Sluggish economy needs a new round of supply-side tax cuts

by Jack_Kemp

Although the Commerce Department reported strong gross domestic product growth of 4.9 percent during the summer, most economists predict that economic growth will slow down in the year's final quarter. To wit, the Bush administration revised its economic forecast downward for next year, from 3.1 percent to 2.7 percent real GDP growth. The housing market continues to slide, oil prices remain high and the U.S. dollar needs strengthening. But while many are predicting an economic recession, it doesn't have to be inevitable; indeed, it can be prevented by a more proactive tax and monetary policy.

When I testified on Dec. 13 before the Senate Finance Committee on the credit crunch and severe housing recession, I made the point that we should not settle for weakening economic growth. Instead, our nation should set a goal of achieving at least 4 percent real GDP growth per year. I reflected on the point that the administration is now proactive, the Fed is increasingly proactive, and it's time for Congress to be proactive in lowering the high tax rates on the factors of production and helping people stay in their homes by modifying the bankruptcy laws.

The Federal Reserve Board's policy options to boost the economy are limited because of inflationary pressures, but a new round of tax rate reductions, particularly a cut in corporate income tax rates, would strengthen the demand for dollars, thus strengthening the U.S. dollar here and around the world.

Despite the Bush tax rate cuts, federal tax revenues as a share of our economy have been rising anywhere from 8 percent to 10 percent year over year. Many tax rates remain prohibitively high and on the wrong side of the Laffer Curve - especially the U.S. corporate tax, which is the second highest among industrialized countries. More importantly, current tax law produces dramatic increases in top tax rates on labor and capital when the Bush tax cuts expire in 2011.

House Ways and Means Chairman Charlie Rangel, D-N.Y., has put forth what he has dubbed "the Mother of All Tax Reforms." Rangel's plan includes some good elements - including a reduction in the corporate tax and elimination of the alternative minimum tax - but some counterproductive ones, as well - such as the middle-class surtax, the tax rate hike on capital gains and dividends, and a new tax penalty on unincorporated small businesses.

Despite these problems, Rangel's plan provides Bush and the Republican Party with an opportunity to counter with their own version of pro-growth tax rate reduction and reform, and I would recommend the following core elements.

First, prevent future tax increases on income and capital by permanently extending the Bush tax cuts. If the Bush tax cuts expire in 2011, the top marginal income tax rate for individuals and small businesses will climb from 35 percent to nearly 40 percent, the dividend tax rate will increase from 15 percent to nearly 40 percent, the capital gains tax rate will climb from 15 percent to 20 percent, and the death tax will return from fully repealed back to 55 percent. According to the Heritage Foundation, these tax rate increases will cost more than a million jobs by 2013.

Second, we need to reduce both the top personal and corporate income tax rates to 25 percent, putting it slightly below where President Reagan left it and bringing it roughly in line with our European competitors. These moves, coupled with a liberalized and broadened earned-income tax credit, would make the code fairer for low- and moderate-income families.

Third, let's abolish the alternative minimum tax, as Rangel's plan suggests. Today, about 5 million taxpayers are subject to AMT, rising to 50 million taxpayers by 2015.

Our ultimate goal should be to replace the entire tax code with a flatter, simpler tax system that provides incentives for both labor and capital, not unlike that authored by Rep. Paul Ryan of Wisconsin and a slightly different plan courageously authored by former Rep. Harold Ford Jr. of Tennessee, the chairman of the Democratic Leadership Council.

The budget deficit currently stands at 1.2 percent of a near $14 trillion GDP. Economists of all stripes agree that a prolonged economic slowdown will produce higher deficits as tax revenue collections decline and government income support spending goes up. One thing is certain: Raising tax rates during an economic slowdown is precisely the wrong medicine at the wrong time and will exacerbate deficits and debt.

The best way to keep the deficit in check is to encourage rapid economic growth. As President Kennedy said, "It is a paradoxical truth that the soundest way to raise the revenues in the long run is to cut the rates now. The purpose of cutting taxes now is not to incur a budget deficit, but to achieve a more prosperous, expanding economy which can bring a budget surplus."

According to recent polls, the economy has become a top concern among the public. It's time for Democrats and Republicans to come together to produce a Kennedy-Reagan style tax rate reduction to strengthen the economy.

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