The Daily Dish

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The State Department has set a February 2nd deadline for other federal agencies to weigh in on Keystone XL. There is still no final timeline on when we will see a decision from the State Department. The Senate could begin voting on amendments to a bill approving the pipeline as early as today. Past State Department environmental and economic analysis has come out in favor of building the long delayed pipeline. A majority of Americans also favor building, so the question remains, what is the hold up?

The House Homeland Security Committee will look at border security legislation this week. Scheduled for a Wednesday markup, the bill aims to achieve "operational control" over the United States' southern border. If operational control is not reached then the Department of Homeland Security "political appointees would be barred from travel using government aircraft, non-essential training and opportunities for salary bonuses."

Eakinomics: The President's Tax Plan

While Americans were busy enjoying their Saturday evening this past weekend, the White House spin machine was busy "leaking" the president's tax proposals in tonight's State of the Union address. The highlights are raising $320 billion through higher taxes on more of capital gains, higher taxation of dividends, and a surtax on the largest financial institutions. These taxes would be "spent through the tax code" by radically increasing the size and sweep of the Earned Income Tax Credit, Child Tax Credit, and other education and retirement tax breaks.

Taken item by item, there are some proposals with merit in the 10-page proposal. But taken as a whole, it is unsatisfying for three reasons:

1. It signals a White House out of ideas on growth. The paramount issue of the era is better economic growth, without which there will be no reversal of declining median household incomes, stagnant real earnings, and the broad damage to middle-class and lower-class families that has been the experience of the past 6 years. Instead of strategies for more rapid growth, the tax proposals offer hope by a massive, redistributive tax increase that will do nothing for economic growth. This comes on the heels of proposals for "free" college tuition and back-to-the-housing-bubble FHA fee reductions. Evidently, slow growth, soak-the-rich, and claim victory is the White House middle-class strategy.

2. A closer look reveals politics trumping policy. Piece-by-piece there are some meritorious elements, but these are undercut by the poor policy foundations. Consider the notion of "step up in basis at death." If I buy an asset for $10,000 and at my death it is worth $100,000, there is $90,000 of capital gains. Under present law, if these assets are bequeathed to, say, my children, the tax basis is "stepped up" to $100,000. If they subsequently sell the assets for $110,000 then there is only $10,000 of capital gains — $90,000 has been excluded by the step-up in basis. One may or may not like lower effective tax rates on capital gains — that is the plain effect of step-up in basis. More on that below. But if step-up is, as the White House asserts, a tax loophole then it should be closed. For every dollar and every taxpayer. But that is *not* what the president proposes. Instead, if you have $201,000 of capital gains, it is a loophole. If you have $199,000, it is not. The proposal has nothing to do with

sound tax policy. It is a political attack on the affluent in an accountant's clothing.

The same can be said for the new surtax on large (over $50 billion) financial firms. The essence of good tax policy is to not pick winners (smaller and non-financial firms) and losers (large, financial firms). This does precisely that. The president claims to be worried about excessive leverage, but a more direct way to deal with that would be to restrict the ability of *every* firm to deduct borrowing costs. And, by the way, isn't the Administration claiming that Dodd-Frank *worked*? If these firms have less leverage (they do), more capital (they do), and better supervision (time will tell), then this is nothing more than a shallow, populist attack disguised as financial services policy.

Why a 28 percent tax rate for dividends and capital gains? The White House fact sheet defends this as the "rate under President Reagan." It does not point out that the Tax Reform Act of 1986 was principled tax policy that taxed income from payroll, interest, dividends, and capital gains at the same tax rate — and the top rate was 28 percent. If this White House had such principles, all income would be taxed at a top rate of 39.6 percent. But the Administration knows that the 1986 approach was harmful to growth and unwound quickly, including bipartisan reductions in the effective taxation of capital gains during the 1990s. Higher taxes on the returns to equity investments — dividends and capital gains — *will be* harmful. The White House needs to explain why 28 percent is acceptably detrimental, but 29 percent (or 30, or 31) is not. The truth is that there is no principle at work. It is simply hiding behind President Reagan for a political attack on the rich.

3. It sets back the cause of tax reform. The president claims again and again to favor tax reform. If so, all loopholes would be on the table for purposes of lowering all rates as much as possible and generating additional growth. Cherry-picking loophole closing and spending the money (albeit through the tax code) is not tax reform. Drawing these lines in the sand is not the White House leadership needed to get tax reform done in 2015.

It is an open secret that the real goal of President Obama's tax proposals is to try to put Republicans on the defensive in 2016. That is, it is electoral politics by a president who will never stand for election again instead of efforts for real accomplishment in his final two years. If the president chooses politics over governance on a regular basis, he will quickly (and justifiably) be ignored by Republicans and Democrats alike on Capitol Hill. It is a recipe for a lame-duck to become irrelevant.

From the Forum

Week in Regulation by Sam Batkins, AAF Director of Regulatory Policy

Pimco Provides a Real World Test of FSOC's Systemic Risk Hypothesis