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The Blumenthal Tax Program: Revival Of The 'British System'

The Carter Administration has once again postponed introduction of its controversial "comprehensive income-tax" proposal prepared by the office of Treasury Secretary Werner M. Blumenthal. The bill will not be introduced until the beginning of 1978 at the earliest.

According to some business-community tax specialists, the most controversial provision of the Blumenthal tax proposal — doing away with capital gains — will be scrapped.

SPECIAL REPORT

The general consensus, however, is that the Administration has enough on its hands in getting the Schlesinger energy bill through Congress. At the same time, the Administration is worried about business and popular reaction to impending massive tax increases in individual and especially employer contributions to the social security system, which is again on the verge of insolvency. To quote the Baltimore Sun *of Nov. 2 in referring to the social security bill approved the day before by the Senate Finance Committee. "The Senate panel voted to increase employer taxes more than 500 percent by 1985, scrapping the traditional parity between employee and employer contributions to the federal retirement system."*

Nevertheless, the Administration has by no means dropped the Blumenthal comprehensive tax proposal. The forces behind it are merely stalling for a move favorable moment for its introduction — as, for example, after an engineered "energy emergency" or economic collapse has created a suitable environment for austerity and the antibusiness Blumenthal bill. Therefore, the Blumenthal proposal merits careful examination as a very real threat still hanging over U.S. industry and banking — and because of its "sword of Damocles" quality, working major damage on long-term capital investment plans.

Secretary Blumenthal's tax proposal may be the worst tax regimen this country has been threatened with since the British Stamp acts. The general form of Blumenthal's program is a raid on the investment funds and earnings of U.S. industry and on the living standards of the U.S. workforce, using methods pioneered by the British Empire and, later, by the City of London's puppet, Nazi Finance Minister Hjalmar Schacht.

Unfortunately, Blumenthal's program also provides a provocation to U.S. conservatives to fall into a knee-jerk response to the tax issue, the whole tax issue, and nothing but the tax issue for the next one or two years — the time the tax debate is expected by some to drag on. If conservatives do respond in this fashion, get ready for selling apples and pencils on the corner, for there won't be much of an economy beyond that.

Blumenthal's Tax Program

The general outline of the Blumenthal tax proposal is already known through the Treasury Secretary's own speeches; through the July 1, 1977 speech on the Senate floor by Edward Kennedy; and through the publications of the Brookings Institution, which prepared it. The anticipated bill call for abolition of numerous so-called "tax expenditure" (deductions, exclusions, preferential treatments, etc.) and tax shelter items used by both corporations and individuals. Among these will be capital gains provisions; the intangible oil drilling and development cost deduction; the percentage depletion allowance for oil, gas, and other minerals; accelerated depreciation; tax deferral for foreign subsidiaries of U.S. corporations, etc. The bill will also propose to scrap personal deductions, medical expenses, the right to deduct local and state taxes paid, and the right of indebted homeowners to deduct mortgage interests. The Brookings Institution has in addition suggested that all homeowners shall pay an income tax on the "imputed rent" — the supposed rental income the homeowner receives in his capacity as "landlord" to himself (the British "ground rent").

For wage-earners and salaried workers, the Blumenthal-Brookings tax proposal calls for adding the monetary value of employee benefits received to one's present salary and taxing the sum as income, rather than merely taxing just direct wages or salary alone. This will throw many people into significantly higher tax brackets. Furthermore, under the Blumenthal-Brookings plan, transfer payments (social security, workmen's and veteran's compensation, "black lung disease" payments, and so on) will all be taxed as regular income.

Finally, to ensure that employers don't pay excessive wage increases, under a plan supported by Arthur Okun of Brookings and others, employers who give increases above a federally set ceiling will be assessed at punitive tax rates. Conversely, employers who pay low wages will be rewarded by the government with tax breaks.

Let's examine what the effects of such a program would be.

On capital formation. According to Merrill Lynch's National Market Commentator Robert J. Nurock, the impact on capital formation of the proposed elimination of capital gains treatments *alone* would be "very

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negative." Hit hardest, Nurock writes in the Sept. 12 and 19, 1977 issues of Merrill Lynch's house weekly, *Options Alert*, would be "capital intensive" enterprises and those which "benefit from special provisions of the present tax code."

A computed simulation done by Nurock at Merrill Lynch determined what Labor Party intelligence had already concluded, that those specific sectors that would be worst impacted if the full Blumenthal program goes through would "include most of the energy-related, metal, and mining groups ... the machinery, heavy construction, airline, rail, water transport, and basic industries ... the paper and forest products industries" and "utilities."

By way of compensation for the termination of the U.S. as an industrial power, Nurock reports that dividends under the Blumenthal plan will be excellent among "book publishers, radio-TV broadcasters, and insurance companies." Interestingly, these happen to be sectors of the U.S. economy notably still under heavy City of London control or influence.

The Schachtian tax planners are not entirely ignorant of the consequences of their proposals. One Brookings-associated "tax specialist," writing in the Institution's *Comprehensive Income Taxation* published last month, notes that even if capital gains preferences were to be *only partially* removed (the plan is actually to remove them entirely), "capital accumulation" would be "reduced," "labor productivity and real wage rates would decline," and this "would shift some of the tax burden to labor."

On labor. Added to the negative effects on labor noted above are those of a proposed government-enforced wage ceiling plan, euphemistically called the "Tax Incentive Plan" (TIP) and backed by Brookings's Arthur Okun, *Business Week*, the *Washington Post*, the *New York Times*, and so forth. According to the Oct. 3, 1977 issue of *Business Week*, "An incomes-policy variant called TIP would restrain wage gains without controls... With labor compensation accounting for 75 percent of national income, the so-called underlying inflation rate of 6 percent cannot be cracked without slowing the rate of wage gains, which have been running close to or above 8 percent a year since 1973." TIP was designed by Federal Reserve Board governor Henry C. Wallich, with Sidney Weintraub of the University of Pennsylvania, *Business Week* continues, and "in its simplest form, TIP would hit companies with a surcharge on their corporate income tax if they grant their employees wage increases in excess of some government-set standard. Similarly, by holding their average wage increases below the standard, the companies would be eligible for a tax reduction." The proposal is also backed by the Congressional Budget Office; the Joint Economic Committee of Congress; and the Keynesian panegyrist of the "Brazilian economic miracle," professed Schachtian economist Abba Lerner.

If enacted, TIP would be as harmful to *both* labor and industrial capital as Blumenthal's plans for scrapping capital gains, and the rest. As American Enterprise Institute official Marvin Kosters noted recently, government-enforced wage-limitation proposals tend to allow "low-wage industries to expand and force high-wage industries to contract." They favor labor-intensive "British System" production versus the capital-intensive "American System." And that is precisely the intended thrust of the Blumenthal-Brookings tax proposal, just as it is of Blumenthal's efforts to collapse the dollar and his colleague Schlesinger's "soft energy" program to return U.S. technology back to the 19th century.

The American Fabians

The ideology of these American representatives of the British Fabian Society is instructive. To them all investment credits, medical expenses, accelerated depreciation, and so on, are, in the linguistician's brainwashing phrase the Fabians use, "tax expenditures."

Thus, one Brookings tax planner writing in *Comprehensive Income Taxation*, the just-published work which provides the "theoretical" underpinning for the Blumenthal tax proposal, refers as follows to doing away with personal deductions for medical care, education, and mortgage interest on homes:

> Expenditures of this nature may be regarded as objectionable in principle in two ways: they are not subject to annual budgetary review, and their disguised nature may result in much higher levels than Congress would ever vote outright.

Another idiosyncratic feature of the Fabians is their strange switching around of the meaning of the two terms, "general interest" and "special interest." Thus on July 1, 1977 Senator Kennedy previewed the Blumenthal tax program to the Senate, stating, that by means of "a skilled and effective tax policy team at the Treasury under Secretary Blumenthal ... the Treasury has quickly reassumed its proper and fundamental role as a champion of the public interest and opponent of narrow, special interest tax preferences." The "narrow, special interest" Sen. Kennedy referred to was U.S. industry, the U.S. work force, homeowners, and so on, while the "public interest" meant his City of London friends, including Kennedy estate trustee André Meyer of the Lazards house.

Another curious usage of the Fabian tax planners is the Gertrude Stein utterance, "A buck is a buck is a buck," used by them to justify "comprehensive income taxation." Translated roughly, this amounts to : a buck taxed from productive industry or productive labor is as good as one taxed from the corner slumlord or pimp.

A final item of gobbledygook worth commenting on is the repeated litany that by "expanding the tax base" — i.e. the government's right to tax almost everything — significant "rate reductions" will become possible. Doubtless this will be true — for the first year, at least. But with Felix Rohatyn and his Fabian cronies in Washington running the printing presses, one can guess which way the rates will go the year after, and by how much.

Even were the present Carter cabinet an assemblage of Renaissance humanists instead of scoundrels, the "comprehensive income tax" approach would be the

worst possible. All tax policies are, and must be, discriminatory. This one, however, heavily discriminates against those who should be favored and taxes lightly those that should be taxed into penury.

An income-tax approach to wage earners' incomes — or indeed any other tax on wage earners other than bona fide excise taxes or war emergency taxes — are *at best* a gross administrative waste and more commonly, a pretext for Schachtian accumulations. The point involved is a straightforward one. In a capitalist society, government expenditures properly are financed out of a portion of the society's absolute profit. But the nature of the capitalist realization process is that the social categories of wealth — total constant capital, variable capital, absolute profit, and the remainder of social surplus — appear only in fractional, distributed form as costs, including wages and earnings of enterprises or individual enterprises. Properly speaking, only profit, rent, and interest should be taxed, the presumption being that wage earners as wage earners are merely earning the historically appropriate equivalent for purchase of means of consumption to reproduce themselves and their family.

Under these circumstances, taxation of wage earners (whether by income taxation or other means) either imposes an additional tax on the employer, who must make up for the government's subtractions from his employees, or it means uncompensated looting by the government of a necessary fraction of the consumption needs of the wage earner and his family.

This is by no means to advocate scrapping the existing tax and income-tax structure, merely to squelch pretensions of the lunatic Brookings faction that their tax schemes would work under any conceivable charitable assumptions. They find the present tax structure somewhat cumbersome for anticipated looting purposes, and propose to remedy that situation. The rest of us will do well to squelch their pretensions for good.

The Conservative Approach

In contrast to the Brookings "a buck is a buck is a buck" orientation, the best of the conservatives represent a solidly pro-industrial-development thrust. Exemplary are the opening pages of the 1975 tax program of the U.S. Chamber of Commerce:

> *Capital formation.* The American economy is faced with a major capital shortage. It has been estimated that over the next decade the capital requirements of the United States will be approximately $4.5 trillion.
>
> Our total fixed investment as a share of national output was 17.5 percent during the period 1960 through 1973 — ranking us last among other major industrial nations. Since 1960, our existing base of plant and equipment has increased only about 50 percent, while the total of such assets in Japan has tripled, and almost doubled in West Germany and France....
>
> We cannot continue to ignore this capital shortage problem. It is important that our tax policy be remolded to encourage capital formation. We must apply those principles in our taxing system that promote the modernization and expansion of our productive facilities. The other highly industrialized nations understand these principles and are applying them. If we are to continue to improve our standard of living, reduce unemployment and solve our inflation problem — we must balance our tax policy in favor of capital formation....
>
> It is important that the Congress adopt a tax policy that encourages the replacement of obsolete and inefficient plant machinery and equipment so that American enterprise will outproduce its rivals, continue to provide jobs at the highest wages on earth, and maintain American leadership in the world marketplace.

This is excellent, but there is a problem. Many conservatives actually believe that a business-oriented tax reform will suffice to do the trick. This is a dangerous delusion.

The conservative argument for tax cuts favoring capital formation involves a syllogism: any tax on corporate earnings is a disincentive to investment. Therefore removing part of the tax on corporate earnings constitutes an incentive to investment. Some writers, such as Jude Wanniski of the *Wall Street Journal* and Prof. Arthur B. Laffer of the University of Southern California, have shown that there is an extremely close correlation between low rates of progressive taxation and high rates of economic growth over a broad range of historical examples.

Of course, the built-in fallacy of this neat correlation is that the credit superstructure is "neutral," which Wanniski and Laffer freely admit. On the contrary: credit is the most fundamental element of economic activity, and the least understood by business. Paper credit transactions are the present social form through which the economy makes decisions about future production. In a healthy economy, interest paid to banks and other lenders comprises a portion of the economy's total surplus product. The resources of the banking system centralize and reallocate the "free-energy" resources of the economy for future production.

As any banker will testify, credit decisions are necessarily the most *subjective* of economic activity, since they depend on assumptions about the future of the economy, the competence of the management of the borrowing company, the state of technology, as well as government taxation policy, regulation policy, and other nemeses of the *Wall Street Journal* editorial page.

It happens that the main area of credit expansion in the U.S. banking system over the last period has been the Eurodollar market, which grew tenfold to $500 billion after 1971, to rival the domestic US. banking system in size. No one argues that the Eurodollar market grew because Cayman Islands "shell" branches are less taxed than Chase Manhattan's head office. Eurodollar lending centers overwhelmingly on counter-productive forms of speculation in raw materials and Third World govern-

ments who export raw materials. The City of London vultures who are waiting to take over from the U.S. banks when this operation collapses have pointed out this weakness for years (e.g. Moses Mendelssohn in *National and Grindlay's Review*, August 1973). The rise in the Eurodollar market corresponds to the decline in U.S. capital formation (see U.S. Labor Party, "The Federal Reserve's Role in the Destruction of the U.S. Economy," May 1977).

This cancerous development has virtually wiped out the U.S. banking system as a major source of capital funds for industry. Worse, it has put a sum of dollars outside the control of the U.S. monetary authorities, leaving the dollar subject "to a really catastrophic run," as the London-based *International Currency Review* points out in its current issue. There are no delusions, at least on the level of Federal Reserve staff economists, that the current destabilization of dollar interest rates derive from any other cause than this. Most bank economists, e.g. Manufacturers Hanover's Tilford Gaines in his October 1977 newsletter, admit that this mess could crush the U.S. economy.

The purely subjective decisions of New York City and London bankers account for this development. The big U.S. lenders adopted the standpoint that also underlies the Blumenthal-Brookings package: that profit based on scarcity of raw materials and control of markets is profit just the same. When commodities prices busted in early 1975, banks belatedly discovered their error, and some are rethinking their approach. Meanwhile the credit system is so clogged with debt-obligations attached to bankrupt borrowers that the real cost of borrowing to the productive sector is enormous, crucial Third World markets are shut off due to built-up external debt positions, and corporations view investment planning through a tunnel.

Removing disincentives for investment is associated with an expanding economy, but will not launch an expanding economy. Either the private or public sector has to step in and transform credit conditions with this object in mind. For example, officials of West Germany's Dresdner Bank say that they can finance 150 billion marks of nuclear plant exports, on the Brazil model, through private sector means. Dresdner Bank's initiative includes taking control of the Eurodollar market deposit base away from London, and creating a combined Eurocurrency-lending and gold market center in Luxembourg. If the West Germans and their European collaborators persuade Arab depositors, for example, that investment in banks who finance nuclear energy is more viable than speculation in the London gilts market, they will make a major contribution to world trade. If the West Germans use the Luxembourg project to link Eurocurrency operations to hard-commodity positions in gold, they would be in a position to reform the international monetary system through the private sector.

Or, the Federal Reserve could use its emergency powers under Section 13.3 and 13.13 of the Federal Reserve Act and make direct loans to industry at low interest rates. Congress can create a National Bank along Hamiltonian lines to finance directly industrial sectors that directly contribute to the productivity of the national economy as a whole, principally energy.

Whether the government or the private sector takes the initiative to match present technological potentials to existing industrial capacity is not of much ultimate importance. If business wants to meet this objective they will fight to get the appropriate credit instruments in place — as the Dresdner Bank is now doing. Once high rates of capital formation expand the natural tax base of the Treasury, the mess in the tax system can be sorted out quickly.

Appropriate tax policies derive from credit policies that discriminate between speculative and productive investment.

That understood, the most badly needed reform in the present tax structure is the introduction of the general principle of reduced rates of taxation for productive investment and punitive rates of taxation for speculative activities. The lack of such a distinction at present creates the unwholesome situation that many of the provisions that the Chamber of Commerce is now rightly seeking also serve as loopholes for speculators.

Closely related is the question of proposed tax cuts on the order of $20 billion plus (this had been mooted by Blumenthal in an October news leak and is also favored by the Republican National Committee). Such cuts will only increase the rate of inflation *unless* accompanied by a dominant credit and tax policy that fosters the expansion of productive investment while at the same time contracting speculative swindles in slum housing, Eurodollar market raw materials swindles, and the like.

— *Richard Schulman*