HOW THE KASTEN-WEBER TAX CUT WILL SPUR ECONOMIC GROWTH

The deep and painful recession afflicting America is the result of seriously flawed economic policies supported by George Bush and Congress. Record tax increases, costly new regulatory burdens, and unprecedented increases in federal spending all have combined to discourage job creation and entrepreneurship. Even though the evidence is clear that the economy remains stagnant, Bush Administration economic advisors actively are opposing growth legislation. And Bush apparently is following their bad advice. Warned *The Wall Street Journal* this week in an editorial: "Even as lusty a beast as the U.S. economy can take only so much punishment from its political masters in Washington. The long and short of it is: The world's most important economy is in the grip of economic incompetents." As long as it remains in their grip, American workers and families will remain condemned to lower living standards and rising unemployment.

Yet the economy can grow again if policy makers remove the shackles placed on it last year by the tax and spending increase. To do so, lawmakers must reverse course and correct the mistakes that are causing the recession and adopt policies that encourage job creation and increase incentives to work, save, and invest.

A good start is the Economic Growth and Family Tax Freedom Act of 1991 (S. 1920, H.R. 3744) introduced by Senator Robert Kasten of Wisconsin and Representative Vin Weber of Minnesota, both Republicans. The Kasten-Weber growth package cuts the tax on savings and investment, technically known as the "capital gains tax," lowers taxes on business investment, expands Individual Retirement Accounts (IRAs), offers real estate tax relief, and establishes enterprise zones. Kasten-Weber also relieves the tax burden on families by granting a $1,000 nonrefundable tax credit for children under age 6 and a similar credit of $300 for children age 6 to 18. The credit significantly would reverse the rising tax burden on families caused by inflation's erosion of the dependent exemption over the past four decades.

With the economy mired in recession, the portion of the Kasten-Weber package designed to promote economic growth is particularly critical. Its key features:

15 Percent Capital Gains Tax—Germany, Hong Kong, the Republic of China on Taiwan, and South Korea do not tax long-term capital gains, the difference between an asset's purchase and sale price. In Japan, the maximum tax on capital gains is a mere 5 percent. In the United States, by contrast, capital gains are subject to a 28 percent tax. To make matters worse, the tax code ignores the fact that much of the higher sales prices and profits on savings and investments are due to inflation. American investors cannot use indexing to ensure that taxes only are paid on actual gains rather than changes in asset value caused by inflation.

The Kasten-Weber proposal would cut to 15 percent the capital gains tax for savers and investors in the upper tax brackets and to 7.5 percent for those in the lower bracket. To prevent the unfair taxing of gains that reflect only inflation, the legislation also permits indexing. By calling for a lower rate and including indexation, the Kasten-Weber capital gains proposal goes well beyond the anemic proposal endorsed by the White House and would provide a much stronger stimulus to the economy.

Washington-based economists Gary Robbins and Aldona Robbins of Fiscal Associates, Inc., estimate that lowering the tax to 15 percent would create more than 900,000 new jobs over ten years and boost gross national product growth by an average of 0.36 percent for each year over the ten-year period. Other economists find similar impact from a capital gains tax cut. Allen Sinai, Chief Economist of The Boston Company, estimates that a 15 percent capital gains tax would boost employment by 600,000 within five years and increase the gross national product by 0.2 percent annually. Reducing the capital gains tax also would boost asset values, thus strengthening American banks and homeowners as well as reducing the cost of bailing out the federal government's savings and loan deposit insurance scheme.

Neutral Capital Cost Recovery—Kasten-Weber increases the amount of deductions businesses can take for investment expenses by adjusting "depreciation" schedules for inflation and the value of money. This reform substantially would boost capital formation by reducing the after-tax cost of investment. Under current tax law, businesses cannot deduct the cost of investments in the year when they are incurred. Instead, these costs must be "depreciated" over time, up to 31 years. Eventually, of course, the business is permitted to deduct the entire nominal amount invested. But the true value of this deduction is eroded enormously by inflation.

The Kasten-Weber neutral capital cost recovery approach would address the tax code's bias against business investment. If a business originally was supposed to depreciate $10 million of an investment in the second year, for instance, Kasten-Weber might increase that depreciation to $10.8 million, with similar adjustments in following years so that the value of the deduction would keep pace with inflation and the cost of funds. Correctly structured, neutral capital cost recovery would provide the same incentive for increased investment as plans permitting immediate deductibility of business investment in the first year. This would remove some of the current penalty on productive investment.

IRA-Plus—Kasten-Weber expands upon current IRAs by giving all taxpayers the option to invest in Individual Retirement Accounts. Savers, moreover, would get the option of investing in IRAs that would allow for tax-free withdrawal of both principal and interest income upon retirement. Taxpayers taking advantage of this "back-ended" IRA, however, would not be able to deduct contributions in the year they are made. In addition to allowing tax-free withdrawals upon retirement, Kasten-Weber would permit 25 percent of the IRA to be withdrawn before retirement for initial home purchases, education, and medical emergencies.

Passive Loss Reform—As part of the 1986 Tax Reform Act, so-called passive investors in real estate, those defined as not principally engaged in the business, cannot use rental properties losses to offset other income. Many experts say that this provision has helped trigger the decline in American real estate values and thus has increased the cost of the savings and loan deposit insurance bailout. Kasten-Weber would reform passive loss rules for real estate so they more closely resemble guidelines for other business investments.

Enterprise Zones—To encourage economic growth in impoverished urban centers and other particularly depressed sectors of the country, Kasten-Weber would allow the creation of 50 enterprise zones. Employers opening operations in the zone would receive a tax credit for workers in the zone. No taxes would be levied on capital gains in the zone, and investments in zones could be immediately deducted from taxes in the year they are incurred. These zones especially would help create jobs in inner cities.

Bush Administration and congressional policies have made it unprofitable for businesses to hire new workers and for investors to put their money at risk. Excessive taxation and overregulation have ground the economy to a halt and pushed nearly two million additional Americans into unemployment lines. Meanwhile, Washington policy makers seek not answers, but how to assign blame elsewhere. Bush clumsily blames credit card issuers for high interest rates, while liberals in Congress think higher taxes on the "rich" will spur growth.

There is no mystery about how to restore growth: simply reduce or remove government penalties on job creation, savings, and investment. The Kasten-Weber bill will not solve every economic problem created by policy mistakes, but enactment of the pro-growth legislation would stimulate increased economic activity and reduce the tax burden on families.

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