EDITORIAL/OPINION

America Doesn't Need a Tax Cut

By STEVE CHARNOVITZ

It comes as no surprise that most congressional Republicans want to deliver a hefty tax cut. Throughout the 20th century, whenever the Republican Party gained a majority in Congress, they responded with tax cuts favorable to the wealthy. This happened in 1921, 1948 and 1954, and it may occur again this year.

Nevertheless, a tax cut would be bad policy. Federal revenue already is $243 billion below what is needed to meet current obligations; it would be prudent to avoid any further erosion of the tax base.

The House of Representatives already has given the green light for a $353 billion tax cut over seven years. The more cautious Senate has conditioned its proposed $170 billion tax cut on enactment of spending cuts.

Of course, it is not only Republicans who are seeking tax cuts. President Clinton campaigned in 1992 on a "middle class" tax cut and his budget this year proposes a $100 billion tax cut over seven years.

Yet the case for a tax cut is not strong. Personal taxes as a percent of personal income remained at a remarkably constant 10.6% in the 1960s, 1970s and 1980s. But in the 1990s, this ratio has fallen to 9.8%.

Furthermore, Americans are taxed less heavily than citizens of other developed countries in Asia and Western Europe.

Comparisons over time and among countries are not conclusive, however. The real question is whether people get their money's worth from their federal income taxes.

They don't. The first 28 cents of each general revenue dollar goes to pay interest on the national debt. Additional amounts are wasted on ineffective social programs and inappropriate business subsidies. So it is understandable that the public perceives a low return from its taxes. Even Mr. Clinton, the man in charge, has confessed that he is "skeptical of government."

One of the fascinating aspects of the current economic policy debate is how clever politicians are using our atrophying national standard of living as a pretext for tax cuts. It is true that real average weekly earnings in the private sector have fallen 15% during the past two decades. But that is a pretax phenomenon. This stagnation in incomes cannot be remedied by a tax cut any more than arterial bleeding can be stanched with a Band-Aid. Instead, we need fundamental changes in the way the tax system interacts with the economy.

A top priority of Congress should be to restructure the federal tax system. First, we should lower (or eliminate) taxes on employment, which have risen each decade relative to the gross domestic product. This could foster job creation.

Some of the revenue lost from payroll taxes could be replaced with taxes on energy use and pollution. That would help to bring the price of using energy and polluting the environment closer to the actual social costs of those activities.

To soften the competitive blow to particular sectors, these new taxes could be introduced slowly. The administration also could seek tax harmonization with our major trading partners. A few years ago, the European Commission sought such harmonization with respect to a carbon tax, but got no cooperation from the United States.

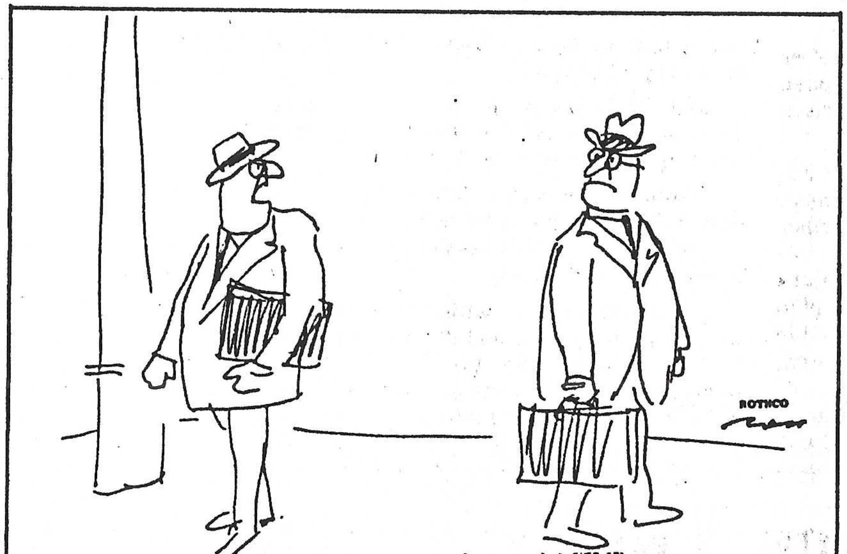
The current tax system reduces the incentive to save. To raise the dismal U.S. saving rate, the United States should overhaul the tax code, taxing consumption instead of income.

Several proposals have been floated for doing this, ranging from a consumed-income tax to a national sales tax. Unfortunately, the current debate has been muddled by proposals for a "flat" tax, which clothe regressivity in the garb of tax simplification. Achieving a tax system with more simplicity and economic efficiency does not require that we abandon longtime norms on equity.

As long as individuals spend all of their income during their lifetime, a consumption tax can be designed to be as fair as an income tax. But switching to a consumption tax does imply increasing taxes on the transfer of savings — for example, at death.

Since 1978, the Treasury Department has taken in more money each year on customs duties and fees than it has on estate and gift taxes. This is especially disturbing considering that tariffs fell after the Tokyo Round of world trade talks and that many large fortunes were created during the 1980s. While there may be little economic justification for either customs duties or inheritance taxes, the latter has an important social justification.

In summary, there are many useful structural changes that can be made to the federal tax system to spur long-term growth and to make the economy more efficient. Over the next several weeks, the House and Senate will be working out their differences regarding a big tax cut. Those discussions will give members of Congress a chance to show who is able to look beyond the politics of short-term gratification.



"A plague on both your houses, and may the IRS disallow accelerated depreciation!"

Steve Charnovitz, based in Washington, writes often on business, economics and the environment.