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March 27, 2014

Chairman Dave Camp
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Camp,

Thank you for the tremendous work you have done on tax reform and the leadership you have shown in releasing a comprehensive tax reform discussion draft. The draft illustrates the types of tradeoffs necessary to reduce tax rates and simplify the code while still maintaining revenue and distributional neutrality. It represents a productive and important step forward in the tax reform discussion.

We will continue to encourage policymakers on both sides of the aisle to engage with you to build on The Tax Reform Act of 2014 and to generate a bipartisan proposal that would lower rates, broaden the tax base, promote economic growth, and help to slow the growth of the rising national debt.

The Committee for a Responsible Federal Budget appreciates the opportunity to offer comments on your discussion draft. I have attached our analysis of the discussion draft which provides a comprehensive overview of our views on the proposal, but will limit my comments in this letter to two of the topics you specifically requested comments on when you released the draft: the treatment of tax extenders in the baseline and the use of dynamic scoring. In both instances we believe that the approach you took in the discussion draft was the proper and fiscally responsible position.

Extenders Policy and Baseline:

We strongly support your decision to use a current law baseline as the standard for evaluating the budgetary effects of tax reform. Using a current law baseline as the starting point is the fiscally responsible position and is consistent with budget scoring principles used by both JCT and CBO. This is the principle applied to legislation under the Statutory PAYGO Act and also embedded in the House-passed Fiscal Year 2014 budget resolution which set a revenue target for tax reform based on a current law baseline.

We believe tax reform should be scored against a current law baseline for several reasons:

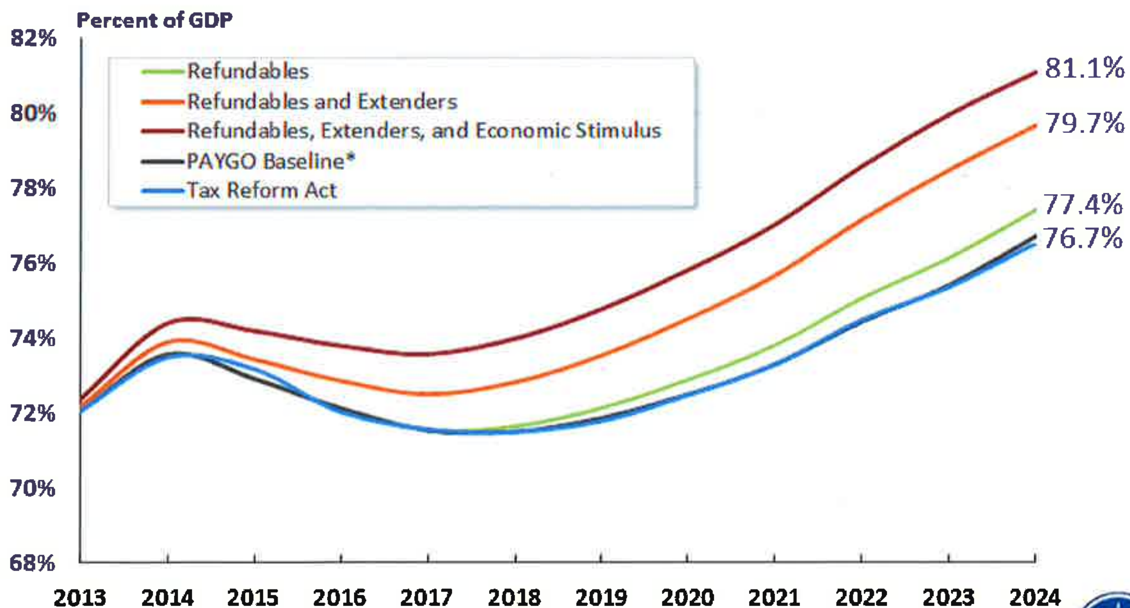
First, most so-called extenders have already expired and are not part of current law for 2014, let alone future years. Therefore, reinstating an extender differs little from passing a new tax break. Both provide new tax breaks not currently in law, and therefore both should be fully offset.

Second, several expiring and expired provisions in the tax code were explicitly designed to be temporary. The largest, bonus depreciation, was originally enacted in 2008 as economic stimulus; it has been continued multiple times in light of the still weak recovery. Assuming this policy is permanently continued would in itself reduce revenue by almost $300 billion over the next decade, even though this provision was only meant to be in place temporarily to help bring the economy out of recession.

Third, assuming that every tax break will be extended over the next decade is inconsistent with the historical record. In the fiscal cliff legislation at the end of 2012, almost a third of tax provisions (21 of 76) that expired in 2011 and 2012 were allowed to permanently lapse. Additional extenders may be allowed to lapse permanently this year, based on the discussions currently underway.

Fourth, many expiring tax breaks were put in place temporarily and scheduled to expire when they were originally introduced in order to limit the cost of enacting them and avoid paying for the full cost of the provision. Assuming permanent extension of those provisions in the baseline would mean those costs were never offset or accounted for in the budget process. Moreover, it would allow policymakers to claim savings for not continuing costs that were never accounted for in the first place. If lawmakers choose to extend a provision beyond its current expiration, they should acknowledge the additional costs and offset them.

Finally, and most importantly, enacting tax reform from a baseline that includes extenders would make an unsustainable debt situation even worse – adding between $460 and $960 billion to the debt. Under current law with a war drawdown, debt levels will grow slowly from about 73 percent of GDP today to 77 percent by 2024, which still leaves debt at unacceptably high levels and will require additional deficit reduction to stabilize the debt. Enacting tax reform relative to a baseline that assumes the extension of expiring tax provisions will increase the debt by 3 to 4½ percent of GDP – to as much as 81 percent if bonus depreciation is included.



Source: CBO, JCT, CRFB extrapolations

**PAYGO Baseline assumes a continuation of current law, along with a drawdown in war spending.*

Moreover, once this principle is applied to expired tax provisions, it can easily be argued that the baseline should also assume the extension of expired unemployment benefits, "doc fixes" to the Sustainable Growth Rate, the health extenders, and even future sequester relief. As a result, debt could ultimately rise to 82 or even 86 percent of GDP by 2024. These debt levels would greatly exacerbate an already unsustainable debt situation.

Given the current fiscal situation, we believe tax reform – and entitlement reform – should be designed to *reduce* deficits. At minimum, however, it should not make them worse.

Likewise, it would be irresponsible to permanently extend even some of the more popular expiring provisions without offsets in advance of tax reform in order to build them into the current law baseline.

We applaud the approach you took in your discussion draft of repealing many expiring provisions, reforming others to reduce their costs and offsetting the costs of the provisions that were permanently extended. It is much less likely that such scrutiny would be applied to expiring tax provisions if they were included in the baseline and could be extended without offsets.

Dynamic Scoring:

We share your objective of pursuing pro-growth policies, as well as your belief that comprehensive tax reform done right would help grow the economy. Economic growth has many benefits ranging from higher wages to lower poverty to improved economic security. In addition, faster economic growth can help to improve long-term fiscal sustainability in a number of ways – including through higher revenue, lower spending on safety net programs, a greater capacity for individuals and businesses to bear tax and spending changes, and a greater capacity of the economy as a whole to carry debt (i.e., a higher GDP will lower the debt-to-GDP ratio).

Dynamic scoring can offer valuable information about growth effects that conventional estimates do not provide, and we fully support your decision to request supplemental dynamic analysis from JCT and believe it provides important information to help lawmakers and the public evaluating the merits of the legislation.

However, there are significant challenges to incorporating macro-dynamic estimates into the official cost estimate for legislation. For one, dynamic estimates of legislation are subject to considerable uncertainty, as evidenced by the wide range of results produced by the four models used by JCT to analyze the macroeconomic effects of your discussion draft. Dynamic scoring is extremely sensitive to the assumptions used and there is no consensus on what some of those assumptions should be. In addition, dynamic estimates often require making assumptions about future legislative actions and monetary policy – a practice which is understandably counter to current scoring conventions.

Given the uncertainty in dynamic estimates and the magnitude of the fiscal challenges we face, the responsible course of action is, as you did, to rely on conventional scoring of legislation and treat the potential dynamic effects of legislation as a "bonus" to help further reduce the deficit and put the debt on a sustainable path. If the potential revenues from dynamic effects of your discussion draft estimated by JCT are realized, the result could be a reduction in the debt to GDP ratio of between 0.3 to 4.0 percent by 2023. However, these numbers are quite uncertain. Relying on projected revenues from dynamic effects to offset rate reductions or other tax breaks and meet revenue goals creates an undue risk that the deficit will exceed projections if the hoped for dynamic effects do not materialize as projected.

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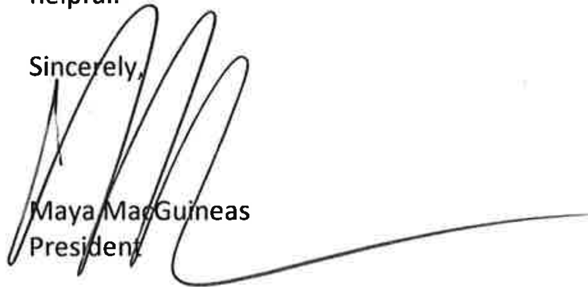
We strongly support the decision to achieve revenue neutrality using conventional scoring while also pursuing – and attempting to measure – pro-growth tax reforms. The tax reform discussion draft adopts the fiscally responsible approach of devoting potentially significant but uncertain dynamic revenue to deficit reduction rather than relying on the funds to offset lower rates or other tax breaks.

Thank you again for your hard work on this important issue. Please let us know how else we can be helpful.

Sincerely,



Maya MacGuineas
President