December 2, 2010
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CTJ Citizens for Tax Justice

Statement on the President's Fiscal Commission Plan

The deficit-reduction plan taking shape before the President's fiscal commission is seriously unbalanced. It relies on cuts in public services for two-thirds of the deficit reduction it strives for, while relying on increased revenues for only one-third. In fact, the plan claims it would somehow "cap" federal revenue at the arbitrary level of 21 percent of the economy. As a result, the plan relies far too much on cuts in public services that will be impossible to make without adversely affecting Americans — including those with very modest incomes.

Part of the problem is the commission's approach to closing tax loopholes. The plan makes bold proposals to close tax loopholes, but unfortunately uses most of the resulting revenue to lower tax rates! Since the goal of this commission is to reduce the budget deficit, it's hard to fathom why lowering tax rates would be on its agenda at all.

Imagine if the commission had proposed to devote most of the money saved from direct spending cuts to lowering tax rates. People would call that crazy. But it seems just as crazy to do so when it comes to cracking down on spending programs embedded in the tax code.

Overview of the Plan

The two co-chairs of the commission, Erskine Bowles and Alan Simpson, introduced their own proposals earlier this month, and the plan that is taking shape now is the same proposal with some modest differences.[1]

Their plan would eliminate the budget deficit (the amount by which federal spending exceeds federal revenues) by 2015, not counting interest payments on the national debt. They would balance the budget entirely (including interest payments on the national debt) by 2035.

By 2020, when many of the provisions of the plan would be fully phased in, discretionary spending (the spending that Congress must approve each year) would be cut by about $300 billion compared to the level recommended in President Obama's most recent budget proposal. That's about a 23 percent drop. (Discretionary spending only makes up about a third of federal spending, just over half of which goes towards defense.)

The plan would also reduce mandatory spending (on health care and Social Security) by about $100 billion in that same year.

Major changes in Social Security wouldn't be fully phased in for several years after that. Social Security benefits would be cut by 10 percent in 2050 and by 16 percent in 2070. Social

[1] The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform, December 1, 2010.
http://www.fiscalcommission.gov/news/moment-truth-report-national-commission-fiscal-responsibility-and-reform

Security already has its own funding source (the Social Security payroll tax). It's true that in the very long-run this funding will not be enough to pay the benefits that are promised. But the program does not add to the budget deficit that Congress is facing today. (In fact, Social Security surpluses have been used to reduce on-budget deficits for years.) Arguably it should not be dealt with in the context of this exercise.

The plan would completely overhaul the federal tax system. Most tax loopholes would be eliminated, including the tax subsidies for capital gains and dividends. These reforms are mostly excellent and long overdue. But, unfortunately, most of the resulting revenue would be used to lower tax rates. The result would be a simpler tax system, but not much in the way of deficit-reduction. The tax reform plan and other smaller revenue measures contemplated by the commission would increase net revenue by $223 billion, or about 5.8 percent by 2020.

Twice as Many Cuts in Public Services as Revenue Increases

Contrary to what many lawmakers say, the United States is one of the least-taxed countries in the industrialized world. In fact, as a percentage of the economy (as a share of gross domestic product, or GDP), tax revenue collected by local, state and federal government in the U.S. is only about 26 percent. That's the third lowest of the countries that are part of the Organization for Economic Cooperation and Development (OECD), which includes all the developed countries. (These figures are for 2008, the most recent year for which data are available.)[2]

So it's curious that the co-chairs of the President's fiscal commission, faced with the task of balancing the federal budget, have decided that the United States desperately needs to limit any tax increases, while achieving twice as much savings through cuts in public services.

Granted, there may be plenty of public services that the federal government provides that are unnecessary or inefficient. For example, it's not obvious why the United States should continue to maintain all the military bases built in Europe during the Cold War.

But the notion that tax increases should play a smaller role than cuts in public services is senseless.

In fact, the two co-chairs of the commission, Erskine Bowles, and Alan Simpson, are seriously taxaphobic. Their initial proposal, and this updated version, would "cap" federal revenue at 21 percent of GDP (or at least purport to do so). It's unclear why a commission tasked with reducing the deficit would want to limit revenues, nor is it clear how such a "cap" could work. Keep in mind that federal spending was over 22 percent of GDP during the Reagan years. That was before the baby-boomers were getting ready to retire and that was also a time when we were not engaged in a war (much less two wars).

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[2]Citizens for Tax Justice, "United States Remains One of the Least Taxed Industrial Countries," November 11, 2010. http://www.ctj.org/pdf/oecd111110.pdf

Why Does the Commission Want to Cut Tax Rates (i.e., Increase the Deficit) as Part of a Deficit Reduction Plan?

To think about what Congress has to do to balance the federal budget, it's helpful to understand the kinds of spending that the federal government does and why we haven't managed to pay for all of it.

One type of spending that Congress does is "discretionary," also called "appropriations" because it must be appropriated by Congress each year. Another type is "mandatory" spending, which is spending that takes place automatically each year without any new action from Congress. These include Social Security, Medicare and Medicaid, which take up large portions of the federal budget.

A third, less noticed type of spending is the spending that Congress does through the tax code, often called "tax expenditures," "tax subsidies," or, to use a more traditional term, "tax loopholes."

For example, one lawmaker may want to provide a million dollar subsidy to a particular industry. Another may want to help families pay tuition, and yet another wants to defray health care costs for workers. If any of these lawmakers face opposition to expanding government in these ways, they may choose to disguise these benefits as tax cuts. They simply enact a tax break (for business, tuition, health care costs or whatever) rather than a direct payment from the government.

The benefit and the cost is the same, to both the government and the recipient, as direct government spending.

The good news is that the deficit commission seems to acknowledge that tax expenditures are a form of spending that should be cut. The bad news is that the commission treats tax expenditures very differently from other types of spending. Savings from cutting discretionary spending and mandatory spending would be used to reduce the deficit, but savings from cutting tax expenditures would be used mostly to reduce tax rates!

As already explained, the plan would cut discretionary spending by about $300 billion and mandatory spending by about $100 billion in 2020. Whatever you think of these proposals, at least the commission proposes to use all the savings to reduce the budget deficit.

At the same time, the commission proposes to scrap hundreds of billions of dollars a year in what it deems to be unnecessary or wasteful spending programs implemented through the tax code. While one can argue about some of the specifics, certainly cracking down on a big part of the trillion dollars a year we spend on tax-based spending programs ought to be a primary target for narrowing the budget deficit.

But then comes the weird part. Does the commission want to use all of the savings from curbing unwarranted "tax expenditures" to reduce the budget deficit? No. Instead, the commission wants to devote most of the money from *these* kinds of spending cuts to reducing personal and corporate income tax rates!

How does this make any sense? Imagine if the commission had proposed to devote most of the money saved from direct spending cuts to lowering tax rates. People would call that crazy. But it seems just as crazy to do so when it comes to cracking down on tax expenditures.