

Dynamic Scoring: Lessons from the Study of the Camp Tax Reform

Jane Gravelle

Congressional Research Service

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Differences Between an Individual Rate Cut and Individual Tax Reform

- For a tax cut, short run stimulus tends to dominate effects in JCT's in house model, MEG (not allowed in intertemporal model). Reasons for excluding this effect include offsetting actions of the Fed, and lack of dynamic scoring for appropriations.
- For a revenue neutral tax reform, stimulus effects are less important, but it is important to incorporate base changes (e.g., no state and local tax deductions) in marginal tax rates, which does not appear to have been done for labor. Would reduce effects, possibly reverse them.

Percentage Increase in GDP

MEG High Labor Substitution Elasticity	0.2
MEG High Labor Substitution Elasticity	0.1
OLG	1.5
MEG High with Stimulus	0.5
MEG Low with Stimulus	0.4

Why Larger in OLG? Two Reasons, Labor Supply and Intangibles

Model	Labor Substitution Elasticity	Income Elasticity	Percentage Change in Labor
MEG High	0.2	-0.1	0.5
MEG Low	0.1	-0.1	0.4
OLG	0.24	-0.4	1.3

But OLG substitution elasticity is only 20% higher than MEG high while labor supply is 160% higher. Elasticity differences would account for about 0.2%. (Note that the model has an increased elasticity compared to the past). Capital differences unlikely to account for more than 0.2%. Remains a mystery, perhaps relating in some way to the calibration and fiscal balancing of the OLG model which does not actually represent the economy. Diamond and Zodrow find much smaller labor supply effects using same model for same policy.

The Other Reason: Intangibles

- It is not possible to explain the output effects with inputs in the OLG simulation. These inputs appear to account for about a 0.9% increase. The remaining 0.6% appears to be due to the shifting of intellectual property and treating it as an input into the production function (like physical capital).
- Intellectual capital is not located physically. Once it exists it can be used everywhere. When a firm discovers Lipitor that knowledge can be applied costlessly to production everywhere. It does not matter if the patent is held in country A and licensed to country B, or vice versa. Therefore, shifting ownership of intellectual property to the U.S. should not increase U.S. productivity because that input is already in existence.

Summing Up

- There is a need for more transparency. JCT already provides a lot of information but not enough in this case to understand why the results are as they are.
- For base broadening, it is important to account for changes in the share of income that is taxed in measuring marginal effective tax rates.
- Should stimulus effects be included? There is a strong case for excluding them.
- The OLG model is problematic, not only because of the elements discussed here, but in general it depicts individual workers as perfectly informed and with perfect foresight. It cannot measure our economy. Should it be continue to be used in providing a point estimate?