Congress Refuses To Fix A System That Is Enemy Of Common Sense

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Here we are in the summer of 2005. The dog days are almost upon us and, alas, the tax code still has not been reformed.

The report of the President's Tax Reform Advisory Panel has been postponed until September, and some of the faithful are beginning to despair. Perhaps it's the heat. Maybe the reform will come next year, they say, or maybe in the next Congress, or maybe never, according to some.

It is time to remind ourselves why we entered this swamp in the first place: The tax code (all 20 pounds of it) is economically destructive and a danger to the Republic.

Like much of the federal government of which it is emblematic, the tax code has a rule for just about everything that exists and some things that do not, such as "passive activity." (That's no joke.)

On the big issues that drastically affect the size of the economy and the lives, jobs and well-being of millions of people, the tax code does everything wrong. Invariably, it does exactly the opposite of what common sense says is in the best interests of the American people.

Even a short list of the tax code's countless inanities is appalling. It favors consumption over saving, imports over exports, foreign investment over domestic, mindless paperwork over genuine productivity, and high rates of tax over high rates of GDP growth. These and other bad influences exerted by the tax code do not exist in a vacuum. They have powerful consequences that feed on one another to produce even worse results in a dynamic world economy.

Because we Americans save and invest too little, we produce too little and consume too much; and because our consumption is too high relative to our production, our imports are too high and our exports too low; and because we import more than we export, we must borrow from foreigners; and if we borrow from foreigners and also continue to consume too much, we must repay them with part of our savings; and when we deplete our savings, it is harder to invest and produce.

At a time when the personal savings rate in the U.S. has declined to the point of almost disappearing, would anyone in his right mind deliberately set out to double tax (and in some cases, quadruple tax) saving? Of course not, but that is what the tax code does and has been doing for many years.

Businesses and their employees are challenged by global economic forces that require that American-made products be produced with maximum efficiency. Why then does the tax code put an extra heavy tax on productivity-enhancing machinery by forcing manufacturers to recover their costs by slow depreciation instead of rapid first-year expensing? Is it government policy to deindustrialize America?

It is essential that U.S. companies be able to compete all around the world by direct participation in foreign markets and by exports from the U.S. - but the tax code goes out of its way to make it hard for them to do either one.

France and other EU countries insist that we impose taxes on exports in a way that makes it hard for U.S. companies to sell American-made products to the EU. But when EU countries export their products to us, they do not tax them at all (and neither do we). Why does the Congress acquiesce in this one-sided farce that puts U.S. companies at a disadvantage?

When U.S. firms go abroad and build plants in lucrative foreign markets that they cannot serve with exports, the tax code denies them an even chance to compete with others seeking to gain a share of those markets.

Many U.S. companies still succeed handsomely in foreign markets. But when they make profits abroad, the tax code does the most stupid, anti-American thing possible: It penalizes them if they bring their profits home for reinvestment in America but rewards them with a tax benefit if they reinvest their money in a foreign country. A tax executive of one such company was recently heard to remark, "We just got our 35% tax credit from the IRS in payment for reinvesting our money abroad."

Power Of The Code

Today's Congress would not as an initial matter enact a tax code so clearly designed to harm America - but it refuses to fix it. And so does just about everyone else. Right now, except for President Bush and his advisory panel, the chairman of the Ways and Means Committee in Congress and a few old-line tax reformers in think tanks and universities, there are not many people bent on reforming the tax code.

At best, the business community is phlegmatic on the issue, and most of the big business players in Washington are outright opposed to tax reform. And not many members of Congress are eager to give up much of the power, authority and political fundraising ability that the present tax code's complex system of rewards and punishments affords them.

Congress has become quite adept at granting enough carefully targeted dispensations and indulgences to prevent a tax revolt - and perhaps to prevent tax reform as well.

Businesses tend to look at the tax code solely in terms of the amount of tax they must pay out of their profits rather than at the way the tax code reduces those profits by harming the economy. Thus, the Congress has been able to buy off enough favored companies, large and small, by granting them special exceptions to the tax code's antibusiness rules - thereby letting them pay less tax than some of their competitors.

Demand Repair

By carefully calibrating personal tax rates in combination with specialized deductions, Congress has also been able to keep a working majority of voters reasonably satisfied, gradually taking huge chunks of them off the income tax rolls altogether and making others grateful for their "refunds" at the end of the year.

(Never mind that Congress has perpetuated a tax code that has cost many of them their jobs and lowered standards of living for almost everyone for several generations.)

In addition, Congress has moderated some of the most severe penalties on economic growth. Tax rates have ceased to be confiscatory and are now simply too high.

Bit by bit, small amounts of personal savings have been allowed to escape from the double-tax penalty - but only in restricted circumstances and primarily for retirement.

And since 1960, when tax depreciation rates were so slow as to be almost nonexistent, Congress has grudgingly allowed businesses more reasonable rates of depreciation for manufacturing equipment. In the recent economic recession, Congress even allowed partial first-year expensing, but then took it back at the end of last year.

Congress is aware of the damage the tax code is doing to America. And Congress knows how to fix the problem.

The American people should demand that Congress get on with the job before more trillions of dollars of GDP are lost, before more jobs are lost and, in the case of some industries, before it is too late.

If the members of Congress do not act, the voters should hold them all to account in the next election.

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