



President's Tax Panel Proposes Broad Reforms

Panelists Warn Against "Cherry-picking"

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Considering the backward direction of the Bush administration's tax policy over the last five years, the proposals from the president's tax panel are something of a relief. The last five years of tax changes have led to declining revenues, massive deficits, and an increasingly unfair tax code. The panel's recommendations are at least neutral on those major choices.

The president's tax reform panel yesterday met for its last public meeting and made public specific outlines of what it will be proposing on November 1. While many of the details are still to be determined, the panel will recommend two distinct options: 1) a reform of the current income tax, and 2) a modified "progressive consumption tax." Each policy, in different ways, shifts taxation away from capital and savings, and onto work and consumption. The second option that moves away from a pure consumption tax and closer to an income tax by retaining some taxes on capital gains and dividends at a 15 percent rate.

While the full proposals will take time to fully analyze once full details are

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presented, they present one major caution and one major concern.

The caution is that while there are many parts of the panel's proposals that seem to have significant merit—especially in ways that might simplify the code by consolidating existing credits and incentives—we fear that the administration and a right-wing-led Congress will ultimately undo politically risky suggestions, or pursue only the parts that fit their prior ideological biases.

Panelist James Poterba warned yesterday that the proposals might be “cherry-picked” and that the panel's two recommended reform options must be viewed as comprehensive packages rather than as a menu of items that could be implemented separately. As an example, the panel warned that implementing expensing for business investment should not be done without eliminating the deductibility of interest expenses. The panel also warned that its savings proposals—consolidation of employer-based, individual retirement and other tax-preferred savings accounts, coupled with a low-income savers credit—should be viewed as a complete package as well.

And the concern is that the commission was precluded, by its mandate and by wanting to be politically neutral, from addressing the largest challenges facing our tax system today. The panel in essence began its work from a handicapped position. The president's executive order instructed the panel to produce revenue neutral policy options which were “appropriately progressive.” Rather than tackling the question of how progressive the system ought to be, the panel decided (in an earlier meeting) to develop options that approximately matched the current distribution of taxes across income groups. This approach effectively

locks in massive deficits as well as the tax changes that benefited high-income earners.

On the other hand, we should be thankful that the panel did not move to make the revenue and distributional outlook even worse than it has become.

Each of the proposals contains some interesting ideas for simplifying the tax code on the individual and corporate side, especially by consolidating already existing retirement savings accounts, and we look forward to hearing more details.

The proposals also contain a number of provisions that will likely be extremely politically difficult to implement, such as severely limiting the home mortgage interest deduction, eliminating the state and local tax deduction, and eliminating virtually all other deductions in the code.

A broader concern is that the panel's nod to economic growth appeared to focus solely on savings and investment incentives. Absent from the discussion was any significant mention of the tax treatment of "human capital." In fact, since both of the proposals eliminate virtually all deductions and credits—except for homeownership, charitable giving, and health care—tax incentives for education and training are left out in the cold.

In addition to setting broad distributional priorities and raising adequate revenue, the success of any tax system also depends on getting the details of the code right and implementing a fair transition to the new system. Unfortunately, we have seen misplaced priorities and multiple failures in this administration's ability to move economic policy in a positive direction—from ineffective eco-

conomic stimulus packages, to a failed push to privatize Social Security.

Tax reform should be a subject of national debate, as the current tax code is increasingly in need of overhaul. We look forward to reading the panel's final report.