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Perot's Polyglot Proposals

The Perot economic revitalization program, "United We Stand: How We Can Take Back Our Country", has received too much hype and too little scrutiny. It is subtitled "A Plan For The 21st Century", and is thereby some twenty times as presumptive as the five-year plans traditionally put forward by most of the formerly-planned economies. The program gives the impression of being judgmental but uninformed, not merely eclectic but incoherent. If there is one central theme, it is that individuals and markets are slighted in favor of corporate power and government-directed activity.

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The Perot plan concentrates on deficit reduction by both spending cuts and tax increases. Tax and spending changes affect the economy differently. Spending cuts release federally-controlled or directed resources that may then be used to expand private economic activity. Spending cuts are not contractionary; rather, they promote private sector efficiency and growth. On the other hand, statutory tax rate increases or "loophole closings" reduce incentives to work, save, and invest by subjecting more income from capital and labor to taxation. Such tax hikes *may* reduce the deficit, if the economy does not falter too much and if Congress does not spend the revenue, but they *surely* reduce GNP, saving, investment, employment, and wages below levels they would otherwise reach. Because tax increases reduce private saving and investment, there is no hope that deficit reduction via tax hikes will lower interest rates and spur investment.

The Perot plan is oblivious to these distinctions. Furthermore, it is internally inconsistent. Each proposal is categorized in a one-dimensional way that masks its impact. For example, higher taxes on the "rich" and the elderly are viewed entirely from a (mistaken) fairness standpoint, but they also constitute a substantial increase in the tax rate on shareholders, bondholders, and other savers, and thereby raise the cost of capital. They are at odds with the investment tax credit Perot proposes to give to businessmen to lower the cost of capital.

Perot would raise the statutory 31 percent marginal tax rate to 33 percent, or, if other sources of revenue fall short of expectations (as they surely would) to 35 percent. He would lift the wage cap on the Medicare portion of the payroll tax (now at about $130,000). Both measures would raise the cost of employing the most productive portion of the population, and reduce their after-tax earnings at the margin, leading them to cut their work, saving, and investment. The plan would increase the gasoline tax 10 cents a year for five years, raising transportation costs on virtually every product in the economy, reducing the real wages of every worker, and leading to demands for higher wages. These cost-raising proposals would make the United States a less competitive place in which to produce.

The plan giveth, and the plan taketh away. On the one hand, it lists expanded saving incentives as a priority. On the other hand, it would penalize retirement saving by making 85 percent of Social Security benefits subject to tax, up from 50 percent at

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present, for those over the income thresholds at which benefits become part of taxable income ($25,000 for a single beneficiary, $35,000 for a married couple). The tax treatment of Social Security benefits is actually a tax surcharge on other income. For each dollar that wages, interest, dividends, and private pensions push a beneficiary's income over the threshold, benefits are added to taxable income, until half of the recipient's benefits are subject to tax. Thus, an extra dollar of interest raises taxable income by $1.50, and, for someone in the 28% tax bracket, the tax liability rises by $0.42. The plan would impose this 42% tax rate on a larger amount of other retirement income, thereby further penalizing saving for retirement.

The plan seeks to encourage investment, but in a targeted, paternalistic, and inefficient manner. It proposes an unspecified investment tax credit for "productive" equipment and machinery. Who would determine what investments were productive, government or business? R&D tax credits are touted, but the biggest spur to R&D is strong investment in plant and equipment incorporating the new technology, for which the plan does not do enough.

The plan proposes a reduced tax rate for long-term capital gains, stair-stepped down over a five-year holding period, and only for purchase of new stock issues that put additional money into corporate treasuries for expansion. It blames the businessman's perceived short time horizon on shareholder's alleged greed for quick increases in profits and stock prices. The proposal's solution is to force shareholders to hold a given share of stock longer than they otherwise would. This is nonsense. If U.S. business has a short time horizon it is due to an excessively high cost of capital, not to a flaw in the moral character of either shareholders or corporate officials.

The right prescription for reducing the cost of capital is a clean cut in the capital gains rate on all shares, old and new issues alike, to make them more attractive as saving instruments. The Perot proposal would impose a higher cost of capital on all businesses than necessary, and fewer investment projects would be affordable than would otherwise be

The Perot plan holds up Japan's Ministry of International Trade and Investment (MITI) as a shining example of enlightened government promotion of high tech growth industries. Perot should take note of Japan's present difficulties, largely due to rising tax rates, benighted financial market regulation, and manipulation by the government. MITI's favored industries have done less well than the innovative companies that have grown up without help from the bureaucrats.

Improved competitiveness in foreign trade is viewed as a matter for jawboning and negotiation by government officials to force open foreign markets, and billing the allies for our defense outlays on their behalf. The movement toward free trade with Mexico would be loaded down with added conditions relating to environmental regulation and greater health care spending on Mexican labor to protect U.S. industry.

These trade views are ill-informed. Most defense spending is on domestic production. Mexican wages are not a threat; they reflect productivity differentials. The free trade agreement would be the fastest way to raise Mexican incomes so they could afford a cleaner environment and better health care. What the American economy needs in order to become more competitive is less protection, less government regulation, and lower taxes on the employment of capital and labor in the U.S.

On the plus side, Perot proposes to cut discretionary spending 15 percent — 5 percent from program eliminations (e.g. the space station, REA, and alcohol fuel subsidies), and 10 percent from across the board reductions in all remaining programs. One might prefer more selective pruning, but given the realities of the political process in the Congress, this may be about the best one can expect. The plan would cut the defense budget $40 billion more than the Administration budget over 5 years. It also calls for a line item veto.

Entitlements would be curbed, though specifics are often lacking. The plan would end farm subsidies for giant corporations, but not for family farms. Federal retirees, civilian and military, would have their cost of living allowances restrained. The elderly, except the poorest, would bear more of the cost of their Medicare Part B coverage. By rights, this health subsidy should be eliminated and the services privatized, with vouchers for the poor. Instead, the plan would expand federal involvement in health matters. Experts would be asked to devise a plan to ensure everyone access to health insurance, and a national board would supervise medical cost containment. The plan uncritically assumes that this socialization of health care can be achieved without cuts in services and research or cost increases.

Some parts of the plan are mindlessly trendy. The plan asserts that recycling and conservation are morally and economically sound policies. They may be economically sound, but only up to the point where they cost more than virgin production and normal waste disposal. Overdoing the "environment thing" does not create jobs when research and recycling work substitute for more gainful employment. Other parts seek to please everyone. The plan hums the Green mantra of energy conservation and alternative energy sources, but blends in the industry chant for energy independence, proposing to develop a safe standardized nuclear reactor design and clean coal technology.

Occasionally, the plan is profoundly correct. School choice, for example, is endorsed both within public school districts and across public, private, and religious school categories. The plan would encourage college professors and business, legal and military professionals with a wide range of advanced degrees and training to teach in elementary and secondary schools, rather than limiting such positions to those with a degree in education. These reforms would foster competition and improve the education available to the future workers of America.

The Perot plan is a mixed bag. It caters to many constituencies on the right and on the left on one issue or another to build a coalition. The plan exhibits little understanding of how the world works, and relies on a blind faith that it can be managed by the right kind of people at the top. There is a willingness to cut government spending, but not its influence. There is no vision of a free people making their own choices in a free-market environment. Rather, a different kind of Uncle is sure that he knows best what is good for you.

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