

PROGRAM FOR PROSPERITY

ANALYSIS OF POLICY INITIATIVES

- 1) *Reduce the capital gains tax rate, and reposition this so it is definitely not seen as a scheme to benefit the rich.*

As you have said, the tax on capital gains is a tax on the American dream. It is a tax on success, on the very creation of jobs and opportunities that are the bedrock of prosperity for all. Maintaining a high capital gains tax harms the poor. It inhibits risk taking, including the higher than average risks of investing in the inner cities and the training of the poor and disadvantaged. Just as the rich and middle class have a stake in bringing prosperity to the inner cities, the poor have a stake in the continued prosperity of the middle class and rich.

When middle class prosperity is under attack the chances for poor people to escape poverty all but disappear. A slowdown in job creation and rising unemployment has a direct impact on those with the least experience and the fewest skills. Since the beginning of the recession, 2.1% of the jobs held by blacks have been lost.

In addition, the current recession and consequent contraction of the tax base is undermining support for programs aimed at helping the poor. California Governor Wilson's proposal to reduce welfare benefits by 25% is an important case in point. Private charity also shrinks during bad times. According to a *New York Times* report, contributions to the United Way, the nation's largest program for charitable giving, are expected to rise between 2 and 3 percent this year -- the smallest increase in 30 years.

Finally, today's high federal capital gains tax rate has reduced capital gains tax revenues to some of our largest states. The stock market rose 62% between 1985 and 1988. However, in many states, including New York, California, Florida, Texas and Illinois, capital gains tax collections were lower in 1988 than in 1985. The resulting pressure for increased revenues leads to tax increases that further reduce the opportunities for employment among the poor and disadvantaged.

Reducing the capital gains tax rate addresses all these concerns. A lower tax on capital gains promotes job creation. Small businesses are the major source of economic growth and new employment opportunity. Between 1984 and 1987, companies with fewer than 100 employees created 110% of the net new jobs, more than offsetting the loss of jobs provided by the nation's largest employers.

The formation of new companies is highly sensitive to the capital gains tax rate. This tax rate was cut to 25% from nearly 50% in 1978, and then to 20% in 1982. Between 1978 and 1985, the number of small company start-ups more than doubled, rising to 640,000 from 270,000 and creating an additional 15 million new jobs. During this time, black employment rose 17% to 10.7 million people.

2) *Reduce to zero the capital gains tax for those who live, work and invest in the inner cities.*

What is sorely needed is to give the poor every opportunity to increase their wealth and the wealth of their community. They should be allowed to keep every dollar of gains that they realize through their investments in their local businesses and neighborhoods.

A zero percent capital gains tax rate for those who live, work, and invest in the inner cities cannot by itself erase poverty in America -- no single program can. But it can cultivate home-grown prosperity where it is most absent -- among America's poor. Moreover, it would affirm the right of the poor and disadvantaged to share in the American dream that has for too long been denied them.

Today blacks constitute 13 percent of the population but have less than one-half of one percent of the nation's wealth. Taxing away any increase in their wealth via the capital gains tax perpetuates this disparity and prolongs the legacy of slavery and racial discrimination.

Until now, Federal programs aimed at alleviating poverty were designed to operate on the inner city. Since 1968 the Federal government has spent \$2,600 billion in helping the poor. To avoid abuse, each program requires a supporting bureaucracy and a series of forms and other qualifications that have to be met in order to receive government funding of one type or another. Such procedures, however, prevent the poor and poorly educated from qualifying for the programs. Moreover, the current state of the inner cities testifies that the indirect benefits of these programs have produced no appreciable lasting benefit to the residents of these impoverished neighborhoods. After two decades of such help, the poor still live in despair.

This proposal for a zero percent capital gains tax rate is designed to *operate within* the existing structure of the inner city. It does not require any government expenditures or diminution of tax revenues -- virtually no capital gains are being reported today by the urban poor. No forms need be filled out, no existing programs need be curtailed. To benefit from the program, an inner city resident must create wealth inside his or her community, knowing that at any time in the future, the consequent gain will not be taxed.

Home-grown capitalism can be a powerful force for lifting the poor out of their poverty. Our history is filled with stories of poor immigrants creating new businesses, contributing jobs to their communities, tax revenues to government, leadership for the United States in important industries, and yes, creating vast wealth for their own families. We cannot know exactly how a zero capital gains tax rate will increase prosperity in the inner cities, but as it turns out, neither did those proposing sophisticated programs that promised the creation of specific numbers of jobs or dollars of investments.

What we *can* be sure of is that eliminating the capital gains tax rate on inner city residents who invest in neighborhood businesses harms no one, and increases the possibilities for business and job creation in the inner city. Permitting the poor to figure out how to take advantage of this benefit is no different from the challenge before every bereft immigrant who has ever landed on our shores.

To show that a lower capital gains tax rate is good for all Americans, make the zero percent inner city rate an integral and important part of your overall capital gains tax proposal, rather than breaking it out as a separate item in your proposal for Enterprise Zones.

3) *Reduce the tax on wages.*

Rolling back the Social Security tax rate increases of recent years will reduce the tax burden and cost of labor, leading directly to increased employment for wage earners. This creation of jobs is far more important to the nation than increasing the current Social Security surplus.

"In 1990 the [Social Security] system had accrued a reserve fund of \$280 billion, twice its size in 1988 and four times its size in 1985. Growing at a rate of \$1.6 billion weekly in 1990 (and more thereafter), reserves are projected to reach a half-trillion dollars in 1992 and \$1 trillion in 1996." (Carolyn Weaver, ed., *Social Security's Looming Surpluses: Prospects and Implications*, The AEI Press, 1991.)

The Social Security tax rate on work has increased 7.4 percentage points in the past 15 years, nearly double the 7.9 percent rate of 1976. More dramatic even than this is the increase of 5.95 percentage points since 1983. (See table below). As a result, when the combined tax rate on workers and their employers is considered, at least 55 percent of America's taxpayers pay more in Social Security taxes than income taxes. This tax does not apply to high incomes. Therefore, reducing the Social Security tax rate will have an immediate positive and direct impact on the income and employment of working men and women. Today, these are the very workers that are correctly far more concerned about their immediate economic well-being than the accumulation of hundreds of billions of dollars worth of government debt in a trust fund that, in the end,

depends on growth in employment and incomes among American workers for its solvency. Reducing the tax on wages is fair and prudent.

Social Security Taxes
Combined Rates: 1978 - 1991

Year	Tax Rate Increase (%)	Tax Rate (%)
1976	-	7.9
1977	-	7.9
1978	+0.2	8.1
1979	-	8.1
1980	-	8.1
1981	+1.2	9.3
1982	+0.05	9.35
1983	-	9.35
1984	+4.65	14.0
1985	+0.1	14.1
1986	+0.2	14.3
1987	-	14.3
1988	+0.72	15.02
1989	-	15.02
1990	+0.28	15.3
1991	-	15.3

4) *Make all of the tax rate reductions effective January 1, 1992.*

The poor and middle class cannot wait for tax relief. A January 1 effective date will permit the positive effects of your program to benefit the lives of working men and women almost immediately. As long as people know that the effective date will be January 1, there will be no reason to wait to begin to take advantage of the lower tax rates. Insisting on a January 1 effective date will also show that you mean it when you say you are making economic growth the first priority, and that you know that the budget can never be balanced without an expanding economy.

The importance of making all tax rate reductions effective in full January 1 cannot be overstated, and can be easily underestimated. Delaying the tax rate reductions in this program to mid-year or worse, 1993 would be disastrous. The promise of lower tax rates in the future causes individuals and businesses avoid today's higher tax rates by postponing as much economic activity as possible into the future, lower tax rate environment. These deferral effects are most pronounced and recognizable in the case of the capital gains tax, where transactions can be postponed simply. While it is more difficult to postpone employment and income, the aggregate effects can be substantial.

In 1982, such a delay in the Reagan tax cuts contributed directly to the severity of the recession, costing the Republican party 26 seats in the House. In 1992, such a delay would prolong the current period of stagnation, putting at risk your Program for Prosperity and your reelection.

- 5) *Demand repeal of the law that prohibits poor people from saving their way out of poverty.*

Today, if a family on welfare saves more than \$1,000, it loses all of its welfare benefits! These savings can include life insurance, and in some states, even tools that could be used in a trade.

The legislation that imposes this penalty was passed in 1935. It clearly fails to deal with the social and economic conditions that now exist. The specific legislation regarding resource limitations is found in Title 4 of the Social Security Act.

- 6) *Reform the welfare system specifically to reward those who supplement their welfare benefits with income from work.*

Today, the immediate loss of welfare benefits and taxes offsets more than 90% of the income earned by those on welfare. This robs the poor of the benefits of their work and traps them in their poverty. As a result, entrepreneurial activity in the inner cities is concentrated in illicit cash businesses, the largest of which is drugs.

Over the past 23 years a "safety net" has been created for the disadvantaged and unemployed in our society. Food stamps, rent subsidies, medical care, and direct income supplements in the form of Aid to Families with Dependent Children are available to alleviate the worst hardships of poverty. In 1990, expenditures on these programs totaled \$110.7 billion.

The true cost of these programs goes far beyond the money spent. It includes the loss of dignity and opportunity for those whom we trap in poverty. Because welfare benefits fall faster than after-tax income rises, those on welfare and their families must pay for the opportunity to work with a lower standard of living. This prevents the poor from gaining the education and training associated with a job, and thereby robs them and their families of the chance to get out of the ghetto, of a stake in the future, and denies them the American dream.

Any change in this system that will permit, at the very least, those who work to suffer no loss in their standard of living, is the essential first step in remedying the current defective system that is supposed to assist the poor and disadvantaged.

7) Implement your program to provide educational choice for all Americans, especially those trapped in the bankrupt school systems that plague our inner cities.

Freeing students and parents to choose schools will allow excellence to be rewarded, and encourage imitation of those educational systems that produce successful students. Improving the literacy and numeracy of high school graduates is fundamental and essential if America's work force is going to be competitive in the years ahead. Because the poor are the least skilled, they suffer a disparate impact from the globalization of our economy, being forced to compete with low skilled workers everywhere in the world. To get their support for your efforts to free trade with Mexico and the rest of South America requires your commitment to improving their educational opportunities and skills. Our standard of living and national security are intimately connected to this reform.

By embracing all Americans, this program positions you to restate the three promises that were central to your election. The program redresses the negative consequences of the 1990 budget agreement, sets the course for creating 20 million new jobs, and by offering prosperity to all Americans, produces a kinder and gentler nation. These goals provide the men and women who will vote next November a compelling reason to give you and the Republican Party the mandate needed to bring this program to fruition in your second term.

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