

Tax Reform in the Proposals of the Deficit-Reduction Commissions

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THE FIRST ESSENTIAL STEP ON THE PATH TO FISCAL SUSTAINABILITY

Diane Lim Rogers

Chief Economist

The Concord Coalition

and

Blogger at EconomistMom.com

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Deficit-Reduction Commissions/Task Forces

- **President Obama’s National Commission on Fiscal Responsibility and Reform** (www.fiscalcommission.gov): co-chairs Erskine Bowles and Alan Simpson
- **Bipartisan Policy Center’s Debt Reduction Task Force** (www.bipartisanpolicy.org/projects/debt-initiative/about): co-chairs Pete Domenici and Alice Rivlin
- **Others:** “Our Fiscal Security” (www.ourfiscalsecurity.org/fiscal-blueprint); “Citizens’ Commission” (www.ourfuture.org/report/citizenscommission); Galston-MacGuineas (www.crfb.org/document/future-now-plan-stabilize-public-debt-and-promote-economic-growth)

Common Strategies in the Tax Reform Components

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- Broaden federal income tax base by reducing tax expenditures
- Keep marginal tax rates low, even lower than under Bush tax policy extended
- Yet raise revenue/GDP above Bush tax policy extended (although not necessarily above current law)
- Also: some consideration of add-on tax bases (e.g., energy and consumption taxes); initial tax cuts (e.g., payroll tax holiday) as more effective and more temporary deficit-financed stimulus

Why These Tax Proposals Are Politically Feasible

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- Recognize short-term vs. long-term needs of the economy
- Start from *here*—reforming the existing income tax system; avoids “can’t get there from here” excuse/problem
- By broadening base by *reducing tax expenditures*:
 - a way to *progressively* increase revenue (appealing to liberals); see TPC analysis by Harris, Lim, and Toder:
<http://www.taxpolicycenter.org/publications/url.cfm?ID=411922>)
 - allows marginal tax rates to come down/stay low, *efficiently* increasing revenue (appealing to conservatives)
 - appeals to general notions of fairness by making tax system more neutral
 - simplifies the tax system
- Potential to work synergistically with health care reform (reduce tax subsidy on employer-provided health care)

“Best of” the Tax Policies in the Commissions’ Plans

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- BPC’s “shock and awe” **payroll tax holiday**
- BPC’s **progressive reduction of tax expenditures** (capping effective subsidy rates, converting to credits)
- BPC’s inclusion of an **add-on value-added tax** (but labeled something else)
- BPC’s **consolidated and automated low-income tax credits** (simplifies, reduces effective tax rates from phase outs)
- President’s commission’s **illustration of tax-policy tradeoffs**: what giving up tax expenditures “buys” in marginal tax rate reduction
- **Trigger** idea in President’s commission’s plan (forced “follow through”)

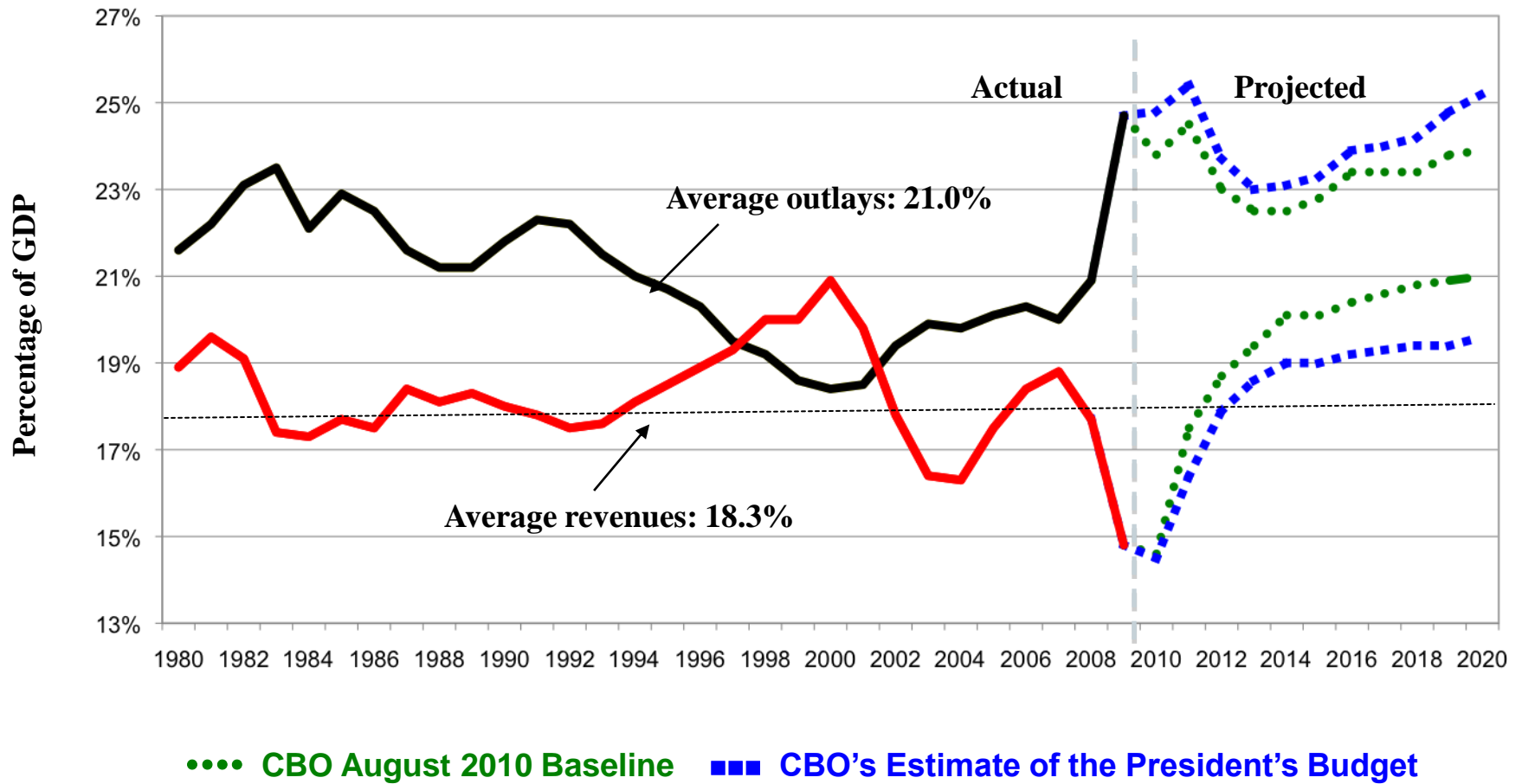
Some Disappointments

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- **President's commission's capping of revenue/GDP (at 21%):** unrealistic given demographic and health cost trends; should probably set a floor, not ceiling! (CBO current-law baseline for revenues has revenues around 21% in 2020 but rising to >23% by 2035.)
- **Continue to put off/backload deficit reduction:** tax revenue increases don't start for several years; silent on wisdom of extended, deficit-financed Bush tax cuts (no proposal for "swapping" better tax cuts)

Could We Really Flat-Line Federal Spending?

Federal Spending vs. Revenues (FY 1980-2020)



Source: Congressional Budget Office, August 2010.

Reception from Policymakers Thus Far

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- No one embracing specific tax increase proposals
- Over \$800 billion in temporary(?), deficit-financed tax cuts passed in lame duck session
- Renewed efforts to exempt tax cuts and avoid tax-increase offsets in pay-as-you-go rules

Commissions' message on tax policy has yet to resonate with the politicians.

So...How to Promote Commission Ideas on Tax Reform with the American People

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- Highlight the tax-policy tradeoffs at the family level (representative households)
- Compare with other ways of reducing deficit: spending cuts (regressive), other revenue increases (less efficient or fair)
- Compare with “do nothing” option and burden of higher deficits or postponing fiscal policy adjustments to future generations (a la Gale & Orszag analysis of true burden of Bush tax cuts)

The Bottom Line on Selling Revenue Increases

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In other words, we need to turn the “largest tax increase in American history” free-lunch rhetoric into a “Would You Rather...?” (adult) conversation.