House Republican Conference

CHAIRMAN
JERRY LEWIS, M.C.
35TH DISTRICT, CALIFORNIA
VICE CHAIRMAN
BILL McCOLLUM, M.C.
5TH DISTRICT, FLORIDA
SECRETARY
VIN WEBER, M.C.
2ND DISTRICT, MINNESOTA

ROOM 1618 LONGWORTH HOUSE OFFICE BUILDING • WASHINGTON, D.C. 20515 • 202-225-5107 • FAX 225-0809 • B. ROBERT OKUN EXECUTIVE DIRECTOR

MONDAY, OCTOBER 1, 1990 Written by FRANK GREGORSKY

Democrats Against The Economy: While They Run, It Stumbles

Help-wanted advertising is one of the most reliable leading indicators of economic downturns. And it's flashing red signals at the moment... In the past 40 years, help-wanted advertising has never fallen this much outside of a recession.

-- **Maury N. Harris** (PaineWebber), Business Week 8/27/90 p. 18

What follows are pages 12 through 18 of this classic House Republican Leadership analysis -- the essentials of the Reagan Prosperity just as the '90-'91 recession was beginning to be felt. For more information, write FrankGregorsky@aol.com…

Irresponsible, Ineffective Tax Cuts?

We know the heart and soul of Reaganomics: Reducing everyone's income tax rates. Nearly every Democratic attack, like a dog with a dinosaur bone, comes back to this policy. For over nine years, Democratic Party leaders have been telling us that the tax reductions were…

- ✓ too big -- or too small;
- ✓ too slanted toward the rich -- or no help in stimulating savings;
- ✓ totally ineffective -- or the most disastrous undertaking in American fiscal history...

Or all of the above (sometimes in a single partisan stem-winder).

Ronald Reagan's reign produced five distinct income-tax reductions, all of which are strengthening family pocketbooks and the U.S. economy this minute:

- ➢ Cuts 1 thru 3 occurred in three stages -- from October 1, 1981, to July 1983; they generated much discussion, pro and con.
- ➢ Cuts 4 and 5 received much less analysis: During 1987-88, a second stage of rate cuts comprised (with corporate tax increases) the core of the 1986 Tax Reform Act.

For 10 years, GOPers mistakenly labelled Reaganomics' first wave a "three-year tax cut," when in fact it was a permanent tax cut delivered in three stages -- another case of selling the party's good deeds short. The 1987-88 cuts were "undermarketed" even more: Scared of initial public grumbling over fading loopholes, party leaders said little or nothing about the parallel cuts in income tax rates. An equivalent default by the other party would be FDR's successors saying nothing about starting Social Security.

This is how Winston Churchill put it after serving as Chancellor of the Exchequer: "In finance everything that is agreeable is unsound, and everything that is sound is disagreeable." As the budget-summiteers can attest, this is largely true -- except for a policy we stopped talking about, i.e. the wholesale cutting of personal income tax rates during the 1980s.

The example of the United States was compelling enough to be imitated by Britain, Portugal, Japan, West Germany, Italy, Belgium, Denmark, Canada, Australia, New Zealand, Indonesia and (swallow hard, Marxist professors) Sweden. On April 4, 1988, the *Wall Street Journal*'s **Alan Murray** noted:

> Policy-makers everywhere have recognized that excessively high marginal tax rates can impair economic growth, particularly in a world where people and capital move freely across borders... That's the lasting supply-side mark that Ronald Reagan has left on the world.

Bengt Westerberg, then-leader of the main Swedish opposition party, offered three arguments for tax-reduction, Reagan-style:

> First, we would run less risk of losing some of our most clever researchers and technicians to other countries and thereby getting behind in technical development. Second, we would increase the possibility of combining higher disposable income with lower nominal wage increases and thus reducing cost-inflation. Third, and perhaps most important, we would increase incentives to work [WSJ 11/11/87 p. 27].

Even when they voted for it, America's Democratic leaders couldn't seem to understand any of the above. Yet only one notable Democrat ever carried his attack on this landmark trend to the logical conclusion: **Jesse Jackson**, who called in 1987 for restoring the top federal income tax rate to its Carter-level high of 70%. At least Jackson stood behind the logic of his rhetoric.

Most every other liberal Democrat lacked candor, intellectual rigor, or perhaps both. Battling Ronald Reagan's tax legacy, Rev. Jackson's fellow party spokesmen don't say exactly what they mean or what they want to do. They simply play to some of this country's enduring populist beliefs:

> The working people who got almost nothing from the tax cuts of the past must not be asked to pay most of the tax increases of today.
>
> -- Rep. **Dick Gephardt**, national TV speech 9/11/90

You would hardly know that a horde of congressional Democrats voted for the <u>Economic Recovery Tax Act</u> (ERTA) on final passage. This same bill also cut the <u>capital-gains</u> tax rate to a 50-year low. On July 29, 1981, the House said yes by 323 to 107, with 56% of Democrats voting "aye." Among them: Bill Alexander, Beryl Anthony, Tim Wirth, Dan Glickman, Byron Dorgan, Mike Synar, Leon Panetta, Wyche Fowler, Dan Rostenkowski, Mary Rose Oakar, Howard Wolpe, Tony Coelho, Tom Foley -- and Congressman Gephardt.

Over in the Senate, only 10 of the 47 Democrats (or 21%) had the courage to oppose a Reagan tax revolution most later denounced as pro-deficit and pro-rich. Meekly adding their support at the 11th hour were, among others, Dennis DeConcini, Alan Cranston, Joe Biden, Paul Sarbanes, Pat Moynihan, John Glenn, Don Reigle, Jim Sasser, Robert Byrd -- and, a big surprise, appointed freshman Senator **George Mitchell**.

If the Democratic National Committee thinks those Democratic tax-cutters helped President Reagan sell the economy into deficit purgatory, no word of formal criticism exists. The criticism on file is more likely to be from Senators Cranston, Glenn and Biden, who ran for President in the Reagan Era bemoaning giveaway tax cuts and large budget deficits. The others did this without a campaign.

Bubble Bubble, Is Amnesia the Trouble?

Five years after helping birth the Reagan Tax Revolution, large numbers of House and Senate Democrats supported the 1986 Tax Reform Act, complete with its now-maligned "bubble." Here is a picture of the bubble from Arthur Anderson & Co. (joint return, four exemptions):

Adj. Gross Income	Marginal Rate	Overall Rate
$38,950	15%	12%
$82,850	28	20
$110,000	33	21
$135,000	33	23
$163,000	33	26
$208,120	28	28

Rep. Obey's floor remarks on September 17 are typical of today's Democrats:

> This gap, this drop in income tax marginal rates for all people making more than $155,000 a year, costs the Treasury $9 billion a year. That little special deal for all people making $155,000 a year or more is what the President's negotiators are principally trying to protect in the tax debate now going on at the summit.
>
> -- Rep. Dave Obey (D-WI) "Stop protecting the super-rich and gouging working families!," *Congressional Record* 9/17/90 p. H 7695

Obey's "super-rich" threshold differs slightly from our table's (probably because of an indexation adjustment) and the summit is beyond the scope of this newsletter. But, if the bubble persists, so will this dogfight.

In May, **Warren Brookes** explained its 1986 origins. To preserve revenue-neutrality, legislators sought to "[m]ake those at the very top income levels…pay the full 28% top rate on all their income by taking away the 15% initial rate on the first $32,000 or so and all personal exemptions."

> The problem was how to phase in this otherwise-abrupt cancellation of benefits. The mathematical answer was simple: Impose an effective 5% higher marginal rate on a "bubble" of incomes below the "rich" cutoff point. The size of the bubble is roughly the amount of income on which a 5% higher rate must be imposed to gradually

> offset all those benefits. There is in fact no explicit 33% rate in the tax code [*Washington Times* 5/31/90].

Really? Listen to Senators **Bob Dole**, **Bob Packwood** and **Pete Domenici**:

> The 5% add-on gradually takes away the $2,050 deduction for personal exemptions and dependents. Personal and dependency deductions reduce the taxes of families. The idea is that a family of four with $30,000 of income cannot afford to pay the same tax as a single person with $30,000 of income. However, higher-income individuals do not need this kind of a tax break, so personal and dependency deductions are taken away by the 5% add-on [*Washington Post* 7/16/90 p. A11].

Still not clear? Try Tax Reform's Conference Report (Sept. 1986):

> Beginning in 1988, the benefit of the 15% bracket is phased out for taxpayers having taxable income exceeding specified levels. The income-tax liability of such taxpayers is increased by 5% of their taxable income within specified ranges... These amounts will be adjusted for inflation beginning in 1989.

Since the 15% bracket's benefits are offset for every upper-income person, <u>every family pays its way thru</u> the 5% "add-on" bubble, no matter how high their adjusted gross income ultimately reaches. Furthermore, the higher the income, the higher one's overall federal tax burden -- because more and more dollars are being taxed at the full 28%. "In fact, the bubble makes the tax code more progressive," explained the three GOP Senators.

In September 1986, on final passage, only 74 House Democrats (29% of those voting) and 62 Republicans (35%) opposed Tax Reform. The Senate was even more emphatic, with just 12 Dems and 11 GOPers saying "nay." This meant a thumping bipartisan yes for the "bubble," and yes to chopping the rate or the richest families from 50% down to 28%. Democrats voting to do this (with all the bill's other commendable steps) were: Bentsen, Biden, Byrd, Cranston, Glenn, Hart, Harkin, Kennedy, Kerry, Metzenbaum, Moynihan, Reigle and Sarbanes.

George Mitchell also voted yes, as did fellow fairness fan Richard Gephardt in the House.

Now, in September 1990, Mr. Gephardt tells the nation his own 1981 and 1986 votes gave "working people almost nothing." Are you confused? He is, but we don't have to be. Working people got two very big benefits from "the tax cuts of the past" -- more take-home pay, more employment opportunities:

- ❖ When income tax rates were cut during Reagan's first term, real GNP growth surged from nothing to its 40-year high of 6.8% (in 1984).
- ❖ In his second term, rates were again cut (this time by a simplified scale, which differs from an "across-the-board" percentage cut). And, during these reductions, annual growth in real GNP expanded from 2.7% (1986) to 4.4% (1988).

The next table conveys, from Eisenhower to Bush, the burden at various <u>real</u> income levels. Note that Reagan stuffed the tax genie back in the bottle.

Marginal tax rates, 1960-89 [Source: 1990 Statistical Abstract, p. 322]

	CURRENT INCOME EQUIVALENT TO CONSTANT INCOME (dol.)						MARGINAL TAX RATE (percent)					
	1960	1970 [2]	1980	1986	1988	1989	1960	1970 [2]	1980	1986	1988	1989
CONSTANT (1988) DOLLARS [5]												
Single person, no dependents:												
$5,000	1,300	1,720	3,480	4,590	5,000	5,240	20	14.0	14	11	15	15
$10,000	2,590	3,450	6,960	9,180	10,000	10,480	20	19.5	18	15	15	15
$20,000	5,190	6,890	13,910	18,360	20,000	20,960	26	22.6	26	23	15	15
$25,000	6,490	8,610	17,390	22,950	25,000	26,200	26	25.6	30	26	28	28
$35,000	9,080	12,060	24,350	32,130	35,000	36,690	30	32.8	34	30	28	28
$50,000	12,970	17,230	34,780	45,900	50,000	52,410	38	40.0	44	38	28	33
$75,000	19,460	25,840	52,170	68,860	75,000	78,610	50	51.3	55	48	33	33
Married couple, 2 dependents: [3]												
$5,000	1,300	1,720	3,480	4,590	5,000	5,240	-	-	[4] –10	[4] –11	[4] –14	[4] –14
$10,000	2,590	3,450	6,960	9,180	10,000	10,480	-	14.0	[4] 12.5	[4] 12.2	[4] 10	[4] 10
$20,000	5,190	6,890	13,910	18,360	20,000	20,960	20	17.9	18	14	15	15
$25,000	6,490	8,610	17,390	22,950	25,000	26,200	20	19.5	21	16	15	15
$35,000	9,080	12,060	24,350	32,130	35,000	36,690	22	22.6	28	22	15	15
$50,000	12,970	17,230	34,780	45,900	50,000	52,410	26	25.6	37	28	28	28
$75,000	19,460	25,840	52,170	68,860	75,000	78,610	30	32.8	49	38	28	28

But what about the rich? What did they get from this wholesale slashing of personal income-tax rates? They got lower tax burdens as a share of income, but the Treasury got more from them as a share of the entire tax load.

Chris Frenze reported last month that, because of work incentives, "higher realization of capital gains, and a shift of funds from tax shelters and discretionary tax-avoidance activities…the share of the income-tax burden shouldered by the top 1% of taxpayers jumped from 18% in 1981 to 25% in 1987, according to IRS data..." Frenze continues:

> Some liberals have dismissed it by arguing: "Of course the rich are paying more tax; their incomes rose much faster than everyone else's." But this is precisely the point they disputed 10 years ago in ridiculing the Laffer Curve. The Kemp-Roth argument was that under lower rates, the taxable income of the rich would expand enough to increase their tax payments. Now that this has happened, the liberal opponents are trying to reframe the issue.

Not just the issue; they want to "frame" the Republicans -- for killing jobs, opportunity, fairness. Most of these Democrats were too scared to stand up at the final moment and vote no, and too brazen ever after to resist misleading the voters about how tax-rate cuts work. After parting with professed principle, they somehow preserve the propaganda.

The best we can say about their 1986 vote for further lowering rates is that the resulting legacy of Tax Reform draws far less hostility from its liberal supporters than the straight income-tax-cut strategy they helped to pass in 1981. Democratic silence is easier to take than amnesia-plus-hysteria. But Republicans can't afford silence or amnesia (and we can do without the hysteria). When all else fails, fall back on fact, and resort to principle.

Tax Cuts Worsen Savings Rate and Budget Deficit?

By the traditional measurement -- percent of disposable income -- income-tax cuts during Ronald Reagan's first tern could not be shown to have increased savings. But, in his book *The Growth Experiment*, **Lawrence Lindsey** suggests using "a much more accurate measure of household savings: the rise in the net worth of households, or the difference between the increase in their assets and the increase in their liabilities." Lindsey explains:

> Between the end of 1981 and the end of 1987, household liabilities rose more than $1.3 trillion, but household assets rose more than $6 trillion. All together, households increased their net worth by $4.7 trillion, or 49%, while prices rose only 23%.
>
> These data indicate a <u>rise</u> in the real savings rate of households: In the five years before the [1981j rate-reduction took effect, using the rise in real net worth as the measure, household savings averaged 7.8% of personal income, but in the five years following the passage of ERTA, household savings grew to 13.5% of personal income [p. 121]...
>
> Nor have households run up exceptionally large credit-card balances. At the end of 1980 consumer credit amounted to $335 billion or 24% of such readily accessible household assets as currency, checking and savings accounts, and money market funds. By the end of 1987 consumer credit had grown to $697 billion, but ready cash had also grown to $2,788 billion. Consumer credit still equaled only 25% of ready cash [p. 122].

Extra reassurance: The second wave of Reagan tax-rate cuts (1987-88) accompanied a surge in the personal savings rate <u>even when measured as a share of disposable income</u> -- from 3.2% in 1987 to 5.4% for 1989. Not only that, but the budget deficit fell from $221 billion in FY 1986 to $148 billion the following year, i.e. simultaneously with the first half of Tax Reform's marginal-rate cuts. This violated establishment forecasts.

When Reagan signed the bill, loophole-lovers sulked, big firms fumed, the voters yawned, and Congress prayed. All its foes dubbed Tax Reform a rushed, risky experiment. After the 25% reductions during 1981-83, individual tax rates were set to plummet further -- from 11 brackets spanning 11-50% to a leaner, cleaner (kinder, gentler) two-bracket system of 15 and 28%.

Here in 1990, real-estate interests still curse the legislation (and in truth 1986, the last <u>pre</u>-Tax Reform year, remains the high for housing starts). But gross domestic private investment is up 16% since the fall of 1986 and, despite closed-down corporate loopholes, <u>after</u>-tax corporate profits climbed from $121 billion in the fail in the fall of 1986 to $189 billion two years later. (Since then, tighter money and skittish consumers have taken a toll, though profits remain roughly 30% above pre-Tax Reform levels.)

Fortune 500 spokesmen told us Tax Reform would wreck overseas competitiveness. But, measured by volume, the trade deficit topped out the very season the '86 bill was signed into law; by 1988 the shrinkage also began to show in dollars.

And, unlike in past times, America didn't shrink the trade deficit by shrinking take-home pay. On the contrary, the GNP picked up steam during 1987-88, laughing off a worldwide stock market panic. Joblessness plunged from 6.8% in late '86 to a low of 5.1% two-and-a-half years later.

It seems plain that Tax Reform at the least coincided with, and partly contributed to, a strong <u>second wind</u> of the Reagan/Bush expansion: Between October 1985 and George Bush's inauguration, with only one exception (inflation), <u>every single indicator of importance improved</u> -- jobs, GNP, personal savings, tax compliance, profits, budget deficit, trade deficit.

Nearly every Democrat ignores that; they either say nothing, or they talk like Gephardt and Jackson. Meanwhile Republicans were not appreciating how strong our case really is -- even on the issue of <u>tax cuts versus higher budget deficits</u>. Let's track the dollars obtained by the U.S.

Treasury from the federal individual income tax during Reagan's rate cuts, in the context of how many Americans were on the job and thus paying income taxes:

Fiscal Year	Unemployment	Tax Rates	Income Tax Revenues	/ Change
1981	7.5%	no change	$286 billion	+17.2%
1982	9.5%	5%, then 10%, cut	$298 billion	+4.5%
1983	9.5%	10% cut	$289 billion	-3.0%
1984	7.4%	no change	$298 billion	+3.1%
1985	7.1%	indexing starts	$335 billion	+12.4%
1986	6.9%	indexing	$349 billion	+4.2%
1987	6.1%	indexing + rate cuts	$393 billion	+12.6%
1988	5.4%	indexing + rate cuts	$401 billion	+2.0%
1989	5.2%	indexing	$446 billion	+11.2%
1990 est.	5.6%	indexing	$468 billion	+4.9%

[Notes: (A) Indexation annually increases, by the amount of CPI inflation, the income levels at which each marginal tax rate kicks in. In this sense it's a tax cut, although the point is simply to prevent the real tax burden from increasing: Indexation stops inflation from causing higher tax burdens on the same purchasing power. (B) Unemployment is for calendar years, while marginal-rate data and income-tax totals are for fiscal years. So the tax totals are three months, or one-fourth of a year, ahead of the related jobless average.]

1) Cumulative rise in income-tax revenues during seven years of Reagan tax reductions (late 1981 thru 1988): $115 billion annual-rate, a 40% gain.
2) Don't be thrown by 1981's spectacular leap -- it reflects the last gasp of inflation (8.9%) and serious bracket-creep. That kind of revenue gain is unhealthy, as witness the slump it immediately helped trigger.
3) Only in FY 1983 -- October 1982 thru September 1983, a period of very high unemployment -- did income-tax proceeds fall. Were Reagan's tax cuts at fault? It seems more logical to blame the revenue dip on the 1981-82 recession, which temporarily shrunk the tax base, than on the reductions in withholding that occurred in October 1981, July 1982 and July 1983. (Most economists said, even back then, that these cuts mitigated the recession's depth.)

"But your great wonderful income-tax revenue totals aren't adjusted for inflation," critics will say. Fair point. From 1981 to 1988, the approximate period of the Reagan tax reductions, the CPI rose 30%; this occurred while proceeds from federal income taxes were climbing 40%.

So -- President Reagan's economy kept Uncle Sam ahead of inflation while everyone's income tax rates were lowered on five successive occasions. Sound too good to be true? Maybe so, but it was good, and it is true -- thanks in large part to a much expanded tax base, the centerpieces of which were the 1980s job-explosion and the reduced tax evasion and avoidance that happen whenever high marginal rates are cut back to sane levels.

Confronted with the above data, liberals choose to talk about other federal taxes (business and payroll). Or they simply repeat, in denial-like terms, that the 1980s red ink must be the result of lower income tax rates. Yet the income-tax totals we've just looked at have nothing to do with FICA or corporate taxation. Therefore, any analyst who values intellectual honesty ought to analyze the income tax in its own right. Aren't the numbers clear enough? And then policy decisions in the two other realms -- corporate taxation and FICA withholding -- can still be debated based on your ideology, economic goals and partisan payroll.

(In brief: Yes, under Reagan there was a shift in burdens from corporate to Social Security taxes. No, it wasn't a "Republican sop to big business," but rather a bipartisan move. Both congressional parties offered extensive corporate relief in their 1981 tax proposals. Both party leaderships agreed on a gradual, multi-step increase in FICA levies. And majorities of both congressional parties supported the corporate-tax loophole-closing that was vital to passing Tax Reform in 1986. So blame no one, or blame everyone.)

But we keep comin' back to the core of Reaganomics -- reducing everyone's income taxes -- and its correlation with a booming jobs market and a pace of income-tax inflow to the Treasury that outran inflation. This suggests that letting workers, savers and investors keep more of their earnings was the single best way to clean up the mess Jimmy Carter left for Ronald Reagan.

Conclusion

As the Reagan Era commenced, "supply-side economics" set forth two premises. One, held to by a few purists, claimed deep tax-rate cuts would "pay for themselves" all the way to the federal ledger. The other, which most every Republican Member of Congress believed and articulated, was that the right kind of tax cuts are a budgetary down-payment on prosperity. The first held out for "free lunch," the second was content with "a necessary expense."

"A necessary expense" is quite easy to argue. And the more rapturous premise -- despite hundreds of anti-Reaganomics editorials and commentaries in the Post, New York Times and Business Week over ten years -- can be defended by any tenacious Republican seeking scenarios that are both economically plausible and politically helpful: Yes, the federal Treasury is getting more from the income tax, with rates sharply lower than those of ten years ago.

In short, we don't have a weak hand on income-tax policy. In this vital zone of federal policy, Republicans have nothing to apologize for. We do not owe the Democrats (or the federal Treasury) a single penance payment.

In fact, the case for the core of Reaganomics is so strong -- economically, fiscally, psychologically -- that one wonders why five more top-to-bottom rate cuts wouldn't be in order during the 1990s. The other party hears this idea and hoots. They think they know what needs to be done. They've got different goals, and a related policy agenda; we've been content with golden memories, impressive charts, and a desire to negotiate.

And so, even as Democratic bullets (regulation, big spending, no capital-gains relief, hysteria against foreign investors) are fired with abandon, the one policy we know will help -- income tax-rate cuts -- stopped almost three years ago.

Is a 1990-91 recession beginning to seem overwhelmingly logical? If so, the investigation launched on page 1 points to Democrats as the guilty party. Are we sure we have the body? If we don't -- if this economic expansion continues to live -- the indictment shifts from Murder One to conspiracy. This would reduce the courtroom drama, but the public will be better off.

URL for this document, digitized and uploaded in February 2010 by the author:

www.ExactingEditor.com/Reaganomics-Rigorously.pdf