ANOTHER SHADY BAIT—AND—SWITCH TAX DEAL

It was probably only a matter of time before congressional lawmakers, unable to say no to the constituencies that thrive on more spending, would take what they perceive to be the easy road to deficit reduction--a tax on business. This is exactly what they seem to be doing in advocating a hefty tax on imported oil. If Ronald Reagan bows to such a tax simply to get a budget agreement, it will be an unambiguous signal that his "unequivocal" campaign vow not to raise taxes was nothing more than an empty vote-catching ploy. His credibility would be in shambles. As bad, a tax increase would relieve Congress of the pressure to make painful, but necessary, reductions in federal spending. Perhaps worse, an oil tax would severely burden the American economy just when concern is growing about its future performance.

Reagan should remember the hard lesson of 1982. In that year he was persuaded that the tax hike in the Tax Equity and Fiscal Responsibility Act (TEFRA) would cut the five-year federal deficit by one-third. Officials and lawmakers promised, moreover, to cut $3 in spending for every $1 raised by TEFRA. The President reluctantly accepted this deal. The result: the deficit continued to soar and the spending cuts proved illusory. Now Congress is trying to lure the President with another shady bait-and-switch tax deal.

As 1982 proved, tax increases do not cut deficits. They merely give Congress an excuse not to cut spending. Lawmakers have already shown that they are not serious about eliminating programs and cutting waste. The Grace Commission's catalogue of redundant military bases, civilian program inefficiencies, and pork barrel projects was given short shrift on Capitol Hill. The Office of Management and Budget's FY 1986 Budget listed 20 programs to be eliminated, saving $36 billion over three years. This was whittled down to 13 (saving $22 billion) by the Senate and then to just one (saving $12.5 billion) by the House. Talk of actually eliminating programs now has all but vanished. And just last week, a minority of the Senate blocked the move to institute a line-item veto, which would have enabled the President to slice the fat out of the budget. For Ronald Reagan to compound this political failure by agreeing to a tax increase would be throwing red meat to insatiable spenders and hungry lobbyists.

As expected, congressional advocates are making this poisoned apple as pretty as they can for the President. The $5 a barrel "import fee" proposal comes at a time when oil prices are falling. And an import tax does not show up on a voter's 1040 tax form. But this only cruelly obscures its many damaging effects.

First, an oil import tax would blunt the much-needed economic boost that is coming from falling oil prices. Oil is a basic cost of production for all American industry, and a component of virtually all export costs. As such, a rise in the price of fuel would drag the economy substantially at a time when concern is growing that output is slowing. According to a 1982 Congressional Budget Office study, a $5 a barrel oil import tax would raise gasoline prices by up to 12¢ a gallon and cost nearly 200,000 American jobs. And it would push up the cost of goods the U.S. exports at a time when most Americans are very worried by the nation's $120 billion trade deficit. Since foreign nations, of course, will not be adding a new tax on oil, they will have an extra advantage in competing with U.S.-made goods.

Second, an oil import fee is a regressive tax. Because it is passed on to the consumer in the form of price increases on such basic goods and services as gasoline, transportation, heating oil, and food, its main burden falls on middle- and especially low-income Americans.

Third, price rises induced by the oil tax would boost the consumer price index. This would revive fears of rekindled inflation, thereby reducing confidence in the economy by domestic and overseas investors. Moreover, a rise in the index would trigger cost-of-living adjustments in dozens of federal programs. The result: a tax designed to cut the deficit would boost outlays.

Fourth, an import tax would send a protectionist signal to the world's traders, inviting retaliation. Britain now exports more oil than Saudi Arabia, and the U.S. imports two-thirds of its oil needs from non-OPEC producers. The U.S.'s biggest source of foreign oil, in fact, is Mexico; a drop in its oil revenues, that is the certain consequence of a U.S. oil import fee, would make it more difficult for Mexico to repay its loans to the U.S. and to sustain the economic health required for political stability. Hitting oil exporters at a time of falling world prices would hardly make them inclined to reduce barriers to American goods.

The oil tax could be the make-or-break decision for Ronald Reagan's entire economic program. If he stands firm, as he often has in the past, he will galvanize his many congressional supporters and will deny Congress an escape route from cutting spending. But if he reneges on the no-tax pledge, he will let Congress off the hook, demoralize his embattled supporters, and threaten the vitality of the American economy. There could be no better recipe for a lame duck presidency.

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For Further Reading:

Thomas M. Humbert, "Breach of Faith: The Tax Package," Heritage Foundation Backgrounder No. 201, August 7, 1982.
Oil Import Tariffs: Alternative Scenarios and Their Effects (Conressional Budget Office, 1982).