

## The Gang of Six Play

*A conceptual breakthrough that has too few details.*

Grand bipartisan budget deals are one of the great come-ons of Washington politics. They rarely work out, and when they do they usually benefit only the political class. The latest offer from the so-called Gang of Six Senators might be an exception, if—and this is a big if—its inviting generalities can be matched by useful details.

The budget outline—that's all it is so far—promises some \$3.7 trillion in deficit reduction that includes rewriting the tax code, reforming entitlements, stabilizing the national debt, freezing domestic spending and rewriting federal budget rules—all in a handy seven pages of talking points. Senate committee chairmen would have wide latitude to write the new laws as they see fit. Anyone up for Max Baucus rewriting the tax code?

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That said, the outline from the three Republicans (including Oklahoma conservative Tom Coburn) and three Democrats is different from most other such offers because it combines spending cuts with reform that would lower tax rates. Most Beltway budget deals combine immediate tax increases with the promise of future spending cuts that somehow never occur. They enhance Washington's claim on the nation's private resources. This deal has promise because it would reduce that claim.

That's especially true of the tax reform outline, which suggests moving to no more than three income tax rates, with a top rate in a range between 23% and 29%. This would be "paid for" by closing loopholes and tax preferences, but a marginal rate tax reduction of that magnitude would be worth giving up a lot. It could be by far the most pro-growth tax change since the 1980s, and the U.S. needs faster economic growth now above all else.



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Sen. Kent Conrad (D., N.D.), a member of the "Gang of Six"

As for spending control, this would come in two stages. The first "down payment" would cut \$600 billion over 10 years, mainly from discretionary programs. These cuts would be enforced by annual spending caps through 2015, admittedly from an inflated baseline after the two-year Obama spending blowout. But spending for most federal departments, public broadcasting, mass transit projects and the rest would be essentially frozen.

The caps would be enforced by automatic sequesters requiring supermajorities in Congress to override. Even better, this first stage would repeal the Class Act, a government program to offer long-term care insurance as part of ObamaCare. The program was deliberately designed not to finance itself—but only outside the first 10-year spending window—and is a future budget killer.

The Gang's outline would also change the consumer price index formula slightly to more accurately reflect real inflation in the economy. This could save close to \$100 billion over 10 years in spending for entitlements and

other programs, while also slightly increasing tax-bracket creep for upper income taxpayers. We think that's justified as more accurate financial measurement and should not count as a violation of any antitax pledge.

Then things get fuzzier. The second phase, to be passed later in this Congress, would include the harder reforms in entitlements, such as ensuring "the 75-year solvency of Social Security," whatever that means. Details to come later. The Medicare and Medicaid reductions look to be mostly more price controls on doctors and hospitals without any of the transformational reforms in Paul Ryan's House budget.

Even trickier is what a tax overhaul would look like in the end. Some of our friends say the outline appears to be a \$2 trillion to \$3 trillion tax increase, while Senator Kent Conrad of North Dakota says it is a \$1 trillion tax cut. Who's right?

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It depends on what assumptions you make about the future of the tax code. The Gang of Six relies on what it calls a "plausible baseline" of future tax rates, but that baseline does not assume a continuation of current tax policies. Instead it assumes that 30 million middle-class Americans get crunched by the Alternative Minimum Tax (AMT), and that the Bush tax cuts are extended past 2013 for those with incomes above \$250,000.

Under that scenario, according to the Senate Finance Committee, taxes are scheduled to go up automatically by some \$3.8 trillion over 10 years. The Gang of Six plan trims the price tag on that tax increase to about \$2.8 trillion and then calls this a \$1 trillion tax cut.

Gang member Mike Crapo of Idaho tells us that about \$1 trillion of the economic growth dividend from the lower tax rates would be counted as new revenues. We will see if that kind of long-overdue dynamic scoring is allowed once Democrats start writing the bill.

The AMT would also be eliminated, saving taxpayers \$1.7 trillion, and the corporate tax code would move to a "competitive territorial system"—two changes we've long endorsed. What makes us nervous is the Gang's instructions that tax writers "maintain or improve the progressivity of the tax code." The current code is already highly progressive, and making it any more so implies higher tax rates or more means-tested tax credits.

Certain high-profile tax breaks, such as the mortgage and charitable deduction and for health care and retirement, would also be "reformed, not eliminated." Our hope would be that the tax writers could duplicate the sweeping 1986 tax reforms that closed scores of tax deductions while slashing personal tax rates to 15% and 28%. The lower and less distorting the tax rate, the less deductions matter. The charitable writeoff is a lot more valuable with the 44% top tax rate that President Obama is seeking than at, say, a 25% rate.

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Regarding the politics, we wouldn't read too much into Mr. Obama's quick endorsement that this is a "very significant step." The plan gave him another chance to pose as a bipartisan defuser of the debt bomb he himself lit, and so he took it. We wonder how much entitlement reform he'd really support in the end. More intriguing is the motivation of Senate Democrats, especially those running for re-election in 2012 who don't want to vote for the tax increases and small-time spending cuts that Mr. Obama has offered so far.

As for Republicans, we understand the skepticism about promises of future spending cuts. GOP leaders need to see more of the fine print. But even the \$600 billion in spending cuts in stage one are worth grabbing as part of a debt ceiling vote. More broadly, Democrats in the Gang are making a big concession by saying that tax rates should go down, not up, and that the older entitlements and even ObamaCare must be reformed.

Maybe, just maybe, the U.S. can avoid a fiscal crack-up and a debt downgrade after all.