

Domestic Credit by Richard Freeman

Tax cut prospects slow and small

Don't count on major business tax relief soon, especially if you're in a 'shakeout' sector.

In his presentation the afternoon of Aug. 28 on plans to revitalize the economy, President Carter is expected to call for a \$25 billion tax cut, including compensation for the higher social security tax which will take effect Jan. 1, 1981.

Carter's tax package, part of a larger "economic package," is seen as an answer to the proposal of Republican Party presidential hopeful Ronald Reagan, who is generally believed to favor a \$30 billion reduction in taxes. This week the Senate Finance Committee reported out a proposed \$11 billion business tax reduction, which would start reducing taxes for business starting with the new year. It is reported to be larger and more immediate than the so-called Republican version of the "10-5-3."

The tax reduction simply to offset the effect of higher taxes that go into effect the first quarter of 1981 and thereafter is a sound idea. On Jan. 1, the Social Security payroll tax will rise from its present 6.13 percent to 6.65 percent while the taxable wage base will go up from \$25,900 to \$29,700, accounting for a tax increase of \$20 billion. There will be a \$20 billion increase of taxes on oil companies from the windfall profits tax and another increase of \$15 to \$20 billion as incomes rise due to inflation and individuals' move into higher tax brackets. This adds up to a \$55-\$60 billion increase in taxes that will be a drag on the economy.

Tax relief of the proper sort would make sense, but there are two reasons why it is unlikely to occur until at least the middle of 1981 and why the amount of tax reduction may be held down.

One congressional source reports that the House, and its Ways and Means Committee is going to assert its power to originate all tax legislation and demand that tax proposals start from ground level zero. The House will then demand a lengthy review process of all proposed tax legislation that will go on for months. By the time the House comes up with an agreed-upon tax change, it will have to be reconciled with the Senate version.

The second reason behind tax cut delays explains the causes of the long procedural tie-up expected in the House. This was most succinctly summed up by the Joint Economic Committee of Congress in a report released to the press Aug. 25. The JEC stated that the U.S. shouldn't go for a quick stimulation of the economy, but concentrate on longer term questions that will lead to eventual growth in productivity in the economy. This means delay and minimal tax cuts.

The rationale behind the JEC proposal is that the U.S. recovery should be slow, and only partial. It is the same thinking governing the monetarist monetary policy of Federal Reserve Board chairman Paul Volcker. By this thinking, the recession will continue through the end

of 1980 and deep into 1981. The fact that auto sales were down 34 percent in the first 20 days of August, when they should have turned the corner upward in late July according to most analysts, exemplifies the depth of recession some key industries are still in. To insure the depressed state of these industries—including the savings and loan institutions, the auto, rubber, airline, trucking and steel industries, as well as residential housing—there must be no tax relief for a while, or at least none of any significant size. These industries will then have to undergo a further shakeout. Whatever tax relief does come will not benefit these industries, but only those cited frequently in magazines such as *Business Week* with great fanfare—computers, telecommunications, military, and synthetic fuels. In other words, once the economy has been restructured or significantly remolded, then tax relief will come.

Those industries that have been put through the wringer will not see much of this money—some of the companies will not even be around. This means that even those tax cuts that are enacted retroactively, say back to Jan. 1, 1980, may not be of much help to these sectors.

With Arthur Burns, Douglas Dillon and other heavyweights lining up behind "not stimulating the economy" and a 1981 snail's-pace recovery, don't bet on major tax cuts. Our expectations are confirmed by the corporatist shape of President Carter's new "revitalization" plan, which makes no commitment to the ailing basic industrial core of steel, construction, or auto, but plans to pour funds into synfuels and "bust OPEC" coal development.