

Stealing a Recovery

That rebound people are counting on in U.S. corporate profits? Washington is going to tax, mandate and regulate it away.

The economy got stimulated. That was Act I. In Act II it is going to be smothered. Tech companies won big when the money was being dished out, with \$37 billion of the February stimulus set aside for health information technology, smart electric grid and broadband investments. They'll also be a prime beneficiary if Congress adopts President Barack Obama's bid to make the research and experimentation tax credit permanent at a cost of \$74 billion over a decade.



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But at the Technology CEO Council, Executive Director Bruce Mehlman says his "number one, two and three" priority these days is to block a Treasury proposal to wring \$210 billion more in taxes over the next decade from multinationals' offshore profits. "We found the Obama Administration a great partner on infrastructure and research, and we hope the distraction of populist tax policies can be shelved so we can help enable a long-term recovery," says Mehlman, whose members include the honchos of IBM, Intel, Dell, HP and Motorola.

When Washington was putting trillions in bailouts and stimulus on Uncle Sam's credit card, many business leaders applauded (or at least stuck out their hands for the cash). Now, with the economy seemingly back from the brink, the cheering has stopped and the defensive game is on. Someone, after all, must pay for all that emergency deficit spending; for the \$46 trillion (net present value) of Medicare and Social Security benefits already promised but not funded under current law; for renewing some of the expiring Bush tax cuts and containing the growth of the dreaded alternative minimum tax. Moreover, someone must pay for the Democrats' expensive shopping list: covering 46 million Americans without health insurance; mandating

paid sick leave; moving to a low-carbon economy; and adopting tougher consumer, worker and investor protections.

The stock market, now trading at 134 times trailing earnings, can be justified only with the presumption that profits will snap back to pre-2008 levels as soon as the recession ends. That may be a naive presumption. No sooner will there be a recovery in corporate profits than Congress will find ways to snatch them away.

"Once the economy looks a little better, we move on to higher taxes, more regulations--all the punitive things that had to be put on the shelf as we saved the economy," says longtime Washington analyst Gregory Valliere, now at Soleil Securities. "It's going to be a modest recovery with all sorts of political risk," he adds.

Candidate Obama promised no tax hikes on families earning less than \$250,000, so Democrats are coming after upper-income folks and big business first. Assuming an economic recovery, rates for the better off will rise in 2011 as the Bush tax cuts expire. Clint Stretch, managing principal of tax policy at Deloitte Tax, speculates Congress might consider following the lead of states such as California, New York and Maryland and creating an even higher rate that kicks in at \$500,000 or \$1 million.

The moral justification for such tax grabs is "pay as you go" budgeting--meaning if Congress wants to give a tax break or a new benefit to one group, it must raise taxes or cut benefits for another. The nature of politics is such that over time tax raises are more likely than benefit cuts.

Budget pressures could produce another nasty side effect besides tax hikes: When elected representatives reach the limit on their federal credit card, they'll be even more tempted to order up new benefits to put on the private sector's tab.

Even during the recession Congress has continued to mandate new benefits. Last October, while approving the \$700 billion bailout for Wall Street, it tacked on a provision requiring group insurance plans to provide the same level of benefits for mental health and substance abuse treatments as for physical ones, beginning in 2010. In February it set aside \$7 billion in stimulus money to prod states to make more workers, including laid-off part-timers and folks who quit jobs for a "compelling family reason," eligible for unemployment insurance. Employers will eventually pay for that expansion through higher insurance premiums. Still, that's small stuff compared with what could come, as Congress wrestles with how to pay for covering the uninsured.

"It's going to get ugly," Stretch says. Ugly enough that businesses will be attacking one another even as they push back the advance of big government. In June Congress made tobacco subject to U.S. Food & Drug Administration regulation. Philip Morris parent Altria Group broke with the industry to support the bill. No coincidence that new restrictions on cigarette advertising should help protect its 50% market share. Then there's the National Retail Federation, which is hoping to capitalize on the banks' current doghouse status to push through legislation giving merchants leverage to cut the fees they pay Visa and MasterCard.

By Janet Novack and Brian Wingfield