Taxed to Death

viewpoint

Alan Reynolds

For some people, it never seems to be quite the right time to cut taxes. The Carter administration argued last year that tax cuts should be postponed until the economy was flat on its back. After obligingly shoving the economy into the pits, they now argue that tax cuts should not occur in election years, either. Those criteria leave only two appropriate moments in the past decade (1970 and 1975), so we missed our chance. It is apparently too late to cut taxes to avert the recession, too early to tell if it is needed in the recovery.

To be fair, there were major federal tax cuts enacted in 1975, 1976, 1977, and 1978. As a result, income and payroll taxes rose only 54 percent from the fall of 1974 to 1979 for middle-income budgets; for "higher" budgets (an obscenely lavish before-tax income of $30,317 for a family of four), the tax increase was merely 66 percent.

In Washington, a "tax cut" means that taxes will not rise quite as fast as otherwise, "tax reform" means taxes are going up, and "tax relief" means that taxes will be lowered only for those with the lowest incomes and lowest tax rates. A "targeted" tax cut means a break for existing large corporations that are not serving consumers well.

Now the Senate Finance Committee is generously offering to cut individual taxes by $22 billion next year, with most of the benefit again going to the very lowest and highest incomes. This at a time when inflation will raise tax rates by at least $14 billion, Social Security taxes go up by $17 billion, and the excise tax on domestic oil drains another $15 billion. With friends like this, taxpayers don't even need Jimmy Carter.

Recent leaks about Carter's latest policy switch emphasize the virtue of delay but hint at a "refundable investment tax credit" (that is, a cash subsidy) for companies without profits that invest in certain forms of physical capital. Consumers and the businesses they make profitable can thus pay higher taxes so that losers can expand.

Higher taxes are, we're told, the price we have to pay to reduce inflation. That is why past tax increases have done such a good job in preventing inflation. It also explains why Britain and Sweden have never had inflation problems, and why the annual tax cuts in Japan have obviously devastated that economy. Perhaps the best example is Jamaica, which decided to help the poor by hiking taxes on the rich—until they left.

A Puerto Rican official once asked writer-economist Jude Wanniski how to raise per capita income, and he said: "Import more rich people, or at least stop exporting so many of them." A viable economy needs managers, professionals, and successful entrepreneurs. Puerto Rico has been cutting income tax rates by 5 percent a year and is swimming in an unexpected windfall of tax revenues from a stronger economy.

This sort of thing bothers some libertarians, and conservatives too. Having suffered at the hands of heavy-handed government, as has everything noble or virtuous in human endeavor, they experience some agony in seeing government share in prosperity, even if the share is smaller. Just as the so-called liberals would rather see a stagnant economy than let anyone get rich by creating prosperity, their opponents sometimes seem to prefer to see the government in a fiscal squeeze even if the cause is a private economy taxed into chronic stagnation. That attitude can end up with government growing in *relative* size and power, as the private economy is emancipated by punitive tax and regulatory policies. The British government isn't really so huge; it's just that there isn't much else left over there.

The most dangerous opposition to meaningful tax cuts is not the Carter administration, which has a credibility problem, but a curious collection of corporate spokesmen and conservative economists whose advice proved so constructive in the Nixon-Ford years. Some, like Herbert Stein, argue that taxes will have to go still higher to finance more arms. Never mind that the already projected tax increases are demonstrably impossible—the economy could not possibly bear them and nonetheless grow at the 4.2 percent rate assumed for 1982-85. Others implicitly believe that the budget really could be balanced by taxing us all into the unemployment lines.

Then there are nitpicking debates about precisely which taxes to cut in which way. Many businessmen agree with President Carter that corporate taxes must come first. But all taxes are paid by people, as suppliers of labor and capital, and the corporate income tax (silly as it is) is relatively trivial. Individual income and payroll taxes are slated to rise from 15 percent of personal income before Carter took office to 20 percent next year and 23 percent by 1983. Corporate taxes are not now planned to take any larger share of corporate profits and are only one-seventh the size of direct personal taxes.

When the Carter folks complain that Kemp-Roth would cut revenues in 1985 by $220 billion, that is indeed alarming. All individual income taxes did not amount to that much last year. In fact, however, cutting tax rates by 30 percent wouldn't lower revenues by anything like $220 billion, because there is no way to hike taxes as much as planned without flattening the private economy and driving recession-related spending through the roof. Actually, if Kemp-Roth passed, the share of personal income going to federal income and payroll taxes would still be substantially higher in 1985 than it was in 1976-78. Kemp-Roth is not drastic tax cutting at all —just a smaller increase.

Now, the plan put forward by Libertarian Party candidate Ed Clark (see Trends, Oct.) really would cut taxes and provide a generally persuasive list of drastic spending cuts, too. But I could do without this part: "The Clark tax cut will have a much greater impact on lower-income taxpayers than higher-income." Has the Libertarian Party adopted an egalitarian ethic?

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spotlight

Environmentalist Cum Economist

By Patrick Cox

One tends to expect outstanding economic and environmental investigation to be centered in large metropolitan areas. High-powered think tanks seem natural in Boston, New York, Chicago, or Los Angeles. So it is surprising to find a superlative center of academic research and dialogue nestled among the mountains of Montana in the city of Bozeman, with a population of less than 25,000.

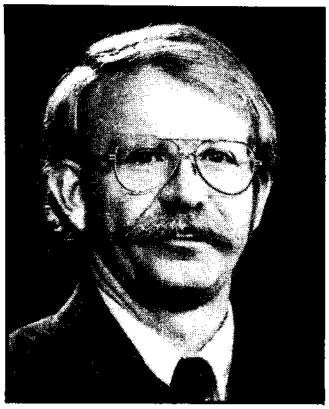
The Center for Political Economy and Natural Resources at Montana State University was organized by John Baden and Richard Stroup in the spring of 1978. Its purpose is to provide an institutional setting for the study of political economy and natural resource issues with the application of property rights and a free-market approach. To this end, the center conducts seminars and conferences, sponsors publications, and offers support to graduate students doing work on resource economics.

Authors working under the auspices of the center have produced a number of publications: *Managing the Commons,* by Garrett Hardin and John Baden; a textbook, *Economics: Private and Public Choice,* by James Gwartney and Richard Stroup; *Earth Day Reconsidered,* edited by Baden; and, forthcoming, *The Birth of a Transfer Society,* by Terry Anderson and P. J. Hill (authors of "An American Experiment in Anarcho-Capitalism: The *Not* So Wild, Wild West," in a 1979 *Journal of Libertarian Studies*). Stroup, Anderson, and Baden also coauthored the forthcoming text *Natural Resource Economics: Foundation for Policy Analysis.*

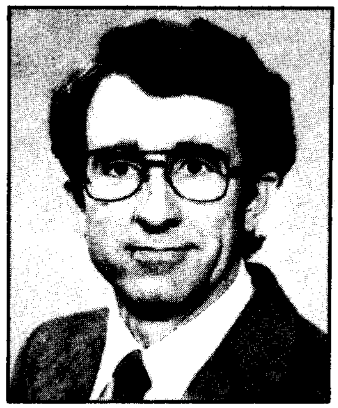
The Cato Institute and Liberty Fund will both have environment-related seminars hosted by the center this year "in the middle of no goddam place," says Baden, obviously amused at the center's unorthodox rural setting. The conferences are held at a guest ranch in the Montana mountains complete with trout fishing and wildlife. "We have a comparative advantage here," Baden admits. "Who really wants to go to Dallas for a convention?"

The partnership of Richard Stroup and John Baden is the prime mover behind the center. It is a colorful if not unlikely alliance. By those who know his work, Stroup is esteemed as a deeply reflective and creative economist. An associate says that "he thinks about everything in terms of economics. He has one of the best analytical minds in economics today." Stroup attended the Massachusetts Institute of Technology, graduated from the University of Washington, and teaches at Montana State University in addition to his activities at the center. His list of publications is nearly four pages long. He is soft-spoken and wary of political involvement.

John Baden is a different case. With a quick grin beneath his bushy mustache, Baden is vocal and enthusiastic. Characterized as flamboyant and a promoter,



John Baden



Richard Stroup

Baden has been successful in raising some $350,000 to carry on the center's work. Being interviewed, Baden was the more talkative of the two, but after answering a question he would turn to Stroup for verification, amendment, or modification.

John Baden is a political scientist—a political anthropologist, to be exact. But he more closely resembles the standard image of an environmentalist. An ex-logger, Baden has purchased and restored a sheep ranch in Montana that was "all gulleys and erosion, naked of fence or building," according to the *Wall Street Journal.* He has contributed to the Sierra Club, the Audubon Society, and the Wilderness Society. He was at one time director of the Environmental Studies Program at Utah State University.

When he first came to Montana State he had little understanding of the problem-solving ways of the market. He credits Stroup with that enlightenment. In his first year at MSU he took on Milton Friedman's proposal gradually to sell off all national forests. Baden's concerns over biotic diversity and watershed maintenance were hard questions even for Professor Friedman, but Baden has gone on to explore the economic approach to such concerns and now shares Friedman's belief in the superiority of private over government management of the forests.

Baden overflows with examples of the market taking care of the ecosystem better than the government. One interesting case is the control of water pollution in Scotland. The Scots have a long tradition of love for the art of fishing, which of course requires high water quality. How do they do it? Not by "a lot of agencies running around trying to enforce laws," says Baden. Such agencies are "totally unable to be site-specific." Instead, "they simply have property rights in the streams.... Some sites sell for many thousands of dollars. If someone degrades the stream, they have done actual damage—tort damage—to the owner of the rights." The happy outcome is that Scotland's streams are full of trout and salmon.

Closer to home, Baden points out the result of government management of Rocky Mountain forest lands. "It's important to understand," he notes, "that God is not especially interested in growing trees in the Rocky Mountains." The combination of slow growing time and difficulty in building logging roads makes the Rocky Mountains naturally unattractive to loggers. Baden points out that 90 percent of the erosion associated with logging is actually caused by access roads. But when the Forest Service is in charge of deciding where and how much timber can be cut, it's done largely on political grounds. So logging in the national forests is divorced from the costs of doing so. "We find that we are subsidizing the destruction of Rocky Mountain forests....Weyerhauser would never log there." In one case that Baden researched personally, taxpayers paid $84,000 per 1,000 board feet of timber removed from a forest. The market price at the time was about $42 per 1,000 board feet.

Though environmentalists tend to re-