Economic Scene
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New York Times (1857-Current file); Jul 15, 1988; ProQuest Historical Newspapers The New York Times (1851 - 2004)
pg. D2

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Candidates Wary On Budget Deficit

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IN their race for the White House, Vice President Bush and Gov. Michael S. Dukakis continue to circle warily around the nation's most critical economic issue: how to eliminate the huge Federal budget deficits, which have increased the national debt in the last eight years to $2.5 trillion from $1 trillion. Those budget deficits have been the underlying cause of the chronic deficits in the balance of payments of the United States, its growing dependence on foreign capital and its vulnerability to a withdrawal of that foreign support.

Stephen Marris of the Institute of International Economics warns that America's creditors have the power to force the United States to eliminate its budget deficit — or suffer the consequences. "If there were the slightest suggestion that the Bank of Japan and the Bundesbank were no longer interested in supporting the dollar," he told the Business Council, "the dollar would nose-dive, U.S. interest rates would soar, Wall Street would crash and a recession would become inevitable."

Like many other economists, Mr. Marris believes the next President should deal forcefully with the budget deficit. But neither candidate wants to be a prophet of doom. Both are selling optimism and pragmatism, with a stress on enhancing "human capital" while preserving a strong national defense and restoring fiscal order.

Mr. Dukakis and Mr. Bush are behaving like what economists call "imperfect competitors" by only marginally differentiating their economic policy positions. They offer closely similar products while seeking to attract extra support by some kind of product differentiation, causing voters to think they see a real advantage. When one imperfect competitor introduces product differentiation, the other is likely to try to match it while keeping his own product slightly different and identifiable.

Mr. Bush, differentiating his product from Mr. Dukakis's, rules out tax increases and calls for cuts in capital gains taxes, blasting his opponent as a liberal tax-raiser and big spender. Prof. Lawrence Summers of Harvard, a Dukakis adviser, said his candidate views the Bush call for capital-gains tax cuts as a "return to voodoo economics."

Mr. Dukakis responded to the attack on him as a liberal tax-raiser by moving a bit closer toward his competitor in choosing the more conservative Senator Lloyd Bentsen of Texas as his running mate. Mr. Dukakis has also distanced himself even further from relying on higher taxes as the primary answer to the budget deficit, continuing to insist that proper enforcement of the existing tax laws would yield an extra $100 billion over five years. But he has held to his marginal differentiation by declaring that "no serious contender for the Presidency can rule out new taxes."

But Mr. Dukakis has not been specific on what sort of tax program he would favor if it should prove necessary to raise taxes. Joseph A. Pechman, president-elect of the American Economic Association and a longtime tax adviser to Democratic candidates, has said in a paper for Mr. Dukakis that "there seems to be a consensus in Washington that the rates established by the Tax Reform Act of 1986 — 15 and 28 percent for individuals and 34 percent for corporations — should remain unchanged." In his view, new revenues for deficit reduction must come from other sources.

He recommends, as the first and best alternative, continued broadening of the income tax base "by eliminating unnecessary deductions and tax favors that remain in the law," such as exempting capital gains transferred by gift or at death, allowing numerous fringe benefits that are not taxable to employees or excluding Medicare benefits.

The second alternative, Mr. Pechman says, would be to raise excise taxes on liquor, tobacco and gasoline. But he concludes that "income and excise tax reform will not provide enough revenues to achieve a budget balance in the foreseeable future." He therefore concludes that additional revenues will be needed and should be raised, "preferably by a flat percentage-point increase in all the income tax rates, both corporate and individual, or, if that is rejected, by the distinctly inferior alternative of a sales or value-added tax." But open discussion of such matters appears to be regarded as political poison by the Dukakis camp.

The "imperfect competitors," seeking a five-year budget balance, agree in relying, first, on a hold-down in the rate of growth of spending; second, on a faster rate of economic growth, and third, with the help of the Federal Reserve, on pushing down interest rates and their cost to the budget.

Mr. Bush calls his approach to holding spending growth below economic growth a "flexible freeze," with increases in some programs offset by cuts in others, without details on cuts to come. But Prof. Michael J. Boskin of Stanford, a Bush adviser, says his candidate has "put out more than Dukakis."

If more budget specifics are not forthcoming, the country may witness a rerun of what happened after President Reagan's election in 1980. In his book, "For the Record," Donald T. Regan, the former Secretary of the Treasury, says the Administration talked "in visionary terms" about deep cuts in spending while Federal spending continued to increase. "The key to the situation," he writes, "was to hold the increase within bounds, controlling it in such a way that it grew at a slower rate than revenues." That never happened.

Today both candidates again offer visions of holding down aggregate spending and raising tax revenues faster without raising taxes. Neither has provided a concrete plan to realize those visions.