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# THE TAX PACKAGE: IT'S UNFAIR

## INTRODUCTION

Raising taxes, by any other name, remains raising taxes. A measure designed to collect an extra $99 billion from American taxpayers and enterprises is going to withdraw, from the economy, precisely that capital which is needed for the investment that yields growth, efficiency and jobs. Tax hikes do not bring down interest rates and government spending. They never have; they never will. To say that they do breaks faith with the Reagan economic program enacted last year. Only significant spending cuts keep that faith.

The President, in an address to the nation, insisted that he has not breached faith with his supply-side economic philosophy by endorsing possibly "the largest tax reform in history." Such a claim deserves close attention. If the budget deficit can indeed be cut by some $99 billion over three years by increasing tax compliance and by making everyone pay their fair share of taxes, who could disagree? If such were true, conservatives, liberals, and moderates should applaud the President.

Everyone agrees that budget deficits and high interest rates are wreaking havoc on the economy. The question remains, however, is the President correct in the solution he currently proposes? No one is rooting for the President more than his conservative following. Conservatives were his earliest and staunchest supporters; many owe their election victories to the popularity of the economic policies that he advocated. And if these policies fail to restore national prosperity soon, they will suffer the voter's wrath. Many of these conservatives waited years for the public to understand and endorse Reagan's message of enhanced economic growth through smaller government. Conservatives for years beat the drums about the dangers of big government and deficit spending.

Why then are these conservatives leading the revolt against Reagan's tax package? And why is it being applauded by those liberals who have done so much to cause the staggering budget deficits by supporting open-ended government spending?

Perhaps, as the President said, there has been great confusion about the tax package. As such, Congress should, one last time before it votes, weigh the merits and drawbacks of the measure.

## TAXES AND INTEREST RATES

The main reason that the country should support a tax increase, say its advocates, is that increased revenues are necessary to reduce the budget deficits--the major cause, it is claimed, for the high interest rates blocking economic recovery. But tax increases will not lower interest rates, stimulate economic recovery or create more jobs. This was convincingly stated at the GOP 1980 Convention in Detroit by Ronald Reagan. When accepting the nomination for President, he declared: "The American people are carrying the heaviest peacetime tax burden in our nation's history, and it will grow even heavier, under present law, next January. We are taxing ourselves into economic exhaustion and stagnation, crushing our ability and incentive to save, invest, and produce. This must stop. We must halt this fiscal self-destruction and restore sanity to our economic system."

An enormous plurality of Americans agree. According to a recent Gallup poll, 47 percent of the public favor budget cuts to reduce the deficit; only 4 percent favor higher taxes, while 20 percent favor both; 18 percent favor neither. Economists also condemn tax increases now. Imposing a tax increase on a weak economy is a recipe for economic disaster. Whether it is the largest tax increase in history, or the second largest, is irrelevant. A tax increase in a recession could hurtle the economy into a steep nosedive and actually aggravate the budget deficit problem by sabotaging economic growth. A defict of $104 billion is currently projected by the Administration for FY 1983, based on an assumed 4 percent growth in GNP next year. If the tax hike slows economic growth to only 2½ percent, the deficit would climb to around $150 billion. As candidate, Ronald Reagan wisely warned that tax increases to cut deficits may be self-defeating.

While deficits should be reduced for many reasons, lowering interest rates is not one. There simply is no statistical or historical evidence linking lower deficits to a dramatic lowering of interest rates. Indeed, if high deficits do cause high interest rates, then why have rates declined so dramatically in recent months? The prime rate was at a lofty 21.5 percent when Reagan took office. Today, when projected budget deficits are over six times higher than projected in the Administration's March 1981 forecast, the prime rate is 14½ percent and falling.

Recently, the Congressional Budget Office raised its projected deficit for FY 1983 by $40 billion. This should have caused interest rates to jump--if big deficits mean high rates. Instead, Treasury bill rates fell below double-digit levels for the first time since spring 1980. It is simply not the case that there is a direct relationship between high interest rates and budget deficits. History confirms this with many examples.

Budget deficits, of course, do mean that the federal government will claim, through increased borrowing, a larger share of the private sector's capital. But tax increases also claim a larger share of the capital. When that capital pool shrinks, interest rates are likely to rise. Thus lowering the deficit by hiking taxes is not going to do much to bring down interest rates. For that to happen, the defict has to be lowered by reducing government spending. Milton Friedman points out that the debate over whether to finance government spending by taxes or deficits is pretty much irrelevant. Both sources of funds represent a loss to the private sector.

BUT IS IT FAIR?

Supporters of the $99 billion tax package maintain that they are not calling for a tax increase but a tax reform. Three-quarters of the revenues are to be raised, they contend, by enhancing tax compliance and plugging loopholes. It sounds good. Who could be opposed to making tax cheaters pay up and making everyone, especially the rich, pay their fair share? Isn't it, as the President asked, a matter of fairness?

Indeed, tax cheaters should be fully prosecuted; laws to do this are already on the books. Mounting tax cheating is a cancer on the tax system, sapping the vigor of what used to be of particular pride to Americans: their voluntary compliance with the tax code.

But the so-called compliance provisions of the tax bill are greatly exaggerated. In fact, it is misleading to call this a tax compliance or fairness measure at all. It is overwhelmingly a tax hike, pure and simple. It is draining $99 billion from the economy. If the measure really is a reform, then cuts equalling the new revenues should be enacted. But the tax bill's revenue will not be returned to the public; it will be spent on government programs. This is a disguised tax hike, not a "fairness" reform.

Despite the attempt to tag the bill a compliance and reform package, only about $2 of every $10 raised comes from what might be called true compliance measures: increased reporting, penalties, and interest charges. The remaining $8 is a tax increase. Many of these compliance items will cost the honest taxpayers--the vast majority of Americans--more in paperwork and expenses. Is this fair to them?

Withholding on interest and dividends--the largest single "compliance" item--typifies the unfair costs imposed on honest taxpayers and businesses. Withholding could inflict on the law-abiding public about $3.2 billion in adminstrative costs and lost interest, plus the very real costs of added time to comply with a new set of regulations.

These costs nearly match the $3.9 billion in new taxes raised by the measure. Is it fair to impose these costs on the vast majority of investors and savers who already pay their taxes honestly? Is it fair to compel honest investors and savers to pay their taxes sooner, essentially giving Uncle Sam an interest free loan of tax dollars? Is it fair to increase enormously the paperwork burden on legitimate financial institutions? It is ironic that these unfair measures are introduced by an Administration pledged to reduce the paperwork burden on business.

Although the bill is entitled the "Tax Equity and Fiscal Responsibility Act of 1982," it has very little to do with either. More properly, it should be called the "Business and Investment Tax Increase Act." Over 60 percent of the new revenues is from increasing business taxes. Among the dozen or so business tax hikes recommended, the package repeals the 1985-1986 depreciation changes, accelerates corporate tax payments, limits the use of investment tax credits, and repeals the safe harbor tax leasing provision.

Businessmen, who were jubilant over last year's tax relief package, are understandably now confused and angry. How can they plan the investments and expansion essential to economic growth if Washington keeps changing the rules? The Administration, in less than a year, seems to have reversed its philosophy substantially on the issue of business tax cuts to enhance capital investment.

According to the U.S. Chamber of Commerce, business received only 19 percent of the tax reductions enacted last year and will lose 70 percent of this if the tax package is enacted. Notes the Chamber: "With profits down, these tax increases will further erode corporate liquidity, diminish investment and delay the time when the business sector can contribute to the economic recovery that is taking its first, faltering steps. Does this sound like Reaganomics? And is this fair to the American workingman, including the unemployed, whose future jobs depend on today's business investments?

Others of the so-called compliance items raise important questions of civil liberities. The tax act grants IRS agents new power, among other things, to issue and enforce administrative summons. This expands the IRS' authority to require financial institutions to divulge confidential information on their customers. These powers are fine when the IRS goes after tax cheats. But the rights of legitimate taxpayers should also be protected. Such civil liberties questions deserve much more attention than the current rushed debate has allowed.

PHANTOM BUDGET CUTS

Perhaps the most seductive argument in the tax package is that the hikes are part of a compromise that includes the reductions in government spending. It is claimed that the $99 billion tax increase is the necessary price to pay for a congressional approval of over $280 billion in budget cuts over three years. Under the terms of this compromise, every $1 in tax increases is supposed to yield $3 in budget cuts. If only this would be true. Most conservatives probably would swallow hard and accept the increases to achieve such budget cuts. The only problem is that the chances are slim that the cuts will turn out to be anything more than phantoms. The compromise is very lopsided: the tax increases, if passed, become effective immediately, while the hopes for budget cuts are fading fast. Under close examination, the $280 billion in cuts melt away. Many of the trumpeted savings are pie-in-the-sky wishes; as for others, Congress is already balking at them. The Concurrent Budget Resolution passed earlier this year recommended the following savings:

| Item | Over 3 Years | Percent of Savings |
|---|---|---|
| Non-Legislative | | |
| Management Savings | $ 46.6 billion | 16.6 |
| Interest Rate Savings | 54.9 billion | 19.6 |
| Debt Service Savings | 52.8 billion | 18.8 |
| Subtotal: Non-legislative | $154.3 billion | 55% |
| Legislative | | |
| Reconciliation Cuts | $ 27.2 billion | 10 |
| Non-Reconciliation Cuts | 13.6 billion | 5 |
| Appropriations Committee Cuts | 85.1 billion | 30 |
| Subtotal: Legislative | $125.9 billion | 45 |
| Total Spending Reduction | $280.2 billion | 100% |

Approximately 55 percent of the alleged $280 billion in budget cuts, or over $150 billion, is to come from three non-legislative items which few experts believe have any chance of saving such enormous sums. The first item, management savings, is supposed to come from things like selling more federal real estate, accelerating the leasing of oil and gas tracts, and reducing waste, fraud and abuse. All fine ideas. The problem is that in each case the government already has been thwarted from saving much or even getting the programs going.

The interest rate savings and debt service savings are even more elusive. These two items account for about one-third of the total savings, but most analysts doubt that these sort of savings on financing the federal debt are realistic. Only a Budget Director desperately searching for easy ways to show reduced budget deficits could predict such interest rate reductions.

On the legislative side, some budget cuts have been made. But Congress is very far from achieving the $125 billion in cuts suggested in the Budget Resolution. So far Congres has acted on only $30 billion in budget cuts over three years. This means that there are only some 30¢ in cuts for every $1 in tax hikes--a ratio exactly the reverse of what Reagan said was the minimum he would accept. Instead of the $3 in budget cuts for every $1 in tax increase, the Congress is most likely to give Reagan only $1 in budget cuts for every $3 in tax levies.

Even much of the $30 billion in budget cuts that the Congress has passed is dubious. Three-year Food Stamp savings fall some $6 billion short of Administration recommendations. The conferees agreed to major changes in the wheat, corn, feed grain and rice support programs. But the savings are achieved only by raising the cost of these basic commodities. The measure offers bigger loans and subsidies to farmers who set aside up to one-fourth of their land. Since this program will increase consumer commodity prices, the budget saving comes only at the consumers' expense.

Non-reconciled spending cuts are almost entirely phantom. Of the $13 billion recommended, only $294 million in cuts are expected. Finally, some $85 billion in cuts still await action by the Appropriations Committees. These savings must be achieved by limiting new authorizations and by reducing appropriations bills. According to a survey by Representative Newt Gingrich (R-GA), the three appropriations bills reported to date have not come close to the recommended cuts. In fact, most of the $85 billion in cuts most likely will evaporate as the committee passes bill after bill exceeding recommendations. According to Gingrich: "To date, the Appropriations Committee has reported out three bills; HUD, Commerce/Justice/State, and Military Construction. These three bills exceed the budget resolution assumptions by $356 million."

What this all means is that Ronald Reagan will see little more than $30 billion in budget cuts over three years, far from the $280 billion in cuts that Congress has promised. Without the budget cuts, however, the compromise that Reagan struck with Congress is not a bargain at all, but a capitulation to the proponents of ever-increasing government spending.

Over the past decade, though revenues have soared by an annual average rate of about 10½ percent, Congress always managed to find new ways to spend the windfall. Despite the tremendous revenue increase, government deficits ballooned from less than $15 billion in 1973 to over $100 billion today. Over the same ten years, federal government spending increased from 21.5 percent of GNP to over 24 percent. Like a cat chasing its own tail, the faster government revenues grow, the faster government spending races.

## CONCLUSION

The tax package is being sold on grounds of fairness. But what is fair about a bill that mainly raises taxes on capital formation that is needed to create jobs? Over 60 percent of the tax hike is directly on business investment and in many cases repeals measures which last year the Administration argued were crucial to business recovery. What is involved is the importance of business investment. Lower investment ripples through the economy--as lower productivity, higher inflation, obsolete technology, business failure, and ultimately to the worker as lower wages or a lost job.

Many policymakers are now focusing on the tiny portion of taxpayers who cheat or who receive favorable tax treatment. Does it make sense, however, to make 100 percent tax compliance the major goal of economic policy? To be sure, abusive tax practices are unfair. So is the loss of economic opportunity and the reduced standard of living that this tax bill will exact from average citizens. If tax compliance is a problem, then it should be solved--but not used as a cloak to disguise an enormous tax boost.

Conservatives are being urged to accept a massive tax increase in exchange for phantom budget cuts and imaginary budget savings. They should not fall for this--even though the pleadings are coming from the Oval Office. This is no time for conservatives to abandon the Reagan economic program even though the White House seems to be. The recession has bottomed out, inflation is down, and interest rates are falling substantially. And this is happening though the Reagan economic program is only ten months old. Tax hikes were bad economic policy last year, they are bad today. Conservatives understand this--and it is hoped that the White House once again will also.

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