THE BENTSEN TAX CUT: REDISCOVERING REAGANOMICS

Last year's budget deal, with its record tax increase, helped throw the American economy into its current painful recession. At last, a growing number of Washington lawmakers recognize that taxes are too high and that tax cuts thus are needed to fuel economic growth and undo in part the damage done by last year's budget debacle. Senate Finance Committee Chairman Lloyd Bentsen, the Texas Democrat, is the latest of several legislators to call for tax cuts. His $72.5 billion proposal would give families long overdue tax relief by providing a $300 tax credit for each child and stimulate savings by expanding eligibility for Individual Retirement Accounts (IRAs). Reductions in revenues would be matched by savings in the defense budget made possible by the collapse of the Soviet Union.

Because of his leading role in the Senate on tax matters, Bentsen's initiative dramatically increases the likelihood that an anti-recession tax cut may become law. Indeed, Bentsen's proposal gives the White House an opportunity to achieve George Bush's long sought capital gains tax cut. The combination of family tax relief, IRA expansion, and a cut in the taxes on investment earnings is a sensible compromise between the White House and Bentsen positions. Marrying the two proposals also will generate more economic growth than either proposal would if enacted separately.

Bentsen's proposal is particularly important because it repudiates the calls from special interest groups to use savings from lower defense outlays to fund additional domestic spending. Bentsen correctly believes that any defense peace dividend should flow directly into the pockets of the American taxpayer, who has footed the Cold War bill for over four decades. Bentsen's proposal would do this by granting a $300 nonrefundable tax credit for each dependent child age eighteen and under; for an average family of four, after-tax income thus would increase by $600. By expanding IRA eligibility to just about all taxpayers, Bentsen's proposal would encourage savings.

Increasing Incentives. Bentsen's welcome proposal confirms the arguments that have been made for nearly a year by Senator Malcolm Wallop, the Wyoming Republican, Representative Tom DeLay, the Texas Republican, and Representative Robin Tallon, the South Carolina Democrat. Early this year, they introduced legislation (S. 381, H.R. 960) that would increase incentives to work, save, and invest by rolling back Social Security taxes to their levels of a couple of years ago, expanding IRAs, lowering the capital gains tax, and reducing the tax bias against investment by allowing businesses to deduct the cost of plant and equipment in the year that it is incurred (this is known as neutral capital cost recovery tax policy).

Senator Bill Bradley, the New Jersey Democrat, meanwhile is proposing a $116 billion tax cut for families combined with savings of $118 billion from lower levels of defense and domestic spending. Representative David Dreier, the California Republican, is proposing legislation similar to the Wallop-DeLay-Tallon bill; it differs mainly in its 10 percent across-the-board reduction in income tax rates in place of the cut in Social Security taxes. Senator Dan Coats of Indiana and Representative Frank Wolf of Virginia, both Republicans, also have introduced family tax relief legislation. Missing from the list of those recognizing that the recession in part is being prolonged by America's heavy tax burden is the White House.

Sound Advice Ignored. The belated recognition by much of Washington that high taxes and high government spending hinder job creation and economic growth certainly is welcome news. More welcome it would have been last year, when lawmakers repeatedly were warned that raising taxes would sabotage America's longest-ever peacetime economic expansion. George Bush and congressional Democrats ignored this sound advice. The result: millions of American workers and their families are paying a steep price. They will be correct if they blame their jobless plight on those who, last year, ignored the lessons of history and raised taxes.

Despite the growing recognition that last year's tax and spending hikes were a mistake that has forced economic hardship on the back of nearly every American, some policy makers still resist the remedy of tax cuts. Some politicians, for example, think the solution to the recession is to badger the Federal Reserve Board to create more money. The downturn was not caused by monetary policy, however, and returning to the inflation of the late 1970s is not going to end the recession either.

The unemployed also will be correct to blame those who now are reluctant to support tax cuts. Some members of Congress and some very senior White House officials inexplicably still defend last year's budget deal rather than endorse tax measures to energize the economy. Under the terms of the budget deal, it is extremely difficult to reduce taxes. Legislation that is estimated to increase the budget deficit is subject to procedural roadblocks. One roadblock is the Congressional Budget Office. When assessing the effects of a tax cut, this agency still relies on what experts call static models. These assume individuals do not change their behavior in response to changing incentives. Such static models, of course, were dead wrong when they predicted that the 1981 Reagan tax cut would cause higher inflation and lower economic growth. The same static analysis was also wrong last year, when higher taxes were predicted to promote higher growth. By using static models, the Congressional Budget Office can say that a tax cut will reduce revenues and thus violate last year's budget deals. This assessment is refuted by more credible models (called dynamic models) that predict tax revenue will not decline because individuals will work, save, and invest more when taxes are low. Another roadblock in the budget agreement is that it forbids policy makers from using defense savings to cut taxes, effectively blocking those tax cuts, such as Bentsen's and Bradley's, which are wholly or partially "financed" by defense savings.

The President and other champions of the 1990 budget deal are correct: tax cuts violate last year's agreement. The appropriate question is whether the agreement is worth preserving. The answer clearly is no. Last year's deal has been a disaster by every criterion. Bush said the deal was needed to reduce the deficit and keep the economy growing. Instead, the deficit has more than doubled and the economy is in recession. The budget deal saddled the economy with a record tax hike, led to a record increase in domestic spending, and will result in America's first $300 billion-plus deficit. Responsible legislators should seize this opportunity to "violate" and reverse the policy mistakes committed as part of the budget deal.

Ducking Responsibility. Some policy makers oppose tax cuts because they recoil at admitting that they were wrong last year when they raised taxes and spending. Both Congress and the White House have ducked responsibility for the recession. In doing this they have squandered the months that could have been used enacting legislation to create jobs. Instead they have engaged in a partisan political battle over extending unemployment benefits. There is no political advantage to holding the country in recession and refusing to return to the American taxpayers the savings realized by the end of the Cold War.

The disintegration of the Soviet Union and concomitant reduction in the threat to United States national security inevitably will lead to reductions in planned defense outlays. Since only the most naive observers believe the savings will be applied to the deficit, the real question is whether the money is returned to the taxpayers or whether it will be used to finance another domestic spending binge. With the economy still suffering from the tax increases imposed last year, the choice should be obvious.

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