Domestic Credit by Richard Freeman

The great tax debate

Congressional Democrats have rejected 'supply-side' magic, and seek a targeted plan for industry.

Leading congressional Democratic tax policy-makers this week rejected the undifferentiated supply-side theory of the Kemp-Roth tax program and sought an alternative tax strategy to provide capital investment programs to rebuild America's industry. Unless they come up with a concrete alternative, it could spell trouble for the Democratic Party, they realize.

"We have rejected the supply-side across-the-board approach because it does nothing for industrial investment," said an aide to House Ways and Means Chairman Dan Rostenkowski (D-Ill.). The supply-side mix of untargeted tax cuts coupled with extremely tight money, on which Kemp-Roth partisans insist, actually encourages a shift of the U.S. economy into the "postindustrial" society, knowledgeable Democrats agree.

Under Fed Chairman Paul Volcker's high interest-rate regime, basic industry such as auto, steel, homebuilding, and the savings banks, which now operate in the red, would get no benefit from supply-side tax cuts, and would still find the cost of borrowing for capital investment prohibitive. The "postindustrial" companies in computers, services, and real estate reap all the tax-break benefits.

Rostenkowski, the Democratic leader responsible for originating tax policy, announced the new Democratic orientation in an April 9 speech in Chicago. Hitting across-the-board suppy-side tax cuts, Rostenkowski called instead for a revitalization of America's industrial base through large investment tax credits. He called for specific breaks for "distressed industry" such as auto and steel, which he stated must not be allowed to decline, but should receive incentives to rebuild through expanded "unused investment tax credits." He also noted that "tax policy must not encourage the migration of industry out of America's urban centers."

Rostenkowski also addressed the vital issue of family formation, in calling for specific tax exemption for families at the poverty line, which his staff defines as $10,000 gross income.

On the Senate side, Democratic moderates led by David Boren (D-Okla.), J. James Exon (D-Neb.), and Russell Long (D-La.), last week announced a seven-point tax program specifically rejecting the Kemp-Roth approach. They propose to "Encourage moderate income families to save through tax incentives for savings and investment; Reduce the capital gains tax; Reduce the employee stock ownership tax; [and] end discrimination against investment income."

These Democrats look askance at the liberals of the House Democratic Caucus, who in an April 8 economic policy statement called for wage/price controls and other programs that are both economically and politically unfeasible in the current environment. "Wage/price controls are simply not a responsible response to Reagan's call for economic growth," said the Rostenkowski aide.

Rostenkowski and the Senate moderates fall down, however, when it comes to "targeting" their "specifics." They have failed thus far to create actual targeting provision in their own tax bills. Rostenkowski's proposed personal income tax cut of $28 billion, for example, falls back on a general reduction in top marginal tax rates from 70 to 50 percent, and a general marginal tax cut for other income levels.

"I have to admit I'm unsatisfied with our specifics," said his aide. "There is in fact no guarantee that the taxes we exempt will move into productive investment. Because our specifics are untargeted, we're in the same bind as Kemp-Roth."

Now gaining attention, therefore, is a plan put forward last November by the conservative National Democratic Policy Committee for a totally targeted tax cut on both the personal and corporate income sides. Known as the "duplicate tax credit," the NDPC plan would favor creating "tax shelters" for persons who invest in the stock of productive industry, agriculture, and in savings deposits in banks which use the funds to promote homebuilding.

Under this plan, corporations would receive a 20 percent investment tax credit, provided the funds went for tangible R&D and capital expansion of their industries. To the extent that a company did this, its stock would be granted a 20 percent or greater "tax-free" dividend—and would become a productive tax shelter for investors.