REVIEW & OUTLOOK

Tax Reform for Growth

Dave Camp's plan would yield $700 billion in extra 'dynamic' revenue.

Feb. 26, 2014 7:28 p.m. ET

The smarter Republicans are trying to reclaim the mantle of economic opportunity, and on Wednesday Dave Camp climbed into this phone booth by proposing a detailed tax reform. The Chairman of the tax-writing Ways and Means Committee wants to lower tax rates and create a fairer, more efficient code, and his plan ought to shift the debate over taxes to growth from redistribution.

The American tax system has changed for the worse since the last reform in 1986, and Mr. Camp has spent three years learning about the dispiriting specifics, including more than 30 hearings. The Michigan Republican is a serious legislator who cares about policy, and his effort shows. We disagree with many details in his 979-page bill, but overall his direction is right. Even if his bill doesn't pass this year, its legwork will inform any future reform.

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The heart of the Camp plan would collapse today's seven income tax brackets into three, with about 99% of taxpayers paying 10% or 25%. The top statutory marginal rate would fall to 35% from 39.6% for individuals earning wage income over $400,000 ($450,000 for joint filers).

House Ways and Means Committee Chairman Rep. Dave Camp (R., Mich.) *Associated Press*

Mr. Camp would also simplify the tax code whose 70,000 pages defy human comprehension and cost $168 billion annually in compliance spending. The plan would sweep out this warren of deductions, credits and interest group carve-outs and raise the standard deduction to $11,000 for individuals and $22,000 for couples. About 95% of taxpayers would no longer itemize, according to estimates from the Joint Tax Committee, or JTC.

Mostly this modernization involves consolidating redundant provisions like the 15 tax breaks for higher education or repealing the Alternative Minimum Tax. For the record, Mr. Camp preserves the mortgage interest deduction for all current loans and, for new mortgages, lowers the cap to $500,000 from $1 million of mortgage debt. For the 5% of filers who would itemize, the plan retains the charitable deduction for contributions greater than 2% of income.

loopholes. U.S. companies are now subject to the highest combined federal-state tax rate in the developed world, which has depressed hiring and wages and driven capital and talent offshore. Mr. Camp's plan would make U.S. business more competitive by cutting the rate closer to the world average.

The larger goal is to impose fewer burdens on income and investment to lift the U.S. economy out of the malaise of President Obama's 2% expansion. For all Mr. Obama's focus on the "middle class," no modern Presidency has been worse for average Americans. Median household income is still 4.4% lower than when the recession ended in 2009, and the predictable result of trying to reduce inequality instead of increasing growth has been more inequality and less growth.

Related Video

Assistant editorial page editor James Freeman on the details behind the new tax reform plan unveiled Wednesday in Washington. Photo credit: Associated Press.

Congress's tax scorers predict the Camp reform would create $3.4 trillion more in economic growth and 1.8 million new jobs. But the bigger intellectual and political advance is that the Joint Tax Committee has scored the Camp proposal in a way that includes the tax revenue payoff from this faster growth.

Normally the JTC practices the occult science called static scoring, which assumes that GDP and investment and work behavior barely change when the tax system does. This model tends to show too much "lost" revenue and too little growth, and thus produces an anti-tax-cut bias. "Dynamic scoring" is another way of saying accurate scoring that recognizes the growth dividend of reforming the code.

Ample evidence shows that cutting rates on marginal income and capital will have significant feedback effects that yield more revenue, including studies by Harvard economists Martin Feldstein, Greg Mankiw and Matthew Weinzierl and others. These columns have pushed this stone up the mountain for decades, and maybe this time it won't roll back.

Statically speaking, the Camp plan is revenue- and distributional-neutral, but dynamically, Joint Tax estimates it will throw off $700 billion in higher receipts over a decade. If Mr. Obama is shrewder than usual, he'll pocket these dollars, call the Camp plan a tax increase on the rich to placate the left and bask in the political glow of more prosperity.

Mr. Camp could get even more bang for his reform buck if he didn't work off the JTC "current law" baseline that pretends that nominally temporary and currently expired tax breaks won't be renewed. But the reality is that Congress is going to extend items like the R&D credit, born in 1981, so reformers should assume they are permanent. That would allow another $1 trillion over 10 years to push rates down further.

In particular, Mr. Camp's top 35% individual rate is still too high, especially because it is structured as a "surcharge" on some but not all earners above $450,000 that will lead to the distortions that reform is supposed to stop. So he proposes that all "production" income should qualify for the 25% top rate, which would capture S corps or "pass-through" businesses. But wait until Congress stuffs its favorite campaign contributors into "production" while salary earners pay higher rates. Mr. Camp is attempting to deflect Mr. Obama's class war claims, but this provision is too clever by half.

Mike Lee who want to mimic liberals in using tax reform to redistribute income—albeit to GOP constituencies by greatly increasing the $1,000 per child tax credit. Mr. Camp does raise the per child tax credit to $1,500 to make the tax cut distributionally neutral, but such credits are expensive and do nothing for growth.

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Most weaknesses in Mr. Camp's plan are due to his trying to offer something that might attract a Democratic President and Senate. Many Republicans are also skeptical, believing they can coast to gains in November by attacking ObamaCare—full stop. They want to avoid voting on Mr. Camp's plan in the House.

Republicans should run against the health law, but they are already going to get those voters. They also need a positive agenda, especially for lifting growth and incomes. The GOP has made clear it's for cutting deficits. Now it needs to restore its reputation as the growth party, and Mr. Camp's proposal should start the debate.