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JEC tax policy

The supply side of the tax-cut debate

On Feb. 28, the Joint Economic Committee of the U.S. Congress issued its Annual Report wherein it proposed a change in national tax policy based on data supplied by a "supply-side" model of economics developed by Otto Eckstein of Data Resources, Inc. Proponents of this model advocate tax cuts as a means to stimulate investment. The JEC Report explains:

"We are convinced that we need to consider a modest tax cut on the order of $25 billion to take effect no later than the summer of 1981, even though there is considerable uncertainty surrounding the economic outlook.

"The tax cut we propose here is not the conventional kind which mostly benefits consumers. On the contrary, at least half of the tax reduction should be targeted to enhance productivity through savings and investment with the remainder going to help relieve taxpayers of the pressure of increased taxes and higher energy costs.

"It is important to recognize why a conventional tax cut is not in order. We do not need another boom in consumer spending. Savings and investment must command a larger percentage of our GNP or we will fail to reverse our dismal productivity performance with the result that we will make little headway in our efforts to slow inflation and raise real incomes. Moreover, it is important that whatever tax relief is given to the business community, it be given on the basis of expanding plant and equipment expenditures. We leave it to the tax-writing committees to work out the precise details of the tax cut proposed here."

The model employed by econometrician Otto Eckstein on behalf of the JEC "assumes that we raise the investment tax credit by 2.7 percentage points beginning in 1980; finally, it assumes that we hold monetary and fiscal policies neutral so that the demand rate of inflation is zero on average over the decade of the 1980s.

"By comparison with the outcomes that would emerge in the absence of these tax policy changes," the Eckstein study concludes, "real business fixed investment would be up 5.7 percent by 1981 and 15.5 percent by 1990, raising the capital stock by 3.5 percent by 1985 and 7.2 percent by 1990. The increased stock of capital would raise potential GNP by 1.1 percent by 1985 (0.2 percent annually in the first half of the decade). The improved capital to labor ratio would add 1.2 percent to the level of productivity by 1985 (0.5 peecent annually). It would raise real wages by 0.9 percent by 1985 and would help to produce a 0.7 percent increase in real consumption. It would help reduce the core inflation rate by 1.3 percent by the end of the decade."

There are two principal problems with this approach.

First, the content of the GNP increases are not stated in the Eckstein study. However, they are stated explicitly by the JEC in accompanying recommendations. Recommendation No. 26 of the report states: "An energy productivity index should be developed to measure progress toward improved national energy utilization. Separate energy productivity indices should be developed for each of the major U.S. industries, for each consuming sector, and for the economy as a whole." These indices "would facilitate establishment of national energy conservation goals."

The report hails the drop in energy consumption per GNP constant dollar, which fell by 4 percent between 1978 and 1979, noting "our real GNP has risen almost 20 percent since 1975, while energy consumption has grown by only 11 percent." It concludes, "Further increases in energy efficiency can occur in ways that do not jeapordize economic growth."

This is devastatingly wrong, as our earlier study, "Energy and Inflation," showed exhaustively. Diversion of investment resources to "energy efficiency" is the principal reason for the drop of the free-energy index (S′) to below the zero margin at end-1979. The implied policy mix of the JEC package is tax incentives for investment in an environment of extreme pressure to conserve energy in industrial processes.

Flaws in the policy

In the prevailing economic environment, additional leeway for investment would tend—due to current administration energy policy—to move into what is strictly an overhead cost to the economy. Factoring out investment in various forms of energy investment, including replacement of auto assembly lines to make fuel-efficient cars, purchases of more fuel-efficient aircraft, coal conversion by utilities, and so forth, little is left of total business capital formation by military-related investments and pollution abatement equipment—as *EIR*'s previous study documented.

Under this policy environment, the JEC recommendations, modest as they are relative to the economy, exacerbating the most counter-productive trends in the economy through fiscal means.

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