# IRET Byline

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## Clinton's Economic Plan

Governor Clinton's economic plan, "Putting People First — A National Economic Strategy for America", might be better named "Putting Government First". It would move the country toward a command economy, with resources directed by political rather than economic forces.

**Missing the point on growth.** The Clinton plan is the opposite of a constructive growth program. Economic growth is promoted by reducing government obstacles to private sector production and income and wealth creation, by reducing tax rates on the earnings of capital and labor, cutting Federal spending, and reducing the costs of regulation. Over much of the past decade, the U.S. economy has labored under rising tax rates, increasing regulation, and increasing government spending, all of which raise the cost of private sector production and retard growth. The Clinton economic program would increase taxes, spending, and regulations, and retard growth even further.

**Tax increases.** Clinton seeks to raise taxes by $150 billion over four years, mostly by trying to soak the rich and foreign firms.

Since 1981, the income tax burden has been shifted substantially toward upper-income individuals. As tax rates were reduced, the higher-income people created more GNP, reported more income, and paid a higher percent of the total tax bill.

Nonetheless, Clinton accuses the rich of not paying their "fair share". The "fair" share of taxes to be paid by the rich is never defined. In practice, redistributionists like Clinton define "fair" as "more".

Clinton would create a new higher tax bracket for the top roughly two percent of taxpayers, impose a 10% surtax on millionaires, and increase the alternative minimum tax. The affected taxpayers produce about one-fifth of the national income. Boosting their combined federal and state marginal tax rates to between 40 and 45 percent would lead to significant cutbacks in their work effort, saving, investment, and economic growth. Much of Clinton's assumed revenue gain would be lost.

Clinton asserts massive tax evasion by the rich on interest and dividend income, and would expand IRS enforcement. This charge is unproved demagoguery. Reforms during the Reagan Administration have enabled the IRS to match 1099 forms to tax returns and impose back-up withholding on payments to taxpayers who have not furnished Social Security numbers to banks and corporations. Increasing the IRS budget won't raise the revenue the governor predicts.

Clinton would raise taxes on U.S. firms operating abroad and on foreign companies operating in the United States.

Contrary to Clinton's assertions, additional taxes on foreign investment by American firms will not cause them to shift the investment back to the United States; it will merely reduce the foreign investment. The U.S. firms will become less competitive in world markets. They will order fewer U.S.-made parts to supply their plants abroad. U.S. saving, investment, employment, and income will be lower than otherwise, and tax revenue will be lower, not higher.

Clinton claims that foreign firms operating in the United States overcharge their U.S. subsidiaries for parts and products to reduce taxable profits in the

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United States and inflate them abroad. The IRS has found little or no evidence of this. It would not pay most foreign investors to shift reported income from the United States to Japan or Europe, where corporate tax rates generally exceed U.S. levels. Foreign firms that have expanded here in recent years have little taxable income because they are still legitimately writing off major outlays for plant, equipment, structures, and other start-up costs. It would take discriminatory taxation of non-existent income to collect the additional $13.5 billion per year assumed in the Clinton paper. Such taxation would drive foreign investment out of the United States, and retard the growth of U.S. productivity, employment, and wages.

Clinton also threatens increased tariffs and quotas by calling for stronger "Super 301" authority to force open foreign markets. This thrust is based on a misperception of weakness in U.S. manufacturing due to unfair trade practices. In fact, U.S. manufacturing is relatively strong, allowing for the effects of the current recession, and U.S. exports have been advancing rapidly.

Clinton would eliminate business deductions for lobbying costs. Businesses are where labor and capital come together to produce the GNP that supports everything that federal, state, and local governments do. Clinton says that business voices ought not to be heard in Washington. Does he make the same objection to lobbying by labor groups, such as the NEA, all of the "cause" organizations, and other supporters of his programs?

Clinton would disallow deductions for corporate executives' compensation above $1 million. How could the government possibly know the worth of a particular employee to a business, and what business is it of the government anyway?

**Spending cuts.** Clinton lists about $144 billion in spending cuts over 4 years. Roughly half are smoke and mirrors which may not materialize at all.

About 42% of the proposed cuts are in defense and foreign affairs. Another 46% are proposed cuts in federal employment and problematic savings from better administration of federal programs, and better management of the federal debt and the Resolution Trust Corporation. Management initiatives have been pursued for years; without cuts in programs and regulations, this is a pipe dream. About 7% is a pledge to cut wasteful spending if Congress approves line item veto authority it has repeatedly denied the President. Another 3% is an increase in the Medicare-B premiums for the elderly with taxable income of more than $125,000; although billed as a spending cut, it represents no decrease in Federal management of resources.

Only 2% of the Clinton spending cuts are real reductions of domestic program spending. They are ludicrously insignificant. For example, out of $15 billion a year spent on agricultural price supports and crop insurance, Clinton proposes to cut only $20 million for two years by ending subsidies for honey production.

**Middle Class Tax cuts.** The proposal states: "Middle class taxpayers will have a choice between a children's tax credit or a significant reduction in their income tax rate." The money for this tax relief is not included in Clinton's revenue table. It would cost about $17 billion, which would not even suffice to drop the 15% tax rate to 14%. Switching from a personal exemption for children to a credit would reduce the tax payments of those in the 15% tax bracket, but it would increase their taxable income, and would actually boost some of them into the 28% bracket, raising their marginal tax rates. The net rate reduction, if any, in this redistributionist portion of the tax package is completely inadequate to counter the anti-growth elements of the rest of it.

**Targeted Tax Cuts.** The plan would reduce the tax on capital gains for those buying stock in businesses in depressed areas, and provide a targeted investment tax credit for selected types of investment. The targeted tax cuts are a form of industrial policy — the picking of winners and losers by government. Such policies are necessarily less effective in promoting growth than a policy which lowers the cost of capital across the board with the marketplace choosing the optimal mix of capital outlays.

**Credit Allocation.** Credit would be reallocated to favored inner city projects through creation of a network of community development banks and requirements that other lending institutions provide more credit to projects in their neighborhoods. Issuing

loans regardless of credit risk would raise the level of non-performing loans and further weaken the capital structure of the nation's lending institutions.

**Public works.** Clinton proposes $50 billion a year in increased public works spending ($20 billion a year from the Federal government "leveraged" with $30 billion a year in "state, local, private sector and pension fund contributions") to promote overall growth and to improve the competitiveness of U.S. manufacturing. In reality, increased public spending would divert resources from alternative private sector investments of generally greater value to the economy, and retard the growth of private sector productivity and income.

**R&D.** The Clinton proposal includes the creation of a civilian research and development agency to bring together businesses and universities to develop cutting-edge products and technologies. This is nothing new. Since 1980, the Federal Government has been using government, business, and university consortia to spur technology transfers from federal labs to commercial applications. They have operated with considerable private sector input to guide the effort in economically useful directions. Clinton, by contrast, would add a new layer of bureaucracy, and arbitrarily steer the research into preselected areas. Some of these areas are already being covered by the private sector (e.g. national data base services, environmental technology). In other cases, the research is more ideological than economical (e.g. "development of new, clean, efficient energy sources" as real energy prices plummet).

**Mandates and price controls.** Clinton's health care proposals — mandated employer health coverage through a "pay or play" option, parental and medical leave requirements, expanded Medicare coverage of long-term care — are a prescription for shortages in the health care market. They would boost federal outlays and increase the demand for medical care, while price controls on hospitals and doctors would restrict its availability. Tax penalties for those who raise drug prices would retard development of new, life-saving medicines.

**Budget impact.** The Clinton program would not reduce the deficit. He projects budget savings in 1996 of $89 billion from his tax increases and spending cuts, but most of these revenue gains and outlay reductions would not occur. In addition, the tax cuts and spending increases proposed in the paper would require $64 billion by 1996, and another $17 billion would be needed for middle class tax relief. At best, the Clinton package would appear to generate only $8 billion in deficit reduction in 1996. Nonetheless, Clinton estimates that, by 1996, deficits under his plan will be $44 billion to $109 billion below those projected under current law. How does he do this? He assumes that his public works projects will raise the economy's real growth, boosting the level of GNP by a hefty 3% to 7% above the baseline forecast by 1996. The upper end of this estimate would require the economy to grow by as much as 4.6% a year in real terms between now and then, about .8 percentage points above the rate in the first four years of the strong Reagan expansion. Since there is nothing in the Clinton proposal that would result in a net expansion of either the labor force or the capital stock, any hope of exceeding the baseline forecast by any amount is completely unrealistic.

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