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JCT Dynamic Score of Bonus Depreciation: Highly Flawed

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Congress requires the Joint Committee on Taxation (JCT) to account for the macroeconomic impact of large tax bills.[1] Dynamic scores, as opposed to static scores, include the budgetary feedback effects of changes in the economy. For instance, when a policy change increases economic growth, the dynamic score would include the effect that more growth has on the federal budget.

Using dynamic scoring to evaluate tax policy provides a fuller analysis of how those policies affect the budget, and the JCT should have implemented it long before Congress finally required it to do so this year. Like all economic modeling, however, dynamic scoring is only as useful as the assumptions on which the models are based. The JCT's recent evaluation of bonus depreciation[2] shows that it needs to revisit basic economic analysis when it comes to dynamic scoring.

Lack of Expensing Suppresses Wages and Job Creation

Congress should establish the full expensing of businesses investment, allowing businesses to deduct the entire cost of their investments in the year in which they make them. With full expensing in place, taxes do not artificially increase the cost of investment and cause investment to be lower than it should be.[3]

This paper, in its entirety, can be found at
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Under the current tax code, full expensing is not allowed; rather, the code requires businesses to depreciate their assets over many years. This means that they can deduct only a certain percentage of the cost of their investment from their taxable income each year during that period.

This type of tax depreciation discourages businesses from making investments. By forcing them to deduct the cost of investments over many years, it raises the cost of investment because a dollar today is worth more than a dollar in the future. A higher cost causes businesses to reduce how much they invest. Less investment is bad for American workers because it reduces their productivity, which leads to fewer jobs and lower wages.

JCT Score of Bonus Deprecation: Unrealistically Low

Congress has moved in the right direction regarding business expensing in recent years. One of those strides is bonus depreciation, which allows businesses to deduct 50 percent of their capital expenses in the year in which they make them. This is faster than under current depreciation schedules and is therefore a step toward expensing. The economic effects of bonus depreciation demonstrate the economic benefits of full expensing. Full expensing gets the tax code halfway to expensing and would be extremely helpful to the economy if Congress made it permanent. It expired at the end of 2014.

The JCT dynamic score of the bill that would make 50 percent expensing permanent shows that it would increase the size of the economy by 0.2 percent over 10 years. This is unrealistically small for such an important pro-growth policy, especially since the bill would make 50 percent expensing *permanent*.

For instance, empirical research has found that past iterations of the policy that were *temporary* had macroeconomic impacts similar to what the JCT found in its analysis.[4] Temporary tax policy is less effective than permanent policy; hence the JCT undoubtedly should have found an effect that was larger.

For comparison, the Tax Foundation finds that permanent 50 percent expensing would increase the size of the economy by 1.1 percent over 10 years.[5] That is five-and-a-half times higher than the JCT's finding and much more reasonable, given its permanence and the economic importance of moving the cost-recovery system halfway to full expensing.

The empirical data show that a consumption tax (a system, such as a flat tax or national retail sales tax, that does not tax saving and investment) could increase the size of the economy by about 15 percent if implemented correctly.[6] Expensing is a major component of a consumption tax. It follows that establishing it halfway permanently should have a strong positive impact on the economy—much larger than the JCT-estimated 0.2 percent. Given its low estimate, the JCT should reevaluate its assumptions and models.

Revenue Impact Overstated

The JCT estimates that making 50 percent expensing permanent will cut tax revenue by almost $281 billion over 10 years on a static basis. Because it underestimates the growth benefits of 50 percent expensing, it estimates positive revenue feedback to be only $13.7 billion.

The Tax Foundation estimate shows a static revenue loss of $336 billion. But because it more accurately accounts for stronger growth from 50 percent expensing, it also estimates a feedback effect from that growth of $262 billion—almost 20 times larger than that found by the JCT—for an ultimate revenue loss only $74 billion over 10 years.

In addition to underestimating the positive impact of 50 percent expensing on the economy, the JCT improperly reduced its official score. In its macroeconomic analysis of the revenue feedback, it factors in the effect that a hypothetical interest rate increase would have on the federal government's interest payments. The JCT assumes that the Federal Reserve will target increased interest rates because 50 percent expensing will increase the deficit.[7] It is impossible for the JCT to anticipate the level of market interest rates in the future. Countless factors influence market interest rates; the Fed's reaction to uncertain future deficits is but a minor factor among many. The JCT reduces the dynamic revenue feedback by $17 billion because of this arbitrary error.

Reversing the JCT's problematic divination of future interest rates shows that by its model it should have reported to Congress that 50 percent expensing would have a revenue feedback of almost $31 billion—more than twice the amount it did report.

1. Senate Concurrent Resolution 11, 114th Cong., 1st Sess., §3112, http://www.gpo.gov/fdsys/pkg/BILLS-114sconres11enr/pdf/BILLS-114sconres11enr.pdf (accessed October 29, 2015).
2. Joint Committee on Taxation Staff, *A Report to the Congressional Budget Office of the Macroeconomic Effects of H.R. 2510, "Bonus Depreciation Modified and Made Permanent," as Ordered to be Reported by the House Committee on Ways and Means (JCX-134-15),* October 27, 2015, https://www.jct.gov/publications.html?func=startdown&id=4844 (accessed October 28, 2015).
3. Curtis S. Dubay and David R. Burton, "How Congress Should Reform Business Taxes," Heritage Foundation *Backgrounder* No. 3022, June 4, 2015, http://www.heritage.org/research/reports/2015/06/how-congress-should-reform-business-taxes.
4. Christopher House and Matthew Shapiro, "Temporary Investment Tax Incentives: Theory with Evidence from Bonus Depreciation," National Bureau of Economic Research *Working Paper* No. 12514, September 2006, http://www.nber.org/papers/w12514 (accessed October 30, 2015).
5. Alan Cole, "Economic and Budgetary Effects of Permanent Bonus Expensing," Tax Foundation *Fiscal Fact* No. 478, September 16, 2015, http://taxfoundation.org/article/economic-and-budgetary-effects-permanent-bonus-expensing (accessed October 28, 2015).
6. Andrew Lundeen, "Slow Economic Growth Does Not Need to Be the New Normal," Tax Foundation, May 15, 2014, http://taxfoundation.org/blog/slow-economic-growth-does-not-need-be-new-normal (accessed March 16, 2015); Robert Carroll, "The Excess Burden of Taxes and the Economic Cost of High Tax Rates," Tax Foundation *Special Report* No. 170, August 14, 2009, http://taxfoundation.org/article/excess-burden-taxes-and-economic-cost-high-tax-rates (accessed October 30, 2015); and Dale W. Jorgenson and P. J. Wilcoxen, "The Long-Run Dynamics of Fundamental Tax Reform," *American Economic Review*, Vol. 87, No. 2 (May 1997), pp. 126–132. More empirical examples are available upon request.
7. Joint Committee on Taxation, *A Report to the Congressional Budget Office of the Macroeconomic Effects of H.R. 2510, "Bonus Depreciation Modified and Made Permanent,"* p. 5.

Major Improvements Needed in JCT's Dynamic Scoring

The Joint Committee on Taxation has a responsibility to produce accurate analysis, but the JCT's score of 50 percent expensing shows that it is not yet capable of providing such analysis. The JCT needs to improve its methods substantially before performing more dynamic scoring.

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