by *Tom Bethell*

Dynamic Scoring

No New Tax Cuts didn't have to become a GOP slogan.

When news came in 1994 that the GOP had taken control of the House for the first time in decades, Jude Wanniski of Polyconomics thought, even before taking his head off the pillow: "Now, we can do dynamic analysis." Which is to say, "Now we can cut tax rates without having to pay for them with spending cuts." But it never happened. The assumptions underlying congressional budget analysis, which could have been amended when the Republicans gained power, were left untouched. Four years later, they still have not been changed. Retiring Speaker Newt Gingrich was too busy with the Contract With America, and never understood their importance. As a result, Republicans have been unable to unite behind their most important weapon, and the only one that scares liberals: Tax Cuts.

I know "dynamic scoring" sounds a little wonkish and technical, but it is important and its neglect tells us a lot about the recent Republican failures. So, after a long absence, I'm afraid, economics class will once again come to order. Assume that you sell hamburgers, and in the course of a month you take in $10,000. Your burgers are $1 each. Now you reduce the price by half, to 50 cents. Now what is your monthly take? Hard to say. At the lower price, you sell more burgers, maybe many more. In fact, you had better be prepared to stock more meat, more buns, and maybe more workers, too. Possibly, more than $10,000 will flow into the till. At the lower price, you may make a profit, maybe a loss. Certainly you will have a larger share of the market.

Estimating the real world effects of price changes is "dynamic analysis." The idea that the demand for something increases when its price is reduced, and declines when the price is increased, is one of the most basic ideas in economics, and it is called "the law of demand." In fact, it is one of the few things in economics that deserves to be called a law. Now we come to an important point. There is one place where this law is regarded with grave suspicion: Capitol Hill. And, in fact, Washington, D.C. more generally. Applying the law of demand to the government's own finances, and to the decisions made by the "consumers" of government (otherwise known as taxpayers), is sometimes called "ideology," sometimes "theology," and in the Reagan era it was called (by an adviser to Reagan) "voodoo economics."

Now we must go back to President Bush's election-losing 1990 budget deal, in which he broke his promise of "no new taxes." The architect of this folly was his budget director, Dick Darman. Not only did Darman undermine his own boss, but he also booby-trapped Republicans in the years ahead. He included in the Budget Enforcement Act a "pay as you go" requirement, now known as PayGo. Fear of the budget deficit was set above all other considerations, so that tax cuts, if enacted, would have to be offset dollar for dollar by spending cuts; and not just any spending cuts, but cuts in entitlement programs such as Social Security and Medicare. (Cutting other budget items such as corporate welfare or highway spending would spending is impossible, politically. And it gets worse, I'm afraid. Darman's anti-tax-cut provision finally expired in 1997, but the GOP-controlled 105th Congress, just ending, has extended it. So we still are not free from the dead hand of Darman's 1990 budget deal. In short, tax cuts have been all-but ruled out by Washington's budget procedures, in which the GOP has been heavily implicated.

Since November 1994, nonetheless, the GOP has been free to get control of the budgetary assumptions used by the Congressional Budget Office—in particular by instituting the aforementioned "dynamic analysis." If such a change were made, the revenue change resulting from a reduction in tax rates would be analyzed by assuming that the lower rates would induce behavioral changes that would both increase tax revenues and stimulate growth in the economy. Thus revenues would be sustained even at the lower rates. The earlier experience with tax cuts has shown that this always happens. Cuts in entitlement programs, therefore, would no longer be needed with dynamic revenue estimating.

The Congressional Budget Office was set up in 1974, at the time of Watergate and GOP disarray. Its first director was Alice Rivlin of the Brookings Institution, who for decades has been a fixture on the liberal side of the policy debate in Washington. Now she is vice-chairman of the Federal Reserve Board. She hired the CBO staff and enshrined the methods used to analyze the budgetary and economic impact of tax and spending programs. 1930's-era Keynesian theory was dominant, with government spending considered a greater contributor to national wealth than private spending, and the discouraging effects of high marginal tax rates ignored.

"Although the CBO would today deny

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Bartlett of the National Center for Policy Analysis wrote recently in the *Wall Street Journal*, "it continues to use the methodologies devised during its early days, and many of its early key players are still on board. For example, the CBO's deputy director and its most powerful presence is James Blum, who has worked for the agency continuously since 1975." Post-Rivlin, a succession of directors declined to tinker with the existing "model" in use.

The key moment came when the Republicans achieved their majority. The *Washington Post* leaped into the breach immediately with an editorial warning that the Budget Office might be turned into a "rubber stamp" for tax cuts, and that "dynamic scoring" loomed as a real possibility. Horrors! Maybe the Republicans would get their tax cuts after all, despite the best efforts of Darman. All the front-page talk was of the Contract With America, but the *Washington Post* understood the real threat. The Contract, after all, would have to pass House and Senate and gain the president's signature; not much danger of all that happening. CBO procedures could be changed unilaterally by the new House leadership.

A few weeks later the *Wall Street Journal* published an article by Harvard economics professor Martin Feldstein, pointing out that "official revenue estimating staffs [in Washington] base their calculations on the false assumption that taxes do not alter how much or how hard people work." This "self-imposed rule" disregarded the impact of tax changes on gross domestic product. As a result, he added, official projections "overstate the revenue gains that would result from increasing tax rates, and the revenue loss that would result from lowering rates." The overall effect was to "slant policy decisions in favor of higher tax rates." By the new year, nonetheless, Democrats were more alert to the threat now posed to big government than Republicans were to their opportunity.

On January 10, 1995, the incoming chairman of the House Budget Committee, John Kasich of Ohio, and his Senate counterpart, Pete Domenici of New Mexico, held a joint hearing to review the subject at hand. A Strange New Respect Award winner and a resolute opponent of tax cutting for lo these twenty years, Domenici immediately signaled his preference—that "we continue to put the maximum amount of discipline into this system." Translation: No change is needed or desired. Departing Senator Exon of Nebraska was of the same mind, opposing "the latest fad in budget scorekeeping." Wouldn't it be more prudent, he added, "to stick with the current procedures which are conservative in the truest sense of the word?" The outgoing CBO director, Robert Reischauer, added his voice to the choir, saluting the senators' "caution and prudence."

Former Fed Chairman Paul Volcker testified that the existing system has provided an "indispensable element of budget discipline," while Charlie Stenholm of Texas intoned sagely: "If it ain't broke, don't fix it." Senator Barbara Boxer was "relieved at the comments of the panel because we had better be conservative.... We should stick to the conservative estimating." (Translation: She enjoys spending other people's money and hopes it continues to flood in to Washington.) Henry Aaron of the Brookings Institution discussed the so-called "income effect," a theory that people seek to stabilize their income, so that when tax cuts increase take-home pay, they just might work *less* hard. (Tax increases would make us all work harder, then.) This justified Volcker's claim that there is "no solid theoretical or empirical base" for dynamic scoring. Markets, Volcker promised, would look upon any change "with great skepticism," and if by some mischance economic growth was deduced from tax cuts, he for one "would not believe it."

In the end, nothing was done. June O'Neill, a Republican moderate happy to take dictation, became CBO director, and the GOP fear of increasing deficits overwhelmed their nervous hope of tax cuts. After their losses this November, Trent Lott has begun to slap his fist into his palm and promise, "By golly, we're going to cut taxes!" Someone might want to suggest to him that he get Pete Domenici's permission first. As for the new speaker, Bob Livingston, he has vowed to get Social Security off budget. Democrats will be happy to cooperate with that. The immediate effect will be to eliminate the current budget surplus. Proposed tax cuts in 1999 will then immediately fall afoul of the PayGo provision. That means "dynamic scoring" will be more essential than ever. June O'Neill is leaving CBO in January, and so it might be possible to appoint a replacement who understands what has to be done. But I doubt that it will happen. If the Republicans were not willing to act at a moment of self-confidence, they will hardly do so at a time of self-doubt.

Bruce Bartlett has a theory that the Republican leadership was never interested in dynamic scoring because they saw it as the enemy of spending cuts. It would remove the pressure to make those cuts if tax reduction could be achieved without them. If there is one lesson that Republicans must re-learn it is the basic supply-side lesson that it is politically impossible to cut spending (except for defense spending) as long as the media's message is the liberal Democrats' message; and there's no sign of that changing. But with determination it is possible to cut taxes. They must be cut as much as possible, and without any thought of the deficit, and without any fear of newspaper editorials. In the 1995 hearing discussed above, almost everyone said how difficult it is to estimate the revenue effects of tax-rate changes. And indeed it is difficult. But this counsel of perfection only paved the way for leftists like Boxer to urge a "conservative" policy of caution. In fact, the best thing would be to shut the CBO down completely. Its five-year projections merely succeed in converting politicians into planners. The last is worse than the first.

Federal taxes as a percentage of gross domestic product are now at an all-time high—higher than they were at the peak of World War II. In the Clinton years, revenues captured by Washington have risen by about 2.5 percent of GDP—a huge increase. In fact, some of the old Keynesians still in our midst—*Business-Week* editorial writers, for example—are beginning to worry that taxes are crowding out consumption. Some of them are even calling for tax cuts. Don't be surprised, then, if there is a tax cut in the next Congress. Clinton and Gore might well get behind it, and the Democrats could smartly take credit for it. If so, they will have succeeded in wresting back from the GOP the most potent (if unused) weapon in their armory.

BIG APPLE

New York's Mayor Rudy Giuliani has championed conservative values in the capital of liberalism. The result is a safer, cleaner, and more livable city. Can he do the same for the country?

JOHN CORRY

New York

If the atmosphere wasn't charged, it was at least prickly: Rudolph W. Giuliani, standing behind a portable lectern at the corner of 47th Street and First Avenue, was answering questions from reporters. Minutes before, he had helped dedicate a monument to Raoul Wallenberg, but now a controversy beckoned. The *Times* had reported that morning that federal officials, "alarmed" by the declining number of welfare recipients in New York, had pressured the city into relaxing its rules. It could no longer require applicants for food stamps and Medicare to make two visits to a welfare office; they would now have to make only one. This would not be much of a news story anywhere else, but remember this was New York. No good deed there can go unpunished. The welfare rolls were at their lowest level in thirty years, so obviously something was wrong. The feds thought the Giuliani administration had been sabotaging the welfare system, and the reporters questioning Giuliani about the *Times* story had their suspicions, too. After all, one asked him archly, wasn't it his "basic philosophy to put roadblocks in the way of people who want welfare?"

And Giuliani, who is the most successful urban politician in America, and who, while speaking at the Wallenberg monument, had called New York "the capital of the world and the most tolerant city in America," and who could have called it the most liberal city in America, as well, answered like a man who still believed there had been a Republican Revolution.

He said the food stamp program had encouraged "scandalous behavior." Cheats had arrived at the welfare office in limos, and addicts had peddled food stamps for drugs. He said "left-wing ideologues" wanted to give benefits to anyone who sought them, and "apostles of dependency" wanted to keep everyone on the dole. He also said apostles of dependency and unhappy bureaucrats had leaked the spurious, frivolous, and wholly misleading story to the *Times*, and that the reporters should not be taking it so seriously.

But the reporters still wanted to know about the change in requiring not two visits to the welfare office but one, and their shouted questions rose in the air. Giuliani told them to "please be civil," and not all talk at once. Telling people to mind their manners, in fact telling the whole city to mind its manners, is one way he governs, and it is almost as novel for a New York mayor to do this as it is for a New York mayor to talk about left-wing ideologues. Ed Koch sometimes called for manners, but when he did it was usually with comic exasperation, and it was hard to know whether he meant it, or if he was just doing shtick. Giuliani, though, seems to mean it. References to civility and courtesy sprinkle his speeches, and in a city famous for the supposed rudeness of its residents he insists that you cannot have an orderly society unless everyone observes rules of appropriate behavior. He is, of course, right, although his calls for decorum, and no-nonsense mien in general, make him suspect among members of the city's elites, and among many of their acolytes, too. In their hearts they know he's right, but in their sensibilities they feel threatened. Think of them as people who once praised graffiti as art, thought *Hair* made a political statement, and now find wisdom in "The Talk of the Town" in the *New Yorker*. Giuliani makes them nervous.

But back to 47th Street and First Avenue, where the sparring between the Mayor and the reporters continues. The reporters still want him to admit the feds caught the city acting improperly, but he declines to do so. Out of either frustration or malice then,

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