THE WALL STREET JOURNAL

FRIDAY, OCTOBER 25, 1985

Ground the Tax-Reform Hijackers

By RICHARD W. RAHN

When President Reagan launched his campaign for tax reform earlier this year, average Americans as well as the business community in general applauded his initiative as a means of promoting economic growth and greater simplicity and fairness in the tax code. That is why the recent hijacking of the president's program in the House Ways and Means Committee is so disturbing. An effort to revive a pro-growth tax-reform program on the House floor is essential. If that effort fails, and the misguided Ways and Means proposals gather momentum, President Reagan should keep his distance from tax reform until next year, when Congress will better realize that he won't acquiesce in the foisting of tax-reform fraud upon the American people.

Nothing less than a national tragedy is unfolding in the House Ways and Means Committee, as its members transmute the laudable goals of tax reform into a complex, anti-growth orgy of redistributive "justice." In an effort to soak the rich in the name of fairness, Ways and Means is developing a bill that would succeed only in derailing the economy, increasing poverty and harming the very people the plan's proponents claim to be helping.

Not Good, Simple or Fair

The Ways and Means Committee staff's options, which are serving as the basis of the committee's drafting process, are not good for the economy, simple or fair. The plan would mandate higher corporate income tax rates than the president's plan, and also saddle the economy with capital cost recovery allowances greatly inferior to those in effect during the "stagnant '70s." As proposed, the staff's capital cost recovery system raises the after-tax cost of some equipment as much as 25%. And most incredibly, the capital gains tax, recognized by Congress back in 1978 as an impediment to growth, is slated for an increase above *present* law. These and other anti-growth provisions, such as a corporate minimum tax that would severely penalize low-profit companies, new capital investment and research-and-development expenditures, would damage the economy and threaten to throw the U.S. into a recession.

Listen to the first sounds of warning: Joel L. Prakken of the consulting firm of Lawrence H. Meyer & Associates, using the Washington University macroeconomic model, has quantified the effects of the House Ways and Means staff options. By 1990, real gross national product would be $58 billion, or 3.1%, lower than under current law. Fixed investment in equipment and structures would be an amazing $39 billion lower by 1990, resulting in a cumulative decline of $102 billion over the next five years. In 1990, the federal deficit would be $16 billion higher and the unemployment rate would be 1.6 percentage points higher than in the absence of the proposed tax changes.

It is not just the pro-growth aspects of the bill that are disappearing. The doubling of the personal and dependent exemption, key to reducing the tax burden on the working poor and restoring protection for families, already has been cut back.

Unfortunately, President Reagan is becoming an unknowing accomplice to this process. He continues to travel around the country insisting the administration-backed proposal will result in a simpler, fairer and more pro-growth tax system. At the same time, some of his subordinates, understandably eager to secure what would be a historic piece of legislation, have been collaborating with the Ways and Means Committee in drafting a program that will likely damage the American economy. These administration officials appear to have let their focus drift, from creating true tax reform—one that includes both substantial reductions in personal and corporate marginal tax rates and strong incentives for productive savings and investment—to producing a bill labeled tax reform—a bill that is reform in name only.

Stopping the frenzied activity on Capitol Hill, aimed at passing a bill at any price, will not put a halt to tax reform. It will simply end the ongoing surrender of the president's program.

It now appears, however, that there is no chance that anything resembling either the president's proposal or the Ways and Means Committee proposal will be adopted. The reason for this is simple: The American people and the business community are not yet convinced that if they give up most of their tax preferences, they will receive corresponding cuts in their tax rates that will make their lives better rather than worse.

Most members of Congress understand these sentiments and hence will not be willing to vote against most of the more popular tax preferences. Without eliminating many tax preferences, the only way the Ways and Means Committee will be able to achieve its revenue targets (on a static basis) is by increasing tax rates. Ways and Means Chairman Dan Rostenkowski (D., Ill.) very much wants a tax-reform bill passed. In an effort to speed up the process, he has scheduled special committee sessions that start today and continue through the weekend. It is quite likely his committee will approve a bill that will contain most of the existing tax preferences and include a maximum 40% personal and corporate tax rate (instead of the 35% personal and 33% business rates in the president's proposal).

The fate of such a bill on the House floor is much more uncertain, but there is a danger it might pass.

Republicans and pro-growth Democrats in the House will then have the opportunity to substitute a true pro-growth tax-reform plan. Given the overwhelming Democratic House majority, such an alternative plan would be difficult to pass. But the battle is still worth waging. At the very least, a spirited debate on the House floor that points out the shortcomings of the Ways and Means bill might help prevent its passage.

-OVER-

The Republican Senate will not accept a Ways and Means tax bill this year, given the president's opposition to both a rate higher than 35% and a broad-based sales tax. And there is not enough time left on the congressional clock this year for the Senate to fashion an alternative bill that could pass both houses of Congress. So, the bottom line is clear: There will be no tax-reform bill in 1985.

Tax reform, however, will be back in 1986, as long as it remains prominent on the president's agenda.

The administration should realize the president's efforts on behalf of tax reform have been hijacked. This realization is not the end of tax reform—it presents the opportunity for a new beginning. The president only recently demonstrated that he knows how to deal with hijackers. You bring them down to earth.

And that is what is necessary today with the present effort. The president must step back and outline to the American people his goals for tax reform. Specifically, tax reform should be designed to lower the cost of labor and capital to spur economic growth and opportunity and to enhance U.S. international competitiveness. Only when these goals are made non-negotiable can there be a return to the bargaining table to work out details.

On the Flip Side

The key to this new beginning will be to reject the notion of revenue neutrality based on static models of the U.S. economy. As demonstrated by the 1981 tax cut (and by the tax cuts of John F. Kennedy and Calvin Coolidge), people do respond to reductions in tax rates by saving, investing and undertaking more productive work. This increases revenue above static model estimates. And on the flip side, eliminating tax credits and deductions brings in less revenue than static models would forecast. Properly constructed, tax reform should lose revenue on a static basis and achieve revenue neutrality through economic growth.

President Reagan's stated goal is to continue encouraging strong economic growth. In this, he has the strong support of the U.S. business community and the nation as a whole. Putting a halt to the frenzied activity on Capitol Hill, which is aimed at passing a bill at any price, will not end the drive for tax reform. It will simply stop the ongoing surrender of the president's program.

Once the president and Congress develop a consensus on the specifics of true tax reform, the U.S. can begin anew, coming up with an alternative bill that is tax reform in spirit as well as name.

Mr. Rahn is vice president and chief economist for the U.S. Chamber of Commerce.