Reagan administration sets IMF plan for America

by David Goldman

Under the deal cut with the International Monetary Fund and European central bankers last month, Treasury Secretary Donald Regan will present a package to Congress Dec. 1 including the biggest peacetime tax increases in American history. Regan will jump from the frying pan into the fire: To avoid the European central bankers' threat that a turnaround of the present $150 billion per year of capital flows into the United States will crush the U.S. economy, he will do so himself, by lancing the consumer-based swelling of the U.S. economy through taxes on consumption.

The core of the package, according to well-placed administration sources, will be some form of national consumption tax—either in the form of a Federal sales tax or a value-added tax—as well as the so-called "flat tax" reform of the progressive tax system.

Although administration officials have been reluctant to state their aims before the television cameras, one concise presentation of the thinking behind the package was offered by Washington consultant Norman A. Bailey, a former National Security Council official who advises Reagan-Bush '84, in an Aug. 29 speech in Sâo Paolo, Brazil. (see below).

Regan's package, already in the final stages of formulation, corresponds to the recommendations, and absorbs the threats, of the International Monetary Fund's Annual Report released last month (excerpts below). IMF officials, in releasing the report, warned of a "precipitous drop of the dollar" and a mass exodus of capital outflows, should the United States fail to accept its demands.

The IMF lividly denounced the United States for promoting its own economy through deficit financing while other nations were forced to contract, adding, "Because of the size of the U.S. economy and the magnitude of the capital inflow now being attracted there, reduction of the U.S. federal government deficit could be expected to have a significant impact on the availability of funds for private investment throughout the world."

In an Oct. 8 report from Washington, one wire service claimed that the mood in Congress had already turned favorable to a value-added tax (VAT), a form of sales tax that imposes a surcharge on each stage of production.

A 5% VAT would raise about $100 billion, and a 10% VAT would raise about $200 billion, or the rough equivalent of the current Federal deficit—straight from the top of consumption. In an economy artificially bloated by a 30% per year rate of increase of consumer credit, a cut in consumption would bring the so-called recovery down like a rock.

To date, *EIR* demonstrated in its economic survey of the first half of 1984, the supposed economic recovery is due largely to two factors. The first is outright statistical fraud, which doubled the actual volume of physical-production increase (as measured by the direct reports of industrial associations and firms). The second is a trade deficit which now adds up to more than 7% of total physical output of the U.S. economy. In other words, 7% of the total U.S. economy now represents a subsidy from the rest of the world, produced physically in Asia and Ibero-America, and financed by capital flows from Western Europe and Japan.

On the other hand, it is not surprising that the administration would sacrifice private incomes rather than corporate profits, as the Mondale tax proposals would, to satisfy the IMF and America's restive creditors. Corporate profits this year are flat at the $250 billion annual rate achieved in the

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first quarter of the year, and most analysts already predict a decline in 1985. The worst of it is that a good quarter of reported profits during the first half of this year are the invention of various kinds of creative bookkeeping. Much of the corporate debt-expansion during the first half of the year fed directly into imaginative ways to put profits onto corporate books, e.g., through leveraged buyouts that permitted corporations to put one-shot asset sale and leaseback agreements onto their bottom line.

All this puts the administration's electoral posture in a queer light. On Oct. 8, Treasury Secretary Regan said that he would recommend a "modified flat tax" for President Reagan's second term. This, Regan said, would be contained in an options paper for federal income tax reform. Administration sources confirm that Regan's proposal would not entirely eliminate progressivity in the tax structure, i.e., taxpayers with higher incomes will pay a higher tax rate than those with lower incomes. Most exemptions and deductions would be eliminated.

Regan emphasized that the so-called flat tax would seek to raise the same amount of revenue as the present system, and therefore should not be viewed as an effort to cut the budget deficit. However, sources familiar with the administration's tax planning report that the deficit-reduction side will be covered by taxes against consumption. It is still not decided whether this will take the form of a national sales tax or a VAT. The difference, in any case, is purely cosmetic.

The Treasury, however, has been silent on the subject of a national sales tax since Aug. 16, when Regan, pressed by reporters, "refused to entirely rule out" such a measure as part of the planned December tax reform package. At the time, Regan still insisted that the entire package would have to be "simple, fair, economically efficient, and revenue-neutral," i.e., not constitute an increase in taxes overall. It is nonetheless transparent enough that the purpose of the sales tax is to boost revenues, so that the Treasury has been reluctant to mention the subject in public since then.

Documentation

Extracts from Norman A. Bailey speech in São Paulo, Brazil:

Fiscal systems must be adjusted to provide incentives for saving and capital formation rather than consumption; they must be adjusted so the taxpayer sees the system as fair, with a minimum of special-interest deductions and exemptions; average rates must not be set to high as to dampen initiative or force it underground. In order to accomplish such a fiscal reform, government budgets must be cut substantially. Years of deficit (and in most cases inflationary) financing have resulted in the imminent danger in many countries of forcing a choice of future stagnation, inflation, or massive credit liquidation.

In the United States, a fundamental review of the tax system is currently underway. A detailed reform bill will be presented to the next Congress.

The objectives of this review are exactly the right ones—to encourage saving and productive investent while removing artificial incentives to consumption, on the one hand, while increasing the intuitively felt fairness of the tax system at the same time. This is surely a program that can be supported by people of all political persuasions, while they will undoubtedly be bitterly opposed by many "special interests" in the strict sense of the term.

What should be the elements of this reform? In my view, they must include in some form the following:

1) A flat or greatly simplified progressive income tax. Studies have indicated that the U.S. Treasury take would remain about what it is now with a flat tax of 19%, even when taking about 25 million low-income people off the tax rolls completely. This is aside from much greater ease of collection and the economic gain to be derived from the lowering of unproductive expenditure and avoidance.

2) Elimination or reduction of capital gains and inheritance taxes and the elimination of double taxation of corporate profits.

3) Imposition of a value-added or federal sales tax to raise the additional funds necessary to reduce the federal deficit.

Extracts from IMF Annual Report:

The past four years have been a period of substantial divergence in the thrust of fiscal policy between the United States, on the one hand, and the other major industrial countries, on the other. From 1979 to 1983, the expansionary impulse imparted by fiscal policy in the United States is estimated to have amounted to almost 2% of GNP. In all other major countries, there was a contractionary thrust, ranging up to some 3% of GNP in the United Kingdom and the Federal Republic of Germany. Partly as a consequence, the actual deficit of the U.S. federal government rose by the equivalent of 4½% of GNP between 1979 and 1983, while the corresponding increase for the other major industrial countries was under 1% of GNP.

According to budgetary plans already announced or adopted, the contrasting paths of fiscal developments in the United States and in the other major industrial countries seem destined to persist through 1984. Although the U.S. federal deficit is likely to decline slightly in the current calendar year, the expected decline would be less than could be attributed to the effects of recovery alone. . . .

The very brisk pace of recovery in the United States . . . provides an exceptional opportunity . . . to make useful and necessary adjustments in their budgetary structures while avoiding some of the adverse repercussions that might have resulted from such actions during the recession period. . . . Because of the size of the U.S. economy and the magnitude of the capital inflow now being attracted there, reduction of the U.S. federal government deficit could be expected to have a significant impact on the availability of funds for private investment throughout the world, as well as in the United States itself.