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A Bipartisan Approach to Economic Policy

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A Bipartisan Approach To Economic Policy

by Murray Weidenbaum

Testimony to the House of Representatives
Committee on Ways and Means
Washington, D.C., December 18, 1991

Any dispassionate examination of the deadlock in economic policy making in Washington quickly concludes that there is enough blame to cover both ends of Pennsylvania Avenue and both sides of the political aisle. This testimony tries to respond by developing a bipartisan approach.

To clear the air, I suggest that both parties abandon their posturing and cliches. I start off with the Republicans, not because their position is so bad, but because I am a Republican. In that vein, I suggest abandoning the fervent attachment to cutting the capital gains tax. A lower capital gains tax might actually help a bit, but I find little justification for insisting so tenaciously on making it the centerpiece of economic policy. A lower rate surely is no panacea. Moreover, there is serious professional disagreement on whether a capital gains rate reduction would raise or lower revenue in the years ahead. Actually, most economists familiar with the subject urge instead indexing the base, so any tax is limited to "real" gains and not extended to the effects of inflation.

As for the Democrats, I suggest dropping the campaign rhetoric of providing tax relief to the "middle class" and financing it by "soaking the rich." They should save the politics of envy for later. The challenge today is to get the economy expanding again. Nobody is going to create a lot of new jobs by cutting my taxes and raising the other fellow's.

Murray Weidenbaum is Mallinckrodt Distinguished University Professor and Director of the Center for the Study of American Business at Washington University in St. Louis. In 1981-82, he served as Chairman of the President's Council of Economic Advisers. The views expressed are entirely personal.

Legislators on both sides of the aisle need to pause long enough to reflect on the nature of the difficulties in the American economy before rushing to enact cures. In that spirit, I offer a diagnosis before suggesting some of my own remedies.

In my view, it is the steep decline in consumer confidence that has propelled economic policy to the top of the priority list. However, it is futile to put a few hundred dollars in the pockets of some "middle class" taxpayers in the hope that such action will turn the economy around. Of course, all taxpayers would prefer to keep more of their money and to see less of it going to the government. But why should we expect a small increase in individual purchasing power to quickly restore consumer confidence? Responsible policy making requires finding out why public sentiment has been plummeting in the first place. Indeed, consumer income has not been falling, though the current rate of increase is microscopic.

The answer is apparent to all economists who step away from their computerized models long enough to speak to real people: many are worried that the next round of business restructuring, "rightsizing," deleveraging, and other euphemisms for cutbacks will hit their jobs. It is no wonder that consumers are being chintzy in their spending, mainly looking for bargains. That is the sensible attitude to take if you are not sure that economic lightning will strike you next. Consumer sentiment tends to follow unemployment. Confidence rose when claims for unemployment compensation declined and confidence is now dropping as unemployment claims rise.

Analysis of economic fundamentals leads to a second point: earlier tax changes had a lot to do with the predicament the American economy is in today — that is, a long period of low growth that started substantially before the recession. At the risk of outwearing my welcome, I feel obliged to report that Congress and the White House were warned by many economists that the politically popular Tax Act of 1986, which tilted the federal tax burden in favor of individuals at the expense of business, was

economically harmful. That tax law shifted the balance away from saving and investment and toward consumption. The problem was exacerbated late last year when Congress and the White House agreed on tax *increases* — and other poorly timed measures, notably the especially burdensome regulation of business — just as we were sliding into recession.

Not too surprisingly, these misguided policies, heightened by stiff foreign competition, have resulted in a steady drum beat of announced job eliminations. Under these circumstances, the standard economic medicine, such as an across-the-board tax cut, will have little positive impact on the economy.

To suggest a reversal of past economic errors is too simple-minded, however. There is no reason to believe that previous policies were ideal. Moreover, given the sustained slowdown in the economy, any short-term measures that are taken should be designed to advance, not detract from, a positive long-term economic agenda. While the Federal Reserve is focusing on the immediate need to supply adequate liquidity to the economy, Congress and the White House should work on longer-lasting changes.

A package of economic policy measures is required to promote the creation of new jobs by investing more in an expanding economy — and such investments are needed in both the public as well as the private sectors. Public policymakers should remind themselves of something most citizens inherently understand: it is the business system that is the principle job creator in the American economy. Here are the key actions that need to be taken on a bipartisan basis:

1. Within the confines of tight ceilings on federal expenditures, shift budget priorities away from entitlements, subsidies, and other consumption-oriented outlays. Devote a rising portion of the budget to civilian research and development, education and training, and rebuilding battered bridges, broken highways, and congested airports. In large part, these are the public-sector contributions to the creation of a more favorable economic environment.

2. Restore growth incentives, such as the investment tax credit, to the Internal Revenue Code. Yes, even a temporary ITC will help jump start the economy. New credits should focus on productivity-enhancing equipment for manufacturing companies, rather than more office buildings.

3. Eliminate the double taxation of dividends. In permitting the deduction of interest but not dividends, existing tax policy has contributed to the high degree of leverage in the economy, and perhaps to a "balance sheet" recession. We need a more neutral tax system with regard to sources of financing.

4. Embark on a carefully designed effort to provide economic rationality to the rapidly expanding gamut of government regulation of business. There is no benefit to imposing the most costly and disruptive means of dealing with environmental pollution, for example. Too often these well-meaning rules become obstacles to business expansion.

5. Face up to the inadequate education of much of the labor force, especially young people who will be at work in the 21st century. It is not a matter of "dumbing down" the content of jobs. Citizens in advanced economies cannot effectively compete for low-paid, low-skill jobs. The developing nations have a "comparative advantage" in that sort of work. On the contrary, Americans do best in the higher-paid jobs — which require increasing amounts of education and training.

Dealing with this set of issues should be the heart of any long-term economic agenda. Unlike a "quick fix," the adoption of such a constructive agenda should help restore confidence to consumers, managers, and investors alike.

To put the matter bluntly, I can find no economic basis for the numerous legislative proposals to energize the economy by granting tax relief, whether the beneficiaries be in high income brackets or low. The current cry of tax cuts for the middle class may sound like good politics, but a note of caution is needed.

Government has often taken actions that seem politically attractive, albeit economically undesirable. Ironically, the policy often ends up, after a while, being neither politically nor economically desirable. The most recent case in point is the arbitrary luxury tax hastily enacted in late 1990.

There is a lesson to be learned. The luxury tax was aimed at the politically vulnerable "rich" people who buy all those luxuries. But Congress' aim was way off. The authors of that plan forgot that high-income folks can spend their money on other items and thus escape the intended tax. Sadly, the people who are really suffering are those who had been producing those "luxuries" and who found their sales — and their jobs — in decline. Bad economics turned out to be bad politics.

Those who believe that the approach I am advocating would be a "give away" to business forget that the object of public policy is not to punish companies and high-income individuals for their economic success. Rather, the new economic agenda that the nation deserves should be more forward looking. It should provide the foundation for expanding production and employment and thus raise consumer living standards for the 1990s.