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Obama's and McCain's Tax Plans: A Mixed Bag

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Senators John McCain (R-AZ) and Barack Obama (D-IL) have released tax plans indicating their priorities when one of them becomes President of the United States. These plans involve significant changes to the federal tax system. While numerous blanks and vagaries remain in both plans, much of their respective plans are now clearly laid out.

As expressions of tax policy design, the two tax plans share the unfortunate attribute of adding to tax complexity. In other respects, the McCain proposal significantly advances good tax policy by emphasizing lower rates while the Obama plan raises tax rates. The Obama plan also suffers in its proliferation and expansion of refundable tax credits, further (and inappropriately) using the income tax system as an income support system.

The Heritage Foundation's Center for Data Analysis (CDA) has a detailed overview of the two plans and an assessment of their economic effects.¹ According to CDA, by 2018 the economy would be more than \$320 billion larger (after inflation), and average household income would be more than \$2,600 greater under the McCain plan than under the Obama plan.

Comparing Proposals. Comparing the McCain and Obama tax proposals reveals important similarities and distinctions. For example, among the similarities:

- **Lower Taxes.** Both sets of proposals, on balance, reduce federal taxes, demonstrating a clear and encouraging understanding by both candidates that federal income taxes are too high. McCain proposes \$300 million more in tax cuts over 10

years. Unfortunately, Obama proposes additional tax increases but delays their implementation until at least two years after the completion of a hypothetical second term.

- **Mostly Validating Bush Tax Policy.** Both sets of proposals recognize the fundamental soundness of the 2001 and 2003 tax cuts. While the Bush tax cuts have been criticized by liberal Democrats in Congress, Obama would make most of the income tax cuts permanent, whereas McCain would make all the income tax cuts permanent.
- **Support for a Reduced Death Tax.** Both sets of proposals recognize the harmful effects and unfairness of the death tax. Unfortunately, both plans retain the death tax but do so at much lower rates and with a larger exemption than existed in 2000.

Key Differences: Growth v. Redistributionism.

For all their similarities, the two plans have important distinctions. The most important is that McCain's tax proposals emphasize job creation and raising wages. This is most apparent in his proposal to extend all the 2001 and 2003 tax rate reductions and his proposals to cut the corporate tax rate from 35 percent—the second highest in the industrialized world—to 25 percent. It is also apparent in his

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proposal to allow immediate expensing of business investment necessary for job growth and international competitiveness.

The McCain plan includes another positive reform in that it replaces the unlimited exemption for employer-sponsored health insurance with a simple tax credit available to anyone purchasing health insurance. This provision corrects a terrible and unfair distortion in the tax code, would be a major step toward fundamental health care reform, and would significantly reduce the number of uninsured in America.²

Obama's tax proposals exemplify his view that redistributing income among citizens is more important than increasing their earnings and creating jobs. This view is apparent in his proposal to raise income taxes dramatically on individuals and small businesses earning more than \$250,000 and then to raise payroll taxes on these same taxpayers after 2018.

Obama's preference for punitive redistributionism over economic growth is also apparent in his proposal to raise the capital gains and dividend tax rates. Capital formation is essential for increasing worker productivity and workers' wages. Taxes on capital gains and dividends are direct and certain impediments to business investment.

While raising taxes on higher-earners, Obama also cuts taxes for those who already pay little or no federal income tax. He achieves this by increasing the child and dependent care tax credit and making it refundable. He further engages in redistributionism through a new, refundable make-work-pay tax credit for low-wage workers and by expanding the earned-income tax credit.

These distinctions in the economic effects of the two plans explain why the McCain tax plan would be expected to be more beneficial for economic growth, jobs, and wages as the CDA analysis suggests. Policy is about choices, and choices often

reflect trade-offs. A common and fundamental trade-off in economic policy is between economic growth and redistributing the income from growth, between job creation and wage growth on the one hand and economic security on the other. Especially with its focus on lower tax rates, the McCain tax plan is more conducive to economic growth and increasing wages; the Obama plan's higher tax rates and proliferation of refundable credits means the United States would forego a significant amount of possible wage growth in favor of redistributing wages and earnings.

Two Different Directions. Through the lens of sound tax policy, both McCain's and Obama's tax plans would leave the tax code more complicated than it is today. Even so, McCain's plan has important advantages through its focus on keeping tax rates low—and lowering them further in some instances—while improving incentives for investment and correcting an extremely harmful tax distortion at the heart of much of the trouble in America's health care financing system.

In contrast, the Obama plan raises income tax rates, raises payroll taxes on a delayed basis, and actively increases the use of the tax system to redistribute income to those who pay little or no income tax. Each of these aspects move the tax code in a decidedly inappropriate direction.

On balance, the McCain plan would be decidedly better for economic growth, largely because it would lower tax rates while the Obama plan would raise tax rates. Under the McCain tax plan, the economy would be expected to be about \$320 billion greater, and average household income about \$2,600 higher than would be the case under the Obama tax plan.

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1. William W. Beach et al., "The Obama and McCain Tax Plans: How Do They Compare?" Heritage Foundation Center for Data Analysis Report No. CDA08-09, October 15, 2008, at <http://www.heritage.org/Research/Economy/cda08-09.cfm>.
2. Robert Moffit and Nina Owcharenko, "The McCain Health Care Plan: More Power to Families," Heritage Foundation Backgrounder No. 2198, October 15, 2008, at <http://www.heritage.org/Research/HealthCare/bg2198.cfm>.