

Tax reform: last nail in U.S. industry's coffin

by David Goldman

Blithely unaware of the bitter irony involved, House and Senate conferees chose the 15th anniversary of Aug. 15, 1971, to approve tax legislation which may well prove to be the most devastating economic-policy blunder since the day that President Richard Nixon unlinked the U.S. dollar from gold. With nearly a fifth of our total physical consumption, and a quarter of our capital goods, accounted for by our trade deficit, the United States hardly exists as an industrial power. Now Congress, with the open support of President Ronald Reagan, proposes to tear down the last remaining policy-supports for heavy industry, agriculture, mining, and basic infrastructure.

By now, the usual commentators have registered the fact—of which *EIR* first warned in January 1986—that tax reform proposed a general deindustrialization of the United States. That is not how the bill has been sold to the President, by such misadvisers as Professor Milton Friedman, who has had Ronald Reagan's ear for much too long. The misadvisers laud "the bottom line of tax reform," as the *Wall Street Journal* editorialized Aug. 20, supposedly that "it is not designed to reward or punish income classes or economic sectors, but to begin dismantling a complex system of reward and punishment. There will be losers, no doubt, but everyone must have some sense by now that the intended direction is toward tax neutrality, certainly the right way to go."

"Tax neutrality" has become the most vapid euphemism in the recent history of economics. Federal revenues now account for a fifth of national income. Tax neutrality? Only a gang of economists who believe that capital magically appears when the market demands it, and that production

magically occurs when there is demand for it, and that there is no economic difference between bordellos and steel mills, could produce such an idiocy.

The central issue of the tax "reform" now before Congress is the elimination of the Investment Tax Credit and the stretching-out of depreciation schedules for industry, intended to raise about \$120 billion from corporations, in order to finance a tax cut to consumers. That is not a "free-market" tax bill (which the President should have suspected, since it originated with liberal Sen. Bill Bradley (D-N.J.) in the first place), but a dirigistic attack on investment in new plant and equipment.

Governments do not tax corporations' cost of doing business; they tax profits. Capital investment is a cost of doing business, as much as are wages and salaries. But that cost is paid out over several years, i.e. over the life of the equipment. If an electric utility chooses to scrap a coal-burning furnace for a more-efficient nuclear power system, increasing its productivity, and lowering the cost of electricity, it absorbs the cost of its earlier investment at the moment it junks the old equipment. Under current rules, it may write off its investment—that is, renew its plant and equipment—over 16 years. The new tax law raises this level to 25 years for power-generating equipment, and the disadvantages to other basic-industry sectors are comparable.

The government proposes, in effect, to order electric utilities to postpone new investments in more productive power generation until 25 years after their earlier investments have been made. It has told the rest of industry to delay improving their plant and equipment, because they may not

treat such improvements as a cost of doing business for tax purposes. That is not tax neutrality; that is a dirigistic directive to heavy industry not to prove productivity.

"Congress is saying that capital-intensive industries aren't as important as service companies," the *Wall Street Journal* Aug. 19 quoted an expert at the accounting firm Touche Ross. By eliminating the Investment Tax Credit, an incentive to capital investment which dates from the Kennedy administration, and cutting back the depreciation schedule for most capital investment, the new tax code penalizes heavy industry more than any other sector.

Real estate the other big loser

The other big loser is the nation's real-estate bubble, the one apparent source of support to the nation's economy during the continuing post-1979 depression. President Reagan's first, 1981 tax revisions sucked virtually all available cash into real-estate development, especially commercial real estate. The new bill prevents real-estate investors from using tax-losses generated by real-estate investments made with borrowed money, to write off taxable income from other sources. In other words, it eliminates the entire rationale for the real-estate bubble of 1979-1985, which produced a 25% vacancy rate in commercial buildings in the nation's major urban centers, and wipes out roughly 40% of the resale value of much commercial real estate.

The result, according to *Executive Intelligence Review's* Quarterly Economic Report for the second quarter of 1986, will be to wipe out \$150 billion in bank loans to real estate, on top of \$100 billion of loans already gone bad. The \$250 billion of bad debt associated with commercial real estate is larger than American banks' loans to South America.

Among the capital-intensive industries, the legislation will:

- 1) Wipe out the last vestiges of the steel industry, which will refuse to make new investments, according to published statements by the management of USX (formerly U.S. Steel);
- 2) Increase the cost of American-made machine tools by at least 10%;
- 3) Destroy the ability of depressed heavy-equipment companies to use their losses of the 1979-1986 period to offset future income in any recovery, and thus hurt their ability to obtain credit; and
- 4) Deliver a final blow to domestic petroleum exploration-and-development companies, which will no longer be able to finance drilling on the basis of tax incentives.

Originally, the tax package had been advertised as a boon to consumers, at the expense of business—in fact, a typical income-redistribution program of the sort the liberal Malthusians have pushed for two generations. Since it was hatched in the office of such a liberal Malthusian, Senator Bradley, that is no surprise. The House-Senate joint bill does something even worse: What the tax bill takes from heavy industry, it hands out to retailers, brokerage firms, broadcasting, and other service-industry sectors.

Agriculture hit worst

But the worst loser of all is the nation's most productive, and most depressed, sector: farming.

A coalition of eight farm groups, led by the Des Moines-based National Pork Producers Council, sent a letter Aug. 15 to members of the House-Senate conference committee warning that the depressed farm economy will be devastated by some of the proposed changes in the tax code. Other groups in the coalition include the American Farm Bureau Federation, the National Cattlemen's Association, the National Corn Growers Association, the National Association of Wheat Growers, the National Cotton Council, the National Grange and the National Milk Producers Federation. The bill would repeal income-averaging provisions in the current tax code and limit health-insurance deductions for self-employed taxpayers, both widely used by farmers. The loss of income averaging alone will cost farmers \$300 million per year.

"If Congress repeals income averaging, it would mean farmers suffering from natural disasters and severe fluctuations in market price would not be able to even out their receipts to more accurately reflect their annual income," a spokesman for the coalition said. In addition, repeal of the Investment Tax Credit would cost farmers another \$1 billion.

Trade collapse

At a time when the administration and Congress are complaining the loudest that the nation's \$170 billion trade deficit is forcing the country into recession, approval of the new tax bill takes on a special kind of lunacy.

Reuters news service reported on Aug. 18, "The tax reform bill passed by a Senate-House conference committee this weekend is likely to further worsen the U.S. trade deficit, analysts said today. They said a major weakness is that it repeals investment tax credits and reduces accelerated depreciation, considered vital to many heavy industries who need to modernize to compete with foreign firms in such fields as steel and car-making. . . . Analysts said the tax bill, which has yet to be approved by the full Congress, will increase the price of buildings and machines used by manufacturers 10% to 15%, and this, one said, is about one-third of total production cost."

This year's \$170 billion trade deficit, up from \$150 billion last year, reflects fewer but costlier imports, given the collapse of the U.S. dollar. Federal Reserve chairman Paul Volcker, among other public officials, is warning that a further collapse of the dollar (now barely above 2 German marks, against 3.4 German marks at its 1985 peak) will destroy America's ability to borrow the funds abroad needed to finance the gigantic deficit.

One bank commentator, Fidelity Bank of Philadelphia, warns, "Current tax reform proposals fundamentally lower the equilibrium level of the U.S. dollar by depressing real after-tax rates of return on U.S. dollar-denominated assets." That is, the tax bill will crush profits, and eliminate any further reason to put money into the dollar.