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Reality lapses
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Over the past several weeks, we have been treated to the spectacle of many prominent people losing touch with reality, starting off with "Baghdad Bob" (a.k.a. Mohammed Saeed Al-Sahhaf), Iraq's Information Minister, who kept insisting the Americans were not in Baghdad, while U.S. tanks were just blocks from him. Some Americans on the right, left and center, and particularly U.S. senators, seem to have caught the reality denial disease.

Some claim American soldiers were deliberately trying to kill journalists. Others insist our Iraqi mission was dictated by the Israeli lobby to support Prime Minister Ariel Sharon. Those who make such claims must be denying reality by assuming that Richard Cheney, Donald Rumsfeld, Colin Powell, Condoleezza Rice, and President Bush, as well as the entire chain of command are all disloyal and irresponsible, with no ability to think for themselves. One may have honest differences of opinions with administration policies without engaging in reality denial.

We have been treated to Hollywood stars telling us hundreds of thousands of Iraqi civilians and tens of thousands of U.S. troops would die, without any basis for such statements. House Minority Leader Nancy Pelosi bought in to some of these numbers, but she is from California, the land of reality denial — so what can we expect? Now that the real killer of the Iraqi people, Saddam, is out, how long do you think we will have to wait for reality to reach Hollywood?

The U.S. Senate has had a mass infection of the denial of reality disease. It has been caught by all of the Democrats, except for Sen. Zell Miller of Georgia, and several of the Republicans. The reaction to the president's proposal to eliminate the double taxation of dividends is a prime example of the disease at work. Opponents of the measure have made several arguments.

One group, led by Senate Minority Leader Tom Daschle, argues that the elimination of the double tax is "unfair." The proposal is only "unfair" if the normal meaning of the word "fair" is denied. How is it "unfair" to stop taxing the same income more than once? How is it "unfair" to reduce the effective tax on this income that exceeds 75 percent for many people? How is it "unfair" to create jobs for people who do not now have them, and boost real incomes by increasing capital formation, which this proposal would do? How is it "unfair" to make us more competitive with foreign countries, many of which do not have this double tax?

The Daschle crowd gets away with this reality denial because too few in the media are knowledgeable enough or courageous enough to ask the obvious follow-up questions.

Another group of senators favors the elimination of the double tax on dividends but wants to do it at the corporate level rather than the individual level. Sen. Jon Corzine, New Jersey Democrat, made this statement at a luncheon hosted by "Kudlow & Cramer" of CNBC last week. This would meet the reality test if Mr. Corzine and his fellow senators, who make similar declarations, would actually introduce a bill and make some effort to eliminate the double tax at the corporate level, but they have not done so.

A legitimate case can be made for eliminating the double tax at the corporate level, but it will "cost" a lot more than the president's proposal, and most of the same people who say we should eliminate it at the corporate level are also saying the deficit is too big. Mr. Corzine clearly understands that the dividend double tax is unfair and economically destructive, but I expect he will vote against eliminating it, with the excuse that it was not done his way. Would you have confidence in a doctor who knows there are two ways of curing your ailment, but will not treat you unless you take his preferred pill rather than another available pill that will also make you well?

Other senators — including Republicans Olympia Snowe of Maine and George Voinovich of Ohio — say they would like to get rid of the double tax on dividends but it will "cost" too much, thus increasing the deficit and driving up interest rates. This could be a valid reason if it were true, but it is not. Some in Washington — with a static view of the world — argue that tax rates have very little effect on behavior and hence any tax rate reduction will reduce revenue thus increasing the deficit (assuming a constant level of spending). Others — with a dynamic view of the world — argue a tax rate reduction on labor or capital will cause people to work or save and invest more, thus increasing economic growth, which leads to some revenue feedback to partially or fully offset the rate reduction.

The tax on dividends is a tax on productive savings and investment. If you have a static view of world, a \$1 decrease in the dividend tax would increase private saving by \$1 and increase the government deficit by \$1 which, by totally offsetting each other, can have no effect on inflation or interest rates.

If you have a dynamic view of the world, a \$1 reduction in dividends will be most likely invested in an activity with a higher return than government and the rate reduction might cause one to save more. These effects will somewhat offset the initial increase in the government deficit, leading to lower inflation and interest rates (with any given monetary policy).

Those who claim reducing the double tax on dividends will increase inflation and interest rates are denying the reality that there are two sides to an equation.

What America cannot afford is senators who, like "Baghdad Bob," deny reality.

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