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The Next Capital Insurgency

*In 1978 Jimmy Carter signed a cap gains cut to lift a sagging economy.
One man thinks the time could be ripe for a similar move.*

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WASHINGTON

A fragile financial system, debt turmoil overseas, sudden gyrations in stock markets, and stubbornly strong unemployment at 9.9%. Today's economic conditions have some resemblance to the late 1970s, when stagflation caused many to worry about the long-term health of the U.S. economy. Mark Bloomfield has seen this movie before, which is why he thinks it's a moment for—hold your breath—optimism.

Mr. Bloomfield is the 60-year-old president and CEO of the American Council for Capital Formation, which makes him a man seriously out of fashion in a country in which tax rates on capital are going up. As the Bush tax cuts expire on Dec. 31, taxes on capital gains are set to rise to 20% from 15%. Add a new 3.8% Medicare tax on unearned income and the rate will hit 23.8% by 2013. Taxes on dividend income will nearly triple.

"I don't want another period in which retirees see their nest eggs shrink, entrepreneurs can't access capital, and a tottering economy takes a body blow it shouldn't have to," Mr. Bloomfield told me recently before one of the monthly dinners he holds for an eclectic group of members of Congress, corporate executives and journalists. The gatherings—which have been taking place for almost 30 years—harken back to a less partisan and hurried time in Washington, when policy was often hashed out informally and off-the-record. Sen. Joe Lieberman of Connecticut calls Mr. Bloomfield's meetings "Washington's last salon."

Dinner that night displays none of the bitterness that characterizes the debate swirling around the health-care bill and other pitched policy battles. Attendees seem relieved to talk about the overall economy rather than insurance mandates. "Everyone is worried about the jobs picture, and I sense an openness here to think in new ways about how to brighten it," says Mr. Bloomfield.

So why the optimism? Because he senses that this a moment for an intellectual comeback. Mr. Bloomfield believes the uncertain

economy has created an opportunity to reprise the success of the 1978 campaign that reduced the maximum tax on capital gains to 28% from as high as 49%. Those tax rates, coupled with rising inflation and an unstable economy, were making it difficult for entrepreneurs to obtain financing, which retarded economic growth and job creation. Jimmy Carter was proposing even higher rates and denouncing ideas for cutting them as "windfalls for millionaires."



But in March 1978, just over a year into the Carter presidency, the late GOP Rep. William Steiger of Wisconsin made common cause with key Democrats such as Jim Jones of Oklahoma and Ed Jenkins of Georgia, who were worried about the economy. Together they co-sponsored a capital gains tax cut. A Silicon Valley entrepreneur named Ed Zschau, whose business was starved for capital, asked Mr. Bloomfield and the Council for help. Together they built grass-roots and media support for the Steiger bill. Their techniques were high-tech for their day: cassette tapes and a plaintive song called "Old Risk Capital Blues," which Mr. Zschau wrote and recorded in the studio used by the Beach Boys.

The movement gained momentum as the

economy sputtered. A companion bill in the Democratic Senate eventually garnered support from 59 senators, including Majority Leader Alan Cranston of California and Finance Committee Chair Russell Long. Cries of "tax fairness" lost to arguments that the existing rates were killing jobs and economic opportunity.

Democratic Rep. Kenneth Holland, who represented a poor district in South Carolina, championed the reform because he said his constituents "want to keep on working." Proposition 13, the famous property tax limitation amendment, passed that summer in California, demonstrating the public's dissatisfaction with taxes. And in October 1978 the Steiger bill passed both houses and was signed by President Carter.

The policy results were unambiguously favorable. Venture capital investment soared to \$1.1 billion from just \$50 million a year in 18 months. The bill increased capital gains revenues by 30% from 1977 to 1979, the first full year after the rate cut.

Congress has since cut capital gains rates three more times (1981, 1997 and 2003), and raised them once (1987). In each case where the rates were cut, capital gains realizations and tax revenues increased. When rates were raised, the opposite happened.

Today's political terrain is more molasses-like than in the 1970s, making a repeat of the 1978 success harder. But over a follow-up lunch at the University Club in Washington last week, Mr. Bloomfield tells me he sees promising signs. Having competed in marathons from Athens to South Africa, he knows the value of persistent effort and is convinced it will pay off in a world economy where U.S. tax policy is increasingly out of step.

"Over the last decade, our foreign competitors have learned economic reality and reduced taxes on investment and business," he says as lobbyists and diplomats glide past in the dining room. "Since 2000, all leading OECD countries have cut their federal and state corporate income tax rates to an average

of 26.3% from 33.5%, while the U.S. rate has remained stuck at over 39%.” He notes that competing for scarce capital is now a key part of international economic policy, “which is why 11 of those economies don’t even have capital gains tax. And yet Congress is poised to raise ours.”

Mr. Bloomfield says people in both parties need to recognize the danger. Even if capital gains rate increases are only applied to those earning more than \$200,000—as President Obama pledged during his 2008 campaign—many ordinary people with one-time capital gains realizations from the sale of a business or retirement stock portfolio will pay tax rates meant for the rich.

Capital gains taxes can also create their own skewed outcomes. If someone owns a small business he bought in 1986 for \$500,000, and today sells it for \$1 million, the IRS will tax it as if that represented a half-million dollar profit. But in reality, inflation having more than doubled in the interim, the seller will have experienced a small loss. Taxing people on imaginary income caused by government-caused inflation is unfair.

Tactically flexible, Mr. Bloomfield notes there are many ways Congress can address the tax increases that will take effect at the end of this year. The most harmful would be if Congress allows most of the hikes to occur, perhaps cementing higher rates for all but lower-income earners into law in a lame duck session with the votes of many members who won’t be returning for the next Congress. “That would represent a tremendous hit on the stock market, retirement security and both wealthy and average Joe investors,” he warns.

There are other scenarios. As with last year’s decision not to act on the estate tax, Congress could punt. It could extend current tax rates on dividends and capital gains for another year. A new Congress, with a substantially new cast of characters and perhaps new leadership, might find it easier to reach a bipartisan consensus. Who might play the role that Bill Steiger and Russell Long did in the ‘70s? Several members with strong policy backgrounds and an ability to cross party lines come to mind: Sen. Max Baucus of Montana

and Sen. Ron Wyden of Oregon on the Democratic side. Then there are House Republicans like Dave Camp of Michigan and Paul Ryan of Wisconsin.

This year, President Obama and the Democratic Congress could also emulate what previous Democratic administrations did on capital gains. While he crusaded against “economic royalists,” President Franklin Delano Roosevelt was also savvy enough to put in a sliding scale for capital gains taxes—the longer an asset was held the lower the rate it paid. By claiming to encourage “investment” rather than “speculation,” Roosevelt was able to satisfy the populists in his party. President John F. Kennedy proposed raising the portion of capital gains excluded from taxable income to 70% from the traditional 50%.

Over the years, other Democrats have championed “rollover” capital gains rates, in which an investor pays no tax so long as any gains he realizes are re-invested. Democratic Rep. Jared Polis of Colorado, who made a fortune as an Internet entrepreneur, has proposed waiving capital gains taxes on all investments in key sectors of the economy like the auto industry.

All of these ideas have been batted around the table at Mr. Bloomfield’s dinner parties. After nearly 30 years of roundtables, he’s learned that an advocate must recognize that changing tax policy involves balancing “ideology, theology and political reality. You have to understand where members of Congress are coming from.”

He himself has an eclectic family background that demonstrates adaptability if nothing else. His father, still alive and alert at 101 years old, was a Russian Jew who fled the Soviet Union in 1921 and later fought in the Polish, French and American armies during World War II. His father later became a State Department official and Mr. Bloomfield grew up overseas before coming to the U.S. to earn an MBA at Wharton. Politically, he began as a moderate Republican, registered as a Democrat a few years ago, and is now about to become an independent.

He is pleased that half of the current membership of the House Ways and Means Committee have attended his soirees. Iowa

Sen. Chuck Grassley, the ranking Republican on the Senate Finance Committee, and Democratic Sen. Ben Cardin of Maryland are scheduled to attend future dinners. At an event this month, Mr. Bloomfield will present House Majority Leader Steny Hoyer with a plaque featuring one of his favorite quotes from Teddy Roosevelt about the courage of “the man in the arena.”

For the next year or so, Mr. Bloomfield plans to be in the arena in a big way. “The campaign to make sure we don’t punish investors and suffocate job growth will have to be bipartisan but it will be persistent,” he vows. He will soon release a study showing that raising the capital gains tax rate to 20% will cost the economy over 200,000 jobs per year, whereas cutting the rate to 10% would increase the number of Americans working by an average of 400,000 jobs per year. He envisions a full-fledged PR campaign that will employ everything from emails urging investors to contact members of Congress to music videos aimed at young people.

He recognizes the obstacles in the way of a capital gains tax cut. Some Democrats are hostile to anything that can be characterized as a “giveaway” to the rich. Many Republicans are distracted by other issues. Groups such as the Business Roundtable are focused on cutting corporate tax rates. And many Wall Street figures won’t come on board until they get a signal it’s politically safe to champion lower rates.

Despite all this, Mr. Bloomfield is convinced conditions are ripe for a capital gains tax cut. “We assembled an amazing coalition in 1978,” he recalls. “With communication vehicles that now look primitive we showed support for fair treatment of capital gains was wide and strong. We got homeowners, stockholders, venture capitalists and retirees all singing from the same page.”

He pauses. “Maybe it’s time to find some new lyrics and update that ‘Old Risk Capital Blues’ song.”

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