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Some Notes on Taxes and Tax Reform

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From the not so Ivory Tower:
The Economy

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By Hyman Minsky

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President Reagan travelled to Florida's Disneyland to unleash the rhetoric of a second American Revolution in support of his proposals to reform the personal and corporate-income tax. He followed this with a calm cliche-ridden speech in which all our hopes for God and Country presumably ride on these proposals. There was no reasoned discussion of why the jerrybuilt structure of income taxation needs reform. The emotional appeal that makes it all but certain that the basic issues at stake will be obscured. As the debate is just beginning, and without the specifics of the President's proposal before us, it nevertheless is useful to examine some fundamentals about our economy and taxes.

Our economy is a capitalist economy, which uses expensive capital equipment, organizes much of production in large for profit units, and contains a complex, sophisticated and ever evolving financial systems. It has been such an economy for over a century. However, in the forty years since World War II, the Federal Government has been a much larger part of the economy than in the sixty years before World War II.

The evidence from history is that our economy is much more successful when government is big than when government is small. This historical evidence is supported by modern theoretical findings to the effect that complex systems which generate movements through time are subject to intermittent breakdowns. Such breakdowns can be contained by interventions or constraints. The deficits of big government which sustain profits and the refinancings by the Federal Reserve which sustain asset values are interventions and constraints that have contained thrusts towards serious depression in recent years.

Before World War II the Federal Government was small: in 1929 its spending was but 3 percent of G.N.P. Recessions and depressions were regular and deep between the Civil War and 1929. In 1929 the Big Daddy of depressions left the economy prostate in the winter of 1932–33. The reforms that led to the Big Government and an active Federal Reserve were put in place in an effort to assure a 1932–33 would never happen again.

Since World War II government has been big. Federal Government spending has grown from about 15 percent of G.N.P. in Truman's time to more than 20 percent of G.N.P. in recent years. The first twenty years after World War II were the best years our economy ever had as measured by stability, growth and fairness. The postwar generation of multimillionaires show that this era was fertile in producing rich and very rich even as it did well by ordinary workers.

The years since 1967 have fallen short of the performance achieved in 1946–66. The economy is obviously more susceptible to recessions, inflation has become chronic, the growth rate has slowed and Reagan's prosperity has failed to reduce unemployment below 7 percent. Its performance since 1967 remains better in terms of stability than the performance prior to 1939. The evidence from 1946–66 shows we can do better than we are now doing; this example is what makes the present performance so disappointing.

When government is small, say 3 percent of G.N.P., the tax system that balances the budget need not be burdensome. Furthermore, different structures of taxation will not seriously affect outputs, techniques, relative prices or incomes. When government is large, so that about 20 percent of G.N.P. must be raised by taxes for a balanced budget, then taxes will be intrusive. What is produced, prices, how production is carried out and the distribution of income can all be affected. In a big government economy the tax system really matters, for it affects the details of the economy as well as its growth, stability, and fairness.

Any tax system, but especially one that raises about 20 percent of G.N.P., will induce tax avoidance and evasion. Tax avoidance is legal; the non-smoker avoids tobacco taxes. Tax evasion is illegal, but the line between avoidance and evasion is sometimes obscure for those with sufficient income and wealth to take advantage of tax shelters. Tax shelters allow a taxpayer to control taxable income. Tax shelters, rather than the rate structure, give rise to the view that the tax system is unfair.

Congress and Presidents did not deliberately decide to create tax shelters. They decided to try to accelerate growth and technical progress by allowing investment tax credits and rapid depreciation. This made it "profitable" for airlines to lease their planes from limited partnerships, which enabled high income partners to deduct the tax credit and depreciation in calculating their taxable incomes. Tax shelters are by-products of attempts to make the tax system induce investment and growth. No legislation was more responsible for creating tax shelters than Reagan's 1981 tax bill. Some of the reforms of 1985 will undo the harm done in 1981.

The tax reform package is not as free from blemishes as Reagan's rhetoric indicates. He neglected the Social Security tax which is an income based tax. This tax, which is only on wage and salary income, begins at the first dollar of wage income. Reagan argued that a representative wage earner with a $12,000 income will pay no income taxes. In truth such a person will pay about $940 in Social Security taxes. Reagan spoke of tax rates of 0 percent, 15 percent, 25 percent, and 35 percent. These rates apply to rent, interest or dividend income. The effective rates on wage and salary income are 7.8 percent, 22.8 percent, 32.8 percent, 25 percent and 35 percent. The dip comes when the ceiling on income subject to social security taxes is reached.

The debate on tax reform should not be limited to the personal and corporate income taxes. The Social Security tax on wage income induces a bias against wage income and low incomes. The employee contribution for social security is a tax that perversely diminishes employment. It should be replaced by a comprehensive value added tax; it now is a partial value added tax. In a rich country well designed excise taxes such as a significant tax on oil or gasoline can serve useful revenue raising and conservation purposes.

I venture the guess that most Americans would think it fair for a million dollar income to pay taxes at a higher rate than a mere hundred thousand dollar income. Additional brackets at the top would improve the fairness and the stability enhancing properties of the proposed tax system.

There are many dimensions to the effects and fairness of a tax system. The President's proposals do not face most of these problems. As a first offering it is a step forward. A serious Congress can improve its effectiveness even as its essential simplifications are retained. ■

AWARDS

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St. Louis Association of Black Journalists

Derrick Payne and **Margene Christian** each won $1000 scholarships in the print media division of the black journalists' association minority journalism workshops. In the same division, **Barbara Wingfield** and **Dionne Peebles** were special honors winners. In the television competition, **Robert Townsend, Steven Edwards** and **Gwen Anderson** each won $700 scholarships. Special honors were awarded to **Donna Fauver** and **Walter Daniels.** In the radio division, **Jeanette Jordan** and **Antoinette Emerson** each won $1000 scholarships; **Erise Williams** and **Carolyn King** were special honor winners.

St. Louis Post-Dispatch

Nancy Williams Stoddard, chief librarian, will receive the Agnes C. Henebry Roll of Honor Award from the Newspaper Division of the Special Libraries Association.

ADVERTISING AND PUBLIC RELATIONS

Advertising Federation

Scholarship winners include **Ann K. Bowman,** a senior majoring in journalism at the University of Missouri, Columbia; **Kimberly Sue Woodard** and **Mary Ann Rinehart,** both juniors at Southern Illinois University's School of Fine Arts and Communications.

David Gutting & Associates

David Gutting & Associates, a St. Louis advertising agency, was the recent winner of three top honors in the Golden Mirror Awards, an international competition sponsored by the Credit Union Executives Society. The agency was incorrectly identified in the May issue of *SJR.*

St. Louis Community College

Angela Reneé Saunders has received the Phillip H. Grogg Award. Saunders is news director of the Florissant Valley community college radio station, KCFV-FM.