposals for which such a note is clearly indicated. The analysis would include a description of the major assumptions as well as a discussion of the degree of certainty with the results.

### BUDGET QUIZ

**Question:** Since September 11th, there has been an ongoing debate within Congress about America's "first responders." The discussion has ranged from defining who are the first responders to deciding which federal agency should be tasked with providing equipment, training, and other services to them. So, who are the first responders, what is their history, and why the big debate about how to allocate resources to them?

**Answer:** When disaster strikes, the first people on the scene are our "first responders" – firefighters, local law enforcement officers, rescue squads and emergency medical personnel. While these brave men and women have always executed a responsibility of local government, the federal government sought to expand their efforts back in 1996.

The National Defense Authorization Act of 1996, created the Nunn-Lugar-Domenici program, authorizing a round of first responder training in 120 major U.S. cities to prepare for potential terrorist attacks involving weapons of mass destruction. While the Department

of Defense originally conducted most of this training, the Clinton Administration (using broad transfer authority provided in the 1996 legislation) shifted the program to the Department of Justice (DOJ), reflecting its civilian involvement. Since its inception, the first responder program has trained a total of 80,000 police, fire, and emergency personnel, nearly completing the goal of 120 cities.

Just one year ago, on May 8, 2001, President Bush directed yet another transfer of the first responder training initiative, collectively known as the National Domestic Preparedness Consortium, to the Federal Emergency Management Agency (FEMA) as well as the creation of an Office of National Preparedness within FEMA that would coordinate all first responder activities nationwide. Since then, the President also has proposed to transfer to FEMA the remainder of the DOJ's counter-terrorism funding associated with domestic preparedness that has also been administered by the Office for Domestic Preparedness, some of which were initially authorized in the Antiterrorism and Effective Death Penalty Act of 1996. Both regular and supplemental appropriations for all of these programs totaled around \$900 million for 2002, of which \$234 million was provided in the regular appropriation bill. (Included in these amounts for first responder training alone was \$33 million in regular funding, with a \$63 million supplemental added after September 11<sup>th</sup>.)

In his latest budget proposal for 2003, the President proposes to increase the funding for FEMA for all first responder activity to a total of \$3.5 billion. Among other things, this funding would provide personal protective equipment, medical equipment, biological and chemical detection equipment and other items that local first responders need. The funds would also be used to conduct more frequent terrorism drills and to upgrade emergency communications equipment throughout the nation.

In part because the President is proposing such a large increase in funding, there is controversy concerning whether the DOJ or FEMA should have responsibility for the first responder initiative. The Director of FEMA, Joe Allbaugh, has assured members of Congress that FEMA is prepared to take on these additional duties immediately and that he believes that his agency is the best qualified for them, considering that FEMA already has primary responsibility for responding to and recovering from natural disasters.

Whether or not that is true, there is some question as to whether FEMA even has the statutory authority to assume these additional responsibilities. At several recent hearings of the Senate Appropriations Committee regarding homeland security, several members, appearing to defend the status quo, queried witnesses, including Director Allbaugh and Attorney General John Ashcroft, about FEMA's authority. The Administration has cited as support for its position (1) the broad transfer authority contained in the Nunn-Lugar-Domenici legislation, (2) FEMA's authorities under the Stafford Act and the Federal Fire Prevention and Control Act, and (3) more recently, a blanket authorization of ODP first responder assistance in the USA Patriot Act passed by Congress last fall. Despite the Administration's claim, however, Director Allbaugh has recently begun consulting with FEMA's authorizing committees on legislative language to statutorily reorganize the program.

### CORRECTION

The first 50 distributed copies of last week's *Bulletin* included a table on the cost of the Trade Adjustment Assistance amendment that was rendered out of date by changing estimates from the JCT. The mailed and website versions of the table are correct, with a 10-year cost of \$11.068 billion.