

TAX CUTS

What Kind of Tax Cuts Will Restore Public Trust?

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Introduction

I like to pay taxes. With them I buy civilization.

Oliver Wendell Holmes, Jr.

Hardly a day goes by when Barack Obama and John McCain aren't vying to outdo each other in the tax cut department. Monday (October 27) on the campaign trail was no different. Obama again promised to reduce taxes on about 95% of America's wage earners and eliminate income taxes on seniors making less than \$50,000 a year. McCain has vowed to keep President Bush's 2001 and 2003 tax cuts and slash corporate tax rates to boot.

The candidates' glee in serving up these goodies is exceeded only by the voters' appetite for more of them. To suggest that someone might actually have to take responsibility and pay for Medicare, Social Security, the wars in Iraq and Afghanistan, interstate highways and the government's \$700 billion banking rescue is to invite ridicule and rejection at the polls.

No one likes paying taxes, of course, particularly given the inevitability that government will not spend all the money that it collects wisely or efficiently. But nearly three decades of anti-tax rhetoric, based on the irresponsible free-lunch notion that tax cuts "pay for" themselves by generating more revenue, has led to huge deficits and selfish attitudes. Instead of being seen as the unpleasant but vital price of a free society, taxes are too often regarded as unnecessary, unpatriotic or, in Leona Helmsley's famous description, only for the 'little people.'

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All the things we need and want our public trust to provide cost money. In the view of Holmes in the above quote, this public trust with public money buys civilization...security, order, liberty, contentment, and opportunity. The assumption of this framing starts there, but takes another turn in today's editorial from USA Today. We're assuming for our discussion that we do want what our public trust is capable of providing, BUT our public trust is broken. Three types of 'cuts' are described in our three approaches...each 'cut' will make a different type of 'healing' possible. What kinds of tax cuts will restore the public trust?

Approach 1: "Elective Surgery"

Fine-tune the Current, Workable Tax Code

'Elective surgery' can correct situations that are serious even though they're not life-threatening. These procedures are generally chosen to increase the quality of life in some way. For instance, joint replacements are many times considered as elective surgery. Because a bad hip or knee is not life-threatening, some health insurance companies call joint replacement surgeries 'elective', even though without it the patient may be effectively crippled.

Since both candidates in the Presidential election advocate for cuts within the existing tax code without changing the foundational system, this approach proposes ‘elective surgery’ on a tax structure that has serious problems, but isn’t seen to be life-threatening to the country. While fine-tuning is needed in the words of both campaigns, neither is advocating a severe transformation of the whole tax system.

What Can Be Done?

- Make 2001 and 2003 tax cuts permanent and slash corporate and capital gains taxes
- Cut taxes for the middle-class who never benefited from previous tax cuts
- Remove contribution limits on Social Security so all income levels pay equally...at the current rate

People Who Agree with this Approach Say....

- Taxes hold people and businesses back from achieving their true potential, so tax cuts fine-tune incentives and limits as the economy and the public’s will require
- While no one likes our tax system a whole lot, it’s still better than any of the alternatives

People Who Disagree with this Approach Say....

- This is just not enough...our tax system is too complex and has too many loopholes to inspire the public trust

A Possible Tradeoff Is....

- I’d like to see more equality in tax cuts, EVEN IF it means that my tax advantages might not be continued

Approach 2: “Taxable-income Resection” Dramatically Simplify Taxes

In surgical terminology, ‘resection’ is the partial removal of an organ or other bodily structure. This is major surgery, and is generally proposed only when the situation is life-threatening. This approach advocates deep cuts in tax rates through the removal of parts of the existing tax system. Steve Forbes, Republican candidate for President in 1996 and 2000, proposed a ‘Flat Tax’ that has been heralded as a success in many Eastern European countries since the fall of the Soviet Union. Mike Huckabee was an advocate of the ‘Fair Tax’ as he ran in the 2008 Republican Presidential nomination. Ron Paul, also running for President in 2008, advocated for ending the federal income tax, and favors allowing workers to opt out of Social Security.

What Can Be Done?

- Replace the current system with a ‘flat tax’ system with a constant tax rate. A ‘flat tax’ would tax household income (and sometimes corporate profits) at one marginal rate.
- Replace the current system with a ‘fair tax’, designed to replace all federal income taxes (including the alternative minimum tax, corporate income taxes, and capital gains taxes), payroll taxes (including Social Security and Medicare taxes), gift taxes, and estate taxes with a national retail sales tax
- Replace the current system with the minimum number of excise taxes and tariffs as needed to sustain a much smaller federal budget

People Who Agree with this Approach Say....

- A ‘flat tax’ is the simplest tax system possible, starting at a base income and taxing equally for everyone who makes more than that

- All three of these options would increase federal revenue as the tax loopholes and methods of evasion in an overly complex tax code disappear

People Who Disagree with this Approach Say....

- None of these 'simple yet equal' tax systems would give incentives or support to those who want to be economically upwardly mobile...these methods protect the 'status quo'

A Possible Tradeoff Is....

- I'd like to see a truly simple tax system, EVEN IF it means our economy might be a little slower in small business innovation and development

Approach 3: "Reconstructive Surgery"

Create a Balanced Portfolio of Taxes through Reverse Federalism

'Reconstructive surgery' is in its broadest sense the use of surgery to restore the form and function of the body. Reconstructive surgeons many times use the concept of a 'reconstructive ladder'...replacing a framework on which several additional layers can be formed and sustained.

This approach advocates a more balanced 'layering' of taxes across cities, counties, and states within an integrated federal system. The term 'layer cake federalism' was coined by Morton Grodzins (who also coined the term 'tipping point') at the University of Chicago. In this 'layer cake', the relationships between the central government of a nation and that of its states, counties, and cities are clearly spelled out and distinct from one another. The powers and policy assignments of the government hierarchy ('layers' of government) are balanced to maximize stability, flexibility and accountability. The national government taxes in order to deal with the issues that are national in scope, while the states, counties, and cities develop an integrated tax structure to deal with their own specific issues.

What Can Be Done?

- Reverse the decades of federalization by slowly but systematically decentralizing appropriate segments of government programs in the Departments of Agriculture, Commerce, Labor, Health & Human Services, Housing & Urban Development, Energy, Transportation, Education and Homeland Security
- End the practice of Congressional spending 'earmarks' immediately
- Clarify what functions need to be met at various 'layers' and pay for them there

People Who Agree with this Approach Say....

- Our tax system is too top-heavy and centralized, making it necessary for Congress to receive taxpayer dollars and then distribute those dollars through agency programs and 'earmarks' back to communities where the taxpayers live
- Tax cut advocates say they want people to have their own money back, but seldom work for increases in state and local taxes to meet the needs that were previously federalized

People Who Disagree with this Approach Say....

- It's naïve to think that this amount of integration and transparency is possible when federal bureaucrats will have to relinquish power in the process

A Possible Tradeoff Is....

- I'd like to see more local accountability for tax dollars, EVEN IF it meant that the overall system might be a little less efficient