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TO: Interested Parties
FROM: Anne Kim, Director of the Middle Class Program, and
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RE: Playing Offense on Taxes

Overview

In 2008, the economy will no doubt dominate the domestic policy debate, and as with every debate on this topic, talk will inevitably turn to taxes. Even more predictably, conservatives are certain to brand progressives who oppose the permanent extension of President Bush's tax cuts as "tax and spenders" and "tax raisers."

This memo is about how progressives can win the tax debate.

We propose a strategy that creates a contest between two competing plans and philosophies—one that benefits the middle class versus one that benefits the wealthy few. We offer a new way to pivot from the debate over a "permanent extension of the Bush tax cuts" to far more advantageous turf for progressives.

This strategy has three key elements:

- **Have your own middle-class economic agenda that includes middle-class tax cuts.** Progressives must offer an economic plan that restores confidence in the American economy, creates middle-class wealth and shows they understand how to get the economy moving for the benefit of average families. This plan should include middle class tax cuts and be promoted as part of an affirmative progressive agenda, as well as a sharp contrast to conservative tax plans.
- **Define defenders of the Bush tax cuts as seeking a "permanent extension of the Bush economic plan."** Rather than being put on the defensive over extending the Bush tax cuts, progressives can take the offensive by defining this agenda for what it really is: a permanent extension of an extremely unpopular and utterly dismal Bush economic plan. 71% of Americans disapprove of the president's handling of the economy. Progressives should make conservatives the defenders of the Bush economic plan and use the tax cuts as proof.
- **Elevate your differences to one of competing values and philosophies.** For decades, progressives have tried to convince Americans that conservatives

¹ Research assistance was provided by Policy Advisor Mark Donnell and Senior Policy Advisor Scott Winship.

are bad people who are in the pockets of big business. This has mostly failed, because it was the wrong assignment. The task is to convince people that conservatives have bad ideas for the economy, not bad motives, and that these ideas are based on values that most Americans do not share. Conservatives believe, for example, that wealthy people—not the middle class—are the engine of the economy. That is why the Bush economic plan has helped the very few at the very top. Progressives believe the middle class is the engine of the economy, and their plan benefits the very many in the wide middle.

This memo offers advice to progressives on each of these elements, including ideas for a middle-class tax cut agenda. In our companion memo, *Talking About the Economy*, we share some insights on how progressives can connect more effectively with the middle class.

I. The agenda: A Progressive Middle-class Economic Plan

Progressives must offer an economic agenda that will put American families back on the path to long-term prosperity and secure a solid future economy. A generous package of middle-class tax cuts should be part of this plan.

We are in favor of a series of targeted middle class tax cuts, because we believe the new pressures put on families by the new economy demand it. It is also the simplest and most effective rebuttal of the “tax and spend” charge. Overall, a middle-class tax cut proposal can provide:

- An efficient and immediate mechanism for providing tangible solutions to middle class problems and anxieties.
- A framework for delivering the message that progressives understand middle-class aspirations and challenges.
- A meaningful contrast between a progressive tax cut plan for the middle class with the conservative tax cut plan for the wealthy, and the potential to challenge conservatives to oppose a middle-class tax cut.

Progressives should offer a tax cut plan that achieves the following goals: (1) to create middle-class opportunity by helping families solve problems and overcome hurdles to their aspirations; and (2) to create a pro-growth environment that will lead to more and better middle-class jobs.

Creating middle-class opportunity

In our new economy, the rules for success have changed. A college degree, for example, was once a luxury but is now a necessity for lasting success and security in the middle-class.

The following package of tax cuts will help middle-class families succeed under these changing rules. These ideas will help families reach the following goals:

- **Pay for college.** Simplify and expand current tax law to create a single generous college tuition tax credit equal to 50% of college costs up to \$10,000. *Estimated cost: \$8.8 billion per year.*¹

- **Balance work and family.**
 - Double the tax break for child care. Provide more money for child care costs by doubling the Dependent Care Credit. *Estimated cost: \$400 million per year.*
 - “New baby” credit. Help families with the costs of caring for a newborn by expanding the Child Tax Credit for parents of young children. *Estimated cost: \$6 billion a year for a \$1,000 credit add-on to the Child Tax Credit for each of the first three years of a child’s life.*
- **Attain homeownership.**
 - First-time homebuyer credit. Create a \$1,500 first-time homebuyer credit to help restart the housing market. *Estimated cost: \$3.6 billion per year.*²
 - Two-year refinancing credit. Help homeowners caught in expensive mortgages transition to lower-cost loans by providing a two-year, one-time \$2,000 credit toward closing costs when they refinance into a fixed-rate mortgage. *Estimated cost: \$2.5 billion over two years.*³
- **Care for aging parents.** Expand the Dependent Care Credit to include caregiving expenses paid on behalf of an elderly parent. *Estimated cost: \$1.4 billion per year.*⁴

Creating an environment for middle-class job growth

Government must help establish a pro-growth economic environment that creates more high-paid American jobs.

In the past, most of the new jobs were created by companies that built things; most of tomorrow’s new jobs will come from companies that create, analyze, improve, and communicate products and ideas.

In a world that favors talent, education, innovation, and new technologies, no country and no people should be better poised for success than America. But we have had no direction from Washington, and our economy has been adrift.

The following measures can help to create and keep jobs here in America by helping our companies grow and thrive at doing what they do best.

- **Permanent expansion of the research and development (R&D) tax credit.** *Estimated cost: \$42 billion over five years.*⁵
- **Broadband infrastructure investment credit.** Provide businesses with tax credits to help finance broadband infrastructure upgrades to accommodate next-generation information technologies and increased demand for capacity. *Estimated cost: \$20 billion over ten years.*⁶
- **Permanent increase in small business expensing limits.** Make permanent the ability of small businesses to deduct up to \$100,000 per year in costs for new equipment and other investments. *Estimated cost: \$20 billion over ten years.*⁷
- **Small business enterprise credit.** Increase the allowable deduction for small business start-up costs from \$5,000 to \$10,000.⁸ *Estimated cost: \$700 million per year.*⁹

II. The critique: A permanent extension of the Bush economic plan.

Conservatives will seek to win the economic debate by supporting a permanent extension of the Bush tax cuts. This *must* be defined as a *permanent extension of the Bush economic plan*.

By offering a tax cut proposal of their own, progressives can move the debate off the conservative terrain of whether a candidate or elected official supports or opposes taxes and onto the stronger ground of who tax policy is supposed to benefit. And here, conservatives are highly vulnerable.

The centerpiece of President's Bush's economic policy was a package of tax cuts that was heavily tilted to the wealthiest of the wealthy, and founded on the belief that helping the wealthy is the best way to help America prosper. This policy is clearly a failure:

- Real overall median household income declined by 2% from 2000 to 2006.
- Real earnings dropped 4.7% among men from 2000 to 2005 to \$44,700 and were flat for women,¹⁰ while the economy grew at an average annual rate of 2.4%.
- Homeownership declined for the first time in 20 years.¹¹ Moreover, homeowners have lost \$240 billion in home equity—the largest source of middle-class wealth—in just the last nine months.¹²

In addition, conservative economic policies have utterly failed to help middle-class families pursue opportunity and achieve security:

- College tuitions have risen unchecked, increasing by 53% since 2000.¹³
- Health care costs are taking up a growing proportion of Americans' paychecks. Premiums have increased \$4,450 since 2000.¹⁴

By supporting the permanent extension of Bush's tax cuts, conservatives are supporting the permanent extension of a status quo in which wealthy people will receive yet more help from government while the middle class continues to tread water. Moreover, by defending the current course, conservatives are showing themselves to be satisfied with the current state of the economy and the current fortunes of the middle class. In short, they are enemies of change.

III. The contrast: Competing philosophies on how to build American prosperity

Over the past four decades, conservatives have so successfully managed to tar the label "liberal" that most progressives now hesitate to embrace it. They won this victory by attacking progressive *beliefs* and *values*—not motives or specific policies. For example, the standard conservative accusation that progressives don't believe in "personal responsibility" is a *value judgment* about progressive beliefs, not a specific criticism about a particular program.

Progressives can use the same tactic to turn the tables and inflict lasting damage on “conservatives.” They can do this by treating the issue of taxes as one of competing beliefs over how best to build America’s future.

Conservative beliefs about economic policies will not benefit the middle class, nor are they beliefs that middle-class Americans even share. For example:

- Conservatives believe that the wealthy, not the middle class, are the engine of American prosperity. Thus, government policies should be skewed toward helping the wealthy. For every 1 dollar in tax cuts directed to the middle class, more than 100 dollars were directed to millionaires .
- Conservatives also believe that markets are infallible. Thus, they failed to intervene in the housing market while the subprime crisis grew. As a result, millions of people have seen the equity in their homes evaporate, and the economy is on the brink of recession.
- Conservatives are enemies of change. They are blind to the challenges posed by the new economy to today’s middle-class families. And they are too ideologically rigid to change course and admit the failure of President Bush’s economic plan.

Conclusion

Over the coming months, conservatives will undoubtedly seek to define progressives as “tax and spenders”—it’s a charge that’s been in the conservative playbook for 35 years. To overcome this attack, progressives must turn this debate into one of competing tax plans and competing philosophies. For progressives, a fight to a draw on the tax debate is as good as a win. But playing offense will be critical if progressives are to succeed.

Endnotes

¹ Third Way estimate based on 2004 National Postsecondary Student Aid Study and IRS data. This credit would replace the Hope and Lifetime credits and the existing college tuition deduction. The credit would be available to families with up to \$150,000 in annual income.

² The National Association of Realtors estimates that about 40% of all homebuyers—or 3.2 million homebuyers annually—are buying their first home. This cost estimate assumes that all first-time homebuyers take full advantage of the credit. We also assume that the credit begins to phase out at \$75,000 in household income.

³ Third Way estimate based on the number of households estimated to benefit from the Bush Administration's rate freeze plan.

⁴ Third Way estimate.

⁵ Office of Management and Budget, *Analytical Perspectives: Budget of the United States Government, Fiscal Year 2008*, available at <http://www.whitehouse.gov/omb/budget/fy2008/pdf/apers/crosscutting.pdf>

⁶ According to industry research reports, the country needs to invest at least \$55 billion in infrastructure improvements to bridge the gap between current capacity and expected demand. See, e.g., various research reports by Nemertes Research, www.nemertes.com.

⁷ Office of Management and Budget, *Analytical Perspectives: Budget of the United States Government, Fiscal Year 2008*, available at <http://www.whitehouse.gov/omb/budget/fy2008/pdf/apers/receipts.pdf>. The 2003 tax law increased the small business expensing limit from \$25,000 to \$100,000 per year through 2009. When the provision expires in 2010, the limit will again be \$25,000.

⁸ See IRS Publication 535 for details on deduction of small business start-up expenses, available at <http://www.irs.gov/publications/p535/ch08.html#d0e5397>. Business start-up include expenses incurred prior to the commencement of business operations, such as advertising, travel, surveys, and training.

⁹ Third Way estimate based on Small Business Administration data on the number of new business starts per year and a 2006 Wells Fargo/Gallup Small Business Index study finding that small-business owners spend an average of \$10,000 on start-up costs.

¹⁰ Ibid.

¹¹ The homeownership rate peaked in 2004 at 69% and declined to 68% in 2007. U.S. Census Bureau data from the Housing Vacancies Survey. <http://www.census.gov/hhes/www/housing/hvs/historic/hist14.html>.

¹² Board of Governors of the Federal Reserve System, "Flow of Funds Accounts of the United States, Flows and Outstandings, Third Quarter 2007," Table B.100. Figures for Q4 of 2007 were projected from the Q1-Q3 change.

¹³ Third Way projections from National Center for Education Statistics data. <http://www.nces.ed.gov/fastfacts/display.asp?id=76>.

¹⁴ Kaiser Family Foundation/HRET Employer Benefits Survey. <http://www.kff.org/insurance/7672/sections/ehbs07-1-12.cfm> and <http://www.kff.org/insurance/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=13423>. Adjusted for inflation by Third Way.